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STATUTORY PRIORITIES IN THE NEW NORDIC RESTRUCTURING LAWS

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STATUTORY PRIORITIES IN THE NEW NORDIC RESTRUCTURING LAWS

High-Level Report

13th March 2024

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Prelude: Waterfall Payments

Waterfall payment structures, as understood in the capital markets, require that higher-tiered creditors receive interest and principal payments, while the lower-tiered creditors receive principal payments only after the higher-tiered creditors are paid back in full.

As this principle may also refer to the rights of equity holders in any insolvency proceeding, they should not be entitled, based on such a hierarchy, to retain their rights in case of a cram down of any creditor class.

This Report will discuss:

i) whether the law requires waterfall payment structures to be followed already at a *statutory* corporate restructuring (and not in a bankruptcy only), and

ii) if so, what kind of exemptions are available.

Interestingly, there is a big variation between the statutory laws in the US, the UK, and the EU Member States on this topic.

Preamble

The research project analyses key elements of the new Nordic restructuring laws after implementation of the Restructuring Directive (EU) 2019/1023 and, particularly, the statutory priorities in the new restructuring laws. The project aims to:

i) provide an in-depth pan-Nordic comparison, essentially from the perspective of debt capital markets, on the key features of the new Nordic restructuring laws, after implementation of the Restructuring Directive (EU) 2019/1023 and

ii) once the project report has been published, arrange (a) high-level discussion forum(s) about topics centered around this important piece of legislation, which may have major impacts on the European capital markets. The report may also be discussed with relevant market organisations, such as the Nordic Capital Markets Forum.

The aim of the **Report on Statutory Priorities in the New Nordic Restructuring Laws (hereinafter the 'Report')** is not only to provide informative legislative analyses about the statutory laws in the Nordics and – for a comparison – in other key jurisdictions, but to also discuss the impact of the new rules on capital markets. Therefore, particular attention has been given to a comparison of the new Nordic statutory priority rules in the restructuring practice and further, *de lege ferenda*, to optional models for the potential enhancement of the rules in the Nordic EU Member States.

The Report concentrates on high-level topics and does not cover issues of a more technical or procedural nature. It is our intention that the Report shall be of use to all capital market experts, not only practicing lawyers. When planning any cross-border capital market transaction, it is essential to understand how the legislation operates in a distress situation. From an economic efficiency perspective, it is vital that the legislative set-up is predictable for market participants, both issuers and investors.

The statutory priority rules in restructuring form a centerpiece for regulating the rights of key stakeholders of a company. Therefore, such rules may have a major indirect impact on capital markets – jurisdictions which regulate this challenging relation between the key stakeholders, shareholders, and creditors in a trustable and predictable way, may be considered to benefit from further capital market activity.

The importance of the restructuring rules has indeed been noted by the European Union. Already in 2015, a need for unification of the key rules in restructuring was considered as a key topic in the EU Commission action plan for the Capital Markets Union. Since then, the EU has made significant progress with putting the building blocks in place, extending beyond the Restructuring Directive. However, deepening the CMU is complex and no single measure will complete it. Therefore, as noted by the EU Commission, the only way to progress is to move steadily in all areas where barriers to the free movement of capital still exist. A lot still remains to be done and

the EU Commission has continued to signal that it is time to step up the level of ambition.[1]

We will also address the development of the Restructuring Directive – how the final Directive adopted the so-called Relative Priority Rule, even as a default rule in the Directive. We note the EU Commission has well understood the importance of a level of playing field with respect to rules in restructuring for the development of the European Capital Markets.

The final Restructuring Directive is a challenging piece of European legislation. In light of the target for a minimum harmonisation of the rules however, the content of the directive becomes more accessible.

We wish for the discussion about the practical impacts of key sections of the directive to continue and hope that our Report may also provide a small addition to the pan-European analyses.

[1] EU Commission, A Capital Markets Union for People and Business – New Action Plan, 24.9.2020. Also see Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law (COM/2022/702 final).

Acknowledgements

The issues discussed in this Report are highly relevant for legislators as well as market participants in all Nordic EU Member States. The need to further develop the solutions to priority matters in the new restructuring frameworks is not unique to the Nordic environment, as demonstrated inter alia by the judgment of the Versailles Court of Appeal in the Orpea case on 22 June 2023 or the widely reported English Adler case from January of this year. However, the Nordic countries have a long history of working together on matters of contract and insolvency, to the benefit of markets and companies that approach the Nordics as a whole. The fact that the work leading up to this Report has allowed discussion and comparison across Denmark, Sweden and Finland is therefore especially valuable.

It has been an immense pleasure to follow the work of the rapporteurs in drafting this Report. During a Round Table Seminar in Helsinki on February 6th 2024, we had a chance to elaborate on some of the more pertinent issues of the Report with other experts, and to reflect on experiences so far of the new restructuring laws in Finland, Denmark and Sweden.

I warmly welcome this Report and the new venues for cross-jurisdictional communication that it has opened, and trust that it will spark further discussion and exchange to the benefit of the Nordic market as a whole.

Göran Millqvist
Professor of Private Law
Director of the Stockholm Centre for Commercial Law at Stockholm University

This high level report provides an outstanding foundation for discussion of statutory priorities in the new Nordic restructuring laws. The question of how value should be calculated, and whether it should be applied down a creditor waterfall, to test the fairness of a non-consensual restructuring plan is extremely difficult to answer. As the authors note, there has been no international consensus on the right approach in those jurisdictions that have adopted a so-called cross-class cram down power in a restructuring procedure. This report manages to provide a wholly accessible, but also sufficiently detailed, account of the principal design choices. It also sets these design choices in the European and the Nordic contexts. I can think of no better basis for the important debate that the Nordic region needs to have in deciding how to structure new restructuring tools.

Sarah Paterson
Professor of Law
The London School of Economics and Political Science

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Executive Summary

The Report addresses priorities of stakeholders in the new Nordic restructuring laws.

i) It aims to: provide an in-depth pan-Nordic comparison, essentially from the perspective of debt capital markets, on the key features of the new Nordic restructuring laws, after implementation of the Restructuring Directive (EU) 2019/1023; and

ii) once the project report has been published, arrange (a) high-level discussion forum(s) about topics centered around this important piece of legislation, which may have major impacts on the European capital markets.

As an interesting observation, it can be noted that the laws with respect to priorities of stakeholders in restructuring do not seem to differ among the countries in the Nordics only, but also at an international level. Clear variations exist between the two key financial law jurisdictions, the US and the UK. In a recent English High Court precedent, it was particularly noted that the judgment issued by the Court would not likely have been feasible in the US, as the US statutory law contains a strict principle of absolute priority, setting it apart from the UK regime.[2]

This Report addresses topical questions. In a recent restructuring of the financial institution Credit Suisse in Switzerland, the financial restructuring facilitated by the local authorities, gave rise to questions centered around this topic; there the bondholders of so called AT1-bonds of Credit Suisse were wiped out without any compensation, despite the equity holders of Credit Suisse receiving some compensation. Further, the new Swedish restructuring rules are set to be addressed in a forthcoming restructuring of the SAS Group at the SAS AB level. In Finland, the administrator of the Stockmann restructuring has given some critical comments about the current legislation being cumbersome in the process.

The Report will first cover statutory priorities in an international context. It compares the US and the UK statutory laws and their notable variation. Along with introducing the objectives of the Action Plans for the EU Capital Markets Union, the Report outlines the road map to the final EU Restructuring Directive. This directive includes the key harmonisation targets for the legislators of the EU Member States in respect of restructuring rules, containing, as a default option, a rule for statutory priorities defined as a 'relative priority rule'.

Our Report seeks thereafter to discuss why some form of relativity may be important in relation to rules on priority in a restructuring context. Noting the academic discussion in the US and in Europe and recent case law developments from the UK, the report recognizes a tendency away from a strict absolute priority towards a certain degree of flexibility, described in the Report as 'relativity'. The Report further

[2] Re Virgin Active Holdings Ltd, Virgin Active Ltd and Virgin Active Health Clubs Ltd [2021] EWHC 1246 (Ch)). Also see DeepOcean [2020] EWHC 3549 (Ch).

conveys a recently published study by the chair of the Rapporteurs, where priority rules in restructuring are tested against the Coase Theorem.

The Report continues with an outline of the development of the current restructuring laws in Sweden, Denmark and Finland after implementation of the Restructuring Directive. The Report notes a clear variation in the implementation of the directive in the Nordic Member States and discusses the potential practical impacts of this finding on the Nordic capital markets.

The fifth section of the Report contains a comparison of key items in Swedish, Danish and Finnish restructuring laws and we also attach as an appendix of the Report a comparison chart of items which are considered significant to be noted by capital markets participants and advisors.

The Report concludes with a summary of the topics covered and a discussion *de lege ferenda (of future legal developments),* outlining further possible options for developing the Nordic laws - or at least for understanding the consequences of retaining current forms of regulation.

The legal structures presented in the Report correlate both with corporate and insolvency law. Hence, benchmarks for the legislative options are introduced both from the corporate and insolvency law points of view. In addition to a required attention from the view of these two legal disciplines, one needs to address the expertise of and the architecture for the tribunal bench systems involved in the process – the expertise and mechanism for handling these types of cases are critical in any major restructuring case.

Project Work

The project has been conducted in close collaboration with the Round Table Members with backgrounds from the following institutions: Stockholm Centre for Commercial Law and the Faculties of Law at the Stockholm, Helsinki, Turku and Aarhus Universities. The Report has been finalised after a Round Table meeting in Helsinki held on 6th February 2024.

The intention of the project has been firstly to provide a comparative report of the key features of the new Swedish, Danish and Finnish laws after implementation of the Restructuring Directive, reflecting the laws particularly from the capital markets perspective.

In connection with the publication of the Report the research team will further facilitate arranging (a) high-level discussion forum(s), targeted, particularly, at key personnel at the Nordic ministries of justices as well at the judiciary. The forum(s) is also aimed to be conducted in collaboration with the Stockholm Centre of Commercial Law, jointly with faculties of law at the Stockholm, Helsinki, Turku and Aarhus Universities.

Members of the Round Table for the Project

Göran Millqvist, Professor at the Stockholm University and Director of the Stockholm Centre for Commercial Law (Chair)

Hans Renman, Partner, Schjødt Attorneys Ltd

Kim Sommer Jensen, Professor at the University of Aarhus

Line Langkjær, Associate Professor at the University of Aarhus

Seppo Villa, Professor at the University of Helsinki and

Tuomas Hupli, Professor at the University of Turku

The Project Team

The practical project work has been chaired by Dr Matti Engelberg, with over 30 years' background as a recognised practitioner in the field of debt capital markets law in the Nordic area. He has recently contributed notable academic publications relating to modern legislative frameworks for corporate restructuring and legal topics at the crossroads of corporate and insolvency laws.

The Swedish angle for the project has been contributed by Senior Researcher Dr Sara Göthlin from the Stockholm Centre for Commercial Law. She has also liaised with the Stockholm Centre for Commercial Law about the Project. Sara Göthlin has 15 years of experience as a legal practitioner and partner within the banking and finance sector. She defended her Doctorate Dissertation on the contractual ranking on claims in June 2023 and has thereafter concentrated on her post doc studies on priorities in restructuring and debt-to-equity swaps.

The Danish angle for the project has been contributed jointly by Partner Jan Bech at Horten Attorneys and Professor Kim Sommer Jensen from the Aarhus university. On the side of his vast restructuring practice Jan Bech has an extensive lecture experience, including as a lecturer at the master's degree programme in law and the Elite Module at the University of Aarhus in Denmark. He has a thorough understanding of the new Danish restructuring law. Professor Kim Sommer Jensen is focused on civil procedure insolvency law and bankruptcy law. He has contributed a significant number of publications relating to, *inter alia*, the theory and practice of restructuring law. Professor Sommer Jensen kindly agreed to contribute to the Report also as a member of the Project Team in addition to his role as a Round Table Member.

Grant from the Nasdaq Nordic Foundation

A grant of the Nasdaq Nordic Foundation for the project has made the project feasible and been an important support for the project. The team is extremely grateful for this support.

Merits for comparative analyses of the new laws, as well as generating professional discussion on this important topic can be foreseen for the capital markets, as well.

The project may be viewed as a contribution to the pan-Nordic legislative work, as each Nordic EU member state has now implemented the Restructuring Directive, but the outcomes of the implementation vary significantly, also among the Nordic Member States.

Further, the topic of the report also appears in the programme for the Finnish Government, where the need for a further review of legislation relating to debt-to-equity swaps and a corporate law scheme of arrangement has been noted. As the directive strives for minimum harmonisation only, the Finnish analyses have established that that the current laws relating to the cross-class cram down of equity in restructuring, may be considered to fulfil the requirement for minimum harmonisation. However, the Ministry of Justice's working group, responsible for drafting the amendments due to the implementation of the Restructuring Directive, noted a further need to analyse Finnish law in this respect.

The new legal setup for restructuring is an extremely important area of legislation, touching the core of the relations between a company and its main stakeholders – owners and creditors, and of such stakeholders between themselves. Therefore, an active Nordic dialogue is desirable, particularly from the Nordic capital markets' angle.

1. Foreword

The idea for the Project evolved following a seminar in January 2023 on Debt-to-Equity swaps, organised by the Stockholm Centre for Commercial law. The seminar introduced the new Swedish restructuring law – lag (2022:964) om företagsrekonstruktion – and in particular the new features enabling a cross-class cram down of equity holders in the restructuring, addressing some concerns and questions in connection thereto.

Some of the professionals participating at the seminar noted that, despite a history of active dialogue on drafting new laws in the Nordic, this important area of statutory law – regulating rights of various stakeholders of a company in a formal restructuring – has been very little discussed among the Nordic Member States, notwithstanding that the Restructuring Directive (EU 2019/1023) strived for harmonisation of the laws.

Based on this discussion an initially 'self-appointed' Project team gathered and introduced the idea of producing a comprehensive comparative Report on the Statutory Priorities in Restructuring to the Round Table Members. Further, the Nasdaq Nordic Foundation kindly provided a grant for the project, which has made the project feasible.

The Report has been produced in close collaboration with the Round Table Group from the following institutions: Stockholm Centre for Commercial Law as well as the faculties of Law of the Universities of Stockholm, Aalborg, Helsinki and Turku. In order to emphasise the academic character of the Project, the Round Table Members, with backgrounds from these institutions, were invited to contribute to and guide the Project work. We acknowledge and thank all the Round Table Members for their support.

Prior to publishing the Report a preliminary Round Table Discussion was held on 6th February 2023 in Helsinki, involving the Round Table Members to discuss the related topics further. We were also extremely pleased that Professor Sarah Paterson from the LSE kindly joined the Round Table Discussion.

Further, we want to note that the Report covers restructuring of non-bank institutions only. Even though, especially after the market turmoil relating to the treatment of so called AT1-bondholders of Credit Suisse, such a case would have supported a comparison of the tools available to authorities in the bail-in of banks, we considered feasible to concentrate on non-banks only and not to address the corresponding issues with respect to the financial sector.

We emphasise that the views expressed in this report do not necessarily reflect the views and positions of the members of the Round Table, nor the views of their respective institutions. The members do not necessarily agree with all the positions put forward and do not necessarily endorse the references to academic and independent studies.

Though, a robust and clear set of ethical principles has guided the drafting process in order to preserve a balanced approach to a variety of views. All members of the Round Table were given ample opportunity to express their views, which are reflected in the final text.

The content of the report and any remaining errors, however, can be attributed only to the Project Team Rapporteurs.

2. Statutory Priorities in an International Context

2.1 The US and the UK statutory law systems – notable variation

When addressing legislative options for the priority systems in restructuring, it is helpful to first understand how the leading finance law jurisdictions – the US and the UK – deal with the topic.

In any legal system, the parties involved in a restructuring need to address at the outset the impacts that the statutory restructuring process and any potential alternative insolvency framework may have on a restructuring process. In particular the 'shadow' effect of a potential bankruptcy proceeding in the relevant jurisdiction(s) should be understood.

Hence, it is important to note that, in a restructuring proceeding, the parties are bargaining in the shadow of the framework provided by bankruptcy and liquidation law. Customarily, restructuring law includes a best interest of creditors test, according to which each creditor has a veto-right with respect to continuation of the restructuring in case his or her return would be estimated to be lower than in a bankruptcy case or based on another benchmark test.

In the US, as an example, the restructuring process is regulated alongside the procedures for insolvent liquidation under the Bankruptcy Code, instead of a separate law.

The US Chapter 11 restructuring facilitates the continuation of the enterprise for the duration of the proceedings. The negotiation process may also be rather fast through potential 'pre-pack' arrangements, where, in private proceedings prior to the public process, the views of various creditors have been collected from the outset.

In the US, a class of creditors - including secured creditors, as well as any class of holders of equity - can be forced to accept a restructuring plan (be "crammed down") against its wishes provided that at least one other class of impaired creditors has accepted the plan. Creditors are protected in Chapter 11 proceedings by the 'best interests' test and other safeguards in section 1129 of the Bankruptcy Code. Section 1129 has also been designed to include an 'absolute priority rule'. In order for a plan to be considered 'fair and equitable', creditors in a dissenting impaired class of unsecured claims must receive or retain property of a value equal to the allowed amount of their claims or, failing that, no creditor or equity holder of inferior priority must receive any distribution under the plan.

McCormack has contributed a recent international report for Insol Europe about the priority rules in restructuring. In a discussion about absolute priority in the US, McCormack refers to a report by the American Bankruptcy Institute (ABI) where the ABI Commission proposed, already in 2014, some reforms to Chapter 11. It proposed that a class receiving no distribution under a restructuring plan but that was next in line to receive such distribution, should be given a 'redemption option value' that

equals the value of an option to purchase the entire company and pay in full or 'redeem' all the outstanding senior debt.

The valuation underpinning the option model was suggested to be carried out using a market-based model such as the Black-Scholes. It was designed to reflect the possibility that, within three years, the value of a restructured company might be such that the senior creditors can be paid in full and there is incremental value for the immediately junior class of stakeholders. The ABI Commission, however, also acknowledged that the redemption option value principles were essentially guidelines for courts and parties to use in developing allocation principles for more nuanced and complex capital structures than those vetted by the Commission.[3]

One noteworthy perspective on the US discussion is the sale paradigm introduced by Douglas Baird. As he explains, a going-concern sale is the most straightforward way to resolve the problem of financial distress. The new buyers can put in place whatever capital structure makes the most sense for the firm, given the condition in which it finds itself. And, if there is an actual sale, the most obvious priority rule is one of absolute priority. The previous investors' role in the ongoing enterprise has come to an end. The only question is one of dividing cash, and the easiest way to do this is to collapse all future possibilities to present value.[4]

The sale paradigm referred to above is important as a systematic backdrop when considering an optimal legislative model for any one jurisdiction.

On a practical note, many of the introduced legislative models for restructuring also allow for a going concern sale of the debtor/debtors' business as an option in court-sanctioned restructuring. Different considerations must be made where a firm is reorganized rather than actually being sold to a third party. In case it is evident that continuing the firm would be a better option for stakeholders than a going-concern sale, the next question is how the legislative system can best protect a successful outcome, i.e., that the process itself might support the creation of a restructuring surplus.

In order to apply the absolute priority rule in the absence of a going-concern sale, the judge may need to determine the value of the firm. The empirical evidence suggests that, in large reorganisations, judicial valuations are unbiased, but that these unbiased valuations are made with high variance. Even if bankruptcy valuations could be improved, a major problem remains: 'All estimates of value are noisy. Coming within ten percent of the true value of the firm merits high praise even when the best experts do it.'[5]

[3] Gerard McCormack, Insol International – Priorities and Fairness in Restructuring and Insolvency Law, 2021, p. 17. See also American Bankruptcy Institute, Commission to Study the Reform of Chapter 11, Final Report, 2014, p. 207-211.

[4] Douglas Baird, Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy, University of Pennsylvania Law Review, 2017, Vol. 165, p. 806.

[5] Idem, p. 807

Turning to the position of statutory law in the other leading finance law jurisdiction, the UK, Sarah Paterson has outlined the UK position towards statutory law priorities after the introduction of the new Part 26A restructuring proceedings in 2020, which also allows for cross-class cram down of creditor classes:

> *Turning to the APR, the first and most compelling reason for not treating the APR as a mandatory test for the fairness of a Part 26A restructuring plan is that the legislature did not choose to incorporate it in the statutory provisions. Of course, a controlling argument in this article is that the legislature deliberately left it to judges to develop the principles which would be applied in determining whether a Part 26A restructuring plan was "just and equitable". Thus, it might be thought that they have simply left it to judges to determine whether the APR should apply or not. However, although CIGA was introduced remarkably rapidly in 2020 during the coronavirus pandemic, it had been foreshadowed by consultation on reform proposals in 2018. In its 2018 response to the consultation, which included a proposal for a new restructuring plan procedure the Government expressly discussed inclusion of a modified version of the APR, without limiting the court's wider discretion. In the event, no absolute priority rule appears in the legislation. No reason is offered in the Explanatory Notes, but the omission stands in stark contrast to the proposal in the consultation, so that the inevitable conclusion is that the APR was deliberately excluded.*[6]

In the article, Paterson suggests that judges retain a wide and flexible discretion in deciding whether to sanction a Part 26A restructuring plan over the objections of a dissenting class, once the statutory conditions for sanction are met. It is not possible to specify completely how such a discretion should be exercised. Nonetheless, Paterson has made some suggestions as to criteria which should guide the judiciary in the exercise of discretion, and a tentative start has been made in developing a decision-making framework:

> *First, the court should assess whether each class gains something under the plan.*
>
> *Secondly, the court should ask itself the fundamental question of whether any class is getting too good a deal (too much unfair value) because of the plan. As a subset of this general inquiry, the court may need to use an amended comparator when assessing a plan which preserves going concern value which is lost in the relevant alternative; should pay close regard to the distribution of additional value created by the plan, to creditors who are left unimpaired by the plan, and to creditors who obtain a priority advantage; should ask itself whether a class which will benefit from any improvement in the company's fortunes should share that upside; and should consider*

[6] Sarah Paterson, Judicial Discretion in Part 26 Restructuring Plan Procedures, (January 24, 2022). Available at SSRN: https://ssrn.com/abstract=4016519

carefully the justification for existing shareholders having equity in the restructured firm.

All these more granular questions are, it is suggested, sub-sets of the overarching inquiry which is left open by the "no worse off" test: is any class getting too good a deal (too much unfair value) because of the plan?

Finally, the debtor should be able to show that it has attempted to bargain with the dissenting class but that rational bargaining was impossible. This provides an important guard rail to prevent debtors from simply rushing to the courthouse door. Ultimately, the cross-class cram down power is exercised where the plan represents a rational bargain for the dissenting class, but there has been a failure of rational bargaining.[7]

The recent Adler case at the Court of Appeal has been noted by the markets as to contain important elements. The judgment considered that a restructuring plan in which a solvent reorganisation is proposed as alternative to insolvency proceedings should be consistent with the fundamental principle of *pari passu* distribution. The decision also affirms the flexibility of the English courts, endorsing a more nuanced approach, allowing for context-specific solutions, and ensuring fairness to all stakeholders. The judgment also noted about the intended approach of the legislators to use, as a central concept of Part 26A, the same wording of "compromise or arrangement" as in Part 26 of the Companies Act. The judgment referred particularly to conclusions by Jennifer Payne in the latest edition of her book for this:

"Crucially, the restructuring plan allows for the cramdown of whole classes of creditors and shareholders. The intention underpinning the Act is that shareholder equity can be transferred, diluted or extinguished as part of a court-approved restructuring plan. This aligns the restructuring plan with Chapter 11 but stands in contrast to cross-class cramdowns elsewhere in the world (such as Singapore) which are confined to creditor classes. It is therefore possible for the restructuring plan to include provisions for shareholders that will involve a reduction in their equity interest in the company and which, provided that these provisions involve more than just a confiscation of their interest and so still represent a 'compromise' of their rights, will be capable of being imposed on them under the cross-class cramdown procedure. It is notable that amongst the amendments to the Companies Act 2006 that the 2020 Act makes to facilitate the implementation of restructuring plans, there is included a disapplication of pre-emption rights. These powers are likely to be welcomed by those seeking to rescue financially distressed companies."[8]

It is evident that the discussion on priorities in restructuring is also continuing in the UK, after the introduction of the Part 26A restructuring framework and some further

[7] Idem.

[8] [2024] EWCA Civ 24, at [271], and Payne, J. Schemes of Arrangement, 2nd ed., 2021, p. 319.

guidance from the judiciary. However, for the purposes of this Report, it is interesting to note that the approach is substantially different in the UK compared to the US.

2.2 Valuation – and its Associated Challenges

In any restructuring a valuation of the firm is crucial. As already referred to in Baird's comment about the 'noisy' valuations of distressed firms, it is imperative to understand the further volatility brought to valuations by the presence of financial distress.

As the level of distress increases, the value of a business can be expected to fall rapidly as the risk of failure becomes a realistic possibility. Coates – Rachel – Smith outline that the enterprise value can be expressed using the following equation:

> *Real enterprise value = enterprise value – present value (PV) of cost of financial distress*

The equation recognises that there are real costs associated with financial distress and the risk of business failure. The risk of business failure grows rapidly with increasing distress, and the cost of financial distress can understandably significantly reduce the real enterprise value.[9]

As examples of costs of financial distress, the following operational and financial items are outlined: detrimental credit terms, reduced access to lines of credit, higher incremental financing costs, fire-sale asset values, investment required for business recovery and professional fees. Further, the following strategic and management items may be expected: restraints on capital investment, project decision-making focused on short-term rather than long-term value, distraction from running the business and conflicts of interest between stakeholders.[10]

With respect to the valuation, the US system has been noted to include an incentive towards a consensual negotiated debt-restructuring plan. As a consensual negotiated debt-restructuring plan is preferable to a cram down, the law needs to supply incentives to motivate parties to try to reach consensus. Absent incentives, holders of senior-priority creditor claims and equity interests would lack motivation to yield value to holders of more junior claims and interests.[11]

Instead, senior creditors would likely insist upon payment in full of whatever distribution they were entitled to under applicable distributional rules — for Chapter 11, this entails payment in full before any junior creditor or shareholder receives any

[9] K. Coates – C. Rachel – G. Smith, Valuation of Distressed Business, Restructuring and Workouts: Strategies for Maximising Value, 3. ed. Graham Lane, 2019, Globe Law and Business Ltd.

[10] Idem.

[11] J. Seymour – S.l. Schwarcz, Corporate Restructuring under Relative and Absolute Priority Default Rules: A Comparative Assessment, University of Illinois Law Review, Vol 2021, p. 8-10.

value. Holders of those more junior priority claims and interests, in turn, would have no incentive to consent to a plan that paid them little or nothing.

Chapter 11 addresses this conundrum by imposing a default rule that would apply in a cram down, absent the parties reaching a consensual, negotiated debt restructuring plan. That default rule is one that most, if not all, of the parties normally want to avoid, because it requires a full valuation of the restructured debtor as a going-concern.

The traditional model for a corporate reorganisation is that equity in the debtor is transferred from pre-petition shareholders to creditors in order to repay claims. In a cram down, the absolute priority rule is followed: creditors share in the debtor's equity according to their state-law priorities, with pre-petition shareholders retaining only what is unnecessary to pay creditors in full. For insolvent debtors, pre-petition shareholders would be wiped out.

To apply the absolute priority rule to a cram down plan that transfers equity, the equity must be valued. Unless that valuation occurs in the marketplace pursuant to an auction or other sale procedure, the value must be determined by the bankruptcy court. As explained, parties understand that such a valuation is likely to be hotly contested, thereby diminishing their ultimate recovery. This creates the penalty default rule that motivates parties to try to avoid cram down and reach a consensual plan.[12]

The default rule of absolute priority may influence all parties to seek consensus in light of the possibility of a valuation hearing. And the prospect of such a hearing incentivises senior creditors, who might otherwise insist on payment in full, to compromise rather than risk a valuation outcome wasted on the valuation process etc., that allocates a greater portion of the debtor's value away from them and to junior classes.

The 'penalty' of absolute priority, though, is most felt by the debtor's shareholders, who face likely exclusion from recovery under the plan. Among the interested parties, shareholders have the greatest familiarity with the debtor's business and are most likely to have information regarding the debtor's true worth. Management, who prior to the insolvency have been acting on behalf of shareholders, have the greatest ability to disrupt the reorganisation. By placing the greatest likelihood of loss in the event of a contested confirmation on shareholders, absolute priority encourages them, and by extension, the debtor itself, to work towards a compromise plan.[13]

For any restructuring, a consensual solution would, by all means, be the most preferred option. It is therefore important to analyse the frameworks in each jurisdiction on the basis that any additional features which may be considered to strengthen the likelihood for a consensual outcome, should be welcomed.

[12] Idem, p. 10–11.
[13] Idem, p. 16.

The importance of incentives in restructuring cannot be overvalued, and it is, therefore, good to also observe the insights brought by Seymour – Schwarcz. Concerning the new European relative priority rule, they note the debtor's incentive to offer the most favorable terms possible to the most senior classes of creditors (who must be treated well in any event) in order to induce them to support the plan which it has otherwise structured to provide the minimum recovery to junior creditors (whose support can readily be dispensed with in the absence of a default rule that penalises the failure to reach consensus) and the maximum recovery to shareholders.[14]

Although this comment relating to the European relative priority rule is good to note, it may also be fair to argue that some form of 'relativity' may be considered to provide additional flexibility for a court to judge any individual case in a way that it considers just and fair, taking into consideration all circumstances. The various layers of stakeholders would, therefore, be unable to rely on their 'holdout' positions. This feature can also be considered to further strengthen the likelihood for a consensual outcome.

When comparing the US and the UK frameworks as benchmarks for the Nordics, one may see benefits with the UK system, which does not contain a statutory priority rule, and also for the European relative priority. These frameworks may arguably be seen as further pushing the parties towards a consensual solution. Where none of the parties can rely on 'absolute rights', at least not directly based on statutory law, each class of creditors and holders of equity may expect that some compromise is needed for a fair outcome and for delivering a 'restructuring surplus'. This may, therefore, be seen as a further incentive than the interplay with a need for a valuation in the US system. A further argument on the correlation between valuation and priority rules is provided by Stephan Madaus:

> *Valuation in insolvency cannot simply ignore the fact that value from future income is available for creditors under a procedural option. Yet, this is exactly what is being done under an absolute priority regime where the outcome of a (hypothetical) liquidation of common pool assets strictly limits the rights of stakeholders in the distribution of future income under a plan. Those who are out of the money in a liquidation may claim no value under a plan. One would have to view the commencement of proceedings as a 'day of reckoning' where 'all future possibilities are collapsed to the present'. This view, however, does not lead to fair results. Such possibilities actually exist. There is a present value of possible future revenue. In jurisdictions where the commencement of (insolvency or restructuring) proceedings prompts a 'day of reckoning', only creditors who are in the money in the purely hypothetical scenario of a liquidation of common pool assets may claim value at all—including, of course, the present value of possible future revenue. Such a framework allows senior creditors (often secured creditors) to not only claim the liquidation value of the current assets of the debtor, but also to claim future income by*

[14] Idem, p. 21.

keeping their stake in the ongoing business and by eliminating all junior stakeholders from the balance sheet. Such a privileged legal position exceeds their rights outside of insolvency or restructuring proceedings by far.[15]

On this it is good to note that the current German model has landed somewhere in-between the APR and RPR, termed by Madaus as a 'relaxed APR'. The German approach gives weight e.g., to possible 'sweat equity' – an additional value which the existing shareholders may be considered to bring into a structure. Allowing a fraction of future surplus to be retained by equity holders may also be justified in light of the value of an 'orderly handover' and cooperation in restructuring, which furthers consensual solutions.

Seymour – Schwarcz also note that the EU Member States may conclude that the benefits that flow from the debtor control over the restructuring process (whether that is understood as control by equity or management) and distributional rules that increase the potential for old equity to retain a stake in the reorganized debtor outweigh any costs associated with decreased settlement. Similarly, even though Chapter 11's policy choices have generally been to the contrary, Member States may be willing to accept the possibility that intermediate creditors see reduced recoveries in reorganisations.

Member States might, for example, theorise that healthy capital markets require robust recoveries in insolvency for senior secured creditors who are likely to be composed of lenders who might otherwise opt not to extend loans, while junior classes — whether tax creditors, employees, or general unsecured creditors such as trade creditors — will likely have less of a choice about extending credit to the debtor, or at least that the harms caused to such creditors are outweighed by the benefits of allowing shareholders to keep value in reorganisations. That policy choice is for Member States. The choice, though, must be made after due consideration of the likely consequences of reordering ordinary bankruptcy priorities.[16] – The complexity of such policy choice is the main underlying reason, why this Report has been produced.

2.3 Action Plans for the EU Capital Markets Union

When it comes to developing debt capital markets as a driver for the economies, the EU seems to still be lagging substantially behind the US. In comparison with the US, where bank credit markets represent only 54 % of GDP, Europe's financial system is considerably more bank-based.

As evidenced by a recent study of the European Capital Markets Institute, the bond market corresponds to approximately 200 per cent of GDP in the US and less than

[15] Stephan Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, Eur Bus Org Law Rev (2018) 19, p. 622.

[16] J. Seymour – S.l.Schwarcz, Corporate Restructuring under Relative and Absolute Priority Default Rules: A Comparative Assessment, University of Illinois Law Review, Vol 2021, p. 21.

100 per cent in the 27 EU countries. Thus, the bond markets in the US are twice the size of the European bond markets. Moreover, with regards to stock markets, the US is three and a half times the size of the European market (EUR 41 trillion versus EUR 12 trillion) and almost three times as deep relative to GDP (227 % versus 81 %).[17]

On a regional level within the European Union, in three out of the four regions (i.e., Central and Eastern Europe, Southern Europe, and Western Europe), the share of debt capital markets as a per cent of GDP has increased from 2015 to 2021 and is approximately two to three and a half times larger than the share of equity markets.

Conversely, in Northern Europe – consisting of the three Nordic countries: Denmark, Finland, and Sweden – the size of debt markets has declined, and equity markets are now bigger, playing a more relevant role vis-à-vis debt markets.[18]

Notwithstanding that, when it comes to overall total capital markets volume, Northern Europe has the highest level measured as a per cent of GDP, representing in total 350 per cent of GDP, the declining trend of the debt securities market is still alarming. Therefore, further attention to the development of the debt securities markets is recommendable in the Nordic area.

As mentioned, the EU commission adopted the first Capital Markets Union Action Plan already in 2015. Since then, the EU has made significant progress putting the building blocks in place, but as evident from the above statistics, there is still ample room for improvement. This was also noted by the EU Commission, who introduced a New Action Plan for the CMU in 2020.

In November 2019, the Commission brought together senior industry executives, experts, consumer representatives and scholars for a high-level forum on the CMU. In June 2020, the forum published its final report with 17 recommendations to the Commission and Member States for advancing the CMU. These recommendations included, *inter alia*, suggestions for further developing the insolvency frameworks in the EU area.

These recommendations invited the Commission to adopt a legislative proposal for minimum harmonisation of certain targeted elements of core non-bank corporate insolvency laws, including a definition of triggers for insolvency proceedings, harmonised rules for the ranking of claims (which comprises legal convergence on the position of secured creditors in insolvency), and further core elements such as avoidance actions.[19]

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[17] Thomadakis, A., Lannoo, K. and Moloney, N. (2022), Time to re-energise the EU's capital markets – Building investable and competitive ecosystems, CEPS-ECMI Study, Centre for European Policy Studies, p. 8-9.

[18] Idem, p. 10.

[19] A New Vision for Europe's Capital Markets, Final Report of the High Level Forum on the Capital Markets Union, June 2020, p. 114. See the ensuing subsequent Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law (COM/2022/702 final).

In order to further strengthen the integration of national capital markets into a genuine single market, the new CMU Action Plan includes measures, set out in section II.1.3 of the Action Plan, where the Commission aims to tackle key remaining obstacles to market integration. Building on progress made under the previous action plan, these measures seek to address barriers related to legal frameworks or barriers driven by long-established national practices. This is in particular the case in the area of taxation, non-bank insolvency and company law. In these areas, the Commission proposes targeted actions, focusing on the most important barriers that cause market fragmentation and deter cross-border investment.

The Commission emphasises that the stark divergence between national insolvency regimes is a long-standing structural barrier to cross-border investment. Divergent and sometimes inefficient national regimes make it difficult for cross-border investors to anticipate the length and outcome of value recovery proceedings in cases of bankruptcy, rendering it difficult to adequately price the risks, in particular for debt instruments. Harmonisation of certain targeted areas of national insolvency rules or their convergence could enhance legal certainty. Furthermore, regular monitoring of the efficiency of national insolvency regimes would allow Member States to benchmark their insolvency regimes against those in other Member States and encourage the Member States with underperforming regimes to reform them. This leads to Action 11 recommendation in the new CMU Action Plan:

> *To make the outcomes of insolvency proceedings more predictable, the Commission will take a legislative or non-legislative initiative for minimum harmonisation or increased convergence in targeted areas of non-bank insolvency law. In addition, together with the European Banking Authority, the Commission will explore possibilities to enhance data reporting in order to allow for a regular assessment of the effectiveness of national loan enforcement regimes*.[20]

From the EU angle, one may expect the Commission to have a close eye on the development of the insolvency regimes, including particularly the restructuring regimes, in the Member States.

It is good to note, that on 7 December 2022, the European Commission already published its new legislative proposal for a directive aiming to harmonise certain aspects of insolvency law (hereinafter the 'Proposal'). The Proposal targets the three key dimensions of insolvency law: (i) the recovery of assets from the liquidated insolvency estate; (ii) the efficiency of procedures; and (iii) the predictable and fair distribution of recovered value among creditors.[21] As the Proposal does not directly

[20] EU Commission, A Capital Markets Union for People and Business – New Action Plan, 24.9.2020, p. 13.

[21] Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law (COM/2022/702 final).

relate to issues of priorities in restructuring, we will only note the Proposal in our Report.

2.4 A Roadmap to the Final EU Restructuring Directive – Further Guidance Feasible?

In 2016 the EU commission published a Proposal for a Directive 'on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU'.

In respect of priority rights, the proposal referred to the US style absolute priority rule. Under a proposed Article 11, a cross-class cram down of a dissenting class was possible, in case it would comply, *inter alia*, with the absolute priority rule. The absolute priority rule was defined to mean that 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. The reasoning emphasised that the absolute priority rule serves as a basis for the value to be allocated among the creditors in restructuring. As a corollary to the absolute priority rule, no class of creditors can receive or keep under the restructuring plan economic values or benefits exceeding the full amount of the claims or interests of such class. The absolute priority rule makes it possible to determine, when compared to the capital structure of the enterprise under restructuring, the value allocation that parties are to receive under the restructuring plan on the basis of the value of the enterprise as a going concern.

Following a consultation, *inter alia*, an expert group with representatives from several universities provided further guidance on the development of the proposed directive. This expert group, also financed by the European Commission, provided a Final Report of the research project 'Contractualised distress resolution in the shadow of the law' ('Codire') in 2018.

In the 'Fairness' chapter of the Codire report, the group introduced a new relative priority rule. The description of this was:

> *Where a plan that affects the rights of a stakeholder class has failed to attract the requisite support amongst class members, it might nevertheless be approved so long as it treats the class fairly. In addition to the requirements described above, the plan must be appropriate and must show due respect for the legal rights of class members. This would at a minimum entail fulfilment of each of the following three conditions:*
>
> *a) The best-interest test is satisfied,*
>
> *b) At least one class of creditors whose rights are to be impaired under the plan has approved it by the requisite majority, and*
>
> *c) The 'relative priority rule' is observed.*
>
> *This requires that (i) each dissenting class is to receive treatment at least as favourable as other classes with the same rank; (ii) no class of a lower rank is to be given equivalent or better treatment than it; and (iii) higher ranking*

classes must receive no more than the full present economic value of their claims.

The relative priority rule was justified in the report as a preferred alternative to the 'absolute priority rule' familiar in US restructuring practice. *'The absolute priority rule makes it a precondition for confirmation of a plan rejected by one or more classes of affected stakeholders that members of each dissenting class would receive the full face value of their claims before the members of a lower class receive, or retain, anything. This approach is defective. 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.*

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. The relative priority rule also makes it more feasible for plans to be confirmed that permit equity holders to retain a stake in the debtor or its business, which in turn is likely to incentivise – particularly in the case of MSMEs – greater and more timely use of restructuring proceedings and the option of drawing on equity's debtor-specific knowledge, expertise, and goodwill. The rule also provides a measure of protection against improper 'loan-to-own' strategies by which acquirers of distressed debt seek to acquire a share of debtor's equity greater than the present economic value of their debt claims.'[22]

Following consultation, a final Restructuring Directive (EU) 2019/1023 was issued in 2019.

In article 11 of the Directive, the priority rule was outlined based on the introduced relative priority rule in the Codire report, but the Member States were also given an opportunity to implement the absolute priority rule.

According to article 11, for cross-class cram down, the restructuring plan shall fulfil, inter alia, the following conditions: it ensures 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; and no class of affected parties can, under the restructuring plan, receive or keep more than the full amount of its claims or interests. ('relative priority rule' or 'RPR').

By way of derogation of the first above condition, Member States may provide that the claims of affected creditors in a dissenting voting class are satisfied in full by the

[22] Best Practices in European Restructuring, Contractualised Distress Resolution in the Shadow of the Law, Ed. L. Stanghellini – R. Mokal – C. Paulus – I. Tirado, 2018, p. 45-47.

same or equivalent means where a more junior class is to receive any payment or keep any interest under the restructuring plan ('absolute priority rule' or 'APR').

When the final Directive was introduced and Member States started the implementation process of the Restructuring Directive, some academic discussion surfaced, both in favor and against, the two alternatives introduced. In the discussion, de Weijs et al reacted quite strongly:

> *Next to upending the basic fabric of private law, EU RPR disregards that the company to be reorganized did not end up in that state by coincidence. Allowing shareholders to retain shares whilst writing down creditors against their majority vote would not only add insult to injury for creditors, but would also provide a further subsidy to shareholders that incentivizes to over leverage companies, leading to instability in the economy*.[23]

As a comment to this critique, it is appropriate to note the counter arguments introduced by, *inter alia*, Bob Wessels:

> *De Weijs et al fail to appreciate that a debtor (a business) under the proposed Directive is not insolvent. This follows directly from Article 1(a), stating that '[t]his Directive lays down rules on: preventive restructuring frameworks available for debtors in financial difficulty when there is a likelihood of insolvency [my italics] with a view to preventing the insolvency and ensuring the viability of the debtor.' This is why applying the logic and rules of insolvency law, including the APR, is not justified. In the absence of insolvency, the arguments for changing the capital structure of the debtor (e.g. by wiping out shareholders and (as the case may be) junior creditors) are unconvincing. Although I understand the criticism by professor De Weijs et al, in the gamut of proposed rules and tools, the RPR is seen and analysed as one isolated aspect. The authors are rather silent on the possibility that the RPR will create incentives for early restructuring. In case of the application of the stern APR, the debtor's company shareholders have very limited incentives to pursue restructuring as their equity will be fully wiped out. One of the major thrusts behind the proposed Directive is to ' ... enable the debtors to restructure effectively at an early stage'.*
>
> *Since the introduction of the APR as the single option disincentivises the debtor's directors and shareholders to use preventive restructuring frameworks, it may hamper the early restructuring of viable debtors in financial difficulties*.[24]

Further, it is salient also to note the arguments brought by Stephan Madaus:

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[23] de Weijs, R.J., Jonkers, A.L., Malakotipour, M. '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 No. 2019-1.

[24] Wessels, Bob, A reply to professor De Weijs et al. 22.3.2019, available at: <www.bobwessels.nl>

> *Insolvency law used to be a set of rules that govern the way a debtor is treated once he became insolvent and stopped trading. Certain mechanisms respond to this incident in order to safeguard a fair treatment of all creditors and other stakeholders with the aim of minimizing the damage. Modern insolvency laws do more. They have been endowed with tools that shall allow for a restructuring of the business of the failing debtor, often combining the common tools of insolvency law, e.g. a collective stay, with new tools to facilitate a restructuring agreement. But why wait until a debtor is insolvent? The idea of early redress to a business failure has led to a number of legislative pre-insolvency initiatives that make such tools available to debtors that are not yet insolvent. The result is a mixture of insolvency and restructuring law that has grown guided by practical needs rather than doctrinal approaches. In this paper, a doctrinal approach is proposed that offers a clear distinction between insolvency and restructuring law. Based on the description of the debt cancellation effect as the common function of all insolvency and restructuring proceedings, the different mechanisms that both types of procedures use lead to a clear categorization of insolvency and restructuring proceedings and their governing law and principles.*[25]

To be noted, there may well exist varying, well-argued views, both in favor or against, the introduced new relative priority rule, or a corresponding regulatory solution in statutory law. For any legislator, it is important to understand the consequences of such a regulation. Based on some further discussion on this important topic, the following chapter of our Report will discuss why some form of relativity in a legislative model may be viewed as justified. Further, we would also see merits for discussion at the EU level, whether there would be benefits of further guidance on the priority rules for the purposes of enhancing the capital markets union.

[25] Stephan Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, Eur Bus Org Law Rev (2018) 19, p. 615.

3. Why Relativity Matters

In this chapter we conclude the above presented discussion on statutory priority rules in restructuring.

The legal treatment of priority rights in restructuring can be described as the legislator setting the 'rules of the game' between a firm and the stakeholders of the firm, and between the stakeholders among themselves. The legislator should understand that such rules are, therefore, of significant importance for the functioning of any economy. Predictability of the rules has also been considered very important, particularly for developing the underperforming European capital markets.

As grounds for additional flexibility one should note, that 'relativity' may also result based on legal qualifications relating to APR in any respective jurisdiction. Germany is a good example of this with their new 'relaxed APR'.

The trend in the US has been described as developing towards a hybrid system of priority in restructurings, which may be more efficient than one centered around absolute priority, though this development may be still seen to happen 'inside the APR' through an option mechanism. As outlined by Baird, one key reason for the development may be that in large restructurings judicial valuations of the firm are unbiased yet made with high variance. Thus, as noted, for the discussion in the US, a 'hybrid system' merely refers to a possibility for junior creditors to receive options to shares of a debtor, where the strike price is set at a level, where higher ranking creditors have received full cover for their claims.

When considering legislative models for the priority rights in restructuring in the Nordics, UK law is also a notable benchmark, as it leaves flexibility for the courts for considering priority-issues in each specific case. In the recent Virgin Active case, Judge Snowden noted:

> '*…that business and assets in essence belong to those creditors who would receive a distribution in the formal insolvency. The authorities take the view that it is for those creditors who are in the money to determine how to divide up any value or potential future benefits which use of such business and assets might generate following the restructuring (the restructuring surplus).*[26]

The referred case is a notable precedent regarding the issues centered around relativity. It illustrates potential problems with a strict APR as a legislative solution. In this case the court ruled that the current owners of the company were able to retain their equity ownership, notwithstanding that senior unsecured claims were reduced in the programme. This was viewed justified as the equity holders had also agreed to provide new junior financing to the company and that this strategy was supported by the only remaining 'in the money' group of creditors. Following the guidance of a

[26] Re Virgin Active Holdings Limited, Virgin Active Limited and Virgin Active Health Clubs Limited, [2021] EWHC 1246 (Ch), 242.

strict APR, this solution would likely not have been possible. This was also referred to in the judgment:

> *'It is also clear that the […] case turned on the interpretation of the codification in 1978 of the absolute priority rule which is now embodied in Chapter 11 of the US Bankruptcy Code. It is important to note that although it had been contemplated in the consultation process, an equivalent absolute priority rule was not enacted in any form as a principle for the exercise of the discretion in Part 26A.'*
>
> *…*
>
> *'the key principle therefore appears to be that both under Part 26 schemes and Part 26A plans it is for the company and the creditors who are in the money to decide, as against a dissenting class that is out of the money, how the value of the business and assets of the company should be divided, the question remains whether there are any limitations upon how the plan company can confer benefits upon other creditors*.[27]

The Virgin Active judgment concluded that plans may legitimately provide for differential treatment of creditors, and such treatment could be justified by reference to factors such as commercial importance and profitability. Thus, as McCormack commented, in this case the door was left open for plan challenges where the respective creditors were 'in the money' but were nevertheless treated differently.[28]

Further, it is important to note that the question of priorities in this context relates to a potential positive surplus brought by a successful restructuring, often referred to as a restructuring surplus. The restructuring frameworks customarily include, *de minimis*, a requirement for a comparison to a bankruptcy scenario to be conducted. This protects amicably all creditors against abuse of the system, as this would provide, also based on the Restructuring Directive, a veto right for each creditor in case a distribution would be less than a comparable liquidation value or any other applicable benchmark value. The Restructuring Directive emphasises that a court is able to reject a plan where it has been established that it reduces the rights of dissenting creditors either to a level below what they could reasonably expect to receive in the event of the liquidation of the debtor's business, whether by piecemeal liquidation or by a sale as a going concern, depending on the particular circumstances of each debtor, or to a level below what they could reasonably expect in the event of the next-best-alternative scenario where the restructuring plan is not confirmed. Satisfying this 'best-interest-of-creditors' test, particularly when this refers to both liquidation and sale as a going concern as comparisons, should be considered to mean that no dissenting creditor is worse off under a restructuring plan than it would be either in the case of liquidation, whether piecemeal liquidation or sale of the business as a going concern, or in the event of the next-best-alternative scenario if the

[27] Idem, p. 259 and 289.

[28] Insol International, Priorities and Fairness in Restructuring and Insolvency Law, Gerard McCormack, November 2021, p. 35.

restructuring plan was not to be confirmed. Member States are hence able to choose one of those thresholds when implementing the best-interest-of-creditors test in national law.

As noted by McCormack, for the EU legislators who have now implemented the Restructuring Directive, the choice of the APR with a set of fairness qualifications for the statutory priority rules might have been sensible. However, in evaluating this, it is important to consider whether a chosen set of qualifications or safeguards provides such level of 'relativity' that the respective legislator considers useful. Another option could have been or could be to use the English law model or the RPR. The law could also outline the APR merely as a principal objective of the law, from which a court can deviate on justified grounds. This is e.g., the status under the new Danish law.

Having a flexible relative priority rule such as the one possible under the Restructuring Directive, offers greater flexibility than for example a strict APR system, now possibly adopted in some of the Member States. The pricing methodology envisaged currently in the US Chapter 11 has also been argued as an inflexible system model. The RPR as introduced in the Directive could work well, particularly when it is understood merely as a developed deviation of the absolute priority principle. Criticism against the RPR rule does not always seem to reflect that restructuring programmes are sanctioned by courts, who also need to consider the property rights of all stakeholders in their judgments.

Further, it is good also to note the technical variations between RPR, the UK model (without statutory rule) and a relaxed APR. As noted by Madaus, also RPR may be viewed too strict, as it may e.g., prevent to leave equity rights untouched whenever a creditor class (whose rights will be adjusted in the programme) objects. The guide of Madaus: *Is the Relative Priority Rule right for your jurisdiction?* contains further information for legislators about these variations.[29]

It is also noteworthy that the Restructuring Directive aims for minimum harmonisation of the rules and Article 11 contains two options, the APR and the RPR, for the priority rules. It is, therefore, an assumption that the Member States follow one of them. Nevertheless, Article 12 can be considered providing some further flexibility vis-à-vis cross-class cram down of equity holders, as the Member States may consider also other legislative models, which ensure, that equity holders are not allowed to unreasonably prevent or create obstacles to the adoption and confirmation of a restructuring plan.

A potential tool for analyses from the economics point of view of the issues connected with priority rules would be the Coase Theorem.[30] The Coase theorem

[29] Stephan Madaus, Is the Relative Priority Rule right for your jurisdiction? available at <stephanmadaus.de/2020/01/20/a-simple-guide-to-the-relative-priority-rule>

[30] Matti Engelberg, A theory of relativity in restructuring developed with the Coase Theorem, Int Insolv Rev. 2023;32:212-227. The Coase Theorem is a legal and economic theory regarding property rights developed by economist Ronald Coase. In 1991 Coase received the Swedish

argues simply that the allocation of legal entitlements between market players is irrelevant for efficiency when the parties can transact these entitlements without costs. So, where there are complete competitive markets with no transaction costs and an efficient set of inputs and outputs, an optimal decision will be selected.

The theorem basically asserts that bargaining between individuals or groups related to property rights will lead to an optimal and efficient outcome, no matter what that outcome is.

Considering a restructuring environment against the Coase theorem, the best outcome for the affected parties may be achieved when the rules for the bargaining-process are treating the parties evenly. In case a rule provides a preferential negotiating position for one party or certain parties only, this would be working contrary to this objective. This might arguably be the case if the law requires a court to follow explicitly, already at the opening of a restructuring, and without noting its potential surplus effect, the absolute preferential distribution rules applicable in insolvent liquidation. This would give possible hold-out incentives to classes of creditors or equity holders, as the case may be.

Subject to the powers given in law, a measure of flexibility, either based on a relative priority rule outlined in the Restructuring Directive, following the guidance from the UK without any statutory rule, or by using a 'relaxed APR' with modifications and/or qualifications, may allow a court and an administrator, from the above presented Coase Theorem point of view, to function ideally by permitting the consideration of the interests of all stakeholder classes involved.

In a restructuring process, wider powers for a court can be argued to stimulate the bargaining of property rights further, pushing the parties to agree the outcome of a restructuring programme. This may arguably protect the creation of a restructuring surplus, as an individual class would be unable to use its rights as a tool for gaining further benefits.[31]

Tools against the abuse of holdout positions are particularly important from the capital markets angle. In a restructuring practice, perhaps the most cumbersome proceedings for market participants are those where a single creditor or a group of creditors are able to use their financial instrument opportunistically – by seeking further benefits to themselves and acting contradictory to the joint interest of creditors with similar rights.

In a 'restructuring game' this may be the case when the terms of the respective financial instrument, such as a publicly traded bond, requires a unanimous acceptance to changes of some critical terms and condition of the bonds, which would, nevertheless, be essential for a restructuring.

Central Bank Price in Economics in Memory of Alfred Nobel for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy

[31]See further Engelberg (2023).

The UK scheme of arrangement provides a highly useful framework for protecting the rights of the majority within the same class in such cases, as a court may sanction any compromise to make it binding against the dissenting minority of the same class of creditors. This is of particular significance where the bond terms and conditions do not contain an efficient procedure for majority decisions.

This 'hold out game' may be played, similarly, by a majority of a class of creditors. Due to a possible combination of the customarily very low corporate valuations in distress scenarios and a strict absolute priority rule provided by the statutory law in a particular jurisdiction, a class of creditors may also be viewed, in some cases, to be abusing the system, when opposing any proposed restructuring programme prepared e.g., by an impartial administrator.

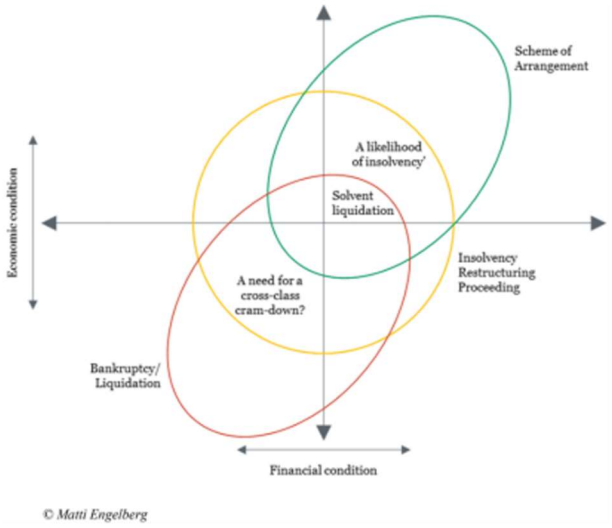
An example of this could be when a class of junior creditors, whose rights are proposed to be adjusted in a restructuring programme, would not accept such a proposal. In such a case, under the absolute priority rule, a court would be unable to let any further lower ranking classes (e.g., holders of equity) receive any benefits or retain any rights in the programme; this might result in the junior creditor class gaining full equity rights in the company. This again might, possibly, deteriorate the position of senior creditors, as it would not be unforeseen that e.g., certain holders of equity may be considered substantially important for the continued operations of a company.

As will be further discussed in the Report, the right amount of flexibility and discretion of a court in restructuring cases will hinge, inter alia, on the competence and mandate of the bench. There is also a balancing act to be carried out between flexibility in preventive restructuring on the one hand, and predictability on the other. In case affected parties cannot be sure of whether *ex ante* positions will be upheld in a formal restructuring, this may counteract consensual solutions since opportunistic debtholders may gain advantages from holding out or holding up. Here, the classic theory of upholding pre-bankruptcy entitlements and the creditors' bargain can be brought to bear on the discussion. Similarly, a lack of foreseeability on the distribution of losses among creditors may prompt individual actions that are detrimental to the group and to the survival of the debtor.[32]

Finally, it is important to note the interplay between the financial condition and the *economic* condition of a company when analysing options and structures for the restructuring legislation. The following chart illustrates hypothetical availability of restructuring frameworks in a matrix of financial and economic conditions of a company.

[32] Thomas H. Jackson, The Logic and Limits of Bankruptcy Law, Harvard UP (1986). For recent perspectives on bankruptcy and restructuring law's answer to collective action problems, see Sarah Paterson, Corporate Reorganization Law and Forces of Change, Oxford UP (2020).

Figure 1 Matrix of potential legal frameworks for a company and its stakeholders © Matti Engelberg



Capital Markets Law Journal, 16 March 2019, kmz003, https://doi.org/10.1093/cmlj/kmz003

In order to understand the fundaments for debt-to-equity conversions, and in particular for the related statutory rules, one may observe the substantial variation in respect of the financial and economic conditions of companies filing for restructuring. Filing for a restructuring may already be needed in case a company faces *financial* difficulties, and, especially in such cases one may assume that the equity of a company would carry some value. This indicates that flexibility in allowing equity holders to retain some rights could be justified.

From recent Nordic restructuring practice, a good example of this is the Finnish iconic department store company Stockmann, which in April 2020 was required to file an application of restructuring due to a collapse in trading caused by Covid-19. The company's economic condition was still reasonable; the latest consolidated balance sheet of the company evidenced an equity ratio of around 38 per cent, which may be considered as a reasonably healthy level.

In the Norwegian ASA and the Swedish SAS restructuring cases the economic conditions were different. The equity levels in both companies' consolidated balance sheets at the time of filings were already at a very low or a non-existing level, meaning that in such cases the question was also about the *economic* conditions of the companies.

Further, it should be noted that none of the Nordic countries have, at least currently, available the scheme of arrangement framework presented in the chart. The scheme of arrangement is a framework available and actively used in the UK and Ireland, and

also contained in the European Model Companies Act (the 'EMCA').[33] The EMCA was created by leading corporate law scholars, who based on reasoned analyses, decided to include a section for schemes of arrangement in the model companies act. As a company law framework, it provides, in addition to a right to sanction any compromises with shareholders and a company, a flexible platform for restructuring of debt instruments, with the approval of the required qualified majority of creditors in each class that a compromise is proposed to.

Importantly, a scheme of arrangement process may involve some of the creditors or shareholders only, so it is an efficient restructuring framework available already prior to any insolvency being imminent. The UK system has evidenced flexibility and efficiency particularly for large corporates, but also provided, through the court sanctioning, safeguards to ensure that the system cannot be abused.

Due to the agreed choice of governing law and jurisdiction provisions in financial contracts, the flexible UK law model is available and has also been used by many major continental and Nordic companies.

[33] Andersen, Paul K. – Andersson, Jan B. edit. European Model Companies Act First edition, 2017, NORDIC & EUROPEAN COMPANY LAW LSN Research Paper Series, No. 16-26.

4. Nordic Implementation of the Restructuring Directive

4.1. Swedish Law Implementation

a. Background: Formal Insolvency Procedures

Swedish law comprises three main in-court procedures for financially distressed companies.

First, both legal and natural persons can be placed in bankruptcy under the Bankruptcy Act (1987:672). In bankruptcy, all assets of the bankrupt debtor are transferred to a bankruptcy estate under the administration of a court-appointed receiver. The main objective of such administration is to liquidate the company's assets and pay its debts, in accordance with the order set out in the Bankruptcy Act read in conjunction with the Priorities Act (1970:979).

Secondly, there are particular rules governing the recovery and resolution of financial institutions, found in the law on resolution (2015:1016) which implements Directive (EU) 2014/59 (BRRD) (as amended). The resolution framework, being a product of EU regulation with global origin and aimed at promoting financial stability, is largely beyond the scope of this Report.

Thirdly, Swedish law has long harboured the possibility of a court-led composition with creditors and, since 1996, company reorganisation. Such procedures are the main focus of this Report and shall be described in more detail below.

In addition to the main bankruptcy and restructuring frameworks discussed in more detail in this Report, Swedish law permits the composition with creditors for entrepreneurs or natural persons that are over-indebted in their personal capacities (see the debt relief acts (2016:675) (general) and (2016:676) (sole traders and entrepreneurs)).

Swedish company law further contains a balance sheet test, pursuant to which the board of directors must take action where a company's assets no longer cover more than half of its registered share capital. Failure to remedy such balance sheet insolvency can lead to personal liability for directors as well as the compulsory winding-up of the company under the Companies Act (2005:551).[34] For the winding-up of a solvent company, Chapter 25 of the Companies Act provides the procedure of liquidation.

[34] An account of the rules, which are found in Ch 25 of the Companies Act (2005:551) is given by Erik Selander in Wessels, B and Madaus, S, Rescue of Business in Europe, ELI and Oxford UP (2020) pp. 1022-1024. The rules are currently under legislative review, see SOU 2023:34 (*Bolag och brott – några åtgärder mot oseriösa företag*).

b. Swedish Implementation of the Restructuring Directive

Swedish law has historically neither prohibited nor contained specific rules to facilitate out-of-court composition or restructuring. Such measures however have a long history of being undertaken through negotiations and voluntary agreements.

During the 19th century, an increase in free trade and commercial activity saw the formation of merchant associations, one of the purposes of which was to oversee and develop the debt negotiations and composition with creditors taking place among members. Alongside similar developments of the laws on bankruptcy and composition throughout Europe, Sweden introduced its first law on composition within bankruptcy in 1862. The first law on composition outside of (and aimed at preventing) bankruptcy was introduced in 1921. This was replaced by the 1970 law on composition, which was produced in close cooperation with the other Nordic countries.[35]

A subsequent Swedish act on company reorganisation in 1996 represented an important evolution of the concept of composition under the protection of a temporary stay on creditor enforcement. Building on existing concepts and market practice, the law enabled voting among creditors, where a certain majority could bind dissenting creditors to a reduction of their claims.

One of the key objectives of the 1996 act was to improve predictability and fairness in relation to the treatment of deeply subordinated creditors. Prior to 1996, it had been unclear whether creditors that had agreed to be subordinated to all others could keep their claims through a composition, where other creditors had been forced to write off a part of their claims. Through the 1996 act, it was made clear that such claims would lose all value in a reorganisation that entailed a reduction of other creditors' claims.[36] However, the law did not permit the cancellation or dilution of share capital within formal proceedings. The unhampered influence of, and retention of value by, shareholders in formal reorganisation thus continued to attract criticism throughout the lifespan of the act.[37]

The Restructuring Directive has since been implemented in Sweden through the replacement of the 1996 act with a new restructuring instrument (2022:964) (the

[35] See SOU 1968:41 (*Utsökningsrätt VII*), SOU 1969:5 (*Utsökningsrätt IX*) p. 39 and prop. 1970:142 (*Förmånsrättslag*) p. 26. For historical accounts of the merchant associations and voluntary restructurings, as well as the development of legislation on court-sanctioned composition, see Ehrenpil (2023) pp. 84–105, with further references. Also see the questionnaire answered by Selander in Rescue of Business in Europe (2020) pp. 1022-1088, describing the state of play prior to the reforms triggered by the Restructuring Directive.

[36] Göthlin (2023) p. 137 with references.

[37] Prop. 2021/22:215 (*Ny lag om företagsrekonstruktion*) p. 175. SOU 2010:2 (*Ett samlat insolvensförfarande*) pp. 295–303. For preparatory texts in relation to the previous Swedish law on company reorganisation (1996:764), see SOU 1992:113 and prop. 1995/96:5. Also see Schytzer (2023) at § 4.5.1.

'FrekL').[38] The act targets businesses that are deemed to be viable, and at the same time insolvent or on the brink of insolvency. The restructuring procedure does not entail the distribution of all the debtor's assets, but the debtor, as a base scenario, remains intact as a legal entity. The law allows for a wide range of possible measures, including the divestment of assets and partial payment of claims.

Market participants will not have been entirely surprised by the contents of the new law, which traces its origins to well-established concepts in the Swedish legislative history in addition to the features motivated by EU harmonisation. The implementation was also accompanied by a high level of stakeholder involvement.[39] However, the concept of a plan negotiation which entails a possible cross-class cram down is new to Swedish law. The same is true for the broad range of company law measures and tools that now are available not only on a consensual out-of-court basis but also within the realm of court-sanctioned measures.

[38] See SOU 2021:12 (*Andra chans för krisande företag*) and prop. 2021/22:215. The 2021 government committee put forth certain proposals that did not end up being realised, notably a simplified procedure for debt restructuring for small businesses and a comprehensive review of the treatment of the debtor's contracts in both bankruptcy and restructuring.

[39] Schytzer (2023) at § 3.

4.2. Danish Law Implementation

a. Background: Formal Insolvency Procedures

Danish law comprises more or less the same in-court procedures for financially distressed companies as Swedish law. However, all Danish procedures are placed in the Danish Bankruptcy Act (LBK 1600/2022).

Both legal and natural persons can be placed in bankruptcy under the Bankruptcy Act, section II. In bankruptcy, all assets of the bankrupt debtor are transferred to a bankruptcy estate under the control of an administrator. The administrator can be elected by the creditors by a certain representation or appointed by the court. The main objective of such administration is to sell the assets in the best possible way – piecemeal or as a (partly) going concern. It is possible to continue the business of the company under the bankruptcy by decision of the administrator. There are also some possibilities of avoidance. The debts are paid in accordance with the order set out in the Bankruptcy Act, chapter 10.

The recovery and resolution of financial institutions are – as a supplement to the Bankruptcy Act – regulated in the Financial Institutions Act (LBK 406/2022) in which the Directive (EU) 2014/59 (BRRD) (as amended) has been implemented (L 334/2015). The resolution framework, being a product of EU regulation with global origin and aimed at promoting financial stability, is largely beyond the scope of this Report.

The possibility of a compulsory composition as part of a company reorganisation has been possible for more than 100 years. Since 2011 it has also been possible to transfer the business as part of a reorganisation process. [40]

The compulsory composition procedures are indeed the main focus of this report and shall be described in more detail in 5.2.2. below.

In addition to the main bankruptcy and restructuring frameworks discussed in more detail in this Report, Danish law permits the composition with creditors for natural persons that are over-indebted in their personal capacities (see the Bankruptcy Act, section IV).

Danish company law further contains – as Swedish company law - a balance sheet test, pursuant to which the board of directors must take action where a company's assets no longer cover more than half of its registered share capital. Failure to remedy such balance sheet insolvency might be a step toward personal liability for directors. However, the tipping point in order to result in liability is not this balance sheet test but the so called "point of hopelessness" of saving the company. The liability is not going to be further discussed in this Report. There is no legal opportunity of compulsory winding-up of the company based only on this balance sheet test.[41] The

[40] See Danish Bankruptcy Act, Section IB.

[41] If the company is not corresponding to different specific rules in the Company Act, a compulsory winding up might be the result, see The Danish Company Act, paragraf 225.

winding-up of a solvent company is regulated in the Danish Companies Act, Chapter 14.

b. Danish Implementation of the Restructuring Directive

Danish law has – as Swedish law – historically neither prohibited nor contained specific rules to facilitate out-of-court composition or restructuring. Such measures however have a long history of being undertaken through negotiations and voluntary agreements. The Danish tax rules support these kinds of agreements to a certain point (for instance via the capital gains taxation).

The first Danish bankruptcy law from 1872 (L 51/1872) contained rules on composition in bankruptcy.

A law on compulsory composition outside bankruptcy was adopted in 1905. The act was hoped also to help in agreeing on voluntary compensations by giving a compulsory alternative. It was possible to postpone a bankruptcy for 4 weeks (and later 8 weeks) in order to try to find a solution outside bankruptcy. This was further strengthened in 1975 with the introduction of rules on suspension of payments and a temporary stay on creditor enforcement in the bankruptcy act (L 266/1975). The law on compulsory composition both in and outside bankruptcy was adopted as a part of the bankruptcy act by the new bankruptcy act in 1978 (L298/1977).[42] The rules on suspension of payments were revised in 2011 in order to strengthening the restructuring of business.

The rules on suspension of payments were at all times only to be used if the debtor was insolvent in the way defined in the Bankruptcy Act.

The Restructuring Directive was implemented in Denmark by a special section – Section IA - in the Danish Bankruptcy Act and amendments in Section IB (L 896/2022). It is aimed at businesses that are deemed to be viable but having a likelihood of insolvency. The restructuring procedure does not entail the distribution of all the debtor's assets, but the debtor, as a base scenario, remains intact as a legal entity. The law allows for a wide range of possible measures, including the divestment of assets and partial payment of claims.

[42] The bankruptcy act was produced in close coorporation with the other Nordic countries, see BET. 606/1971.

4.3. Finnish Law Implementation and Notable Programme of the Government

a. Background: Formal Insolvency Procedures

Finnish bankruptcy proceedings are conducted as statutory proceedings under the Finnish bankruptcy act (120/2004, as amended) (hereinafter the 'Bankruptcy Act'), whilst restructuring proceedings are conducted as separate proceedings under the Restructuring Act.

On the interplay with bankruptcy proceedings and restructuring proceedings in Finnish law, these proceedings are separate, but a potential simultaneous filing for the opening of the bankruptcy proceeding is statutorily subordinate to the filing for the opening of the restructuring proceeding relating to the same entity, i.e., a respective opening of the bankruptcy proceeding must wait for the outcome of the filing for the opening of the restructuring proceeding, before a bankruptcy judgment may be issued. In case where the restructuring proceeding has been opened, the company may be declared bankrupt only on the basis of the economic situation that cannot be recovered by any restructuring plan.

As a background to the Finnish law implementation of the Restructuring Directive, it is first good to note the historic development of the Finnish Restructuring Act. In the early 1990's Finland faced a drastic downturn in the economy, also described at the time as the toughest downturn in any OECD country after the WW2.

This downturn was partly due to an overheated economy caused by liberalisation of the financial market regulation, but also due to the collapse of the Soviet Union, with whom Finland had prior extensive trade relations.

Seeking further possibilities for rescue of eligible major companies was, therefore, very high on the agenda of the government at the time. The Ministry of Justice reviewed the then prevailing international benchmarks for new restructuring laws and was mostly inspired by the US Chapter 11 framework.

The Chapter 11 mechanism was significantly used as a benchmark for the introduced new Finnish Act. After intensive preparatory work, and also public discussion with variable views, Finland introduced, as a first Nordic country, a new restructuring of enterprises act (1993/47) (referred to herein as the 'Restructuring Act'), which entered into force on 8th February 1993. About the tone in the discussion, it is good to note that even the president of Finland criticised the new law as a 'poor' legislation. As former chair of the Bank of Finland, he was mostly concerned about the possible implications of the new law for the financial markets.

As an aftermath, it may be fair to say the law has worked well, a significant number of eligible companies have been rescued with it, and it has not been substantially abused. Though, in contrast to Chapter 11, this act remained, from the very beginning, unclear about the position of the shareholders in restructuring – there are neither specific provisions for a cross-class cram down of equity holders in the law, nor are the shareholders viewed as a voting group in the proceeding.

Before the Restructuring Act was enacted, the key insolvency law was based only on the former Bankruptcy Act 31/1868, so the statutory insolvency rules had been rather historic by nature. After the new law was introduced, there were two alternative routes for the insolvency proceedings, one aiming, with eligible firms, for restructuring, and the second, for insolvent non-eligible firms, for bankruptcy.

The dual routes in insolvency law – the operation of the restructuring under the shadow of bankruptcy – correlates with the theory of creative destruction created by economist Joseph Schumpeter. A decision matrix outlined by Risto Koulu emphasises the need for a market economy to be able to put an end to non-eligible firms, but the dual target for the modern insolvency law is also to enable eligible companies to continue with operations.[43]

However, the dual target for the system does not always succeed. As Koulu outlines, in the dual system you may end up with two types of mistakes. The first one would be the bankruptcy of an eligible firm, and the second systemic mistake would be to provide a possibility of restructuring for a non-eligible firm. Koulu notes that, when weighting factors in favor of the 'survival' against those for 'liquidation', the first type of a mistake would be less harmful for a court, as for the economy the survival of a firm may be considered more important.

In 2007, the Restructuring Act was amended, e.g., by introducing some further criteria about the validation of 'eligibility' of a firm. The new regulation (1993/55) given in connection with the amendments included, *inter alia*, a further requirement for the auditors of a firm to express views about the realistic nature of the grounds for the restructuring application.

b. Finnish Implementation of the Restructuring Directive

A 'road map' for the Finnish implementation of the Restructuring Directive included an appointment by the Ministry of Justice of a 'working group' and a 'steering group' for drafting the amendments due to the directive. In the respective appointment of the groups, topics relating to debt-to-equity conversion were deliberately instructed to be outside of the groups' scope of work.

Hence, the preliminary report of the working group includes comprehensive analyses of the eligibility of the current Finnish law with respect to the requirements of the directive, and these analyses covered also the principles introduced in Articles 11 and 12 with respect to cross-class cram down of equity holders in restructuring.[44]

As key reasonings for the above analyses the working group refers first to Article 9 of the directive, according to which Member States must ensure that only any 'affected parties' must be able to vote on the acceptance of a programme. According to the definitions of the directive, 'affected parties' means creditors, including, where

[43] Risto Koulu, uudistettu yrityssaneeraus, WSOY Pro, 2007, p. 14.
[44] Finnish Ministry of Justice, Oikeusministeriön julkaisuja, Mietintöjä ja lausuntoja 2021:18, p. 61, 71-86.

applicable under national law, workers, or classes of creditors and, where applicable, under national law, equity holders, whose claims or interests, respectively, are directly affected by a restructuring plan. Further according to Article 9.3 Member States may exclude equity holders from the right to vote.

The analyses continue to discuss Article 12 of the directive, which requires, inter alia, that where Member States exclude equity holders from the application of Articles 9 to 11, they shall 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.

For this the analyses also refer to recital 57 of the directive, according to which *'[a]nother possible means of ensuring that equity holders do not unreasonably prevent the adoption of restructuring plans would be to ensure that restructuring measures that directly affect equity holders' rights, and that need to be approved by a general meeting of shareholders under company law, are not subject to unreasonably high majority requirements and that equity holders have no competence in terms of restructuring measures that do not directly affect their rights*.'

The Finnish government law proposal for amending the Restructuring Act based on the Restructuring Directive was given in early 2022. The motivation for the proposal notes, as in the above working group report, that Article 12 of the directive does not, as such, require amendments of the Restructuring Act. As a reason for this, the proposal notes the rules of the Finnish Companies Act, where e.g., a two thirds majority of shareholders may accept a targeted share issue, and that the shareholders are only entitled to vote on matters of a restructuring programme, which may have a direct impact on their position.

These analyses have, however, also been met with some criticism. The aim of Article 12 of the directive speaks in favor of Member States having an efficient mechanism in place for a cross-class cram down of all classes, including equity holders, and it may be fair to say that Finnish law is currently rather unclear on this.

In contrast, Finnish law has included, from the day the Restructuring Act was introduced, an absolute priority rule among classes of creditors. According to the wording of section 54 of the Finnish Restructuring Act, the absolute priority rule is applied in cross-class cram down only. A restructuring programme may be approved at the request of the person who had prepared the draft, the administrator, or the debtor, subject to the following conditions: '…. according to the programme, creditors with claims that have a lower priority than the group of creditors voting against approval, other than one composed of secured creditors, *are not to receive payment'*.

When noting the rather strict absolute priority rule among classes of creditors on the one side and the unclear position of equity holders in the process on the other, the position of junior creditors, in particular, may be considered weak in the Finnish restructuring process.

It is good to note that the working committee in charge of drafting the implementation of the Restructuring Directive also assessed as its conclusion: *legislative needs for debt-to-equity conversions should be further examined in the future as a mean for corporate restructuring*.[45]

Further, in the legal practice there has been, even a rather frequent, use of debt-to-equity conversions, where the transactions have been executed with the required approval of the shareholders' meeting. A related court process has either waited until such an approval has been given prior to confirming a restructuring programme, or confirmed a programme, with a condition or note, that the Restructuring Act contains provisions, where a court may order a programme to lapse, in case e.g., after the approval of the programme circumstances come to light which would have prevented the approval of the programme had they been known at the time.

c. Forthcoming New Legislation

A forthcoming need for legislative work has also been noted in the current government's programme in Finland. The government programme refers, as one of the key tools 'to secure financial markets which would bring along growth', that corporate restructurings should enable debt-to-equity swaps and corporate law schemes of arrangements.[46] On 28th November 2023, the Ministry of Justice established a working group and a steering group to prepare the respective legislation for enabling debt-to-equity swaps in restructuring, as referred to in the government programme.

As noted, the Finnish law status may be considered particularly unclear from the statutory priority rules point of view. Clause 54 of the Restructuring Act, which contains the above-mentioned absolute priority rule, only refers to the application of such a clause among classes of creditors – creditors with claims that have a lower priority than the group of creditors voting against approval.

There is no statutory guidance in the law about the possibility of a debt-to-equity conversion – other than the reasoning of the law noting that a programme may include amendments to terms of credit or otherwise to the *capital structure* of a company. For the latter, the government reasoning pertaining to the original law also refers to the possibility of a debt-to-equity conversion.

As a precedent, a Supreme Court judgment (KKO 2003:73) has been noted, which may illustrate the problems in the Finnish law. In this case a company had issued and outstanding a convertible capital notes issue, under which the right to payments was removed in the relevant restructuring programme. The Supreme Court established that such creditors were neither entitled to convert their claims into shares of the company, even though the terms of the notes contained such a possibility and such

[45] Finnish Ministry of Justice, Oikeusministeriön julkaisuja, Mietintöjä ja lausuntoja 2021:18, p. 21.
[46] A strong and committed Finland, Programme of Prime Minister Petteri Orpo's Government, 20.6.2023, p. 102.

conversion right had been accepted at a shareholders meeting. One may read this court precedent as signaling that Finnish law accepts that the position of shareholders may remain unchanged in a statutory restructuring, even though creditors may lose their claim against a company in the process.

Though, it is good to note that this judgment was made before the Finnish companies act was reformed in 2006. The new companies act (624/2006) cut the previous link between a company's share and its share capital so that shares do not currently need to have any nominal value – a company is, on special grounds, even entitled to issue shares without receiving any compensation.

As the shares do not, under the current law, have a direct tie to the share capital, companies can, from the company law point of view, consider issuing shares without any compensation. Hence, if a corresponding case should arise under the current law, notwithstanding that a debt may be removed in a restructuring programme, one could argue that a right to convert such a receivable into shares should remain in place (at least prior the removal of the debt), as this has also been accepted by the shareholders at the time of accepting the conversion rights.

As a final note, a useful tool for preparation of the forthcoming changes in law, is a comparative study on debt-to-equity conversion conducted by the Finnish government in 2018. The project organisation for the study conducted an evaluation of how national legislation governs corporate restructuring and corporate arrangements for purposes of determining possible revisions into Finnish law. This evaluation required a comprehensive comparison of provisions governing the respective company laws, insolvency laws and other corporate arrangement laws in certain relevant countries (namely Sweden, Denmark, the United Kingdom, the United States of America, the Netherlands, Germany, France, and Switzerland). This comparison may form a good basis for the forthcoming law review in Finland and, perhaps, a useful tool for the other Nordic and European jurisdictions, too. The review contains, as an example, a well drafted summary table, which illustrates the key characteristics, at the time this Report was made, of the systems in the reference jurisdictions.[47]

[47] An international study on debt-to-equity conversion in connection with corporate arrangements and insolvency, Publications of the Finnish Government's analysis, assessment, and research activities 6/2018.

5. Comparison of the Statutory Priorities in the Current Swedish, Danish, and Finnish Restructuring Laws

5.1. General Introduction

In this and the next section we will discuss in more detail the content of the laws in the Nordic EU Member States after implementation of the Restructuring Directive. We will address e.g., control rights of secured creditors as a backdrop to the ensuing account of restructuring law. This is because the powers of secured creditors to direct the route for execution against the debtor, as well as the distributions to enable it to be paid, are factors that will play into the incentives and the determination of safeguards in relation to alternatives to bankruptcy. It has been argued that bestowing control rights in the hands of a single creditor or group of creditors increases monitoring incentives in a way that promotes access to credit. Others have argued that far reaching control rights can lead to inadequate incentives for the controlling group to maximise net recoveries.

For providing veto rights to creditors the Restructuring Directive refers to a 'best-interest-of-creditors' test, meaning that no dissenting creditor is worse off under a restructuring plan than it would be either in the case of liquidation, whether piecemeal liquidation or sale of the business as a going concern, or in the event of the next-best-alternative scenario if the restructuring plan was not to be confirmed. Member States should be able to choose one of those thresholds when implementing the best-interest-of-creditors test in national law.

As the aim of this Report is to analyse the priority rights based on the new laws for distribution under any restructuring programme, we have considered feasible not to analyse further the potential impacts of jurisdictions choosing one or several levels for the best-interest-of-creditors test. However, one may generally note that bankruptcy is thought of as the alternative to restructuring in a Nordic context, also after the implementation of the Restructuring Directive – to be compared with e.g., the UK framework, where there might be "other alternatives".

Further, when addressing priority rules in each jurisdiction, we will discuss the set-up of the judicial system, including the standard of restructuring professionals and their appointment. It carries great weight when assessing the effectiveness of the proceedings. This is also the case when evaluating the optimal scope for flexibility or discretion to be afforded in the process. In the context of priority rules, there is an argument to be made for greater flexibility where the process is perceived to be fair and led by persons that are competent in interpretation of the law as well as reading detailed balance sheets and financial agreements.

A Nordic feature to be noted, as opposed to the UK Part 26A restructuring, is the substantial reliance of the system on the impartial professional administrators, who, *inter alia*, are in charge of drafting of the restructuring programmes or plans.

Unless the process is perceived to be sophisticated enough, the court-led restructuring system must either conform to highly predictable rules, such as an APR

with only very narrow exceptions, or it will be reserved for smaller, less complex cases. Creditors of a certain size would expect a certain degree of predictability when it comes to the application of fairness standards and the upholding of ex ante priority positions. Unless the legal system can be relied upon to keep a restructuring within the boundaries of generally accepted principles, this prevents the mid- and large market segments from effectively accessing a court-led restructuring.

We also note that the systemic difference relating to duality in the UK and US concerning equity and common law is not exactly matched in the Nordic countries. The application of Nordic law has been described as pragmatic, where reasonableness and fairness are fundamental parts of e.g., contract law.[48] Hence, the fairness issues are something to be considered by the courts in the future based on e.g., the exemptions provided to the statutory priorities under the new restructuring rules.

5.2. Swedish Restructuring Law

5.2.1. Creditor Priority in the Bankruptcy of a Swedish Debtor

a. Introduction

The rules on priority between creditors in a Swedish bankruptcy context are found in the Bankruptcy Act (1987:672) (Ch 3, 5 and 11) read together with the Priorities Act (1970:979).

When assessing the position of a particular creditor in the bankruptcy of a debtor, the following legal factors must typically be considered.

First, a creditor may have a claim attaching to certain assets or funds under the rules on separation or segregation of assets. This derives from the principle that only the assets owned by the insolvent debtor shall be part of the bankruptcy estate and subsequently distributed. This means that, e.g., assets acquired under hire-purchase or sale and leaseback arrangements may be separated from the estate prior to other creditors starting to share in any distributions.

Secondly, a creditor may be entitled to set-off against a claim that the debtor holds against the creditor. This method of getting paid represents an important form of *de facto* security under Swedish law, not least for banks that are able to make themselves paid in return for forgiveness of debtor deposits. Further, Sweden has implemented the Security and Finality Directives, allowing for close-out netting and margin calls to benefit market participants in their management of counterparty credit risk.[49]

[48] See further e.g., Nina Wilkman, Interpretation of Share and Business Acquisition Contracts, Unigrafia, 2018, p. 54-56.

[49] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems. Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements. Also see the Restructuring Directive, recital (94).

Thirdly, certain creditors may have obtained a privileged position by means of taking security over assets of the debtor.[50] Security will typically entitle the holder to priority of payment out of the value of the assets over which security has been granted. The order of priority between different forms of security are set out in the Priorities Act (1970:979).

Under the Priorities Act, claims that are not secured or subject to general priority shall be treated equally, which means that they should give rise to payments pro rata. A creditor may also have agreed to be subordinated to all others, or belong to the category of 'senior non-preferred' in the capital structure of a financial institution.[51] Costs pertaining to the administration of the bankruptcy estate are to be met prior to the general distribution to creditors taking place.

b. The Scope of Secured Creditor Control

In this section, *control* signifies influence over the choice between alternative routes of execution in relation to a financially distressed debtor, as well as over the actions taken within a designated route.[52]

In an out-of-court restructuring, the influence of secured creditors that hold a single point of enforcement cannot be overstated.[53] Where the creditor's claim amounts to the value of a pledged company, the creditor is typically entitled to make itself paid by taking control of the company and selling it to a third party.

The precise extent of influence that can be exerted by a secured creditor varies between different types of security. It further varies, naturally, with the valuation of the assets of the debtor, the capital structure at large, and the debtor's line of business.

A creditor whose claim is fully secured by the assets of a debtor is generally not thought to have a legitimate interest in applying for bankruptcy. Such a creditor is instead able to rely on sequestration of assets or other executive measures, with or without the aid of the Enforcement Agency (Sw: *Kronofogdemyndigheten*). The law is further designed to distribute the costs of bankruptcy administration on secured creditors only to the extent that the work undertaken by the receiver relates to assets from which they can expect payment.[54]

[50] Security and guarantees may also have been provided by third parties. However, focus here is on the rules that govern the distribution of the assets of the debtor's estate, and hence third-party security providers and guarantors are not dealt with in detail.
[51] See Priorities Act § 18. The effects in insolvency of a creditor having agreed to be subordinated to some, but not all, other creditors are discussed in Göthlin (2023) *passim.*
[52] Armour et al (2009).
[53] Göthlin (2023) p. 165.
[54] Ch 14 § 18 Bankruptcy Act.

In addition, there is a formal right for a creditors' committee or individual creditors to be heard on material matters.[55]

Against this background, and depending on the valuation of secured assets, a secured creditor may have limited interest in participating in a restructuring. This is reflected in FrekL, which allows for fully secured creditors – whether by virtue of pledges over assets or the right of set-off – to be kept outside of a composition proposal if it is justified to leave them unaffected.

Any security holder is under an obligation to exercise due care in its dealings with the security assets, during the life of a loan but also in connection with enforcement. Further, any surplus remaining after the realisation of an asset for payment towards the secured claim must be transferred to the pledgor.

Finally, the influence of secured creditors is limited by a general stay on enforcement once a restructuring has been formally initiated.[56]

c. The Position of Shareholders in Bankruptcy Proceedings

Swedish priority rules do not explicitly address the position of shareholders. Shareholders, being residual claimants, are not typically part of the analysis of a payment waterfall on insolvency. Only in the extraordinary case of a surplus remaining after the satisfaction of all claims in bankruptcy would the shareholder be entitled to receive any proceeds.[57] Consequently, the negotiation position of shareholders once a company has entered into bankruptcy is typically poor. A degree of influence can however exist in cases where there is a prospect of selling the company's business as a going-concern or otherwise using the bankruptcy form for transferring the assets of an insolvent company while still relying on the network and expertise of previous owners.

d. Subordination of Claims and Enforceability of Intercreditor Agreements

The Priorities Act acknowledges that a creditor may have agreed to be subordinated to all other creditors. In such case, the subordinated creditor shall be paid only after all other creditors have been satisfied. Certain public claims in relation to fines or penalties are also subordinated by law.

It has not been established by legal authority whether subordination to certain other creditors (but not all) shall be upheld in the bankruptcy of the debtor, although such

[55] In restructuring, the court shall appoint a creditors' committee upon request of a creditor. The administrator shall hear the creditors' committee on material matters, unless prevented from doing so in cases of urgency or where consultation is impossible (2 Ch 18 § of the Restructuring Act). The role of a creditors' committee is that of an advisory body to the administrator. If no creditors' committee is put in place, the administrator must ensure in some other way that the creditors, if they so wish, receive information about the progress of the proceedings relevant to their position.

[56] 2 Ch 23–26 §§ FrekL.

[57] See Companies Act (*aktiebolagslag (2005:551)*) 25 Ch 51 §, Persson and Karlsson-Tuula (2016) p. 559.

agreements are valid and binding as between the parties. The position of this author is that subordination or intercreditor agreements should typically be upheld in the bankruptcy of the debtor, except where such arrangements purport to infringe third party rights.[58]

e. Agents or Trustees as Enforcement Intermediaries in Secured Bond Issues

When a financially distressed debtor has issued loans or bonds that are distributed among multiple creditors, the collective action problems associated with insolvency gain an additional layer. In addition to coordination of *different claims* of the debtor, bond issues require coordination *within the same loan*. Let us first note the general legal conditions for joint creditor action through a representative in relation to a distressed debtor.

Swedish law does not provide for trusts and Sweden has not acceded to the Hague Trust Convention.[59] The recognition in Sweden of trusts constituted under laws of other jurisdictions is therefore uncertain. Unlike Denmark and Finland, Sweden has not enacted particular legislation to establish a security agent or trustee-like function to ensure predictability in respect of the parties' arrangements. Instead, representation of a collective of lenders or bondholders under Swedish law will rest on a contractual framework, with powers of attorney or agency agreements entered into according to an evolving market practice.

The function of an independent agent has developed mainly through the activities of arranging banks and private agency companies, notably Nordic Trustee & Agency AB. In the investment grade segment of the Swedish bond market, banks as issuing agents still tend to assume the role of coordinator in case of bond meetings or (the unlikely) acceleration of the bonds.

Bondholder collectives can be expected to be assembled and vote on a unified course of action in relation to a distressed debtor, through fairly standardised procedures for bondholder meetings contained in bond terms and conditions.[60] However, the current legal framework does not allow for the conclusion that bondholders may relinquish their right to take independent legal action through non-action clauses, nor does it ensure that agents may themselves appear in court absent having collected powers of attorney from each individual investor.[61]

5.2.2. Creditor Priority in a Swedish Restructuring

a. The Fundamental Differences between Bankruptcy and Restructuring

[58] See Göthlin (2023) pp. 363 ff for a summary of the argument. Also see prop. 2021/22:215 p 217 where it is stated that the status of intercreditor agreements in a restructuring context is a matter for development in legal practice and ultimately a matter for the ECJ.

[59] For signatories and status re the Hague Trust Convention, see the convention website: https://www.hcch.net/en/instruments/conventions/status-table/?cid=59

[60] Andrews (2022) p. 33.

[61] Göthlin (2023) p. 350 ff.

As outlined above, priority in bankruptcy is set in the context of an insolvent liquidation, where all assets of a company are converted into cash for distribution in a certain statutory order. Restructuring, on the other hand, is rather a mechanism for distributing the costs of immediate rescue and the potential future surplus arising as a consequence of that rescue among investors and creditors. The bankruptcy setting is, however, important to this Report, for the reasons discussed above.

b. Statutory Priorities in a Restructuring Negotiation and the Ensuing Plan

The priority status of claims or interests shapes the plan negotiation process under Swedish law in a number of ways. At the same time, the process influences priority. This is because a party's relative position may be altered by the establishment of a restructuring plan.

A restructuring plan has the same effects as a binding agreement between all parties (4 Ch 29 § FrekL). At the same time – in line with the core idea of formal restructuring – a plan can be adopted against the will of certain minorities or dissenting classes, as long as the conditions for court sanctioning are met.

From a procedural point of view, the following review is a matter of establishing what conditions must be met, or safeguards be observed, in order for a plan to be pushed through the different stages of (i) the determination of affected parties, (ii) voting and confirmation of a plan with the approval of all voting classes, albeit with dissenting minorities within classes; and (iii) a potential confirmation of a plan through a court-sanctioned cram down of dissenting classes. (The adoption of a wholly unanimous restructuring plan is not of interest to the analysis since such agreements may be concluded within the boundaries of the freedom of contract and do not need to be sanctioned by a court).

c. The Determination of Affected Parties

First, under Swedish law, the priority status of a claim or interest influences the determination of "affected parties". That is, creditors or owners falling within the scope of restructuring measures. For example, creditors that enjoy full security or a right of set-off for their claim may be excluded from a plan negotiation, as well as minor trade creditors or shareholders, should the debtor believe that the plan can succeed in returning the business to viability without such interests being affected.[62] The mere fact that the value of a company's equity may increase as a consequence of a successful restructuring does not mean that shareholders are "affected" within the meaning of the law.[63]

The conditions for the demarcation of affected parties allows, on a plain reading of the law, junior stakeholders to be left out of a restructuring plan altogether. While

[62] 4 Ch 3 § FrekL. As a first condition of participation in a plan negotiation, a creditor's claim must have arisen prior to the company being put into formal restructuring. The same does not apply to shareholders, whose ownership interest may have been created during the life of the process and still be included. Further see prop. 2021/22:215 p. 194.
[63] Karlsson-Tuula (2022) at 4 Ch 3 §.

that means that they may not vote, it also entails that they are untouched at the same time as more senior creditors would accept a reduction of claims. The determination of affected parties shall be motivated and reviewed by the court upon submission of a restructuring plan.[64] However, the scrutiny of such determination may not run very deep in practice, absent one of the parties raising objections (4 Ch 14 § 2 para FrekL). The potential for violating the absolute priority rule in a cross-class cram down by means of leaving certain parties out of a plan is further discussed in 5.2.3 below.

d. Voting and Confirmation of a Plan with the Approval of all Voting Classes

A Swedish law restructuring plan shall stipulate classes of affected parties for voting purposes. There are five mandatory main classes:

1) creditors who are senior to ordinary unsecured creditors;

2) unsecured creditors;

3) creditors with public law claims (notably tax), if the claim is not as referred to in 1 or 4;

4) claims that are subordinated to ordinary unsecured creditors in bankruptcy; and

5) equity holders.[65]

The class formation is intended to reflect a sufficient equivalence of interest, and, in line with the Restructuring Directive, builds on the priority of a claim or interest in the insolvent liquidation of a debtor. In addition to the mandatory classes, parties may be divided into sub-classes based on similar interest.[66] Any additional classes must however not comingle claims that would belong to separate mandatory classes.

The division is based upon the nature of a claim, meaning that a creditor can belong to a class of senior secured creditors with parts of its claim, and to a class of unsecured creditors to the extent that their claim is not covered by the value of its security assets.[67]

The voting class formation, like the determination of affected parties, shall be reviewed by the court *ex officio* and may be subject to the court's alterations. The classes may also be tried by the court upon an objection by the administrator, the debtor or any affected party.

The adoption of a plan requires a two-thirds majority within each class, both in respect of the parties voting and the value of claims or interests. The court shall

[64] 4 Ch 7 § 6 para and 4 Ch 17 § FrekL. Karlsson-Tuula (2022) at 4:17. Ehrenpil (2023) p. 267.
[65] 4 Ch 5 § FrekL.
[66] See Ehrenpil (2023) p. 278 for a discussion on strategic group formation.
[67] Prop 2021/22:215, p. 218. For a discussion of whether and to what extent the existence of an intercreditor agreement between certain of the company's creditors shall be taken into account in the class formation, see Göthlin (2023) Ch 12.7.

confirm an adopted plan subject to certain conditions, which are derived from the Restructuring Directive (art 10(2)). First, the court shall examine if:

(i) affected parties in the same class are treated equally and in proportion to their claim or interest;

(ii) the plan has reasonable prospects of success;

(iii) there is reason to believe that the debtor has secretly favoured any affected party to influence the plan negotiation or has engaged in other deceitful behaviour during the plan negotiation;

(iv) the plan is contrary to law or regulation, or is clearly detrimental to an affected party; and

(v) the restructuring procedure has not been conducted in accordance with the law, and the error may have affected the outcome of the negotiation.

Further, if the restructuring plan provides for new financing, such financing must be assessed by the court to be necessary and to not unfairly prejudice the interests of creditors.

In addition to the above legal conditions to be examined by the court, an affected party may raise objections against the plan on the basis of the best interest of creditors test. That is, that it receives less in the plan than it would have in the insolvent liquidation of the debtor. Upon the objection of an affected party, the court may also refuse confirmation of a plan that is in other ways detrimental to an affected party, that lacks adequate security for performance of the plan, or where the court finds other extraordinary reasons to refuse.

Finally, as a general condition, a plan may not impose positive obligations on affected parties. That is, it may proscribe that a creditor or shareholder loses all its interests in the debtor company, but not oblige any of them to inject more funds unless voluntarily agreed.[68]

e. Cross-Class Cram Down

Absent the plan being accepted by all voting classes, a cross-class cram down procedure may be proposed by the debtor, the administrator, or an affected party.[69] This means that a minority of voting classes are not able to definitively block a plan confirmation by dissenting, but to push the process into cram down, thus invoking additional statutory safeguards.[70]

In order for a plan to meet the cram down criteria, a (simple) majority of classes must still accept the plan. Further, either at least one of the accepting classes must be senior in priority to the ordinary unsecured creditors; or at least two affirming classes

[68] See Ehrenpil (2023) on *inter alia* p. 252 f. for a discussion of this criterion.
[69] 4 Ch 25 § FrekL. If the plan is proposed by an affected party or the administrator, the debtor's consent is required where it is an SME, see 4 Ch 27 § FrekL.
[70] Ehrenpil (2023) p. 293.

must be ones that would receive payment or keep any interest in the case of bankruptcy. Voting classes must be treated at least as favourably as any other class of the same priority and more favourably than any junior class. In addition, the plan may not result in any affected parties receiving or keeping more than its original claim or interest.[71]

Finally, a successful cram down requires observation of the Swedish absolute priority rule, which will be further discussed below.

f. New and Interim Financing Priority

A typical restructuring hinges on the debtor company's ability to find liquidity providers during the process, as well as new financing to take the company into the post-restructuring phase. Therefore, providers of new and interim financing will take priority over pre-commencement creditors in accordance with FrekL.

Interim financing entered into with the consent of the administrator will enjoy a general right of priority, meaning priority over the debtor's general estate (not in relation to particular assets) in bankruptcy. Such right of priority ceases once a plan has been confirmed, or three months have passed from the closure of proceedings without a plan having been confirmed, and provided no petition for bankruptcy has been filed within that time. New financing that is agreed as part of a restructuring plan may also carry a general right of priority. For this to apply, the new financing must have been deemed necessary and form part of a confirmed plan. The priority agreed upon in such cases may be limited in time.[72]

g. Conditions for Debt-to-Equity Swaps

A Swedish restructuring plan may contain a wide range of measures, including the exchange of debt for newly issued shares of equity in the restructured company. Company law actions, such as the adoption of a new capital structure, shall in such case be part of the restructuring plan and filed with the Companies Registrations Office (Sw: *Bolagsverket*).

While debt-to-equity swaps have previously formed part of the market practice for out-of-court restructurings, the new FrekL allows such operations to be carried out against the will of a dissenting minority within a class or cram downed classes. This, in turn, raises a number of legal issues, the solutions to which are currently evolving.

From a capital markets perspective, one such issue is to what extent it will be justified under the APR (described below) to permit a certain number of existing shareholders to retain some value in order to preserve a market in the company's shares. In cases where creditors obtain a large equity stake, a determination may also have to be

[71] This requirement is of particular interest in relation to debt-to-equity swaps, where an agreement may entail that creditors accepting a hair-cut can continue to receive dividends or instalments for a future period of time. The net present value of the future dividends or instalments may in such case, within the literal meaning of the text, go beyond the current value of the claim.

[72] Prop. 2021/22:215 p. 258 ff.

made on whether the restructuring triggers public take-over rules for mandatory bids.

Another matter for consideration is how to apply the APR standard of senior classes being 'fully paid', when part of that 'payment' takes place through the issue of shares in a company that is on the brink of insolvency. As always, the valuation underpinning a restructuring plan is crucial for its justification, as is the agreed distribution of future revenue.

Finally, where the company has publicly traded bonds, the framework for voting and negotiation among bondholders will be fundamental for the success of a restructuring. The Swedish bond market has developed and grown significantly in the high-yield space over the last decade.[73] Thus far, as mentioned above, there is no legislation or court precedent to support the enforceability of non-action undertakings by individual bondholders, nor the representation of bondholders by an agent in restructuring proceedings. This means that there is ample room for speculation and hold-out strategies among minority bondholders, as well as significant transaction costs driven by legal uncertainty, in a scenario where a creditor class in restructuring is constituted by bondholders.

5.2.3. Absolute Priority, Relative Priority or a "Relaxed" Absolute Priority Rule?

a. The Swedish solution

Sweden has chosen to implement an absolute priority rule (APR) that applies in case of a cross-class cram down. The APR entails that a dissenting class must be satisfied in full where a more junior class is to receive any payment or keep any right. However, the legislator also chose to implement an exception.

The exception states that a plan may be confirmed even if it deviates from 4 Ch 25 § item 3 or 4, which contain the APR, if there are extraordinary reasons (sw: *synnerliga skäl*). In the relevant cross-referenced sections, which are found in a list of conditions for cross-class cram down, the priority rules are stipulated as follows (our translation):

> *3. the class or classes of affected parties that have voted against the plan are treated at least as favourably as other classes which would have the same priority as the dissenting class/classes in the debtor's bankruptcy;*
> *4. the class or classes of affected parties that have voted against the plan are fully satisfied with the same or equivalent means, if a class that would have a lower priority in the debtor's bankruptcy is to receive any payment or keep any right under the plan […]*[74]

[73] See The Swedish Corporate Bond Market and Bondholder Rights, OECD and Swedish Corporate Governance Institute 2022.
[74] See 4 Ch 26 § FrekL. In accordance with the Restructuring Directive, art. 11 (2) subpara. 2.

The exception is primarily thought to enable owners to keep a certain interest in the restructured business, even where creditors are not paid in full. The scope and precise content of this exception is under development in Swedish market practice and literature and has not yet been the subject of Supreme Court precedent. One of the typical scenarios where a junior party could be entitled to keep an interest even though general creditors would accept a write-down of their claims, is where the continued engagement of shareholders is necessary to ensure the continuation of the debtor's business.

In scholarly debate as well as in emerging lower court practice, the view has been taken that the law allows for circumvention of the APR rule by means of leaving the shareholders or another junior class out of the restructuring plan by designating them as "unaffected parties" at the outset.[75]

The view of this author is that a cram down which implements a reduction of creditors' claims should not typically leave more junior classes, such as shareholders, out of the restructuring plan since such plan would run contrary to the intent and purposes of the plan framework. That is, in order to approve that a shareholder is to be 'unaffected' by a plan that is later subject to a cram down of one or more creditors, the court should make the same kind of judgment of the plan's eligibility for exemptions to the APR as it would at a later stage, had shareholders been 'affected'.

One of the legislator's reasons for including equity holders in plan negotiations was to remedy the previous state of the law, which had attracted continuous criticism from both market participants and scholars.[76] Should the mechanical application of the new law as suggested by early lower court practice prevail, the position of shareholders vis-à-vis creditors will turn out to not have changed significantly after all.

One possible interpretation that could reconcile the wording of the law with its underlying policy objectives – in line with settled EU legal method – could instead be the following: The requirements that must be met to invoke the statutory "extraordinary reasons" exception to the APR under 4 Ch 26 § FrekL, should also serve as a standard for deviating from the creditor hierarchy in relation to 'unaffected' parties. This means that administrators and debtor companies that envisage that a plan may be subject to cram down, should analyse at the outset whether their treatment of unaffected parties would be justified in the APR context.

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[75] Schytzer (2023), Renman (2022) pp. 29–44. Ehrenpil (2023) p. 266 f. Especially see the Court of Appeals judgement Ä 1828-24 (Hovrätten för Västra Sverige) dated 29 February 2024. In the particular case, the plan as a whole may of course have been found to provide for adequate value to be contributed by the existing shareholder. This could motivate - along the lines of the discussion of the German APR in Section 2.2 above - derogations from absolute priority in a cram down situation. Further, in many restructuring cases, there are no creditors or external parties willing or able to assume ownership of the debtor company. The decision to allow equity to retain a certain interest should in my opinion however not be subject to different standards depending on at what stage of the proceedings the judgment is made.

[76] Prop. 2021/22:215 (*Ny lag om företagsrekonstruktion*) p. 175. SOU 2010:2 (*Ett samlat insolvensförfarande*) pp. 295–303.

The application of a single standard for when junior classes may retain value even though senior classes have not been paid in full may be guided by the Restructuring Directive . There, a derogation from the APR is explained to be justified where it is 'fair' (as in Recital 56) or necessary to obtain the restructuring objectives, and such derogation does not unfairly prejudice the interest of affected parties (as in article 11.2 para 2).[77]

This interpretation is also supported by the wording of the Restructuring Directive article 11, as well as the implementing Swedish statutes. The Directive, both in relation to the RPR and the optional APR, speaks of a comparison between a *dissenting voting class* and *a more junior class.* It does not – and neither does the Swedish legal text - stipulate that a comparison should be made between a dissenting voting class and a more junior *voting* class. This means that neither the RPR nor the APR allows junior classes to be satisfied or retain their interests if more senior classes are crammed down, regardless of whether those junior classes are voting or not.

b. The Scope for Discretion and Competence of the Bench

As seen from the above, the restructuring frameworks introduced throughout Europe following the Restructuring Directive are intended to accommodate situations of great complexity. Further, as creditors can be made to suffer losses in a going concern-scenario, requirements of fairness and benchmarking against alternative scenarios are paramount for their functioning. The potential effects of this on the adjudicator and court system have been keenly discussed.[78]

Indeed, the standard of potential administrators (Sw: *rekonstruktör*) has become stricter than under the previous law. Under the FrekL, the restructuring professional must meet the same requirements as receivers in bankruptcy, with experience of operating a bankruptcy estate or performing similar tasks. In addition, he or she shall enjoy the confidence of the creditors in each case. The government has also been given the mandate to decrease the number of district courts handling restructuring proceedings. Thus far, such mandate has not been utilized, but a restructuring shall be opened with the district court where a debtor has its domicile.

In Sweden, the Enforcement Agency is responsible for the supervision of restructuring proceedings, as well as over bankruptcy proceedings and professionals. However, there is no insolvency board or similar body that is equivalent to the Finnish Bankruptcy Ombudsman.

[77] See e.g. Dammann at p. 153 and Veder at p. 189 in Paulus and Dammann (2021).
[78] Prop. 2021/22:215 p. 329 ff., Mellqvist, M. Rekonstruktionsdomaren – några reflextioner. Ny Juridik 4:22 p. 95.

5.3. Danish Restructuring Law

5.3.1. Creditor Priority in the Bankruptcy of a Danish Limited Liability Company

a. Introduction

The principle of equality of creditors – pari passu - also applies under Danish law. However, this general principle is limited by the division of creditors into a number of classes, where the equal division applies within the class, but to the effect that dividends cannot be paid to a lower-ranking class until the higher-ranking class has been fully satisfied. A rule on absolute priority in bankruptcy, which is described in Chapter 10 of the Danish Bankruptcy Act. The following provides an overview of the system.

Only the assets owned by the insolvent debtor shall be part of the bankruptcy estate and subsequently distributed. Therefore, a creditor having a claim attaching to certain assets or funds under the rules on separation or segregation of assets may be separated from the estate prior to other creditors starting to share in any distributions. Also, creditors having security over assets of the debtor are entitled to payment before distributions.[79] Security will typically entitle the holder to priority of payment out of the value of the assets over which security has been granted. The order of priority between different forms of security are set out in the same order as outside bankruptcy.[80]

A creditor may be entitled to set-off against a claim that the debtor holds against the creditor. This method of getting paid represents an important form of *de facto* security under Danish law, not least for banks that are able to make themselves paid in return for forgiveness of debtor deposits. Set-off in bankruptcy is possible only with some limitations. It is a complicated system, but, in general, it is possible to set off two claims made prior to the commencement of the bankruptcy or a prior enforcement restriction order.[81]

Further, Denmark has implemented the Security and Finality Directives, allowing for close-out netting and margin calls to benefit market participants in their management of counterparty credit risk.[82]

Under Danish bankruptcy law, the costs of bankruptcy proceedings are considered part of the bankruptcy order and the most prioritised part. The debt items covered are the costs of the commencement of the bankruptcy (legal costs and filing fees), the costs of the administration of the bankruptcy estate (trustee's fees and the like)

[79] Security and guarantees may also have been provided by third parties. However, focus here is on the rules that govern the distribution of the assets of the debtor's estate, and hence third-party security providers and guarantors are not dealt with here.

[80] See Chapter 9 of the Danish Bankrupty Act.

[81] For further details, see sections 42 – 45 of the Danish Bankruptcy Act.

[82] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems. Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements. Also see the Restructuring Directive, recital (94).

and debts incurred by the estate during the administration (other costs approved by the trustee as part of the administration).[83]

General priority is given to different types of claims and with different reasons. First the costs of any attempts to obtain an overall arrangement on the debtor's financial situation (legal costs and the like) as well as costs approved by the administrator appointed by the bankruptcy court when there is an enforcement restriction order.[84] Thereafter, wage claims with a certain temporal connection to the bankruptcy have priority - as a general rule, claims due later than six months before the bankruptcy.[85] These claims can be covered by the Employees' Guarantee Fund, which fulfils Denmark's obligations under Directive 2008/94/EC of the European Parliament and of the Council of 22 October 2008 on the protection of employees in the event of the insolvency of their employer. A number of special taxes must then be paid. These are specific taxes on goods delivered for resale, where the supplier must pay the tax in full to the state regardless of the coverage ratio of the acquirer. This is a special rule that in reality is only relevant in the event of the bankruptcy of a grocery store.[86] In general taxes are not given priority.

After the above-mentioned bankruptcy classes, which in Danish law are collectively referred to as preferential claims, the estate's ordinary creditors are paid.[87] This is thus in principle the main group of the estate's creditors and often by far the largest bankruptcy class. All claims are treated equally in the group. It reflects Pari Passu also in the sense that a higher priority cannot be agreed, but only applies to creditors covered by the statutory preferential positions briefly described above. A lower priority can be agreed or may appear from the rule on subordinated creditors described immediately below.

Statutory subordination applies to interest (and certain leasing payments) after the commencement of bankruptcy, a number of fines and unfulfilled gift promises.[88] These claims are rarely satisfied, but in the event of a distribution, they are given internal priority meaning that interests are paid before fines, which are paid before unfulfilled gift promises.

Contractual subordination is possible. Subordination can also be agreed within the individual creditor class, which in reality will be a subordination among the ordinary claims. See further details in section e below.

b. The Scope of Secured Creditor Control

Secured Creditors have a special position to the extent the security provides coverage. The realisation of the security is carried out by the estate (the

[83] For more details, see section 93 of the Danish Bankruptcy Act.
[84] For more details, see section 94 of the Danish Bankruptcy Act.
[85] For further details, see section 95 of the Danish Bankruptcy Act.
[86] For further details, see section 96 of the Danish Bankruptcy Act.
[87] See section 97 of the Danish Bankruptcy Act.
[88] For further details, see section 98 of the Danish Bankruptcy Act.

administrator). This can be done at a forced sale, where the sale is made to the highest bidder and uncovered charges are cancelled by the security. Realisation in free trade can only be done with coverage of all charges or by agreement with the chargees. The costs of the realisation must be paid via the charge and may not be a burden on the rest of the assets of the estate. Security pledged can be realised by the security holder outside the estate.

It is not possible to make a binding valuation of the pledge except for certain assets covered by a floating charge. If an agreement cannot be made it is therefore necessary to make a forced sale.

c. The Conditions for Applying and Having a Bankruptcy Decree

The condition for bankruptcy under Danish law is that the debtor is unable to fulfil its obligations as they fall due. In principle, a debtor may therefore be sufficient when the bankruptcy order is issued. In reality, however, this is mostly a theoretical possibility. It is therefore expected that the creditors will only be partially satisfied based on the order of priority outlined above. For the same reason, the stakeholders are the creditors.

A creditor whose claim is fully secured by the assets of a debtor is generally not thought to have a legitimate interest in applying for bankruptcy. Such a creditor is instead able to rely on sequestration of assets or other executive measures, with or without the aid of the Bailiffs Court. In case of a floating charge the creditor is anyhow under Danish law entitled to applying for bankruptcy. The law is further designed to distribute the costs of bankruptcy administration on secured creditors only to the extent that the work undertaken by the administrator relates to assets from which they can expect payment.[89]

Among the creditors, it is the bankruptcy class that has the prospect of partial coverage that is considered the primary stakeholders of the estate. It is this group that can participate in any voting during the administration of the estate (election of administrator and certain other issues). Also, only creditor groups that are expected to obtain coverage in the estate are notified during the further administration of the estate. This applies regardless of whether the lower priority is due to the above statutory order of priority or an agreed lower priority.

d. The Position of Shareholders in Bankruptcy Proceedings

Danish priority rules do not explicitly address the position of shareholders. However, the shareholders are no longer considered stakeholders in the estate administration and are not entitled to information about the further administration of the estate. Only in the extraordinary case of a surplus remaining after the satisfaction of all claimants in bankruptcy - or by a compulsory composition in bankruptcy -would the shareholders have a right. The company will in a case like this be declared out of

[89] Section 14 Ch 9 of the Danish Bankruptcy Act.

bankruptcy and as a result the shareholders will again be able to use their rights as owners of the shares.

A degree of influence can however exist in cases where there is a prospect of selling the company's business as a going-concern or otherwise using the bankruptcy form for transferring the assets of an insolvent company while still relying on the network and expertise of previous owners. This is not a right as shareholders but a possibility because of information relevant to the administrator.

e. Subordination of Claims and Enforceability of Intercreditor Agreements

An agreed poorer position can generally be divided into an agreement to subordinate to all other creditors in a certain class or subordination in relation to a single creditor.

An agreed subordination of Claims is not regulated by Danish insolvency law. There is no prohibition against such agreements. The content of these agreements is considered a contractual relationship between the parties involved. This contractual interpretation is between the parties involved and is determined based on principles of contract law. In relation to the other creditors of the estate, the agreement cannot have negative impact on their dividend right or other rights in the estate.

A creditor may have agreed to be subordinated to all other creditors. In such case, the subordinated creditor shall be paid only after all other creditors have been satisfied. It is a matter of contract interpretation if the subordination also must be subordinate to other legally subordinate creditors as mentioned above. Probably the subordination must accept interest (and certain leasing payments) after the commencement of bankruptcy, but not fines and unfulfilled gift promises.[90] If not otherwise agreed the subordination in case of a compulsory composition is placed after the company's ordinary creditors, see Bankruptcy Act, section 10, subsection 3, number 2.

Subordination to certain other creditors (but not all) shall be upheld in the bankruptcy of the debtor, except where such arrangements purport to infringe third party rights. Such subordination will as a starting point be interpreted as as an assignment of the dividend right and with it, the voting right, to that individual creditor.[91]

f. Agents or Trustees as Enforcement Intermediaries in Secured Bond Issues

The holders of bonds could give rise to special problems and gain an additional layer to the treatment of creditors. If it is a single loan the creditors must consent on the voting according to the loan. This is a contractually matter between the creditors and the issuer.

The Danish act on Capital Market, Chapter 4, regulates some aspects of this.[92] The issuer of bonds may have appointed one or more representatives, who will represent

[90] See Lars Hedegaard Kristensen, Studier i erhvervsfinansieringsret (2003), page 434ff
[91] See U 1964.253 H.
[92] LBK 41/2023.

the interest of all bondholders. The rights of the representatives must be agreed in the issuing documents or in an agreement. A list of representatives is held by the Danish Financial Supervisory Authority and made public.

In relation to the estate, the creditors do not obtain a better right through an Intercreditor Agreement. The enforceability against the estate is therefore the same as a request for individual enforcement.

Similarly, in the case of Secured Bonds, the estate's rights are not limited by an Intercreditor Agreement on enforcement via Agents or Trustees. These will therefore have the same - limited - enforcement options in relation to the estate as the individual secured creditor would have. The estate will have to recognise an agreement on who represents a group of creditors. In practice, an administrator will often cooperate with an Agent or a Trustee to realise secured assets.

It has been discussed in Danish law to which extent the estate's other creditors and thereby the estate can rely on a subordination agreement. The question has hardly been finally resolved.

5.3.2. Creditor Priority in Restructuring

a. The Fundamental Differences between Bankruptcy and Restructuring

Under Danish law, a company can only be wound up through bankruptcy proceedings, as restructuring is intended to be applied to a continuation of the company. However, the picture is not entirely clear-cut.

Bankruptcy proceedings will generally be the liquidation of the legal entity. A business in the legal entity can be continued during the bankruptcy proceedings and may be sold by the trustee as a going concern if this provides the best result for the creditors. Thus, the trustee is not bound by a specific form of liquidation. There is even the possibility of carrying out a compulsory composition during the bankruptcy proceedings and in this way make the legal entity solvent, after which the bankruptcy proceedings will be ceased.

Restructuring can be carried out voluntarily, during a preventive restructuring or during restructuring. Voluntary restructuring is contractually based and only binds participating creditors and is not discussed in further detail below.

A restructuring of a company within the statutory framework can take place through a compulsory composition or other measures which imply that the debtor ceases to be insolvent and can thus continue. However, it is also possible within a restructuring process to involve the transfer of all or part of the company. A rescue of the business through a business transfer will often be followed by a bankruptcy of the debtor (company). If the sole purpose from the beginning is to wind up the company, this cannot be done during a restructuring procedure.

In practice, the difference between bankruptcy and restructuring is thus blurred in Danish law. In reality, it is possible to apply the same solutions to both types of

administration. The decisive factor in all cases should be how to maximise the total amount of funds available to the creditors.

b. Statutory Priorities in a Restructuring Negotiation and the Ensuing Plan

First, it affects the parties falling within the scope of restructuring measures. For example, creditors that enjoy full security or right of set-off for their claim may be excluded, as well as minor trade creditors or shareholders.

A restructuring plan has the same effects as a binding agreement between all parties.[93] At the same time – in line with the core idea of formal restructuring – a plan can be adopted against the will of certain minorities or dissenting classes, as long as the conditions for court sanctioning are met.

c. Determination of Affected Parties

Claims with a preferential position in bankruptcy as stated above in section 5.2.2. cannot be included in a compulsory composition and must therefore be fully covered in connection with a compulsory composition. Therefore, they do not participate in the voting either. In principle, the claims must be satisfied by the due date, but often the preparation of a compulsory composition will take place in connection with a process with an enforcement restriction order, and in that case the enforcement restriction order generally also covers these claims.

Claims arising after the submission of the restructuring plan are treated in the same way and must therefore be fully covered in connection with a compulsory composition.

It is also possible to exclude smaller claims - which would otherwise be covered by a compulsory composition - from the composition. There is no statutory minimum limit. The exclusion of these claims must be reasonably justified, and it is not possible to distinguish between different groups of claims, for example, only the exclusion of consumer claims.

An arrangement can neither be made on mortgage debt to the extent to which the mortgage extends. The part of the debt that is not covered by the charge is subject to compulsory composition to the extent that the claim is attributed to the group that is subject to composition. As a general rule, the valuation of the charge cannot be made in connection with the compulsory composition. Such a binding valuation can only be carried out for certain specified types of charges and certain types of assets (in particular floating charges). However, the pledged claims participate in the voting on the composition plan if the voting takes place in separate voting classes, see below in section d.

A compulsory composition can also be implemented on a stand-alone basis for certain subordinated claims as well. In that case, the prior claims must be fully

[93] See Danish Bankruptcy Act, paragraph 14.

covered, and these prior claims will therefore be treated in the same way as other preferential claims.

The shareholders are not seen as part of the affected parties and have no voting right.

Secondly, the priority status of a claim affects the voting process through the division into groups with “similar interests”.

d. Class Formation Process

Group formation is only compulsory for companies that are not SMEs (and this group is extremely limited in Denmark). For SMEs, group formation only takes place if the debtor has requested it when submitting the restructuring plan. The division into voting groups was only implemented in Danish law to meet the requirements of the directive. Thus, the Bankruptcy Council stated as follows:[94]

> *In the opinion of the Bankruptcy Council, the directive's rules on division into voting classes are unnecessarily complicated and the rules may easily lead to an increase in the costs of restructuring, partly because the different voting classes will often need separate advisers and partly because disputes may arise on the actual division into classes. Furthermore, the Bankruptcy Council finds it questionable that division into classes may, under certain circumstances, create a majority of classes that can adopt a restructuring plan, regardless of the fact that the creditors in this class majority do not together represent more than half of the total debt*.

The Danish plan and its preparatory works are characterised by the quoted view.

Proposals for division into classes must be submitted to the bankruptcy court no later than five days before the meeting in the bankruptcy court to vote on the restructuring plan.

The division into classes is closely related to the possibilities of dividing the creditors into different groups of creditors.

A Danish compulsory composition can only include one group of claims in an order of priority, in reality this is an application of an absolute priority rule. The compulsory composition can thus include the estate's ordinary creditors (and a number of penalty claims), in which case all subordinated creditors' claims will lapse in full and they will not have the right to vote on the composition plan. Alternatively, the compulsory composition may include claims that are contractually subordinated to the other creditors in the event of bankruptcy, in which case ordinary creditor claims must be paid in full and they will not participate in the vote for this reason. Finally, a compulsory composition can - at least theoretically based on the legal basis - only include contractual penalties that do not represent an incurred loss.

For all the above cases of compulsory composition, it is an option - but not a requirement - that the share capital is reduced to 0 and newly subscribed by cash

[94] BET. 1579/2022, page 137.

contribution. It is specifically decided that it should not be an option to make a formal compulsory "debt-to-equity swap" as the new capital must be paid in cash. However, the same result can be achieved with cash contribution from one or more creditors.

Once the group of claims to be included in a compulsory composition has been determined, the claims in this group can be divided into voting classes within this group. The voting classes must reflect a sufficient overlap of interests. Covered mortgage claims must always constitute one voting class. The class division is only briefly described in the legislative framework, and there is so far no case law on this. It is likely – but not mandatory - that there will be a division into, for example, public law claims, claims belonging to financial creditors and other claims (these may be further divided according to a specific assessment). The voting class formation, like the determination of affected parties, shall be reviewed by the court and may be subject to alterations. The court's decision regarding the division of creditors into voting classes cannot be appealed to a higher court.

There is no voting right for groups of creditors who obtain full or no coverage, and these are therefore not included in the division into voting classes.

However, if a creditor has made a commitment to waive the claim conditional on the adoption of the compulsory composition, voting rights are granted regardless of such waiver. In that case, the right to vote is conditional on the fact that, apart from the commitment, there would be a right to vote.

The adoption of a plan requires a simple majority within each class. Only the value of the claims is decisive. The number of parties voting is without influence.

The court shall confirm an adopted plan subject to certain conditions. Mainly, the court shall examine if:

(i) affected parties in the same class are treated equally

(ii) there is reason to believe that the debtor has secretly favoured any affected party to influence the plan negotiation

(iii) the plan is contrary to law or regulation, hereunder is clearly detrimental to an affected party

(iv) the restructuring procedure has not been conducted in accordance with the law, and the error may have affected the outcome of the negotiation and

(v) that no creditor will be better off in case of bankruptcy

Finally, as a general condition, a plan may not impose positive obligations on affected parties. That is, it may proscribe that a creditor or shareholder loses all its interests in the debtor company, but not oblige any of them to inject more funds unless voluntarily agreed.

e. What Principles (Safeguards) Apply to Different Types of Creditors, from the Vantage Point of their Priority Status?

As stated above, all priority creditors are entitled to full coverage in a compulsory composition for a lower class. In general, they can continue to pursue their claims even during the compulsory composition process. However, this will often take place in court with an enforcement restriction order. In this case, the priority creditors cannot, in general, continue to pursue their claims. However, for secured mortgage claims - which cannot be avoided in the event of bankruptcy - the debtor must pay the ongoing payments during the restructuring process upon request from the secured creditor.

In a preventive restructuring process, the debtor's employees with preferential claims are not subject to an enforcement restriction order.

f. Capital Markets Perspective on Treatment of Non-Consenting Creditors or Shareholders / Cram Down

i) Outline of the voting process

According to Danish law, the restructuring process and thus also the reconciliation process contain two parts.

Initially, a so-called restructuring plan must be prepared, which sets the framework for a subsequent restructuring proposal. The restructuring plan must be presented to the creditors at a meeting in the bankruptcy court no later than four weeks after the commencement of a notified restructuring process (at the meeting it is possible to postpone the meeting to a new meeting within 4 weeks). A qualified majority of creditors must vote against the plan if the process is to be stopped. In a preventive restructuring, the restructuring plan does not have to be voted on.

The vote on the restructuring proposal takes place at a meeting in the bankruptcy court. The meeting is convened with at least 14 days' notice and the restructuring proposal itself must be sent to the creditors no later than five working days before the meeting.

The right to vote is determined based on which claims are affected by the plan/proposal. See above in section 2.1.2, paragraph 2. Claims belonging to the debtor's related parties are not entitled to vote (related parties are shareholders with a significant ownership interest, see section 2 of the Bankruptcy Act).

If there is no division into voting classes, voting shall be carried out collectively among the creditors concerned. The proposal is adopted if a majority by the amount of the creditors represented at the meeting and participating in the voting process votes in favour of the plan. Therefore, a qualified majority is not required, regardless of the amount of dividend.

There must be a division into voting classes if the debtor has requested it or is not an SME. The division into classes must reflect a sufficient community of interest between the creditors in each class. Each voting class votes separately. If a majority of the voting classes vote in favour of the proposal, it is deemed adopted.

Voting is always based solely on the amount of the claims, and there is thus no requirement for a certain number of creditors to vote in favour.

If a proposal is adopted by the creditors, the proposal must be affirmed by the bankruptcy court to be valid, see section d.

ii) Can voting in restructuring take place through bondholder agents or trustees?

Participation in the voting process does not require physical attendance. It is always possible to vote by proxy, and it is also possible to vote in writing to the bankruptcy court prior to the meeting (however, this rarely happens in practice). A proxy will often have been given to a lawyer attending the meeting to cast the vote.

It is therefore also possible to vote through bondholder agents or trustees. It is only a matter of contract law whether the right to vote has been surrendered. It is also possible on a contractual basis to assign voting rights to others prior to the determination of (the possibility of) insolvency. As mentioned above the The Danish act on Capital Market, Chapter 4, contains a possibility of registration of agents at the time of issuing the bonds.

iii) Noteholder or shareholder meetings as sub-meetings in a restructuring negotiation

The legislative framework does not provide for meetings other than those mentioned above in section f. regarding the restructuring plan and the restructuring proposal.

Whether some creditors or groups of creditors wish to hold separate meetings is thus not regulated by law and thus not prohibited. There is probably often some coordination between at least some creditors in the process. The extent of this is inherently difficult to determine.

iv) Disclosure obligations and confidentiality in a restructuring process

When submitting a restructuring plan/proposal, various information must be enclosed with it. This includes an overview of the debtor's status, including an overview of the debtor's assets with valuations, an overview of the debtor's liabilities, secured claims with valuations. In addition, any restructuring administrators and trustees must comment on the information to the extent necessary, as well as various additional information. They must also provide an estimate of dividend in the event of bankruptcy.

If the proposal involves a business transfer, the transfer price, the identity of the transferee, and the assets, liabilities and executory contracts involved must be disclosed.

No creditor may be granted any benefits outside the plan, regardless of whether the costs are paid by the debtor or a third party.

g. New and Interim Financing Priority

The Danish Insolvency Act contains no specific rules on new or interim financing. The possibilities of giving financing priority are therefore regulated in the same matter as the possibilities of giving priority to other contracts. This means that it is possible for the debtor with the acceptance of the administrator to acquire such financing. The acceptance of the administrator will of course only be given if it is relevant and necessary.

The priority will as described above be just after the costs related to bankruptcy proceedings in case of bankruptcy and in case of a compulsory composition it will not be affected.

h. Conditions for Debt-to-Equity Swaps

A Danish restructuring plan may contain a wide range of measures, including the exchange of debt for newly issued or existing equity in the restructured company. Company law actions, such as the adoption of a new capital structure, shall in such case be part of the restructuring proposal and filed with the Companies Registrations Office.

However, as mentioned above, it is not possible to cram down creditors to accept a debt-to-equity swap. Furter, it is only possible to exclude the rights of the shareholders in total and new capital must be paid in cash. As a consequence, it is not possible to permit a certain number of existing shareholders to retain some value in order to preserve a market in the company's shares.

The theoretical starting point is that the shareholders are not affected by the compulsory composition, se above. Therefore, it must probably be possible to have an agreement in which the shareholders as part of the compulsory composition agree to make a decision on debt-to-equity swap at a general assembly in accordance with an agreement with the involved creditors. It is a matter of consideration whether such a decision will be seen as being in accordance with the APR.

5.3.3. Absolute Priority, Relative Priority or a 'Relaxed' Absolute Priority Rule?

Denmark has chosen to implement an absolute priority rule (APR) to safeguard affected parties in all kinds of compulsory compositions. This means that all creditors with priority above the affected parties must be paid in full (unless otherwise accepted by the individual creditor), and more junior classes cannot receive any payment or keep any interest.

An exception is the status of the shareholders. As a starting point – and for historical reasons – they are not seen as affected parties and therefore not a party to the compulsory composition. They will for this reason still be shareholders after the reconstruction of the company.

Since the implementation of the directive, it has been possible, as part of the compulsory composition, to exclude the rights of the shareholders as part of the proposal. Even in a situation like this the shareholders are not seen as affected parties in such a way that they have the right to vote.

It is not possible for any junior class to keep any interest in the company if all senior classes are not paid in full.

5.4. Finnish Restructuring Law

5.4.1. Creditor Priority in the Bankruptcy of a Finnish Limited Liability Company

a. Introduction

The priority ladder in case of an insolvent liquidation in Finland is regulated in the act on the order of creditors' priority of payment (1992/1578 as amended) (hereinafter the 'Priorities Act').

Section 1 of the act confirms the Priorities Act is applicable in a bankruptcy and distraint proceedings in case the assets of a debtor are insufficient to cover liabilities. It is good to note that the act does not refer the applicability of the act to restructuring proceedings.

The construction of the Priorities Act is such that the priority ladder is based on the numeric order of sections in the act. The priority ranking is similar with respect to all creditors within same section, unless otherwise stated. For this e.g., section 6 includes subsections, which do also have an internal ranking order.

For the most senior rankings, section 1 refers to effective real security rights and rights with higher priority relating to real estate and property. Such rights are based on property laws and other corresponding laws on registered mortgages (other than the law on floating charge based corporate mortgages; Fi: Yrityskiinnityslaki 634/1984). Creditors of such real security rights are entitled to payments according to the respective laws.

Section 2 of the Priorities Act contains a general principle of *pari passu*, confirming equal right for creditors in the same class to receive payments in case the assets of a debtor are insufficient to cover all liabilities, unless the Priorities Act otherwise provides.

Section 3 of the Priorities Act covers other security rights than referred to in section 1, including*, inter alia*, reservation of title and other security rights based on ownership, a right of recovery, and a right of retention that produces a priority right to the object in question. This section clarifies further that rights based on corporate mortgages are covered in section 5.

Section 3 a refers to any debt incurred by a debtor after commencement of restructuring proceedings, but prior to confirmation of a restructuring programme. This section provides priority for such a debt incurred during the restructuring proceeding.

Section 4 refers to liabilities of private individuals with respect to childcare, and, thus, are, in principle, irrelevant for corporates.

Section 5 covers rights based on corporate mortgages. Finnish law contains a separate act on corporate mortgages (634/1984). This law contains rules relating to the operation of a floating charge with respect to assets of a company. In principle such

a mortgage provides a 50 per cent security right on the assets specified in the law after certain deductions.

Section 6 refers to subordinated rights for payments. Such rights include:

i. rights to certain interest payments after bankruptcy,

ii. some fines and sanction type payments,

iii. subordinated bonds (debentures) where the terms and conditions of the bonds include subordination of rights for payments against other creditors,

iv. payments relating to such loans (including capital loans under Finnish companies act) where terms of the loan entitle payments, in case of bankruptcy or dissolution, only after all other creditors of the debtor,

v. payments relating to a commitment of a gift (as further ruled under a respective law).

As the Priorities Act covers only ranking of payments in bankruptcy, where the liabilities of the debtor exceed the assets, it does not as such regulate an opposite situation. Though, from the general company law principles it is clear, that all assets possibly remaining after all liabilities have been fulfilled, belong to the shareholders of a limited liability company. Hence, in terms of ranking, shareholders ultimately remain as the last group of stakeholders.

On the subordination of claims and enforceability of possible intercreditor agreements, the courts are, in principle only stipulated to follow the aforementioned statutory order of priorities, but in practice the proceedings may take a note of any contractual arrangement, e.g., an intercreditor agreement, particularly in case all related parties to such an arrangement confirm their acceptance to this.

5.4.2. Creditor Priority in Restructuring

a. The Fundamental Differences between Bankruptcy and Restructuring

For insolvency proceedings, the law outlining bankruptcy proceedings under the Bankruptcy Act is reasonably straightforward. The question is merely about insolvent liquidation, where all assets of a company are converted into cash for distribution in a statutory order, referred to above. In reality, bankruptcy cases may differ a lot, and it is not uncommon that the estate may continue the business, and that the final distribution to creditors happens only after many years the proceeding had been initiated, depending on the nature of the respective bankruptcy estate.

For a restructuring under the Restructuring Act, it is good to note that the law provides the possibility to sell the business of the debtor, in part or as a whole, also as a part of a restructuring programme. This in turn may mean, that such a case would, thereafter, be closer to the abovementioned simple distribution of the funds to the creditors.

The key difference of the two proceedings – bankruptcy and restructuring – is that one assumes a potential future upside to be available in restructuring, customarily referred to as a restructuring surplus (see Sections 2-3 above).

Section 53 of the Restructuring Act contains the key principle on a related 'best interest of creditors test', in Finnish law. As one of the barriers to approval of a programme, it states that a creditor who voted against approval shows it to be probable that the payment to be made to him or her in accordance with the programme would be less than what he or she would receive in the bankruptcy of the debtor.

b. Statutory Priorities in a Restructuring Negotiation and the Ensuing Plan

About the restructuring process itself, it is important to note that the Finnish restructuring process is almost always conducted by an impartial professional administrator, typically an attorney specialised on such assignments and appointed by a court for such a role. Only in very limited circumstances may a Finnish restructuring process be conducted without the appointment of an administrator, though this has now been made a bit easier under the new preventive restructuring proceedings.

The key amendment into Finnish law based on the Restructuring Directive included a slightly less regulated optional process referred to in the current Restructuring Act as a preventive restructuring proceeding. Such a proceeding can be commenced if the debtor's insolvency is imminent, but the debtor is not insolvent.

In practice it is very much up to a court-chosen impartial administrator to conduct the negotiations among the stakeholders and to draft a proposal for a restructuring programme.

c. Voting Rules

The voting groups are stipulated rather explicitly in section 51 of the Restructuring Act. The creditors shall be divided into groups for voting as follows:

(1) secured creditors;

(2) creditors holding a floating charge as security for their claims;

(3) other than secured creditors, so that one group is formed by creditors whose claims may be enforced without a judgment or court order, as provided in the Act on the Collection of Taxes and Public Charges by Enforcement (367/1961);

(4) creditors with lowest-priority claims in accordance with section 6 of the Priorities Act, so that the groups are formed in accordance with the priority order of such claims.

One may also end up with splitting of some parts of the creditors' receivables into several of the above groups, e.g., creditors who hold a partial coverage of a security

or a floating charge. This may cause a splitting of a part of his/her receivable as a secured credit/floating charge receivable and a part as a non-secured receivable.

It should be noted that there is no rule prohibiting a programme from including a proposal for a debt-to-equity conversion, even though shareholders are not mentioned as one of the voting groups. In practice, in case a restructuring programme has included measures affecting the rights of shareholders, the courts have either waited until a shareholders' meeting has passed through a respective resolution before confirming a restructuring programme, or confirmed a programme, but noted that a court may, on the request of the supervisor or a creditor, order that the restructuring programme is to lapse if, after the approval of the programme circumstances come to light, which would have prevented the approval of the programme had they been known at the time. For debt-to-equity swaps a judgment may have referred to the condition that such a programme has assumed forthcoming acceptance of a shareholders' meeting.

The majority required for the approval of a programme shall be deemed to exist if more than one half of the creditors participating in the vote in each group of creditors vote for approval, and the total claims of the creditors in favour of approval in each group of creditors is more than one half of the total claims of the creditors participating in the vote.

d. Drafting of a Programme and Competing Programmes

One of the key duties of an administrator under the Restructuring Act is to see to the preparation of a draft restructuring programme. The new preventive restructuring proceeding entitles, in special circumstances, a proceeding without the appointment of an administrator. In such a case, the drafting of a programme would be done by the debtor.

In addition to the programme prepared by an administrator, a competing programme may be introduced by the debtor or creditors of the debtor. If several draft restructuring programmes fulfil the requirements for approval of the programme, priority shall be given to a draft that can be approved with the acceptance of all creditors. A draft may be approved without the acceptance of majorities in all groups of creditors only if there are no drafts that fulfil the requirements of section 50 or sections 51 and 52 of the Restructuring Act (acceptance by all creditors or creditor groups). If there are several programmes with the acceptance of some of the creditor groups only, the one that has received the widest acceptance among the groups of creditors shall be approved.

e. Eligibility Conditions

The Finnish law conditions for eligibility of a company for a restructuring differ with respect to the new preventive restructuring and for the standard restructuring proceedings. For the preventive restructuring the key criterion is that the debtor's insolvency is imminent, but the debtor is not insolvent. For the standard insolvency proceeding the debtor may also be insolvent, but in such a case a barrier, and a

ground for interruption, of the proceeding, is that it is likely that the restructuring programme will not remedy the insolvency or that the debtor's insolvency can be prevented from recurring only temporarily.

For the definition of 'insolvency', the Restructuring Act refers to other than a temporary inability of the debtor to repay its debts as they become due. This may be considered as referring merely to financial conditions rather than to purely economic balance sheet conditions.

f. Debtor Acceptance

For the new preventive restructuring, a new feature is also that a restructuring programme cannot be adopted under this alternative, if the debtor does not consent to the adoption of the restructuring programme. This reflects the feature that only the debtor is entitled to file an application for the commencement of preventive restructuring proceedings. The consent referred to above, which is found in paragraph 2 of subsection 2, is not required from large companies as defined in Chapter 1 Section 4 c of the Finnish Accounting Act (1336/1997).

5.4.3. Absolute Priority, Relative Priority or a 'Relaxed' Absolute Priority Rule?

In Section 4, we noted that Finnish law contains an absolute priority rule in case of a cross-class cram down among classes of creditors, but this rule is not reflected vis-à-vis holders of equity.

The new law, after introduction of the new preventive restructuring, has however slightly different wordings for a related condition in case of a standard restructuring proceeding and in case of a preventive restructuring:

For the standard restructuring such a rule refers to conditions, where a court *may* confirm a programme: section 54(1)(5) of the Restructuring Act states as such a condition: according to the programme, creditors with claims that have a lower priority than the group of creditors voting against approval, other than one composed of secured creditors, are not to receive payment.

For the preventive restructuring, such a rule is written in the opposite way, ruling when a court *may not* confirm a programme: section 54(2)(3):… one of the groups of creditors referred to in Section 51(3)(4) has voted against the adoption of the programme and the programme includes a proposal to make payments to creditors whose receivables are ranked lower than those of the group of creditors that has opposed the adoption of the programme.

For the priority rules it is further important to note that these rules apply only in case of approval without acceptance of majorities in all groups of creditors. In case such majority approvals would be available, the limitations on drafting and accepting of a programme are less restrictive. However, e.g., the 'best interest of creditors' bankruptcy comparison test referred to above does also apply in such a case.

It may still be considered unclear how the priority rules work in relation to equity holders. As mentioned in Section 4 above, a debt-to-equity swap has been viewed as

a potential instrument to be contained in a restructuring programme and it has also been used rather frequently, but the law refers to the absolute priority with respect to creditor classes only.

Further, the government reasoning for the original Restructuring Act contained a note about a possibility for 'surrogate' payments as a means for debt restructuring. For such a 'surrogate payment' the possibility of a targeted share issue was mentioned as an example.

Thus, when analysing the current Restructuring Act on (i) does it contain a possibility for a cross-class cram down of equity holders and (ii) which priority rules should be followed vis-à-vis equity, the Restructuring Act does not give a clear guidance.

In relation to the first question, it may be fair to note that an existing court precedent has observed the importance of reviewing, in connection with drafting a restructuring programme, the possibilities for restructuring of all parts of the capital structure of a company, i.e., also a possibility of restructuring of equity instruments.[95] But for the second question, which priority rules one should follow on this, the analyses may be even more difficult.

As mentioned, the topics of enhancing rules for debt-to-equity swaps, as well the potential establishment of a corporate law scheme of arrangement, are noted in the programme for the current government in Finland, so one may expect forthcoming legislative action on these topics. When considering new legislation in this important area of law, we hope that our Report might serve as a useful briefing.

a. Capital Markets Perspective

Finland has a special act on bondholders' representatives (574/2017). This law provides rules for the appointment of an independent agent for bondholders. The act also provides rules for the representation of the bondholders, *inter alia*, that an appointed independent agent is, in principle, the only person entitled to act on behalf of the bondholders in case of a bankruptcy or corporate restructuring proceeding. Such an appointment may also cover the role of a security agent in the case of security pools, but also makes possible an appointment of an agent or a security agent for other collective credit instruments, such as syndicated loans.

This act was introduced based on the proposals of a working group on bond market development of the Ministry of Finance.[96] For developing the bond markets, the working group considered a need to clarify the normative grounds for representation of the bondholders. The act on bondholders' representatives contains provisions on the designation of bondholder representatives and security agents acting as representatives in connection with bond issuance or later during the bond's period of validity.

[95] See Finnish Supreme Court KKO 2003:120.

[96] Working group on bond market development, Working group memorandum, Ministry of Finance publications 25/2016.

The act also contains provisions on the validity of representation agreements with regard to bondholders, later endorsees, and bondholder creditors. This may be considered particularly useful, as there might otherwise appear to exist some level of uncertainty on how the representation would work, e.g., in case a bondholder would, notwithstanding an authorisation given in terms and conditions for a representative of the bondholders, act in contradiction to such an authorisation.

Relating to the current law position on debt-to-equity conversion, the major Finnish economic institutions, e.g., Finance Finland (which represents the banks, life and non-life insurers, employee pension companies, finance houses, fund management companies and securities dealers), Confederation of Finnish Industries (which is the leading business organisation representing the private sector and companies of all sizes) and the Finland Chamber of Commerce have given statements noting a need for a reform of Finnish law with respect to debt-to-equity conversion, particularly from the capital markets' perspective. These views were expressed e.g., in connection with the Ministry of Justice request for comments about the comparative study on debt-to-equity swaps published in 2018.[97]

b. Company Law Requirements for Debt-to-Equity Conversion

The variable practices in court judgments to cover debt-to-equity conversions have already been noted. The important take-away is that current Finnish law does not consider as sufficient a conversion through a restructuring plan/programme only; further authorisation and measures are required in accordance with company law requirements. These would, in particular, require an approval of a shareholders' meeting authorizing e.g., a targeted share issue relating to the conversion.

Under Finnish company law, a shareholders' meeting is able to accept a targeted share issue, but, as it would entail a derogation from the pre-emptive rights of shareholders, this would need a special decision, as further referred to in the law.

Firstly, a resolution to deviate from the pre-emptive right of shareholders requires a weighty financial reason. In the assessment of the permissibility of a directed share issue, special attention shall be given to the relation between the subscription price and the fair price of the share. A directed share issue may be a share issue also without payment, but only if there is an especially significant reason for this, both for the company and with regard to the interests of all shareholders in the company. A decision at a general meeting on a targeted share issue shall be made by a qualified two thirds' majority of the votes.

Further, for the use of an existing receivable from a company as a setoff for a payment of the subscription price, an approval of the board of directors is required under the Companies Act. The board of directors, the managing director as well as the auditors of a company are required to give statements to the national register upon

[97] Kansainvälinen selvitys velkakonversion ulottuvuuksista yritysjärjestelyiden ja maksukyvyttömyystilanteiden näkökulmasta. Lausuntotiivistelmä. Oikeusministeriö. Mietintöjä ja lausuntoja 25/2018.

registration of a share issue, where they confirm that all applicable rules of the Companies Act have been followed in connection with payment of shares.

From the company law angle, questions may arise, e.g., relating to whether one can consider a company to receive a sufficient monetary value, when a setoff is used for a receivable, which will ultimately lose its value in a restructuring programme. Even though, from the accounting perspective, a debt reduction in a statutory restructuring programme may be considered to provide additional capital to a company, the rules relating to acceptance of payments for new shares need to be further verified according to the company law rules.

c. The Problem of Receiving Equity Against One's Will

The potential problem of stakeholders receiving shares unwillingly has hitherto been addressed rather pragmatically in Finnish cases. Restructuring programmes have included a right to conversion only as an option for the relevant creditors. However, in case a creditor does not use such an option, a part or whole of his/her receivable will be cut off in the programme. On this it is, though, good to note that in a bankruptcy proceeding following a restructuring a creditor may be able to claim the original value of the receivable, but in case he or she has accepted a conversion into shares, this would not be the case.

For collective debt instruments, it may also be possible to tie the hands of creditors of e.g., a bond instrument contractually, by a decision of a qualified majority of bondholders in accordance with the terms and conditions of a particular bond. Here, it is good to note that the model terms for high yield bonds drafted by an expert group of the Finnish Securities Market Association contains such a possibility, as the terms and conditions entitle a mandatory exchange of the notes for other securities, with the consent of a qualified majority of the noteholders.

d. The Competence of the Bench

Currently restructuring cases are handled by some dedicated courts in Finland, not by all local courts. The total amount of such local courts is nine. Still, particularly when considering a future setup for the bench system, for handling restructuring cases, which might also touch on the rights of equity holders, some comments have been made in favour of centralising further the handling of such cases, e.g., into a single local court only, or even establish a new court, e.g., on the side of the special Market Court of Finland to handle the company law issues.

It may be predicted that there would not be a huge number of cases, but the implications of these cases for the financial markets may still be considered as vital. A special 'corporate court' might, possibly, be best equipped with the necessary skills needed for this type of cases, and the importance of the expertise has also been emphasised in the Restructuring Directive.

Further, in case one would consider developing the Companies Act by including a new regime for a scheme of arrangement framework, this would also support such

functions of the bench system to be combined under the same umbrella or even within the same entity.

6. Conclusions *De Lege Ferenda* – Options for Developing the Nordic Laws

a. Model for *Preventive* Restructuring

In Sections 2 and 3 we discussed the UK scheme of arrangement framework combined with the recently enacted Part 26A restructuring framework. For the UK frameworks it is notable that the statutory frameworks are contained in the Companies Act, hence, particularly the Part 26 scheme of arrangement can be viewed as a corporate law framework. This brings some further benefits to the practical use of the framework; a scheme of arrangement framework is available relating to both solvent and insolvent debtors.

The target of the Restructuring Directive relating to the availability of early-stage restructuring tools works well with the UK setup – there is no need to evidence any likelihood of insolvency in order to get access to the proceedings. The UK scheme proceedings are also extremely flexible, as the debtor may involve all creditors and/or holders of equity or any class of them in the process.

Some of the recently introduced insolvency law preventive restructuring frameworks provide for a reasonable measure of flexibility as well. A proposal for restructuring may be directed to some of the creditors only, but it is essential that all such parties, whose position would change due to the proposed programme – the affected stakeholders – are entitled to join the relevant negotiations and voting.

From the Nordic angle, we note that the new preventive proceedings are reasonably similar. All creditors of the debtor are, in principle, involved in the processes, but it is still possible to draft a restructuring programme that proposes changes to certain creditors' positions only.

The memorandum of the Swedish preparatory committee for implementing the Restructuring Directive also included a separate proposal for a lighter preventive process, a draft for law for court-controlled creditor compositions – lag om offentlig skulduppgörelse. This proposal was however not included in the final government bill. When introducing the new restructuring law to the parliament, the government noted on this topic that there is nothing to prevent a restructuring programme from impacting the positions of certain creditors only, which would limit the need for a separate proceeding provided by the special law. Another reason for not going forward with the proposal would be that it did not provide for a general stay against enforcement actions, at the same time as the stay is one of the main reasons to opt for court-led restructuring rather than a purely voluntary arrangement.

A potential argument, still in favor of a separate law for creditor compositions, would however be the more flexible proceeding in this law proposal as compared to the proceeding under the new restructuring acts. We would see merits for analysing this further, particularly from the point of view of companies with market financing. Another alternative would be to consider a new preventive framework under

company law, by using the UK / Ireland law and / or the European Model Companies Act as a precedent. It is good to note that the UK SOA does not contain a stay either.

The questions about variation between a 'holistic' restructuring law against e.g., the UK scheme of arrangement type flexible law are in more detail discussed in a recent article of Paterson and Walters about the US Chapter 11's Inclusivity Problem.[98] In the article the authors argue:

(i) that modern market participants frequently seek legal tools to compromise selected liabilities and not all the liabilities of the firm;

(ii) that it is difficult to achieve a selective corporate restructuring in Chapter 11 given its inclusivity (this may also be compared with e.g., the proposed separate Swedish law against the new Restructuring Act);

(iii) that selective corporate restructuring strategies are normatively desirable but must only be permitted within strict boundaries; and

(iv) that US practitioners have worked around the challenges which Chapter 11's inclusivity poses to selective strategies, but sufficient boundaries have not been placed around these workarounds.

When considering an optimum legislative model for *preventive* restructuring, the topics discussed in the Paterson – Walters's article may be useful for the Nordic legislators, as well the reasonings in the EMCA about the benefits of a scheme of arrangement framework.

b. Model for Cross-Class Cram Down and Priority Rules

In section five above we noted the variation of the cross-class cram down in the Nordic laws. The new Swedish law introduces a rather strict absolute priority rule as a method for the cross-class cram down, i.e., in a cram down of a dissenting class, the law requires, in principle, that in case there is a dissenting class ranking higher, a junior class may not receive any distribution or retain any value in a restructuring programme, in case the amounts of the receivables of the dissenting higher ranking class would be adjusted in the programme.

Such a situation may also occur, where a class of subordinated creditors will be wholly or partially cut off in a proposed restructuring programme. The absolute priority rule requires, that shareholders of the debtor may not retain any value (brought by their shares) in case a majority of the subordinated creditors would not accept such a proposal. Assuming that the higher-ranking creditors of the debtor would not be cut off in the programme, this might mean the subordinated creditors may be entitled to receive a right to all of the shares in the company in a related debt-to-equity conversion, as the current shareholders' ownership, in such a case, would be required to be nullified.

[98] S. Paterson – A. Walters, Chapter 11's Inclusivity Problem,15th May 2023, available at SSRN: https://ssrn.com/abstract=4448945.

The new Swedish law setup for the cross-class cram down and the related absolute priority has been discussed in more detail in an article by Hans Renman.[99] For the absolute priority he also refers to a discussion about a potential interpretation of the rule in the Restructuring Directive in a way, which leaves a possibility of an escape from the absolute priority rule by excluding shareholders (or certain creditors) from the plan. As he notes, the Restructuring Directive includes an exemption of the rule relating to the absolute priority, referring to special circumstances only. This rule, already by itself, may be viewed as speaking against such an interpretation.

In Section 3 we emphasised the merits of some form of relativity giving wider powers for an impartial administrator drafting a programme and for a court to sanction it. We also discussed that such a 'joint discomfort' for all stakeholder groups might also incentivise the parties to agree reasonable compromises. This would work for the joint benefit of all stakeholders and support the creation of a restructuring surplus.

The Restructuring Directive has, understandably, been drafted from an insolvency law point of view. However, it is good to note the key issues discussed in this report, relating to cross-class cram down of equity holders, have customarily been viewed also as company law issues, including e.g., rules for the shareholders' decision for a targeted share issue and payment of the subscription of shares through a setoff.

There is no restriction that the statutory provisions for debt-to-equity conversion may also be contained in the company law of a respective jurisdiction, and that the restructuring law of a respective jurisdiction may, in such a case, refer to e.g., an option for a court for opening a simultaneous company law proceeding (corresponding to the UK Part 26A proceeding) to handle any proposal for a debt-to-equity conversion.

This setup could be drafted also on the basis of a combination of the new UK Part 26A type proceedings alongside a new scheme of arrangement framework. A benchmark for the SOA is also the European Model Company Act (the 'EMCA'). In any case, the position of shareholders in a restructuring, particularly the availability of a cross-class cram down mechanism and the decision between optional methodologies – i.e., between relative or absolute priority – in the case of cross-class cram down, need to be considered in detail.

c. Potential Case Illustration

In the above sections, we have introduced the current restructuring laws in the Nordic EU Member States, Sweden, Denmark and Finland. In order to understand the potential consequences of the chosen statutory law structures, we assess the new laws without any certainty in relation to potential real outcomes. One benchmark for discussion of real outcomes may however be the Virgin Active case referred to in Section 3 above.

[99] Hans Renman, Något om de nya planförhandlingsreglerna, Ny Juridik 4:22, p. 28–44. Also see Section 5.2.3 of this Report.

As a simplified structure, we assume for a hypothetical case a company which files for statutory restructuring, and which has two classes of creditors, fully secured creditors and normal senior creditors alongside its shareholders. When drafting a restructuring programme for the company the administrator considers that the only group eligible for distribution under the restructuring programme would be the secured creditors, and even their loan maturities may need to be adjusted in the programme. The shareholders of the company have, however, committed to giving further subordinated financing to the company, which would be for the benefit of the only 'in the money' class of creditors.

d. How would this Case be Judged in Denmark, Finland and Sweden under the Current Restructuring Laws?

From the authors' view, for such a case in the Nordic area, one might come closest to reaching a similar judgment under the new Danish framework, compared to the outcome in the UK Virgin Active case. In this judgment, a court allowed shareholders to retain their rights as the shareholders at the same time as no distribution was made to unsecured senior creditors. This might be possible in case a court views such a judgment as justified, as the Danish law does not include a direct absolute priority rule relating to the equity holders but refers to this as a guiding principle only.

This could also be the outcome for a similar case in Finland, however, due to a different reason, as the current Finnish framework does not contain a cross-class cram down of equity holders.

Also, the Swedish act contains some qualifications to the APR referring to extraordinary reasons. There, the pivotal question might instead be whether the shareholders' contribution of new funds would constitute grounds for deviating from the APR as a condition for cram down of senior unsecured creditors.

e. The Expertise and Architecture of the Tribunal Bench Systems

In the introductory sections, this Report referred to the US law setup, where the courts expect evidence of the valuation of equity in case a cross-class cram down of equity would be disputed by a majority of the shareholder class. Due to a likely preference of the creditors for avoidance of such a dispute, a shareholder class may be, in non-disputed cases, entitled to retain a small portion of the ownership, notwithstanding that the financial balance sheet condition would not, as such, give support for this.

We also emphasised the difficulties relating to a valuation of a distressed company and that a restructuring process may already be needed due to the problems relating to e.g., the liquidity of a company – the financial standing of a company may already be deteriorated, even though the economic balance sheet condition is healthy.

Solving problems relating to any major distressed company is difficult; timing is crucial, and if legal proceedings take a long time, this in itself may be devastating. It is further important to note the difficulties relating to valuation of equity rights, i.e.,

for any dilution of the existing shareholders' rights against any proposed debt-to-equity conversion.

From the economics point of view a predictable expert tribunal system may be considered recommendable for any restructurings which may involve debt-to-equity conversion, particularly for cases which may involve difficult judgments for e.g., cross-class cram down of equity-holders. The UK Financial List judge-system may operate as a useful benchmark for this.

A dual process system, where such a part of a restructuring proceeding, which may involve amendments to the rights of shareholders, would be dealt with a simultaneous corporate law proceeding by an expert tribunal, alongside of the respective restructuring proceeding, might also be a feasible legislative route on this. The UK Companies Act Part 26A proceeding may form a benchmark for this.

A well drafted legislation for restructuring works proactively. Cases may be resolved consensually by the groups of stakeholders and professional administrators without any further court involvement.

Particularly in cases where SME companies would be exempted from the regulation, the caseload for courts relating to cases including debt-to-equity conversion may be predicted to be nominal, but all such cases would be important, and would highly benefit from swiftness and expertise in the process.

For planning the insolvency court setup, a recent article of Casey and Macey identify four general considerations relevant to the design of court system for insolvency courts in any jurisdiction:

a) the sophistication and development of the relevant private markets and private law,
b) the applicable background corporate law principles,
c) the competence — in terms of experience and sophistication, capacity and resources, efficiency, and neutrality and lack of corruption — of the courts in question, and
d) the availability of alternative systems through forum and venue shopping or other forms of exit.

Having identified these considerations, the article explores how each affects the role that insolvency courts should play, and the level of discretion courts should exercise. The authors also discuss the extent to which other procedural or insolvency provisions can substitute for judicial oversight and discretion. [100]

They note the Insolvency systems are not static, in the United States there has been — at least, according to the academic literature — an evolution from excessive

[100] A.J. Casey – J.C. Macey, Insolvency courts: General principles for systems design, Int Insolv Rev.2023;1–17.

management control to excessive creditor control to excessive sponsor control, all within the lifetime of the current bankruptcy code.

Changes in bankruptcy law cannot explain these shifts. Rather, the cause is likely related to the evolution of private markets, contracting innovations, corporate governance laws and norms, and the make-up of the judiciary hearing the cases. Any insolvency system must account for this evolution. This may not require flexibility and broad discretion of the courts, but it certainly requires some mechanism for flexibility and the ability of the insolvency system to adapt responsively the rate of change and evolution of institutions, markets, and other laws vis-à-vis the above factors.[101]

f. Final Conclusions

The discussion about priority rights of stakeholders in restructuring will, by no doubt, continue in the Nordics. As noted, the government of Finland has also introduced an intention to modify legislation in connection therewith. This high-level report may hopefully serve as a tool for the capital market experts and legislators to gain a deeper understanding about the topics and the current variation relating to this important regulation and also to reflect the international discussion about this.

Restructuring involves multiparty conflicts, which are difficult for the law to resolve and impossible to contract over in advance. Parties can never bargain to or write down a contract that is complete enough to account for the web of potential maneuvers and varied contingencies that financial distress introduces. As Casey — Macey note, virtually all firms in distress face incomplete contracting problems. This dilemma of incompleteness is equally challenging for lawmakers. As no contract can set out a complete system of terms to resolve the multiparty bargaining problem, no *ex-ante* legislation can construct a complete system of rules to achieve that resolution.

As a result, a well-designed corporate insolvency law should implement a mechanism helping the judiciary *ex-post* to resolve the bargaining problem that arises with financial distress. This ideal system would guide the stakeholders towards an efficient renegotiation of their relationships with the debtor and each other, by eliminating for each the incentive and ability to act opportunistically when the firm is in distress, while also ensuring that the availability of recourse to the insolvency system does not distort the incentives or behavior of stakeholders prior to financial distress. *Thus, the ideal system would eliminate opportunistic bargaining, while having no effect on the value distribution*.[102]

As final conclusions, for the Nordic discussion on priority rules in restructuring it is important to note:

[101] Idem, p. 17.
[102] Idem, p. 17.

i) the statutory priority rules in restructuring should be considered as setting the principal rules among a company and its stakeholders – the legislators shall note that such rules are important for developing the financial markets as well;
ii) the expertise and speed of the courts handling the cases involving debt-to-equity conversion are vital for both a debtor company and all its stakeholders;
iii) flexibility granted in the rules for an impartial administrator and a court may be considered as a balanced incentive for the stakeholders to seek compromises to divide, in a justified manner, ultimately confirmed by a court, any potential surplus arising from the restructuring and;
iv) variations in the restructuring rules support the continued dialogue on the enhancement of the rules in the Nordic countries. A further unification of the priority rules in restructuring could strengthen the EU Capital Markets Union as well.

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NORDIC IMPLEMENTATION OF THE RD*

*The table is for illustrative purposes only

SUBJECT MATTER	RESTRUCTURING DIRECTIVE (RD)	DENMARK	FINLAND	SWEDEN
Secured Creditor Control over Restructuring - Stay on Enforcement	Recitals (25), (30), (32)-(39) Recital (47) on dissenting secured creditors must be possible to overrule. Recital (94) on exemption for finality and security directives. Art 2.1 (4) definition of "stay of ind enf ac" and art (6)-(7) on its contents.	In general, secured creditors can continue to pursue their claims during a compulsory composition process under a preventive restructuring process. However, a stay may be ordered by the court if requested by debtor. In this case, the priority creditors cannot, in general, continue to pursue their claims. For secured mortgage claims - which cannot be avoided in the event of bankruptcy - the debtor must pay the ongoing payments during the restructuring process upon request from the secured creditor. In case of a restructuring process (not preventive) there is always a stay.	Stay applies during restructuring proceedings and prevents handling of bankruptcy filing etc. Security may not be enforced unless the court approves and measures not detrimental to restructuring. Stay does not prevent enforcement of third-party security and guarantees.	Stay applies during restructuring proceedings and prevents bankruptcy filing etc. Security may not be enforced unless practitioner approves and measures not detrimental to restructuring. Stay does not prevent enforcement of third-party security and guarantees.
Subordination of Claims by Agreement and Enforceability of Intercreditor Agreements	Recital (44)	A creditor may have agreed to be subordinated to all other creditors. Extent of subordination is a matter of contract interpretation. If not otherwise agreed the subordinated creditor ranks after ordinary creditors in compulsory composition. Subordination to certain other creditors (but not all) shall be upheld in the bankruptcy of the debtor, except where such arrangements purport to infringe third party rights. Such subordination will as a starting point be interpreted as as an assignment of the dividend right and with it, the voting right, to that individual creditor It is not settled law to what extent the estate's other creditors and thereby the estate can rely on other aspects of an intercreditor agreement.	Creditors' agreements to subordinate to all other creditors upheld according to the law on priorities. As for intercreditor agreements, the courts are, in principle only stipulated to follow the statutory order of priorities, but in practice the proceedings may take a note of any contractual arrangements, particularly in case all related parties to such an arrangement confirm their acceptance to this.	Agreements to subordinate to all other creditors upheld according to the law on priorities. As for intercreditor agreements, the courts are, in principle only stipulated to follow the statutory order of priorities, but in practice the proceedings may take a note of any contractual arrangements, particularly in case all related parties to such an arrangement confirm their acceptance to this.
Agents or Trustees as Enforcement Intermediaries in Secured Bond Issues	N/A	The estate will have to recognise an agreement on who represents a group of creditors. In practice, an [administrator] will often cooperate with an Agent or a Trustee to realise secured assets. Statutory support for agent and non-action undertakings binding.	Statutory support for agent and non-action undertakings binding in accordance with the law on bondholders' agent (2017/574).	Though contractual arrangements are customarily relied upon, there is no statutory support for bondholder agents and uncertainty in relation to non-action.
The determination of affected parties in a plan negotiation, especially relating to equity	Recital (59) supporting that "orderly handover" and know-how of owers has value. Art 2.1 (2) definition of affected parties for "debtors and affected parties". Art 12 on excluding equity holders. Art 4.5 2nd para on coherent application of safeguards. Art 8.1 (c)-(e) on content and motivations in plan.	Equity holders are as a starting point considered as not affected parties and have no voting right. Claims of debtor's related parties (shareholders with a significant ownership interest) are not entitled to vote.	Equity holders not a voting class. In practise the programs have included measures affecting shareholders' rights, but in such cases the respective resolutions have been conducted at a shareholders' meeting.	Owners that control the board effectively control plan proposal and, if SME, board must consent to cram-down. Equity may form voting group(s) but may also be kept out of plan negotiaton if motivated in the plan and subject to court review.
Voting and confirmation of a plan (not considering cross-class cram down)	Recital (42)-(44) on group formation, voting rights. Recital (47) on hold-out or up protections. Art 2.1 (6) NCWO definition. Art 9.4 on class formation and 9.5 on judicial confirmation. Art 9.6 and 7 deals with majorities and informal voting. Art 10: substantive requirements for confirmation.	Group formation is only compulsory for companies that are not SMEs. For SMEs, group formation is subject to debtor's request. Plans are adopted with simple majority and votes counted in value, not number of parties.The court shall confirm the group formation and an adopted plan subject to certain conditions, derived from the RD art 10(2). The courts decision regarding the group formation is final and can't be appealed to a higher court.	Four mandatory voting classes stipulated by statute. In case of preventive restructuring, debtor must consent to the plan. The court can confirm an adopted plan subject to certain conditions, outlined in section 46 of the Finnish Restructuring Act.	Five mandatory classes and sub-classes permitted. Voting class formation reviewed by the court and may be subject to alterations. Class formation may also be tried by the court upon objection by practitioner, debtor or an affected party. The court shall confirm a plan subject to certain conditions derived from the RD art 10(2), such as the NCWO. For adoption: two-thirds majority within each class, both in number and value.
Cross-class cram down	Recitals (53)-(58), art 11.	If parties are divided into voting classes, a plan can be adopted by a simple majority of classes voting in favour. See above regarding the formation of groups and voting classes.	Cross-class cram down criterias defined in section 54 of the FRA. This refers to absolute priority rule, though does not include equity: the programme includes a proposal to make payments to creditors whose receivables are ranked lower than those of the group of creditors that has opposed the adoption of the programme.	A (simple) majority of classes must consent. Further, either at least one of the accepting classes must be senior in priority to ordinary unsecured creditors; or at least two must be ones that would receive payment or keep any interest in bankruptcy. Each class must be treated at least as favourably as any other class of the same priority and more favourably than any junior class. In addition, the plan may not result in any affected party getting more than original claim or interest. Finally, observance of the APR is required.
New and interim financing priority	Recital (68) Art 2.1 (7)-(8) definitions. Art 8.1 (g)(vi) on content and motivation in plan. Art 17 (esp 17.4) on substantive rules for new and interim financing	No specific rules in Danish insolvency law. Suchs rules was suggested but not adopted. This means that new security etc. must be established in order to secure new financing during restructuring (eg. as a floating charge). If the new financing is accepted by the court appointed Restructuring Officer (rekonstruktøren) it will have priority.	The debt arising between the commencement and the discontinuation of the restructuring proceedings, and the interest accruing on it until the date of repayment, shall be repaid in the bankruptcy at a priority immediately following that of debts referred to in section 3 of the Act on the Ranking of Claims (1578/1992), (referring to secured claims/retention rights).	Interim financing with consent of practitioner will enjoy general priority in bankruptcy. Such priority ceases once a plan has been confirmed, or three months passed from closure of proceedings without plan confirmation, and provided no petition for bankruptcy. New financing agreed as part of plan may also carry general right of priority. New financing must be necessary and not detrimental to other creditors. The priority agreed upon in such cases may be limited in time.
Conditions for debt-to-equity swaps	Recital (2), (96) on derogations from company law.	In complulsory composition, it is an option - but not a requirement - that the share capital is reduced to zero and new shares are issued against cash contribution. Formal compulsory "debt to equity swap" not an options since new capital must be paid in cash. However, same result is achievable with cash contribution from creditor(s). Company law measures included in the plan may be filed with the Companies Registrations Office and in that case replaces ordinary company law measures.	Not within scope of formal restructuring.	Can be carried out as part of plan; plan replaces company law measures and can be filed with Companies Registrations Office.
Absolute Priority, Relative Priority or a "Relaxed" Absolute Priority Rule?	Recitals (55)-(57), art 11.1 (c) and 11.2	APR among creditors. Equity however remains unaffected, as a main rule, but can be reduced to zero. See above.	APR among creditors. According to the wording of section 54 of the Finnish Restructuring Act the absolute priority rule is applied in cross-class cram-down only.	APR applies in cram-down only, and with exception possible on "synnerliga skäl" (eng. extraordinary reasons). At the same time, possible to make a junior party unaffected by plan if motivation approved by court, meaning that the APR is not in fact applied in an eventual cram down.
On the Mandate and Competence of the Judiciary	Recitals (30) and (31) on practitioners (as defined in (87) and art 2.1 (12)) Recital (46) on examination of class formation and affected parties. Recital (48)-(50) and (52) on judicial confirmation and NCWO. Recital (63) on valuations. Recitals (85)-(89) on competence and training. Arts 14, 25-27	Restructuring cases handled by local bankruptcy courts. Comments have been made to centralise the handling of such cases further, but will probaply not be initiated.	Restructuring cases handled by nine dedicated courts. Comments have been made to centralise the handling of such cases further in future for cases involving e.g., debt to equity conversion into a single local court only, or even establish a new specialised court on the side of the Finnish Market Court.	Not yet concentration of restructuring cases to fewer courts, but discussion on-going in the restructuring community.