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A STAY OF INDIVIDUAL ENFORCEMENT ACTIONS AS A BASIS FOR EFFECTIVE RESTRUCTURING PROCEEDINGS

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Abstract. This article focuses on the implementation of a stay of individual enforcement actions in corporate restructuring proceedings. The authors analyse the general goals of a stay of individual enforcement actions in restructuring proceedings by considering, for instance, the economic reasons for such a stay, when it should be applicable, and the exceptions that should be established for its application. The Directive on restructuring and insolvency, adopted on 20 June 2019, reforms the regulation of a stay of individual enforcement actions in Member States of the European Union, aims to increase the efficiency of restructuring proceedings by providing legal instruments to facilitate a debtor's negotiation of a restructuring plan, and provides certain rules as to how a debtor's assets should be protected during these negotiations. Namely, a stay of individual enforcement actions and the protection of essential executory contracts should protect a debtor and ensure the equality of all creditors (pari passu) during the negotiation of a restructuring plan. However, in practice these goals result in less protection – especially for ordinary creditors. The authors analyse which aspects of a stay of individual enforcement actions are harmonized under the Directive on restructuring and insolvency, and whether they are sufficient to ensure the effective negotiation of a restructuring plan. Nevertheless, a fair balance between the interests of the debtor and their creditors should be ensured in restructuring proceedings, and the authors assess whether or not such a balance is established.

Keywords: restructuring proceedings, European Union law, pari passu, a stay of individual enforcement actions

Introduction

It is commonly agreed that restructuring is a business rescue process which is the opposite of bankruptcy proceedings, with the latter leading to the liquidation of the debtor (Bork, 2020, p. 181; Westbrook, 2010, p. 122).

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In restructuring proceedings, the financial well-being and viability of a debtor's business can be restored and the business can continue to operate via the use of various means – possibly including debt forgiveness, debt rescheduling, debt-equity conversions, or the sale of the business (or parts of it) as a going concern (European Law Institute, 2017, p. 71). Thus, insolvency law shall provide instruments to enable the restoration of a debtor's business and facilitate the conclusion of an agreement with creditors for the modification or fulfilment of obligations. The issue with insolvency is that creditors tend to rush to enforce their claims when they notice a debtor's financial problems. This race to secure repayment can quickly deprive a debtor of their assets, meaning that not only is the debtor unable to continue to operate their business, but also other creditors may be unable to resolve their financial claims. To tackle this problem, insolvency law proposes a temporary (automatic or not) stay of enforcement on the actions of individual creditors, which should focus on two economically significant goals: i) the continuation of the debtor's business, as their assets are protected; ii) maintaining an equal chance of satisfying the respective claims of all debtors (pari passu). The satisfaction of these two goals is a win-win situation for both the debtor and the creditors. Nevertheless, these goals can lead to other problems – for instance, for how long should the enforcement of individual claims be stayed? Should a stay encompass all claims, or only some specific ones? Should creditors have the right to dispute a stay of individual enforcement actions?

Insolvency (restructuring) law is a branch of national law. Nevertheless, the number of international insolvency law instruments has increased significantly in recent years, showing that the harmonization of insolvency proceedings and the establishment of common international standards are significant economic tools in tackling the financial and economic problems of enterprises. Unsurprisingly, the Legislator of the European Union also seeks to step in and propose common solutions for the rescue of viable companies which encounter financial (or other) problems which may lead to their liquidation. Some authors have pointed out that the European Union has responded to market developments by embarking on an aggressive new phase of corporate rescue-oriented legislative endeavour that focuses on so-called pre-insolvency, or preventive insolvency, proceedings (Mevorach & Walters, 2020). To achieve these goals, the Directive on restructuring and insolvency (hereinafter – the Directive) was adopted on 20 June 2019.

The aim of the Directive is to increase the effectiveness of restructuring proceedings, and it demonstrates a willingness to harmonize certain procedural and material aspects of restructuring proceedings in the Member States. Some authors have rightly pointed out that the Directive is based on the idea of "structured bargaining proceedings", in which a debt rescheduling plan is proposed and negotiated amongst all (or certain types of) creditors (Eidenmüller, 2017). One of the major tools for ensuring the effectiveness of this bargaining procedure of a restructuring plan is a stay of individual enforcement action, which is regulated by Articles 6–7 of the Directive. Some of these provisions are mandatory for Member States, but some of them are optional, meaning that Member States are free decide whether or not to transpose them into their national legal systems. The Directive acknowledges that it is crucial to ensure that the debtor is be able to continue to conduct business during negotiations for a restructuring plan, and that a stay of individual enforcement actions could contribute to this goal. However, the question then arises as to how the interests of creditors should be protected in such proceedings. Insolvency law cannot prioritize only the debtor's interests, and should instead aim for a fair balance between the interests of the debtor and the creditors. Thus, this article will seek to analyse whether the Directive establishes a fair balance between these interests in restructuring proceedings.

The analysis of a stay of individual enforcement actions established in the Directive is relevant for a few reasons. First, it is a new instrument of EU law which shall not be transposed into the laws of Member States until 17 July 2021, meaning that, as yet, there is no case law relating to this new legal regulation. Second, the current global financial situation – one of widespread insolvency – demonstrates that restructuring proceedings may become extremely important in a post-pandemic world in which debtors will seek to restore business activities. Third, the analysis of a stay under the Directive has not yet attracted the attention of scholars, and thus the legal analysis of this topic is vitally necessary.

The goal of this article is to analyse the aims and goals of a stay of individual enforcement actions, and to assess whether the Directive increases the effectiveness of restructuring proceedings in Member States. Therefore, the authors assess the general goals of a stay of individual enforcement proceedings in restructuring law alongside the regulations of the Directive. The authors also focus on the specific issues related to a stay of individual enforcement proceedings under the Directive, such as the basis for and duration of a stay and exceptions to the general rules.

1. The need for a stay of individual enforcement actions in insolvency proceedings

A stay on enforcement actions suspends the right of a creditor to enforce their claim against a debtor, and reflects the collective nature of these proceedings. Insolvency proceedings are "collectivized debt collection" (Jackson, 1986, p. 7), meaning that they include all of a debtor's creditors. This is a fundamental aspect of insolvency proceedings, as creditors should participate in them as a group. This problem of insolvency proceedings is referred to as "grab law" – reflecting its first-come first-served (Jackson, 1986, p. 9) nature – meaning that creditors who are aware of a debtor's financial difficulties may seek to quickly enforce their claims, which may result in the debtor becoming assetless. Other authors argue that the imposition of a stay on an individual creditor's enforcement action aims to address a common problem of the creditors and the associated "asset race" (Eidenmüller, 2016; Madaus, 2018), whilst giving the debtor time to file a plan for reorganization or simply relieving them of the financial pressures that drove them into bankruptcy (Murphy, 1986). A stay of individual enforcement actions against a debtor's property is crucial in restructuring proceedings, as the safeguarding of the debtor's assets is necessary to ensure the possibility of satisfying creditors' claims to the fullest possible extent. Nevertheless, a stay serves another crucial purpose – ensuring the continuation of the debtor's business activities during restructuring proceedings. The basic principle of restructuring proceedings is that a debtor shall continue business activities during their execution, concluding contracts and competing in the market. Thus, in contrast to bankruptcy (liquidation) proceedings, during restructuring proceedings creditors should play an active role in the rescue of the debtor's business.

However, as insolvency proceedings signalize a debtor's solvency problems, some creditors may seek to satisfy their claims before others by using the most efficient debt recovery tools. In such a scenario, a debtor could be quickly deprived of assets that should primarily be used to maintain business activities. This situation can then quickly lead to the problem of a debtor lacking the assets required to continue to operate their business, and consequently the satisfaction of other creditors' claims in the future becomes more difficult. Therefore, insolvency law shall respond to this problem of the individual enforcement actions of creditors and establish rules to stay such actions. However, whilst a stay of individual enforcement actions is undoubtedly economically and socially beneficial for a debtor, it may be detrimental to creditors. If a stay of individual enforcement actions is imposed, all creditors temporarily lose their individual enforcement rights against a debtor. Thus, not only the basis of such a stay, but also strict rules regarding its duration shall be clearly established in the law. A stay shall also ensure the fundamental principle of pari passu, which means that all creditors shall be equal in insolvency proceedings.

Some international studies on insolvency law define a "stay" or a "stay of individual enforcement actions" as a temporary suspension of the right to enforce (or supporting contractual rights to terminate or accelerate) a claim by a creditor against a debtor, ordered by a judicial or administrative authority (European Law Institute, 2017, p. 73). Other international soft-law documents define a stay as a measure that prevents the commencement, or suspends the continuation, of judicial, administrative, or other individual actions concerning the debtor's assets, rights, obligations, or liabilities, including actions to make security interests effective against third parties or to enforce a security interest; and prevents execution against the assets of the insolvency estate, the termination of a contract with the debtor, and the transfer, encumbrance, or other disposition of any assets or rights of the insolvency estate (UNCITRAL, 2004, p. 7).

One of the most well-known examples of a stay of individual enforcement actions in restructuring proceedings is established in US bankruptcy law, which recognizes an automatic stay (Kennedy, 1978). According to Article 362 of Chapter 11 of the US Bankruptcy Code, an application filed for bankruptcy operates as a stay, applicable to all

entities, such as of: (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title; (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title; (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate; (4) any act to create, perfect, or enforce any lien against property of the estate; (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title; (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title. Some authors argue that this provision protects a debtor and/or their property against most of the collection or proceeding actions of creditors. In other words, it prevents formal and informal actions and proceedings regarding the collection of assets or the recovery of claims by the creditor against the debtor, the property of the estate, or property of the debtor. The scope of an automatic stay in US bankruptcy law is intended to be broad to protect both creditors and debtors (Restrepo, 2018). It seems that the regulation of a stay in the Directive is also based on similar ideas of a stay in restructuring proceedings, and that Chapter 11 of the US Bankruptcy Code served as a source of inspiration for the Directive.

2. The goals of a stay in restructuring proceedings in the law of the European Union

Before the adoption of the Directive, the European Commission acknowledged that a properly defined "stay" of individual or collective enforcement actions is a crucial element of any useful restructuring procedure. Inadequate or overly restrictive stay provisions are likely to reduce the chance of a successful turnaround, and damage the overall value of the business. The European Commission also found that during the negotiation of a restructuring plan a debtor should be able to apply to court for a suspension of individual enforcement actions (a "stay"), otherwise the success of the restructuring process is in jeopardy. A stay could be requested against any type of creditor. A stay would not be effective if, at the same time, a debtor's duty to file for insolvency was not suspended for the period of the stay, or if creditors were allowed to enforce their rights through collective action during this time (Commission Staff Working Document Impact Assessment, 2016/0359 (COD)).

According to the *travaux préparatoires* of the Directive, the goal of a stay is to ensure that a debtor can effectively conduct restructuring negotiations, and to provide "breathing room" from creditors' claims. Nevertheless, it was recognized that the exact configuration of a stay can vary, but it should also suspend the duty to file for formal insolvency procedures in order to be effective (Commission Staff Working Document Impact Assessment, 2016/0359 (COD)). A debtor should be able to benefit from a temporary stay of individual enforcement actions, whether granted by a judicial or administrative authority or by the operation of law, with the aim of supporting negotiations on a restructuring plan, in order to be able to continue operating or at least to preserve the value of the debtor's estate during negotiations (Recital 32 of the Directive).

According to Article 2(1)(4) of the Directive, a stay of individual enforcement actions means a temporary suspension, granted by a judicial or administrative authority or applied by the operation of law, of the right of a creditor to enforce a claim against a debtor and, where so provided for by national law, against a third-party security provider, in the context of a judicial, administrative, or other procedure, or of the right to seize or realise out of court the assets or business of the debtor. This definition of a stay reveals more technical aspects of it as an instrument, and reflects the dominant approach to a stay of individual enforcement actions in restructuring proceedings. However, in this definition there is no indication as to when and for what purposes a stay should be imposed in restructuring proceedings.

Article 6(1) of the Directive establishes that Member States shall ensure that debtors can benefit from a stay of individual enforcement actions to support the negotiation of a restructuring plan in the framework of preventive restructuring. Nevertheless, said article establishes that judicial or administrative authorities can refuse to grant a stay of individual enforcement actions where such a stay is not necessary, or where it would not achieve the objective of supporting the negotiation of a restructuring plan. The wording of this provision is crucial as it reveals the aim of a stay of individual enforcement actions in restructuring proceedings, which is to support the negotiation of a restructuring plan. This is a clear indication that a stay can be granted only if it is necessary for these negotiations (McCormack, 2020). It seems, then, that an important precondition of a stay is that the negotiation of a restructuring plan is ongoing, and that it is a burden of the debtor to prove that these negotiations are taking place. This requirement would allow for the separation of frivolous attempts to negotiate a restructuring plan from real efforts to conclude it.

The Directive lays down grounds for the imposition and non-imposition of a stay of individual enforcement action. It establishes that Member States should be able to establish, on a rebuttable basis, presumptions for the presence of grounds for refusal of a stay. Such a basis could be the "typical conduct of a debtor", such as previous failure to pay debts as they fall due (e.g., substantial default vis-à-vis employees or tax or social security agencies), or where a financial crime has been committed by the debtor or the current management of an enterprise which gives reason to believe that the majority of creditors would not support the commencement of negotiations (Recital 33 of the Directive). However, such rebuttable grounds are only an option for Member States. The rationale of such a basis is that only good faith debtors should enjoy a stay of individual enforcement actions, meaning that a failure to pay debts before the commencement of restructuring proceedings should serve as an indication that a debtor's perspective on the rescue of their business is somewhat opaque. Nevertheless, such a vague criterion for the non-imposition of a stay of individual enforcement actions is debatable. Restructuring proceedings are primarily designed to tackle issues of solvency (i.e., failure to pay debts), thus the fact that a debtor fails to pay debts should not curb access to effective restructuring proceedings. Therefore, it seems that the Directive couples the restriction of a stay of individual enforcement proceedings only with a failure to pay certain debts which have particular social relevance (for instance, failure to pay debts to tax authorities or employees).

Another significant aspect to consider is whether a stay of individual enforcement actions is collective or individual. The Directive establishes that a stay should apply only to some individual creditors or categories of creditors, and gives a wide margin for Member States to add specific creditors (Recital 34 of the Directive). It seems that the Directive provides both options to Member States, and therefore national legislators should provide guidance on whether a stay of individual enforcement actions can be general, covering all creditors, or limited, covering one or more individual creditors or categories of creditors (Article 6(3) of the Directive).

An important question also arises as to whether, when restructuring proceedings are commenced, a stay is automatic or not (Eidenmüller, 2016). The laws on restructuring proceedings often establish an automatic stay of individual enforcement actions, meaning that a debtor receives immediate respite from the claims of creditors and the debtor's assets are protected from individual enforcement. For instance, such a stay is established in Article 28(1)(2) of the Law on Insolvency of Enterprises of the Republic of Lithuania and Article 89(1) of the Insolvency Law of Germany. Since the Directive does not prohibit the establishment of an automatic stay, Member States can choose to employ this model to increase the effectiveness of the negotiation of a restructuring plan (McCormack, 2020).

A stay of individual enforcement actions significantly restricts the rights of creditors. The Directive provides few solutions to the problem of achieving a fair balance between the interests of the debtor and their creditors. The general rule is that a stay of individual enforcement actions can cover all types of claims, including secured claims and preferential claims (Article 6(2) of the Directive). However, a few exceptions can (indeed, should) be established. First, a stay is not applicable to an employee's claim (Article 6(5) of the Directive). This is a socially justified restriction, as often the satisfaction of an employee's claim is a priority. Further, it is intended that a

company shall continue business activities, which in most cases means that labour relations must be maintained. Second, Member States may exclude certain claims or categories of claims from the scope of the stay of individual enforcement actions, in well-defined circumstances, where such an exclusion is duly justified and where: (a) enforcement is not likely to jeopardize the restructuring of the business; or (b) the stay would unfairly prejudice the creditors of those claims (Article 6(4) of the Directive). It seems that the Directive recognizes the importance of enforcement proceedings and justifies a stay of enforcement actions only in cases when enforcement could jeopardize the restructuring of the business. Such a situation might occur when enforcement proceedings relate to the specific, significant assets of the debtor which are crucial to the continuity of business, or when the amount of the sum to be enforced is so significant that the debtor may be unable to maintain their business.

However, a question arises as to whether such a suspension of enforcement proceedings is compatible with the right to a fair trial established in Article 6 of the European Convention on Human Rights (hereinafter – the Convention). Since the European Court of Human Rights (hereinafter – ECtHR) found in *Hornsby v. Greece* (1997), a landmark case, that that execution of a judgment given by any court must therefore be regarded as an integral part of the "trial" for the purposes of Article 6, procedural guarantees deriving from the right to a fair trial shall be guaranteed in enforcement proceedings. The ECtHR has not yet dealt with the question of whether a debtor's restructuring proceedings may suspend enforcement proceedings, but the court has emphasized that an unreasonably long delay in the enforcement of a binding judgment may therefore breach the Convention (*Arbačiauskienė v. Lithuania*, 2016). The Directive justifies the suspension of enforcement proceedings only when they would jeopardize restructuring proceedings. However, such an exception is particularly vague, and may trigger unwanted disputes as to whether the enforcement of a particular claim would jeopardize restructuring proceedings or not. The term "jeopardize" also engenders legal riddles, as it has no concrete definition in the Directive and its interpretation may lead to significantly different results. The authors of this paper believe that, considering the obligation of ensuring a reasonable length of enforcement proceedings alongside the goals of restructuring proceedings, only the enforcement of major financial claims could jeopardize restructuring proceedings. In such a case, the debtor has to prove that the enforcement of a particular claim would be so detrimental to the business that it would simply cease to operate.

A further exception is very broad, and gives courts significant discretion to decide whether a concrete individual enforcement action may harm the rights of another creditor. Nevertheless, the wording of this provision also raises difficulties. There is no guidance in the Directive for how the term "unfairly prejudice claims" should be interpreted. Again, it seems that the Directive seeks to establish a certain balance between the interests of the debtor and their creditors but leaves too much room for interpretation, which may trigger additional disputes regarding its understanding and application in practice.

3. The time limit of a stay of individual enforcement actions

Since the imposition of a stay of individual enforcement actions restricts the rights of creditors to enforce a claim, it shall be strictly provisional. The Directive recognizes the need to ensure the temporal limitation of a stay of individual enforcement actions, and establishes strict time limits for their duration. It seems that the provisions governing the duration of a stay are mandatory, from which no derogations can be established in the laws of Member States.

The initial duration of a stay of individual enforcement actions shall be limited to four months (Article 6(6) of the Directive). This period can be shorter, but the maximum period cannot be longer. The idea of this rule is that it ensures that a stay is a strictly limited instrument which should facilitate the negotiation of a restructuring plan. The total duration of a stay of individual enforcement actions, including extensions and renewals, shall also not exceed 12 months (Article 6(8) of the Directive). It may be debatable whether such regulation of the duration of a stay is reasonable and compatible with Article 6 of the Convention. However, the presence of such clear rules regarding time limits for the duration of a stay are, at least, a positive result. The Directive establishes the grounds on which the time period of a stay can be prolonged, and who has the right to demand such a prolongation. A

debtor, a creditor, or a practitioner in the field of restructuring may request that the court extend the stay period (Article 6(7) of the Directive). Interestingly, the right to request the extension of the duration of a stay is also granted to creditors, although creditors do not have the right to initiate restructuring proceedings under the Directive. Furthermore, other authors also share the view that the regulation of the duration of a stay and its consequences may bring about imbalance between the interests of a debtor and their creditors. According to Tollenaar (2017), the combination of exclusivity in favour of the debtor and the possibility of a stay lasting up to 12 months enables the debtor to keep creditors from exercising their rights for longer than might be in their interests.

According to Article 6(7) of the Directive, the extension or commencement of a stay of individual enforcement actions shall be granted only if well-defined circumstances show that such an extension or commencement is duly justified, such as: (a) relevant progress has been made in the negotiations on the restructuring plan; (b) the continuation of the stay of individual enforcement actions does not unfairly prejudice the rights or interests of any affected parties; or (c) insolvency proceedings which could end in the liquidation of the debtor under national law have not yet been opened in respect of the debtor. Since these exceptions are not cumulative (the disjunction "or" is used), it seems that any one of them could justify the extension of the duration of a stay or the imposition of a new stay, and the applicant has the burden of proving that such an exception exists. Nevertheless, the wording of these exceptions is again vague (aside from the third exception, which is coupled with the non-commencement of liquidation proceedings). Interestingly, this provision not only provides for the possibility of the extension of a stay but also allows for a new stay to be established.

The Directive requires that Member States shall ensure that judicial or administrative authorities can lift a stay of individual enforcement actions in the cases established in Article 6 (9) of the Directive. The authors of this paper believe that the wording of this provision is mandatory, meaning that Member States do not have the discretion to choose whether to implement this provision or not. As such, these requirements to lift a stay of individual enforcement actions are not optional. However, said article establishes, under the first subparagraph, that Member States may limit the power to lift the stay of individual enforcement actions to situations where creditors have not had the opportunity to be heard before the stay came into force, or before an extension of the period was granted by a judicial or administrative authority. Member States may provide a minimum period, which does not exceed the period referred to in paragraph 6, during which a stay of individual enforcement actions cannot be lifted.

4. The consequences of a stay of individual enforcement actions

A stay of individual enforcement actions brings about several consequences. Though, in general, a stay means a stay of the enforcement of all creditors' claims against the debtor, the Directive establishes some concrete consequences of a stay in restructuring proceedings. First, it suspends the obligation to commence bankruptcy (liquidation) proceedings. Second, it protects the execution of essential executory contracts during the negotiation of a restructuring plan. Both consequences are analysed in this article.

4.1. A stay of obligation to commence insolvency proceedings

A stay of individual enforcement actions means that a debtor's obligation to commence insolvency proceedings in case of insolvency during the negotiation of a restructuring plan is suspended. Pursuant to Article 7(1–2) of the Directive, where the obligation of a debtor, provided for under national law, to file for the opening of insolvency proceedings which could end in the liquidation of the debtor arises during a stay of individual enforcement actions, that obligation shall be suspended for the duration of the stay. In accordance with Article 6, a stay of individual enforcement actions shall suspend, for the duration of the stay, the opening, at the request of one or more creditors, of insolvency proceedings which could end in the liquidation of the debtor. The rationale of these provisions is based on the idea that the debtor's bankruptcy (liquidation) proceedings shall not be opened during the negotiation of a restructuring plan. First, the Directive suspends the debtor's obligation to file for bankruptcy, and, second, it suspends creditors' right to file for bankruptcy. Thus, during a stay of individual enforcement actions a debtor

should concentrate only on negotiating a restructuring plan, and bankruptcy (liquidation) proceedings should not be commenced. This is a particularly significant advantage for the debtor, and provides “breathing room” during negotiations with creditors. However, the question then arises as to whether directors have to follow the duties under Article 19 of the Directive. The authors of this paper believe that, since the debtor has encountered solvency problems, a director should act diligently during the negotiation of a restructuring plan and fulfil said duties, which are important for the protection of creditors.

Nevertheless, the Directive also establishes certain derogations from these provisions. According to Article 7(3) of the Directive, Member States may derogate from the provisions of Article 7(1-2) of the Directive in situations where a debtor is unable to pay their debts as they fall due. In such cases, Member States shall ensure that a judicial or administrative authority can decide to keep in place the benefit of the stay of individual enforcement actions if, taking into account the circumstances of the case, the opening of insolvency proceedings which could end in the liquidation of the debtor would not be in the general interest of creditors. Thus, the Directive acknowledges that only solvent companies are supposed to use restructuring proceedings, and actual insolvency should annul a stay of individual enforcement procedures. Interestingly, in this case the Directive employs cash flow insolvency (the inability to pay debts as they fall due), but not balance sheet insolvency.

4.2. The protection of essential executory contracts

During the negotiation of a restructuring plan, the continuation of a debtor’s business activities can be ensured if creditors do not terminate the necessary contractual obligations which are important in the running of the debtor’s business. According to Article 7(4) of the Directive, Member States shall provide for rules preventing creditors to which the stay applies from withholding performance or terminating, accelerating, or in any other way modifying essential executory contracts to the detriment of the debtor, for debts that came into existence prior to the stay solely by virtue of the fact that they were not paid by the debtor. It seems that the Directive found inspiration for the protection of essential executory contracts in Chapter 11 of the US Bankruptcy Code, which establishes executory contracts and unexpired leases in bankruptcy proceedings. Pursuant to Article 365(a) of Chapter 11 of the US Bankruptcy Code, the trustee, subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.

For executory contracts, any legal framework must balance the competing interests of the debtor’s estate (and its creditors) with the interests of the counterparty in light of the general goals of the laws in which such a framework functions (European Law Institute, 2017, p. 232). Thus, restructuring law should assist in the separation of prospectively profitable contracts which are necessary for business from burdensome and loss-bearing contracts that would only add to the debt pile (Bork, 2020, p. 181). International standards also suggest considering specific legislation for executory contracts that are essential for continuing the business of the debtor – such as, for instance, real estate leases, energy supply contracts, intellectual property and domain services, or license agreements. Moreover, it is recognized that the rules prohibiting the termination of executory contracts should be strictly limited in time, and such prohibitions should be lifted as soon as efforts to continue the business fail and (piecemeal) liquidation is inevitable (European Law Institute, 2017, pp. 238–239). In other words, the termination of executory contracts should be prohibited until it is necessary for effective restructuring proceedings, and this prohibition should end immediately when liquidation proceedings are commenced. The supervision of the court over the performance of executory contracts may be required in insolvency proceedings (Chuah & Vaccari, 2019, 1.26).

The Directive requires that Member States should provide that creditors to which a stay of individual enforcement actions applies, along with those whose claims came into existence prior to the stay and who have not been paid by the debtor, are not allowed to withhold performance of, terminate, accelerate, or in any other way modify essential executory contracts during the stay period, provided that the debtor complies with their obligations under contracts which fall due during the stay (Recital 41 of the Directive). Therefore, the Directive essentially provides protection for essential executory contracts which the debtor has failed to fulfil prior the imposition of a stay.

Creditors are not only restricted from terminating such contracts, but also from modifying them in any way which would be detrimental to the debtor's business.

The Directive also establishes a definition of an essential executory contract. According to Article 7(4) of the Directive, an essential executory contract shall be understood to mean executory contracts which are necessary for the continuation of the day-to-day operations of the business, including contracts concerning supplies, the suspension of which would lead to the debtor's activities coming to a standstill. However, it also acknowledges that Member States are not precluded from affording such creditors appropriate safeguards with a view to preventing unfair prejudice against such creditors as a result of said subparagraph. Member States may provide that this paragraph also applies to non-essential executory contracts (Article 7(4) of the Directive). The authors of this paper believe that the vagueness of the definition of essential executory contracts may again trigger disputes over whether a certain contract is essential for day-to-day business operations or not. It seems that a debtor would have to persuade a court that a concrete contract falls under this definition. However, the Directive establishes that certain types of contracts, such as contracts for essential supplies such as gas, electricity, water, telecommunications, and card payment services should be regarded as essential for day-to-day business (Preamble 41 of the Directive). The authors of this paper also believe that such contracts are strictly related to those which are crucial for the regular operation of the business. In other words, if a contract may have economic benefit to the debtor but is not necessary for the continuation of the business, it seems that such contract does not fall under this definition.

The regulation of the protection of essential executory contracts is related to the need to preserve the contractual relationships of the company being restructured with the contractors with whom the performance of the concluded contracts is necessary to ensure the continuity of the company's activities. Assessing said regulation in the light of contract law, it appears to restrict the principle of freedom of contract and the right to terminate a contract. In this case, the other party to the contract may suffer some inconvenience because the debtor's default is tolerated. These rules apply only to those contracts that are directly related to and necessary for the economic and commercial activity of the company. It is considered that this circumstance must be substantiated by the debtor via proof that the termination of a particular contract would mean (for the most part) the impossibility of further economic commercial activity. In such a case, the nature of the debtor's activities and whether they really require the continuation of a specific contract should also be assessed.

The authors of this paper believe that although the Directive's aim of ensuring continuity in the performance of essential executory contracts in restructuring proceedings is economically reasonable, it may cause some difficulties. First, it may engender additional disputes between a debtor and creditors as to whether a certain contract is essential or not for day-to-day business. Second, a debtor may be willing to abuse their contractual rights and justify the non-performance of contractual obligations.

The Directive also establishes the protection of the debtor against so-called "ipso facto" clauses, which allow termination of a contract when certain circumstances appear (for instance, when a debtor becomes insolvent). The Directive acknowledges that such clauses could also be triggered when a debtor applies for preventive restructuring measures (Recital 40 of the Directive). Pursuant to Article 7(5) of the Directive, Member States shall ensure that creditors are not allowed to withhold performance or terminate, accelerate, or in any other way modify executory contracts to the detriment of the debtor by virtue of a contractual clause providing for such measures, solely by reason of (a) a request for the opening of preventive restructuring proceedings; (b) a request for a stay of individual enforcement actions; (c) the opening of preventive restructuring proceedings; or (d) the granting of a stay of individual enforcement actions as such. Thus, the Directive not only protects the performance of essential executory contracts, but also restricts the modification of such contracts in cases where this is justified solely by the debtor's application for restructuring proceedings.

Conclusions

1. A stay of individual enforcement actions is a provisional solution which should facilitate the negotiation of a restructuring plan and provide a debtor "breathing room" to continue business activities. A stay of individual enforcement actions is economically beneficial to a debtor, but it may be detrimental to creditors as they temporarily lose access to individual enforcement actions against the debtor.
2. The Directive lays down grounds for the imposition and non-imposition of a stay of individual enforcement actions. A stay should not be imposed if a debtor fails to fulfil major obligations to employees or tax or social security agencies, or has committed a financial crime. Thus, only good faith debtors should be granted a stay of individual enforcement actions in restructuring proceedings.
3. In the view of the Directive, the aim of a stay of individual enforcement actions in restructuring proceedings is to support the negotiation of a restructuring plan. This regulation should assist a debtor in finding a common agreement with creditors, and avoid the deprivation of assets during such negotiations. It seems that an important condition of a stay is that the negotiation of a restructuring plan is legitimate, and an agreement with creditors is possible. This requirement should allow for the separation of frivolous attempts to negotiate a restructuring plan from real efforts to conclude it.
4. The Directive lacks any guidance on how a stay of individual enforcement actions should be compatible with the procedural guarantees of the right to a fair trial. The Directive allows for the suspension of enforcement proceedings only when they would jeopardize restructuring proceedings. However, such an exception is particularly vague and gives rise to riddles concerning whether the enforcement of a particular claim would jeopardize restructuring proceedings or not. If a dispute arises, the court should not only consider the interests of the debtor, but also whether the application of this instrument is compatible with the right to a reasonable length of enforcement proceedings.
5. In the Directive, a stay of individual enforcement actions has two significant consequences: the suspension of the duty to commence insolvency proceedings, and the protection of essential executory contracts. The authors of this article found that the regulation of the protection of essential executory contracts may cause further problems, as it may trigger additional disputes between a debtor and creditors as to whether a certain contract is essential or not for day-to-day business. Further, a debtor may be willing to abuse contractual rights and may seek to justify the non-performance of contractual obligations.

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