IN-DEPTH ANALYSIS
for the JURI committee

The Impact on SMEs of the Proposal of Preventive Restructuring, Second Chance and Improvement Measures

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POLICY DEPARTMENT FOR CITIZENS’ RIGHTS AND CONSTITUTIONAL AFFAIRS

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Abstract

This study was commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs at the request of the JURI Committee. It looks at the effects the recent Commission proposal might have both on micro and small and medium-sized enterprise, thus reflecting the diversity of SMEs. It identifies and explains the issues at stake of concerned SMEs related to their capacity as both debtors and creditors.

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LIST OF ABBREVIATIONS

COMI	Centre of Main Interest
MSME	Micro, Small and Medium-sized Enterprises
OEM	Original equipment manufacturer
PIFOR	Practitioner in the field of restructuring
SME	Small and medium-sized enterprises
TFEU	Treaty on the Functioning of the European Union

EXECUTIVE SUMMARY

Background

The proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU[1] does not specifically address the needs of "micro, small and medium-sized enterprises (SME)". It does, however, propose a preventive restructuring framework that should also facilitate the restructuring of SME debtors. Moreover, the Directive would provide for a robust second chance for failed entrepreneurs who have mostly run small businesses.

The European Commission defines small and medium-sized enterprises (SME) in the Recommendation of May 6, 2003.[2] This definition is rather broad and includes a wide range of enterprises that may have very little in common – from the sole entrepreneur or artisan to a company of 250 employees and €50 mill. annual turnover. It is necessary though to look separately at the classical small or medium sized enterprise and at the micro enterprise, because the differences as to their needs in the insolvency context are significant, both as creditors and as debtors.

Aim

- This paper reflects the diversity of SME by using two examples for illustrating the possible effects of the proposed Directive: a microenterprise and a medium-sized enterprise. The analysis reveals that specific rules may only be required for the small fraction of SME: micro and small businesses (MSME) or even only microenterprises.
- MSME creditors should receive protection from a stay and a restructuring plan impairing them.
- MSME debtors should be able to find a low cost advice institutions when facing a business crisis, not just a model restructuring plan in a brochure.
- MSME debtors should also benefit from a short minimum duration of a stay of one or two weeks.
- MSME debtors should benefit from a robust and quick discharge mechanism following a liquidation of their business.

Overall, this analysis also indicates that provisions regarding the scope of a stay as well as the scope of a restructuring plan should be more flexible.

It must be mentioned that a full scale solution of non-performing SME loans in Europe would not only require a viable (preventive) restructuring option, but also an efficient liquidation process. The proposed Directive addresses the latter only in Title IV by setting rather general benchmarks for involved institutions (judges, courts, practitioners).

The proposed Directive does not specifically address the needs of SME. The analysis reveals that specific rules may only be required for a fraction of SME: micro and small businesses, sometimes only microenterprises.

[1] COM(2016) 723 final.

[2] Commission Recommendation 2003/361/EC, OJ L124/36 of 20.5.2003.

1. GENERAL INFORMATION

1.1. The Proposed Directive

On November 22, 2016, the European Commission proposed a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.[3]

The proposal does not harmonise core aspects of insolvency. Instead, it aims to enhance the rescue culture in the EU by harmonising or implementing certain features in national insolvency and restructuring frameworks. Early warning mechanisms and pre-insolvency restructuring tools (mediation, stay, plan confirmation, safe harbours) would enable debtors in financial difficulties to restructure early. Harmonised provisions on a quick discharge of failed, but honest entrepreneurs are meant to encourage entrepreneurial activity by offering a true second chance to these entrepreneurs to restart their business activities. The Commission expects the creation of some 3 million jobs across Europe, mainly with small and medium-sized enterprises (SME).[4]

1.2. Micro, Small and Medium-sized Enterprises (SME)

The European Commission defines "micro, small and medium-sized enterprises (SME)" in the Recommendation of May 6, 2003.[5] It comprises any entity engaged in an economic activity, irrespective of its legal form, that is not part of an enterprise group and falls within a set of three criteria:

- staff headcount (micro: <10; small: <50; medium: <250)
- annual turnover (micro: <€2 mill.; small: <€10 mill.; medium: <€50 mill.)
- annual balance sheet (micro: <€2 mill.; small: <€10 mill; medium: <€43 mill.)

The binding[6] definition of SME is rather broad and includes a wide range of enterprises – from the sole entrepreneur or artisan to a company of 250 employees and €50 mill. annual turnover. Such enterprises may have very little in common. This paper reflects the diversity by using two examples for illustrating the possible effects of the proposed Directive.

Box 1: Two different test enterprises[7]

1. **Microenterprise**: The first test enterprise is a house-painter with two employees and an annual turnover of €500.000. The enterprises mainly works as a subcontractor for a specific building company, but also contracts for small jobs with individual customers.

2. **Medium-sized enterprise**: The second test enterprise is an automotive supplier company with 80 employees and an annual turnover of €40 mill. The enterprise only works for one specific OEM (original equipment manufacturer) and secures its in-time supply with car seats.

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[3] COM(2016) 723 final.

[4] See Explanatory Memorandum, COM(2016) 723 final, at 6, fn. 16.

[5] Commission Recommendation 2003/361/EC, OJ L124/36 of 20.5.2003.

[6] Art. 8 (1) of the Commission Recommendation 2003/361/EC, OJ L124/36 of 20.5.2003.

[7] Distinguishing micro and small firms within the group of SME has proven to be significant; see Izidin El Kalak and Robert Hudson, *The effect of size on the failure probabilities of SMEs: An empirical study on the US market using discrete hazard model*, International Review of Financial Analysis 43 (2016) 135–145; see also .

2. EFFECTS ON SME CREDITORS

The proposed restructuring and discharge framework would affect SME **both in the role as the debtor and a creditor of the debtor.** The issue of protecting SME from a too intrusive framework largely occurs only in the latter scenario which is why the "SME creditor" scenario is discussed first.

2.1. Art. 3, 18 – Early Warning and Early Measures

The restructuring framework would start early in a business crisis. The proposal intends to incentivise debtors who start to experience financial problems to take early action. SME with a business relationship to the troubled debtor would not be affected significantly by any early warning tools because reporting and monitoring duties with regard to the debtor's business development are not a common part of their business relationships. The only exception are SME working as tax or legal advisors to the debtor. The proposed framework could prompt Member States to implement a specific duty to check for a significant negative development of the debtors business and advice the debtor's management accordingly.[8] In many Member States, such duties for advisors are already in place.

2.2. Art. 6, 7 - Stay

Significant disturbances for the business relationship of an SME with a debtor would follow from a stay under Art. 6 and 7 of the proposed Directive.

2.2.1. Effects of a stay

In the eyes of the Commission, a key element of any restructuring framework is the availability of a temporary stay of individual enforcement actions where such a stay is necessary to protect the prospects of negotiations on a restructuring from such actions.[9] While this presumption may be undisputed, the very detailed rules, proposed by the Commission, would mandate Member States to introduce quite a far reaching pre-insolvency instrument.

- Stay of enforcement actions

Art. 6 (1) states the common assumption that "debtors who are negotiating a restructuring plan with their creditors may benefit from a stay of individual enforcement actions if and to the extent such a stay is necessary to support the negotiations of a restructuring plan." Such a stay ensures that creditors with enforcement rights on unpaid claims are barred from picking apart the assets that may be essential for the continuation of the debtor's business. To this extent, the proposed stay would simply resemble a "standstill" agreement that is commonly agreed on by all participating creditors during restructuring negotiations.

- Stay of contractual rights to terminate, accelerate or withhold

The continuation of the debtor's business during restructuring negotiations would also be guaranteed if counterparties to executory contracts were banned from modifying or terminating such contracts under contractual or statutory modification or termination clauses. As executory contracts are all contracts which are not yet performed by both parties, the suspension of such rights would mainly affect supply contract (raw materials, energy, water), service contracts (telecom, banking, labour) and lease.[10] A stay suspending

[8] See Art. 3 (1) and Recital 16 of the proposed Directive.

[9] See Recital 18 of the proposed Directive.

[10] See Recital 21 of the proposed Directive mentioning some of these types of contracts.

such rights will have a significant impact on other businesses. Still, Art. 7(5) would mandate all Member States to suspend contractual modification rights (ipso facto clauses) in such contracts during a stay.

- Stay of statutory rights to terminate, accelerate or withhold due to old debt

In addition, Art. 7 (4) also suspends any (statutory) right to "withhold performance or terminate, accelerate or in any other way modify executory contracts to the detriment of the debtor". At least, the latter (more general) suspension shall only affect rights with regard to debt that arose prior to the stay and can be limited by national legislators to "essential contracts". As a result, there is nothing barring a supplier from invoking a statutory right to withhold future performances until being paid in exchange and, consequently, Art. 7 (6) expressively allows the debtor to pay such a creditor.

- Stay of a duty to file and of a right to file

For the Commission, restructuring negotiations are not only threatened by a disruption in the debtor's ordinary course of business, but also by the initiation of formal insolvency proceedings. Therefore, under Art. 7 (1) a stay would also suspend the obligation of the debtor to file for insolvency under national law if such an obligation arises during the period of the stay. Only if the economic situation of the debtor deteriorates during the stay to the point that he is unable to pay his debts as they fall due (illiquidity test), a duty to file may still apply according to Art. 7 (3) provided that the seized insolvency court would be able to defer the commencement of formal insolvency proceedings if the court finds that restructuring negotiations are nearing a successful conclusion.

In case of a general stay, Art. 7 (2) provides that any creditor's right to file for formal insolvency proceedings shall be suspended for the duration of the stay.

Box 2: Effects of a stay

1. **Microenterprise**: The house-painter who mainly works as a subcontractor for a specific building company would be directly affected by a stay prompted by restructuring negotiations of that company. Unpaid claims from finished projects would not be enforceable for the duration of a stay, but payable under Art. 7 (6). Contracts on current projects are executory contracts which means that the painter would be banned from terminating such contracts or withhold performance under a contractual clause according to Art. 7 (5). Thus, the performance under the contract would be owed as if no restructuring effort (indicating a business crisis) had occurred unless a statutory right would also allow for a modification. Here, Art. 7 (4) would restrict the use of such statutory rights to future performances while such rights could not be invoked for old unpaid claims (e.g. payment due under the contract for the first stage of a building project). Where Member States opted to limit the application of this provision to essential contracts, it remains unclear whether a subcontractor to a building company can be held "necessary for the continuation of the day-to-day operation of the business" – a definition that aims at suppliers. These limitations only end when the stay expires or is lifted. If the debtor is or becomes insolvent, formal insolvency proceedings would only commence if the debtor files. He would be obliged to file only in case of illiquidity and only if Member States chose to implement such a duty. The painter could also initiate formal insolvency proceedings unless a general stay was imposed.

2. **Medium-sized enterprise**: The situation is very similar for an automotive supplier company which only works for one specific OEM if that OEM would be protected by a stay. Here, a supply contract would definitely meet the definition of an "essential contract" which would guarantee that the just-in-time supply of the car manufacturer would not be harmed

by restructuring efforts and possible pre-dating breaches of contracts. This example illustrates the importance of suspending termination or modification rights for some types of debtors.

2.2.2. Duration of a stay

Art. 6 (4) provides that the stay should be granted for a period of no more than four months. By giving no minimum duration, the provision appears to leave room for Member States to provide for shorter periods.

The Commission also acknowledges that complex restructurings may require more time[11] which is why Member States may decide that extensions may be granted up to a maximum total of 12 months (Art. 6 (7)). The first extension would require evidence that relevant progress has been made in the negotiations on the restructuring plan and that the continuation of the stay of individual enforcement actions does not unfairly prejudice the rights or interests of any affected parties (Art. 6 (5)). Any further extension would also require the demonstration of circumstances indicating a strong likelihood that a restructuring plan will be adopted (Art. 6 (6)).

2.2.3. Scope of a stay

Art. 6 (2) provides that a stay shall be available against actions from all types of creditors, including secured and preferential. Art. 6 (3) would only exempt workers' unpaid salary claims unless such claims are fully protected under a guarantee scheme.

Art. 6 (2) further provides that a stay "may be general, covering all creditors, or limited, covering one or more individual creditors, in accordance with national law." How Member States use this option makes a huge difference.

Providing for a general stay would require the involvement of a "practitioner in the field of restructuring" (PIFOR) according to Art. 5 (3) (a). This would result in a judicial order of collective proceedings involving an insolvency office holder – a procedure very similar to formal restructuring or insolvency proceedings in most Member States. As a consequence, there is no need to initiate formal proceedings as well and Art. 7 (2) suspends the effects of any creditor's motion to open formal proceedings.

Things look quite different in case of opting for a limited stay instead. In such a framework, restructuring negotiations would take place without any protective umbrella, but also without a PIFOR and a court or agency. Here, the effects of a stay may only be directed against a limited circle of creditors which would allow for a more sophisticated and more balanced application of the stay. Yet also a limited stay would always entail all effects described above, because the proposed Directive does not yet include the optional use of these instruments as well. In addition, as all effects of a stay only apply after the stay is ordered, any individual stay would require the debtor to know in advance which of his creditors are probably going to use enforcement actions or termination/modification rights. The proposed Directive does not yet provide for a "look back" mechanism that would invalidate creditor actions taken immediately prior to the motion for a stay.

Box 3: Duration and scope of a stay

[11] See Recital 19 of the proposed Directive.

In Member States opting for a general stay, both the house-painter and the automotive supplier company would automatically be affected by a stay protecting restructuring negotiations of their main contracting company as described in Box 2 for the duration of the stay which could be anything between a couple of weeks or 12 month depending on national legislation. In the worst case scenario, they could neither enforce old unpaid claims nor terminate executory (running) contracts with the debtor due to unpaid old claims; they would also be barred from filing for formal insolvency proceedings on those grounds. They could, however, use statutory rights (if applicable) to secure payment for performance still due under executory contracts. Where no such rights are available, SME creditors would have no right to enforce payments for the duration of a stay which may certainly lead to their insolvency if their business model depends heavily on payments from a specific business partner. A general stay combined with a duration of several month up to a year may, therefore, significantly increase the risk of prompting additional business failures, in particular with microenterprise creditors.[12]

In Member States opting for a limited stay, such side effects can be mitigated. Less important business partners, like the house-painter in our scenario 1, would not be (automatically) impaired by restructuring efforts. Instead, they would retain all contractual and statutory rights unless a stay is ordered against their specific actions.

2.2.4. Ordering and lifting a stay

Any stay requires the respective request from a debtor to a judicial or administrative authority.[13] The authority is required to test whether the requested stay

- is necessary to support the negotiations of a restructuring plan (Art. 6 (1)), and
- does not unfairly prejudice an individual creditor or a single class of creditors (Art. 6 (9), in particular by disadvantaging their position compared to a scenario without a stay[14]).

When making the decision, the authority (usually a court) would also consider

- whether the requested stay would preserve the overall value of the estate,
- whether the debtor acts in bad faith or with the intention of causing prejudice, or
- whether the debtor generally acts against the legitimate expectations of the general body of creditors.[15]

The protection of creditor interests is even more dominant in Art. 6 (8) governing the lifting of an ordered stay. According to Art. 6 (8) (b), a general stay may be lifted anytime, as a whole or partially, at the request of the debtor or the PIFOR appointed. In addition, any stay may be lifted ex officio under Art. 6 (8) (a) as soon as it becomes apparent that a proportion of creditors who under national law could block the adoption of the restructuring

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[12] See Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 Cap. U. L. Rev. 413 1994, stressing the specific vulnerability of such businesses to disruptions.

[13] The text of the proposed Directive does not specifically express that a stay must be ordered by a court or administrative authority initially; see Art. 6 (1) of the proposed Directive. Recital 19 mentions, however, that a "debtor should be able to request the judicial or administrative authority for a temporary stay" which indicates that the Commission also assumes that any stay must be ordered.

[14] See Recital 21 of the proposed Directive mentioning the case that "their claims would be made substantially worse-off as a result of the stay than if the stay was not granted, or if the creditor is put more at a disadvantage than other creditors in a similar position."

[15] See Recital 20 of the proposed Directive.

plan does not support the continuation of the negotiations. Depending on the required majority under national law, major creditors could hold a blocking position which would also allow them to terminate a stay. Also, the simple fact that a creditor group with sufficient veto power walks away from negotiations would empower every single creditor, also the smallest, to challenge the stay and request it being lifted. In addition, any creditor should also be able to challenge the order of a stay based on the ground that the conditions for a stay are not actually met.[16]

Box 4: Ordering and lifting a stay

In Member States opting for a general stay, both the house-painter and the automotive supplier company could challenge the order issuing a stay. In order to be successful, they would have to demonstrate that the conditions for a stay are not met. They could argue, in particular, that the stay does unfairly prejudice them compared to other unsecured creditors which could follow from the simple fact that the stay affects them disproportionately more than other (larger) creditors, e.g. by causing a severe business crisis. If convinced, the court can limit the scope of the stay by lifting it partially for the so affected creditor or group of creditor.

In Member States opting for a limited stay, the same rules apply for ordering and lifting the stay. There is, however, no PIFOR appointed who could also request to lift a stay. In addition, any stay ordered only against a specific creditor or group of creditors will require an in-depth no-discrimination test.

2.3. Art. 8-15 – Restructuring Plan

While a stay may only temporarily (nevertheless significantly) hurt SME creditors, a restructuring plan would modify or terminate their claims permanently.

2.3.1. Are SME creditors even affected?

A restructuring plan under the proposed Directive is not necessarily a collective tool. The debtor is empowered to decide which creditors are relevant and thus affected by the intended restructuring effort and may choose only to involve them in restructuring negotiations and a resulting restructuring plan while leaving unaffected parties aside.[17] From the debtor's angle, small creditors may not contribute significantly to the debt pile and should, therefore, be left aside in order to focus on negotiations with relevant creditor groups. If so, SME creditors may not be affected by a plan at all and expect a full payment after a successful restructuring.

2.3.2. Are SME creditors sufficiently protected if affected?

If the debtor decides to involve SME creditors in a restructuring, often by setting up a class of general unsecured creditors encompassing SME creditors, SME creditors would have very limited influence at the negotiation table under the proposed Directive.

- No veto right in a value-oriented voting regime

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[16] See Recital 23.

[17] See Art. 8 (1) (c)-(e) and Recital 24 of the proposed Directive.

The Directive would only mandate a classification of creditors' claims in the plan that distinguishes secured and unsecured claims.[18] At the same time, a plan would be adopted in each of these classes if a majority in the amount of their claims is obtained in each class and the required majority may be set by Member States between 50 and 75% (Art. 9 (4)). Such a regime would see SME creditors, who typically hold smaller claims, dominated in the class of unsecured creditors by larger creditors. A rational evaluation of their situation would prompt SME creditors to not actively participate in a (costly) negotiation and voting process. It would also incentivise the debtor to negotiate only with the larger creditors in the class.

Adding the requirement of a minimum number of claims[19] or even creditors[20] voting in favour of the plan would give a numerous group of creditors with smaller claims more leverage in negotiations. It would, however, also add complexity to the process.

- Cross-class cram-down against a separate class of SME creditors

The proposed Directive would not invalidate a classification of creditors' claims in the plan that further distinguishes unsecured claims, in particular by forming specific classes for "vulnerable creditors, such as workers or small suppliers".[21] If SME creditors are put in a separate class, they could, of course, veto a plan by forming an opposition in their class that is sufficiently large to block under national law. This, however, may still not guarantee them a spot at the negotiating table because Art. 11 requires Member States to also implement "cross-class cram-down" rule that would allow for a plan confirmation against the veto of one or even more classes. In principle, Art. 11 (1) requires only one class of affected creditors that actually support the plan with the required majority (which again may be set by Member States at a low threshold of a simple majority). So, if all other classes rejected the plan, it could still be confirmed if the court finds that the plan complies with all legal requirements, offers more to affected parties than in a possible liquidation[22], does not unfairly privilege new finance creditors or distributes value against the priority in an insolvency liquidation.[23] As a result, the debtor may calculate that a veto of the SME creditor class has no vetoing power because it can be overcome by a cram-down considering that these creditors are unsecured and would only receive value in a liquidation after all secured and preferred creditors.

Box 5: Restructuring plan affecting SME creditors

1. **Microenterprise:** In a restructuring of a business partner like the building company, a microenterprises like the house-painter would probably have a very limited amount of unpaid claims compared to other creditors like banks or suppliers. While this fact limits the relevance and influence of the painter, it could also lead to him not being affected at all. If a plan would involve a reduction or suspension of his claims, the painter would probably neither have the skills nor the resources to actively participate in negotiations. Considering the very limited vetoing power, it is also rationale to stay passive and accept any outcome.

[18] See Art. 9 (2) and Recital 25 of the proposed Directive.

[19] See the US Bankruptcy Code's requirement of a majority of more than two-thirds in amount and more than one-half in number of the allowed claims for plan acceptance in 11 U.S.C. § 1126(c).

[20] See the German Insolvency Code's requirement of a majority of more than one-half in amount of claims and in number of voting creditors for plan acceptance in § 244(1).

[21] See Recital 25 of the proposed Directive. The last sentence in Art. 9 (2) only mentions a specific class of workers (claims).

[22] See Art. 10 (2) (b) referring to a "best interest test" which is defined in Art. 2 (9).

[23] See Art. 9 (2) referring to the "absolute priority rule" which is defined in Art. 2 (10) in a way that does not comprise the common standard of that rule in the original US bankruptcy context; compare with 11 U.S.C. § 1129(b).

2. **Medium-sized enterprise**: Medium-sized enterprises like the automotive supplier company would be key actors in a restructuring of the OEM. The amount of unpaid claims could also give such creditors a veto power if national law requires a 75% majority and a majority of classes actually voting to accept the plan (option under Art. 11 (2)). The special interest of protecting the supply chain could, however, also prompt the OEM to not include suppliers in a restructuring and to limit restructuring measures to financial creditors like banks and bondholders instead.

2.4. Art. 16, 17 – Safe harbour

The safe harbour provisions in Art. 16 of the proposed Directive protect financing agreements and payments made under such agreements which support the plan procedure (interim financing) or the implementation of restructuring measures under the plan (new financing). They have no immediate relevance for SME creditors, because such creditors will hardly ever provide for such financing. The proposed privileges for financing creditors would, however, indirectly affect SME creditors in case of a subsequent insolvency procedure, because their protection from avoidance actions and particularly their priority under Art. 16 (2) would lead to less value in proceedings that can be distributed to ordinary creditors like typical SME creditors.

Things are quite different with regard to the safe harbour in Art. 17 protecting transactions related to the restructuring. With the wide scope of this provision in mind, such transactions can be made by SME creditors. Being a tax, business or legal advisor, SME creditors would be protected with regard to paid fees under Art. 17 (1), (2) (a) or (b). Being a business partner, payments received from the debtor in the ordinary course of business or under a restructuring plan provision would be protected under Art. 17 (1), (2) (d), and (4). As a result, such payment would only be avoidable in a subsequent insolvency of the debtor if the parties acted fraudulently or in bad faith.

Box 6: Safe harbour for SME creditors

1. **Microenterprise**: In the course of a restructuring of a business partner like the building company, a microenterprises like the house-painter would be asked to continue working for the company and, thus, receive payments in return. If the company would later enter formal insolvency proceedings, these payments would be protected under Art. 17 (1), (2) (d).

2. **Medium-sized enterprise**: The protection of payments received in the due course of continued contracts would also apply to medium-sized enterprises like the automotive supplier company in a restructuring of the OEM. If the company was to be affected by a restructuring plan and receive payments under such plan, these payments would also be protected in a subsequent insolvency of the OEM (Art. 17 (4)).

2.5. Art. 19-23 – Discharge and Second Chance

Title III of the proposed Directive does not aim to rehabilitate a business, but to rehabilitate the once owner of a failed and liquidated business – the failed entrepreneur. Art. 19-23 mandate Member States to modify their existing framework for discharging such individuals, often laid down in insolvency laws, towards a common, debtor-friendly standard:

- Full automatic or payment plan discharge within three years after the initiation of insolvency proceedings, a specific discharge procedure or a payment plan (Art. 20);
- Full and automatic reinstatement after a disqualification with the discharge (Art. 21);
- Full discharge of business and personal debt (Art. 23);

The Commission promotes such innovative discharge rules for two reasons. They notice the negative macroeconomic as well as microeconomic effect of inefficient second chance frameworks in most Member States. As a result, entrepreneurs are currently locked into debt-traps or driven to the black economy, or forced to relocate to other jurisdictions to access more friendly regimes. Both options cause high economic and human costs for entrepreneurs.[24] A more debtor-friendly discharge regime across all Member States would not only safe the costs of forum shopping. It would also allow entrepreneurs to use their experience to set up a new business and have a second chance without the burden of old debt.[25]

Of course, the benefit of a discharge must not be given to entrepreneurs who act dishonestly or fraudulently. Therefore, Art. 22 allows Member States to limit the application of the discharge regime. The practical problem of distinguishing honest from dishonest unsuccessful entrepreneurs is not specifically addressed in Art. 22. Instead, the Directive would allow Member States to lay down longer discharge periods

- where the over-indebted entrepreneur acted dishonestly or in bad faith towards the creditors when becoming indebted or during the collection of the debts;
- where the over-indebted entrepreneur does not adhere to a repayment plan or to any other legal obligation aimed at safeguarding the interests of creditors;
- in case of abusive access to discharge procedures,
- in case of repeated access to discharge procedures within a certain period of time, or
- in cases where the main residence of an over-indebted entrepreneur is exempt from liquidation.

Disqualification periods may be longer or even indefinite where the over-indebted entrepreneur is a member of a profession to which specific ethical rules apply or where disqualifications were ordered by a court in criminal proceedings. Finally, Member States may exclude specific categories of debt, such as secured debts or debts arising out of criminal penalties or tortious liability, from discharge or lay down a longer discharge period.

Overall, the proposed regime promotes an assumption of honesty and quick discharge while leaving plenty of options for Member States to implement thresholds to prevent abuse and public outcry. Experience in Member States with an even more debtor-friendly discharge regime than the one proposed by the Commission (see e.g. UK or France) also shows that such regimes do not prompt a rise in unpaid claims or a widespread tendency of debtors to misuse available discharge options. For SME creditors the discharge regime would render (unsecured) claims that have not been paid in a liquidation unenforceable within a three years period.

Box 7: Quick discharge

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[24] See Explanatory Memorandum, COM(2016) 723 final, at 4.

[25] See Recital 37.

1. **Microenterprise**: For a microenterprises like the house-painter, the moment of a discharge of claims against former business partners is a nominal loss of value at first sight. However, the economic effects of this lost have already hit them well ahead. Considering the "resource poverty"[26] of a microenterprise like our painter business, value is already missing in the moment that a claim is not being paid as it falls due. This is already the moment of a significant disturbance for such businesses[27] who, in addition, have little resources to enforce claims in court. Three years later when a discharge is finally rendering an unpaid claim unenforceable after all assets of the debtor were liquidated or a payment plan fulfilled, the effect of a discharge is commonly rather declaratory and not causing a new disturbance in the painters' cash management. It may even provide for a tax credit. At the same time, a discharged entrepreneur with good contacts to the painter may set up a new enterprise and provide for new business opportunities for our painter. Overall, it may be better to forget about "sunk costs" and look at the future.

2. **Medium-sized enterprise**: Medium-sized enterprises like the automotive supplier company would also commonly experience the real economic effects of a claim left unpaid to their cash management far ahead of the moment of a final discharge. Even though medium-sized businesses commonly have sufficient resources to handle isolated defaults or even enforce claims in court, they also – just like microenterprise creditors – would not expect payments on a claim anymore at the time of a discharge. Again, the discharge would allow for claiming tax credits and forget about the past.

2.6. Art. 24-28 – Institutional Background

The measures under Title IV of the proposed Directive aim to improve the institutional basis of restructuring, but also insolvency proceedings by

- improving the qualification, training and specialisation of involved judges (Art. 24),
- improving the qualification, training and supervision of PIFORs including the development of codes of conduct (Art. 25), and
- standardising the principles governing the appointment, removal and resignation of PIFORs (Art. 26) as well as their proper supervision and remuneration (Art. 27).

While all these measures are certainly of outmost importance for the principal functioning of an efficient insolvency and restructuring framework, they bear little specific relevance for SME creditors.[28]

Well qualified, specialised and motivated judges and practitioners are a key factor in running any insolvency or restructuring procedure, including SME cases. It should be stressed here that, as Art. 24-28 prove, the proposed restructuring framework is and should not be designed to avoid an inefficiently run or insufficiently equipped national liquidation regime. It adds a survival option – an option that should also be effectively

[26] See Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 Cap. U. L. Rev. 413, 427-428 1994.

[27] See Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 Cap. U. L. Rev. 413 1994, stressing the specific vulnerability of such businesses to disruptions.

[28] See also David Burdette and Paul Omar, *Enhancing practice qualifications and conditions: The European dimension*, eurofenix 2017, 25.

available for SME[29] – to a default liquidation routine, and both procedures require a well-structured and well-equipped institutional background.

[29] Weak foreclosure and insolvency regimes in many EU Member States limit the ability to restructure viable small businesses and liquidate nonviable ones in a timely and effective manner; see Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, *Tackling Small and Medium Sized Enterprise Problem Loans in Europe*, IMF SDN 15/04, 2015, 9.

3. EFFECTS ON SME DEBTORS

An evaluation of the effects of the proposed Directive on SME has quite different results if we look at a **scenario in which the SME is the troubled debtor**.

3.1. Art. 3, 18 – Early Warning and Early Measures

Any timely restructuring effort is premised on the fact that the debtor or the debtor's management recognises that their business is about to fail. The proposal intends to ensure such recognition by promoting "early warning tools" in Art. 3 (1) "which can detect a deteriorating business development and signal to the debtor or the entrepreneur the need to act as a matter of urgency." Such mechanisms should include "accounting and monitoring duties for the debtor or the debtor's management as well as reporting duties under loan agreements. In addition, third parties with relevant information such as accountants, tax and social security authorities could be incentivised or obliged under national law to flag a negative development."[30]

Once the business deterioration is detected, Art. 3 (2) requires Member States to ensure that debtors know what to do by providing relevant up-to-date, clear, concise and user-friendly information about any means available to them to restructure or to wind up the business and obtain a discharge of personal debt.

The Commission is well aware that proper accounting and monitoring is common in bigger companies with respective resources and governance structures. Such businesses are also aware of the available options in a business crisis or, at least, know where to turn to for quality advice. SME are prone to insufficient accounting and monitoring practices[31] as well as limited knowledge on restructuring options and limited financial resources to hire expert advice.[32] Art. 3 (3) thus allows Member States to limit the regime on early warning tools and additional support of early measures to SME.

Box 8: Early warning for SME debtors

1. **Microenterprise**: Early warning mechanisms are particularly relevant for microenterprises like the house-painter. With limited personal and financial resources, the business development is often more "felt" than monitored due to insufficient internal accounting and monitoring. The simple act of stating accounting duties may not bring much of a change for better because it does not give such entrepreneurs more expertise, resources or time. The house-painter will, however, usually have a tax advisor for annual tax reports who can be mandated to monitor the business situation (at least annually) and inform the owner of a foreseeable business failure. In contrast, tax agencies, social security agencies and banks would only notice a failure to pay dues. At this point in time, any warning may be too late for a restructuring outside of formal insolvency. Asking these stakeholders to implement an effective monitoring system for all their SME customers would seem quite costly for the banking industry and public authorities.

2. **Medium-sized enterprise:** Medium-sized enterprises like the automotive supplier company would commonly have sufficient resources to install accounting departments and monitoring systems. Company law often also obliges managers to flag a serious business

30 Recital 16 of the proposed Directive.

31 See Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 Cap. U. L. Rev. 413, 427 1994.

32 See Brian A. Blum, *The Goals and Process of Reorganizing Small Businesses in Bankruptcy*, 4 J. Small & Emerging Bus. L. 181, 194-195 2000.

crisis to shareholders. In such a situation, these companies are well equipped to explore restructuring options by using the knowledge and resources of their managers and shareholders, but also the advice of external experts.

3.2. Art. 6, 7 - Stay

While the proposed stay may cause significant disturbances for a SME creditor, a SME debtor may profit from a rather extensive stay ordered under Art. 6 and 7 of the proposed Directive.

3.2.1. Effects of a stay

As described above in detail, the stay is connected to restructuring negotiations that would be protected from disturbances. Such protection would always include a stay of enforcement actions (Art. 6 (1)), a stay of contractual rights to terminate, accelerate or withhold (ipso facto clauses, Art. 7(5)), a stay of statutory rights to terminate, accelerate or withhold due to old debt (Art. 7 (4)), and a stay of a duty to file and, possibly, of a right to file for creditors (Art. 7 (1)-(3)). Art. 7 (6) clarifies that the stay would "not prevent the debtor from paying in the ordinary course of business claims of or owed to unaffected creditors and the claims of affected creditors that arise after the stay expressively allows the debtor to do so".

3.2.2. Duration of a stay

The stay can be granted for up to four months (Art. 6 (4)) and extended up to a maximum total of 12 months (Art. 6 (7)) as long as the development in the negotiations justifies the extension.

3.2.3. Scope of a stay

The stay may affect all types of creditors and, depending on national legislation, can be collective or limited to some or even one creditor (Art. 6 (2)).

3.2.4. Ordering and lifting a stay

Any stay requires the respective request from the debtor in which he demonstrates to a judicial or administrative authority that the requested stay is necessary to support the negotiations of a restructuring plan (Art. 6 (1)), and does not unfairly prejudice an individual creditor or a single class of creditors (Art. 6 (9), in particular by disadvantaging their position compared to a scenario without a stay). When making the decision, the authority (usually a court) would also consider whether the requested stay would preserve the overall value of the estate, whether the debtor acts in bad faith or with the intention of causing prejudice, or whether the debtor generally acts against the legitimate expectations of the general body of creditors.[33]

Any stay may be lifted ex officio under Art. 6 (8) (a) as soon as it becomes apparent that a proportion of creditors who under national law could block the adoption of the restructuring plan does not support the continuation of the negotiations: In addition, a general stay may be lifted anytime, as a whole or partially, at the request of the debtor or the PIFOR

[33] See Recital 20 of the proposed Directive.

appointed (Art. 6 (8) (b)). Finally, any creditor is also able to challenge the order of a stay based on the ground that the conditions for a stay are not actually met.

Box 9: Protection of a stay

1. **Microenterprise:** The house-painter who faces troubles paying his dues would only profit from the protection of a stay if he is able to initiate substantive "restructuring negotiations" with one or some of his creditors. Such could be talks with a lessor about a decrease in the rental fee or a waiver or temporary suspension of unpaid claims. It could also be negotiations with bank providing a credit line, tax agencies demanding payment or customers like the building company demanding damages or a rectification of defects. Only for the duration of such negotiations, the house-painter could profit from a stay of pending enforcement actions as well as from the suspension of termination or modification rights or an obligation to file for insolvency. All these protective effects end when the stay is lifted due to the end of negotiations. In case of a small business owner, the underlying facts are hardly ever complex and bargaining powers are in the hand of creditors. Thus, negotiations with a creditor may not last much longer than a couple of days. Long periods of a stay are meant for complex cases, not for a microenterprise. Connecting the duration of a stay strictly to the duration of negotiations serves as a protection of creditors from abusive debtors who try to hide behind a stay while distributing remaining wealth to insiders; it does not protect microenterprises.

2. **Medium-sized enterprise:** The situation is very different for a medium-sized enterprise like an automotive supplier company. Businesses of such a size have some leverage in a restructuring negotiation (due to their size or relevance for a supply chain) which may prompt such negotiations to take a couple of weeks. Here, a stay may be effective and needed. At the same time, the continuation of the debtor's business is safeguarded by the effects of a stay on supply contracts against counterparties supplying the debtor ("essential contracts"). The protection under Art. 7 (4) and (5) would, if construed literally, also include the rights of customers with regard to executory contracts like the OEM which would provide additional safeguard the continuation of the business during the negotiation period. However, in order to protect a long-term relationship with customers (like OEM), it would be preferable to exclude such sensible business partners from the ramifications of a restructuring process. Instead of a general (collective) stay, sensible supply chains or other customer relations could be spared from a stay if Member States choose to make a limited, more targeted stay available to troubled debtors.

3.3. Art. 8-15 – Restructuring Plan

While a stay only offers temporary relief to SME debtors, a restructuring plan would bring a permanent debt relief.

3.3.1. Are SME debtors sufficiently equipped?

The proposed Directive would introduce a legal regime for the adoption and confirmation of a restructuring plan that resembles the regime in formal insolvency proceedings. Tools like classification of claims and class voting, cross-class cram-downs, valuation of the debtor's assets on a going-concern or piece meal basis, overcoming shareholder resistance, or limiting the effects of appeals are insolvency specific and difficult to understand or to even master by common debtors and their managers. Debtors require expert advice to design a restructuring plan and have it successfully adopted and confirmed in the proposed process. Current restructuring practice demonstrates that such advice is not available at a bargain

price. SME debtors in crises commonly do not have sufficient resources to cover such restructuring costs ("resource poverty").[34] As a result, they are rather poorly advised or stay away from court-supported restructuring efforts in the first place. In any case, SME debtors are typically not equipped to take advantage of the full range of (coercive) tools available in their respective restructuring framework. Instead, they are prone to use a simply version of the process with as little legal uncertainty as possible. The proposed Directive does not reflect this limitation of SME debtors by offering a simplified restructuring option.[35]

3.3.2. Model restructuring plans

The Commission is well aware of the limited resources of SME debtors in a restructuring situation and their specific need for a low cost path. In response, the Commission promotes the development of "model restructuring plans" which shall be made available nationally and allow the SME debtor to go online and adapt the model plan to the needs of its business situation.[36]

The key issue for SME debtors is low cost advice in a restructuring. Model restructuring plans could offer such advice provided that they will be more than just a collection of plan examples. If Member States were to develop modern software solutions to design a template that would query the specifications of a debtor and its business situation as well as an initially intended restructuring solution and translate this information in some options to choose from (e.g. payment plans) before producing the plan for the chosen option, plan templates could actually provide the low cost advice needed. Such efforts should, however, not preclude the implementation of additional support, like e.g. state-(co-)funded advice provided by chambers of commerce, local business support groups or publicly funded organisations. There is a lot of start-up support existing in many Member States, and restructuring support could be funded in similar ways.

Box 10: Restructuring plans for SME debtors

1. **Microenterprise:** A failing microenterprise like the house-painter would have very limited financial resources to pay for advice on how to manage a turnaround. In addition, the entrepreneur is usually not qualified to initiate and manage successful restructuring negotiations with his bank or main business partner. It is particularly difficult for these business owners to calculate a financial plan that can be used to offer payments on old debts in a payment plan. Here, low cost advice from "business angels" or a sophisticated template gathering and processing relevant facts would be of tremendous importance to even initiate a restructuring process. In addition, the option to overcome the passivity or opposition of one (often a public) creditor by using the plan process may prove to be important for small entrepreneurs.[37]

2. **Medium-sized enterprise:** Medium-sized enterprises like the automotive supplier company would usually still possess resources to hire a CRO or advisors that would develop a turnaround plan and not only initiate a restructuring, but also navigate the management through such a process. Of course, such advice would come with significant costs.

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[34] See Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 Cap. U. L. Rev. 413, 427-428 1994.

[35] See Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, *Tackling Small and Medium Sized Enterprise Problem Loans in Europe*, IMF SDN 15/04, 2015, 9.

[36] See Art. 8 (2) and (3) and Recital 13 of the proposed Directive.

[37] Such an option was suggested by Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, *Tackling Small and Medium Sized Enterprise Problem Loans in Europe*, IMF SDN 15/04, 2015, 20.

3.4. Art. 16, 17 – Safe harbour

For a SME debtor both safe harbour provisions have significant relevance. Financing protection and privilege under Art. 16 could help finding such financing in the first place and, thus, only enable a restructuring. Transaction protection under Art. 17 safeguards the continuation of the business by reassuring business partners that all due payments are free from risk despite an ongoing restructuring. It would also protect payments to advisors. Both safe harbour depend on both parties acting in good faith.

Box 11: Safe harbour for SME debtor

Both a microenterprise like the house-painter and a medium-sized enterprise like the automotive supplier company could guarantee their bank that, if they were to provide a new line of credit, payments under the agreement would be protected under Art. 16 (1), and could even enjoy a privilege under Art. 16 (2). Financing negotiations could be facilitated. Payments in the ordinary course of business and under the plan, but also payments to advisors would be protected under Art. 17.

3.5. Art. 19-23 – Discharge and Second Chance

The Commission's effort to impose a more debtor-friendly discharge regime is focused on SME debtors who are often individuals or company managers who own their firm.[38] Following the failure of their firm and an insolvency liquidation, these entrepreneurs are commonly left with a pile of unpaid claims. They may nonetheless set up a new business, but the incentive to take new risks is impeded by the fact that old claims would have to be paid on top of running the new business.[39] At the same time, old debt ruins credit scores and a disqualification period may prevent the establishment of a new unburdened company. The Commission's proposal works on most of these levels. It allows for a quick discharge that would also encompass an end to a disqualification. It does not, however, clean up a credit score.

The limitations under Art. 22 would ensure that fraudulent debtors as well as debtors who showed no interest in bookkeeping or in complying with rules on monitoring and cooperation with officials and creditors may not enjoy a quick discharge. Fraudulent entrepreneurs may even be disqualified from running a company indefinitely.

Box 12: Quick discharge

1**. Microenterprise:** The house-painter could, after his firm failed and was liquidated, get a quick discharge anywhere in Europe under the proposed regime. COMI shifts to England or France would become unnecessary. Due to the limited resources as well as psychological effects, however, such entrepreneurs show a tendency to improper bookkeeping or business communication in times of crisis which would lead to a possibly delayed discharge under the "not adhering to legal obligation aimed at safeguarding the interests of creditors" rule in Art. 22 (1) (b). A large group of entrepreneurs could, thus, not benefit from the proposed quick discharge. In addition, a discharge period of three years from the start of liquidation proceedings may delay a fresh start of our house-painter quite significantly. A

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[38] See Brian A. Blum, *The Goals and Process of Reorganizing Small Businesses in Bankruptcy*, 4 J. Small & Emerging Bus. L. 181, 194 2000; also see Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 Cap. U. L. Rev. 413, 427-428 1994.

[39] See Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, *Tackling Small and Medium Sized Enterprise Problem Loans in Europe*, IMF SDN 15/04, 2015, 10.

discharge within a year, which is practiced in a number of Member States, that includes all unpaid debt, could be a significant motivator for the painter to get back on track or even voluntarily and timely initiate a liquidation of his indebted business.

2. **Medium-sized enterprise:** Enterprises like the automotive supplier company would not directly benefit from the discharge provisions. The individuals behind such a company (e.g. in a family-owned company) would only require a discharge if the failure and liquidation of the company led to the insolvency of these individuals because they were directly liable for business debt (based on e.g. personal guarantees, sureties or company law rules). In such a case, they could benefit from a quick discharge and would not be vulnerable to limitations under Art. 22 if they did not manage the company in person.

3.6. Art. 24-28 – Institutional Background

As noted above, the measures described in this title of the proposal bear little specific relevance for SME creditors or debtors.

4. IMPETUS FOR RECOMMENDATIONS

The evaluation of the situation of SME with and without the proposed Directive must start with repeating the fact that circumstances are quite different for microenterprises compared to larger (in particular medium-sized) enterprises.[40]

4.1. Improvement for SME under the Proposed Directive

For microenterprises the current shattered legislative landscape in Europe means that they are treated quite differently in case of a business crisis and insolvency depending on their place of business. Some jurisdictions provide for a restructuring framework, others have no such framework; some have a specific insolvency regulation for SME, others have not. Some have a well-functioning out-of-court debt settlement practice while others face a significant non-performing loan problem that may involve a significant share of microenterprise debt considering the share of such businesses in the respective economy.[41] Some have an efficient claim enforcement and insolvency regime, others have not. Some provide for a quick and full discharge for individuals, others make a rehabilitation process a long and burdensome journey. In times of a business crisis, the "resource poverty" of microenterprises precludes such firms from moving their business to a jurisdiction with the best legal framework to restructure. It also prevents the failed entrepreneur from shifting to a better rehabilitation or debt relief regime.[42] Harmonised best practice standards would eliminate these differences and allow for an equal treatment and equal chances for individual entrepreneurs across Europe.

The situation may be a little different for **small enterprises** as they possess more resources which allows them to respond to a business crisis more actively. Still, placed in a jurisdiction with no or a malfunctioning restructuring and insolvency regime even such firms are not able to use the common market for a better regime. Shifting the place of business in order to access a foreign restructuring regime is expensive and may become even more difficult under the recast Insolvency Regulation.[43]

Overall, any harmonisation that improves national regimes on claim enforcement, restructuring and insolvency is particularly important for SME as they can hardly ever choose their legal forum.[44] The proposed Directive offers a first step by setting standards for the institutional background of national regimes and a pre-insolvency restructuring framework.

[40] See Izidin El Kalak and Robert Hudson, *The effect of size on the failure probabilities of SMEs: An empirical study on the US market using discrete hazard model*, International Review of Financial Analysis 43 (2016) 135–145. See also Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, *Tackling Small and Medium Sized Enterprise Problem Loans in Europe*, IMF SDN 15/04, 2015, 20.

[41] For statistical data, see Khrystyna Kushnir, Melina Laura Mirmulstein and Rita Ramalho, *Counting MSMEs Across the World*, IFC, http://www.ifc.org/msmecountryindicators. See also Oya Pinar Ardic, Nataliya Mylenko, Valentina Saltane, *Small and Medium Enterprises a Cross Country Analysis with a New Data Set*, The World Bank Financial and Private Sector Development Consultative Group to Assist the Poor, Policy Research Working Paper 5538, January 2011.

[42] Accessing another jurisdiction's restructuring and insolvency framework commonly requires to move the office and activities of the business there in order to meet the "centre of main interest or COMI"-test under Art. 3 (1) of the Insolvency Regulation, OJ L141/19 of 5.6.2015. Such a move is expensive and disruptive for a microenterprise and, therefore, not a viable option. The same reasons prevent a failed entrepreneur from moving his COMI to a discharge-friendly jurisdiction as that would require leaving home and moving abroad.

[43] See Art. 3 (1) and Recitals 27-31 of the recast Insolvency Regulation, OJ L141/19 of 5.6.2015.

[44] See Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, *Tackling Small and Medium Sized Enterprise Problem Loans in Europe*, IMF SDN 15/04, 2015, 20.

4.2. Possible Harm for SME under the Proposed Directive

Any effort to harmonised legal rules must ensure that, while establishing a new common framework, it does not interfere with what works well.[45] In addition, the proposed framework should not make things worse for those who should be doing better.

The evaluation of the effects of the proposed Directive on SME revealed a number of issues that could potentially hurt SME.[46]

- Stay

A stay of enforcement actions and contractual rights hits microenterprises as creditors disproportionately hard. As such firms work with fairly limited resources and are more vulnerable to disturbances, any longer stay and the resulting reduction of available cash may cause them to fail as well. This is particularly relevant for microenterprises with a principal business partner. To avoid such hardship, the Directive should either exempt microenterprises (but not all SME) from a general (collective) stay or, at least, limit it's duration against this specific group of creditors. Under the currently proposed regime, the specific needs of microenterprise creditors may easily be overlooked by the authority (court) issuing a (collective) stay.

Microenterprises are also disadvantaged by the proposed regime when they are in the debtor's position. The strict connection between the duration of a stay and the duration of still ongoing and promising restructuring negotiations does not allow for a longer stay for such enterprises, because their talks with their very limited number of relevant creditors would commonly not last long. For such firms, a minimum duration of a stay (of max. 2 weeks) could be introduced.

Overall, the evaluation of SME also indicates that preferably, a stay outside of formal insolvency or restructuring proceedings should not be issued automatically, should not automatically extend to all types of creditors (collective) and all types of creditor actions (full stay). Instead, a more flexible approach seems preferable – when a stay is ordered and when it's lifted.

- Restructuring Plan

For SME creditors, the evaluation of proposed regime for restructuring plans also showed that micro- and small enterprises (MSME) should be distinguished from medium-sized enterprises. While medium-sized enterprises may be involved in a restructuring of a business partner with relevant claims and thus may have leverage in negotiations, MSME are usually irrelevant in a system based on amounts of claims. While this fact can be good for them if the legal framework allows their class to remain unaffected by a restructuring, it can be very bad if they may have to participate in a class of unsecured creditors, but also in a separate class under a far-reaching cram-down rule. The proposed Directive could reflect the vulnerability of small claim creditors by exempting such claims from the scope of the restructuring framework. This could be done by limiting the scope of restructuring plans to claims of financial creditors.[47] It could also be achieved by mandating a specific class for affected small claims while also exempting such a class from excessive cross-class-cram-down rules. As both options could work well, the Directive should allow Member States to choose which form of protection to implement.

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[45] This view is shared by the Commission, see Explanatory Memorandum, COM(2016) 723 final, at 7.

[46] For a German evaluation of these issues, see Madaus, Europäische Ideen für einen präventiven Restrukturierungsrahmen und Handlungsspielräume für das deutsche Recht, Working Paper 2017, at 20-26, available at http://stephanmadaus.de/wp-content/uploads/2017/03/Madaus-RL-Vorschlag-zur-vorinsolvenzlichen-Sanierung-Working-Paper-M%C3%A4rz-2017-v2.pdf.

[47] Such a limitation is proposed by a number of German stakeholder, most prominently the Federal Chamber of the German Parliament (Bundesrat); see Brat Drucks 1/17 of 10.3.2017, at no. 13.

For SME debtors, a specific regime is again required for micro- and small enterprises (MSME). Their resource poverty limits their access to quality advice in times of a crisis, so low cost advice is required. Here, the Directive should mandate Member States to support private organisations (e.g. business angels or help desks in Chambers of Commerce), but also consider providing such advice directly through public authorities. In addition, the model restructuring plan approach should be developed into designing online templates for MSME.[48]

- Quick discharge

The reduction of discharge periods is not relevant for SME creditors, because by that time they have long written off the defaulting claim. At the same time, a quick discharge is essential for a SME debtor, in particular again the entrepreneur of a micro and small enterprise, which are very vulnerable to any disturbance in their business operations. Here, a discharge may work as a good incentive to comply with relevant obligations against creditors particularly in times of crisis. At the same time, however, not every violation of a legal obligation by a small entrepreneur should suffice to deny a quick discharge as it is currently proposed in Art. 22 (1) (b). Instead, the higher threshold of a "substantial" violation would better reflect the ability of a single MSME entrepreneur to comply with all obligations in a crisis.

In addition, any debtor should benefit from a presumption of honesty that would require dishonesty to be proven. Considering the passivity of creditors in small business cases, such a presumption would specifically promote the discharge of micro- and small business entrepreneurs.

4.3. Conclusion

The proposed Directive does not specifically address the needs of SME. The analysis revealed that specific rules may be required for the small fraction of SME: micro and small businesses or even only microenterprises. MSME creditors should receive protection from a stay and a restructuring plan impairing them. MSME debtors should be able to find a low cost advice institutions when facing a business crisis, not just a model restructuring plan in a brochure. They could also benefit from a short minimum duration of a stay of one or two weeks. Overall, this analysis also showed that provisions regarding the scope of a stay as well as the scope of a restructuring plan should be more flexible.

[48] Templates and standardised processes were also considered by Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, *Tackling Small and Medium Sized Enterprise Problem Loans in Europe*, IMF SDN 15/04, 2015, 22 and 25.

5. RECOMMENDATIONS

The analysis has resulted in highlighting a number of specific necessities for micro and small enterprises under the proposed Directive. Their special needs could be reflected in the text of the Directive by adding the following phrases (underlined and in italic):

Art. 3 (3)

Member States may limit the access provided for in paragraphs 1 and 2 to small and medium sized enterprises or to entrepreneurs. *For these types of debtors, Member States shall also provide access to professional advice on a low cost basis.*

Art. 6 (2)

[…]The stay may be general, covering all creditors, or limited, covering one or more individual creditors, in accordance with national law. *The stay may include all effects listed in Art. 7 or only some of them, in accordance with national law.*

Art. 6 (3)

Paragraph 2 shall not apply to *micro and small enterprise claims and* workers' outstanding claims […].

Art. 6 (4)

Member States shall limit the duration of the stay of individual enforcement actions to a maximum period of no more than four months. *Member States may provide for a minimum duration of a stay of two weeks in case of micro or small enterprises.*

Art. 8 (2)

Member States shall *provide access to professional advice for micro and small enterprises on a low cost basis and* make a model for restructuring plans available online. […].

Art. 9 (1)

Member States shall *determine which types of creditors can be affected by a restructuring plan and* ensure that any affected creditors have a right to vote […].

Art. 9 (2)

[…].Member States *shall* also provide that workers and *micro and small enterprise claims* are treated in a separate class of their own.

Art. 11 (2)

Member States may vary the minimum number of affected classes required to approve the plan laid down in point (b) of paragraph (1), and exempt a class of *micro and small enterprise claims from any cross-class cram-down*.

Art. 22 (1) (b)

[…] the over-indebted entrepreneur does *substantially* not adhere to a repayment plan or to any other legal obligation aimed at safeguarding the interests of creditors;

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Abstract

This study was commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs at the request of the JURI Committee. It looks at the effects the recent Commission proposal might have both on micro and small and medium-sized enterprise, thus reflecting the diversity of SMEs. It identifies and explains the issues at stake of concerned SMEs related to their capacity as both debtors and creditors..

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