Restructuring versus Liquidation

The Austrian Perspective and Answers

KSV1870

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What is coming your way?

- Creditor Representation in Austria
- Success Factors for Restructuring
- Austria: World Champion in Restructuring
- Secured versus unsecured creditors
- The Minimum Payout Threshold
- A Macroeconomic Model of Restructuring
- Proposal for Directive on Pre-Insolvency Restructuring Framework of Nov. 2016

KSV1870

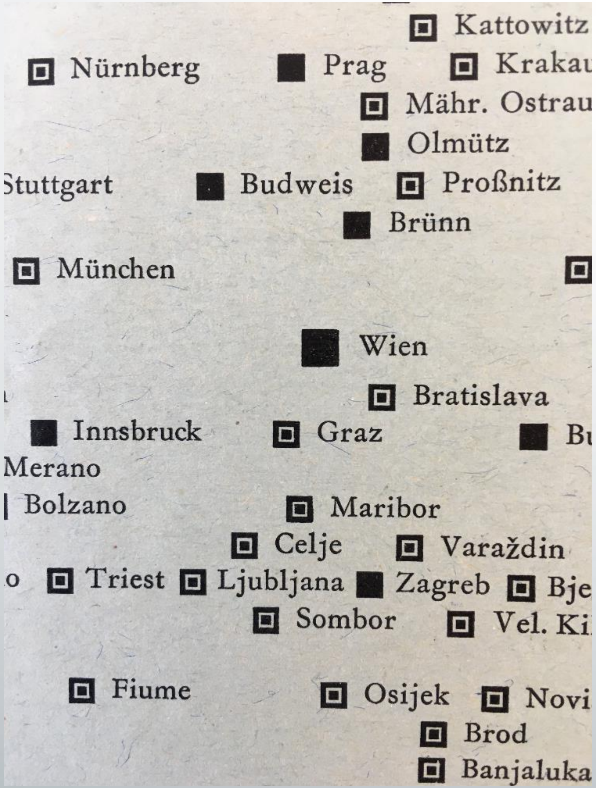
Brief description of KSV1870?

KSV1870

schafft Wissen

sichert Werte

Many years of experience since 1870



Representation of creditors since 1870
Created as an Association of businessmen
Presence between 1918 and 1938 as depicted
24,000 members as of today – 400 employees
active in
./ Credit Information (credit bureau)
./ Debt Collection
./ Insolvency Services
most sizeable representative of creditors in Austria

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Success Factors for restructuring

- Early activity by management – Every Insolvency Practitioner confirms that debtors invariably come too late;
- Simple and workable framework for secured loans (secured debt);
- Partially secured debt creates a positive correlation with no. of restructurings ;
- Simple and workable rules for restructuring mechanism (voting by creditors – affected and unaffected creditors – valuation and participation of creditors);
- Few parties to negotiate with (banks – tax authority – trade creditors – employees);
- Quick solutions and minimal court intervention;
- Seasoned Insolvency Practitioners.

Austria -

World Champion in Restructuring

- Simple rules for collateral: eg land register;
- No fixed and floating charge;
- No register for charges upon movable assets;
- Very restrictive rules for retention of title;
- Fast and simple mechanism (3-6 months and only unsecured creditors vote);
- Inexpensive mechanism due to minumum payout quota (20%);
- Austria **restructures approx one third** of all (opened) business insolvencies every year;
- This is a success rate not shared anywhere else in the world.

The minimum payout quota threshold for materially sound restructurings

- By law, restructurings need to offer a minimum of 20% payout to unsecured creditors in Austria;
- Therefore a simple mechanism helps calculate the amount of money to be paid to unsecured creditors (within a maximum period of 2 years);
- Businesses not bearing the necessary promise to return to profitability in the future will therefore not be rescued;
- This calculation is not done by expert valuation or court decision, but by the secured creditors, who normally have very good information about the business and have been stakeholders of the business for a long time.
- The minimum payout quota therefore acts as **proof of substance** for restructurings.

Secured versus unsecured creditors

- In legal terms, a restructuring is a deal between the debtor and his unsecured creditors;
- In business terms this is quite something else:
- Restructurings always need a financing party (owners – banks);
- This financing party is normally a secured bank not wanting to see their collateral auctioned off today;
- Within certain boundaries therefore, such secured bank would be willing to extend further money to buy into a lighter future with possibly 100% collateral ratio and a full payback;
- It is therefore the secured creditor negotiating with unsecured creditors: the secured creditor advances more money and keeps the collateral and the unsecured creditors waive large parts of their claims and get a fair minimum payment of 20%.

A macroeconomic model for restructuring

- **Competition** is the main underlying force in our economy;
- Competition also the force driving businesses into insolvency;
- Restructuring insolvent businesses in essence means: **helping the weakest player** in the competition game at the expense of all the stronger players;
- Liquidating a weak competitor looks like giving a „windfall profit“ to the strong competitors. Such profit, however, has been earned by them and is therefore the „medal in the competition“ rather than a windfall profit.
- Fair restructuring chances give incentives to management to act responsibly and early.
- Early insolvency puts an end to the **wastage of resources** in the economy (trading at a loss);
- Restructuring a business preserves value and offers a „second chance“.
- The minimum payout quota in Austria is a simple and effective mechanism to further both goals.

Proposal for Directive on Pre-Insolvency Restructuring Framework of Nov. 2016

- The Proposal is a mixture of ch 11 (US) and Scheme of Arrangements (UK);
- Both systems are strongly creditor driven;
- **Loan to own** is the new strategy;
- Debt for equity conversions and ch 11 like systems help taking over companies without having to pay out large sums of money;
- The proposal therefore creates a complex and costly mechanism that enables large creditors (locusts) to buy into bad debt and subsequently take over large companies by kicking out the owners and the creditors alike (creditors' best interest test: everybody must accept what they would attain in a full liquidation)
- The „value added or preserved" by restructuring goes to the strongest player (the locust presumably).

Proposal for Directive on Pre-Insolvency Restructuring Framework of Nov. 2016

- The proposal will therefore create new rules for very large companies only;
- Nothing for the SME;
- The procedure will be costly (expert valuations);
- The procedure creates dangers for existing owners (creditor driven);
- The procedure lacks inherent fairness: no sharing of the value added.

- It is still being negotiated in Brussels and a trilog agreement will propably be reached in November 2018 and will pass Parliament in Feb 2019 with coming into force in 2022.
- It will by then haven been largely watered down and will have lost much of its impetus.

Thank you for your most valuable gift:
your attention.

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