The Restructuring Directive: a functional law and economics analysis from a French law perspective

By Vasile Rotaru

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ABSTRACT: *From a law and economics perspective, the existence of insolvency law is justified insofar as it is necessary for ensuring orderly and efficient coordination and negotiations between the stakeholders in case of a debtor's economic or financial distress. The so-called "preventive" restructuring proceedings are no exception. They should, therefore, help identify and distinguish viable and non-viable businesses and facilitate the operational and financial restructuring of the former where an added value to the benefit of all the stakeholders is expected compared to their immediate liquidation.*

In this respect, the recent Restructuring Directive is somewhat disappointing. Its final text bears the marks of the divergent perspectives and objectives pursued by its different drafters: the preservation of the debtor's company at all costs, or, on the contrary, the maximization of the value of the debtor's assets in the interest of all its stakeholders. The resulting text lacks, therefore, a coherent conceptual foundation, and should be understood as proposing several distinct types of proceedings.

Nevertheless, the Restructuring Directive introduces some major innovations for preventive restructuring proceedings, both with respect to the approval of restructuring plans (vote of the plan by classes of creditors, possibility of a cross-class cram-down, treating shareholders as a class of creditors in order to facilitate debt-equity swaps) and to the protections afforded for the benefit of stakeholders (best interests of creditors test, priority rules). However, the puzzling variety of diverging options for the transposition of these measures requires legislators to seek clear guidelines in order to build the national preventive restructuring proceedings on coherent foundations, even where they are all but absent at the European level.

The stakes are particularly high concerning the specific case of France, for the imminent transposition of the Directive provides a unique opportunity to create economically efficient and internationally competitive proceedings. From our point of view, it requires, however, for the legislator to be aware of the conclusions of the functional law and economics analysis. Specifically, the transposition will have to be accompanied by a vast reform of the French restructuring and insolvency law, aimed at increasing its transparency and predictability. These are the necessary conditions in order to ensure an optimal allocation of resources in the economy and to stimulate the development of the French financial markets, and more particularly the bond and distressed debt markets. In the long term, these reforms should both bring down the ex-ante costs of financing for French companies and turn France into a true challenger for the role of a leading jurisdiction for European cross-border restructuring.

This paper is structured as follows. After a brief introduction in Part I, Part II provides the general conceptual framework of our analysis, largely based on what will be called a 'functional' law and economics approach. It explains what objectives restructuring proceedings should pursue and the basic structure that such proceedings should have in our opinion. Practitioners more interested in the Restructuring Directive in itself could skim through Part II and focus on Part III of the paper, which provides an analysis of the different models hidden in the Directive, their respective objectives and most important measures (statutory moratoria, decision-making, protections of stakeholders' interests), including a comparison with current French pre-insolvency proceedings. Finally, Part IV addresses some issues specific to the transposition of the Directive into French law.

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[3] - Droit & Croissance / Rules for Growth Institute is an independent and non-partisan think tank, founded in 2012 and open to all those who share its ambition to realise and popularise studies in the field of law, economics and finance. Since 2016, Rules for Growth has been affiliated with the Louis Bachelier Institute, a non-profit organization under the supervision of the Ministry of the Economy and Finance, comprising 350 researchers. Rules for Growth's mission is to challenge public and private actors, as well as to feed into debates in civil society, in order to emphasize the importance of the research in the fields of law and economics and behavioral economics.

I. Introduction

1. On the 20th of June 2019, the final text of directive n° 2019/1023 on preventive restructuring frameworks (the "Restructuring Directive" or "Directive") has been approved, after several years of negotiations between stakeholders with profoundly divergent interests. article 196 of a law passed by the French Parliament on 22nd of May 2019 (the "Pacte law") empowers the government to implement the Restructuring Directive into French law through ordinances, as quickly as possible. In this context of hastened implementation, the purpose of this paper is to offer an analysis of the Restructuring Directive from a 'functional' law and economics perspective, in order to identify its major innovations and their respective theoretical underpinnings.

2. The entry into force of the Restructuring Directive seems especially timely, as it is supposed to tackle some of the worries of the European legislator relating to a possible future financial crisis. In fact, since the 2008 financial crisis, the European Central Bank has deployed unprecedented means in order to maintain historically low interest rates, thus boosting economic growth and preserving the Euro.[4] This accommodative policy has led to an explosion in the private corporate debt market, be it the bond market (especially the high-yield bond market)[5] or highly leveraged loans.[6] The low returns on traditional investment instruments on the financial markets (due to the intervention of the European Central Bank) explain why the segment of distressed company debt is attracting new investors, as they are looking for higher yields. This increased demand for risky debt instruments has naturally tilted the balance in favour of borrowers[7]. Thus, the quality of borrowers (that is, their future debt repayment capacity) and the creditors' contractual protections (the "covenants") have drastically decreased.[8] At the same time, private debt structures have become increasingly complex in order to finance projects pursued by risky and increasingly indebted businesses.[9] This new economic reality is all the more worrying as the European economy is approaching the end of an economic cycle, with some factors suggesting that a crisis of private debt is likely in the coming years,[10] when very large amounts of debt will mature.[11]

3. The likely repercussions of the future cycle reversal on the European economy and its banking system, as well as the need to consolidate the Capital Markets Union, pushed the European Union to consider the development of a common framework for restructuring.[12] Since the harmonization of traditional insolvency proceedings is not politically feasible,[13] the Commission has proposed a framework for "preventive" restructurings of European companies' financial debts, that is to say in anticipation of a debtor's formal insolvency (which

4 - See Thibault Dubreuil and Olivier Klein, « La sortie de la politique monétaire très accommodante de la BCE : enjeux and défis », Revue d'economie financiere N° 127, no 3 (22 Dec. 2017) 335-52.

5 - See OECD, « Corporate Bond Markets in a Time of Unconventional Monetary Policy - OECD », OECD Capital Market Series, Feb. 2019.

6 - See R. Wigglesworth, Non-bank lenders thrive in the shadows, Financial Times, 4 Feb. 2019.

7 - See for a recent analysis of the reasons for the rise of the covenant lite debt market, Sarah Paterson, The Rise of Covenant-lite Lending and Implications for the UK's Corporate Insolvency Law Toolbox, Oxford Journal of Legal Studies, Vol. 39, 3 (2019), 654–680.

8 - See Bo Becker and Victoria Ivashina, « Covenant Light Contracts and Creditor Coordination », Swedish House of Finance Research Paper No. 17-1, s. d., who notes: "In 2015, 70% of newly-issued leveraged loans had weaker enforcement features, called covenant light or « cov-lite; » this is nearly a three-time increase in cov-lite issuance compared to a previous peak in 2007"; See also, S. Çelik, G. Demirtaş M. Isaksson, op. cit., p. 16 : "In the post-crisis era, bond investors' search for yield in an environment of historically low levels of interest rates Seem to have given bond issuers an opportunity to weaken the protection that covenants offer."

9 - See S. Indap, Investors in debt-laden companies face messy workouts, Financial Times, 22 Jan. 2019.

10 - See R. Wigglesworth, Non-bank lenders thrive in the shadows, Financial Times, 4 Feb. 2019.

11 - It must indeed be understood that this discounted debt is not amortisable, the borrower only pays interest over the term of the loan, which explains the formation of "walls of debt". See OECD, « Corporate Bond Markets in a Time of Unconventional Monetary Policy - OCDE », 6: "Considering the size and maturity profile of the current outstanding stock of corporate bonds, corporations in both advanced and emerging markets are facing record levels of repayment requirements in the coming years"; p. 24: "For instance, up to 2023, companies in advanced economies are supposed to have repaid 47% of their corporate bond debt that was outstanding by the end of 2018. On the other hand, emerging market companies will need to have repaid 69% of the outstanding amount."

12 - See COM (2016) 723: « The single market problems are not limited to purely cross-border situations. Even purely national insolvencies may have a domino effect on the functioning of the single market… An instrument limited to cross-border insolvencies only would not solve the single market problems, nor would it be feasible for investors to determine in advance the cross-border or domestic nature of debtor's future potential financial difficulties. »

13 - See Horst Eidenmüller, « Contracting for a European Insolvency Regime », European Business Organization Law Review 18, no 2 (1 June 2017): 275: "undertaking this harmonization with respect to Member States' 'traditional' insolvency regimes is sure to meet considerable political resistance. In particular, issues such as the governance of insolvency proceedings (including the role of the courts, insolvency administrators and the debtor), as well as the substantive ranking of claims are dealt with very differently across Member States, which reflects diverse regulatory traditions and contested value judgments."

comes from a liquidity problem). This was done first through the Commission's recommendations of 12 March 2014[14] and then in the draft Restructuring Directive.

4. This proposal is part of a worldwide movement favorable to the development of "debtor in possession" (DIP) preventive proceedings, which are, for example, the reference for the new Singaporean proceedings.[15]

5. The final text of the Restructuring Directive is the result of multiple consultations with different stakeholders and professional organizations. A group of 22 experts was created in 2015 in order to assist the Commission with its coordinating the different inputs.[16] The Commission also organized meetings with more than 250 representatives of national governments and Parliaments, workers' unions, consumers' organizations and interested economic actors.[17] Multiple public consultations have also been put in place as part of the Capital Markets Union initiative. All in all, the Commission received more than 420 inputs from stakeholders from all the members of the EU.[18] What seemed clear from reading these different inputs was the wide range of diverging objectives the new preventive restructuring frameworks had to pursue in the eyes of different stakeholders. Generally, commercial and central banks were in favor of harmonizing insolvency proceedings and of reducing the length of statutory moratoria, while the workers' unions and SME representatives were pushing for a harmonization aimed at enhancing business rescue and diminishing the fixed costs of the proceedings.[19] The same diverging objectives appeared to be favored by different European institutions, with the Commission aiming at a high degree of harmonization of financial restructuring frameworks based on the model of "second-age" Chapter 11[20] and the English Schemes of Arrangement[21], while the Parliament was cautious to preserve the interests of the affected workers,[22] and the European Council intended to retain the greatest possible flexibility for national legislators. [23]

6. The French negotiators, for their part, were trying to bring about a reform of the French pre-insolvency proceedings, especially of their decision-making proceedings, while preserving the current two-steps approach[24] of confidential amicable *conciliation* proceedings followed, if an unanimous agreement is not obtained but a re-

14 - See EC (2014) 1500.

15 - Generally, Aurelio Gurrea-Martínez, « The Future of Reorganization Proceedings in the Era of Pre-Insolvency Law » (Ibero-American Institute for Law and Finance Working Paper No. 6/2018, 20 Dec. 2018), https://papers.ssrn.com/abstract=3290366 ; for Singafor, see Gerard McCormack and Wai Yee Wan, « Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's Restructuring and Insolvency Laws: Opportunities and Challenges », Journal of Corporate Law Studies 19, no 1 (2 Jan. 2019): 69-104.

16 https://ec.europa.eu/info/about-european-commission/service-standards-and-principles/transparency_en

17 https://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=30874

18 https://ec.europa.eu/finance/consultations/2015/capital-markets-union/index_en.htm

19 See Gert-Jan Boon, « Harmonising European Insolvency Law: The Emerging Role of Stakeholders », International Insolvency Review 27, no 2 (2018): 150-77.

20 - These are the consensus-based proceedings practiced in the United States between 1978 and the mid-1990s, based on the "creditor's bargain theory" and leaving the greatest room for negotiations between the debtor and the creditors, whereas initially judges played a much bigger role. The original idea is that the insolvency proceedings should be an extension of the contracts between the creditors and their debtor and serve to facilitate the coordination of a same debtor's creditors among themselves. Since the mid-1990s, these consensus proceedings have evolved in practice. While historically, they gave rise to a restructuring of the equity and debt of the debtor company, they are now assimilated to essentially liquidation proceedings, after which the operating company is sold. See Mark J. Roe, « Three Ages of Bankruptcy », HarSee Bus. L. ReSee 7 (2017): 188: "The 1978 Code announced that, from thenceforward « [t]he parties are left to their own to negotiate a fair settlement... » […] In the New Deal's 1938 chapter X, the court decided on the distribution of value in the restructuring, without deferring to the parties' deal. But in the 1978 Code, the creditors voted by class on a proposed deal.65 If a majority of each class of similar creditors approved a plan, the decision-making structure called for no judicial finding on the plan's fairness, the value of the debtor, or whether the plan respected priority. Administration after 1978 was weak."

21 - See Sarah Paterson, "Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform" (3 March 2017).

22 See from the perspective of the French negotiators from the CIRI, Clément Tiret, « Retour sur les débats intervenus autour de la directive Insolvabilité au sein des institutions européennes », RPC, no 3 (2019) : 16.

23 - A will that resonates in the criticism of the text of the Commission's initial proposal by H. Eidenmüller, who insists on the need to maintain legislative competition between the Member States, even if this also means proposing a unified European system chosen voluntarily by Member State companies, Eidenmüller, « Contracting for a European Insolvency Regime », 304: "The great advantage of having an optional European restructuring/insolvency regime in place is that it preserves horizontal regulatory competition between the Member States for the best restructuring/insolvency 'product' and adds a vertical dimension to that regulatory competition. […] If the European regime fails, it simply would not be used. But, in any case, it will not be a system that creates mandatory European-wide inefficiencies, such as the draft RD, if adopted, would create. Likewise, it will not block Member States' incentives and freedom to experiment with new, potentially more efficient proceedings."

24 - See regarding an initial fear of overflow of the US model, J. Ernst Degenhardt, « Le droit français est-il conforme à la proposition de directive européenne du 22 novembre 2016 visant à harmoniser le droit des procédures collectives ? », Bull. Joly Entrep. diff., 2017, 153.

structuring plan seems likely to be adopted through a majority vote, by accelerated *sauvegarde* proceedings (accelerated financial proceedings, or "SFA", or simply accelerated proceedings, or "SA") as a closing phase of the negotiations. The two-steps approach is considered by some practitioners to be efficient but has been criticized from the point of view of its inability to ensure long-term turnaround of companies.[25]

7. The proposed new framework intends, therefore, to address two simultaneous issues. On the one hand, the concern of the Latin countries to facilitate the refinancing on equivalent terms and at a lower cost for European debtors,[26] thus avoiding insolvency situations and subsequent job losses.[27] On the other hand, the framework addresses the concern of the Nordic countries seeking to facilitate the cleansing of banks' balance sheets by reducing the number of non-performing loans.[28] The final text is the result of difficult negotiations, especially regarding the rules on the stay of individual enforcement actions, the adoption of restructuring plans and the protection of creditor rights. These different pressures and divergences of objectives explain the lack of harmonization and hesitations within the final text of the Directive, which does not rely on any coherent intellectual base.

8. It appears to us that Member States have two choices to make. On the one hand, they must choose between two formal models of proceedings, one based on a single and public proceedings, the other on amicable proceedings combined with brief closing public proceedings. On the other hand, they have to choose between two different ways of conceiving what the preventive proceedings are meant to accomplish: the preservation of businesses at all costs, or the maximization of the value of the assets of the company in the interest of all stakeholders. As we will see, only this second objective meets the requirements laid out by an economic analysis of insolvency proceedings.

9. These two choices do not necessarily overlap, and it is perfectly conceivable, therefore, that four different types of preventive proceedings emerge within the European Union. The fact remains that a decision on the desired model must be taken, as both choices dictate how to proceed where the Directive leaves some leeway for national legislators. It is therefore necessary, in the transposition race sure to be undertaken by the different Member States,[29] to clarify the nature of the different options which still remain open, in order to give the future French preventive proceedings a solid conceptual base, thereby ensuring, within the limits of what is permitted by the text of the Directive, their coherence and economic efficiency.

10. The remainder of this paper is structured as follows. Part II provides the general conceptual framework of our analysis, largely based on what will be called a 'functional' law and economics approach. It explains what objectives restructuring proceedings should pursue and the basic structure that such proceedings should have in our opinion. Practitioners more interested in the Restructuring Directive in itself could skim through Part II and focus on Part III of the paper, which provides an analysis of the different models hidden in the Directive, their respective objectives and most important measures (statutory moratoria, decision-making, protections of stakeholders' interests), including a comparison with current French pre-insolvency proceedings. Finally, Part

[25] - See especially Alain Pietrancosta and Sophie Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », RTDF, no 1 (2010): 1; Sophie Vermeille, « Analyse des conséquences de l'inefficacité du droit français sur la restructuration des entreprises de taille significative » (Droit and Croissance, June 2017).

[26] - See Eidenmüller, « Contracting for a European Insolvency Regime », 279: "Simply put, the Commission's thesis is as follows: (i) financing costs of firms are a function of recovery rates for lenders in bankruptcy – the higher these recovery rates, the lower the financing costs; (ii) (allegedly) efficient pre-insolvency restructuring proceedings maximise recovery rates for creditors; (iii) it is therefore important that firms in Europe have access to such proceedings regardless of where they are located – large listed firms are able to cross-border forum shop for an efficient restructuring regime in another European jurisdiction, SMEs will not enjoy this opportunity; and thus, (iv) the European lawmaker must harmonise pre-insolvency restructuring proceedings so that all European firms benefit from lower financing costs.". See also COM (2016) 723, 17: « In particular, the proposal will contribute to eliminating the additional ex ante costs incurred by investors when assessing the risks associated with debtors experiencing financial difficulties in one or more Member States, as well as the ex post costs incurred by companies in the restructuring phase which have places of business, creditors or assets in other Member States, usually as part of the restructuring of international groups of companies. »

[27] - See Restructuring Directive, recital 2 : « Those frameworks should help to prevent job losses and the loss of know-how and skills, and maximise the total value to creditors — in comparison to what they would receive in the event of the liquidation of the enterprise's assets or in the event of the next-best-alternative scenario in the absence of a plan — as well as to owners and the economy as a whole. »

[28] - See COM (2016) 723: « Effective insolvency frameworks are particularly important economically in the financial sector, with high levels of private debt and non-performing loans, as is the case in some Member States. The European Central Bank has identified, in its overall assessment of 2015, non-performing exposures in the banking system for a total amount of EUR 980 billion. These loans weigh heavily on banks' ability to finance the real economy in several Member States. »

[29] - See Reinhard Dammann and Vasile Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives », D., 2018, 2195.

IV addresses some issues specific to the transposition of the Directive into French law.

II. The economic approach of preventive restructuring

1. Insolvency proceedings from an economic perspective

1.1. The choice of a 'functional' law and economics approach

11. A brief survey of influential studies and international instruments relating to insolvency proceedings seems to show that while most of them refer in some way or another to 'efficiency', the term is seldom clearly defined.[30] Where a clarification is offered, it is often limited to diminishing the fixed costs and increasing the speed of such proceedings.[31] It seems to us, therefore, that we should clarify from the onset our approach to the analysis of the Restructuring Directive.

12. The economic approach to the analysis of law rests on the idea that real life consequences of the enacted rules do count and should be taken into account when evaluating the merits of such rules. Methodologically, it assumes (at least traditionally) that the model of the rational economic actor is a good enough approximation of the real behavior of humans given the descriptive and cognitive limits of the researcher.[32] Efficiency means, from this point of view, an adequacy between the means and the ends pursued by the legal decision maker. Normatively, the economic approach generally implies that the legal decision maker should aim by default to bring about a more 'efficient' world. Except in cases where there are persuasive reasons to pursue non-economic objectives and values, it is thought that a world in which more preferences are satisfied is preferable, *ceteris paribus*, to the alternative. Efficiency is not to be conceived as an exclusive value, but the analysis from an efficiency standpoint should make the legal decision maker aware of the consequences of its choices and allow for a subsequent balancing of the potentially competing values and interests.[33] The utilitarian heritage of such a notion seems obvious, insofar as the aim is to ensure an allocation of the available resources such that the aggregate satisfaction of individual preferences would be maximized.[34]

13. Two conceptual methods are traditionally used in order to give a more precise formulation to this intuition of preference satisfaction. The first one is that of the Pareto criterion, which refers to an allocation such that no subsequent reallocation could enhance the satisfaction of the preferences of one agent without diminishing that of another agent.[35] Without going into details, it has long been acknowledged that the Pareto criterion suffers from several serious shortcomings. First of all, it seems rather useless in a world where any intervention is sure to adversely affect the interests of at least one stakeholder.[36] Second, the Pareto criterion is extremely conservative, insofar as it takes the current distribution of resources for granted.[37]

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30 See Rachel Siew Lin Lee, « How is 'efficiency' determined in the insolvency context? Clarifying the meaning of efficiency with the conjunction of insolvency jurisprudence and economic methodology » (T.C. Beirne School of Law, The University of Queensland, 2015).

31 See for instance IMF - Legal Department, "Orderly & Effective Insolvency proceedings) Key Issues", 1999, "An insolvency proceeding is a dynamic process. Unlike many other adjudicative proceedings, which involve an inquiry into historical events, an insolvency proceeding takes place in 'real time': delays in a court's adjudication can have an adverse effect on the value of the assets or the viability of the enterprise. It is therefore critical that proceedings be put in place to ensure that hearings can be held quickly and that decisions are rendered soon thereafter. Similarly, it is critical that an accelerated appeal process be available. In any event, during the period of appeal, the lower court's decision should normally continue to be binding"; in the same vein, see United Nations Commission On International Trade Law, "UNCITRAL Legislative Guide on Insolvency Law (Date of adoption: Parts one and two, 25 June 2004; part three, 1 July 2010; part four, 18 July 2013)": "Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business activities of the debtor and to minimizing the cost of the proceedings. Achieving timely and efficient administration will support the objective of maximizing asset value, while impartiality supports the goal of equitable treatment. The entire process needs to be carefully considered to ensure maximum efficiency without sacrificing flexibility. At the same time, it should be focused on the goal of liquidating non-viable and inefficient businesses and the survival of efficient, potentially viable businesses".

32 See R. Posner, *Frontiers of Legal Theory*, 35: « Most economic analysis consists of tracing out the consequences of assuming that people are rational in their social interactions ».

33 See Posner, 101: « although economists cannot generate or validate a theory of distributive justice, they can make some descriptive points that might help other social theorists up with or defend such a theory ».

34 See Richard A. Posner, *Economic Analysis of Law, Ninth Edition*, 9e éd. (New York: Wolters Kluwer Law & Business, 2014), 4.

35 See Herbert Hovenkamp, « Distributive Justice and the Antitrust Laws », *George Washington Law Review* 51 (1983 1982): 9.

36 See Guido Calabresi, « The Pointlessness of Pareto: Carrying Coase Further », *Yale Law Journal* 100 (1991): 1225; see also Gerrit De Geest, « Any Normative Policy Analysis Not Based on Kaldor–Hicks Efficiency Violates Scholarly Transparency Norms », in *Law and Economics. Philosophical Issues and Fundamental Questions (Ed. Aristides N. Hatzis, Nicholas Mercuro)*, 2015, 184.

37 See Qi Zhou, « The Evolution of Efficiency Principle: From Utilitarianism to Wealth Maximization », *SSRN*, 2005, 10.

14. The second one is the Kaldor-Hicks criterion. Briefly stated, it implies that a rule is efficient insofar as the move from the current state of the world *W* to the world *W'* where the rule is enacted is such that the agents whose preferences are thus satisfied would be able to *hypothetically*[38] compensate those agents whose preferences are frustrated to the point where the later would become indifferent while the former would still prefer *W'*.[39] This criterion seems to be a metarule concerning the conflicts of different values, which implies that all the all the elements that agents consider relevant be taken into account and translated into a transparent 'common currency' allowing for meaningful comparisons.[40] It is, however, challenging to understand how exactly the comparison of sets of individual preferences is supposed to work. If they are to be expressed in cardinal numbers, the researcher is likely to run into the impossibility of comparing incommensurable values,[41] or simply the inability to obtain reliable information about individual preferences.[42] If the sets were to be compared based purely on ordinals,[43] the researcher would have to neglect the relative intensity of preferences,[44] or even run into logical inconsistencies.[45]

15. For these different reasons, the economic approach to law seems to prefer limiting what is to be taken into account, at least by default, to the maximization of wealth, meaning the aggregation of all goods and services which could be exchanged and valued in monetary terms, rather than those who have a utility for the agents (of which there are much more).[46] In our perspective, this approach is first of all justified by pragmatic concerns and does not mean that unevaluable goods and services are valueless.[47] The information and error price to be paid for a complete utility calculus, as well as the uncertainty of the end result, seem to render any more ambitious criterion simply impracticable.[48]

16. We do not entirely follow, however, the methodology of traditional law and economics, at least as we understand it. In fact, while the traditional approach is substantial, favoring an allocation of resources thought to be, from an *ex ante* perspective, efficient in the abovementioned sense, we are deeply skeptical about the capacity of legal decision makers to undertake an accurate enough analysis for such an allocation and prefer therefore a functional, or procedural, approach, aiming at favoring the emergence of the necessary epistemic conditions allowing for the best decision partaking to the allocation of resources to be taken in due course.[49] The basic intuition is that the agents themselves, whose skin is in the game, are the best decision makers. In a Coasean approach, the *ex ante* legal decision maker should therefore aim to reduce the transaction costs first, and only

[38] If the compensation were real instead of hypothetical, the Kaldor-Hicks criterion would be the equivalent of the Pareto criterion, see Jules Coleman, « Efficiency, Utility, and Wealth Maximization », Hofstra Law Review 8 (1980): 513.

[39] See Richard A. Posner, « Utilitarianism, Economics, and Legal Theory », The Journal of Legal Studies 8, n° 1 (1979): 103.

[40] See Gerrit De Geest, « Any Normative Policy Analysis Not Based on Kaldor–Hicks Efficiency Violates Scholarly Transparency Norms », in Law and Economics. Philosophical Issues and Fundamental Questions (Ed. Aristides N. Hatzis, Nicholas Mercuro), 2015, 184.

[41] See Lewis Kornhauser, « The Economic Analysis of Law », in The Stanford Encyclopedia of Philosophy, éd. par Edward N. Zalta, 2017 e éd. (Metaphysics Research Lab, Stanford University, 2017).

[42] See Richard A. Posner, « Norms and Values in the Economic Approach to Law », in Law and Economics: Philosophical Issues and Fundamental Questions (ed. Aristides N. Hatzis) (Routledge, 2015), 1.

[43] See Armen A. Alchian, « The Meaning of Utility Measurement », The American Economic Review 43, n° 1 (1953): 47.

[44] See Kornhauser, « The Economic Analysis of Law »: « As the representations are ordinal, one cannot conclude anything about K's intensity of preference; her Q-based representation of her preferences "assesses" the difference between Z and Y as six times the difference between Y and X while her P-based representation of her preferences thinks the difference between Z and Y is only three times the difference between Y and X. not prefer Z to Y. The choice of baseline may thus affect the choice of policy ».

[45] See Tibaux Scitovsky, « A Note on Welfare Propositions in Economics », Review of Economic Studies 9, n° 1 (1994): 77-99.

[46] See Posner, « Utilitarianism, Economics, and Legal Theory »: 119: "the value in dollars or dollar equivalents ... of everything in society. It is measured by what people are willing to pay for something or, if they already own it, what they demand in money to give it up. The only kind of preference that counts in a system of wealth maximization is thus one that is backed up by money-in other words, that is registered in a market".

[47] See Louis Kaplow and Steven Shavell, Fairness versus Welfare (Cambridge, Mass.; London: Harvard University Press, 2006).

[48] See Eric A. Posner, « Cost-Benefit Analysis: Definition, Justification, and Comment on Conference Papers », in Cost-Benefit Analysis: Legal, Economic, and Philosophical Perspectives, ed. Matthew Adler and Eric A. Posner (University of Chicago Press), 319-20, 333: "I do not want to stake my all on a defense of the Kaldor-Hicks concept of efficiency [(i.e. wealth maximisation)]. For me the ultimate test of cost-benefit analysis employing that concept is a pragmatic one: whether its use improves the performance of government in any sense of improvement that the observer thinks appropriate... Cost-benefit analysis need be "founded" on nothing deeper or more rigorous than a showing that it has consequences that we like" .

[49] See for an explanation of the functional approach, Francesco Parisi and Jonathan Klick, « Functional Law and Economics: The Search for Value-Neutral Principles of Lawmaking », Faculty Scholarship at Penn Law, 2004; Jonathan Klick and Francesco Parisi, « Functional Law and Economics », in Theoretical Foundations of Law and Economics, Mark D. White, 2008, 41-54.

then, if this turns out to be impossible, try to simulate the result of frictionless bargaining.[50]

17. It seems to us that a true cost-benefit analysis is so complicated as to render any *ex ante* decision at best suspicious, for it requires an unlikely anticipation of the real-life market conditions at the moment when the redistribution of resources proves to be necessary. Unfortunately, our predictions track record does not seem to be very encouraging.[51] Our skepticism is strengthened considering that the *ex ante* decision would likely be taken by agents who do not have themselves a skin in the game and are likely to be subject to rent-seeking activities of interested parties.[52] More fundamentally, it seems to us quite difficult to systematically tell whether the best decision on the maximization of wealth and distribution of resources in the economy at large has been taken, for it implies hazardous comparisons between possible worlds. From an *ex ante* perspective, therefore, the only sensible thing to do, from our point of view, is to ensure that the best possible epistemic conditions emerge and that the decision making power is given to those agents who are most likely to take the right decision when the moment of redistribution of resources comes. The irreducible uncertainty of the world making any *ex ante* contracts necessarily incomplete,[53] the legal decision maker should aim at allowing the parties to 'complete' them by creating optimal negotiation frameworks, which implies incentivizing agents to reliably reveal their preferences and bear the costs of their actions while diminishing as much as possible any coordination failures and conflicts of interests.[54] The basic intuition is, then, that by ensuring transaction costs efficiency, the distributional efficiency, which is the ultimate substantive goal, is more likely to follow.[55]

18. As stated above, our approach, seems to bear some resemblance to several trends in the law and economics literature, especially Buchanan's constitutional economics[56] and the school of new institutional economics. For our current purpose, it seems to us that we try to address the same concerns as those identified by Anthony Casey through his recent "structured renegotiation theory" of bankruptcy,[57] which acknowledges the uncertainty inherent in any distributional decision making and therefore limits the scope of insolvency law to ensuring efficient procedural safeguards. Unlike Professor Casey, however, we do not see why such an approach would imply the abandonment of the 'creditors' bargain theory' rhetoric (on which more later).

1.2. The objectives of insolvency proceedings

19. It is not easy to agree on the exact objectives a legal system should pursue with respect to companies in distress. However, from an economic point of view, it seems to play two roles. Upstream, it determines the financing conditions of the economy as a whole. Downstream, it favors the continuation of business and the preservation of jobs created by debtors whose business is viable.

1.2.1. Facilitating the *ex ante* access to finance

20. Insofar as one of the objectives of corporate law in general is to diminish the costs of access to finance, it seems reasonable to expect from any legislative intervention, except where there are valid reasons to do otherwise, to ensure better financing conditions and therefore stimulate economic growth.[58] It is sufficient to note in this regard that the treatment of creditors in the event of their debtor's difficulties is a major factor for a debtor's access to financing *ex ante*.[59] Insolvency proceedings are not a closed and isolated system,

50 See Ronald Coase, « The Problem of Social Cost », The Journal of Law and Economics 3 (1960): 1.

51 See Philip Tetlock, Expert Political Judgment: How Good Is It? How Can We Know? (Princeton University Press, 2006).

52 See Jonathan Klick and Francesco Parisi, « Functional Law and Economics », 44.

53 See Oliver Hart and John Moore, "Incomplete Contracts and Renegotiation", Econometrica 56, n. 4 (1988): 755-85.

54 See Parisi and Klick, « Functional Law and Economics », 448: « functional law and economics suggests that institutions should provide incentives, such that individuals will naturally act in a desired way without any external monitoring or coercion. This necessarily requires that individuals have the ability and incentive to reveal their own subjective values and preferences, and that all costs and benefits generated by an individual's actions accrue to that individual ».

55 See on these two types of efficiency, Rizwaan Jameel Mokal, Corporate Insolvency Law: Theory and Application (Oxford University Press, 2005), 24-26.

56 See James M. Buchanan, « The Constitution of Economic Policy », The American Economic Review 77, n° 3 (1987): 243-50. See on this link, Klick and Parisi, « Functional Law and Economics », 45: « recognizing that market failures limit the natural evolution of efficient legal rules, functionalists attempt to design institutions that internalize the external costs and benefits created by individual behavior in order to achieve the social goals chosen at the constitutional stage ».

57 See Anthony J. Casey, « A Structured-Renegotiation Theory of Corporate Bankruptcy », SSRN Electronic Journal, 16 mars 2019.

58 See Sarah Paterson, « The Cost of Capital – the Normative Foundation of Corporate Law: A Reply », European Company and Financial Law Review 14, n° 2 (2017): 316–335.

59 - See Sophie Vermeille and Adrien Bézert, « Sortir de l'impasse grâce à l'analyse économique du droit : Comment rendre à la fois le droit des sûretés réelles and le droit des entreprises en difficulté efficaces ? », RTDF, no 1 (2014): 166.

but should be seen as part of the wider legal and economic system.[60]

21. Essentially, if the creditor has the *ex ante* certainty that her interests will be effectively protected, the risk of her investment is reduced and the cost of financing for the company should be lowered.[61] In this respect, two elements seem to be of utmost importance: the effective protection of the rights of creditors on the one hand, and the predictability of the treatment they will receive in the case of insolvency proceedings on the other.[62] Several empirical studies seem to show that the general cost of financing is diminished when creditors are afforded the possibility of controlling the debtor's behavior, rather than where the legal system simply offers a complete protection of the economic interests of some creditors through bankruptcy-remote securities.[63] Such results might be explained by the fact that control rules are more likely to allow for an alignment of interests between different stakeholders, as creditors who are fully immune to insolvency proceedings have no reason to take part in any negotiation whatsoever.[64] Moreover, if a system were to simply afford such an immunity to some creditors, the cost of financing could seem to be too high in the eyes of the debtors themselves, who would undergo the risk of their assets being scattered at the first signs of financial trouble and could prove to be, consequently, less willing to accept the risk of their own default.[65]

1.2.2. Effective ex-post distribution of resources

22. The question of the objectives to be pursued by the insolvency proceedings once the distress hits the debtor's business seems to be more contentious, for such distress has direct consequences not only for creditors, but also for particularly vulnerable stakeholders.

23. Some authors, grouped under the banner of 'traditionalism', think that the objective of insolvency proceedings must be in all circumstances to rehabilitate all the companies that encounter difficulties, the economic and social stakes of a bankruptcy being too important to be ignored in the name of efficiency.[66] Amongst the authors writing in this vein, Prof. Korobkin's take seems to be the closest to our approach.[67] His argument rests on the observation that financial distress affects different parties, whose interests and self-perception may clash but cannot be ignored. In order to ensure that these interests are correctly balanced, Korobkin borrows the Rawlsian 'veil of ignorance' technique,[68] requiring that the limits of

[60] - See Douglas G. Baird, « Bankruptcy's Uncontested Axioms », The Yale Law Journal 108, no 3 (Dec. 1998): 589.

[61] - See one of the founding articles of the Law and Finance movement, Rafael La Porta et al., « Legal Determinants of External Finance », The Journal of Finance 52, no 3 (1997): 1131-50; See also Robert K. Rasmussen, « The Ex Ante Effects of Bankruptcy Reform on Investment Incentives », Washington University Law Review 72, no 3 (1 Jan. 1994): 1159-1211; and Andrea Moro, Daniela Maresch, and Annalisa Ferrando, « Creditor protection, judicial enforcement and credit access », The European Journal of Finance 24, no 3 (11 Feb. 2018): 250-81, https://doi.org/10.1080/1351847X.2016.1216871; For an analysis on the importance of safe harbours in the development of derivatives markets, see Philipp Paech, « The Value of Financial Market Insolvency Safe Harbours », Oxford Journal of Legal Studies 36, no 4 (1 Dec. 2016): 855-84.

[62] See Francesca Cornelli and Leonardo Felli, « *Ex ante* efficiency of bankruptcy proceedings », European Economic Review, Paper and Proceedings of the Eleventh Annual Congress of the European Economic Association, 41, n. 3 (1997): 476: « In particular, we take the protection of creditors" claims to consist in both the attempt to maximize the proceeds to the creditors from the reorganization (what we call revenue efficiency) and the respect of the relative seniority of their claims (known as absolute priority rule) ».

[63] See Simon Deakin, Viviana Mollica, and Prabirjit Sarkar, « Varieties of Creditor Protection: Insolvency Law Reform and Credit Expansion in Developed Market Economies », SocioEconomic Review 15, n° 2 (2017): 381: « Debtor control laws are largely about shifting the balance of power within the firm from shareholders to creditors while the firm is a going concern, and thereby operate to increase the supply of debt finance to firms. In contrast, credit contract laws give external creditors enhanced power over the managements of the firm by enabling them to seize corporate assets in the event of default. Laws of this kind, once they pass a certain threshold, depress the demand for credit. »

[64] See Sarah Paterson, « Rethinking Corporate Bankruptcy Theory in the Twenty-First Century », Oxford Journal of Legal Studies 36, n° 4 (2016): 697-723: « Part of the distributional concern arises because creditors at the top of corporate bankruptcy law's order of distributional priority have little incentive to agree to a restructuring if (i) they will recover all or most of their claims on a sale of the business and assets; and (ii) a sale may be more timely, and cheaper to implement. »

[65] See on the stifling effect on the demand for credit, Deakin, Mollica, and Sarkar, « Varieties of Creditor Protection », 380: « The finding that laws of this kind have a dampening or negative effect on private credit suggests that laws strengthening creditors' security rights may depress demand for credit, as managements and shareholders find the terms on which security rights are enforced to be excessively onerous. »

[66] See Donald R. Korobkin, « Rehabilitating Values: A Jurisprudence of Bankruptcy », Columbia Law Review 91, n° 4 (1991): 766-68; Elisabeth Warren, « Bankruptcy Policy », U. Chicago L. Rev. 54, n° 3 (1987): 775; Karen Gross, « Taking Community Interests into Account in Bankruptcy: An Essay », Washington University Law Review 72, n° 3 (1 janvier 1994): 1031-48.

[67] See Donald R. Korobkin, « Rehabilitating Values: A Jurisprudence of Bankruptcy », Columbia Law Review 91, n° 4 (1991): 766-68

[68] See John Rawls, A Theory of Justice. Revised Edition, 2 e éd. (Harvard University Press, 1999), 118: « no one knows his place in society, his class position or social status; nor does he know his fortune in the distribution of natural assets and abilities, his intelligence and strength, and the like ».

insolvency proceedings be determined by reference to a hypothetical negotiation between potentially affected parties ignoring their exact role in the real life and forced to put themselves in the shoes of all such parties, including the most vulnerable. Such an approach is akin to the one that we will propose later on in this paper, under the banner of the 'creditors' bargain theory', but it should be underlined that we infer from it somewhat different conclusions. In fact, Korobkin thinks that such a hypothetical negotiation cannot but result in an insolvency regime aiming at always maximizing the satisfaction of the greatest number of competing objectives and, when this proves to be impossible, the satisfaction of the interests of the most vulnerable party (much as in Rawls' theory of justice).[69] It seems to us, however, that such a conclusion is contrary to the long-term interests of all the stakeholders and, therefore, would be rejected if the epistemic conditions for a rational hypothetical negotiation obtained.

24. It seems to us that the traditionalists' approach amounts to ignoring the fact that a market economy is based on the success of some companies and the failure of a majority.[70] This aspect of market economy seems, at least partly, responsible for long term economic development, for it allows for the selection of the best fit businesses at a certain time and space and forces, if the conditions for an efficient market obtain, the distribution of knowledge and resources in the economy to their best possible usage.[71] The defining characteristic of market capitalism, at least in theory, is to create the conditions of competition allowing for the emergence of a 'natural selection' of the best business endeavors.[72] Indeed, a recent OECD study shows that economic productivity is higher in countries where the employees are more efficiently distributed amongst the active businesses.[73] Unsurprisingly, it appears that legal rules shielding businesses from such market pressure seem to undermine such an efficient distribution of resources.[74]

25. It follows that artificially maintaining an unsustainable company is only delaying the inevitable and unnecessarily diverting resources that could be better distributed in the wider economy.[75] As long as these resources remain immobilized, potentially more efficient businesses are penalized, since their access to finance is more complicated. In the long run, it is economic growth and job creation that bear the costs of a systematic bias in favor of saving unviable businesses.[76]

26. It seems to follow from the foregoing that the fundamental purpose of any legal system for tackling insolvency is to identify economically viable companies with bad capital structures and treat them differently from those pursuing simply an unsustainable business.[77] In other words, only

69 See Donald R. Korobkin, « Contractarianism and the Normative Foundations of Bankruptcy Law », Texas Law Review 71 (1993 1992): 565-71.

70 - See Douglas Baird, « A World Without Bankruptcy », Law and Contemporary Problems 50, no 2 (1 April 1987): 183; See Baird, « Bankruptcy's Uncontested Axioms », 580: « the cold realities of a market economy: Success is rewarded and failure is brutally punished. Most firms fail. Keeping firms intact that cannot effectively compete results in more harm than good over the long run ».

71 See Anne Marie Knott and Hart E. Posen, « Is Failure Good? », Strategic Management Journal 26, n° 7 (2005): 617-19: « three potential mechanisms through which failure (excess entry) might affect market structure and thereby efficiency growth. The first mechanism is a selection effect--firms surviving from a larger pool (more excess entry) ought to perform better on average than the same number of firms surviving from a smaller pool... The second mechanism is a competition effect—the more firms in a market, the greater the stimulus to innovation... The third mechanism is a spillover effect—the knowledge produced by excess entrants while "wasted", in that it is no longer appropriable by the failed firm, may be captured by survivor firms through spillovers ».

72 - See Joseph Alois Schumpeter, Capitalism, Socialism and Democracy (Routledge, 1976), 82-83.

73 See Dan Andrews and Alessandro Saia, « Coping with Creative Destruction », OECD Economic Department Working Papers, 2017, 7: « more productive firms are likely to account for a much larger share of employment in the United States than in the European Union. Relative to a random allocation of labour across firms, this actual allocation of labour boosts manufacturing sector labour productivity by almost 60% in the United States, but only by 30% across the European Union on average. Digging deeper, significant differences also emerge within Europe, ranging from relatively efficient labour allocation in some Nordic economies to widespread misallocation in southern Europe ».

74 See Elisa Gamberoni, Paloma Lopez-Garcia, and Claire Giordano, « Capital and Labour (Mis)Allocation in the Euro Area: Some Stylized Facts and Determinants », European Central Bank Working Paper, 2016: « regulations that shelter firms from competition might result in poor allocation of resources because low productive firms will keep operating instead of downsizing or exiting »

75 - See Thomas Jackson and David Skeel, « Bankruptcy and Economic Recovery », Faculty Scholarship at Penn Law, 1 July 2013, 5: « bankruptcy plays a crucial role in undergirding the mobility of assets to their highest and best use ».

76 See on the 'French anomaly' in this regard, Jean Tirole, Économie du bien commun (Paris: PUF, 2016), 334-35

77 - See Baird, « Bankruptcy's Uncontested Axioms », 581: « bankruptcy law exists to solve the problem of financial distress. Outside of bankruptcy, our legal system does not intervene to keep firms in economic distress in business »; Eidenmüller, « Contracting for a European Insolvency Regime », 15: « a financially distressed firm should be restructured and kept alive only if it is economically viable, i.e. if it does not suffer from financial and economic distress »; See Guillaume Plantin, David Thesmar, and Jean Tirole, « Les enjeux économiques du droit des faillites », Notes du conseil danalyse economique n° 7, no 7 (1 Dec. 2013): 1-12; See also for a comparative study of the functions attributed

companies whose going concern value is greater than the value obtained from selling their isolated assets in case of liquidation should be maintained as a going concern, insolvency proceedings aiming first of all at reducing the frictions which preclude the distribution of resources according to their best use in the economy.[78] Insolvency law's other objectives should be subordinated to that of ensuring such a partition. If a company is not viable, keeping it in business only to preserve jobs can only be a short-term solution, potentially detrimental to long-term job creation.[79]

27. The objective, therefore, is not that of sacrificing one stakeholder for the betterment of the other,[80] for the long-term interests of all stakeholders seem to converge where insolvency proceedings are correctly designed given the market realities. In fact, several comparative studies seem to show that where legislators aim to pursue too many objectives at once when designing insolvency proceedings, the final results turn out to be suboptimal from the point of view of all these objectives.[81]

28. A further point which makes the traditionalist approach, very much dominant in France, unappealing in our eyes is that it relies on the need for the ultimate decision maker to balance competing values and interests, which may be simply incommensurable and afford, in any case, a great deal of discretion to the decision maker.[82] This point is especially important for us given that the traditionalist authors generally do not go into many details as to the values to be taken into account and their expected relative weight.[83] The ensuing uncertainty diminishes the foreseeability of the outcomes of such proceedings and creates non negligible risks for the creditors, forcing them to increase their own control of the debtor's activities.[84] More prosaically, even where it seems that saving an unviable business is fair towards some of the vulnerable parties, it might be pointed out that such a decision is functionally equivalent to an indirect subsidy (for the state forces a redistribution of resources in favor of the saved business), to the detriment of the companies which are in direct competition with such debtor, and their own employees and other vulnerable stakeholders.[85]

to insolvency law, Régis Blazy et al., « Analyse économique du droit de la faillite : les dix fonctions des procédures collectives », Revue d'economie financiere N° 129, no 1 (15 June 2018): 117-60.

78 See Thomas Jackson and David Skeel, « Bankruptcy and Economic Recovery », Faculty Scholarship at Penn Law, 1 juillet 2013, 5: « bankruptcy plays a crucial role in undergirding the mobility of assets to their highest and best use »; See also the OECD study, Müge Adalet McGowan and Dan Andrews, « Design of Insolvency Regimes across Countries », OECD Economic Department Working Papers, 2018, 89-90: « Creative destruction is a key feature of well-functioning economies... There is growing recognition, however, that the labour productivity slowdown experienced over the past two decades is partly rooted in a rise of adjustment frictions that rein in the creative destruction process... In this view, reviving productivity growth will, in part, depend on policies that effectively facilitate the exit or restructuring of weak firms ».

79 - See Jackson and Skeel, « Bankruptcy and Economic Recovery »; Sarah Paterson, « Rethinking Corporate Bankruptcy Theory in the Twenty-First Century », Oxford Journal of Legal Studies 36, no 4 (2016): 3: « If capital is withdrawn from businesses which are failing and redeployed in businesses which are succeeding, the rest (in terms of jobs and prosperity) will follow. One the other hand ... if corporate bankruptcy law pursues the protection of jobs as an independent objective, capital may continue to be deployed in less-efficient producers in the economy ».

80 - See for a critique of certain economic approaches to law, which neglect real human preferences for equitable rules, Michael B. Dorff and Kimberly Kessler Ferzan, « Is There a Method to the Madness? Why Creative and Counterintuitive Proposals Are Counterproductive », in Theoretical Foundations of Law and Economics (Ed. Mark D. White) (Cambridge University Press, 2008), 21-40.

81 See Kristin Van Zwieten, « Corporate Rescue in India: The Influence of the Courts », Journal of Corporate Law Studies 15, n° 1 (2015): 8-9: « motivated by broader concerns, including the desire to strengthen the industrial sector in newly independent India, and an anxiety to protect workers of sick industrial companies from unemployment led to delay, inefficiency, dysfunction and ultimately the need for reform ».

82 See Jackson and Skeel, « Bankruptcy and Economic Recovery », 512: « Accomplishing a world in which bankruptcy maximized its contribution to economic growth and recovery would be aided by a clear understanding that one can only ask bankruptcy to do so much. »

83 See Warren, « Bankruptcy Policy », 360: « The development of a list only begins the policy inquiry. It does not explain how far to pursue a goal - should we reallocate all the resources of a business to parties who are poor risk spreaders? - nor does it resolve what to do when goals conflict ».

84 See Barry E. Adler, « Financial and Political Theories of American Corporate Bankruptcy », Stanford Law Review 45, n° 2 (1993): 317: « For example, if a high- priority creditor anticipated the possibility of making concessions in bank- ruptcy reorganization, it might expend resources to monitor a firm and pro- tect its interest in anticipation of bankruptcy. Had the creditor been able to rely on its priority in bankruptcy it may have saved these resource ».

85 See Jackson and Skeel, « Bankruptcy and Economic Recovery », 413» If the government was to provide assistance (whether training grants or other forms of economic assistance) to Chrysler workers who lose their jobs as a result of a liquidation of Chrysler, that decision can be argued on its own merits. The irony of the failure to do so is that the workers of the other auto manufacturing firms that inevitably lost jobs as a result of the Chrysler bailout, never had the opportunity for a discussion about similar assistance to them ». See also Frost, « Bankruptcy Redistributive Policies and the Limits of the Judicial Process », 121: « Desperate to prolong the life of a dying company, shareholders might urge management to price the company's goods and services low enough to maintain the business in the short term-even if the cost is longer term operating losses... industry competitors and their dependents may bear some of the cost of such protection as they are forced to match the pricing of the bankrupt business or lose customers ».

29. Focusing the insolvency proceedings on the limited set of objectives explained in the previous parts of this paper would also go a long way towards diminishing the stigma linked with business failure, which has long been documented across different countries, [86] and seems to be highly detrimental to the failed entrepreneurs' access to financing after having undergone formal proceedings.[87] The European Commission explicitly addressed this worry in its proposals regarding the Restructuring Directive.[88]

30. The foregoing should not be understood as implying that the capitalist 'creative destruction' should not be coupled with measures smoothing out its temporary social and economic costs. Indeed, such accompaniment of resources displacement seems warranted both from an economic perspective, as it addresses market frictions precluding the immediate reorientation of vulnerable stakeholders to other companies, and, above all, from a purely humane perspective, if the system as a whole is to be perceived as being fair. There are other means, however, for doing so, without burdening the insolvency regime with tasks which it is not best equipped to tackle. State intervention should proceed, from this point of view, through taxation and subsequent publicly accountable distribution of resources,[89] especially active labor market policies.[90]

31. If our arguments are right, then there is much to be gained from focusing the insolvency regime on a simple objective: ensuring that it will be possible to tell apart viable from nonviable businesses and to treat them differently, allowing for a restructuring of the first and a smooth liquidation of the latter. When the value of the operating business is greater than its net asset value, it is in the interest of all the stakeholders that the business be kept as going concern. It would be reasonable, therefore, for them to agree on such a rescue in order to maximize the value of the business. However, once the economic distress arises, the stakeholders are confronted with problems of coordination likely to prevent the emergence of such an agreement. As we will see, it is the very existence of these coordination deficiencies that justifies, from an economic point of view, the existence of insolvency law.

1.3 The creditor's bargain theory: a hypothetical negotiation behind the veil of ignorance

32. When the debtor, whose business is otherwise viable, faces liquidity problems that prevent her from fulfilling her payment obligations, the creditors are confronted with certain collective action problems, largely studied in the framework of game theory. Since the debtor's assets probably are not sufficient to satisfy immediately all claims by isolated asset sales, the creditors are strongly incentivized to make use of the common pool of the debtors' assets, thereby endangering the continuation of the activity, despite it being beneficial for all stakeholders.[91] In other words, they are confronted with the tragedy of the commons in a context of conflictual management of common resources, insofar as their rational individual actions lead to a suboptimal result in the absence

[86] See Robert I. Sutton and Anita L. Callahan, « The Stigma of Bankruptcy: Spoiled Organizational Image and Its Management », Academy of Management Journal 30, n. 3 (1987): 405-36; Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, « Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings », Stanford Law Review 59, n° 2 (2006): 233: « (bankryptcy stigma is) 'a cost associated with filing for bankruptcy based on injury to reputation or violation of moral standards »; Tibor Tajti, « Bankruptcy Stigma and the Second Chance Policy: The Impact of Bankruptcy Stigma on Business Restructurings in China, Europe and the United States », China-EU Law Journal 6, n° 1 (2018): 1-31.

[87] See Deniz Ucbasaran et al., « Life After Business Failure: The Process and Consequences of Business Failure for Entrepreneurs », Journal of Management 39, n° 1 (2013): 163-202; Stephan Madaus, « Rescuing companies involved in insolvency proceedings with rescue plans » (NACIL Reports, 2013), 18: « to prevent the stigma of insolvency, the special proceeding should be called "rescue proceeding" or "confirmation proceeding". The preference between these two options would be for "confirmation proceeding", which has a more neutral character. The word "rescue" makes it clear that there is a need to rescue something ».

[88] See COM/2007/0584.

[89] See Frost, « Bankruptcy Redistributive Policies and the Limits of the Judicial Process », 136: « Taxation decisions, at least on the federal level, can be conducted with an eye toward aggregate economic effects. Congress, unlike the judiciary, may consider forward-looking information regarding the broad range of economic effects taxation and transfer payments may entail ».

[90] See Andrews and Saia, « Coping with Creative Destruction », 17: « higher expenditure on active labour market policies (ALMPs) as a per cent of GDP is associated with a high probability of re-employment one year after plant closure...On average, this policy reform (note: a 1% increase in the level of public expenditure on ALMP) is associated with an increase in the predicted re-employment probability for both workers. However, the estimated impact for workers who lost their job due to business closure is about twice as large as the estimated impact for other workers. Given the political salience of job loss due to firm exit and the limited fiscal room to manoeuvre in many OECD countries, these results suggest that there may be a case to tailor ALMP expenditures toward workers displaced by firm exit, as opposed to workers displaced due to other involuntary reasons ».

[91] - See Nicolaes Tollenaar, Pre-Insolvency proceedings: A Normative Foundation and Framework (Oxford, New York: Oxford University Press, 2019), par. 2.10: "Although agreement on a collective approach is in the joint interest of the creditors, they will often be unable in practice to reach agreement on a coordinated approach to enforcement. A statutory system is therefore needed to resolve the prisoner's dilemma and facilitate collective action."

of meaningful coordination.[92] In this context, it appears that the debtor's financial difficulties hinder the proper coordination of the parties. On the one hand, such coordination would require providing effective means of supervision and control to all creditors during the negotiations, enabling them to verify for themselves that the debtor does not reserve preferential treatment to some of them.[93]

33. At the same time, stakeholders face a tragedy of the anticommons situation,[94] that is a hypothesis where agents cannot make use of certain set of resources without the prior consent of all the others, each stakeholder having an exclusive right to use a portion of such resources. The tragedy of the anticommons emerges where the transaction costs of the agents' strategic behavior prevent the pooling of resources, to the detriment of the interests of all the involved stakeholders. Where the tragedy of the commons arises when it is impossible for agents to coordinate in order to maximize the common value, the tragedy of the anticommons arises when each agent is rationally incentivized to extort as much value as possible from her hold-out right. In case of restructuring proceedings, where the debtor's business is to be kept as a going concern, the tragedy of the anticommons arises insofar as the refusal by some of the stakeholders to approve a restructuring plan in hope of extorting more value for themselves might lead to a suboptimal underuse of resources if the business has to finally be liquidated.

34. The transaction costs in such a tense situation are simply too high for an optimal solution to systematically emerge without the intervention of some formal negotiation framework. Moreover, it is simply not possible for the creditors to systematically anticipate, in the debt contract, the circumstances of the distress so as to efficiently bind themselves *ex ante* regarding the treatment of such distress. Faced with the unpredictability of the real world, such a contract would, in fact, necessarily be incomplete.[95]

35. The creditor's bargain theory ("CBT"), developed in the 1980s in the United States by Thomas Jackson and Douglas Baird,[96] is based on the recognition of these inherent difficulties in trying to determine the legal rules likely to provide a satisfactory answer to the problem of coordinating creditors. This theory has remained fundamental to the economic approach to insolvency proceedings.

36. The central point of the CBT is that the limitations of creditors' rights, that is their inability to demand the immediate repayment of their mature debts, are justified only if they correspond to what would have been accepted in a hypothetical *ex ante* negotiation by the stakeholders themselves, who are also aware of the dangers that have just been exposed.[97] It is understandable that the CBT offers a vision of insolvency law that some would describe as "liberal", which contradicts the way insolvency law has been construed in France since the 1985 law, which is based on the idea of an interventionist law aimed at saving businesses and jobs at any cost in the short term.

[92] - See regarding the prisonner's dilemma, for example, Steven Tadelis, Game Theory. An Introduction (Princeton University Press, 2013), 48; On the tragedy of the commons and the anticommons and its application to law, see Lee Anne Fennell, « Commons, anticommons, semicommons », in Research Handbook on the Economics of Property Law (ed. K. Ayotte and H. E. Smith) (Edward Elgar Publishing, 2011), 35-56.

[93] - See Barry E. Adler, « The Creditors' Bargain Revisited », U. Pa. L. Rev. 166 (2018): 1855: « each creditor would know that it could be left without recourse to any assets if it delayed its own action on the mere hope that the creditors would both find one another and agree to act collectively ».

[94] - See founding article Michael A. Heller, « The Tragedy of the Anticommons: Property in the Transition from Marx to Markets », Harvard Law Review 111, no 3 (1998): 621-88.

[95] - See founding article Oliver Hart and John Moore, « Incomplete Contracts and Renegotiation », Econometrica 56, no 4 (1988): 755-85; Anthony J. Casey, « A Structured-Renegotiation Theory of Corporate Bankruptcy », SSRN Electronic Journal, 16 March 2019, 26: « In times of distress, the proper response for each party in these relationships turns on the specific characteristics of the entire constellation of interests. The best way to choose between and implement a reorganization, going-concern sale, or liquidation, will turn on the state of the market, the causes of distress, and the relationships that exist between the parties. The specific causes of distress will impact the willingness and ability of outsiders to provide new capital and of insiders to take a haircut or forbear on enforcing claims. The specific agreements and relationships that exist at the time of distress will affect their ability and incentives to coordinate behavior. And so on. If we imagine claimants bargaining ex ante, they will face an insurmountable challenge in any attempt to write contingent substantive rules for every distress situation. The same will be true of any attempt to write those rules into legislation ».

[96] - See Thomas H. Jackson, « Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain », Yale Law Journal 91, no 5 (1982): 857-907; Douglas G Baird and Thomas H Jackson, « Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy », The University of Chicago Law Review 51 (1984): 97 ; Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (Beard Books, 2001).

[97] - See Jackson, « Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain », 860: "a system designed to mirror the agreement one would expect the creditors to form among themselves were they able to negotiate such an agreement from an ex ante position"; Creditors would accept, to use the Homeric image, to bind themselves to the mast for their own benefit. For a use of this image to explain the *ex ante* limitations of freedom of action by legal rules, see Jon Elster, Ulysses Unbound, 2000.

37. For the CBT to be able to serve as an intellectual basis for insolvency law, that is to say, in order for us to consider that insolvency law corresponds to what the stakeholders themselves would have accepted in the context of a hypothetical *ex ante* negotiation, two conditions must be fulfilled.

1.3.1 The need for the "veil of ignorance"

38. Even if the authors who recognize themselves in this approach to insolvency law do not always admit it[98] (unlike some authors of the traditionalist school, for instance Korobkin), it seems to us fundamental that the stakeholders be behind a 'veil of ignorance'[99] for us to consider that insolvency law indeed maps onto what the stakeholders would have accepted in a hypothetical *ex ante* negotiation.

39. In other words, it is not appropriate to start from a particular case and imagine the outcome of hypothetical negotiations, given the real interests and existing hold-out positions in such a case, these interests and powers of hindrance being due to the disparity of bargaining power between creditors facing the same debtor. Rather, it is necessary to imagine a negotiation between rational agents who do not know their respective roles in a specific case. For example, they do not know if they will be in a position of a subordinated or senior creditor, or whether they have provided their credit alongside other lenders with rights similar to their own but with much larger claims and therefore in a position to more easily bargain their way out of the proceedings. These rational agents are therefore forced to imagine that they could end up having any legally and economically conceivable role.[100] On this condition, these rational agents must internalize the conflict between the different clashing interests during a restructuring, without having a preference for one or the other (for example that of a secured creditor) since they could ultimately assume any role in the insolvency proceedings in a particular case. In other contexts, it has been proven that the strategic preferences of agents negotiating over the rules of their future cooperation are minimized in cases of role-reversibility or stochastic symmetry during the contemplated cooperation.[101] This hypothetical negotiation could therefore lead to efficient results, as all participants seek to identify the best way to balance the same interests, instead of defending a particular one.[102]

40. To be sure, the "veil of ignorance" should not prevent the hypothetical *ex ante* negotiation participants from knowing the long-term conditions of the market (for example, the fact that in a developed economy there now exist a multitude of creditors with different rights), meaning the general characteristics of the actual markets in which the contemplated legal insolvency regime is to be integrated.[103] As we will see, it is precisely these general conditions and the actual issues of stakeholder co-ordination that usually arise which justify the legislator's intervention imposing a formal negotiation framework.[104] In this regard,

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[98] - See Jackson, « Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain », 869: « There are at least two ways of fashioning the argument. The first is to assume that creditors already know their non-bankruptcy entitlements, and, possessing those entitlements, attempt to agree, consensually, to a collective proceedings. This is the descriptive approach of the text, although it is subject to some limitations...It would be equally possible to invoke the Rawlsian veil of ignorance...The ultimate resolution, however, Seems the same using either approach ».

[99] - We are here aiming at the thought experiment used by John Rawls as a foundation for a theory of procedural justice. It is a matter of imagining the agreement on the distribution of resources, rights and privileges in society that would have been accepted by the stakeholders during a hypothetical *ex ante* negotiation without these negotiators knowing what positions they will occupy in the society. See John Rawls, A Theory of Justice. Revised Edition, 2 ed. (Harvard University Press, 1999), 118: « no one knows his place in society, his class position or social status; nor does he know his fortune in the distribution of natural assets and abilities, his intelligence and strength, and the like ».

[100] - See Robert K. Rasmussen, « An essay on optimal bankruptcy rules and social justice », U. Ill. L. ReSee, no 1 (1994): 12: « Use of the veil of ignorance is indeed a valuable approach to assessing bankruptcy law. Rather than artificially narrowing the inquiry solely to a particular firm in distress, or specific creditors of that firm, use of the veil of ignorance permits an examination of a bankruptcy regime's overall effects on the way in which the basic structure distributes society's primary goods ».

[101] See Vincy Fon and Francesco Parisi, « Role-reversibility, stochastic ignorance, and social cooperation », The Journal of Socioeconomics, Behavioral Dimensions of the Firm Special Issue, 37, no 3 (1 June 2008): 1061-75.

[102] - See Rawls, A Theory of Justice. Revised Edition, 17: « For example, if a man knew that he was wealthy, he might find it rational to advance the principle that various taxes for welfare measures be counted unjust; if he knew that he was poor, he would most likely propose the contrary principle. To represent the desired restrictions one imagines a situation in which everyone is deprived of this sort of information. One excludes the knowledge of those contingencies which sets men at odds and allows them to be guided by their prejudices. In this manner the veil of ignorance is arrived at in a natural way ».

[103] - See for a definition of a thick veil, followed by a critique of the second aspect, Thomas Pogge, John Rawls: His Life and Theory of Justice (Oxford, New York: Oxford University Press, 2007), 66: « the veil of ignorance deprives the parties not just of all particular knowledge about the individuals they represent. It also deprives them of any - even probabilistic - knowledge about the particular enduring conditions of their society ... This second deprivation is unnecessary for ensuring that the original position is fair ».

[104] - By analogy with the causal link identified by Prof. Gilson and Gordon in terms of governance structures, it can be said that the contours of efficient rules of insolvency proceedings depend on the concrete problems to which they intend to respond and, in

the rules of such proceedings cannot be fixed forever and must evolve with the actual conditions of the market.[105] A similar intuition explains why the transplant of US insolvency law in some Eastern European countries in the 1990s was a failure, as these economies did not have the same basic characteristics and the same level of financial markets sophistication as the US economy.[106]

1.3.2 The interests represented in hypothetical negotiations

41. The second necessary condition for accepting the CBT concerns what exactly is to be understood by the term "stakeholders" in the hypothetical negotiations. It is important to clarify which interests have a say in determining the legal framework necessary to deal with coordination problems. The traditional position is to be limited to the sole interests held by the financial creditors, since it is essentially their rights which are limited at the onset of insolvency proceedings.[107] However, such a restriction does not seem to us to be justified.

42. Any insolvency framework creates externalities, that is, it affects the debtor's stakeholders and the economy in general. To take just one example, a credit institution that lends to a debtor while having privileged access to information but does not worry about the financial and operational fundamentals of the company, as long as it manages to negotiate a very good security on the debtor's assets, causes certain damage to other lenders who do not have the same information and do not have sufficient bargaining power to demand as effective a security. Therefore, it seems legitimate to consider the interests of all those who are likely to be affected when defining the applicable legal framework.[108] To the extent that all participants in the hypothetical negotiation conceive of themselves as being in the role of all affected parties, a legal system for insolvency would only be chosen if the interests of the least advantaged party are maximized.

43. Contrary to what has been sometimes defended,[109] this does not mean that economically efficient distributions would be prevented if in a real case scenario, the short-term interests of a stakeholder are sacrificed. Indeed, the CBT must be understood as a means of justifying the rules of insolvency proceedings *in abstracto*.[110] When the parties negotiate *ex ante* behind the veil of ignorance, they imagine themselves in all possible roles (creditors, shareholders, employees, etc.). The question they must therefore ask themselves is whether they accept the risk that their short-term interests be sacrificed (for example if they imagine themselves as employees of an unsustainable company destined to be liquidated) if this risk is offset by a long-term gain that benefits all stakeholders (e.g. better access to credit for frail companies).

44. The answer seems to be positive if one accepts our reasoning on the justification of the legitimate objectives to be pursued by insolvency frameworks. It seems rational for all participants to conceive of a legal system that promotes access to corporate finance, efficient distribution of resources and long-term economic growth, as all stakeholders benefit. At the same time, it seems rational for all participants to accept that such a regime could create some limits for creditors who have the best access to information and the strongest bargaining power, to ensure that other creditors can also finance the business on good terms.[111] Indeed,

this sense, depend on the actual state of the financing market and its own coordination problems. See Ronald J. Gilson and Jeffrey N. Gordon, « The Agency Costs of Agency Capitalism », Columbia Law Review 113, no 4 (2013): 872 et seq. : « Innovation in the capital markets determines the efficient structure of corporate governance; the manner in which risk is transferred and the corresponding governance structure that supports that transfer depend on capital market evolution ».

105 - See critiquing an approach detached from the real market conditions, Paterson, « The Cost of Capital – the Normative Foundation of Corporate Law », 318: « Yet often this 'economic' analysis of the law Seems to us curiously detached from the reality of the situations with which we are concerned ».

106 - See Daniel Berkowitz, Katharina Pistor, and Jean-Francois Richard, « Economic development, legality, and the transplant effect », European Economic Review 47, no 1 (2003): 165-95; Daniel Berkowitz, Katharina Pistor, and Jean-Francois Richard, « The Transplant Effect », The American Journal of Comparative Law 51, no 1 (1 Jan. 2003): 163-204.

107 - See Jackson, « Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain », 870 et seq. ; a similar conclusion could be justified by considering that insolvency proceedings are only the terms of the original contract between the debtor and his creditors , see Robert K. Rasmussen, « Debtor's Choice: A Menu Approach to Corporate Bankruptcy », Texas Law Review 71 (1993 1992): 55-68.

108 - On fairness considerations in restructurings, see Sarah Paterson, « Debt Restructuring and Notions of Fairness », Modern Law Review 80 (13 July 2017): 600-623; Such consideration is also required if one adopts a Habermasian position that a rule is justified only to the extent that all those affected by it would have accepted it if a rational debate under ideal conditions could take place., see Jurgen Habermas, Between Facts and Norms (MIT Press, 1996), 107; See explaining why this broader economic approach is also consistent with the non-utilitarian view of social justice as advanced by John Rawls, Rasmussen, « An essay on optimal bankruptcy rules and social justice ».

109 - See Rasmussen, « An essay on optimal bankruptcy rules and social justice », 20.

110 - See raising this point, Tollenaar, Pre-Insolvency proceedings, 24.

111 - See noting that even in the United States, where restructurings are not confidential, senior creditors may abuse their position in refinancing restructured companies, B. Espen Eckbo, Kai Li, and Wei Wang, « Rent Extraction by Super-Priority Lenders », Tuck

pushed to the extreme, the argument that the general legal framework must necessarily maximize the rights of senior secured creditors, that is to say credit institutions, leads to a legal system where any misjudgment by these creditors would lead to a loss of value, ultimately detrimental only to junior creditors and not to those who are responsible for this assessment error. Some senior creditors, and in particular credit institutions, who have the easiest access to information related to the debtor's financial and operating status, would not then be sufficiently incentivized to make decisions beneficial to all stakeholders.[112] This risk, in turn, stifles the sufficient development of bond markets.[113] Risky companies are then obliged to limit themselves to bank financing only,[114] or to pay significant premiums compared to their competitors located in jurisdictions favoring bond financing, while it has been shown that corporate access to diversified sources of financing promotes growth and increases the financial system's resilience, to the benefit of all stakeholders.[115]

2. Preventive restructuring from an economic perspective

45. Before proceeding further to the analysis of the rules justified under the objectives of insolvency proceedings, using the CBT concepts reinterpreted from a functionalist perspective, it is first of all necessary to specify that 'preventive' restructurings are in no way different. Indeed, these proceedings, which may lead to a restructuring of the debt, the debtor's capital and, where appropriate, its activity, are only alternatives to liquidation, and have to meet the same objectives and tackle the same problems as the latter.[116]

2.1. Preventive proceedings are insolvency proceedings like any other

46. As Professor Eidenmüller points out, what characterizes insolvency proceedings is not the actual insolvency of the debtor, but the fact that they address the problems of coordinating creditors.[117] This type of problem may surface before the debtor is formally insolvent, that is, before the debtor has a liquidity problem. This is particularly the case if certain creditors, or even shareholders, anticipate the debtor's difficulties and act immediately to protect their selfish interest, to the detriment of other stakeholders. Such a situation is likely to compromise pre-insolvency negotiations between the debtor and its creditors.

47. That is why preventive proceedings, which are fast becoming a new international standard,[118] are insolvency proceedings like any other. Regardless of their form, public or confidential, with or without the debtor's dispossession, concerning all or only some of the creditors, if the contemplated proceedings provide an answer to the problems of coordination, then preventive proceedings are but a variation on the same theme. It follows that they are justified only with respect to the same objectives, that is, maximizing the value of the company's assets in the interest of all stakeholders[119] and promoting the efficient distribution of resources in the economy.[120]

School of Business Working Paper No. 3384389 (2019), 2019: « We present strong evidence of supra-competitive pricing of debtor-in-possession (DIP) loans to firms filing for Chapter 11 bankruptcy. Fully collateralized and with super-priority and strong covenants, DIP loans have near-zero default risk. Nonetheless, their spreads and fees exceed those of even junk-rated loans, adding billions to the borrowing costs of Chapter 11 firms ».

112 - See on the virtues of risk retention by those who have to make decisions, Nassim Nicholas Taleb, Skin in the Game: Hidden Asymmetries in Daily Life (New York: Random House, 2018); Ingo Fender and Janet Mitchell, « Incentives and Tranche Retention in Securitisation: A Screening Model », BIS Working Papers N° 289, 2009; Saltuk Ozerturk, « Moral hazard, skin in the game regulation and CRA performance », International Review of Economics & Finance 52 (1 novembre 2017): 147-64.

113 - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 23.

114 - See Bo Becker and Jens Josephson, « Insolvency Resolution and the Missing High-Yield Bond Markets », The Review of Financial Studies 29, no 10 (1 Oct. 2016): 2814-49: « our model predicts that safe firms will issue bonds (to avoid paying high interest rates required by banks), but higher risk firms, for which insolvency is more likely, issue bonds as long as bankruptcy is efficient. For less efficient bankruptcy regimes, however, risky firms are stuck with bank loans ».

115 - See Financial Stability Board, « Corporate Funding Structures and Incentives », 2015; Soonwook Hong, « The Effect Of Debt Choice On Firm Value », Journal of Applied Business Research (JABR) 33, no 1 (2017): 135-40.

116 - See Jackson, The Logic and Limits of Bankruptcy Law, 210, who refers to restructuring proceedings as a "debt-collection device".

117 - See Horst Eidenmueller, « What Is Insolvency proceedings? », European Corporate Governance Institute (ECGI) - Law Working Paper No. 335/2016, 2017, 19: « What matters, therefore, is not the material insolvency of the debtor, but rather whether the proceedings attempts to solve a common pool problem of the creditors ».

118 - See Gurrea-Martínez, « The Future of Reorganization Proceedings in the Era of Pre-Insolvency Law », 6 et seq.; McCormack and Wan, « Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's Restructuring and Insolvency Laws ».

119 - See Jackson and Skeel, « Bankruptcy and Economic Recovery »: "Where bankruptcy proves its weight in gold is in the reorganization arena… If the assets are worth more together, they can be kept together".

120 - See Jackson and Skeel, 476: "Modern bankruptcy law primarily exists to help reduce the frictions that otherwise would impede assets from moving to their highest-and-best use… Accomplish-

48. The key to articulating these two types of proceedings is provided by the CBT. It is rational for participants in hypothetical *ex ante* negotiations to accept preventive proceedings only insofar as they more effectively serve the purpose of insolvency proceedings, on the one hand, and provided that the interests of any identifiable group are not injured by that decision, on the other hand. In other words, the possibility of using preventive proceedings must make it possible to improve the situation of all the parties, without hurting those of some of them.

2.2. Specificities of preventive proceedings

49. These conditions are fulfilled only when an early opening of proceedings makes it possible to better deal with the debtor's difficulties, in the interest of all stakeholders. Moreover, this requires that the alternative to the preventive proceedings, i.e. the liquidation of the company, is itself effective and predictable, since the negotiation of a restructuring agreement always takes place in light of the situation in which no agreement were to be found.

2.2.1. An early opening of proceedings in the interest of all stakeholders

50. By assumption, preventive proceedings should be accessible earlier than the standard liquidation proceedings,[121] but only when the debtor has no real prospect of being able to discharge its debts, so that no creditor has a legitimate reason to want to delay their opening.[122]

51. Any effective insolvency proceedings must be able to bind creditors under certain conditions. However, it must be understood that such a decision amounts to the imposition of a certain distribution of the current value of the company to the stakeholders. This is tantamount to provoking a collapse of future potentialities, since it is considered that the debts coming to maturity are now due and all future prospects of the debtor's company are brought to the present.[123] However, as long as the debtor has real prospects for recovery without the opening of proceedings, all creditors benefit from an economic option on this favorable event (for example, if the debtor finds a new client and signs a favorable contract). In this perspective, the opening of insolvency proceedings results in depriving some junior creditors of the value of such favorable possibility.

52. It follows that the initiation of preventive proceedings is only acceptable to the participants in a hypothetical *ex ante* negotiation if either the insolvency of the debtor is so predictable that the junior creditors have lost all hope[124] or what is to be gained is enough to compensate their loss and still augment the general wealth. If there is good reason to believe that insolvency is not inevitable, in principle a unanimous agreement of creditors is required to modify their rights.[125] In any case, if proceedings are initiated, the loss of opportunity suffered by some creditors should be compensated.

53. In practice, it seems difficult to fully appreciate the moment at which the insolvency of the debtor becomes so "predictable" as to render any further discussion useless, as the parties can have divergent views stemming from conflict interests or, simply, different levels of information. As a pragmatic approximation, however, it seems possible to consider that it is time to initiate a restructuring of the debt when it is observed that the debtor's management, constrained by the company's indebtedness, favors the short term over the long term, in other words when she makes decisions guided by the desire to settle her debt problem in the short term, to the detriment of the long-term sustainability of the company. This is particularly the case, for example, when the management decides to sell the company's essential assets at unjustifiably low prices.

2.2.2. Specific restructuring measures

54. The main specificity of preventive proceedings lies in the nature of the measures that can be adopted in this context. They must be analyzed without losing sight of the fact that preventive proceedings are justified only to the extent that they best serve the objectives discussed above.

ing a world in which bankruptcy maximized its contribution to economic growth and recovery would be aided by a clear understanding that one can only ask bankruptcy to do so much. If it is to allocate assets to their highest and best use, it probably should not be asked, as a matter of an independent policy, to save jobs as well".

[121] - It should be noted that the preventive proceedings should be accessible at the request of the debtor as well as at the request of the creditors, as long as their rights would be better preserved if they did not have to wait for the formal insolvency of the debtor.

[122] - See Tollenaar, Pre-Insolvency proceedings, 78.

[123] - See Nicolaes Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », Insolvency Intelligence 30, no 5 (2017): "Decisive for the qualification as insolvency proceedings is whether a forced distribution of the available value takes place or can be procured. That is the intent and direct effect of collective debt enforcement".

[124] - See Donald S. Bernstein and Douglas G Baird, « Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain », Yale Law Journal 115, no 8 (2006): 1937.

[125] - See Tollenaar, Pre-Insolvency proceedings, 71-80.

2.2.2.1. Remissions and rescheduling of debts

55. The two measures one naturally thinks of when thinking about preventive proceedings are debt remissions and rescheduling.[126] Yet neither is justified without the consent of the relevant creditors. The reason is simple: the two measures are likely to transfer wealth from creditors to shareholders.[127] Indeed, the latter escape having to crystallize their losses by accepting their dilution via a conversion of debt into shares. Often, in the case of SMEs, they may even continue to receive remuneration for functions performed within the company. However, this is done to the detriment of the creditors who, in turn, must make concessions, except when these concessions are actually remunerated by the company, in the form of a rise in interest rates and the settlement of commissions. In any case, the interests of the creditors are likely to be harmed while the shareholders are sheltered.

2.2.2.2. The transfer of the business to third parties

56. Preventive proceedings may very well result in a sale of the business to a third party (or to the debtor's shareholders themselves for that matter) and the subsequent distribution of the price to the creditors. From the point of view of the creditors, there is no difference between this sale and the liquidation of the debtor by a sale of the going concern. Such a sale upstream of formal insolvency should allow a better rate of satisfaction of the creditors, insofar as the company has not yet fully suffered the harmful consequences of the financial distress in which the debtor finds herself.[128] The negotiation with the potential third party buyer should be facilitated by the restructuring frameworks, insofar as the debtor's assets are stabilized and the buyer is sure to be acquiring a legally valid title, therefore diminishing the uncertainty and augmenting the acquisition price.

57. Such an upstream transfer to third parties is also the least intrusive solution from the point of view of the continuation of the company, since the only change is that of the owners, while the activity itself, including current contracts and employment, is in principle unaffected (although, of course, the acquisition might be conditional upon the realization of some disinvestments). In addition, the buyer is likely to have the motivation to make her investment flourish and is therefore more likely to make good decisions for the company going forward than out of the money parties. This is particularly the case if the third-party buyer is an actor in the same industrial sector, who has the necessary knowledge to run the business and ensure synergies with her existing activities.

58. In order for such a sale to be truly efficient, however, the refinancing market should be sufficiently strong and, importantly, the potential buyers should be informed about such investment opportunities. Unfortunately, this does not seem to be the case in France. Tellingly, only 8% of third parties who manifested their interest to buy the business of a distressed company in 2018 were non-French,[129] which might be explained by the fact that were the information is publicly available (in public 'formal' proceedings, as opposed to preventive conciliation frameworks), it is mostly published in French language official journals. While this is the case, it is not sure that the offered price is the best market price. Additionally, transparency about the sale to a third party seems to be warranted in order to tackle potential conflicts of interests. For instance, senior creditors, which are first in line to be paid, are not necessarily incentivized to seek the best offer for the debtor's business if they can be satisfied by the first available one, while junior creditors could potentially benefit from any additional funds. It seems reasonable for the hypothetical *ex ante* negotiators to take this into account. Moreover, transparency seems necessary, as clearly shown in the recent American Safety Razor LLC case in the US,[130] in order to diminish the likelihood of management colluding with some potential buyers who offer them a direct or indirect incentive and pushing through the relevant offer without seeking better ones first.

[126] - With regard to French law, it should be noted, however, that if under article L. 626-18 of the French Commercial Code the court may impose uniform payment terms on creditors, it may only acknowledge consented debt remissions, without being able to impose it. See Le Corre, Droit and pratique des procédures collectives 2019/2020, n° 522.16 and n° 522.18.

[127] - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 15.

[128] - See Philippe Aghion, Oliver Hart, and John Moore, « The Economics of Bankruptcy Reform », Journal of Law, Economics, & Organization 8, no 3 (1992): 530: "… there can be a serious loss in value-because of managemential distraction, incompetence, or negligence; forgone investment opportunities; or a drop-in demand (either because competitors behave more aggressively or because customers lose confidence). Also, suppliers may be unwilling to extend credit".

[129] See KPMG, « Les reprises à la barre : un outil efficace pour la préservation de l'emploi », 2019, 15, https://home.kpmg/fr/fr/home/media/press-releases/2019/06/reprises-a-la-barreoutil-efficace-pour-preservation-emploi.html.

[130] See Jared A. Ellias and Robert Stark, « Bankruptcy Hardball », California Law Review (à paraître) (19 janvier 2019): 46 et seq., https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3286081.

59. What seems to follow is that the sale to a third party should not be left to the sole discretion of senior creditors, the proceedings should be transparent and, given the objective of ensuring higher returns for the stakeholders, the best priced offer should be systematically favored.[131] It should be noted in this regard that judges are not always required to do so. For instance, article L. 642-1 of the French Commercial Code provides that the transfer of the business to a third party (applicable to liquidation proceedings) should aim at maintaining viable activities and the associated jobs, as well as increasing the amount recovered by creditors, without giving any further guidance as to the hierarchy between the three objectives. It is not surprising, therefore, that French judges tend to favor the latter objective; indeed, a wide empirical study of the French practice in 2018 showed that in 73% of cases judges accepted the offers which promised to safeguard the largest number of jobs.[132]

60. If the additional conditions mentioned above obtain the justification from a hypothetical *ex ante* negotiations point of view is immediate, since the value recovered by the creditors is hypothetically greater than what they would have been entitled to in the event of a liquidation, and where no other stakeholder is worse off. It should be noted, in this regard, that such an upstream sale of the whole business as a going concern is impossible under current French law, for the total sale of business is prohibited in non-liquidation proceedings.[133] At the same time, during a partial sale of the business, the French judge is not bound to choose the best price offer and could favor those which give non-financial undertakings, to the detriment of creditors.

2.2.2.3. The transfer of business to creditors

61. The emblematic measure of preventive restructuring proceedings is, however, the possibility of converting the debt into equity, which is equivalent to selling the company to the creditors.[134]

62. Overall, such a conversion could be deemed acceptable from the point of view of *ex ante* hypothetical negotiators when the immediate and accelerated transfer of the individual assets or the operating business to a third party in a liquidation proceedings would lead to a significant discount compared to the "fair market value" of the business.[135] Note that what is meant by "fair market value" is the price of the business if it could be sold in a hypothetical free, open and efficient market,[136] possibly including a discount related to the illiquidity of the company or its assets in the market as it really is.[137]

63. A significant discount can occur when the underlying industry is experiencing a temporary contraction, which means that potential industrial investors are likely to be experiencing difficulties themselves,[138] and financial investors (non-

[131] Such proceedings could therefore take the form of public auctions, see Vincent Buccola and Ashley C Keller, « Credit Bidding and the Design of Bankruptcy Auctions », Geo. Mason L. Rev. 18 (2010): 99.

[132] See KPMG, « Les reprises à la barre : un outil efficace pour la préservation de l'emploi », 2019

[133] See Alain Lienhard, Procédures collectives 2019-2020, 8e éd. (Delmas, 2019), n° 81.11 ; Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir ? », 20.

[134] - See for the state of French law, Francois-Xavier Lucas, « La conversion de créances en actions à l'occasion d'un plan de sauvegarde ou de redressement », in Mél. en l'honneur du Pr H. Hovasse (LexisNexis, 2016), 152; Francois-Xavier Lucas and Didier Porrachia, « L'expropriation de l'associé qui ne finance pas la restructuration de la société en redressement judiciaire », in Études à la mémoire de P. Neau-Leduc, Le juriste dans la cité (Lgdj, 2018), 629-55; Sarah Farhi, « La conversion de créances en titres de capital lors d'une procédure collective », ReSee proc. coll., no 1 (2019): 1.

[135] - See Tollenaar, Pre-Insolvency proceedings, 49 "In theory, the main reason for choosing a restructuring over a liquidation is that even if a sale is implemented through the instrument of a plan, the expected proceeds from a sale to a third party will be so far below the perceived value of the enterprise that the creditors prefer to take over the enterprise themselves".

[136] - See Jay E. Fishman, Shannon P. Pratt, and William J. Morrison, Standards of Value: Theory and Applications, 2nd ed. (Wiley - Blackwell, 2013), 75-76: "The requirements of fair market value may not always reflect what would happen in the open market… The notional market looks to identify a sale price without an actual sale… The notional market assumes: an arm's length transaction; economic rather than sentimental value, equally informed and uncompelled parties; equal financial strength and bargaining ability; a consistent market; and a free, open and unrestricted market environment. The real world does not always work in these terms, and that is often why there are discrepancies between fair market value and open market price".

[137] - See Shannon P. Pratt, Valuing a Business, 5th ed. (McGraw Hill Professional, 2007), 66: "… lack of marketability reduces the security's value as compared with a security that is identical in all respects but is otherwise marketable". See also, Lucas, « La conversion de créances en actions à l'occasion d'un plan de sauvegarde ou de redressement »; Farhi, « La conversion de créances en titres de capital lors d'une procédure collective », 2: "For creditors, plan deadlines are a constraint that diminishes the valuation of their rights. Not to reduce the value of the receivable converted according to this period would be a breach of equality of creditors subject to collective discipline. To avoid such differentiation, the value of the converted claim must be reduced by calculating the discount rate".

[138] - See Andrei Shleifer and Robert W. Vishny, « Liquidation values and debt capacity: a market equilibrium approach », The Journal of Finance 47, no 4 (1992): 1344: "Unfortunately, most assets in the world are quite specialized and, therefore, are not redeployable […] The principal reason for asset illiquidity-and the principal contribution of is the 'general equilibrium aspect of asset sales. When firms have trouble meeting debt payments and sell assets or are liquidated, the highest valuation potential buyers of these assets are likely to be other firms in the industry.

industrial) are too few in number, the refinancing market not being deep enough.[139]

64. This could also be the case where the debtor's assets are illiquid because of a high degree of market information asymmetry, such that a sale at an acceptable price would require an excessively long period of negotiations, which is not affordable in the context of a restructuring.[140] Indeed, the privileged access of existing creditors, over third parties, to information concerning the debtor's operational and financial status may lead them to consider that an asset, or an activity, is worth more than what is proposed by the third parties on the market. This problem of information asymmetry would be overcome if creditors and third parties could negotiate for a sufficiently long period to arrive at an equivalent valuation of the assets or the business. Moreover, long negotiations would seem to be necessary in order to convince such third parties that the sale to outsiders is not motivated by the creditors' belief that the debtors' state is even worse than what appears to be the case.[141] Unfortunately, the urgency that accompanies cases where the debtor requires restructuring often prevents such a price discovery from actually happening.

65. In such cases, it seems rational for hypothetical *ex ante* negotiators, putting themselves in the creditors' shoes, to accept a system that avoids unwarranted liquidation discounts by allowing creditors to become purchasers of the company by converting their debt into equity. This is desirable, for example, when privileged access by creditors to information related to the debtor's financial and operating status allows them to better evaluate the assets or value of the business over the long term.[142] The opening of the proceedings could neutralize, if need be, the often-unjustified nuisance caused by the current shareholders, who have lost everything but refuse to sell the company to creditors willing to buy it by trying to reduce their losses through extortion strategies vis-à-vis other creditors.[143] From a financial point of view, the conversion of debt to equity has significant perks. It makes it possible to cleanse the company's balance sheet and thus allows for a true fresh start. The company thereby has greater leeway to allocate its free cash flow to necessary investments, for example so as not to lag behind technological innovation or in order to take advantage of external growth opportunities.[144]

66. If these conditions are fulfilled, the option of such preventive proceedings, proposed as an alternative to liquidation proceedings, is justified by the CBT because it is rationally acceptable for negotiators behind the veil of ignorance. This theoretical foundation having been laid, the remainder of this paper is dedicated to the analysis of some fundamental elements of the framework proposed by the Restructuring Directive. We argue that the transposition of this European text is likely to innovate and significantly improve French preventive proceedings, but that it is fundamentally a failed opportunity from a functional law and economics viewpoint.

III. What is the Restructuring Directive all about?

67. The Restructuring Directive, whose final text has been adopted on the 6th of June 2019, is part of a broader international movement favorable to preventive restructurings, ahead of a debtor's liquidity crisis.[145] It is also an opportunity for the Commission to achieve a certain harmonization of insolvency proceedings at the European level without directly affecting traditional insolvency

But these firms are themselves likely to have trouble meeting their debt payments at the time assets are put up for sale".

139 - See Roe, « Three Ages of Bankruptcy ».

140 - See Tollenaar, Pre-Insolvency proceedings, par. 3.33: "The price realized in an expedited sale of the unmarketable object will be lower as a rule than the fair market value thus established, precisely because it is unmarketable. To sell an unmarketable object at a price level approaching its fair market value would, in principle, require an extended sale period and is sometimes not even possible".

141 See Douglas Baird, « Priority Matters », University of Pennsylvania Law Review 165 (2017): 790: « Buyers may therefore fear that the existing investors want to sell the firm because things are worse than they appear. The existing investors possess private information. Buyers of firms are like buyers of used cars. They are not willing to pay top dollar because of the risk that the firm is being sold only because the current owners know it is going to fail and want to rid themselves of a lemon ».

142 - See Jackson, The Logic and Limits of Bankruptcy Law, 214: "The underlying justification for a reorganization process, Seen in terms of bankruptcy as a debt-collection device, must be that the assets are worth more to the claimants themselves than they would be to third parties"; Douglas Baird, « Priority Matters », University of Pennsylvania Law Review 165 (2017): 790: « By the time a distressed firm is sold, the investors have organized themselves. They have hired experts and spent time reviewing and assessing the quality of the managements and their plans for the business going forward. As a result, they may know much more about the value of the business than any potential buyer ».

143 - We will return to the justification for a forced conversion of the debt into equity when some of the creditors themselves refuse it (See Part III, Section 4.4.1.2.).

144 - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 5.

145 - See Gurrea-Martínez, « The Future of Reorganization Proceedings in the Era of Pre-Insolvency Law ».

proceedings, a politically sensitive subject.[146] Incidentally, the Directive is supposed to address the fears of certain Member States regarding "virtuous" forum shopping in favor of London's legal and financial market.

68. At the end of the day, it appears that the drafters of the Directive sought to address pressures and objectives which are too divergent to be coherent. The preventive proceedings, as initially envisaged, were largely inspired by the second-generation Chapter 11 restructurings, but also by the British Schemes of Arrangement, while keeping in tune with the lessons derived from the law and economics movement. The difficulty was in combining these two sources of inspiration, which themselves respond to different dynamics,[147] resulting in hybrid and even "schizophrenic" proceedings.[148] The end result is a text lacking a clear coherent intellectual foundation and, for this reason, likely to lead to considerable deviations, insofar as conventional tools for insolvency proceedings are made available for purposes other than those of a coordinated exercise of the rights of stakeholders in their common interest.[149]

1. The two models hidden in the Restructuring Directive

69. Before proceeding with an analysis of the Restructuring Directive's main measures in light of the law and economics teachings and the basic rules justified by the functional CBT, it should be emphasized that the final text proposes, in effect, two formal models and, more profoundly, two different types of insolvency proceedings. The panoply of options available to Member States, covering no less than 70 different options,[150] could quickly become cacophonous if we do not keep this fundamental aspect in mind.

70. The proceedings as initially envisioned by the Commission, mainly inspired by second age Chapter 11 and the English Schemes of Arrangements, were supposed to be a unitary, public proceedings with a general stay of individual enforcement actions for up to four months. The second model, which is very clearly offered in view of the changes made mainly by the European Council,[151] is largely inspired by the French preventive proceedings, which it intends to strengthen and export. It can take the form of two consecutive proceedings.[152] The first step, amicable,[153] devoid of wide publicity[154] and accessible well in advance of a formal insolvency[155] would be accompanied by a relatively long stay of individual enforcement actions, granted exclusively on a case by case basis (in light of the limited publicity or confidentiality of such proceedings). The second step would be simply the closing phase, necessarily public,[156] triggered only

146 - See F. M. Mucciarelli, "Not Just Efficiency: Insolvency Law in the EU and Its Political Dimension" (2013), European Business Organization Law Review, 14(2), 175–200.

147 - See Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) ».

148 - See Tollenaar, 76: "However, the Commission designed proceedings with a schizophrenic character that has fundamental architectural flaws".

149 - See Stephan Madaus, « Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law », European Business Organization Law Review 19, no 3 (4 June 2018): 616-18, https://doi.org/10.1007/s40804-018-0113-7: « The legislative frenzy has created "restructuring and insolvency law", a legal area that lacks normative foundations with clear lines between insolvency proceedings and (debt) restructuring... Any solution that goes beyond the common pool requires an agreement between the debtor and (most of) his creditors (about future income). Such a solution is always a contractual solution and, consequently, any legal framework supporting the conclusion of such agreements (restructuring law) should be based on contract and company law principles instead of those of a liquidation (insolvency principles) ».

150 See Horst Eidenmueller, « The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union », Oxford Legal Studies Research Paper No. 37/2019 European Corporate Governance Institute - Law Working Paper No. 456/2019, 2019, 16.

151 - See notably the new recital 13, added by the Council as Recital 10b, which clearly acknowledges the possibility of starting the restructuring framework with an amicable and confidential first phase.

152 - article 4 (5) : "The preventive restructuring framework provided for under this Directive may consist of one or more proceedings, measures or provisions, some of which may take place out of court, without prejudice to any other restructuring frameworks under national law".

153 - It should be noted that such a possibility means that the restructuring framework would start with proceedings not covered by Annex A of Regulation 2015/848, the judges therefore not being subject to the competency criteria of the COMI.

154 - Recital 13 : "It does not change the approach taken in that Regulation of allowing Member States to maintain or introduce proceedings which do not fulfil the condition of publicity for notification under Annex A to that Regulation."

155 - Recital 28 : "The time frame relevant for the determination of such threat may extend to a period of several months, or even longer, in order to account for cases in which the debtor is faced with non-financial difficulties threatening the status of its business as a going concern and, in the medium term, its liquidity. This may be the case, for example, where the debtor has lost a contract which is of key importance to it". See also C. Paulus, NZI Beilage 1/2017, 5-7, who notes that "probability of insolvency", a concept not defined by the Restructuring Directive and left to the Member States, is not to be confused with the notion of "threatening insolvency" provided for by the InsO.

156 - Recital 13: "Although this Directive does not require that proceedings within its scope fulfil all the conditions for notification under that Annex, it aims to facilitate the cross-border recognition of those proceedings and the recognition and enforceability of judgments." For such recognition to be automatically ensured, the closing phase of the restructuring must be proceedings referred to in Regulation 2015/848. On the possibility of

if the plan is to be imposed on dissenting creditors and, during this short period, accompanied by a general stay of individual enforcement actions. This model clearly accommodates the French conciliation / SFA or SA pair, which the French government intends to keep but which would nevertheless undergo some considerable reforms.[157]

71. Between these two formal models, Member States will have to choose, since the mix of the different possible structural measures is limited by the need to create coherent proceedings. Nevertheless, a wide scope of flexibility is left to the Member States as to the very nature of the proceedings they intend to create, irrespective of the formal model chosen. It seems to us quite clear that the Directive was written by multiple authors pursuing divergent objectives and purposes: on the one hand an efficient treatment of the debtor's difficulties in the interests of all stakeholders, on the other hand the preservation of the company and the associated jobs at all costs. Unfortunately, this mix of approaches leaves limited hope for clear conceptual coherence. The fact remains that legislators will have to choose between these two incompatible approaches to what restructuring proceedings are supposed to be and be guided by one or the other when the Directive gives them some leeway. From our point of view, functional economic analysis requires that the first approach guide the transposition, even if the French government intends to keep the two-step conciliation / SFA or SA model.

72. From a certain point of view, the flexibility afforded to national legislators is likely to encourage a virtuous normative race to the top,[158] especially between Member States choosing a transposition favorable to an easier recognition of jurisdiction by their courts. It seems to us, therefore, that the transposition of the Directive is likely to strengthen the regulatory competition, debtors and their main creditors having a kind of "à la carte" choice"[159] between the different models proposed by national legislators.[160] In this respect, it seems to us that some of the concerns regarding the initial drafts of the Restructuring Directive, which were likely to cause a sub-optimal harmonization of national preventive proceedings, [161] have been somewhat alleviated, despite defendable views to the contrary.[162]

73. In fact, the Directive doesn't seem to stifle the ongoing regulatory competition of national restructuring proceedings. Indeed, while insolvency law was traditionally considered to be an 'island' of resistance to internationalization,[163] the increasing development of international finance prompted multiple initiatives towards either the harmonization of substantive insolvency and secured transactions law, without great success,[164] or the emergence of clear conflict of laws and jurisdictions rules.[165] In the EU, a full-blown

considering that the debtor's COMI was transferred to France if the negotiation of the restructuring in the context of a settlement took place with its main creditors, see Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives ».

157 See Tiret, « Retour sur les débats intervenus autour de la directive Insolvabilité au sein des institutions européennes ».

158 - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 2: "While it is still worrying, this normative competition nonetheless has a positive aspect, which is that it can also be a factor accelerating the modernization of national insolvency laws. The effect may be all the more beneficial in France, since around the world our insolvency law continues, despite significant legislative efforts made in recent years, to be perceived as relatively hostile to lenders".

159 - See favouring an "à la carte" approach in the US, Rasmussen, « Debtor's Choice »; See also in favour of a European normative competition in insolvency proceedings, Horst Eidenmüller, « Free Choice in International Company Insolvency Law in Europe », European Business Organization Law Review 6, no 3 (1 Sept. 2005): 423-47.

160 - See on the opportunities offered by the directive on the restructuring of international groups, Daoning Zhang, « Preventive Restructuring Frameworks: A Possible Solution for Financially Distressed Multinational Corporate Groups in the EU », European Business Organization Law Review, 7 Jan. 2019.

161 - See Eidenmüller, « Contracting for a European Insolvency Regime ».

162 See Eidenmueller, « The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union », 16: « At the same time, it is clear that the ERD will bring about some harmonisation. It will, to a non-trivial degree, reduce Member States' room to experiment with innovative and potentially radical new types of restructuring procedures. The ERD is a Procrustean bed that rules out radical innovations with respect to corporate restructuring regimes. In the future, for example, efficient regimes will not only be digital ones—these regimes will probably also, to a significant degree, be automated and assisted by artificial intelligence. This is impossible with the ERD as the relevant governing platform ».

163 See Jacques Béguin, « Un îlot de résistance à l'internationalisation : le droit international des procédures collectives », in L'internationalisation du droit. Mélanges Y. Loussouarn (Dalloz, 1994), 31-56.

164 See Catherine Walsh, « A Transnational Consensus on Secured Transactions Law? The 2016 UNCITRAL Model Law », in Transnational Commercial and Consumer Law: Current Trends in International Business Law, ed. Toshiyuki Kono, Mary Hiscock, and Arie Reich, Perspectives in Law, Business and Innovation (Singapore: Springer Singapore, 2018), 63-89; Teemu Juutilainen, Secured Credit in Europe: From Conflicts to Compatibility (Oxford ; New York: Hart Publishing, 2018).

165 See for early doctrinal efforts, Rolin Albéric, Des conflits de lois en matière de faillite, vol. 14, Recueil des cours (Brill, 1926); J. A. Pastor Ridruejo, La faillite en droit international privé (Volume 133), vol. 133, Recueil des cours (Brill, 1971); Paul Volken, L'harmonisation Du Droit International Privé de La Faillite (Volume 230), vol. 230, Recueil Des Cours (Brill, 1991).

substantive harmonization being politically inconceivable,[166] the latter efforts lead to the enactment of regulation n° 1346/2000 and then n° 2015/848 (the "Insolvency Regulation"). For better or for worse,[167] the Insolvency Regulation has not definitively precluded any further forum shopping, given the somewhat liberal understanding of the 'center of main interests criterion' by some national courts,[168] especially where such forum shopping is perceived as a means to enhance the chances of handling efficiently the restructuring, in the interest of all creditors.[169]

74. Despite European Commission's desire to the contrary, the Restructuring Directive plays into this general trend, insofar as it allows for the restructuring frameworks to begin with a preliminary procedure not cited in Annex A to the Insolvency Regulation and subject, therefore, to general national conflict of jurisdictions rules. The European legislator was fully aware of that and this is why a protection against abusive forum shopping has been added in the last version of the Directive at article 6(8), which limits to four months the maximum length of statutory moratoria if the debtor's COMI has been moved to the Member State where the proceedings are opened in the three months prior to such opening.

75. This is precisely the reason why so many French practitioners plead in favor of maintain the conciliation / SFA or SA model. In fact, a French court could very easily open conciliation proceedings for a foreign debtor, for the jurisdiction rules are governed by liberal national conflict of jurisdiction rules.[170] If an unanimous agreement is found amongst the creditors participating in the conciliation proceedings, its recognition across the EU is ensured by the Rome I Regulation, insofar as the agreement is, in fact, a contract.[171] Where it seems necessary to proceed forcefully by imposing the restructuring plan on some dissenting creditors, the opening of safeguard proceedings seems warranted, according to French scholars and some past court decisions, insofar as the negotiations between the debtor and its main creditors in France during the conciliation proceedings leads to a transfer of the debtor's COMI to France.[172]

76. Such a transfer of COMI is only possible, of course, if the main creditors accept the negotiations under a certain national law during the first phase. In should be noted, in this regard, that the jurisdiction which has benefited the most in recent years from such virtuous forum shopping has undoubtedly been England,[173] whose schemes of arrangement are very often chosen by mutual agreement between debtors and creditors as a framework for restructuring negotiations.[174] Multiple reasons seem to explain this choice, from the high degree of financial and legal sophistication of London insolvency practitioners[175] to the perception of English law as being the most protective of creditors' interests.[176] The imminent exit of the

[166] See Eidenmüller, « Contracting for a European Insolvency Regime », 275: "undertaking this harmonization with respect to Member States' 'traditional' insolvency regimes is sure to meet considerable political resistance. In particular, issues such as the governance of insolvency proceedings (including the role of the courts, insolvency administrators and the debtor), as well as the substantive ranking of claims are dealt with very differently across Member States, which reflects diverse regulatory traditions and contested value judgments."

[167] Generally, for better in our view. See, for arguments in favor of such forum shopping, Franco Ferrari, « Forum shopping : pour une définition ample dénuée de jugements de valeurs », Rev. crit. DIP janv.-mars (2016): 85; Horst Eidenmüller, « Free Choice in International Company Insolvency Law in Europe », European Business Organization Law Review 6, no 3 (1 septembre 2005): 423-47.

[168] See for example, 73 IE 1/08, ZinsO 2008, p. 363, note F. Frind ; Cass. com. 30 juin 2009, n° 08-11.902, n° 08-11.903, n° 08-11.905, n° 08-11.906, RPC 2009, comm. 147, Th. Mastrullo ; RPC 2009, étude 16, concl. R. Bonhomme ; R. Dammann and G. Podeur, D., 2006, 2329.

[169] The London High Court is the most explicit in this regard, see Re Codere Finance (UK) Ltd. (2015) EWHC 3778 (Ch.): « In a sense, of course… what is sought to be achieved in the present case is forum shopping… In cases such as the present, however, what is being attempted is to achieve a position where resort can be had to the law of a particular jurisdiction, not in order to evade debts, but rather with a view to achieving the best possible outcome for creditors. If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping ».

[170] See Reinhard Dammann and Marc Sénéchal, Le droit de l'insolvabilité internationale (Joly, 2018), n° 375 et seq.

[171] See Gilles Podeur, « Accords de conciliation and plans de sauvegarde. Les restructurations de dettes au confluent du contractuel and du judiciaire », D., 2017, 1430.

[172] See Reinhard Dammann and Marc Sénéchal, Le droit de l'insolvabilité internationale (Joly, 2018), n° 375 et seq., citing the *Eurotunnel* precedent.

[173] - See Gerard McCormack, « Jurisdictional Competition and Forum Shopping in Insolvency proceedings », The Cambridge Law Journal 68, no 1 (2009): 169-97; Gerard McCormack, « Bankruptcy Forum Shopping: The UK and US as Venues of Choice for Foreign Companies », International & Comparative Law Quarterly 63, no 4 (Oct. 2014): 815-42.

[174] - Legal scholars, English and European case law are all favourable to this, see Susan Block-Lieb, « Reaching to Restructure Across Borders (Without Over-Reaching), Even after Brexit », American Bankruptcy L.J. 92, no 1 (2018); J. Payne, « Cross-Border Schemes of Arrangement and Forum Shopping », European Business Organization Law Review 14, no 4 (2013).

[175] See Eidenmueller, « The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union », 7.

[176] - See thus justifying the favorable reception of foreign debtors by the English courts, Re Codere Finance (UK) Ltd. (2015) EWHC 3778 (Ch.): « In a sense, of course… what is sought to be achieved in the present case is forum shopping… In cases such as the present, however, what is being attempted is to achieve a position

United Kingdom from the European Union, which calls into question the future cross-border effectiveness of English court judgments in this domain,[177] prompted some legislators to compete in becoming the new "capital" of European cross-border restructuring proceedings.[178] In order to achieve such feat, legislators must convince creditors of the transactional efficiency of their restructuring proceedings and the protections afforded to creditors participating in negotiations.[179]

77. It should be noted, finally, that the absence of complete harmonization of preventive proceedings by means of the Restructuring Directive leaves the hope that, irrespective of the aforementioned jurisdictional competition issues, the Member States will be able to adapt their restructuring frameworks to the real conditions of their markets. As noted above, the economic efficiency of insolvency law depends on the economic conditions and characteristics of the financial markets of each country, as well as the sophistication of the institutions and actors involved in the restructuring of viable businesses.[180] In this respect, too much harmonization seems counterproductive given the great disparity between the economies of the Member States.

78. In any case, it is certain that the Restructuring Directive will lead to at least some harmonization around a common core. As we will see, this core does not always respond to the expectations set out by our functional law and economics analysis, although efficient transpositions seem still possible.

2. The multiple objectives of the European legislator

2.1. An unfortunate mix-up of objectives

79. In light of our discussion so far, it seems that the first and, in certain regards, the fundamental flaw of the Restructuring Directive, which renders its transposition potentially problematic, is that it encompasses a mix of divergent objectives and a confusion of types of proceedings. This is not entirely surprising given that, as we have noted, a full harmonization of insolvency proceedings has been so far politically inconceivable precisely because national insolvency laws tend to address distributional concerns, highly dependent on local political pressures.[181] Across the EU, a general trend towards a 'rehabilitation culture' has long been observed.[182] To take but one EU level example, regulation n° 1346/2000 expressly concerned liquidation proceedings and made no mention of stakeholders other than creditors, while the Insolvency Regulation also applies to some pre-insolvency proceedings (Recital 10) and is intended to favor the preservation of jobs (Recital 72). The final Report of the European Law Institute on "Rescue of Business in Insolvency Law", which laid the foundation of the Restructuring Directive, explicitly sets the protection of jobs and of debtors in some specific industries as legitimate objectives of the proposed preventive proceedings, [183] as did the European Commission in its 2014 recommendation.[184]

80. It is therefore not surprising that the initial draft of the Restructuring Directive suffered already

where resort can be had to the law of a particular jurisdiction, not in order to evade debts, but rather with a view to achieving the best possible outcome for creditors. If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping »; see also, Sarah Paterson, « Finding our way: secured transactions and corporate bankruptcy law and policy in America and England », Journal of Corporate Law Studies 18 (8 mars 2018): 12.

177 - See Block-Lieb, « Reaching to Restructure Across Borders (Without Over-Reaching), Even after Brexit »; Chris Umfreville and al., « Recognition of UK Insolvency proceedings Post-Brexit: The Impact of a 'No Deal' Scenario », International Insolvency Review 27, no 3 (2018): 422-44, https://doi.org/10.1002/iir.1325; A. Walters, « The Impact of Brexit on Judicial Cooperation in Cross-Border Insolvency and Restructuring in the European Union », Orizzonti Del Diritto Commerciale 2018 (Dec. 2018); See however an analysis concluding that Brexit will not have a significant impact on London's financial center, Wolf-Georg Ringe, « The Irrelevance of Brexit for the European Financial Market », European Business Organization Law Review 19, no 1 (1 March 2018): 1-34.

178 - This is an important aspect, admitted by Prof. M. Veder at a conference on the Restructuring Directive organised by the Royal Institute of Jurisprudence and Spanish Legislation in Madrid on 30 May 2019. Prof. Veder pointed out at the conference that while the reform of preventive proceedings initiated by the Dutch government in 2012 did not initially aim to make the Netherlands more attractive for cross-border restructuring, the situation has changed since Brexit.

179 - Regarding this race, see Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives »; Reinhard Dammann and Vasile Rotaru, « Plaidoyer pour une approche fonctionnelle du droit des sûretés », RJSP, no 17 (2019): 6.

180 - See Berkowitz, Pistor, and Richard, « Economic development, legality, and the transplant effect »; Berkowitz, Pistor, and Richard, « The Transplant Effect ».

181 See Federico M. Mucciarelli, « Not Just Efficiency: Insolvency Law in the EU and Its Political Dimension », European Business Organization Law Review 14, n. 2, 2013 : 175-200.

182 See David Burdette, « Why Rescue? », in Turnaround Management and Bankruptcy, ed. Jan Adriaanse and Jean-Pierre van der Rest, 2017, 211. ; Boon, « Harmonising European Insolvency Law ».

183 See Gert-Jan Boon, « Toward a European Business Rescue Culture », in Turnaround Management and Bankruptcy, éd. par Stephan Madaus and Jean-Pierre van der Rest, 2017, 238.

184 See Recommendation n° 2014/155/EU, Recitals 1 and 12.

from a general bias in favor of safeguarding debtors, even though it stated from the onset that it was intended to only rescue viable businesses.[185] In fact, the Directive lays the groundwork for genuine insolvency proceedings, but justifies the interference with the rights of creditors not only by the need to coordinate their actions to respond to the tragedies of the commons and the anticommons, but also by the need to balance the interests of creditors with considerations of "general interest", that is, the preservation of businesses and jobs at all costs.[186] The European legislator seems to imply that a restructuring is always preferable to a liquidation, which, in light of what we have already seen, doesn't seem to be exactly right.

81. For instance, the original draft did not even provide for the possibility that the restructuring plan could lead to a sale of the operating business to a third party, which contradicts the conclusions of the economic analysis presented. Fortunately, since the Council's reading, such a possibility has been provided for, but only as an option for national legislators (article 2 (1)), which shows once again that the various drafters of the Directive did not understand the instruments they were creating in the same way. As we have already noted, the transposition of the Directive should be the occasion for French law to be made more efficient in this regard.

82. Other additions by the European Council are less commendable, for they seem to strengthen the perceived bias in favor of restructurings at all cost.[187] For instance, Recital 2 states that the "frameworks should help to prevent job losses and the loss of know-how and skills, and maximize the total value to creditors… as well as to owners and the economy as a whole", and the text is generally abundant in its references to the protection of the rights and interests of employees, a special protection, separate from that of other stakeholders.[188] In this regard, it should be noted in particular that since the Council's reading, a judicial validation of the plan is mandatory when it entails the loss of more than 25% of the workforce,[189] even where the affected workers were consulted as a separate class of creditors[190] and where their claims are fully preserved under the best interest of creditors test.

83. This confusion of objectives is further strengthened by the fact that the economically reasonable objective of an express liquidation of non-viable companies is stated in two recitals,[191] without being included in the legally binding body of the Directive. Yet an abundance of language favorable to restructuring at all cost risks making the judges lose sight of the objectives of an economically efficient proceedings.[192] Given the short-term political cost of liquidations, it is highly likely that judges will find in these confused objectives sufficient justification to maintain the operation of inefficient firms. Indeed, as we have already mentioned, some empirical studies clearly show that French courts already suffer from such a bias.[193] For in-

[185] See Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 4-5.

[186] - Danish Technological Institute (DTI), « Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law », 2016, 59: "This sub-option [the possibility to interfere when only a likelihood of insolvency exists] does not have negative impacts on fundamental rights, as most Member States have now recognized that the need to safeguard the rights of creditors must be balanced against the general interest of saving companies and jobs, and for this reason some interference with (dissenting) creditors' rights in order to make restructuring effective is justified. The social impacts of such proceedings should be positive, as one of the main objectives of early restructuring proceedings is to save jobs by saving the companies which employ them".

[187] - Recital 2: "Those frameworks should help to prevent job losses and the loss of know-how and skills, and maximise the total value to creditors (…) as well as to owners and the economy as a whole."; Recital 3: "A significant percentage of businesses and jobs could be saved if preventive frameworks existed in all the Member States in which businesses' places of establishment, assets or creditors are situated. In restructuring frameworks the rights of all parties involved, including workers, should be protected in a balanced manner."; article 13, dedicated to labour rights; article 2(6), which now provides that the "best interest of creditors test" must compare the situation of the creditor with his situation in case of liquidation "or in the event of the next-best-alternative scenario if the restructuring plan were not confirmed", which implies that such an alternative solution can exist.

[188] - For example, Recital 1: "… without affecting workers' fundamental rights and freedoms…" ; recital 3 : " …the rights of all parties involved, including workers, should be protected in a balanced manner…"; recital 43 : "Creditors affected by a restructuring plan, including workers (…) should have a right to vote on the adoption of a restructuring plan…"; article 2(1)(2) : " 'affected parties' means creditors, including, where applicable under national law, workers…".

[189] - See article 10 (1)(c).

[190] - See article 9 (4) and article 13(2).

[191] - Recital 2 of the initial draft, which became recital 3 of the final version: " At the same time, non-viable businesses with no prospect of survival should be liquidated as quickly as possible."; and recital 39, which became recital 85 : "It is necessary to maintain and enhance the transparency and predictability of the proceedings in delivering outcomes that are favourable to the preservation of businesses (…) or that permit the efficient liquidation of non-viable enterprises.".

[192] - Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 5: « Under the approach of the Commission a measure or action may be permissible even when it prejudices the interests of the creditors as a group, if it promotes other interests which are deemed to carry greater weight than the interests of the creditors ».

[193] - See noting the sensitivity of French consular judges to maintaining employment, Jean-Daniel Guigou and al., « Entreprises en

stance, where a transfer of business to a third party takes place, judges systematically (in more than 73% of cases in the dataset of a recent KPMG study) favor the offer which promises to safeguard the largest number of jobs, leading to the financial recovery of creditors' claims being limited, in such cases, to a mere 6%.[194] It seems that where courts are asked to pursue several objectives at the same time, that of an efficient *ex post* distribution of resources in the economy is the first one to be sacrificed.

84. As we have seen, however, the economically justified objectives of insolvency proceedings, whether they are liquidation or preventive restructuring proceedings, are to facilitate the *ex ante* access to financing and the effective *ex post* distribution of resources. In both cases, considering all the interests involved should lead to favoring proceedings that only maintain companies in operation if their restructuring can generate economic value, and otherwise effectively liquidates them. All stakeholders benefit from this approach in the long run.[195]

2.2 Should a business viability test be required to access preventive proceedings?

85. In light of what has been discussed in the previous section, we understand the fears expressed by some commentators of the initial drafts of the Directive that it could end up offering a refuge to failing companies, contributing therefore to an *ex ante* increase in the cost of financing.[196]

86. This risk is probably diminished by the fact that, as we shall see, the proceedings may lead to a debt-equity swap ridding the company of its former shareholders. One could thus consider that debtors are not particularly incentivized to test the extent to which the judge would be understanding of their situation, as even the preservation of jobs and the on-going business doesn't really need the owners to be left in place. It is for this reason, for example, that a deliberate choice has been made by the US legislator to not provide for an entry test into the Chapter 11 proceedings.[197]This is also why the Commission's original draft only provided that restructuring plans must contain "a reasoned opinion or statement ... explaining why the undertaking is viable" (article (8) (1) (g)), without it being possible to challenge this opinion.

87. These arguments are perfectly understandable and the aforementioned fears do not seem to us to be warranted in general, but they are not applicable to SMEs.[198] Indeed, any plan imposed by a forced cross-class cram-down, that is to say, despite the opposition of a class of voting stakeholders, requires the agreement of the debtor in the case of SMEs.[199] In fact, the option not to require such an agreement, which should be taken if our previous analysis is correct, does not apply to SMEs.[200] As such, SME owners do not have to fear being kicked out of the company if they were to be treated as a class of creditors. The situation is even more favorable for SME shareholders if they are not treated as a particular class. In this case, the option set forth in section 12(3) applies, requiring legislators to adapt " what it means to unreasonably prevent or create obstacles", taking into account, for example, the nature of the company and of its shareholders.

88. This seems to us a curious choice on the part of the European legislator. Despite the insistence of the Directive on the need to facilitate the financ-

difficultés : l'arbitrage des tribunaux entre maintien de l'emploi and apurement du passif », Economie and Statistique 443, no 1 (2011): 51-75.

194 See KPMG, « Les reprises à la barre : un outil efficace pour la préservation de l'emploi », 2019.

195 - See Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 4: « The conclusion from the foregoing is that the European Commission set itself the wrong goal. The goal should not have been to design a "preventive" proceedings that provides the debtor with an instrument to avoid insolvency proceedings. The goal should have been to design an efficient insolvency proceedings that offers the creditors an instrument to enforce their rights in a manner that is more efficient and flexible that is currently possible with the existing insolvency proceedings... This would both further access to credit by improving creditors" enforcement rights and, at the same time, facilitate business rescue in cases where that is appropriate" ».

196 - See Eidenmüller, « Contracting for a European Insolvency Regime », 17.

197 - See Elizabeth Warren, Chapter 11: Reorganizing American Businesses, 3rd ed. edition (New York, NY: Aspen Publishers, 2008), 24.

198 - It should be noted that the Restructuring Directive does not provide a definition of SMEs, as this notion is understood in the sense given to it by national law (article 2 (2)), but encourages national legislators, in its recital 18, to take into account Directive 2013/34 / EU or the Commission recommendation of 6 May 2003 on the definition of micro, small and medium-sized enterprises. In view of what will be explained below, it seems to us desirable to restrict this definition as much as possible in French law, since the Restructuring Directive imposes some suboptimal harmonizations as regards the proposed preventive proceedings applied to SMEs.

199 - See article 11(1) : " Member States shall ensure that a restructuring plan which is not approved by affected parties, as provided for in article 9(6), in every voting class, may be confirmed by a judicial or administrative authority upon the proposal of a debtor or with the debtor's agreement, and become binding upon dissenting voting classes…"

200 - See article 11(1), par. 2: " By way of derogation from the first subparagraph, Member States may limit the requirement to obtain the debtor's agreement to cases where debtors are SMEs."

ing of SMEs, the proposed preventive proceedings are not adapted to their case. Indeed, the creditors of SMEs very rarely face coordination problems that would justify that such formal proceedings be triggered, especially considering that they are likely to prove pretty expensive in light of the necessary going concern valuation.[201] The fact that the access of SMEs to these proceedings is so encouraged by the Directive (in particular by reducing as much as possible its costs),[202] coupled with the fact that the shareholders do not have much to fear from initiating them, points to the objective of rescuing these companies, whether such rescue is economically justified or not. Unfortunately, what seems to be forgotten is the fact that the cost of financing SMEs can only increase if creditors fear unjustified openings of proceedings, with a stay of individual enforcement actions lasting up to 12 months. Indeed, in the absence of accurate and credible information on the projects and the financial perspectives of SMEs, creditors seem to generally rely in their risk analysis on the predictability of their treatment in the event of default.[203]

89. In this respect, a salutary development of the final text of the Directive must be noted. Since the Council's reading, the text now provides that "Member States may maintain or introduce a viability test under national law, provided that such a test has the purpose of excluding debtors that do not have a prospect of viability" (article 4 (3)). It seems to us that national legislators should opt for such a test regarding SMEs. Indeed, the fact that it is but an option, where it should really be an obligation regarding such companies, only goes towards strengthening our general understanding that the Directive reflects a plurality of sometimes divergent objectives. We think, therefore, that it is of utmost importance to provide for such a test in the French transposition of the Directive, especially if the conciliation / SFA or SA model is maintained, without reducing such test to the mere observation of a lack of formal suspension of payments, as companies may be unsustainable without being formally insolvent. Such a test for SMEs should prevent unnecessary and unjustified captures of resources in businesses which have no prospects for the future and whose maintenance as a going concern addresses short-term problems to the detriment of long-term economic growth.

3. Significant improvements to the system of the stay of individual enforcement actions

90. The Restructuring Directive provides for a system of stay of individual enforcement actions, i.e. moratoria (either general or on a case-by-case basis), which bears the signs of long and difficult debates, the result being somewhat complicated without clear guidelines for reading its text.[204] As we will argue, this is an essential element of the future proceedings, which can significantly improve the current French system.

3.1. The economic justification for the stay of individual enforcement actions

91. The stay of individual enforcement actions is essentially a response to the prisoner's dilemma, that is, to hypotheses where the impossibility of coordination between the stakeholders is such that their separately rational actions result in a suboptimal result for these stakeholders as a whole. In this respect, the moratorium is unquestionably justified in principle. Indeed, coordinated action would hypothetically maximize the value of the debtor's assets for the benefit of all creditors and ensure an efficient distribution of the value if a liquidation proved necessary.[205] As insolvency proceedings are specifically designed to address these problems by promoting the stabilization of the debtor's assets, it is generally stated that this is one of their essential elements.[206] For the drafters of the US Chapter 11, this is a fundamental

[201] - An aspect clearly stated by Professor Ignacio Tirado during the conference on the Restructuring Directive held in Madrid on May 30, 2019.

[202] - See recital 17 : "Enterprises, and in particular SMEs, which represent 99 % of all businesses in the Union, should benefit from a more coherent approach at Union level. (…) SMEs, especially when facing financial difficulties, often do not have the necessary resources to cope with high restructuring costs and to take advantage of the more efficient restructuring proceedings available only in some Member States. In order to help such debtors restructure at low cost, comprehensive check-lists for restructuring plans, adapted to the needs and specificities of SMEs, should be developed at national level and made available online."

[203] - On the specific problems posed by SME financing, See Louise Gullifer and Ignacio Tirado, « A Global Tug of War: A Topography of Micro-Business Financing », Law and Contemporary Problems 81, no 1 (4 May 2018): 114-15.

[204] - The Nordic countries, which consider preventive proceedings as a way to relieve the burden of non-performing loans (unpaid for more than 90 days), insisted on a suspension period of less than 3 months. On the other hand, the Latin countries, especially France, who see such proceedings as a way to save companies at all costs, insisted on the need for very long suspensions. The final compromise provides for a suspension of 4 months, extended up to 12 months if necessary and justified.

[205] - See Baird and Jackson, « Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy ».

[206] - See Oscar Couwenberg and Stephen J. Lubben, « Essential Corporate Bankruptcy Law », European Business Organization Law Review 16, no 1 (1 March 2015): 49.

tool that protects the debtor from undue harassment.[207]

92. It should be borne in mind, however, that the stay of individual enforcement actions is justified only to the extent that it addresses such value destructive coordination problems and must not serve adjacent objectives.[208]

93. In fact, the threat of an immediate individual enforcement action is an important lever of pressure and control in the relations between the creditors and the debtor.[209] In order to obtain conventional stand-still agreements, the debtor must generally show signs good faith and prove that the planned restructuring has reasonable chances of succeeding. When the creditors are not convinced, it is a good sign that the debtor is not viable, and that its liquidation must not be delayed any further. This aspect is even more relevant in light of recent developments in financial markets, which seem to reduce the risks of coordination problems. Two trends must be pointed out in this regard. On the one hand, where secondary debt markets are sufficiently deep and liquid, impatient creditors can sell their claims to those investors who are more willing to wait in order to extract the restructuring value. On the other hand, syndication of loans, that is to say, the situation in which credit institutions come together to finance the same project, decreases the number of interlocutors, to the extent that one of the institutions generally assumes the lead role within the syndicate. Where these two tendencies occur, coordination of creditors is not as difficult as it might have been a few decades ago.[210]

94. Nevertheless, in some cases, the interests of individual creditors may not be aligned with those of all stakeholders (to take but one example, this may be the case of creditors benefitting from credit default swaps, or CDS).[211] In these cases, the creditors might have the incentive to enforce their claims against the debtor even if a surplus value could be gained from an orderly restructuring. A possibility of granting a stay of individual enforcement actions must therefore exist.

95. In order to respond to these two concerns, it is simply necessary that the creditors' powers of control, exercised through a credible threat of immediate enforcement action, be neutralized only on a case-by-case basis, as a general neutralization might prove counter-productive. Additionally, such neutralization should not be longer than necessary to attain the legitimate objectives of the proceedings.

3.2. A possibility of transposition in accordance with economic analysis

96. The system of the stay of individual enforcement actions in the framework of French restructurings, and more specifically of conciliations / SFA or SA, doesn't seem to be in line with the above analysis. In fact, during the amicable conciliation phase, the debtor must negotiate stand-still agreements with its debtors, who generally require that such agreements be renewed on a rolling basis within short intervals of time. This situation in principle offers creditors leverage when negotiating with the debtor. During the second closing phase, a general automatic stay of individual enforcement actions is afforded.

207 - See S. Rep. No. 95–589: "The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy". It should be noted in this respect that one of the fundamental criticisms addressed to the English Scheme of Arrangement is not to provide for the suspension of individual proceedings. Nevertheless, this apparent absence seems largely outweighed by the possibility of asking the judges to grant individual injunctions to this effect, see for example In Re Telewest Communications Plc (2004) EWHC 924 (Ch).

208 - See Tollenaar, Pre-Insolvency proceedings, 196: « A stay, if conceived properly, should not harm, but should instead aim to serve, the joint creditors" interests... A statutory stay is not a structural solution and must not be regarded or used as such. It is only a temporary measure to facilitate the realization of a structural solution" ».

209 - See Vincent S. J. Buccola, « Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress », SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, 16 March 2019).

210 - See, arguing that a stay of proceedings is no longer necessary in major restructurings, an argument that we cannot fully endorse, Douglas Baird and Robert Rasmussen, « Antibankruptcy », Yale Law Journal 119, no 4 (1 Jan. 2010): 681 et seq.; Buccola, « Bankruptcy's Cathedral », 16; Paterson, « Rethinking Corporate Bankruptcy Theory in the Twenty-First Century », 711.

211 - To take a single example, this is the case of creditors benefiting from a CDS, who might have an interest in causing a default event, see Baird and Rasmussen, « Antibankruptcy », 681: « When a lender purchases a credit default swap, however, it retains the control rights that accompany the loan. The protection seller now bears the economic risks of the loan, but rights under the credit agreement remain lodged in the protection buyer. If a waiver of an event of default is needed, the holder of the loan is free to vote as it Sees fit. But now its economic interest has changed ». See also in this regard, "Proposals for a Restructuring Moratorium – A Consultation. Response of City of London Law Society Insolvency Law Committee", The City of London Law Society 2010, p 2.

97. The problem is that during the amicable phase, if dissenting creditors, or creditors simply not invited to negotiations, intend to obtain the payment of their debts, the debtor may ask the President of the commercial court which opened the proceedings to grant a legally binding individual grace period, pursuant to article 1343-5 of the French Civil Code, applicable by reference by article L. 611-7 of the French Commercial Code.[212] Such grace periods could go up to 24 months, which is certainly excessive and allows for a substantial transfer of wealth benefitting the shareholders, even though the debtor is expected to be restructured within a shorter period. In addition, this measure carries very costly effects for credit institutions, since their debt becomes almost automatically non-performing and requires the constitution of provisions in this regard.[213] This possibility is all the more open to criticism as the decision granting a legal grace period is not subject to any appeal.[214]

98. Granted, such individual grace periods are seldom given in practice. However, it seems to us that their mere possibility turns article 1343-5 of the Civil Code into a formidable threat to the benefit of the debtor. It surely has a great impact on negotiation dynamics, as this simple threat may compel creditors to make concessions, without them being necessarily justified in view of the debtor's perspectives, or indeed in light of the order of loss absorption, to the extent that the current shareholders are the beneficiaries of such wealth transfers.

99. The transposition of the Restructuring Directive provides an opportunity to correct the French system in this regard. Depending on the general model chosen by national legislators, Member States have the choice between a general and automatic stay of individual enforcement actions (first model) or a stay granted on a case-by-case basis (second model). While the Directive doesn't explicitly forbid a mix in this regard, it seems to us that the general coherence of such proceedings command the choice of the type of moratoria, insofar as a general stay is only possible where the proceedings are subject to wide publicity, as noted by the European Commission in point 11 of its 2014 recommendation.

100. Importantly, the final text specifies that national legislators could provide that a stay of individual enforcement actions not be granted when it "is not necessary or when it does not fulfil the objective" of "allowing the proper conduct of negotiations concerning a restructuring plan" (article 6 (1)). This is an important clarification, as it avoids unnecessary stays of individual enforcement actions, although the end result ultimately depends on how the objectives of such proceedings will be understood by national courts.[215] One can only hope that the objectives brought to light by the economic analysis will prevail in practice, despite the European legislator's wording to the contrary.

101. A second salutary clarification is to be found in article 6(9), which states that the judicial authorities must be able to lift the stay of individual enforcement actions when it no longer fulfils its objectives, for example because the majority required for the adoption of the plan is unlikely to emerge. A two-pronged option is also left to national legislators to provide that the stay should be lifted "if one or more creditors or one or more classes of creditors are, or would be, unfairly prejudiced by a stay of individual enforcement actions" or "if the stay gives rise to the insolvency of a creditor". In view of the economic analysis presented, both branches must be adopted.

102. Finally, it should be noted that a stay granted on a case-by-case basis cannot be applied to creditors who have not been informed of the ongoing negotiations (article 6(3)). This clarification clearly refers to proceedings that begin with an amicable phase. The rule is, then, fully justified: to the extent that a creditor has not been asked to join the negotiations, it is not a significant creditor and the debtor should be able to satisfy its claims. A stay against such a creditor is never justified by the needs of the restructuring.

4. An enhancement of creditors' decision-making power

103. The economic analysis of insolvency proceedings, as performed through functional CBT, requires

[212] - See Le Corre, Droit and pratique des procédures collectives 2019/2020, n° 142.12.

[213] - Regulation 2018/0060 (COD) amending Regulation (EU) No 575/2013 as regards the minimum coverage of losses on non-performing exposures, article 1.

[214] - Douai, 27 March 2007, BICC 2007, n° 1889 ; JCP E 2008. 1433, note Lebel ; RTD com. 2008. 413, obs. Macorig-Venier ; ReSee proc. coll. 2008, n° 104, obs. Delattre ; See also Aix-en-Provence, 2 Feb. 2012, RTD com. 2013. 333 , obs. Macorig-Venier ; LEDEN Oct. 2012, p. 2, obs. Staes. See contra, Rennes, 2 April 2013, Bull. Joly Entrep. diff. 2013. 214, note Hart de Keating.

[215] - See with regard to grace periods granted in conciliation proceedings, Le Corre, Droit and pratique des procédures collectives 2019/2020, n° 142.12: "These grace periods seem to us to fit strictly into the purpose they pursue: to allow the conciliation agreement to be obtained ... That is why, it must be decided that they will end in the event of a failure to reach a conciliation agreement and the end of the conciliator's mission, an opinion shared by some, but not by others".

that the decision-making power be devolved as much as possible to stakeholders who have some skin in the game. The Restructuring Directive only partly meets this requirement.

4.1. The economic rationale for devolving the decision-making power to creditors

104. The fundamental economic objective of restructuring proceedings is to identify and safeguard viable companies. It is therefore reasonable for stakeholders to agree to give decision-making power to those who are most likely to make the right decisions in this regard. From an economic and epistemological standpoint, these are those parties whose interests offer the best approximation of the broader interests of all stakeholders.[216]

105. When the company is solvent, the shareholders seem to meet this requirement, insofar as they bear the residual risks of the company.[217] Any loss and any additional earnings of the company have an immediate impact on their interests, to the extent that they recover all the gains in the event of liquidation of the company once the fixed creditors have been paid. They are thus better able to exercise effective control and decision-making because they are incentivized to do so.[218]

106. The situation is quite different in the event of financial distress. To the extent that the shareholders have nothing to lose, they are likely to take unjustified risks, creating moral hazards leading to a decrease in the value of the company.[219] Shareholders might therefore pursue asset dislocation or asset dilution strategies,[220] or simply substitute stable assets with risky investments.[221]

107. From this point on, creditors are the ones who bear the residual risk and therefore have the best incentive to distinguish viable companies from those that must be liquidated, on the one hand, and to identify the best opportunities for reorganizing the company's business on the other hand. The decision-making power must therefore be attributed to them. Two elements seem to follow from this analysis. First, the debtor's role must be limited and in no case must she maintain a monopoly on decision-making power. Second, and contrary to what is the case under current French law, the role of the intervening judge must be limited to the strictly necessary. Indeed, there is no reason to think that the latter is particularly able to identify the best economic opportunities for the reorganization of the debtor.[222] This follows from our previous analysis, because the judge's personal interests are not necessarily aligned with those of the stakeholders who would benefit in the event of a successful recovery of the business, and if the judge makes a mistake in this respect she will not bear the costs. Moreover, judges very rarely have the economic and financial competence necessary to be able to substitute her judgment for that of economic actors active on the market. Therefore, the judge's role must be limited to what is essential in order to facilitate the negotiations.[223] In particular, her intervention is necessary to put an end to the valuation wars, insofar as the different groups of creditors are necessarily in conflict of interest regarding this valuation, which determines each party's share in the distribution of the restructuring added value.[224] It is also necessary to

[216] - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 8-9. It is therefore necessary to identify the people whose interests are most in line with the interests of all the stakeholders, even if this alignment is not perfect.

[217] - See Oliver Williamson, « On the Governance of the Modern Corporation », Hofstra Law Review 8, no 1 (1979): 63-78; David Millon, « Theories of the Corporation », Duke Law Journal 39, no 2 (1990): 235.

[218] - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 8: "They are therefore those who value the most political rights or control rights exercisable in the company: if these rights were auctioned, economic rationality would predict that they would be the highest bidders".

[219] See Reinier Kraakman et al., The Anatomy of Corporate Law: A Comparative and Functional Approach, 2 edition (Oxford ; New York: Oxford University Press, 2009), 116.

[220] See Katherine H. Daigle and Michael T. Maloney, « Residual Claims in Bankruptcy: An Agency Theory Explanation », The Journal of Law & Economics 37, no 1 (1994): 157-92.

[221] See Erik P. Gilje, « Do Firms Engage in Risk-Shifting? Empirical Evidence », The Review of Financial Studies 29, n° 11 (2016): 2925-54: « Risk reduction is most prevalent among firms that have shorter maturity debt, bank debt, and tighter bank loan financial covenants. These findings suggest that debt composition and financial covenants serve as important mechanisms to mitigate debt-equity agency conflicts, such as risk-shifting, that are not explicitly contracted on ».

[222] - See Baird, « Bankruptcy's Uncontested Axioms », 593: « Giving discretion to the judge makes sense only when she is well-positioned to use it. The judge has no magical ability to make business decisions, let alone to outwit the market ».

[223] - See by drawing a critique of the role of the judge in the current French system , Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 15: "The judge should intervene only as a last resort. His mission is essentially to reduce the asymmetry of information between the debtor's managements and the creditors and allow the company to emerge quickly from the insolvency proceedings... The judge's mission would thus have to evolve. It would borrow less from the idea of economic magistracy, to place itself more at the contract's service".

[224] - See Mokal Stanghellini and Tirado Paulus, « Best practices in European restructuring. Contractualised distress resolution in

protect the interests of stakeholders against potential abuses and expropriations.[225]

4.2. The still excessive role of the debtor under the Restructuring Directive

108. The final wording of the Directive suggests that in the mind of the European legislator, and in particular the Commission, "debtor in possession" proceedings are equivalent to proceedings benefitting the debtor, a shelter against its creditors, instead of simply being a more efficient way of dealing with the debtor's difficulties for the benefit of all stakeholders. Yet, the Directive also signals a salutary shift of decision-making power towards stakeholders.

4.2.1. The initiative to initiate proceedings

109. The initial draft proposed by the Commission provided that preventive proceedings would be accessible only at the request of debtors (article 4 (4)). Such a limitation was in no way justified from an economic point of view, if preventive restructurings were to better achieve the specific objectives of insolvency proceedings.[226] The OECD guide on insolvency proceedings, for example, clearly favors proceedings which can be opened at the request of creditors.[227]

110. Here again, the Council made a salutary amendment, adding as an option for national legislators the possibility of opening such proceedings at the request of creditors or employee representatives (article 4 (8)). Nevertheless, the debtor's agreement is still required, unless Member States opt to limit such requirement to SMEs.

111. Under current French law, preventive restructuring frameworks clearly rely on the idea that the debtor is the one in charge of organizing the negotiations, being the only one who could request the opening of conciliation proceedings and determining whom amongst its creditors to invite to the negotiation table.[228] The transposition of the Directive is, maybe, the occasion to change the French law in this regard. It should be noted, however, that following this path requires correlatively that a clear definition be provided for "likelihood of insolvency", so as not to open preventive proceedings against debtors who do not need it, thus upsetting their normal business conduct.

4.2.2. The right to propose a restructuring plan

112. The same apparent confusion, reflecting the diverging objectives pursued by the various drafters of the Directive, seems to explain the different options offered as to the right to propose restructuring plans.

113. The Commission's initial draft provided that only the debtor could propose a restructuring plan. Clearly, limiting the right to propose a plan to the debtor alone might give it leverage for an undue transfer of wealth to its benefit. This would be the case in particular where it appears necessary to transfer the business to creditors by converting their debt into equity, to the extent that the debtor could require a share for former shareholders before agreeing to propose a certain plan.[229] This would also limit the chances of finding the best restructuring solution, as the proposed plan would not be subject to competition from alternative plans.[230] The creditors would therefore be faced

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the shadow of the law » (CEDAM, 2018), 37, https://www.codire.eu/materials/: « Senior claimants have incentives to undervalue the business, since that enables them to claim a greater proportion of its postrestructuring value, whereas junior claimants have corresponding incentives to overvalue it »; on the difficulties related to the random nature of the valuation exercise, see Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 9.

225 - See Jennifer Payne, « The Role of the Court in Debt Restructuring », The Cambridge Law Journal 77, no 1 (March 2018): 124-50.

226 - See Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 5.

227 See McGowan and Andrews, « Design of Insolvency Regimes across Countries », 98: « Creditors are able to initiate restructuring. The possibility of starting restructuring procedures early is a key element of an efficient insolvency regime as delays can increase costs and reduce the likelihood of a successful restructuring (World Bank, 2015; Bricongne et al., 2016). As a result, non-viable firms are less likely to linger in the market and viable firms which encounter temporary financial distress are less likely to become impaired due to a lack of impetus to restructure. As the debtor may have incentives to delay restructuring, it is crucial to give the creditor the opportunity and the right incentives to initiate such procedures ».

228 See Le Corre, Droit and pratique des procédures collectives 2019/2020, 412 et seq.

229 - See Tollenaar, Pre-Insolvency proceedings, 209: « Requiring the debtor to propose a plan that respects pre-existing entitlements and the applicable order of priority, and thus (…) allocates all of the available value to the creditors and nothing to the equity, is like asking a 'turkey to vote for Christmas ». This is the reason why the possibility for creditors to propose a plan has been introduced in Chapter 11 proceedings, see Bankr Act Revision, Serial N° 27, part 3, Hearings on HR 31 and HR 32 before Subcomm On Civil and Constitutional Rights of the Comm On the Judiciary, 94th Cong., 1976, pages 1875-1876: "the take-it-or-leave-it attitude on the part of debtors as permitted by Chapter XI is fraught with potential abuse. Granting creditors a right to propose plans of reorganization and rehabilitation serves to eliminate the potential harm and disadvantages to creditors and democratizes the reorganization process."

230 - See Stephan Madaus, « Rescuing companies involved in insolvency proceedings with rescue plans » (NACIL Reports, 2013), 21: « As in this scenario the right solution to the business situation is still to be found, a competition of plans about the

with a suboptimal binary choice: accept the plan as proposed or reject it, without any possible improvement thereof.

114. It is therefore laudable that the Council has proposed an amendment in this respect. article 9 (1) now states that "Member States may also provide that creditors and practitioners in the field of restructuring have the right to submit restructuring plans and provide for conditions under which they may do so". This option, which corresponds partially to what is already provided for in French law since the infamous Coeur Défense case,[231] must be followed.

115. In fact, under the current French law applicable to conciliation proceedings, article L. 611-7 of the French Commercial Code provides that the mission of the restructuring practitioner (the conciliator) is to favor the conclusion of an agreement between the debtor and its main creditors in order to put an end to the difficulties of the company. The practitioner can, in this regard, present her own proposals and can be put in charge, upon the debtor's demand, of preparing a "pre-packaged" plan. In other words, the practitioner is in full charge of the negotiations, but only upon the debtor's request. In practice, the plans are negotiated with the main creditors, as their consent is necessary. In case the conciliation does not end in a unanimous consent and safeguard proceedings are opened (or, indeed, if no conciliation phase has been opened), article L. 626-30-2 of the French Commercial Code provides that the debtor shall present the restructuring plan. Creditors are also entitled to present a plan, but only to the restructuring practitioner, who subsequently decides, together with the debtor, whether to submit such plan to the vote of all the creditors (article R. 626-57-2 of the French Commercial Code).

116. The problem with the Directive, as with the current French law, is that creditors are not provided with sufficient access to information concerning the debtor's financial and operating status.[232] Without such access, creditors would be less able to provide an adequate plan to meet the debtor's difficulties. This is an unfortunate oversight, especially where a statutory moratorium is provided, and creditors' leverage of immediate enforcement actions is neutralized. Such an opacity might be exploited by debtors' management and shareholders and should be corrected in the transposition.

4.3. The increased role of creditors in the approval of restructuring plans

117. While the role of the debtor provided for by the Directive seems to serve divergent purposes, there is less doubt about the role of creditors. Indeed, the latter are called to vote, in accordance with the theoretical analysis provided in the first part of this paper, on the approval of the restructuring plans.

118. It is clear, however, that if the decision-making power is given to the creditors, a new tragedy of the anticommons may emerge. Indeed, when participation in the coordinated action requires the unanimous agreement of the creditors, some of them could be encouraged to adopt an extortion tactic, to draw a right of veto from this situation, in order to improve their recovery rate to the detriment of other creditors.[233] This could either lead to the rejection of a plan even if its adoption is in the interest of all stakeholders, or to an improper transfer of wealth to the wayward creditors. The question thus arises as to whether and to what extent it is economically justified to impose the plan despite the opposition of certain creditors.

4.3.1. Cram-down within a class of creditors

4.3.1.1. The economic justification for a decision with a reinforced majority

119. It seems quite reasonable for the participants in the hypothetical *ex ante* negotiations to provide for the possibility to proceed with a cram-down within a class of voting stakeholders. In so far as it allows

appropriate distribution of value and loss Seems favorable. The expenses of designing and negotiating a plan proposal should result in a very few cases of competing plans anyway. But as experiences under U.S. bankruptcy law suggest, it is effective to negotiate a debtor's plan proposal with a competing proposal of a creditors' group as it balances the level of negotiations ».

231 - See article L. 611-7 of the French Commercial Code for the conciliation proceedings and article L. 626-30-2 of the French Commercial Code for the safeguard proceedings. In the United States, any stakeholder may propose a plan after an initial exclusivity period (Section 1121 (b) US Bankruptcy Code). In the United Kingdom, creditors, shareholders and designated restructuring practitioners may propose a scheme of arrangement (section 896 (2) of the Companies Act 2006).

232 - See however the report funded by the Commission, Stanghellini and Paulus, « Best practices in European restructuring. Contractualised distress resolution in the shadow of the law », 123: « An issue that has consistently surfaced in the qualitative empirical study is the need for the debtor to present creditors with adequate information in order for them to be able to decide in an informed and timely manner ».

233 - See Baird and Rasmussen, « Antibankruptcy », 648. Tollenaar, Pre-Insolvency proceedings, 14: "if one or more creditors do not consent, the result will be a holdout position: they can try to leverage a higher proportionate share for their consent. That higher share is obtained at the expense of creditors that have given their consent, whose share is correspondingly reduced. Every creditor has an incentive to withhold consent, which may ultimately prevent the plan from coming into effect".

for the maximization of the value of debtors' assets in the interest of all creditors, this violation of the principle of *pacta sunt servanda* appears justified, provided, as we shall see below, that the interests of all stakeholders are truly safeguarded. Such a cram-down enhances the epistemic quality of the negotiation framework by suppressing unjustified holdouts.

120. A decision taken by a simple majority of the creditors, however, does not seem sufficient. A reinforced majority seems desirable. First, such a rule allows for a high degree of predictability to be maintained over the possible outcomes of the proceedings, to the extent that some creditors may be assured through *ex ante* discussions with other creditors that a majority would not emerge without their approval.[234] Second, our intuition is that a decision rule with a reinforced majority has sufficient epistemic value to alleviate the fears that the dissenting minority might actually be right.[235] In this respect, the argument is based on the idea that creditors are in the best position to identify what is truly in their interest. It follows that the reason dissenting creditors are bound when a majority votes in favor of the plan is that it is hoped that such approval actually shows that the creditors are adequately protected.

121. This last statement needs to be qualified. Indeed, it is obvious that creditors do not all have the same interests in all contexts. It is therefore perfectly conceivable that a group of creditors find it appropriate to impose a restructuring plan resulting in the expropriation of another group, if this is possible. This danger is perfectly perceptible behind the veil of ignorance of hypothetical *ex ante* negotiations. A decision imposed according to democratic rules, that is to say by a majority, is justified only to the extent that those voting have aligned interests. Two lessons follow. First, creditors who are not affected by the decision should not vote because their interests are not aligned with anyone else's. Note that the valuation decision needed to determine whether or not certain creditors are affected can obviously not be taken in a democratic manner. This is one of the fundamental roles of the judge. Next, those stakeholders who have an interest in the vote must vote within classes of stakeholders whose situations are sufficiently similar for their interests to be aligned. It is a *sine qua non* condition for a majority decision to be truly an indication of the plan being in the interest of the class in question.

4.3.1.2. Class voting under the Restructuring Directive

122. The European legislators have tried to draw lessons from the considerations just described, but the result is perfectible.[236]

4.3.1.2.1. Voting only by the affected parties

123. First, not all stakeholders are invited to vote on the approval of the proposed plan, but only those that would be affected by its effects (article 9(2)). Such a limitation is justified to the extent that those affected are the most likely to appreciate the value of the proposed plan. Correlatively, if a stakeholder is not invited to vote, it should not be affected by the plan.[237]

124. Some optional exceptions are nevertheless provided for (article 9(3)). Two of these exceptions, the one on super-subordinated creditors[238] and the

[234] - See Tollenaar, Pre-Insolvency proceedings, 86.

[235] - See on the epistemic conditions that must be satisfied to justify such hope, David M. Estlund, Democratic Authority (Princeton University Press, 2007); Cass R. Sunstein, Infotopia: How Many Minds Produce Knowledge (Oxford, New York: Oxford University Press, 2006).

[236] - See article 9(6) : "A restructuring plan shall be adopted by affected parties, provided that a majority in the amount of their claims or interests is obtained in each class. Member States may, in addition, require that a majority in the number of affected parties is obtained in each class". It should be noted, however, the curious option left by article 10 (3) to national legislators to provide that the judicial authority may " refuse to confirm a restructuring plan where that plan would not have a reasonable prospect of preventing the insolvency of the debtor or ensuring the viability of the business". One wonders why the judge would be better equipped than a majority of creditors to determine that a plan is not justified.

[237] - French law currently provides that the judge adopting the safeguard plan must ensure that the interests of all creditors are sufficiently protected. This includes both creditors who are committee members but opposed to the proposed plan and non-committee creditors. The same applies in the case of a judicial approval of a conciliation agreement, which must not affect the interests of non-signatory creditors. On these "very vague" protections, see Lienhard, Procédures collectives 2019-2020, n° 82.41.

[238] - See in France, Pierre-Michel Le Corre, « Porteurs de titres super-subordonnés and élaboration des plans de sauvegarde ou de redressement avec comités », D., 2010, chron. 839; Nicolas Borga, « Titres super-subordonnés and plan de sauvegarde », Bull. Joly Entrep. diff., no 6 (2010): 604, who notes: « If the super-subordinated securities correspond to previous receivables this was not sufficient to justify that the holders obtain voting rights proportional to the nominal debt in the meeting of bondholders. Holders of TSS are similar, like the creditors of equity loans, to creditors known as "hypo unsecured". To treat these claims within the safeguard plan is inconceivable. In fact, since their payment can only be made after that of other creditors, even unsecured ones, to make them benefit from the conditions of payment contained in the plan would be to offer them, unfairly, a right to payment which would normally be denied to them. It was therefore impossible to grant holders of TSS voting rights commensurate with the nominal amount of the bond, since this would have led to granting them political weight such as enabling them to weigh-in decisively on the content of the plan while knowing themselves to be "immune" regarding the nominal debt". On the treatment of subordinations of conventional claims

one on parties in conflict of interest, seem entirely justified in that they exclude from the vote parties who are subject to incentives running contrary to the common interest, their judgment having no epistemic value.[239] This is somewhat similar to what is provided for by article L. 626-30-2 of the French Commercial Code, which requires all creditors in case of safeguard proceedings to inform the restructuring practitioner of the existence of any convention subjecting their vote to some conditions or resulting in their claim being partially satisfied in case of default. Subsequently, the practitioner may choose to apply voting rights adjustments to such creditors.

125. This is for instance the case of "hyper unsecured" creditors, meaning those "whose claims rank below the claims of ordinary unsecured creditors" (article 9(3)(b)), who are sometimes excluded from the set of voting creditors under current French practice.[240]

126. The situation is less clear concerning the case of creditors benefiting from CDSs, who have an interest in the debtor being in default even if a restructuring gain can be secured in the long term if an efficient restructuring takes place.[241] In fact, such creditors cannot be excluded from the vote on the basis of article 9(3)(c) of the Restructuring Directive, insofar as it refers to related parties. Two other bases come to the rescue. Where the CDS is activated not only in case of default, but also where preventive restructuring proceedings are opened, the creditors could be excluded from the vote as not being affected by the plan (article 9(2)). Where they have an active interest for the plan *not* to be adopted in order for the CDS to come into play, reference should be made to recital 47, which states (this being a late addition by the Council) that "Member States should be able to lay down rules in relation to affected parties with a right to vote which do not exercise that right in a correct manner". This reference to "correct manner", which is by itself troubling, should be enough to allow national legislators to exclude from voting the creditors currently referred to under article L. 626-30-2, paragraph 4, of the French Commercial Code.

127. The situation of shareholders should also be mentioned. Under current French law shareholders are required to vote during a shareholders' general meeting on the adoption of any plan involving a change to the company's share capital (L. 626-3 and L. 626-31 of the French Commercial Code), which leads, as we shall see, to some undue transfers of wealth. The Directive provides in this regard an option to exclude from the vote of the plan the shareholders, in which case they should simply be prevented from unreasonably precluding its adoption. Such an exclusion would preclude subjecting them to a cross-class cram-down. As we will explain in a latter part of this paper, it seems to us that this would be unfortunate.

4.3.1.2.2. The vote within classes of affected stakeholders

128. Next, article 9(4) provides that the vote by the stakeholders would take place within "separate classes which reflect sufficient commonality of interest". Following the models of the US Chapter 11, the UK Schemes of Arrangement and the German single insolvency proceedings, the European legislator thus introduces a major innovation, at least from the standpoint of current French law, that is fully in line with our analysis.

129. Of course, French law doesn't ignore the distinction between secured and unsecured creditors.[242] For instance, article L. 621-10 of the French Commercial Code provides that where several controllers are designated amongst creditors during safeguard proceedings, at least one should be secured and another one unsecured. It appears, therefore, that the potential conflict of interests between the two types of creditors is acknowledged in this regard. Nevertheless, the same observation has not been transposed to the rules organizing the vote of restructuring plans. Indeed, current French law provides, contrary to any common sense, that any safeguard plan must be voted on by creditors organized in three separate bodies: the credit institutions' committee, the main suppliers' committee and, where appropriate, a single general meeting of bondholders

in French insolvency proceedings, See Mathias Houssin, La subordination de créance (Lgdj, 2018).

239 - See Tollenaar, Pre-Insolvency proceedings, 90: « in order to safeguard the binding authority of democratic decision-making, the courts must have the power to discard the voting of a creditor in circumstances where that creditor's voting behaviour is predominantly diven by individual interests that are not representative of, or may even run couter to, the interests of the class ».

240 See Pierre-Michel Le Corre, « Porteurs de titres super-subordonnés and élaboration des plans de sauvegarde ou de redressement avec comités », *D.*, 2010, chron. 839; Nicolas Borga, « Titres super-subordonnés and plan de sauvegarde », *Bull. Joly Entrep. diff.*, nº 6 (2010): 604.

241 - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 14, who note regarding the Technicolor case: "The restructuring of Technicolor also poses the problem of the treatment of CDS and the security they offer to creditors. Granting the right to approve the plan only to creditors whose assets would be affected by the issue of the reorganization, would undoubtedly neutralize these conflicts of interest".

242 See Houssin, *La subordination de créance*, 347 et seq.

(which is *de facto* a third committee). No attention is given to the imperative of ensuring homogeneity of interests in the deliberative bodies, with senior and junior, privileged and unsecured creditors finding themselves haphazardly in the same committees. The French legislator has sought to find a solution by allowing the restructuring practitioner to modulate the voting rights of creditors in a committee according to their guarantees or eventual subordination agreements (article L. 626-30-2, paragraph 2 of the French Commercial Code). However, the absence of objective criteria for such a modulation gives rise to great legal uncertainty and explains why in practice this possibility is seldom used. [243]

130. Unsurprisingly, the current system leads to countless abuses, as evidenced by the recent CGG case. In this case, several holders of bonds convertible into new or existing shares ("OCEANE") contested the preferential treatment afforded to the holders of NY law high yield bonds by the plan approved during CGG's safeguard proceedings. The two groups of bondholders had obviously diverging interests but were grouped in the same general meeting of bondholders, where the OCEANE holders were a minority. By a decision from 17th of May 2018, the Paris Court of Appeals decided that the OCEANE holders could not contest the substance of the adopted plan, their only hope being that of proving the existence of an abuse of majority powers.[244] An appeal to the *Cour de cassation* has recently been filed.

131. From this point of view, the transposition of this provision into French law will lead to a revolution long called for by a large part of the French restructuring community,[245] insofar as the approach of organizing the vote depending on the creditors' quality will finally be abandoned in favor of focusing on creditors' interests.

132. It should be noted, however, that article 9(4) provides that national legislators may exempt SMEs from the obligation to have creditors vote in separate classes. It seems to us that such an exception must not be granted. Indeed, the problem is that some creditor protections, to which we will return, only apply where a cross-class cram-down occurs. This is particularly the case with the analysis of the plan with respect to the priority rules provided for in article 11(1). In this respect, such an exception could lead to a breach of these protections, essential from an economic analysis standpoint, if some creditors are crushed by a majority whose interests are substantially divergent from their own. Basically, this would amount to allowing for the same abuses as those identified in current French law and brought to light by the CGG case raised earlier.

4.3.1.2.3. Class distribution criteria

4.3.1.2.3.1. The need for objective but flexible criteria

133. It remains to be determined, however, what criteria will allow creditors to be divided into different classes. The text of the Directive does not give much guidance on this subject. It is only specified that the allocation must be pursuant to a "sufficient commonality of interest based on verifiable criteria" and that secured and unsecured creditors must be placed in separate classes. The determination of the adequate criteria has been the object of heated debates in countries where such systems already exist, [246] so that a thorough study seems to be required before any transposition of the Directive. For our purposes, however, several observations can be made.

134. First, it seems necessary to provide sufficient flexibility to constitute truly homogeneous classes, whose members share both the same legal situation and the same treatment in accordance with the terms of the proposed plan.[247] In fact, nothing

[243] - See Reinhard Dammann and Gilles Podeur, « Le rééquilibrage des pouvoirs au profit des créanciers résultat de l'ordonnance du 12 March 2014 », D., 2014, 752; See also, Gabriel Archibald, « Valorisation de la société and droits de vote au sein des comités de créanciers », Bull. Joly Entrep. diff., 2018, 232.

[244] - See Dammann, « L'introduction des classes de créanciers dans l'optique d'une harmonisation franco-allemande des procédures d'insolvabilité », 226.

[245] - See speaking of a French system which artificially puts on an equal footing creditor whose interests diverge, Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? »; See also on the abuses arising from the current French system and an explanation of the German system, Reinhard Dammann, « L'introduction des classes de créanciers dans l'optique d'une harmonisation franco-allemande des procédures d'insolvabilité », in Mélanges Claude Witz (LexisNexis, 2018), 920.

[246] - SEE Scott F. Norberg, « Classification of Claims under Chapter 11 of the Bankruptcy Code: The Fallacy of Interest Based Classification », American Bankruptcy Law Journal 69 (1995): 119; Bruce Markell, « Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification », Bankruptcy Developments Journal 11 (1995): 1; For an exhibition of the German system, which gives great flexibility to insolvency practitioners, see Dammann, « L'introduction des classes de créanciers dans l'optique d'une harmonisation franco-allemande des procédures d'insolvabilité ».

[247] - See stressing the need to fulfill both conditions, Tollenaar, Pre-Insolvency proceedings, 87; note that creditors whose claims are secured in part only by security must belong both to the class of creditors with the same security, for the secured part of their debt, and to the class of unsecured creditors, for the unsecured part. SEE Tollenaar, 94: « The voting behaviour of a secured creditor with a relatively large collateral shortfall could be driven to a significant extent by the treatment of the unsecured part of its claim ».

in the Directive prevents treating creditors differently even where they are in fact in the same legal situation, as article 10 (2) (b) only provides that "creditors with sufficient commonality of interest *in the same class* are treated equally, and in a manner proportionate to their claim".

135. Second, this flexibility should not be seen as a *carte blanche* to ensure that the required majority will be achieved. Such gerrymandering would be contrary to the epistemic rationale for class voting, that is, the idea that a plan approved by a sufficiently high majority within a class of stakeholders whose interests are similar is not likely to adversely affect the interests of the dissenting minority.[248]

136. Finally, too great a flexibility could end up rendering inapplicable some of the protections afforded by the Directive to creditors' interests. For instance, in case of a cross-class cram-down, the court should make sure not only that the protections given in articles 10(2) and 10(3) (i.e. the adequacy of class formation and, where the plan is contested, the best interest of creditors' test), but also that the plan respects the priority rules and that no class gets to receive or keep more than the value of its claims (articles 11(c) and 11(d)). It would suffice, if class formation criteria were too flexible, to create classes so that a majority within each class is achieved in order to circumvent such additional, and necessary, safeguards.

4.3.1.2.3.2. The need for predictable criteria

137. Another fundamental aspect of the distribution of creditors into classes is, unfortunately, lacking in the text of article 9: the predictability of the criteria used for such purposes. This is an important inadequacy of the Directive, which French law must not reproduce.[249]

138. In fact, the actual vote is only a last resort and is not intended to occur in most cases. Rather, the debtor and its creditors negotiate "in the shadow" of what is foreseeable if a vote were to take place.[250] In this respect, the class distribution rules determine the respective "weights" of the stakeholders in the negotiations. They also allow creditors to predict to a certain extent what would happen if the debtor encountered difficulties. The definition of clear and predictable criteria is therefore fundamental, both to reduce the risk of *ex ante* credit and to facilitate negotiations by clarifying the respective weights of the different stakeholders.

139. This observation further implies that the division of creditors into separate classes should take place well in advance of the vote, as soon as the proceedings are initiated. It is indeed unimaginable that creditors could negotiate without being able to guess whether the necessary majorities are acquired for a particular proposal. This implies, as we will see, that it is desirable to systematically designate a restructuring practitioner and to determine the final division of creditors into classes, as well as to put an end to the valuation wars, as soon as practically possible.

4.4. Cross-class cram-down

140. What happens if some classes of creditors vote against a proposed plan? In this respect, the Restructuring Directive brings a very important innovation, the cross-class cram-down, which is beneficial in certain cases and economically justified if certain safeguards are put in place.

4.4.1. The economic justification for a cross-class cram-down

4.4.1.1. The necessity of a cross-class cram-down

141. It seems reasonable for the hypothetical *ex ante* negotiators, concerned with protecting the interests of all creditor groups, to be suspicious of a plan that has not been approved by all classes of creditors. The fact that a class, or even a majority of classes, has approved the proposed plan does not guarantee anything with regard to the adequate protection of the interests of the dissenting classes. The interests of the latter are, in virtue of the very principle of division into distinct classes, not exactly aligned with those of the other classes. A majority of classes may very well decide to expropriate a dissenting minority without itself suffering the consequences. Such a scenario is cer-

[248] - See for a critique in this sense in the context of Chapter 11, Peter E. Meltzer, « Disenfranchising the Dissenting Creditor through Artificial Classification or Artificial Impairment », American Bankruptcy Law Journal 66 (1992): 281-322; Markell, « Clueless on Classification ».

[249] - This omission by the European legislator is all the less acceptable as recitals 15 and 85 make it clear that legal certainty and predictability of the treatment of creditors in insolvency proceedings is necessary to promote the financing of European companies. The explanation of this oversight is undoubtedly in the will of some drafters to allow the definition of classes according to the needs of the cause, to "save" a company even if the creditors oppose it, which is a reliable sign to consider that the business is not viable.

[250] - See the classic, Robert Mnookin and Lewis Kornhauser, « Bargaining in the Shadow of the Law: The Case of Divorce », Yale Law Journal 88, no 5 (1 Jan. 1979); Sarah Paterson, « Bargaining in financial restructuring: market norms, legal rights and regulatory standards », Journal of Corporate Law Studies, 2014, 338: « All financial restructuring negotiations happen in the shadow of insolvency law ».

tainly to be avoided if the functional CBT theory is to be accepted.

142. This does not mean, however, that a cross-class cram-down would never be acceptable. As we have said, the majority vote is only a safeguard against abusive decisions, but it is not the only one. It seems reasonable to us to accept that a plan could be imposed as long as it ensures the maximization of the value of the debtor's assets, in the interests of all the stakeholders, and that the interests of none of them are unjustifiably sacrificed. If this possibility of a cross-class cram-down were not available, classes of creditors would have effective leverage to unduly limit their losses to the detriment of the classes for which the adoption of the plan is more important (for example because they have a lower tolerance for losses).[251] It follows that the rejection of the plan by a class of creditors must not preclude its adoption, as long as other safeguards against the unfair treatment of recalcitrant creditors, to which we will return, offer sufficient protection.

4.4.1.2. The particular case of a forced conversion of debt into equity

143. Some extra caution is warranted with respect to forced conversions of debt into equity. This decision is not trivial. Even if one considers that the value of the financial instruments allocated in case of such conversion is equivalent to that of the converted claims, this alternative payment is not a perfect substitute for cash payment.[252]

144. Indeed, the form of the final payment, and in particular its liquidity and expected level of risk, is an essential element for creditors in their decision to contract with the debtor. These elements are reflected in the cost of financing because creditors anticipate, in their decision, the moment when their exposure to the risks of the financed business will halt and the provided capital may be used for other purposes.[253] In the absence of a sufficiently liquid secondary market on which creditors could swiftly sell the instruments they are allocated, without suffering any significant discount, any payment in an alternative form actually forces creditors to continue financing the company against their will and their initial forecasts.[254]

145. Some authors consider that such a breach of creditors' rights would never be justified under the CBT.[255] This is also the position of the the Dutch legislator, who provided that a cross-class cram-down can only take place under the new Dutch preventive proceedings if dissenting classes entitled to cash payments are granted such payments.[256]

146. We do not share this position. It seems reasonable for the hypothetical *ex ante* negotiators, in anticipation of the possible lock-down situation, to admit such a breach when it is strictly necessary. Such a position could find some support in the classical theory of Calabresi and Malamed, who note that two ways of protecting an interest exist: according to the rules of ownership (in the broad sense, not legal), and by rules of responsibility. In a recent article, Buccola emphasizes that it is reasonable to envisage metarules to move from one form of protection to another when monopoly situations prevent the consensual emergence of an efficient solution. This is the case, for example, in the absence of alternative financing when a creditor threatens to withdraw its financing, even if the continued operation of the company is the best solution in the circumstances. To avoid undue

[251] - See highlighting a classic critique of English schemes of arrangement, McCormack and Wan, « Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's Restructuring and Insolvency Laws », 9: « there is no ability to cram-down a dissenting class of creditors in a scheme of arrangement. This results in an excessive emphasis on the classification of creditors, with the result that creditors placed in a different class tend to bargain for excessive rights ».

[252] - See for a critique of the conversion imposed on minority creditors in a committee with respect to current French law, Serge Pelletier and Constance Verroust-Valliot, « Comités de créanciers : la loi de la majorité peut-elle vraiment imposer des conversions forcées de créances aux minoritaires ? », ReSee proc. coll., 2017, étude n°10, who note in particular that violations of property rights, the right not to contract and the principle of affectio societatis could be raised. In our opinion, however, it is a breach of these rights that would be accepted in the context of a hypothetical *ex ante* negotiation between the stakeholders.

[253] - Any alternative payment increases the creditor's risk exposure, which should have resulted in additional cost to the debtor if the extension could be anticipated. Yakov Amihud and Haim Mendelson, « Liquidity, Asset Prices and Financial Policy », Financial Analysts Journal 47, no 6 (novembre 1991): 56: "Risk adverse investors require higher expected returns to compensate for greater risk. Similarly, investors prefer to commit capital to liquid investments, swhich can be traded quickly and at low cost whenever the need arises".

[254] - In that regard, Jackson and Baird's argument that a payment in the form of alternative financial instruments of a value equal to the expected payment is entirely satisfactory cannot be followed. As they themselves acknowledge, this would only be the case if the creditors did indeed have the possibility of immediately selling the financial instruments so allocated to recover the full value of their claim. Baird and Jackson, « Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy », 120.

[255] - Tollenaar, Pre-Insolvency proceedings, 31 et seq., 155 et seq., 236 et seq.

[256] - See Clifford Chance client memo, Revised Draft "Dutch Scheme (WCO II)", 2017.

extortions of value by this holdout behavior, a shift to liability rules seems warranted. [257]

147. The possibility of such a forced conversion makes it possible to safeguard the added value of a restructuring, that could otherwise be destroyed in the event of an unreasonable refusal by certain classes of creditors to receive an alternative payment. Indeed, in some cases an immediate cash payment could only be secured by an isolated sale of the debtor's assets, which could jeopardize the subsequent viability of its business following the restructuring. Senior creditors who have a right to cash payment would thus be granted a *de facto* veto right over the restructuring plan, which contradicts the very purpose of cross-class cram-downs.

148. Moreover, such a possibility of forced conversion could enhance the credit providers' accountability. In fact, their credit decisions create externalities, that is to say they affect third parties as well as the economy in general.[258] It seems reasonable, therefore, that these creditors be encouraged to carry out a real analysis of the debtor's projects before granting the requested facility. In post-crisis regulation, this need is reflected in the principle of retention of part of the risk by credit institutions (the so called "skin in the game").[259] Additionally, it has long been noted that the possibility of losing part of the value of the claim in case of restructuring or insolvency proceedings plays a disciplining role, insofar as creditors could exert a certain control over each other's behavior by threatening to cause such a loss to all the stakeholders involved.[260] In this regard, if it were unthinkable that, in certain circumstances, an alternative payment could be forced upon such creditors, their incentive to make sure that the credit is indeed justified and that the funded project is viable would surely be lessened.

149. However, in order for such a forced conversion of debt into equity to be justified, it is not sufficient that the creditors receive a value equivalent to that of their cash claim. It is still necessary that the conversion be really necessary, that is to say that it is not possible to remedy the absence of a third party willing to buy the debtor's business as a going concern and thus provide an immediate exit to the existing creditors. This is not the case if the absence of a buyer is due to inefficiencies created by the rules of the preventive proceedings themselves. For example, the conciliation proceedings in France, which have overly strict confidentiality rules, as we will see, prevent the emergence of a sufficiently developed secondary debt market.[261] If the creditor's cash payment can be secured by a change in this type of rule, forcing the creditor to continue financing the company through a forced conversion of its debt into equity appears to be a disproportionate breach of its rights. In our view, it would not be justified under the functional CBT.

4.4.2. Cross-class cram-downs under the Restructuring Directive

150. In view of what has just been stated, article 11 of the Restructuring Directive, which deals with cross-class cram-downs, introduces a major and welcome innovation.[262]

4.4.2.1. The two models of forced cross-class cram-down

151. Two models of forced cross-class cram-down served as inspiration for the European legislator.

152. The Commission's initial draft followed the Chapter 11 model, requiring that the plan be approved by at least a class other than the shareholders and those who, on the basis of a going concern valuation, that is to say, a

257 - See Buccola, « Bankruptcy's Cathedral »; See also the classic Guido Calabresi and A Douglas Melamed, « Property Rules, Liability Rules, and Inalienability: One View of the Cathedral », Harvard Law Review 85, no 6 (1972): 1089; For a more recent study, see Ian Ayres and Eric Talley, « Solomonic Bargaining : Dividing a Legal Entitlement to Facilitate Coasean Trade », Yale Law Journal 104 (1995): 1027; Ilya Segal and Michael D Whinston, « The Efficiency of Bargaining under Divided Entitlements », The University of Chicago Law Review 81 (2014): 273.

258 - See Emre Ozdenoren and Kathy Yuan, « Contractual Externalities and Systemic Risk », The Review of Economic Studies 84, no 4 (1 Oct. 2017): 1789-1817;; Zhiguo He and Péter Kondor, « Inefficient Investment Waves », Econometrica 84, no 2 (2016): 735-80;; Javier Bianchi, « Credit Externalities: Macroeconomic Effects and Policy Implications », American Economic Review 100, no 2 (mai 2010): 398-402.

259 - See Rosa Lastra, « Systemic Risk and Macro-Prudential Supervision », The Oxford Handbook of Financial Regulation, 1 Aug. 2015.

260 See Anthony J. Casey and Douglas G Baird, « No Exit? Withdrawal Rights and the Law of Corporate Reorganizations », Columbia Law Review 9, no 1 (2013): 113.

261 - See Sophie Vermeille, « Les effets pervers de la règle absolue de confidentialité applicable durant les procédures de prévention des difficultés. Plaidoyer à l'attention du législateur and des tribunaux en faveur de plus de transparence », RTDF, no 4 (2018): 27: "the confidentiality of amicable proceedings increases the cost of credit by limiting the efficiency of the secondary debt market and hinders the competition of new money introducers just as it leads to the misuse of the privilege attached to it, in violation of the rights of third parties".

262 - article 11(1) : "Member States shall ensure that a restructuring plan which is not approved by affected parties, as provided for in article 9(6), in every voting class, may be confirmed by a judicial or administrative authority upon the proposal of a debtor or with the debtor's agreement, and become binding upon dissenting voting classes where the restructuring plan fulfils at least the following conditions …".

hypothetical transfer of the business kept operational, would not be entitled to any payment in the event of liquidation. In other words, the plan must be approved by a class which is "in the money" and situated "where the value breaks". In theory, this is an efficient rule, as the interests of this class of creditors are, in principle, aligned with those of all stakeholders, because they benefit from all the gains and suffer all the losses of the decision to be taken. In practice, however, such a system encourages a war of valuations between classes of creditors.[263] In fact, depending on the valuation of the debtors' business, some classes may alternatively be in or out of the money. This exercise is all the more risky because valuation is done on a going concern basis, the difficulty of which has already been mentioned.[264] If this proves to be complicated even in the United States, where judges have significant experience with these types of valuations, it is not difficult to imagine the uncertainty it is likely to give rise to in European jurisdictions, which are not used to such valuations.[265]

153. In response to criticism from some Member States, the Council introduced into the text of the Directive a second model of cross-class cram-down, inspired by the German model. Article 11(1)(b) thus provides that the plan must at least be approved by "a majority of the voting classes of affected parties", "provided that at least one of those classes is a secured creditors class or is senior to the ordinary unsecured creditors class". This rule has at least the merit of ease and predictability.[266] One could also hope that the aggregation of the views of a majority in favor of the approval of the plan, including a class of secured creditors (who are supposed to be, *a priori* at least, "in the money" and thus interested in identifying cases where restructurings are justified), should ensure that the approved plan respects the interests of all stakeholders. This model does not preclude, however, a majority of classes of creditors from voting in their common interest but contrary to the interest of a dissident class, which explains the need to provide for effective protections of creditors by fair treatment rules and respect for the order of priorities.

154. The relationship between the two alternative systems (as stated in article 11(a)(b)) shows, if it still had to be proved, that the European legislator intends, unfortunately, to promote as much as possible the adoption of restructuring plans, even if a majority of creditors oppose it. Indeed, in the absence of an approval by a majority of classes of creditors according to the "German" inspired system, we go back to the Chapter 11 inspired system. Everything is done in order for the plan to go through. The divergent views of the drafters of the Directive are crystal clear in this regard, as the more reasonable (for European purposes) "German" approach is immediately forgotten if a majority does not exist. Consequently, the aforementioned uncertainties related to the going concern valuations do not disappear, for creditors will still have to undergo such valuations in order to assess the likelihood that one plan or another could be forcibly adopted despite their potential disapproval. It remains to be hoped that national courts will not understand this alternation between the two cross-class cram-down systems as yet another proof that they need to make sure that the restructuring plan gets through at all costs in order to save the company in the short term, even where it is not viable in the long run.[267]

4.4.2.2. The shareholders, a class like any other

155. Another major innovation of the Directive, which should be welcomed, is the facilitation of debt equity swaps by treating shareholders as a class of creditors in their own right. Where the debtor encounters significant financial difficulties, its shareholders are often "out of the money" from an economic point of view. They have nothing to lose and should be the first ones to absorb the losses, their place being taken by other creditors through a conversion of debt into equity. Such a conversion is very popular in restructuring practices in the United States[268] and, as we have already pointed out, has significant economic and financial benefits.

263 - See, explaining that junior creditors are incentivised to overvalue while senior creditors are incentivised to undervalue the company , Stanghellini and Paulus, « Best practices in European restructuring. Contractualised distress resolution in the shadow of the law », 37.

264 - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 9.

265 - See Gurrea-Martínez, « The Future of Reorganization Proceedings in the Era of Pre-Insolvency Law », 14.

266 - See for a study of the German system, Dammann, « L'introduction des classes de créanciers dans l'optique d'une harmonisation franco-allemande des procédures d'insolvabilité ».

267 - See the report funded by the Commission, Stanghellini and Paulus, « Best practices in European restructuring. Contractualised distress resolution in the shadow of the law », 34: « There is no reason to believe that a plan that has failed to obtain requisite creditor majorities would permit the business to continue, nor that it would allocate the value in the estate fairly, i.e. respectfully of legal rights, duly informed by debtor-specific knowledge, and in a cost-effective manner ».

268 - See Lucian Arye Bebchuk, « A New Approach to Corporate Reorganizations », Harvard Law Review 101, no 4 (1988): 775-804.

156. Yet from a legal point of view, shareholders have, at least in France, a *de facto* veto right over this type of restructuring plans, which requires a reduction to zero of the nominal capital followed by an immediate capital increase paid for by a conversion of the debts into equity (what has come to be called in France a "*coup d'accordéon*"), or simple a sale of their shares. As we have noted, both types of measures require the shareholders' approval,[269] which gives them enough leverage to cause an undue transfer of wealth to the detriment of their creditors (as they need to be paid off before agreeing to such measures).[270]

157. In this respect, the Directive offers a salutary innovation. Under article 12(1), shareholders may be treated as a class of creditors, therefore being subject to articles 9 to 11. In this case, a compulsory cross-class cram-down would be fully possible in their regard, even where the plan provides for a debt equity swap.[271] It should be noted, in this respect, that when shareholders vote on the plan, they do so precisely within a *class* as provided for by the Restructuring Directive, and not in a general shareholders' meeting, within the meaning of corporate law. Therefore, the special rules for class votes apply, including the required majorities and the protections afforded by the Directive (e.g. the "best interest of creditors test" and the priority rules).

158. Alternatively, legislators may choose to simply ensure "by other means that those equity holders are not allowed to unreasonably prevent or create obstacles to the adoption and confirmation of a restructuring plan". It is difficult to understand what these alternative means could be.[272] In addition, this option has the disadvantage of exempting the shareholders from the application of the rules relating to the order of loss absorption provided for in the Directive.[273]

159. The possibility of treating shareholders as a class of creditors should therefore be preferred. It enacts, in our view, a significant paradigm shift in European private law. This innovation is based on the implicit but necessary recognition of the concept of capital structure, whereby there is no fundamental difference between creditors and shareholders beyond their respective ranks of payment and loss absorption.[274]

160. In order to measure the importance of the conceptual disruption of traditional categories of European private law likely to be caused by such a shift, it suffices to remember why the conversion of debt into equity, allowed for under very strict conditions in France by the "Macron" law of 2015, had to be limited to the judicial recovery proceedings (*procédure de redressement judiciaire*) and was excluded for safeguard proceedings.[275] In fact, the *Conseil d'État*, consulted in this respect of the draft proposal, refused to accept that such a conversion could take place before the debtor's formal suspension of payments (i.e. during a safeguard proceedings), relying on the idea that a fundamental difference exists between the constitutional protection granted to the shareholders' property rights and that granted to the creditors' property rights.[276] If the conceptual space opened by the Restructuring Directive is fully embraced, no difference should remain in this respect between the

269 - Under current law, the general meeting of shareholders voting under the plan remains sovereign and could very well reject it. See Cass. com., 15 Jan. 1991, n° 89-15822: Bull. civ. IV, n° 27, BJS 1991, p. 425, note P. Le Cannu, holding that the refusal of the general meeting to authorize an amendment to the articles of association provided for in the plan cannot give rise to compulsory execution in kind but is only a cause for the resolution of the plan. At the most, the court determining the safeguard plan may, under article L. 626-16 of the French Commercial Code, mandate the receiver to convene a general meeting, and decide that the special majority rules provided for in article L. 626-16-1 of the French Commercial Code (majority of the votes of shareholders present or represented) will be applicable by derogation from the common rules governing shareholders' meetings. On these issues, see Le Corre, Droit and pratique des procédures collectives 2019/2020, n° 515.22.

270 - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 11: "This state of the law engenders a paradoxical situation in which the voting right of the shareholders is called to be monetised, even though the value of the securities to which it is attached is equal to zero".

271 - We have pointed above to the unfortunate misunderstandings that will prevent the application of such a solution to SMEs.

272 - See Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 5: « Parties may not act unreasonably generally. article 12 does not Seem to add anything to this general rule and appears superfulous ».

273 - This is the case in Italian law, where a rule of absolute priority exists, but case law considers that it does not apply to shareholders as they are not treated as a class in their own right.

274 - See recitals 2 and 45.

275 - See article L. 631-19-2 of the French Commercial Code. See on this article, Blanc, D. 2015. Chron. 2460 ; Roussel Galle, ReSee sociétés 2015. 636 ; Cerati-Gauthier, JCP E 2015. 1461 ; Dammann and F.-X. Lucas, BJS 2015. 521 ; Parachkévova, BJS 2015. 529 ; Teboul, LPA 22 oct. 2015 ; Degenhardt, BJE 2015. 432 ; Bourbouloux and Fort, BJE 2016. 287.

276 - See for a commentary on this aspect of the Macron law, as well as for a critique of the different treatment regarding the respective property rights of the shareholders and creditors, Jérémy Martinez and Sophie Vermeille, « Quand la constitution s'en mêle. Le respect des droits de propriété respectifs des créanciers and des actionnaires dans les entreprises en difficulté : une question de survie », RTDF, no 2 (2014): 35.

two types of providers of corporate finance.[277] The limits of this shift will most likely be tested before the French Constitutional Court when the Directive is transposed.[278] We have explained in other publications why the French Constitutional Court should be more sensitive to economic considerations and take the step that the *Conseil d'Etat* did not want to take.[279] At the very least, it should recognize that the constitutional protection of the creditors' property rights is as strong as that granted to the shareholders' property rights.

161. In any case, it remains to be seen how the transposition of the Directive will be articulated with the AMF's unofficial (and ungrounded) practice of systematically requiring, in cases of restructurings of listed companies, that shareholders be allocated between 5% and 10% of the value generated by the restructuring.

4.4.2.3. The appointment of a restructuring practitioner

162. The framework proposed by the Restructuring Directive is built on a DIP model, where the debtor is not dispossessed of the day-to-day management of the company.[280] The European legislator seems to conclude that it is up to the debtor to organize negotiations with its main creditors, which is supposed to keep down the costs of such proceedings and avoid unnecessary disruptions of the debtor's day-to-day operations.[281] The default rule in article 5 is, therefore, that no restructuring practitioner should in principle be appointed. Nevertheless, article 5(3) provides that a practitioner must be appointed in certain cases, in particular "(b) where the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down".

163. Such a concatenation of the default rule and its exception is only understandable, in our view, in a system whose purpose is to push through a plan at any cost rather than organize the right conditions of negotiation between creditors. In this case, being able to allocate creditors in classes according to very flexible criteria, and, above all, doing so at the very last moment, according to the practical needs of the case, can prove to be a valuable tool in the hands of the debtor.[282]

164. On the other hand, if the purpose of the preventive proceedings is rather to facilitate negotiations among creditors in the interest of all stakeholders (as required by a law and economics approach), it must be borne in mind that negotiations always takes place in the shadow of what is likely to happen if there were no unanimous agreement. The possibility of a cross-class cram-down is therefore part of the bargaining array from the first day of negotiations. Accordingly, a restructuring practitioner, who should in principle be responsible for the distribution of creditors into separate classes if a cross-class cram-down proved to be necessary, should systematically be appointed, in order to inform the creditors as soon as possible of their potential distribution.[283] In this respect, it seems desirable to make use of the option opened by article 5(2) and to provide for a systematic appointment of restructuring practitioners.[284] The

[277] - See noting that shareholders are no longer an impregnable fortress, Lucas and Porrachia, « L'expropriation de l'associé qui ne finance pas la restructuration de la société en redressement judiciaire ». On the irruption of the notion of economic property of the company in French insolvency law, See Francois-Xavier Lucas, « Le traitement des difficultés de l'entreprise à l'épreuve des droits de l'actionnaire : propriété économique and propriété juridique, qui doit financer la restructuration ? », Bull. Joly Entrep. diff., no 5 (2013); Françoise Pérochon, « Comité des établissements de crédit : mode d'emploi ! », Bull. Joly Entrep. diff., 2016, 229: « in 2017 France (...), as regards the committees, the shareholder is a creditor like any other! »

[278] - As was the case with the Macron law, the Constitutional Council having validated the possibility of a converson of debt into equity despite shareholder opposition, under the conditions provided for by law. SEE Martinez and Vermeille, « Quand la constitution s'en mêle. Le respect des droits de propriété respectifs des créanciers and des actionnaires dans les entreprises en difficulté : une question de survie ».

[279] - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 11 et seq.; Martinez and Vermeille, « Quand la constitution s'en mêle. Le respect des droits de propriété respectifs des créanciers and des actionnaires dans les entreprises en difficulté : une question de survie »; Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives », 2201.

[280] - Recital 30 and article 5.

[281] - While the concept of DIP proceedings has long been known in the United States, for the first time the concept was formally defined in Europe by Regulation 2015/848, after being used by the Commission in Recommendation 2014/135 / EU , which emphasized that DIP proceedings are adapted to open proceedings upstream of financial difficulties in that they avoid unnecessary costs. See Bob Wessels and Stephan Madaus, « Rescue of Business in Insolvency Law », Instruments of the European Law Institute, 6 Sept. 2017, 154 et seq.; B. Wessels and R. de Weijs, « Proposed Recommendations for the Reform of Chapter 11 U.S. Bankruptcy Code », Amsterdam Law School Legal Studies Research Paper 2015, no 37 (2015): 9.

[282] - See LJ Rusch, « Gerrymandering the Classification Issue in Chapter Eleven Reorganization », 1992, 63 UCoLR 43-64.

[283] See on the important rôle played by restructuring practitioners in the French practice, Lienhard, Procédures collectives 2019-2020, chap. 42 and 43.

[284] - We do not fully follow, therefore, the criticism of Prof. Eidenmüller, see Eidenmueller, « The Rise and Fall of Regulatory Competition in Corporate Insolvency Law in the European Union », 16: « This requirement restricts contractual freedom, reduces flexibility and makes the restructuring process more complicated and costly. Engaging advisors or experts should have been left to the participating stakeholders as it is in a Chapter 11 or a Scheme of Arrangement process ».

same reasoning applies to the option opened by article 9(5) of the Directive regarding the definitive validation of the class allocation at a stage prior to the judicial approval of the plan. This option seems desirable, insofar as it helps increase the predictability of the outcome of the proceedings.[285]

165. The practitioner could also play the role of "valuation ombudsman",[286] arbitrating between the differing valuations proposed by senior creditors and junior creditors,[287] and thus reducing the uncertainty of the final valuation if the court had to finally confirm the plan.[288]

5. An insufficient protection of the creditors' substantial rights

166. For an alternative solution to the liquidation of the debtor to be justified despite the lack of unanimous agreement between its stakeholders in this regard, the alternative must be both more efficient for all stakeholders, and not detrimental to the interests of some of them, or, at least, it should be possible to compensate them so as to make them neutral between the alternatives, if a restructuring is better for the stakeholders as a whole. Otherwise, the hypothetical *ex ante* negotiators, putting themselves in the position of the least favored stakeholders, would (reasonably) reject such alternative proceedings.

167. Adequate protection in this regard requires that several tests be satisfied. This is to ensure that the opening of insolvency proceedings does not involve any unjustified alteration of the material rights of stakeholders.[289] Otherwise, some parties would be incentivized to strategically seek the opening of proceedings and others to avoid it, to take advantage of different redistributions of subsequent wealth.[290]

5.1. The "best interest of creditors test"

168. The immediate consequence of the requirements set out above is the "best interest of creditors test", which states that a dissenting creditor must not be treated less favorably in a restructuring plan than in the alternative situation where the plan was not approved (i.e., for most practical purposes, in the event of liquidation through a sale of assets).[291]

169. The Restructuring Directive found an inspiration, in this regard, in the US Chapter 11. The test is defined in article 2(6) as follows: (a test) " that is satisfied if no dissenting creditor would be worse off under a restructuring plan than such a creditor would be if the normal ranking of liquidation priorities under national law were applied, *either in the event of liquidation, whether piecemeal or by sale as a going concern*, or *in the event of the next-best-alternative scenario* if the restructuring plan were not confirmed".

170. The counterfactual analysis required by this test is not an easy feast, since the terms to be com-

285 - This option seems all the more important as the final distribution of creditors into classes is an art rather than a science, so that even jurisdictions where class voting has been in existence for a long time suffer from a certain unpredictability, which cannot be raised only by a final upstream decision. See regarding the division of creditors into classes in Chapter 11 proceedings, LJ Rusch, « Gerrymandering the Classification Issue in Chapter Eleven Reorganization », 1992, 63 UCoLR 43-64 ; PE Meltzer, « Disenfranchising the Dissenting Creditors through Articifical Classification or Artificial Impairment », 1992, 66 ABLJ 281 – 321.

286 - See Paterson, « Bargaining in financial restructuring: market norms, legal rights and regulatory standards », 359.

287 - See Stanghellini and Paulus, « Best practices in European restructuring. Contractualised distress resolution in the shadow of the law », 37: « Senior claimants have incentives to undervalue the business, since that enables them to claim a greater proportion of its post restructuring value, whereas junior claimants have corresponding incentives to overvalue it ».

288 - It should also be noted that the designation of a restructuring practitioner is necessary in view of the fact that the principle of DIP restructurings increases the risk of opportunistic behavior on the part of debtors, particularly in companies with concentrated ownership. See J. Armour, G. Hertig, K. Kanda, "Transactions with Creditors" in J. Armour, L. Enriques and al., "The Anatomy of Corporate Law: A Comparative and Functional Approach" (OUP, 2018): 109 – 114.

289 - See Jackson, The Logic and Limits of Bankruptcy Law, 33: « the first rule of a collective proceedings designed to serve bankruptcy law's historic role is that it should take the value of entitlements as it finds them. The difficult substantive issue of whether those entitlements are correct is an important question, but it is not a bankruptcy question ».

290 - See Tollenaar, Pre-Insolvency proceedings, 21: « This limited definition of the concept allow Jackson and Baird to avoid legal-political debate on the desirability of adjusting the material rights of creditors in the even of the debtor's insolvency and to limit themselves to a relatively clear efficiency analysis: a comparison between enforcing material claims through an uncoordinated cascade of individual enforcement actions and enforcing those claims through a coordinated collective enforcement proceedings ».

291 - The emblematic manifestation of this test finds its source in US law, which has existed since 1898 with respect to unsecured creditors and since 1978 for secured creditors. See Jonathan Hicks, « Foxes Guarding the Henhouse: The Modern Best Interests of Creditors Test in Chapter 11 Reorganizations », Nevada Law Journal 5, no 3 (1 March 2005).See for an interesting first French commentary on the « best interest of creditors test », Mathias Houssin, « Le test du respect des intérêts des créanciers ou « best interest test » », ReSee proc. coll., no 4 (2018): étude n°19. French law currently provides in article L. 626-31 of the French Commercial Code that the judge adopting the safeguard plan must ensure that "the interests of all creditors are sufficiently protected". This notion is judged by the legal practitioners to be "considerably vague" and does not seem to offer sufficient legal certainty for creditors. See on this concept, Lienhard, Procédures collectives 2019-2020, n° 82.41.

pared are difficult to grasp. First, concerning the treatment of the creditor in the context of the proposed plan, its assessment is particularly complicated in the case of a forced conversion of the debt into equity. Such an assessment would require making reasonable assumptions about the future performance of the company, on which depends the value of the financial instruments given to its former creditors.[292] In addition, all the idiosyncratic factors associated with each creditor must be considered, such as their risk tolerance, usual investment horizon and liquidity needs. However, as we have pointed out, in the absence of a sufficiently developed secondary market, obliging creditors to continue financing the business is not trivial and must be handled with care.[293]

171. Next, as regards the hypothetical liquidation, the test requires a hypothetical determination of both the transfer price of the assets, without resorting to an actual sale on the market, and of the exact outcome of a hypothetical subsequent distribution of the sums obtained between the stakeholders entitled to payment. As we will see, this aspect of the "best interest of creditors test" renders its application particularly problematic in jurisdictions such as France, where the distribution of sums in case of liquidation is very context sensitive and cannot truly be anticipated.[294]

172. It should also be noted that since the reading of the European Council, the relevant comparison is not limited to a hypothetical liquidation, but also concerns the "best alternative solution" in the absence of approval of the plan. This option is somewhat troubling from our point of view. In fact, the restructuring is justified, as we have seen, only to the extent that it is a better alternative to the liquidation of the debtor. It shouldn't be understood, therefore, that the debtor could avoid being liquidated even where no restructuring plan has been found, for this would turn the restructuring proceedings into a simple way for debtors to get rid of their debts, even where their survival is not called into question as they could avoid formal insolvency through other means. The only reasonable way to read the Council's addition, in our perspective, is to consider that it refers to an alternative restructuring plan to the one under consideration. If such a comparison were to be systematic, however, the proceedings would be likely to become far too costly and complicated, as several competing plans would systematically have to be prepared and presented. It seems to us, therefore, that the text should be understood as requiring that the stakeholder not be worse off than under a competing plan where such a plan exists.

173. In fact, as the best interest of creditors only needs to be checked where "the restructuring plan is challenged on that ground", supposedly by the dissenting affected parties (as provided in article 10 (2) of the Directive), and in case of an appeal the court could still "confirm the restructuring plan… (if) compensation is granted to any party that is incurred monetary losses and whose appeal is upheld" (article 16 (4) of the Directive), it seems reasonable to consider that where an alternative plan is more favorable to the interests of a dissenting stakeholder, while the approved plan is more favorable to the stakeholders as a whole, the application of the best interest of creditors test should simply lead to a compensation so as to render the dissenting stakeholder neutral between the two alternatives. It should be stressed, yet again, that such a scenario would only be acceptable where the approved plan leads indeed to wealth maximization for stakeholders as a whole.

5.2. The fair treatment of dissenting classes

174. Even where such a compensation is possible, it seems to us, in light of the multiple reasons given above, that the satisfaction of the "best interest of creditors test" is not a sufficient protection of stakeholders' rights. Even if the uncertainties of the test could be removed, a plan that satisfies it could result in an undue transfer of wealth, to the extent that some creditors would receive their share of the hypothetical net asset value while the surplus from the going concern would be retained by other creditors, or even by shareholders, especially where no alternative plan ends up being

[292] - See for the test under Chapter 11, Nicholas Regoli, « Confirmation of Chapter 11 Bankruptcy: A practical guide to the best interest of creditors test », TJBL, no 41 (2005): 1; See McCormack and Wan, « Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's Restructuring and Insolvency Laws », 21: « Valuation experts, however eminent or distinguished their qualifications, are not able to forecast future economics with perfect precision ».

[293] - See in the context of the Singapore reform, « Report of the Insolvency Law Review Committee: Final Report » (Insolvency Law Review Committee (Singapore), 2013), 155-56: « comparative valuations between rescue and liquidation are often speculative or in some cases nuanced to make rescue sound more attractive », which requires « a high threshold of proof ».

[294] - See for a criticism of the illegible treatment of collateral in the event of insolvency proceedings in France, Vermeille and Bézert, « Sortir de l'impasse grâce à l'analyse économique du droit : Comment rendre à la fois le droit des sûretés réelles and le droit des entreprises en difficulté efficaces ? »; Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives »; Reinhard Dammann and Vasile Rotaru, « Pour une réforme cohérente du droit des sûretés and de la loi de sauvegarde dans une approche d'harmonisation franco-allemande », ReSee proc. coll., 2018, dossier 23.

proposed and the benchmark is that of distributions is case of liquidation.[295]

175. It seems reasonable to assume that such scenario would be rejected by hypothetical *ex ante* negotiators: if they agree to a partial or alternative payment, it seems unlikely that it is to be a gift to other stakeholders. This intuition reflects the requirement that dissenting classes be treated fairly. Basically, it is about ensuring that stakeholders have the right to share the restructuring value, and not just the liquidation value, according to the order of payment priorities.

5.2.1. The rationale for respecting priority rules: the right to share the restructuring value within the order of priorities

5.2.1.1. The economic justification of the necessary respect for the order of priorities

176. All stakeholders in a company have an interest in it, to the extent that they all participate in the financing of its activity, directly or through their labor. These interests are ordered, both the underlying risk of the investment and the expected yield depending on such order. In other words, this order of distribution and loss absorption defines the cost for the debtor of each layer of financing.

177. The agreement regarding the distribution of the value of the company's assets in the event of a liquidation is therefore an essential condition of contemporary finance.[296] Such a liquidation event occurs when the debtor cannot honor its debts. In this case, its assets could be sold separately or, alternatively, the entire business could be sold to a third party. In this scenario, the collected amounts are distributed according to the order of priorities negotiated or accepted when the specific investment was made by the various stakeholders.[297]

178. There is no *a priori* reason to believe that the situation should be different if, instead of being sold to a third party, the company is sold to its creditors through a restructuring, which is but an alternative form of satisfying the claims of creditors while safeguarding valuable businesses whose value as a going concern is superior to its liquidation value. The order of priorities obtaining in case of the debtor's liquidation should therefore be the default rule, in relation to which stakeholders will consider whether the alternative proposed by preventive proceedings is indeed in their best interest.

179. The implication of these concerns, which seem to make good economic sense and correspond to the practices of valuation of the costs of different layers of corporate finance, is the rule of absolute priority.[298] In the event of an alternative to a formal liquidation, that is to say in the event of restructuring, all possibilities of future change of the debtor's situation are collapsed to the present.[299] As a result, the wealth as it exists at the time of the restructuring is distributed among the classes of stakeholders according to the order of priorities.[300]

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[295] - See Rolef de Weijs, Aart Jonkers, and Maryam Malakotipour, « The imminent distortion of European Insolvency Law: how the European Union erodes the basic fabric of private law by allowing "relative priority" », Amsterdam Law School Legal Studies Research Paper, 2019, 7: « In case a company is facing liquidation with an estimated liquidation value of 400, the secured creditors with a secured claim of 350 would receive 350 and the unsecured creditors would have to share the remaining 50. If unsecured creditors together have a claim of 400, this would result in 12.5% payout... If the 'best interest of creditors'test would be the only test and the court would have the power to overrule an entire class, creditors can be forced to be content with any higher distribution than the low water mark (12.5%) of their expected pay out in case of liquidation... The entire starting point is, however, that the company needs to be saved because the company is worth more going concern than liquidated, for example 700. If the higher going concern value of 700 is put in the balance sheet after a debt write down to 15% this results in positive equity with a value of 290. Who gets the 290 generated by the reorganisation? ».

[296] - See Douglas Baird and Thomas Jackson, « Bargaining after the Fall and the Contours of the Absolute Priority Rule », University of Chicago Law Review 55, no 3 (1988): 740: « Part of the initial bargain among those who contribute capital to a firm is an agreement about how assets of the firm will be divided if there is a day of reckoning on which everyone's ownership interest is valued. In most firms, one set of owners will take before others. Debt will be paid before equity. In many firms, there are multiple layers of ownership ».

[297] - See Baird and Jackson, « Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy », 112: « that rights are hierarchically arranged merely reflects the different bargain each interest holder has struck in acquiring those rights ».

[298] - On the current inadequacies of the French system of distribution of the sums among the creditors in French insolvency proceedings, See Maxence Guastella, Les grands principes des répartitions dans les procédures collectives (L'Harmattan, 2019).

[299] - See Bernstein and Baird, « Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain », 1937.

[300] - See Baird and Jackson, « Bargaining after the Fall and the Contours of the Absolute Priority Rule », 742: « As applied to these cases, the absolute priority rule simply restates the idea of a layered ownership structure in which one owner has bargained for the right to be paid before others ». This does not preclude a majority in a class of creditors, if it is well constituted, from accepting a derogation from the normal order of priorities. See Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 5: « A departure from the applicable priority rules may be permitted if a majority within each class that receives less than it should, consents to such treatment. The proposed solution can then be deemed to be in the interest of the class. This can for instance be the case if the proposed solution avoids a time consuming and costly valuation dispute ».

180. Beyond this theoretical justification, compliance with the priority rules in the event of restructuring is also required by considerations of economic efficiency. First, it avoids encouraging certain stakeholders to engage in strategic maneuvers in order to create the conditions for a certain type of liquidation of their respective investment over another one. If between the two alternatives (i.e. restructuring and liquidation proceedings) the respect of the substantial rights of the parties were to differ, some creditors would be incentivized to do just that.[301] In other words, such a possibility would induce a misalignment of the interests of different stakeholders, each one having a rational incentive to engage in a regulatory arbitrage rather than to collaborate in order to achieve the best overall result. In this regard, respecting the order of priorities reduces the risks of this type of opportunistic and abusive behavior, in particular on the part of insiders who can more easily anticipate the outcome of the various contemplated proceedings.[302]

181. Second, compliance with this rule increases the predictability of the treatment of all creditors and thus reduces the cost of *ex ante* financing. In fact, if the restructuring could derogate from the order of priorities negotiated between the investors, who knowingly chose the layer of their investment in the business' capital structure, they should take into account the risks of such a derogation when computing the cost of the provided capital.

182. Finally, during the restructuring negotiations, the respect of the order of priorities plays a very useful role: it is this rule that ensures the distribution of initial 'weights' between the various stakeholders.[303] In other words, it indicates who is entitled to what by default, without preventing them from negotiating a redistribution if it appears necessary.[304] If such a default distribution did not take place and the parties had to negotiate everything from scratch, prohibitive transaction costs would prevent any deal from emerging.[305]

5.2.1.2. The right to share the restructuring added value

183. Traditionally, the priority rule, the nature of which has just been explained, has been understood simply as stating that a dissenting class of creditors must be fully disinterested before a lower class can benefit from a distribution or retain an interest in the restructuring plan.[306] However, in view of the economic justification of the rule, it seems that such a formulation is not sufficient.[307]

184. Assume a debtor has a senior debt of 10 and a junior debt of 10. The net asset value of the company is 10. The restructuring value is 20. The restructuring plan values the company at 20 but allocates full value to the senior debtor. Nothing prevents this plan from being approved: the "best interest of creditors test" does not help the junior creditor, who would have received nothing in the event of a piecemeal liquidation; the absolute priority rule as stated in the previous paragraph cannot provide relief to the extent that it protects the interests of the senior creditor before those of the junior creditor.

185. In light of such an absurd (and certainly unacceptable under the CBT) result, it has long been accepted in the United States that a necessary corollary of the absolute priority rule is the rule that senior creditors cannot receive more than 100% of the value of their debt.[308] This corollary, of good economic sense, cannot be forgotten.

301 - See Jackson, The Logic and Limits of Bankruptcy Law, 20.

302 - See the letter sent to the European legislators, Rolef de Weijs, « Preventive Restructuring Framework and the last moment introduction of Relative Priority (letter) », 20 March 2019, 4: « Shareholders (would) be able to opportunistically orchestrate the need for reorganization and retain value at the cost of creditors ».

303 - See Jonathan C. Lipson, « The secret life of priority. Corporate Reorganization after Jevic », Washington Law Review 90 (2018): 672: « Although the APR is largely viewed as a distributive principle, it also has important participatory effects because it can force (or induce) plan bargaining. »

304 - See Baird and Jackson, « Bargaining after the Fall and the Contours of the Absolute Priority Rule », 741: « The rules must tell us how these negotiations are to be conducted and whose consent is needed to renegotiate the original ordering of ownership interests »; Bernstein and Baird, « Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain ».

305 - This is indeed the teaching of the Coase's fundamental analysis, because if the initial distribution of rights does not count in a world without transaction costs, the real world has many such costs. See Ronald Coase, « The Problem of Social Cost », The Journal of Law and Economics 3 (1960): 1; In the context of negotiations around restructuring, See Baird and Jackson, « Bargaining after the Fall and the Contours of the Absolute Priority Rule », 755: « We argue that, notwithstanding the costs that everyone suffers if the bargaining breaks down, the bilateral negotiations that follow a default are useful... This description of rights on default seems consistent with the initial bargain one typically sees ».

306 - See Section 1129(b)(2)(B) du US Bankruptcy Code: "(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property".

307 - See for a critique and examples used below, Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 5.

308 - See In Re Genesis Health Ventures, Inc. 266 BR 591, 612 (Bankr D Del 2001): "A corollary of the absolute priority rule is that a senior class cannot receive more than full compensation of its claims".

186. Assume further that a debtor has two groups of creditors of the same rank, each with a claim of 10. The two groups, however, have different interests, which justify their division into two separate classes.[309] The liquidation value of the company is 5, its restructuring value is 10. A plan is then proposed, which assigns the entire restructuring value to one of the two groups. Again, if the plan is approved, the priority rule in its original wording is of no help to the members of the second group. This is why the absolute priority rule is supplemented, under Chapter 11, by a rule of fair treatment of classes of creditors of the same rank.[310] If there are good reasons for distributing creditors of the same rank into different classes with regard to their particular interests, there may also be good reasons not to treat these creditors of equal rank in a perfectly equal manner: equitable is not equal. However, any difference of treatment in this respect must be justified.[311]

187. Together, these three rules, and not just the absolute priority rule as originally formulated, allow in principle that the order of priorities be truly respected. This is also how the rule is generally implemented and interpreted by judicial jurisprudence under Chapter 11.

5.2.1.3. The sharing of the restructuring added value through a "relative" priority rule

188. For some years now, certain authors have pointed out that the tripartite formulation of the absolute priority rule that we have just described is not the best expression of its underlying economic justification. They suggest, therefore, what they call a "relative" priority rule, which is in fact a rule of absolute priority with a delayed crystallization.[312]

189. The argument is based on the observation that there is a fundamental difference between the sale of the business to third parties in the open market (liquidation) and the sale of the business to the creditors (restructuring). The first is very clearly a judgment day: the value of the business is crystallized through a real sale and all that remains is to settle the accounts and distribute the recovered amounts between the different stakeholders depending on their respective place in the order of priorities. At the end of they, this is the best case scenario for all the stakeholders, provided that the financing market is deep and liquid enough to allow for a sale of the business as a going concern to a third party without a significant discount, which explains why Chapter 11 proceedings end up in such a sale more often than in a true restructuring.[313]

190. The second, on the other hand, takes place without recourse to the market and is based on a hypothetical going concern valuation. As already stated, this exercise is very risky and uncertain.[314] Two conclusions seem to follow from this uncertainty. First, the stakeholders are incentivized to engage in a war of valuations, the uncertainty of which could have a great impact on the ongoing negotiations, insofar as it is not certain which parties are in or out of money and what exactly they may be entitled to by default. For instance, the possibility that the court would accept a valuation higher than the one suggested by the senior creditors (who are interested in the valuation being as low as possible) means that the possibility for junior creditors to force such a judicial valuation has a positive value in itself, which should be taken into account and compensated by the senior creditor.[315]

309 - As pointed out, it is necessary that the allocation take into account both the ranks and the outcomes of the creditors according to the terms of the proposed plan. Therefore, the mere fact that two otherwise equal groups receive different treatment justifies their being placed in two different classes.

310 - See Section 1129(b)(1) de US Bankruptcy Code : "… shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan".

311 - Case law has been developed in the United States on this subject. For example, there may be good economic reasons to treat key economic partners, such as suppliers, differently from other unsecured creditors, See examples cited in Tollenaar, Pre-Insolvency proceedings, 131 et seq.

312 - See Anthony J. Casey, « The Creditors' Bargain and Option-Preservation Priority in Chapter 11 », University of Chicago Law Review 78, no 3 (2011): 759; Bernstein and Baird, « Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain »; Baird, « Priority Matters ».

313 See Baird, "Priority Matters", 810.

314 - See Bernstein and Baird, « Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain », 1941: « The valuation problem in a reorganization case is fundamentally different from the one associated with valuing a lottery ticket. With a lottery ticket, the parties know the probabilities and payoffs with certainty. Risk-neutral investors will place the same value on the expected outcome. Collapsing future possibilities to present value is a matter of arithmetic. It yields a sum certain. A business, however, cannot be valued with such precision... The uncertainties associated with the factors affecting predictions about future cash flows and with determining the appropriate discount rate leave considerable room for skepticism about the value the expert arrives at for the business. In the end, such a valuation is nothing more than a guess compounded by an estimate ».

315 Such a compensation has been observed in the negotiation practices in the US in the shadow of Chapter 11, see James C. Bonbright and Milton M. Bergerman, « Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization », *Columbia Law Review* 28, nº 2 (1928): 161; see also, Baird, « Priority Matters », 822: « Both junior and senior creditors will take account of this departure from absolute priority in their negotiations. Valuation variance itself creates option value, and

191. Second, if the court has to intervene to put an end to the valuation wars, the ensuing collapse of all future possibilities and the immediate distribution of the value of the company thus estimated seems problematic.[316] In fact, such a collapse seems to neglect what came to be called the value of the junior creditors' "option" on the debtor's recovery, therefore violating the spirit of the absolute priority rule.[317] Essentially, the immediate distribution of value based on such a collapse means that senior creditors accept to continue financing the underlying business, but force the junior creditors out of its capital structure.[318]

192. Take two investors, [319] A and B, who together finance a project organized in the form of a company. They agree that once the project is finished, A will be entitled to 150, while B will get all of the residual value. At one point, it appears that the project has a probability of 0.5 of eventually deriving a value of 200 and a probability of 0.5 of eventually deriving a value of zero. At this precise moment, therefore, A's investment has a present value of 75, in the sense that it would be rational for a third party to pay such a sum in exchange for the claim. B as a residual creditor has a claim whose present value is of 25, which reflects the fact that there is a probability of 0.5 that the project ultimately provides 50 more than is necessary to satisfy A.[320] An event then occurs which requires that the balance sheet of the company be cleansed up, and it is decided to restructure the debt through a debt-equity swap. What are the two investors entitled to? Applying the absolute priority rule as explained above amounts to collapsing the forecasts over the company's future value to the present moment: since the present value is 100 (in view of the equal distribution of the probabilities between 200 and 0 of future value), while A is entitled to 150, all the equity shares would be allocated to A. The value of B's option, evaluated at 25, is thus written off. In addition, if the company eventually makes 200, A gets 50 more than expected, which corresponds to B's shortfall, for B's interests are cancelled at the time of the restructuring. Alternatively, one could accept the uncertain character of the hypothetical valuation and preserve the value of B's option. This would mean not forcing an acceleration of the moment when the accounts must be made between A and B.[321] For example, A could receive all the company's shares, while B would be given 'return to better fortune' securities which could eventually allow him to buy A's shares for 150 and thus benefit from the surplus value as if the restructuring had not taken place.

193. For some authors, such treatment of restructuring would prevent business cycle fluctuations from leading to a transfer of wealth between the two types of investors.[322]

194. Others see it as a way to simplify the negotiations between stakeholders by reducing the conflicts of interest,[323] insofar as they need not engage in any valuation wars anymore.[324] or to avoid valuation wars.[325] The conflicts of interests which

this option value will be cashed out in any deal they strike... Valuation variance is just one way in which junior creditors can take advantage of the bankruptcy judge being imperfectly informed about the value of the firm. »

316 See V. Baird, « Priority Matters », 786: « Much of the complexity and virtually all of the stress points of modern Chapter 11 arise from the uneasy fit between its starting place (absolute instead of relative priority) and its procedure (negotiation in the shadow of a judicial valuation instead of a market sale). »

317 See Casey, « The Creditors' Bargain and Option-Preservation Priority in Chapter 11 ».

318 See Baird, "Priority Matters", 790-91: « Outside of bankruptcy, senior creditors facing a debtor in default sometimes prefer to maintain their stake in the firm rather than insist on a sale to a third party. They choose to waive their right to declare a default and repossess collateral. When they do this, however, they must allow junior creditors to remain in place. Outside of bankruptcy, they cannot simultaneously keep their stake in the ongoing business and eliminate those junior to them in the capital structure. »

319 - The example is borrowed from Baird, « Priority Matters », 792 et seq.

320 - See Baird, 793: « The possibility that the project might ultimately be worth more than what is owed the senior investor gives option value to the junior investor's stake. A rational investor would be willing to pay up to $25 for the option to acquire the project in a year from the senior investor in exchange for $150 ».

321 - See Baird, 793: « Options are a component of every investment instrument. Whenever one investor has priority over another, whether absolute or relative, the junior investor has what is in effect a call option. The junior investor has the ability, set out in the investment instrument, to terminate the rights of the senior investor by paying her off. This call option is the right to buy a particular position for a fixed price. Like a call option on any asset, it is defined by a strike price and an exercise date. The strike price is simply the amount owed the senior investor. The exercise date sets the time when the holder of the option must decide whether to exercise the option. The essential difference between absolute and relative priority is the effect of bankruptcy on the exercise date of the call-option component of the junior investment instrument. Under absolute priority, the bankruptcy accelerates the exercise date; a regime of relative priority leaves it untouched ».

322 - See the ABI report, which recommends the introduction of such a relative priority rule, « ABI Commission to Study the Reform of Chapter 11 » (American Bankruptcy Institute, 2014).

323 - See Casey, « The Creditors' Bargain and Option-Preservation Priority in Chapter 11 ».

324 See Bernstein and Baird, « Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain », 1930: « it may well be easier to reach agreement if the day of reckoning can be postponed for a time through designing a distribution mechanism that to some extent preserves the option value of the junior investor's position. »

325 - See Baird, « Priority Matters ».

weigh on the debtor's management could also be lowered, as the debtor's shareholders, even where they are out of the money, wouldn't lose the value of their option and could benefit where the restructuring creates, in time, enough value to satisfy all the other creditors. The shareholders themselves wouldn't have an incentive, therefore, to avoid such restructurings, which could push them out of the debtor's equity, at all costs.

195. The spirit of the absolute priority rule would therefore be better preserved by using such a "relative" priority rule. The difficulty is, however, that senior creditors might thus be incentivized to arbitrage in favor of an immediate sale to a third party where such a sale is possible, even if some restructuring value is lost, as long as they are immediately and fully reimbursed, for any surplus value would in any case end up being distributed to junior creditors. It is not unreasonable to expect, in such a case, that senior creditors could exert their control powers in order to limit junior creditors' and the court's access to information in order to accelerate the negotiations and force a sale to a third party allowing them to liquidate their investment as soon as possible.[326] The possibility of such an arbitrage doesn't seem to be avoidable, which is the more reason for all the other protections of creditors' interests to be seriously taken into account.

5.2.2. The ineffective priority rule of the Restructuring Directive: an earthquake with delayed effect

196. The Restructuring Directive in its final version offers the choice between two types of priority rules. The default rule is now a relative priority rule that frontally contradicts the conclusions of the economic analysis, while the optional rule is an absolute priority imported from across the Atlantic, but in an incomplete form. Since the default rule is truly a delayed-effect earthquake, the choice of the absolute priority rule is necessary in our opinion.

5.2.2.1. The priority rule in the Commission's initial draft

197. The original draft as proposed by the Commission provided in article 11(1)(c) that a restructuring plan could be approved by the judge following a cross-class cram-down only if it complied with the absolute priority rule. The definition of the latter was to be found in article 2(10): " a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan".

198. This was the classic formulation of the absolute priority rule, which we have already commented on. However, commentators were quick to point out that the other two rules guaranteeing fair treatment of all classes of creditors were absent.[327] Thus, the rule prohibiting a class of creditors from receiving more than the total amount of its claims appeared only in recital 28, formulated in a manner clearly inspired by the American model.[328] However, the rule did not appear anywhere in the legally binding part of the initial project. It was to be hoped, however, that the legislators and the courts would not have ignored its consecration in clear terms through the recital and would have followed it in national transpositions. On the other hand, the rule of fair treatment between classes of creditors of the same rank did not appear anywhere. No principle of equal treatment even between creditors of the same rank was provided for.

5.2.2.2. The relative priority rule introduced by the Council

199. Since the draft proposed by the Council, there has been a significant shift in the definition of the priority rule in the text of the Directive. Without mentioning it among the 'main elements' of the new compromise reached between the Council and Parliament in its 17 December 2018 version, the Council deleted the definition of the absolute priority rule from article 2 and introduced substantial changes in article 11, which were kept the final version.[329]

200. The first amendment is salutary, formally enshrining the corollary of the absolute priority rule in article 11(1)(d): "no class of affected parties can,

[326] See Baird, « Priority Matters », 826.

[327] - See Tollenaar, « The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017) », 5.

[328] - See recital 28 of the initial draft: "The absolute priority rule serves as the basis for value to be allocated among the creditors in the context of the restructuring. Corollary to this rule, no class of creditors may receive or retain, under the restructuring plan, any interest or economic benefit exceeding the total amount of the claims or interest of that class."

[329] - These changes have been the subject of considerable criticism by a group of legal practitioners, particularly in the Netherlands, to the point of jeopardizing the adoption of the Restructuring Directive itself. It would seem that these changes were finally maintained because these authors' "offensive" was initiated too late to be able to lead to last-minute amendments. See for this critique, not. Weijs, Jonkers, and Malakotipour, « The imminent distortion of European Insolvency Law: how the European Union erodes the basic fabric of private law by allowing "relative priority" ».

under the restructuring plan, receive or keep more than the full amount of its claims or interests".

201. The other is much less so. Henceforth, the default priority rule is formulated in article 11(1)(c), which provides that a cross-class cram-down may be admitted by a judge only on the condition that "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". This priority rule thus makes it possible to neglect the order of priorities when senior creditors are treated in a better way than the creditors subordinate to them (including, in particular, the shareholders), without specifying what "more favorably" would mean.

202. Two different types of considerations seem to be behind this approach. On the one hand, some authors justify it by stating that the restructuring surplus simply does not belong to the creditors. From a strictly legal point of view, the latter would have the right to share only the net asset value of the debtor's assets. Anything that exceeds this net asset value would then belong to the shareholders, whose assets are out of the reach of the debtor's creditors. There would then be no problem, according to these authors, in violating the strict rules of priority with regard to amounts which exceed what each creditor may expect in the event of an immediate liquidation.[330]

203. We have explained at length why such a distinction between "preventive" and insolvency proceedings does not seem to us to be justified from a law and economics point of view. Preventive proceedings are simply an alternative to "formal" insolvency proceedings and must pursue the same objectives as the latter. If the opening of preventive proceedings results in violating an order of priorities explicitly negotiated or accepted by the stakeholders at the moment of their investment, this would, to borrow the expression of some commentators, undermine the very fabric of European private law.[331]

204. Furthermore, some authors at the origin of the European relative priority rule seem to see the proposed rule as a means of facilitating restructuring negotiations. Traces of this argument can be found in the "Best Practices" report funded by the European Union, whose authors believe that the absolute priority rule would be too rigid and give certain classes of creditors a harmful lever of extortion.[332] On the other hand, the proposed relative rule would make it possible to sufficiently protect the order of priorities while ignoring unjustified dissenting behaviors.[333] More specifically, and this seems to be an essential motivation, such a rule would allow for the distribution of some of the restructuring value to the shareholders even if they are out of the money, when their continued participation in the company seems necessary for its subsequent success.

205. The authors of the report of the Institute of European Law ("IEL") propose the same argument and refer explicitly, in support of their approach, to the work of Professor Baird on the aforementioned relative priority rule.[334] However, it seems obvious that the relative priority rule proposed by the Restructuring Directive does not correspond to the suggestions made by Professors Baird and Casey discussed above. In a letter to European legislators, Professor Baird emphasizes this beyond any doubt.[335]

330 - See not. Madaus, « Rescuing companies involved in insolvency proceedings with rescue plans », 7: « It is quite obvious that creditors are not entitled to a reorganisation surplus value by the legal position based on their claim against a debtor as equity interest is not part of the debtor's estate and thus not part of a creditor's entitlement under the law of execution or insolvency law. Creditors may liquidate all the assets of the debtor, which may lead to a sale of the debtor's business. If the auction price reflects a going concern value of the business, it is to be distributed among creditors only. This auction option creates a liquidation level that is guaranteed to every creditor under insolvency law as well as by their right of property under constitutional law. In a plan confirmation hearing, the court applies a "best interest test" to ensure that no dissenting creditor receives less ».

331 - See Weijs, Jonkers, and Malakotipour, « The imminent distortion of European Insolvency Law: how the European Unuion erodes the basic fabric of private law by allowing "relative priority" ».

332 - See Stanghellini and Paulus, « Best practices in European restructuring. Contractualised distress resolution in the shadow of the law », 46: « It incentivises dissent from the plan so long as the dissentients expect the plan to receive sufficient support from claimants in other classes. Such dissentients would expect to free-ride on others' sacrifice by being paid in full while those others accepted a haircut. This makes confirmation of the plan less likely, however, since each class might in this way have some such incentive to dissent ».

333 - See Stanghellini and Paulus, 46: « The relative priority rule provides a more realistic alternative, ensuring fairness for dissentients by protecting their relative position against all other affected stakeholders but without creating hold-out incentives »; See also, in favour of a relative priority rule, Madaus, « Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law », 615.

334 - See Wessels and Madaus, « Rescue of Business in Insolvency Law », 334.

335 - See letter by Prof. Baird annexed to Weijs, « Preventive Restructuring Framework and the last moment introduction of Relative Priority (letter) »: « it would be a serious mistake to equate relative priority as I and others conceive it with the idea that is being put forward in the latest European directive. Relative priority, properly understood, is altogether different from a regime in which senior stakeholders are entitled only to be treated more

206. It seems to us that the introduction of this rule reflects once again the diverging objectives pursued by the different authors of the Directive. Indeed, if one intends to create proceedings whose purpose is to better safeguard the interests of all the stakeholders, who must themselves negotiate a restructuring agreement in an optimal negotiation setting, such a relative priority rule is not understandable. Instead of facilitating negotiations, it blurs the initial bargaining positions of creditors and broadens the scope of possible agreements beyond what can reasonably be discussed under time pressure. Each creditor is thus incentivized to try and win a little more from the agreement, without there being any significant limits to such behaviors, as multiple possibilities are open. In particular, creditors are granted a hold-out position, since they could hope for better treatment under an alternative plan, a little keener on wealth transfers in their favor, particularly given the fact that the "best interest of creditors test" now allows for a comparison with such alternatives. To use Professor Baird's expression, it's as if the creditors were playing tennis without a net.[336] A great deal of uncertainty would be created, and the cost of *ex ante* debt financing would necessarily increase.

207. The relative priority rule as formulated by the Restructuring Directive is understandable only if it is intended to create proceedings aimed at "saving" companies at all costs, even when creditors do not believe in the existence of a restructuring value and oppose the proposed plan. It is only in this sense that the relative rule can "help": it would not facilitate negotiations between creditors, rather it would help the restructuring practitioner in finding and forcing through the agreement that seems reasonable while saving the debtor's company, despite creditors' opposition.

208. If, as we have argued, the latter approach to preventive proceedings is to be rejected, the relative priority rule proposed by the Directive must also be rejected.

5.2.2.3. The absolute priority rule in its latest wording

209. It seems preferable, then, to opt for the alternative provided by article 11(2) in favor of the absolute priority rule. Its current wording offers enough flexibility to respond to fears of possible hold-out situations. Indeed, article 11(2) now provides that senior creditors must be "satisfied in full by the same or equivalent means" before a subordinate class can be paid.

210. It should first be noted that the current wording again forgets the need to treat creditors of the same rank in an equitable manner. Nothing, however, precludes the provision of such a requirement in national laws.[337]

211. Second, national legislators are given considerable leeway to assess the meanings of "full satisfaction"[338] and "equivalent means",[339] which should make it possible, for example, to pay junior creditors as soon as senior creditors have been granted efficient securities.[340]

212. Moreover, as under the US Chapter 11, exceptions may be allowed where they are equitable, for example to the benefit of the company's essential suppliers.[341] Nothing seems to preclude, in some cases, relying on this exception to distribute part of the restructuring value to the shareholders themselves, where it is justified by their contribution "in kind" (their idiosyncratic knowhow for example) to the subsequent success of the underlying business. The possibility for such an exception should be enough to answer the concerns voiced by the drafters of the "relative" priority rule of the Directive without accepting their dangerous proposal.

5.3. Creditor protection against the debtor's abusive behavior

213. A few brief clarifications seem warranted, finally, regarding the creditors' broader protections

favorably than those junior to them... (it) fully respects the rights of senior creditors to be paid before junior creditors. It differs from absolute priority only in the way it identifies the time at which the rights of the agents are assessed ».

336 - See letter by Prof. Baird annexed to Weijs.

337 - In this respect, it should be noted that the wording of the rule proposed in the Netherlands for the new preventive restructuring proceedings addresses this concern, since it aims at distributing the restructuring surplus value according to the order of priorities. See Clifford Chance client memo, Revised Draft "Dutch Scheme (WCO II)", 2017.

338 - See recital 55 : "Member States should have discretion in implementing the concept of 'payment in full', including in relation to the timing of the payment, as long as the principal of the claim and, in the case of secured creditors, the value of the collateral are protected."

339 - See recital 55 : "Member States should also be able to decide on the choice of the equivalent means by which the original claim could be satisfied in full."

340 - See Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives », 2200.

341 - See recital 56 : "Member States should be able to derogate from the absolute priority rule, for example where (…) essential suppliers covered by the provision on the stay of individual enforcement actions are paid before more senior classes of creditors". This clarification was introduced following criticism of the excessive rigidity of the absolute priority rule, see Dammann and Sénéchal, Le droit de l'insolvabilité internationale, n° 2293.

against debtor's abusive behavior, which do not properly follow from the CBT,[342] because it is not a question of defining the conditions of the creditors' collective exercise of their rights.

214. One of the major drawbacks of preventive proceedings, which are now fast becoming the rule throughout the world, is the absence of typical protections afforded by insolvency proceedings against abusive behavior, especially rules on wrongful trading and avoidance actions. [343] For instance, if nothing changes in this regard with the transposition of the Directive, the annulment actions of the 'suspect period' wouldn't apply to preventive restructurings in French law, insofar as articles L. 632-1 and L. 632-2 of the French Commercial Code are subordinated to the establishment of a date of cessation of payments.

215. This omission is unfortunate, as creditors might not be able to sufficiently protect their own interests in this regard through contractual control mechanisms in the covenant-lite environment.[344] It is not even sure that it is preferable to rely on such contractual protections even where they do exist, for creditors might force debtors to reduce the risks of their investments to a suboptimal level,[345] and it is not clear how the diverging interests of different types of creditors might be reconciled through such mechanisms.[346] In any case, some recent cases have conclusively shown that even where contractual protections are provided for (through covenants or supposedly bankruptcy remote mechanisms), they are not always effective.[347]

216. The omission in the Directive of protections against abusive behaviors might therefore facilitate transfers of assets to other stakeholders than the debtors or other abusive dilutions before the opening of preventive proceedings.[348] In the absence of such traditional protections, nothing could be done to recover these assets once the proceedings are open.[349] The European Commission is fully aware of such shortcomings and seems to be engaged in efforts to harmonize such rules at the European level, although it seems to succeed more in establishing conflict of law and jurisdictions rules under the Insolvency Regulation rather than substantive rules under the Restructuring Directive.[350]

217. Finally, the Restructuring Directive has one last unfortunate omission, namely it lacks any rules on the transparency of the contemplated proceedings and the rights of creditors to be fully informed of the debtor's economic and financial health. Indeed, it is quite conceivable that a debtor opens confidential proceedings only with some of its creditors and that these proceedings do not lead to a conventional restructuring plan, in which case formal insolvency proceedings would be required. Once such proceedings are opened, the price of the claims against the debtor on the secondary market are likely to fall. However, between the two proceedings, the creditors invited to the first proceedings, being perfectly aware of the difficulties encountered by the debtor, could sell their claims on the secondary market at a price higher than that which could be subsequently recovered by the other creditors (provided that market abuse is avoided). In addition, creditors invited to the first confidential proceedings could in the meantime buy some of the debtor's assets (or those of other companies of the same group), which inevitably raises questions about whether these agreements, entered into during periods of distress are truly transactions reflecting normal market conditions.[351]

342 - These broader protections, which do not flow directly from the rules of creditors' collective exercise of their rights, will be the subject of further study in a forthcoming publication.

343 - See Gurrea-Martínez, « The Future of Reorganization Proceedings in the Era of Pre-Insolvency Law », 17.

344 See on the implications of this new covenant lite reality, Ellias and Stark, « Bankruptcy Hardball ».

345 See V. Viral V. Acharya, Yakov Amihud, and Lubomir Litov, « Creditor rights and corporate risk-taking », *Journal of Financial Economics* 102, nº 1 (2011).

346 See Hideki Kanda, « Debtholders and Equityholders », *The Journal of Legal Studies* 21, nº 2 (1992): 444.

347 See Ellias and Stark, « Bankruptcy Hardball »; for a French case, see the Coeur Defense case, where a Luxembourg based SPV didn't provide the protection expected by creditors, which later prompted the emergence of so-called "double LuxCo" structures, see Reinhard Dammann and Amaury Levenant, « Percer le mystère du montage "double LuxCo" », *Bull. Joly Entrep. diff.*, nº 5 (2013): 268; Xavier Couderc-Fani and Philippe Thomas, « Incertaine efficacité and alternatives aux doubles LuxCo », *RD bancaire and fin.*, nº 4 (2015): 20.

348 - The European Commission seems to be aware of this. According to what Prof. M. Veder said at the conference on the Restructuring Directive organized by the Royal Institute of Jurisprudence and Spanish Legislation in Madrid on 30 May 2019, it would be the next project of harmonization of rules relating to insolvency proceedings at the European level.

349 - See expressing these fears about the Anglo-American markets in a covenant-light context, Jared A. Ellias and Robert Stark, « Bankruptcy Hardball », California Law Review (forthcoming) (19 Jan. 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3286081.

350 See Andrew Keay, « The Harmonization of the Avoidance Rules in European Union Insolvencies », *International & Comparative Law Quarterly* 66, nº 1 (2017): 79-105.

351 - On these questions, see Vermeille, « Les effets pervers de la règle absolue de confidentialité applicable durant les procédures de prévention des difficultés. Plaidoyer à l'attention du législateur and des tribunaux en faveur de plus de transparence ».

218. Some protection could be expected from rules covering the behavior of managers of companies in financial distress. In France, such rules would correspond to actions 'en comblement de passif' (making whole the debtor's estate where managers are found to be liable), provided for in articles L. 651-1 et seq. of the French Commercial Code, or professional sanctions, such as management bans. However, none of these liabilities apply in case of preventive restructurings through conciliation and safeguard proceedings. Moreover, no general fiduciary duty towards creditors is provided for in case of financial distress.

219. In this regard, some salutary protection could come from the obligations stemming from article 19 of the Restructuring Directive. This article has had a turbulent history, being first provided in the Commission's initial draft, before being deleted by the Council and replaced by a simple mention of the managements' duties in recital 36. Ultimately, the article was reinserted into the text of the Directive by the European Parliament.

220. Several obligations, of unequal scope, are provided for "when there is a likelihood of insolvency". Management must, in particular, "have due regard" to "(b) the need to take steps to avoid insolvency" and "(c) the need to avoid deliberate or grossly negligent conduct that threatens the viability of the business". These two measures seem to be aimed specifically at the kind of behavior traditionally repressed in French law under the abovementioned provisions. It seems, therefore, possible to simply enlarge the scope of the existing provisions in order to cover management's behavior in the 'zone of insolvency' before preventive restructurings are opened.

221. A third obligation is to take into account, more generally, "(a) the interests of creditors, equity holders and other stakeholders". This is a clear reference to the shift of management's fiduciary duties toward the new residual owners of the company, that is, its creditors. Such obligations are already provided for in some European jurisdictions, especially Cyprus, Denmark, Estonia, Hungary, Ireland and Malta.[352]

222. However, English law seems to be the only one in Europe to explicitly provide for a shift in fiduciary duties, under Section 172(3) of the Company's Act, the exact nature of this shift having been hotly debated for a long time[353] and having given rise to somewhat contradictory case-law. [354] In particular, there are uncertainties related to the exact moment when the duties of the management are supposed to undergo such a shift, which might incentivize them to be overly risk adverse.[355] Moreover, it seems unclear which interests are to be taken into account given the heterogeneity of stakeholders. Some decisions point out, for instance, that the interests of each creditor have to be considered separately,[356] while some commentators fear that such a rule would be impracticable.[357] This concern is enhanced in light of the wording of article 19, which refers to the interests of all stakeholders, and not only creditors. All the interests would therefore have to be balanced, which gives some leeway to management.

223. In this regard, some authors radically question the suitability of such corporate law concepts as fiduciary duties and balancing acts for the purposes of restructuring negotiations, where the interests to be considered are much broader.[358] Indeed, the danger is that such an obligation would end up being unfeasible and impractical. If the manger has to serve all the separate interests at the same time, the 'boat' having no captain.[359] In this case, either managements would end up having too much of a leeway, or the costs of justifying its actions in the event of the debtor's subsequent default would prevent optimal risk-taking.[360]

[352] See Gerard McCormack, Andrew Keay, and Sarah Brown, *European Insolvency Law: Reform and Harmonization* (Cheltenham, UK: Edward Elgar Publishing Ltd, 2017).

[353] - See for a complete study, Andrew Keay, Directors' Duties, 3rd New edition edition (Bristol: Jordan Publishing Ltd, 2016); Andrew R. Keay, « Financially Distressed Companies, Restructuring and Creditors' Interests: What Is a Director to Do? », 7 Dec. 2018; Douglas Baird and Robert Rasmussen, « Private Debt and the Missing Lever of Corporate Governance », University of Pennsylvania Law Review 154, no 5 (1 mai 2006): 1209; Henry T. C. Hu and Jay Lawrence Westbrook, « Abolition of the Corporate Duty to Creditors », Columbia Law Review 107, no 6 (2007): 1321-1403; Ellias and Stark, « Bankruptcy Hardball ».

[354] - See in favour of a shift in fiduciary duties, Crédit Lyonnais Bank Nederland, N.SEE See Pathe Commc'ns, Corp., No. 12150, 1991 WL 277613, 1155, n. 55 (Del. Ch. Dec. 30, 1991) ; See however, Trenwick Am. Litig. Trust See Ernst & Young, L.L.P., 906 A.2d 168, 170-174 (Del. Ch. 2006); Quadrant Structured Prod. Co. See Vertin, 102 A.3d 155, 174 n.4 (Del. Ch. 2014), where it appears that the Delaware Supreme Court no longer recognizes standing to creditors who claim that the managements have violated their fiduciary duties.

[355] See Keay, *Directors' Duties*.

[356] See Bell Group Ltd (IN LIQ) [2012] WASCA.

[357] See R. Maslen-Stannage, « Directors' duties to creditors: Walker v Wimborne revisited », *Company and Securities Law Journal*, 2013, 76.

[358] See Hu and Westbrook, « Abolition of the Corporate Duty to Creditors ».

[359] - See Pietrancosta and Vermeille, « Le droit des procédures collectives à l'épreuve de l'analyse économique du droit. Perspectives d'avenir? », 7.

[360] - See Claire A. Hill and Alessio M. Pacces, « The Neglected Role of Justification under Uncertainty in Corporate Governance and Finance », Annals of Corporate Governance 3, no 4 (2018).

224. For these various reasons, it seems reasonable to focus the management's duties on those provided for in article 19 (b) and (c). Concerning the general fiduciary duty, it seems preferable to provide for a duty to maximize the value of the underlying business, which should be indirectly in the interests of all the stakeholders.[361] It is unlikely that a more precise duty to balance all the separate interests would give better results.

IV. Specific concerns relating to the French transposition of the Restructuring Directive

225. The transposition of the Restructuring Directive into French law will have to be thought through, for obvious reasons, so as to fit harmoniously into the existing legal system at large, as well as the economic realities of the French economy and financial markets. Indeed, when it comes to restructuring and insolvency legislation, there is no miracle solution and it is unlikely that we would ever reach "the end of bankruptcy" in terms of legal design. In order to find out which rules are likely to lead to the best results from an economic standpoint, an empirical study of the actual conditions of the market and of the incentives that the different agents are subject to is essential.[362] Indeed, borrowing Professors Gilson and Gordon's remark, the causal link seems to only go one way: the real conditions under which businesses can finance their activities determine the structure of optimal and efficient corporate governance (and, we shall add, restructuring negotiations), and not the other way around.[363]

226. One can only hope, in this respect, for the emergence of truly interdisciplinary research in law, finance and economics, the absence of which is cruelly felt in France.[364] Some brief observations can, however, already be made on the particularities of the transposition of the Directive in France.

1. Fostering the emergence of an efficient secondary debt market

227. The objectives of preventive proceedings, that is, maximizing the company's value for the benefit of all stakeholders through a restructuring, where it is justified, are best achieved where a well-developed secondary debt market exists. In our view, stimulating the development of this market requires for the confidentiality rules surrounding French preventive proceedings to be somewhat.

1.1. A way to facilitate the going concern valuation

228. The emergence of an efficient secondary debt market is, first of all, a way to increase the ease and precision of the going concern valuation, which is a central feature of any restructuring proceedings which rely on an absolute priority rule. We have already noted that this valuation is extremely complicated, even in jurisdictions where restructuring professionals and specialized courts have been engaged in such valuations for a long time. The difficulty is likely to be even greater in European jurisdictions, such as France, where there has been no need, so far, to engage in valuations of such a great sophistication.

229. In this regard, several recent empirical studies show that the dissemination of information concerning debt renegotiations in the secondary markets is linked with a drastic reduction of the percentage of erroneous valuations (as determined compared with the price offered on the secondary market for the relevant financial instruments once the restructuring proceedings are over) and facilitates a convergence between different stakeholders over the proposed valuation. One study on the dissemination to the secondary markets of OTC bond transfers negotiated under Chapter 11 proceedings go so far as to estimate that it allows for a drop from 58.4% to 24% of the percentage of erroneous valuations and for a correlative drop from 56% to 28% of the unjustified wealth transfers due to such valuations.[365] The reason seems pretty clear, for such dissemination allows for a convergence of valuations on the open market: where a potential wealth transfer is identified, the financial actors are quick to react. Moreover, such dissemination allows for the valuation to be updated depending on new information even after the judicial valuation has been determined, allowing stakeholders to change their attitude towards the proposed plan if it becomes obsolete in the meantime. In this regard, it should be noted that the disciplining effect of such dissemination seems to be even stronger where secondary debt hedge funds have a substantial

[361] See Keay, « Financially Distressed Companies, Restructuring and Creditors' Interests ».

[362] - See also noting the need for empirical studies to identify rules adapted to the state of financial markets, Paterson, « Rethinking Corporate Bankruptcy Theory in the Twenty-First Century ».

[363] - See Gilson and Gordon, « The Agency Costs of Agency Capitalism », 872.

[364] - This is precisely the objective professed by the think tank « Droit and Croissance »

[365] See Cem Demiroglu, Julian R. Franks, and Ryan Lewis, « Do Market Prices Improve the Accuracy of Court Valuations in Chapter 11? », Finance Down Under 2017 Building on the Best from the Cellars of Finance, 14 mai 2018.

economic interest in the restructuring, for their presence is linked with a decrease of the conflicts of interest between senior and junior creditors.[366]

1.2. A way out for impatient creditors

230. The existence of efficient secondary debt markets seems equally essential in fulfilling the European institutions' objective of reducing the exposure of credit institutions to non-performing loans,[367] which is also one of the official objectives of the drafters of the Restructuring Directive.[368]

231. Indeed, any exposure to outstanding and unpaid debts for more than 90 days is qualified as non-performing loan exposure for credit institutions. Credit institutions are therefore obliged to capitalize and make provisions in connection with such exposure.[369] These concerns explain why traditional creditors are not always willing to extend the period of their involvement in financing the distressed debtor's business. It is in their interest to minimize exposure to risk through swift liquidation, even if the return on their debt is reduced. Furthermore, the banks' business model is not particularly compatible with loan to own strategies, which force them to take control and manage operational companies.

232. Such creditors, as well as those who are 'impatient' for other structural reasons (for instance, investment vehicles approaching the exit moment for their own investors), could prefer claiming immediate payment even where a restructuring added value potentially exists over the long run. It seems therefore necessary to provide them with an exit option in order to safeguard the possibility for efficient restructurings.

233. Moreover, such an exit option would also help reduce the cost of *ex ante* financing, since credit institutions, as well as other investors, would no longer have to fear the possibility of being exposed to the risk of the debtor's underlying business for a period longer than the one initially expected. It has long been observed, in fact, that the existence of a liquid secondary market is strongly correlated with a reduced cost of access to finance.[370]

1.3. An entry route for distressed debt hedge funds

234. If impatient creditors can get out of the process through secondary markets, they can be replaced by economic agents who are more interested in the success of the restructuring.

235. This may be surprising in France, where discounted debt hedge funds have a bad reputation, but empirical studies in other jurisdictions seem to conclusively prove the potential beneficial contribution of these new agents in preserving viable businesses and increasing the recovery rate for other stakeholders.[371] The intuition explaining such results in these foreign markets is that while traditional creditors are primarily interested in minimizing their losses and exposure to the risk of the debtor's underlying business, the objective of the distressed debt funds is to maximize the yield of their investment in the purchased debt.[372] Therefore, where some senior creditors would be interested in swiftly liquidating the debtor's assets, the distressed debt funds are fully incentivized to favor a restructuring where a restructuring added value is expected.[373]

236. Indeed, the strategy of these hedge funds is precisely to buy debt they consider to be discounted compared to the debtor's prospects of recovery,

366 See Wei Jiang, Kai Li, and Wei Wang, « Hedge Funds and Chapter 11 », *The Journal of Finance* 67, nº 2 (2012): 513-60.

367 - See ECB, « Guidance to banks on non performing loans », March 2017; Plan d'action for la lutte contre les prêts non performants, 11 July 2017 (doc. 11170/17). Sur ces points, See http://europa.eu/rapid/press-release_MEMO-18-6547_fr.htm?locale=FR.

368 - See COM (2016) 723: « Effective insolvency frameworks are particularly important economically in the financial sector, which is faced with high levels of private debt and non-performing loans, as is the case in some Member States. The European Central Bank has identified, in its overall 2015 assessment, non-performing exposures in the banking system for a total amount of EUR 980 billion. These loans weigh heavily on banks' ability to finance the real economy in several Member States. »

369 - See Regulation 2018/0060 (COD) amending Regulation (EU) No 575/2013 as regards the minimum coverage of losses on non-performing exposures, article 1.

370 - See Ronald J. Gilson and Charles K. Whitehead, « Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets » 108 (2008): 231.

371 - See Wei Jiang, Kai Li, and Wei Wang, « Hedge Funds and Chapter 11 », The Journal of Finance 67, no 2 (2012): 513-60: « Hedge fund presence increases the likelihood of a successful reorganization, which is usually associated with a higher recovery of junior claims (unsecured debt and equity) and an increased likelihood of their being converted into new equity... The presence of hedge fund unsecured creditors is associated with both higher total debt (including secured and unsecured) recovery and a more positive stock market response at the time of a bankruptcy filing, suggesting a positive effect of hedge fund creditors on the firms" total value. Such value creation may come from overcoming secured creditors' liquidation bias, confronting underperforming CEOs, retaining key personnel, and relaxing financial constraints" ».

372 - See Michelle M Harner, « The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing », Fordham Law Review 77, no 2 (2008): 750-54.

373 - See Paterson, « Rethinking Corporate Bankruptcy Theory in the Twenty-First Century », 711.

eventually after a cleansing act of debt equity swap.[374] They are often well equipped, recruiting people capable of managing the company's operations, and have adequate investment horizons prioritizing restructuring.[375]

237. The exit of impatient creditors through secondary markets also allows, in principle, for a concentration of debt in the hands of a small number of hedge funds. A limited number of creditors, who are much more exposed than the original creditors to the risks of restructuring and are more likely to have a long practical experience related to restructuring proceedings, seem more likely to achieve a compromise where a gain is to be made, as well as to discipline the debtor's management during the proceedings by exercising an effective oversight.[376]

238. As previously stated, we cannot make a definitive argument with regard to France based on studies concerned with foreign markets, with their own realities and legal structures. Rather, it should be understood that the view, widely shared in France, that these actors are unruly and lawless "vultures" is not always justified. One can only hope that serious empirical studies will be initiated soon to identify the extent to which the remarks we have just made are transposable to the specific conditions of the French market.[377]

239. Our intuition, for what it's worth, is that if the same actors behave differently in the Anglo-American markets compared with the French market, the reason is in the particular incentives created by the relevant normative environment, because any negotiation takes place in the shadow of what is likely to happen if they were to be aborted.[378] Thus, if the treatment of creditors, including junior creditors, in the various insolvency proceedings is not predictable, this could encourage hedge funds to be excessively short-term oriented and seek to extract a quick gain from their investment, rather than submitting to the risk of an unpredictable and potentially unfair subsequent treatment. Where this is the case (and France seems to be, in our view, a case in point), the normative environment that creates these suboptimal incentives should change, so as to enable markets and the self-interested actors thereof to better perform their disciplining role.

1.4. The need to relax the French confidentiality rules

240. As we have argued, the emergence of a liquid secondary market whose normative infrastructure creates optimal incentives is essential to promote restructuring and the protection of all stakeholders' interests. Such an efficient secondary market is, however, not imaginable where information about different investment opportunities in distressed but viable businesses or their debts cannot swiftly travel through the market. One of the obstacles in this regard under French law comes from the very vigorous confidentiality rule in the conciliation proceedings.[379] In our view, such a strong rule is likely to make rather difficult the task of the French legislator in designing efficient

374 - See Harner, « The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing », 715: « Investors generally realize a gain on distressed debt investments when the debtor achieves; or the market anticipates, a successful turnaround »; Baird and Rasmussen, « Antibankruptcy », 671: « Banks want their money back; hedge funds loan to own »; Jiang, Li, and Wang, « Hedge Funds and Chapter 11 »: « While the bankruptcy process was traditionally classified as either "management driven" or "senior creditor driven", hedge funds have driven the transformation of the restructuring process into one that is best characterized as "management neutral" where managements facilitate and implement the distressed firms' restructuring plans but do not control the restructuring process ».

375 - See Baird and Rasmussen, « Antibankruptcy », 662.

376 - For an empirical study on the effect of the presence of discounted debt funds in the context of Chapter 11 proceedings, See Jared A. Ellias, « Do Activist Investors Constrain Management Moral Hazard in Chapter 11?: Evidence from Junior Activist Investing », Journal of Legal Analysis 8, no 2 (1 Dec. 2016): 493-547: « This article examines the hedge fund investment strategy of buying junior claims of Chapter 11 debtors and playing an activist role in the bankruptcy process. These hedge funds are often accused of rent-Seeking by managements. I use a new methodology to conduct the first empirical study of this investment strategy. I find little evidence that junior activists abuse the bankruptcy process to extract hold-up value. Instead, the results suggest that they constrain managemental self-dealing and promote the bankruptcy policy goals of maximizing creditor recoveries and distributing the firm's value in accordance with the absolute priority rule ».

377 - See stressing that the economic efficiency of insolvency proceedings rules depends above all on the real conditions of the market ,Casey, « A Structured-Renegotiation Theory of Corporate Bankruptcy »; See also Paterson, « Rethinking Corporate Bankruptcy Theory in the Twenty-First Century »: « Finally, a note of caution is sounded for the future. This article is written at a time of extraordinary liquidity, fueled in no small part by government policy in the financial crisis. If this liquidity were to dry up, so that the distressed debt market could not fulfil the role prescribed for it here, then the law and practice of restructuring and insolvency may yet move back to something far more reminiscent of the early 1990s. Moreover, the capital markets are in constant, and rapid, change... As ever, writing in a fast moving and unpredictable area, a crystal ball would be a friend ».

378 - See Mnookin and Kornhauser, « Bargaining in the Shadow of the Law ».

379 - Article L. 611-15 of the French Commercial Code provides that "any person who is called to conciliation proceedings or to an ad-hoc mandate or who, by virtue of his duties, is aware of them is bound by confidentiality". On the extent of this obligation, see Le Corre, Droit and pratique des procédures collectives 2019/2020, n° 141.61.

preventive restructuring proceedings while keeping the conciliation / SFA or SA model.[380]

241. Indeed, in order for efficient secondary markets to develop, it is necessary that the actors have sufficient information on the debtor's situation so as to be able to evaluate its future prospects. Without such shared knowledge, an agreement on the secondary market over the fair price of the financial instruments attributed to its creditors is unlikely to emerge, as the creditor is likely to have more information on the debtor's financial and operational status that a third-party buyer.[381] If the seller cannot disclose the information on the market, it is unlikely that a satisfactory price will be found, as the two potential parties would assess the future prospects of the underlying business differently. If they do not accept an important discount related to this dissymmetry of information, creditors could therefore end up being (potentially inpatient) captives in the preventive proceedings, with all the negative consequences that follow from it.

242. To be sure, relaxing these confidentiality rules does not mean ensuring a broad publicity of the proceedings, as such publicity could potentially harm the debtor's commercial relations and its subsequent prospects of refinancing. Nor is it required to transform the French conciliation proceedings into public proceedings within the meaning of Regulation 2015/848. Rather, creditors must simply be able to find willing buyers for their claims and share critical business information on the company's status so that they can agree on an acceptable price.[382]

2. Reforming the secured transactions regime in case of insolvency or restructuring proceedings

243. The transposition of the Restructuring Directive into French law must also be the occasion for a profound reform of the treatment of securities and collateral in insolvency and restructuring proceedings. Fortunately, the government has been given this opportunity through article 16 of the Pact Law.[383]

244. A reform in this regard seems quite urgent in light of the imminent transposition of the Directive, insofar as certain safeguards it provides for cannot be implemented effectively under the current state of the law.[384] This includes the "best interest of creditors" test, which requires a comparison between the creditor's treatment under the restructuring plan and its hypothetical fate in the event of an immediate liquidation of the debtor (or the best alternative). In fact, the order of distributions and loss absorption of different stakeholders in the event of a liquidation under current French law is quite illegible, for it is extremely context sensitive.[385] The treatment of creditors depends heavily on the competing claims of super-secured creditors (mostly, the fund charged with satisfying the claims of salaried workers and the tax administration) and is, in any case, different in the event of a sale of the busi-

[380] - See on this question, Vermeille, « Les effets pervers de la règle absolue de confidentialité applicable durant les procédures de prévention des difficultés. Plaidoyer à l'attention du législateur and des tribunaux en faveur de plus de transparence », 27 et seq.

[381] - See R. Ophèle, president of the AMF, during a hearing in the French Senate on 29 May 2019: "The AMF must maintain a balance between the requirements of transparency and good information given by issuers. We need to understand the stakes, the accounts, the issues ... and, on the other hand, we need to ensure that the markets function properly and that the formation of prices on the markets is done transparently and without manipulation. ... if there are only passive investors, the markets do not work. "

[382] - See on the proposed solutions, as well as all the arguments in favour of a reform of the rule of confidentiality, Vermeille, « Les effets pervers de la règle absolue de confidentialité applicable durant les procédures de prévention des difficultés. Plaidoyer à l'attention du législateur and des tribunaux en faveur de plus de transparence ». In this respect, we welcome the modest development shown by the recent decision of the Paris Court of Appeal of 6 June 2019 (RG 18/03063). To overturn an interim injunction ordering the deletion of information concerning the amicable proceedings opened to the benefit of Conforama from the website "Challenge", the Court notes: "Yet, the disclosure of this information cannot constitute a clearly unlawful behaviour unless it proves with the evidence required for interim injunctions that it does not contribute to the legitimate information of the public on a debate of public interest ... It cannot therefore be deduced, from the evidence required for interim injunctions, that this one piece of information, set out in the conditional tense and in this context, may have compromised the chances of success of the ad hoc mandate proceedings."

[383] - See regarding the treatment of collateral in insolvency proceedings, Philippe Roussel Galle and Françoise Pérochon, « Sûretés and droit des procédures collectives, le couple infernal », Rev. proc. coll., 2016, 65-66; on the treatment in French insolvency law of new property security rights, see Yaya Diallo, Les sûretés and garanties réelles dans les procédures collectives (L'Harmattan, 2019); on the reform of insolvency proceedings under the Pact law, see Philippe Roussel Galle, « Principales innovations intéressant le droit des entreprises en difficulté dans le projet de loi PACTE », Rev. proc. coll., 2018, 14-16.

[384] - See for other arguments regarding a necessary reform of the treatment of collateral in insolvency proceedings in the light of the normative competition, Dammann and Rotaru, « Plaidoyer pour une approche fonctionnelle du droit des sûretés ».

[385] - See for a criticism of the illegible treatment of property security rights in the event of insolvency proceedings in France, Vermeille and Bézert, « Sortir de l'impasse grâce à l'analyse économique du droit : Comment rendre à la fois le droit des sûretés réelles and le droit des entreprises en difficulté efficaces ? »; Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives »; Dammann and Rotaru, « Pour une réforme cohérente du droit des sûretés and de la loi de sauvegarde dans une approche d'harmonisation franco-allemande ».

ness as a going concern or the isolated sale of its assets.[386]

245. We have suggested in other publications that the way forward is, in our view, the functional approach to security rights.[387] Such an approach would be in line with the latest international trends,[388] and would go further than what has been achieved by the 2006 reform of French secured transactions law under the guidance of a commission headed by Professor M. Grimaldi.[389] The basic idea of such an approach, which could find its theoretical foundation in Calabresi and Malamed's theory,[390] would be to treat in the same way functionally similar securities. Such treatment could be based on a general criterion of the utility of the asset to the continuous exploitation of the debtor's business (concerning the moment when the security could be enforced) and, in any case, the preservation of the value of the asset for the benefit of the creditor in case of sale of the business or of the debtor's assets, eventually discounted so as to force creditors to always have some 'skin in the game' and therefore incentivize them to favor value preserving restructurings.[391]

3. Reforming more generally insolvency law to ensure its coherence as a whole

246. The last point we would like to raise concerns the broader coherence of the French restructuring and insolvency legal system. In this regard, there are several reasons, in our opinion, pleading in favor of abolishing the judicial recovery proceedings (*redressement judiciaire*).

247. First, it seems of utmost importance to ensure that if a restructuring proves to be impossible, the debtor is liquidated as soon as feasible.[392] Preventive proceedings must, as we have pointed out, meet the same objectives as "standard" insolvency proceedings and are only justified insofar as the end result is better for all the stakeholders than the expected result of liquidation proceedings. If they are initiated but prove to be unsuccessful, because the creditors could not find a suitable agreement while negotiating in suitable epistemic conditions, there are good reasons to believe that no restructuring value gain is to be expected. In other words, the lack of agreement between those who are best positioned to identify and preserve viable businesses is indicative of the fact that there is no reason to delay a liquidation, either by the sale of the business as a going concern to a third party (which is unlikely, as it could have taken place during the restructuring proceedings) or by an isolated sale of assets. Swiftly filtering and treating viable and non-viable businesses differently is, indeed, one of the essential functions of effective insolvency proceedings.[393]

248. Moreover, if the debtor can benefit from other non-liquidation type proceedings following the failure of preventive restructuring proceedings, it could be encouraged to try its luck with these different proceedings one after the other in a rather opportunistic manner. The delays for treating businesses in distress could then end up being unreasonably lengthened.

249. Additionally, this very possibility is likely to change the dynamics of the restructuring negotiations, insofar as the debtor would be in a position to threaten its creditors to wait for the formal suspension of payments in order to open judicial recovery proceedings, which carry an unpredictable outcome, if the plan favored by the debtors were to be rejected (especially where a plan cannot be accepted without the debtor's consent).

250. Finally, the existence of several distinct types of proceedings that respond in principle to the same type of factual situation increases the uncertainty faced by the debtor's stakeholders. The latter cannot foresee, in fact, which specific proceedings are likely to be initiated. This is likely to result in un-

386 - See Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives », 2199; Reinhard Dammann and Martin Guermonprez, « For une réforme du droit des sûretés en adéquation avec le droit des entreprises en difficulté », D., 2018, 1160.

387 - See Vermeille and Bézert, « Sortir de l'impasse grâce à l'analyse économique du droit : Comment rendre à la fois le droit des sûretés réelles and le droit des entreprises en difficulté efficaces ? »; Dammann and Rotaru, « Plaidoyer pour une approche fonctionnelle du droit des sûretés »; See also Prof. Riffard's thesis, Jean-François Riffard, Le security interest ou L'approche fonctionnelle and unitaire des sûretés mobilières : contribution à une rationalisation du droit français (Lgdj, 1999).

388 See V. Marek Dubovec and Giuliano G. Castellano, « Global Regulatory Standards and Secured Transactions Law Reforms: At the Crossroad Between Access to Credit and Financial Stability », *Fordham International Law Journal* 41, nº 3 (2018): 531.

389 See, Muriel Renaudin, « The modernisation of French secured credit law: law as a competitive tool in global markets », *International Company and Commercial Law Review* 24 (2013): 385-92.

390 See Calabresi and Melamed, « Property Rules, Liability Rules, and Inalienability: One View of the Cathedral ».

391 See Dammann and Rotaru, « Plaidoyer pour une approche fonctionnelle du droit des sûretés ».

392 - See Gurrea-Martínez, « The Future of Reorganization Proceedings in the Era of Pre-Insolvency Law », 26.

393 - See Eidenmüller, « Contracting for a European Insolvency Regime », 15: « a financially distressed firm should be restructured and kept alive only if it is economically viable, i.e. if it does not suffer from financial and economic distress »; See Plantin, Thesmar, and Tirole, « Les enjeux économiques du droit des faillites ».

predictability and, correspondingly, an increase in the cost of *ex ante* corporate financing.[394]

V. Conclusion

251. The Restructuring Directive is a highly complex text, which reflects the divergent aims and inspirations of its multiple drafters. For this reason, it suffers, from our point of view, from a certain confusion which renders its comprehension difficult if it is not read through the lenses of the four basic models it proposes. If the aim of the drafters was to create harmonized European insolvency proceedings in line with the requirements and lessons of the law and economics movement, then it is, in our opinion, a regrettable failure.

252. The fundamental problem seems to come from the fact that the European legislator sought to fight the wrong battle. The goal of preventive proceedings must not be that of saving companies at all costs, even when they are not viable in the long run. Rather, they should first of all aim at filtering viable businesses from those that are not. The former must be restructured well before a formal insolvency, while the latter must be swiftly liquidated, so that the company's resources can be more efficiently distributed in the economy. Only then can the costs of *ex ante* financing be reduced, and long-term economic growth be ensured.

253. As we have seen, some of the Restructuring Directive's provisions give wrong answers to false problems and leave no leeway for national legislators. Fortunately, this is not the case of all of its provisions. Our analysis, based on a functional approach to law and economics, suggests that it is essential for the French legislator to keep in mind the objectives that should be pursued by the contemplated restructuring proceedings, and ignore those which seem to be unsuitable. In this regard, it seems important to ensure that the future French preventive proceedings effectively filter viable from non-viable businesses, allowing a restructuring of the former according to predictable rules respectful of the rights and respective ranks of different stakeholders. We also believe it essential to stimulate the emergence of a liquid and efficient secondary debt market, which could prove very useful in achieving the economic objectives of preventive proceedings.

254. These are, in our opinion, the *sine qua non* conditions for turning the French preventive restructuring proceedings, which already have multiple commendable aspects, which cannot be denied, truly efficient from a functional economic standpoint. The financing of French companies, by credit institutions as well as through the bond markets, would thus be facilitated. These are also the conditions for French law to become, in the current environment of normative competition, a credible challenger in the competition for the place of leader of future cross-border European restructurings.[395] All the stakeholders would have much to gain if these goals were to be achieved.

[394] - See Gurrea-Martínez, « The Future of Reorganization Proceedings in the Era of Pre-Insolvency Law », 26: « many debtors that do not deserve to be reorganized (i.e. non-viable firms and viable businesses managed by the wrong people and non-viable companies) may opportunistically file for reorganization. And if so, creditors may respond with an ex ante increase in the cost of debt, and jobs can be lost if economically viable businesses managed by the wrong people are not quickly sold to third parties ».

[395] - See regarding competition issues, Dammann and Rotaru, « Premières réflexions sur la transposition de la future directive sur les restructurations préventives ».