Creditors with standing to sue or be sued for termination of contracts under a pre-insolvency restructuring plan

Notes on Articles 618, 619 and 620 of the Insolvency (Recast) Act 2022.

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§1. Bilateral contracts pending performance under Article 618 of the recast version of the Insolvency Act ('TRLCon') may not be terminated by creditors ("solely by virtue of submission or identification as suitable for consideration of an application for court approval of [a] plan, of court approval of [a] plan or of any other circumstance that is analogous or directly related to the foregoing"), but they may be terminated when there has already been a material breach by the debtor ("solely by virtue of", Articles 598(1) and 618(1) TRLCon), prior to the approval ('homologation') of the plan (*see* Article 671(1)).

§2. The only bilateral contracts that *may not be terminated* for breach of contract are those considered essential under Article 619(3) TRLCon (and Article 599(3)). Of course, the creditors may terminate them normally if they have been removed from the scope of the restructuring plan, which is the most appropriate solution for the instigating party of the plan. Those who may not terminate under this rule may invoke the *exceptio inadimpleti contractus*, which, for the present purposes, is as if they terminated. However, it is essential to remember that, despite the decontextualisation of Article 619(3), the prohibition on

Any bilateral contract pending performance that is affected by the plan can be terminated by the creditor for subsequent defaults

termination is only effective in respect of obligations that predate the "stay for negotiation", in accordance with Article 7(4) of the 2019 Directive on restructuring and insolvency. Any breach of contract, subsequent to the application for court approval of the plan, gives rise to termination in the ordinary manner.

§ 3. Any breach *subsequent* to the application for court approval, may give rise to termination (*see* Article 644 TRLCon), as well as, of course, any breach subsequent to court approval of the plan, if after the same the contracts continue to be bilateral contracts pending performance. This possibility exists even for the type of contracts mentioned in Article 619(3) ('essential'; thus, Article 7(4) of the Directive) and this standing is independent of whether such creditors could not request *the termination of the court-approved arrangement* as a result of that breach of the plan (Article 671(1)), circumstances which suggest that the best option for the debtor or instigating party of the restructuring plan is to leave these creditors outside the scope thereof.

§ 4. We now turn to Article 620 of the recast version. Court approval of the restructuring plan is required when the termination of *bilateral contracts pending performance* is sought, *in the best interest of the restructuring*, but only by the debtor (Article 635.2 TRLCon). It is not necessary for the contract to be a *continuing* bilateral contract, so it may well be a sale or a contractor agreement, and not just a lease or supply contract.

§ 5. It does not follow from the law that creditors who bear a termination of contract in the best interest of pre-insolvency proceedings must necessarily constitute a class other than the ordinary class to which they would belong for the amount of the compensation for termination (Art. 620(2)). However, in our opinion, inclusion in the class of ordinary or secured creditors is not sufficient, because the creditors under Article 620 are having a claim extinguished that is novated by a recovery claim and, furthermore, if it is a continuing contract, it may be a contract that is *in the money* and contains a promise of future earnings. Therefore, a separate class is required for creditors to whom Article 620 is intended to apply.

§ 6. Let us imagine that the debtor in the court approval seeks, in the best interest of the insolvency proceedings, the termination of a bilateral contract *pending performance only by the debtor subject to restructuring, who is the debtor of money*. He may request termination if he is in a position to return the specific performance of the other party and be exposed to damages for non-performance that are less than the outstanding price; there may be a "best interest of the restructuring" because returning and paying damages may involve a lower amount than simply performing the obligation. However, the debt in terms of the return of the specific *res* or the money in which the specific *res (facere)* to be returned is valued will not be affected by the plan (*see* Article 620(2) *in fine*: "the claim for compensation"); nor will the debt of compensation resulting from the termination, because it is implicit in Articles 620(4) and 657(2) that

the compensation must be 'adequate' to the harm caused by the termination, and therefore cannot be "reduced" by the restructuring plan. In other words, both return and compensation for termination are in fact treated as unattached claims, in substance, as claims against the 'insolvent estate', even if Article 620(2) suggests otherwise.

§ 7. Let us now assume that the bilateral contract pending performance only by the debtor binds him to a characteristic performance that is not pecuniary (to give, to do, not to do). The specific performance claim is not an 'affected' claim within the meaning of Article 616, because it is not a pecuniary claim. The debtor who approves the plan may convert it into an "affected" claim by means of the termination under Article 620, which gives rise to the debt to return the money received; this change may in theory be 'in the best interest of the restructuring'. But is it possible to convert an unaffected claim into an affected claim solely by virtue of the retroactive effect of the termination approved with the restructuring plan? We do not have a definitive answer.

Sometimes it will be more profitable for the pecuniary creditor to have the contract terminated than to have his pecuniary claim included as an affected class.

§ 8. We now assume a bilateral contract that is *continuing pending future performance by both parties*, regardless of who is the obligor of the specific performance. The termination provided for in Article 620 would normally apply, which would not have retroactive effect, meaning, in particular, that it would not have retroactive effect on the obligor's debts that are already due and remain unpaid; but these debts, with or without termination, are subject to the restructuring plan if they are pecuniary obligations, and not otherwise.

§ 9. Let us now consider the termination of a bilateral contract in which the party "in bonis" is the holder of a (pecuniary) claim that is covered by security. In theory, Article 620 could be applicable. However: *a*) in any case, this creditor who loses security in accordance with the restructuring plan deserves his own class; *b*) this deprivation already violates *a limine* the rule of the superior interest of the creditor in Article 654(7). Therefore, *it should not be admitted at the approval stage itself, because it is the order approving the restructuring plan (and not the plan itself) that produces the (court-ordered) termination of the contracts — so that the order does not have mere declaratory effects here — as is also the case in Article 165(3)*; *c*) the creditor who had security prior to the restructuring process does not cease to be a secured creditor by virtue of the effectiveness, retroactive or otherwise, of the termination, and therefore continues to have the defence based on the priority principle of Article 655(2)(4) and, more importantly, the legal prohibition of 'less favourable treatment' compared to other types of secured creditors who are not affected by the effects of Article 620; *d*) if the conditions of Article 651 are met, this creditor may elude homologation and contractual termination by enforcing its security outside the pre-insolvency proceedings.

§ 10. The *suretyship* provided by the debtor seeking homologation is not a bilateral contract pending performance, *as a rule.* However, it may be, and in that case termination is subject to the *quid pro quo* of fully discharging the creditor from the bilateral relationship through which he received the suretyship, and this *quid pro quo* is not in turn subject to reductions in the restructuring plan.

§ 11. The last example of a bilateral suretyship, as well as any other in which the defaulted debt of the party seeking homologation would be a debt of money, illustrates that it will sometimes be preferable for the creditor *in bonis* to terminate the contract rather than have his pecuniary claim fully subject to the vicissitudes of the restructuring plan. In other words, *Article 620 may even be favourable to the creditor.*