

Chapter 9

Corporate Rescue: Workshop Report

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Introduction

There has been increased attention on corporate rescue over the past few years in Europe and elsewhere around the world. The workshop provided insights on this topic from both legal and business perspectives. Efforts made in Belgium to introduce and improve legal tools for corporate rescue and research on turnaround management were discussed. The workshop started with an introduction by Professor Bariatti,¹ chair of the workshop, on the Commission's Recommendation on a new approach to business failure and insolvency ("Recommendation").²

Recommendation of the European Commission

Professor Bariatti acted as one of the Reporters for the INSOL Europe Study³ that was commissioned by the European Commission. The results of this Study were used in preparing the Recommendation. She discussed some background details of the Recommendation, in particular the initial idea of the Commission to draft a directive. This should provide for a uniform pre-insolvency proceeding to be adopted next to the currently existing proceedings under national law. Several Member States were already in the process of reforming their insolvency laws, also, Member States were not keen at transferring powers on this topic to the EU. Presenting a Directive would therefore not be realistic. Still the Recommendation will bring novelties to some countries, whereas others might take its contents into account during their process of drafting.

Three pressing challenges regarding the Recommendation were discerned by Professor Bariatti. First of all, there is a fondness in the Recommendation for pre-insolvency proceedings to rescue viable companies and maximise value for

1 Professor of Private International Law, University of Milan.

2 Commission Recommendation 12.03.2014 on a New Approach to Business Failure and Insolvency, COM(2014) 1500 final.

3 INSOL Europe, "Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices" (2014), available at http://ec.europa.eu/justice/civil/files/insol_europe_report_2014_en.pdf (last viewed at 15 June 2014).

creditors. The real problem however, as was experienced by national experts of the INSOL Europe Study, is that entrepreneurs start insolvency proceedings usually too late to be effective. By then, companies are often not viable anymore, which makes it much more difficult to take effective measures. Secondly, there are no clear and reliable statistics on the outcome of pre-insolvency proceedings. The choice for such proceedings is not supported by empirical data. Thirdly, there are issues relating the coordination of the Recommendation with the European Insolvency Regulation (“EIR”). Pre-insolvency proceedings are considered in the proposal of the Commission for amending the EIR, but there are still a number of issues that need to be solved.

Corporate Rescue in Belgium

A lot of effort has been put in designing effective corporate rescue proceedings in Belgium over the past years. Professor Vanmeenen⁴ explained the developments that have taken place since 1998. In that year, the *Concordat Judiciaire* was introduced, specifically designed for the rehabilitation of distressed companies. It is a simple scheme of arrangement where the debtor remains in possession. A reorganisation plan would be drawn up by the debtor, the creditors could vote on it, and a court would need to approve it. It did not work well. Statistics show that, over a period from 2002 till 2009, the number of these proceedings went down from 180 (out of 6000 bankruptcies) to 25 cases. Out of these cases, only 20% did not end up in a bankruptcy.

As of 1 April 2009, the Belgian Continuation Act (“BCA”, *Wet betreffende de continuïteit van de ondernemingen*) came into force. The BCA, aimed at commercial undertakings only, allows for informal and formal proceedings. It was considered too debtor friendly. The BCA was amended in the summer of 2013 to better protect creditors and reduce the misuse made of it. As of 200, the number of proceedings under the BCA has risen from 633 in 2009 to 1459 in 2013, but it seems to have decreased again since the amendment in 2013.

Commercial Investigation Procedure

The commercial court overlooks all companies in its district, they have access to financial information on them. A Commercial Investigation can be started when the court expects a company to face financial problems. It aims to ensure early warning and corporate cleansing. The commercial court can call up the management to inquire after their plans to address the situation. In 2013, the

4 Professor of Insolvency Law and Commercial Law, University of Antwerp.

Commercial Investigation Procedure was amended as management did not often show up at hearings. Now the accountant and auditor have a legal obligation to warn the company of threats to continuity. If the company takes no subsequent action, they need to inform the commercial court.

The court can only question the management about their plans, in order to stay impartial they cannot give any advice. However, they can appoint a business mediator to assist the management. Professor Vanmeenen questions if this framework is sufficient to prevent insolvency, as there are no figures available on its success.

Access to Formal Reorganisation Proceedings

The entry requirements for formal reorganisation proceedings have changed over time. Under the BCA, a formal reorganisation procedure (a collective agreement, amicable agreement or transfer of business) provides the company with an initial stay of six months, and a maximum of twelve months. From 1998 until 2009, the judge would decide who would be let in. On the contrary, the BCA of 2009 allows any company in when its continuity seems to be threatened, either immediately or in the future. The judge cannot take the viability of the company into consideration. This led to many filings without a rescue purpose. The amendments in 2013 imposed more requirements on applications for a formal reorganisation proceeding. Companies need to pay EUR 1000 (previously EUR 60) and provide financial statements and a budget for the stay, to be prepared with the support of an external accountant or auditor. The question remains whether better prepared applications will lead to a higher success ratio. Currently 70-80% of the reorganisation proceedings result into a bankruptcy. However, the BCA requires companies to stick to a rescue plan for five years. In 2014, five years after its introduction in 2009, the first results of the BCA should therefore become available.

Turnaround of Companies in Distress

Professor Adriaanse⁵ took another perspective, as he tries to bridge the world of business and insolvency law. Research can help to better understand the reasons for failure and success of companies. Often a lack of marketing and strategic thinking causes the problem, but frequently management also starts reorganising too late. Some research has shown that after having experienced a reorganisation, management would like to have started on average 16 months earlier.

5 Professor of Turnaround Management, Leiden Law School.

The crisis experienced by management evolves over time. 17% of the companies only start reorganising when cash is almost up (liquidity crisis). 54% of the companies act at an earlier stage when the company starts making losses. The right moment for reorganising lies prior to this earnings crisis, it is when the company is in a strategic/assumption crisis. This is the moment when the company needs to redefine who it is, what it does, and what it is that makes the product and the brand a success. 29% of the companies reorganise the company already when such a crisis takes place. The difficulty is that a company is still profitable and both internal and external stakeholders may be reluctant to do a reorganisation. However, stakeholders will have more trust and confidence in reorganising the company at an early stage, than when the company is already in a liquidity crisis.

Successful and Unsuccessful Turnarounds

Professor Adriaanse discussed that in order to accomplish a successful turnaround the company needs to take a holistic approach. This requires:

- stabilisation of the company (for example cash management and cost cutting);
- analysing the situation (including writing a reorganisation plan);
- repositioning; and
- reinforcing the company.

Turnarounds often fail as companies lose trust from their stakeholders. Also, there is not enough attention on communication with the stakeholders, as well as improving the operational and strategic performance of the company. Research has shown that successful companies show an active attitude towards the shareholders. They take adequate turnaround measures, going beyond pure financial issues. They are transparent towards their stakeholders, financiers are involved in the turnaround process and the company is seeking risk bearing capital.

Professor Adriaanse characterises insolvency law as being often creditor unfriendly (and at the same time debtor friendly). He questions how this relates to success and failure factors found in turnaround research. Does insolvency law and discourse on law reforms support the company management to do a more holistic turnaround planning? Also, does teaching on insolvency law pay enough attention to turnaround management?

Discussion

There were three main issues during the discussion. Professor Paulus stated that, irrespective of the available legal tools, the eternal question remains what can be

achieved if the decisive factor is always the human factor. Although it is in no way a counter argument for great legislation on corporate rescue as in Belgium, the human factor is necessary to put things in reality. In this way lousy legislation may turn out very well with excellent insolvency office holders. Professor Paulus also emphasized the importance of already small numbers of reorganisations. Rescue proceedings in France and the United Kingdom do not serve large numbers of companies successfully too, nevertheless, when a rescue is successful it can still be very meaningful. Professor Vanmeenen added that with both easy and more restricted access to reorganisation proceedings the success rate remained low in Belgium. It may also be obvious as companies in such proceedings have a relatively high chance on bankruptcy. Still, in Belgium they are curious if the BCA will bring better results.

Participants in the workshop were very interested in the insights of turnaround management. It enables a broader perspective to better address the challenges of distressed companies. In particular principles of turnaround management would be useful, for example in teaching insolvency law.

Dr. De Weijs responded to Professor Adriaanse's remarks to take a holistic approach and give more attention to strategy and acquiring risk bearing equity. He considered that it may be difficult for a lawyer to come up with a new business strategy. He also noticed that there is a tendency to overlook the role of shareholders, discussions on corporate rescue tend to be focused on the creditors. They often have to accept a haircut, but could also be given a part of the company when they are not being paid in full.

This led to some discussion. Some stated that creditors would prefer money, instead of owning a part of the company, others mentioned that trade creditors would even consider the continuation of the business relation to be more valuable than payment of the debts at all. Dr. De Weijs replied that creditors would rather have a part of the company than having a haircut while the shareholders are left in place. When the creditors own part of the company they will also benefit from the upside potential. Of course, creditors may prefer a payment in full rather than getting risk bearing equity, but they can still decide to sell their shares.

Professor Bariatti concluded the workshop after a lively discussion. The workshop highlighted pressing issues in dealing with corporate rescue. Professor Vanmeenen discussed how the Belgian BCA deals with those challenges, and Professor Adriaanse showed what the insights of turnaround management can add to support successful corporate rescue.