The Grand Project: Reform of the European Insolvency Regulation

Professor Stefania Bariatti
Professor of Private International Law, Milan Law School

and

Paul J. Omar
Professor of International and Comparative Insolvency Law, Nottingham Law School

Editors

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Notes on Contributors

Spyridon Bazinas is a Senior Legal Officer in the International Trade Law Division of the United Nations Office of Legal Affairs at the Secretariat of UNCITRAL. Email: Spiros.Bazinas@uncitral.org

Ian Fletcher QC is the Emeritus Professor of International Commercial Law, University College London, United Kingdom. Email: I.F.Fletcher@ucl.ac.uk

Jennifer Gant is a Doctoral Candidate at the Nottingham Law School, Nottingham, United Kingdom. Email: jennifer.gant2010@ntu.ac.uk

Antonio Leandro is an Assistant Professor in International Law at the University of Bari Aldo Moro, Bari, Italy. Email: antonio.leandro@uniba.it

Bernard Mac Namara is the Chairperson of the Civil Law Working Party on Insolvency at the Ministry of Justice and Equality of Ireland, Dublin, Ireland. Email: BTMacNamara@justice.ie

Gabriel Moss QC is a member of Chambers at 3/4 South Square, Gray's Inn, London, United Kingdom. Email: gabrielmoss@southsquare.com

Paul J. Omar is the Professor of International and Comparative Insolvency Law at the Nottingham Law School, Nottingham, United Kingdom. Email: paul.omar@ntu.ac.uk

Marie Padellec is the holder of a Doctoral Degree from the Law School at the Université Paul-Cézanne, Aix-en-Provence, France. Email: marie.padellec@wanadoo.fr

Jessica Schmidt is the Professor of Civil Law, German, European and International Company and Capital Markets Law at the University of Bayreuth, Bayreuth, Germany. Email: jessica.schmidt@uni-bayreuth.de

Chindar Teo is a Doctoral Candidate at Victoria University, Melbourne, Australia. Email: chindarteo@yahoo.com

Giulia Vallar is a Research and Teaching Assistant in the Department of Italian and Supranational Public Law, University of Milan, Milan, Italy. Email: giulia.vallar@unimi.it

Jean-Luc Vallens is a Judge and Associate Professor at the University of Strasbourg, France. Email: jlvallens@yahoo.fr

Signe Viimsalu is a Venture Investor with the Estonian Business Angels Network, Tallinn, Estonia. Email: sign9@me.com

Vincenzo Volpe is a Graduate of the LLM in Corporate Law, University College London, United Kingdom. Email: vincenzovolpe3@gmail.com

Bob Wessels is the recently retired Professor of International Insolvency Law at the Leiden Law School, Leiden, the Netherlands and formerly the Distinguished Adjunct Professor of Comparative and International Insolvency Law at the St. John's University School of Law, New York, the United States. Email: bwessels@bobwessels.nl

Matteo Winkler is an Adjunct Professor of International Law and European Union Law at the Bocconi University School of Law, Milan, Italy. Email: matteo.winkler@unibocconi.it

Editorial Preface

The European Insolvency Regulation is the result of a project nearly four decades long in the making. The project has its roots in the context of work supplementing the European Treaty framework, the intention being to create a common legal system in certain matters, and which began with the foundation of the European Community (now Union) in 1957. One of the fundamental principles enshrined in Article 2 of the EC Treaty provided that the purpose of the Community was the establishment of a common market. The extension of the EC Treaty framework to achieve this purpose was to be effected in certain cases by further treaties or conventions between the member states adopted under Article 293, in particular through instruments in the private international arena designed to secure the simplification of formalities governing the reciprocal recognition and enforcement of judgments. The advent of the European Insolvency Regulation is also a part of this history as it is the successor text to the European Insolvency Convention 1995, which was intended for adoption under the same private international law initiative.

The history of this insolvency initiative is complex and, in fact, the 1995 text was only the last in a series of drafts whose remit moved from procedural harmonisation with some elements of substantive law being rendered the subject of common rules towards procedural harmonisation pure, involving choice of forum and choice of laws issues alone. There were a number of false starts, including the suspension of work after a failure to reach a consensus on a second draft in 1985. This project was revived, however, in the face of competition from a rival project sponsored by the Council of Europe, which saw the adoption of the Istanbul Convention 1990, which nevertheless remains without force. The project did see the approval of a text that was titled the European Insolvency Convention 1995, but this did not enter into force because the United Kingdom failed to adhere within the time period open for signature. Following a proposal co-authored by Germany and Finland in 1999, the project was revived in the form of the European Insolvency Regulation without major amendment to the convention text and which entered directly into force on 31 May 2002 in all of the member states in the European Union subject to Title IV of the EC Treaty, governing “Freedom, Security and Justice” then fourteen in number (excluding Denmark).

As new member states have joined the European Union, the European Insolvency Regulation has been amended by the relevant Acts of Accession. There have also been a series of regulations updating the lists of insolvency proceedings and officials in the annexes to the European Insolvency Regulation to reflect changes in domestic insolvency law rules. In 2012, the European Commission launched an initiative seeking to review and reform the text of the European Insolvency Regulation. A time of writing, a number of drafts of an amendment text have been produced and it is likely that the process will be completed by early 2015.

The intention behind the present text, consisting of papers delivered at two conferences: a Joint Conference with the Academy of European Law in Trier, Germany on 18-19 March 2013 and the Annual Conference of the INSOL-Europe Academic Forum in Paris, France on 25-26 September 2013, is that it will form an up to date account of viewpoints on the reform process and, in particular, how the text of the European Insolvency Regulation might be improved. It is particularly noteworthy that members of both INSOL Europe and the Academic Forum have cooperated with the work that has taken place in the European Parliament leading up to the reform process, and which has formed the basis for the discussions that led to early suggestions of reforms to the Commission. Furthermore, many members have also added their voices to the deliberations and studies looking into how the European Insolvency Regulation has been applied across the European Union. The skills and talent of members of the Academic Forum have played a more than modest role in shaping the text as it has now emerged.

As such, the papers here are truly cutting edge and will increase awareness of the impact of European insolvency law within domestic, regional and global contexts. Submissions for this collection have come from prominent academics, researchers and doctoral students in the field representing a number of jurisdictions from common law, civilian and mixed traditions within Europe and further afield. This has ensured that the contents of the research and analyses included in this text are of the highest quality and will be useful and thought-provoking. It is hoped that this will render the contributions here as well as the further references they contain of great value for researchers in the field.

In summary, we would like to express our appreciation to all those who have assisted in making the project a success, not least the contributors themselves, but also the administrative staff members of INSOL Europe, particularly Caroline Taylor and Wendy Cooper, together with other members of the team, as well as their respective partners. Special thanks go to Myriam Mailly and Emmanuelle Inacio, INSOL Europe Technical Officers, and Rolef De Weijs, Chair of the Young Academics' Network, who organised the submission of conference papers by members of the network. If not otherwise noted by the contributors, the law is stated as at 15 June 2014.

Stefania Bariatti
Professor of Private International Law
Milan Law School, University of Milan
Email: stefania.bariatti@unimi.it

Paul J. Omar
of Gray's Inn, Barrister
Professor of International and Comparative Insolvency Law,
Nottingham Law School
Email: paul.omar@ntu.ac.uk

A Note on the Academic Forum

The INSOL Europe Academic Forum, founded in 2004, is a constituent body of INSOL Europe, a Europe-wide association of practitioners in insolvency. The Academic Forum's primary mission is to engage in the representation of members interested in insolvency law and research, to encourage and assist in the development of research initiatives in the insolvency field and to participate in the activities organised by INSOL Europe. The membership of the Academic Forum includes insolvency academics, insolvency practitioners with recognised academic credentials as well as those engaged in the research and study of insolvency. The Academic Forum meets annually in conjunction with the main conference of INSOL Europe and also arranges half-yearly conferences around suitable themes of interest to the practice and academic communities. Previous meetings have taken place in Prague (2004), Amsterdam (2005), Monaco (2007), Leiden and Barcelona (2008), Brighton and Stockholm (2009), Leiden and Vienna (2010), Milan, Venice and Jersey (2011), Nottingham and Brussels (2012), Trier and Paris (2013) as well as Leiden (2014).

At Paris, Professor Christoph Paulus (Humboldt University Berlin, Germany) was elected Chair of the Academic Forum for a three-year term. He replaces Professor Stefania Bariatti (University of Milan, Italy), who served as chair between 2010 and 2013. Paul Omar (Nottingham Trent University, the United Kingdom) serves as Secretary to the Board, while Florian Bruder (Max Planck Institute, Germany), Jessica Schmidt (University of Bayreuth, Germany), Rolef de Weijs (Chair of the Young Academics' Network), Emmanuelle Inacio and Myriam Mailly (INSOL Europe Technical Officers) as well as Professor Michael Veder (Radboud University Nijmegen, the Netherlands) are ordinary members of the Board. Professor Rebecca Parry (Nottingham Trent University, the United Kingdom) is the Editor of the Conference Proceedings series and ex officio a member of the board. A Supervisory Committee has also been established as a consultative board for Academic Forum projects whose membership includes senior insolvency academics and practitioners.

With sponsorship made available by Edwin Coe LLP over a seven-year period from 2007-2014, the Academic Forum has been able to offer young scholars travel grants to attend its conferences, research grants for scholarly projects as well as prizes for outstanding legal scholarship awarded on the basis of monographs and publications. Edwin Coe LLP has also kindly sponsored an annual lecture to be given by a scholar of international repute. These have included Professor Jay Westbrook (University of Texas, the United States), Gabriel Moss QC (3/4 South Square, Gray's Inn, the United Kingdom), The Hon Mr Justice Ian Kawaley (Supreme Court of Bermuda), Professor Karsten Schmidt (President of the Bucerius Law School, Germany), Professor Bob Wessels (Leiden Law

School, the Netherlands) and Professor Ian Fletcher QC (University College London, United Kingdom).

A series of publications arising from Academic Forum conferences was inaugurated in 2009 by reports from the 2008 Leiden and Barcelona events with the intention being to publish conference proceedings booklets from all of the conferences listed above. Overall, the publications are intended to form a comprehensive report of the conferences and contain accounts of recent research in the insolvency field useful for academics and practitioners alike.

The Academic Forum's next meetings are scheduled to take place in cooperation with the Academy of European Law on 19-20 March 2015 and in conjunction with the INSOL Europe conference in Berlin on 30 September-1 October 2015, with further conferences being planned for 2016 and beyond. Details of academic conferences will be posted at the Academic Forum website at: www.insol-europe.org/academic/ as and when available. An on-line registration facility for academic conferences as well as further information about the work of the Academic Forum can also be obtained via the website as well as a dedicated Facebook page.

A Note on the Academy of European Law

The Academy of European Law is a non-profit public foundation that provides training in European law to legal practitioners. Its patrons include most EU member states and it is supported by the EU. ERA organises conferences and seminars around Europe. It also has an e-learning platform and publishes a legal journal titled "ERA Forum".

The Academy of European Law began its work in Trier in March 1992. Its genesis was associated with the rapid pace of European integration during the late 1980s and 1990s. With the Single European Act in 1986 and the Maastricht Treaty in 1992, the scope of European legislation became wider than ever before. It was clear that lawyers, judges and other legal practitioners at all levels and in almost all fields of law would need regular training and a forum for debate in order to keep up-to-date with the latest developments. In 1990, the European Parliament recommended that the Commission invest in a centre for the continuing education of lawyers in order to improve the application of European law. At about the same time, Peter Caesar, the Minister of Justice of the German Land of Rhineland-Palatinate, together with Horst Langes and Willi Rothley, Members of the European Parliament from the same region, were drawing up proposals for an Academy of European Law to be established in Trier. In 1991, the European Parliament endorsed these proposals in a report drafted by the Dutch MEP James Janssen van Raay.

An Association for the Promotion of the Academy of European Law was established to turn the idea into reality. The association continues to support the Academy's work and is known as the "Friends of ERA". The Luxembourg Government, led by Prime Minister Jacques Santer and Justice Minister Marc Fischbach, also lent its support, and the European Commission agreed to the Parliament's decision to provide the Academy with regular funding. Trier was chosen as the location of the Academy because of its proximity to the judicial capital of the European Union in Luxembourg. On 8-9 November 1991, the project of an Academy of European Law was formally launched at a ceremony in Trier with, as founding patrons, the Grand Duchy of Luxembourg, the Land of Rhineland-Palatinate and the City of Trier. In the intervening years, a majority of EU Member States has joined the foundation.

Many other leading figures in the field of European law have actively supported the launch of the Academy. Notable among these was Ole Due, then President of the European Court of Justice, who together with many of his fellow judges began a tradition of close co-operation between the Court in Luxembourg and the Academy. The Academy took possession of its purpose-built premises, provided by the Land of Rhineland-Palatinate, in the summer of 1998, where its activities are hosted. The Academy has also built up a specialised library that includes publications on all areas of Community law from both the European and national perspectives. Since 1999, it has also served as a European Documentation Centre with an up-to-date archive of all official EU publications in English, French and German.

PART I
THE TRIER PAPERS

Chapter 1

Domestic and European Perspectives on the Reform Proposals

Bernard Mac Namara

Text of the Intervention:[1]

Good Morning.

I wish to commend the European Law Academy and its Director Dr. Fuchs in cooperation with the INSOL Europe Academic Forum for their organisation of this very timely Conference to address the latest case law in regard to European cross-border insolvency and the proposed revision of the Insolvency Regulation. From my perspective – as the Chairperson of the Council Working Group which has just commenced its examination of the revised Regulation proposal – the Conference will, no doubt offer very valuable insights, information and perspective on the Commission proposal. I very much intend to listen and learn from the distinguished experts present over the next two days.

This morning, I would like to reflect some of our domestic experience in reform in Ireland and also the Presidency perspective on elements of the Commission proposal.

The Regulation of 2000 on insolvency proceedings (in operation since 31 May 2002) established a European framework for cross-border insolvency proceedings. It applies whenever the debtor has assets or creditors in more than one Member State, irrespective of whether they are a natural or legal person. The Regulation determines which Court has jurisdiction for opening insolvency proceedings.

As the Conference brochure states and my colleague from the Commission has explained in her presentation, the European Commission is proposing to move forward from the 2000 Regulation. It is seeking to modernise the current rules on cross-border insolvency so that they can better support a second chance and restructuring for viable businesses or honest entrepreneurs in difficulties and create an environment of rescue rather than liquidation. In that regard, the Commission

1 This intervention was made on behalf of the Irish Presidency of the European Union (2013).

proposal asks us to consider significant new policy and legal issues in regard to the scope of the Regulation, the insolvency of groups of related companies and clarifying the criteria applying to the determination of the Centre of Main Interest or COMI. Technical cooperation would be enhanced by increasing transparency by means of publicly accessible insolvency registers and closer cooperation between courts and liquidators.

The Commission proposal is part of a welcome response to the economic downturn being experienced across Europe. Modernised cross-border insolvency law, to make proceedings more efficient, can benefit both debtors and creditors throughout the European Union. The debt crisis of the past number of years has a direct effect on our people, their jobs and their business activities.

Member States have only had a short period since its publication in December to consider the proposed Regulation. We will all require time to conduct detailed internal evaluation and consultation. The development of the proposed new cross-border insolvency approaches will, I believe, require an open approach by all Member States during the negotiation process. I know that many States, like Ireland, have recently, or are in the process of, modernising their national insolvency laws and practice. This will be of some assistance in the debates to come.

I can speak with some degree of knowledge of the recent Irish experience having been directly involved in regard to the reform of our personal insolvency law. Ireland is endeavouring to cope with, and respond to, a very significant crisis in regard to over-indebtedness. This affects both corporate entities and natural persons and consumers. While our corporate insolvency law is well developed – we have processes for receivership, examinership (which is broadly similar to US Chapter 11) or liquidation – such was not the case for natural persons who have consumer debt, mortgage debt, trade and investment debt difficulties or, indeed, a combination of all of these debts.

The debt crisis for many Irish persons has effectively manifested itself since 2008 and can be directly related to the negative economic situation and a significant rise in unemployment to nearly 15%. There have been, as is well documented, significant impacts on the solvency of many of our financial institutions, some of which have had to be recapitalised.

Insolvency reform was thus critical. Until October 2011, Ireland's personal insolvency law had consisted of judicial bankruptcy only, with no real prospect of discharge from that state. The Irish participation in a Programme of Financial Support with the EU/ECB/IMF Troika included a commitment to reform personal insolvency. The Personal Insolvency Act 2012 fulfils that commitment and offers new and essentially "non-judicial" debt resolution processes. These processes are designed to return the debtor to a productive engagement with the economy and society over a period of years. There is provision for full debt write-off of debt up to EUR 20,000 in some cases. For amounts beyond that, there are negotiated processes for the resolution of secured and unsecured debt over a period of 5 or 6 years.

Our new Personal Insolvency Arrangement has, we understand, introduced a unique process. It provides for the agreed settlement of secured debt up to €3 million, (although this cap may be increased with the consent of all secured creditors), and unsecured debt without limit, normally over six years. In potentially accommodating highly indebted individuals, the Arrangement might be described as functioning as a type of personal examinership. It is designed to avoid the prospect of bankruptcy and liquidation with an agreed repayment perspective to offer a better return to creditors. Thus, our second chance approach predates the Commission proposal.

The new debt resolution processes require the engagement of a personal insolvency practitioner who negotiates on behalf of the debtor with their creditors, during a court approved "protective certificate" or standstill period of 70 days. During this period, creditors are prevented from taking action against the debtor. If a successful Arrangement is concluded, the debtor will make repayments over a 5 or 6 year period and the debts concerned will be written off as agreed.

A significant number of Irish people own property in other Member States. The provisions of the new Insolvency Regulation and the likely listing of our new debt resolution processes in the next revision of Annex A of the current Regulation may well have an impact on creditors in those States. The revised and modernised Regulation can thus facilitate a more informed and coherent EU approach to personal insolvency and a mechanism for the mutual recognition of non-judicial debt settlement arrangements, such as those contained in the Irish Personal Insolvency Act 2012.

Ireland has been pleased, as the current President of the European Union, to facilitate the "political" launch of the proposed Regulation. The initial discussion took place at the informal Justice and Home Affairs Council meeting of EU Justice Ministers held in Dublin on 18 January last. The Ministers engaged in a lengthy and constructive discussion on the proposals. There was certainly a focus on the importance of a more uniform approach in regard to the establishment of the centre of main interest so as to combat potential abuses which have given rise to allegations of "bankruptcy tourism". The Ministers were also concerned in regard to the modalities of a rescue approach in regard to dealing with possible fraudulent behaviour by directors and the consequences for creditors where one business obtained debt write-down.

The broad thrust of the Commission's proposals received a very positive political welcome from our Ministers. The Irish Minister for Justice & Equality, as President of the Council, has made it clear that he wishes to see a comprehensive and intensive examination of the Regulation during the Irish Presidency. This priority is reflected in the scheduling of seven meeting days of the Council Working Group. I had the honour to Chair the first meeting of the Working Group in February and we resume again later this week.

The legal basis for the Insolvency Regulation is found in Article 81(2) of the Treaty on the Functioning of the European Union. Title V of Part Three of the Treaty is not applicable to Ireland and the United Kingdom, unless they choose to exercise the right to "opt-in" to the negotiation of the proposed measure within the allowed time period. The Irish Government has approved a Motion to the Irish Parliament to exercise our opt-in and that Motion will be debated by the Parliament on 27 March next. We would expect that it will be approved, so that Ireland will be in a position to formally notify the fact before the deadline.

Ireland and all of the Member States have commenced their own internal examination of the detail of the proposals contained in the Regulation. However, it is not yet possible to offer definitive national comments beyond our broad initial welcome of the stated objectives of bringing greater clarity to cross-border insolvencies and expanding the scope of the existing Regulation. Also, it would be inappropriate for Ireland, as current holder of the Presidency of the European Union to seek to express, on behalf of the Council and the Member States, a firm opinion on the detail of the Commission proposals at this early point of our examination.

This Conference will be discussing all of the major themes contained in the Commission proposal. I would not wish to repeat the detailed presentation of those themes given already by my Commission colleague. However, perhaps I might be allowed some brief thoughts on certain of those themes.

The Commission's proposal extends the Regulation's scope by revising the definition of "insolvency proceedings" to include the restructuring of a company at a pre-insolvency stage and hybrid proceedings which may leave the existing management in place as well as debt discharge and other insolvency proceedings for natural persons where these processes exist in a Member State. This is a critical extension of the scope of the Regulation. It is a desirable objective and is in tune with our approach to seek where possible, to provide a mechanism to restructure potentially economically viable debtors.

We are conscious that it may take some time to arrive at a common understanding and recognition of the type, efficiency and effect of such pre-insolvency proceedings or procedures. We will need to understand the criteria Member States would require if there is to be recognition of other Member State's procedures as there will, no doubt, be some differences of approach in regard to the evolution of definitions in this regard. There will be some compromise required.

This leads me to one of the key features of the revised Regulation that is the move away, where possible, from the traditional liquidation approach to insolvency to one that facilitates the continuation in business of viable companies or relief for indebted individuals in financial difficulty. There will be a requirement obviously to have behaved in an honest fashion. This is a potentially very significant new tool to protect and nurture business activity and to preserve employment across the EU.

However, in pursuing a second chance approach, we must be conscious of balancing the legitimate rights and expectations of creditors as much as we want to assist debtors. Other concerned actors, such as our respective Revenue and tax authorities may have their own perspectives on this approach. Member States will have to critically examine and perhaps change long established insolvency processes. Issues will arise in the development and understanding of the restructuring approach to apply to cross-border insolvency proceedings.

Ireland supports the second chance approach. However, let me utter a word of caution. Our Company Law Review Group, in its 2012 Report on Proposals to Reduce the Cost of Reduce of Rescuing Viable Small Private Companies, was concerned that the more effective a rescue system is in writing down debts owed by an ailing business, the more likely it is that other businesses (perhaps better managed and more deserving of survival) will receive less than they are owed such that their own solvency may be endangered.

It is thus essential, that in pursuing a second chance approach, that we must avoid giving an unfair competitive advantage to certain companies through an insolvency process. Winding up insolvent and economically unviable companies should remain the default position. We do not wish to increase the risk of a "chain" event, whereby the rescue of one company leads to the potential consequential financial demise of other companies or individuals – who have supplied goods or services in good faith – further down the chain.

The Commission's most newsworthy proposal is in regard to the retention of the now established concept of Centre of Main Interest or COMI and seeks to ensure that it is consistent with the body of case law that has developed. The COMI test is extended to private individuals or natural persons. There will be a duty on the court that opens the insolvency proceedings to examine the COMI of the debtor and specify the ground on which their jurisdiction is decided. Creditors from other Member States will have a right to challenge the Court's decision. It is a matter for the court concerned to satisfy itself that the provisions in its national law in this regard have been observed.

We must be conscious of the need to avoid abuses in this regard, often described as forum shopping or bankruptcy tourism. As I already mentioned, Ministers discussed this point at the Informal JHA Council. However, on the other hand, we have to bear in mind that a company or natural person is entitled to change a COMI and could do so for a number of purposes. This entitlement arises under the broad rubric of freedom of movement in the Internal Market and such freedom has been enforced by decisions of the European Court of Justice.

The COMI test Ireland will apply for our new personal debt resolution processes or reformed judicial bankruptcy is that the debtor be normally resident for one year in Ireland. We are not, however, anticipating a rush of debtors from outside the State. It is worth noting that we will now have automatic discharge from bankruptcy after 3 years. This period is in line with the broad European norm.

Despite this reform, we are likely to continue to see a number of Irish people establishing a COMI in the UK to seek to take advantage of the 1 year discharge period for bankruptcy there. However, we have also noted in regard to several Irish applicants, some of them very notable persons that the UK Courts can and have refused to accept or have revoked jurisdiction in insolvency proceedings where an abuse has been detected.

In regard to secondary proceedings, the abolition of the requirement that they be winding-up proceedings only, and the new requirement for cooperation between the liquidators involved are desirable. However, again I would sound a note of caution here. In practice, such cooperation might be somewhat difficult to achieve. There may well be language difficulties and differences in insolvency cultures and approach. We should be careful in expecting too much.

The Commission proposal will require Member States to publish relevant decisions in cross-border insolvency cases in a publicly accessible electronic register and provides for the interconnection of national insolvency registers. There is no mandatory publication or registration of the decisions in the Member State where a proceeding is opened, nor in Member States where there is an establishment. Again, I believe that this is a very worthy initiative in regard to publicity requirements. However, there are practical considerations involved. Not all Member States have developed such Registers or have them to the extent that the Regulation would appear to require. Extra costs may well arise.

The Council Working Group has not yet had the opportunity to discuss the issues involved in regard to the treatment of insolvency where a group of companies is concerned. It is a sensitive issue which will likely give rise to a variation of views. The Commission proposes to retain the company by company approach to the insolvencies of group companies, but seeks to improve coordination of efforts. The courts and liquidators involved in different proceedings on group companies will be obliged to communicate and cooperate.

In conclusion, the review last year of the EU Insolvency Regulation was timely. The Commission has identified a need for further improvement and clarification in certain critical aspects. It has brought forward proposals that can assist us in putting economic growth at the heart of our civil justice agenda and in strengthening the Internal Market. We in the Council are at the beginning of the process of our consideration of the various elements of the proposed Regulation, and that much further work remains to be done. It is incumbent on us to respond to the very significant indebtedness problems that our businesses and citizens are suffering.

In preparing for the Informal JHA Council last January, Ireland put forward the following questions for discussions by the Ministers. I repeat them here and would suggest that they can also provide a useful aid to our discussions. The questions were as follows:

- are the measures contained in the proposed Regulation broadly sufficient to achieve a second chance culture for viable businesses encountering temporary financial difficulty and for individuals?
- are the proposed measures adequate to counteract the difficulties resulting from bankruptcy tourism?
- are there other areas of insolvency law which might also be addressed during the discussions on the Insolvency Regulation?
- are the proposed measures an appropriate basis on which to further develop the EU's insolvency law and procedures along the lines suggested in the Commission Communication?

I wish to again, thank the European Law Academy for organising this important and timely Conference. I believe that our discussions over the next two days can inform the debate. I look forward to the interaction with the many experts gathered here and to enhancing my understanding of the issues and thus, would be better equipped to contribute to the ongoing Council discussions.

Thank you.

Chapter 2

Master and Servant? Relationship between Main and Territorial Proceedings in Light of *Bank Handlowy* (Case C-116/11)

Gabriel Moss QC

Introduction

It is well known that the system of the European Insolvency Regulation involves the potential for both main and secondary proceedings relating to the same legal entity. At present, only main proceedings can be rescue or reconstruction proceedings and secondary proceedings have to be winding-up proceedings. The European Commission's proposals suggest a change removing this restriction on secondary proceedings.

The current restriction is designed to reflect the supremacy of the main proceedings. The main proceedings apply throughout the EU (except Denmark) except and to the extent that a secondary proceeding has been started in another Member State. Such a proceeding can only be begun if there is an "establishment" in that Member State, as defined by Article 2(h) of the EIR.

The EIR contains express provisions for co-operation and communication of information between main and secondary liquidators (Article 31). It has been held in Austria and the UK that an obligation for courts to co-operate is implied.[1]

The opening of a secondary proceeding whilst the main insolvency proceeding "liquidator" (as defined in Article 2(b)) is trying to rescue or reconstruct a company or to sell it as a going concern, can be very disruptive. For this reason, it is often preferable not to have the opening of a secondary proceeding.[2]

In the UK, we have developed the ability for insolvency practitioners to persuade local creditors against requesting the opening of secondary proceedings in return for a promise that if no secondary proceedings are opened then local priorities will be respected in respect of the assets which would have been part of the secondary

1 *Re Stojevic* (Higher Regional Court of Vienna, 9 Nov 2004) 28 R 225/04w; *Re Nortel* [2009] BCC 343 (HCJ, England).

2 G. Moss, I. Fletcher and S. Isaacs QC, *The EC Regulation on Insolvency Proceedings* (2nd ed) (2009, OUP, Oxford), at paragraph 8.151-3.

proceedings. The giving of such undertakings is accepted by the English courts as being valid and effective.[3]

The giving of such undertakings is not possible in some EU Member States and therefore the European Commission has proposed that the ability to give such undertakings be provided expressly by a change to the EIR.

The *Bank Handlowy* Case

The debtor, Christianapol, is a company registered in Poland whose ultimate parent is a French company. A French Tribunal de Commerce opened *sauvegarde* proceedings as main proceedings in respect of the company, on the basis that the debtor's centre of main interests was in France.

Whilst the main proceedings were continuing in France, Bank Handlowy, a Polish bank asked a Polish court to open secondary proceedings under Article 27 of the EIR. It made an alternative claim that if the opening in France were to be held to be a breach of Polish public policy under Article 27 of the EIR, the debtor should simply be wound up under Polish law.

The French court approved a rescue plan for Christianapol which involved the payment of its debts in instalments spread over 10 years. The French court appointed a person to oversee the implementation of the plan.

The debtor contended in the secondary proceedings that they should be discontinued, since the main proceedings had closed. It also contended that on the basis of the plan put in place by the French court, no claims were outstanding against it under Polish law and therefore there were no grounds for supporting a declaration of insolvency.

The Polish court asked the French court whether the insolvency proceedings in France were still pending.

> "The answer given by the French court did not provide the necessary clarification."

The Polish court referred three questions to the European Court of Justice:

(i) Should the term "closure of insolvency proceedings" in Article 4, relating to choice of law, have an autonomous meaning or should it be understood in the sense of the national law of the State of the opening, in that case France?

3 *Re Collins & Aikman* [2006] BCC 861, *Re Nortel* [2009] BCC 343.

(ii) Does Article 27 of the EIR prevent the court asked to open secondary proceedings from ever examining the insolvency of a debtor in respect of whom main insolvency proceedings had been opened in another Member State, even though it has been established in the main proceedings that the debtor is *not insolvent*?

(iii) Can secondary proceedings be opened even though a plan is being implemented by the debtor? It seems that the assets of the debtor were in Poland and the opening of a secondary proceeding excludes the effects of the main proceeding within the relevant Member State, in this case Poland.

By way of background to the problem, Article 1(1) of the EIR says that the EIR shall apply to "collective insolvency proceedings". Article 2(a) defines "insolvency proceedings" as the collective proceedings referred to in Article 1(1) and states that those proceedings are listed in Annex A. Thus the EIR has both a definition of insolvency proceedings and also a definitive list.

The French have persuaded the EU to add the *sauvegarde* procedure to Annex A by way of an amending Regulation, even though it is not strictly speaking an insolvency proceeding, but a *pre-insolvency* proceeding. The Commission has proposed the expansion of the scope of proceedings within the EIR to pre-insolvency proceedings, but they were not intended to be within the current text.

The Polish court did not raise any question for the ECJ as to whether the definition overrode the reference to Annex A or vice versa. The ECJ, on the basis that sauvegarde is included in Annex A, concluded at paragraph 35 that the debtor had to be regarded as being insolvent and in insolvency proceedings.

With regard to question (i), although provisions of EU law are usually given an autonomous and uniform interpretation, it was held that that principle only applies where the provisions make no express reference to the law of a particular Member State (paragraph 49). Since Article 4 was a choice of law clause, which provides that the closure of main proceedings is governed by the law of the main proceedings, then the question of closure cannot be given an autonomous interpretation but must be decided by the law governing the proceedings.

In other words in the *Bank Handlowy* case, the question of whether the main French proceedings had closed had to be decided in accordance with French law (paragraph 50). The question of whether the *sauvegarde* proceedings have been closed under French law was, however, to be decided by the court requested to open the secondary proceedings (paragraph 54).

With regard to question (iii) the ECJ held that the authority to open secondary proceedings in Article 27 and Article 3(3) of the EIR makes no distinction between cases where the main proceedings are "protective", i.e. pre-insolvency proceedings, and therefore those provisions must be construed as authorising the opening of secondary proceedings where the main proceedings, such as French *sauvegarde* proceedings, have a protective purpose.

The ability to open secondary proceedings even where the main proceedings are of a "protective" nature, creates a risk of undermining the main proceedings (paragraph 59). The ECJ however pointed out that the EIR provides mandatory rules for co-ordination and for the dominant role of the main proceedings (paragraph 60). Under Article 33(1) of the EIR, the liquidator in the main proceedings may request an order for stay of the process of liquidation in the secondary proceedings subject to certain conditions. Under Article 34(1), the liquidator in the main proceedings may propose closing the secondary proceedings with a rescue plan, a composition, or a comparable measure. Article 34(3) provides that during the stay of the process of liquidation under Article 33(1) of the EIR, only the liquidator in the main proceedings or the debtor, with the liquidator's consent, may propose such measures.

The answer to the potential disruption of the main, rescue, proceedings is the "principle of sincere co-operation", which requires the court having jurisdiction to open secondary proceedings to have regard to the objectives in the main proceedings and to take account of the scheme of the EIR and the aim of ensuring efficient and effective cross-border insolvency proceedings through mandatory co-ordination between the main and secondary proceedings, guaranteeing the priority of the main proceedings (paragraph 62). In short, the Polish court is obliged to consider and to co-operate with the French main proceeding and its goals.

With regard to question (ii), Article 27 provides that the opening of main proceedings shall permit the opening in another Member State of secondary insolvency proceedings:

> "…without the debtor's insolvency being examined in that other State."

The wording is not entirely clear as to whether, although the examination of the debtor's insolvency is not necessary, it nevertheless remains possible, or whether it is ruled out altogether.

The ECJ points out that the EIR does not define insolvency or lay down criteria for determining whether a situation of insolvency exists, but instead refers to national law. It is therefore a prerequisite for the opening of main proceedings that a court having jurisdiction has established that the debtor is insolvent under national law. The ECJ considered that once a finding of insolvency had been made in the main proceedings then that is binding on the court considering the opening of secondary proceedings. That interpretation is the only one liable to avoid the difficulties which would arise of the application by different courts of diverging national definitions of the concept of insolvency. If it were possible to have different assessments in the different countries, that would be:

> "…incompatible with the objective of efficient and effective cross-border insolvency proceedings."

The ECJ therefore ruled that the words in Article 27 mean that the court considering a request to open secondary proceedings where a main proceeding has been opened cannot examine the insolvency of a debtor, even where the main proceedings had a "protective" purpose.

This does give rise to the odd result that, because pre-insolvency proceedings such as *sauvegarde* have been smuggled into Annex A, they have to be treated as insolvency proceedings and the court opening the main proceedings has to be regarded as having found insolvency. On this basis the court considering an application to open secondary proceedings must accept that finding of insolvency and must treat the debtor as if it were insolvent.

The European Commission has proposed the ending of this rather artificial approach by expanding the scope of insolvency proceedings, expressly to include pre-insolvency proceedings.

Discussion

The facts of a case like *Bank Handlowy* raise difficult questions about the inter-relationship between main and secondary proceedings where the centre of main interests is in one Member State but the assets are in another. Hopefully, the ECJ rulings on the preliminary issues have assisted the Polish court in safeguarding the plan in the main proceeding.

It seems to me however that if a plan is adopted in the main proceedings before secondary proceedings are opened, then the assets and liabilities of the debtor become subject to that plan and this cannot be interfered with by the opening of secondary proceedings. Even if the main proceeding terminates by reason of a plan or some similar exit route, a further proceeding, whether main or secondary, should not be able to interfere with the disposition of the assets and liabilities dealt with by the plan in the prior main proceeding.

This still leaves a question mark. What if the Polish court had opened secondary proceedings before the plan in the main proceeding was adopted? In that case it seems that the assets in Poland could never have become subject to the plan in the main proceeding. However, the liquidator in the main proceeding could have requested a stay of the process of liquidation in the secondary proceeding, pursuant to Article 33 and proposed a plan parallel to the proposed plan in the main proceeding, using his special power under Article 34(3).

As the ECJ pointed out, no question was asked about a potential conflict between Annex A and the definition of insolvency proceedings as being collective insolvency proceedings in Article 1(1). For example, Annex A contains some proceedings which can be insolvency proceedings or may not be insolvency proceedings. A winding-up proceeding in the United Kingdom can be a solvent winding-up requested by a shareholder who has demonstrated to the court that the assets will be greater than the liabilities and that he will receive a distribution as a shareholder. It is not at all clear whether such a proceeding, based on solvency rather than insolvency, should be regarded as being within the EIR.

Chapter 3

Scope of the European Insolvency Regulation and Definition of Insolvency

Jean-Luc Vallens

Introduction

The European Insolvency Regulation covers insolvency proceedings without providing any definition of what insolvency is. The fact is that the EIR concerns insolvency proceedings opened by domestic courts whatever insolvency actually means. However, such a lack does not create any difficulty for other courts: why?

The reason is that the purpose of the EIR was not to create an insolvency regime applicable to all European distressed companies. Its main goal was only to facilitate recognition and enforcement of orders issued by courts, based on local conditions.[1]

Mechanisms provided for by the EIR did not really need any definition and, moreover, did not need a common definition of insolvency. Every Member State therefore had kept the possibility to define insolvency in line with its own legal traditions.

Such a choice has however entailed some shortcomings, for differences between domestic legislations created some degree of uncertainty with respect to the scope of the text and to the consequences of foreign proceedings. A recent example of such negative aspects can be observed with the *Bank Handlowy* case : if a main proceeding opened in France is not based on insolvency, do Polish courts have to recognize it, when an application is filed for a secondary proceeding?

The question could seem serious, for the opening of the main proceeding normally implies that the debtor is deemed insolvent.[2] As a reply to this challenge, the ECJ rejected any control of the opening conditions by the second court.[3]

But in most countries, the EIR has been applied without any real difficulty, thanks to specific rules provided for in the EIR:

1 Recital no. 6, EIR.

2 Ibid., Article 27.

3 ECJ 22 Nov 2012, C 116/11, *Bank Handlowy*.

- A list of proceedings covered by the text, mentioned in two annexes;[4]
- An application of the legislation of the opening State for defining the legal conditions for opening the proceedings;[5]
- An automatic mutual recognition of foreign proceedings, without reviewing its substance;[6]
- A principle of mutual trust;[7] and
- Finally, no examination of the insolvency, when a secondary proceeding is requested.[8]

I will now address 3 points:

Today: no definition, and a rather clear scope;

Tomorrow: a flexible approach;

Later: a possible harmonization of the concept of insolvency.

Today: No Definition, and a rather Clear Scope

Member States have avoided difficulties with respect to the scope of the EIR, by giving force to foreign proceedings based on the definition of proceedings covered by the text[9] and the list of proceedings contained in the annexes.[10]

As regarding to possible issues raised by the virtual differences between the definition of insolvency proceedings and the proceedings listed in the annexes, that can be more flexible, the ECJ clarified this question by stating that any proceeding mentioned in the lists is an insolvency proceeding subject to recognition. That is exactly what the proposed future EIR provides for in its Art 2:

> "…insolvency proceedings means the proceedings listed in Annex A."

That is why the scope is clear enough: as soon as a proceeding is mentioned in the list, it should be viewed as an insolvency proceeding and recognized in other Member States. Such an approach however is not always so clear: in the

4 Article 2a, EIR.
5 Ibid., Article 4.
6 Ibid., Articles 16 and 17.
7 Ibid., Recital no. 22.
8 Ibid., Article 27.
9 Ibid., Article 1.
10 Ibid., Article 2.

Eurofood case, the ECJ decided that the interim proceeding should be recognized in other Member States, for it entails similar effects, despite the fact that it was not mentioned in the list.[11]

It was probably the best choice that could be made: the EIR is mainly a set of international private law rules. One can see that 26 Member States may have 26 definitions of insolvency… According to B. Wessels, about 100 different kinds of proceedings are available among Europe, meaning that maybe 100 legal conditions exist for opening proceedings…

Moreover, differences do not only relate to substantial conditions but also to procedural requirements:

- Who may file for bankruptcy?
- Must the debtor file an application?
- Is it easy to get a judgment?
- May the applicant choose among different proceedings?
- Are there specific conditions for creditors when presenting a demand?…

The EIR leaves it to Member States and domestic courts to decide themselves the conditions to be met. That is the main meaning of Art 4:

> "the law of the State of the opening of proceedings shall determine the conditions for opening of those proceedings."

One should here mention that, in spite of those differences, most lawmakers adopted 2 (or maybe 3) conditions for opening proceedings:

- a financial test ("cash-flow test"): a debtor cannot pay its outstanding debts anymore;
- a balance sheet test (assets are not sufficient any more for the debtor to meet with its liabilities);
- more recently (in the last 20 years), a more debtor-friendly condition based on imminent insolvency: if the debtor is likely to become unable to pay its debts in the short term.

That leads me to the second point.

11 ECJ 2 May 2006, C 341/04, *Eurofood*.

Tomorrow: A Flexible Approach

The revised EIR is based on observations made by the European Commission: most domestic laws support the purpose of rescuing troubled companies which are not yet insolvent. That is why it has been decided to propose a more flexible approach, by giving debtors the possibility to file for bankruptcy before being insolvent.

Such a trend goes back to Chapter Eleven of the US Bankrupty Code. Rescuing companies can be made easier if the managers may get the protection of a legal general stay as early as the mere threat of insolvency occurs. Various names have been used to describe this condition for opening proceedings: financial difficulties, likelihood of suspension of payments, crisis…

This means that rescuing the troubled company will be possible if it still has some cash but is already facing a serious risk of insolvency. Such proceedings have been successful for some major airline companies.

Another idea, close to the former one, has been noticed by the Commission: rescue can be facilitated by leaving the debtor in possession. If it keeps its management powers over its business, it may have the confidence of its creditors for presenting a workable rescue plan.

These points have been viewed as relevant aspects and significant trends of domestic laws. Nevertheless, the Commission acknowledged that insolvency laws remain different in spite of such a convergence.

For these reasons, the revised EIR amends the provisions related to its scope: it will apply to collective proceedings:

- based on a law relating to insolvency (as opposed to a proceeding based on insolvency as such);
- which may have the purpose of rescuing companies;
- which entails either a divestment of the debtor or a control or a supervision by a court.

This more flexible approach is supposed to give the debtors better chances for rescuing their business. It would probably be helpful for meeting the goals of the Small Business Act for Europe and the wishes of the European Commission regarding the needs of small and medium-sized enterprises.

Besides, in parallel, it must be underlined that the Commission proposes to check the new proceedings submitted by Member States, to be listed in the annex against the above criteria: such a control should be necessary to enforce the more specific scope of the final text….

At this point, is it possible to go further? Is harmonization of laws a realistic way for the European legislator? That will be my third point.

Later: A Possible Harmonization of the Concept of Insolvency

2 questions may be raised in that respect: do we need harmonization? Is harmonization possible? I would say yes on these 2 aspects.

- Harmonization is necessary.

The current text aimed at avoiding and preventing forum shopping .[12] One must admit that the EIR was not successful in that respect. It failed namely because of differences between domestic laws.

The absence of a common criterion for opening insolvency proceedings is actually one of the issues. As long as it will be easier to file for bankruptcy in a court than in another one, such a forum shopping will go on.

This does not give any legal certainty to creditors and investors, who face the risk of a misconduct by the debtor filing an application with a foreign court…

Harmonization therefore would create a fairer and clearer legal framework linked to this risk.

- Harmonization is feasible.

It seems permitted by the TFEU itself, the articles 65, 81 and 114 of which allow for some degree of harmonization or approximation of laws. Several harmonized rules are already provided for by the current EIR, in particular with regard to information of creditors and lodging of claims. It also includes a common set of international private law rules…

The revised EIR proposed by the European Commission adds some more harmonized rules relating to the lodging of claims. The observed convergence between national laws, already mentioned above, make harmonization possible.

12 Recital no. 4, EIR.

Let me conclude with a mention of the Legislative Guide on Insolvency Law, adopted by UNCITRAL, several recommendations of which suggest criteria for opening insolvency proceedings.[13] It would be a useful tool for the European legislator.

13 UNCITRAL, Legislative Guide on Insolvency Law (2004), Recommendations nos. 15, 16 and 17.

Chapter 4

Courts should be Leading in Solving Cross-Border Insolvency Matters

Bob Wessels

Introduction

> "Main insolvency proceedings and secondary proceedings can... contribute to the effective realisation of the total assets only if all the concurrent proceedings pending are coordinated. The main condition here is that the various liquidators must cooperate closely, in particular by exchanging a sufficient amount of information. In order to ensure the dominant role of the main insolvency proceedings (italics supplied), the liquidator in such proceedings should be given several competencies for intervening in secondary insolvency proceedings which are pending at the same time. For example, the main liquidator should be able to propose a restructuring plan, a composition or apply for realisation of the assets in the secondary insolvency proceedings to be suspended."

Thus states Recital no. 20 preceding the text of the European Insolvency Regulation. The model of the EIR is based on the coordination between a main insolvency proceeding opened in one Member State and one or more secondary proceedings opened in other Member States. The first significant point to note therefore is that main insolvency proceedings, opened in one Member State do not deprive the courts in other Member States of the authority to open secondary proceedings, for which see Article 16(2) of the EIR. The universal effect of the main proceedings throughout the European Union does not apply to the secondary proceedings, opened in another Member State, whilst the effects of the secondary proceedings may not be challenged in other Member States following Article 17 of the EIR. The procedural and substantive effects of the secondary proceedings are determined by the *lex concursus*, through rules contained in Articles 4 and 28 of the EIR, the focus of the secondary proceedings is the protection of local interests.[1]

1 See S. Kolmann, *Kooperationsmodelle im Internationalen Insolvenzrecht. Empfielt sich für das Deutsche internationale Insolvenzrecht eine Neuorientierung?* Schriften zum Deutschen und Europäischen Zivil-, Handels- und Prozessrecht (2001, Verlag Ernst und Werner Gieseking, Bielefeld), who characterizes this focus understandably as a 'protective function' ('Schutzfunction').

Secondary Proceedings: The European Context

There are however other aspects of this primary function of secondary proceedings, which make it necessary to view the secondary proceedings as being a national proceeding, with quite a European context. The following reasons support this European dimension:

(i) despite secondary proceedings being opened in another Member State (in which the debtor has an establishment, see Article 3(2) and Article 2(h)), the secondary proceedings are concerned with the same (insolvent) debtor as the main insolvency proceedings;

(ii) despite the secondary proceedings only being permitted to be proceedings as listed in Annex B, and therefore winding-up proceedings with territorial effect (Article 3(2) and Article 27), Chapter III of the EIR provides the liquidator appointed in the main insolvency proceedings with several powers to change the character of the secondary proceedings and to align the proceedings in accordance with developments in the main proceedings;

(iii) despite 'local' creditors being able to lodge claims in secondary proceedings, they are also allowed to lodge claims in the main proceedings or in other secondary proceedings (Article 32).

The Spanish professors Miguel Virgós and Francisco Garcimartín refer to secondary proceedings having an auxiliary function and therefore should be considered in the context of the main proceedings.[2] The EIR does not aim to ring-fence secondary proceedings; these proceedings have their formal character and comprise assets, located in its territory, but the EIR's concept of universality of the main proceedings:

> "is allowed to become fragmented, but is not finally renounced'.[3]

The mutual connection between both proceedings is founded on the maxim that, ultimately, the administration concerns one debtor with one estate and one group of creditors. See Recital no. 3, indicating that the EIR stems from the need for:

> "coordination of the measures to be taken regarding an insolvent debtor's assets."

This may be referred to as the principle of unity of estate.

2 M. Virgós and F. Garcimartín, *The EC Regulation on Insolvency Proceedings: A Practical Commentary* (2004, Kluwer Law International, The Hague), at paragraph 287.

3 See I.F. Fletcher, *Insolvency in Private International Law. National and International Approaches* (Oxford Private International Law Series) (2nd ed) (2005, OUP, Oxford), at paragraph 7.136.

Community Powers of the Liquidator in Main Proceedings

The concept of one debtor with one estate to satisfy all creditors is reflected – though less systematically – by the powers assigned to the liquidator in the main insolvency proceedings by the EIR. The following illustrates these rights, powers and duties:

(i) he has the power to apply for secondary proceedings in other Member States (Article 29);

(ii) he can ask liquidators in the secondary proceedings for information (Article 31(1));

(iii) he can demand that liquidators in secondary proceedings cooperate with him (Article 31(2));

(iv) he can exercise the power to put forward certain proposals in the context of the secondary proceedings (pursuant to Article 31(3));

(v) he may request a stay of the process of liquidation in these secondary proceedings (Article 33(1));

(vi) he may request the termination of a stay (Article 33(2));

(vii) he may propose a rescue plan in the secondary proceedings (see Article 34(1)), also during the stay of the process of liquidation (Article 34(3));

(viii) he shall lodge in other proceedings claims which have already been lodged in the main proceedings (Article 32(2)); (is this a duty?)

(ix) he has the power to participate in the other proceedings on the same basis as the creditors (Article 32(3));

(x) he has the right to request the return of anything already obtained by creditors as they have satisfied their claims by any means on the assets of the debtor situated in the other Member State to the main proceedings(Article 20); and

(xi) he has the power to collect any remaining assets from the secondary proceedings if all claims in these proceedings have been met (Article 35).

These powers have their origin in the EIR and therefore may be regarded as the "Union" powers of the main liquidator. In addition, he may use in the whole of the European Union (except for Denmark) his domestic powers, for which see Article 18. The recitals devote only a few words to the guiding notion of unity of the estate. Recital no. 3 states that:

> "The activities of undertakings have more and more cross-border effects and are therefore increasingly being regulated by Union law. While the insolvency of such undertakings also affects the proper functioning of the internal market, there is a need for a Union act requiring coordination of the measures to be taken regarding an insolvent debtor's assets."

See also Recital no. 12, explaining the characteristics of main proceedings and secondary proceedings, adding that:

> "Mandatory rules of coordination with the main proceedings satisfy the need for unity in the Community."

Furthermore, Recital no. 20 states that:

> "Main insolvency proceedings and secondary proceedings can, however, contribute to the effective realisation of the total assets only if all the concurrent proceedings pending are coordinated. The main condition here is that the various liquidators must cooperate closely, in particular by exchanging a sufficient amount of information."

Recital no. 21 sets out the principle that:

> "Every creditor, who has his habitual residence, domicile or registered office in the Community, should have the right to lodge his claims in each of the insolvency proceedings pending in the Community relating to the debtor's assets...".

Bank Handlowy v Christianapol

The system of coordinating main proceedings and secondary proceedings really comes to a test when main proceedings are initiated as rescue proceedings, whilst the secondary proceedings must be a winding-up proceeding. How should a clash between the two be prevented or resolved? The Court of Justice of the EU has provided an answer in November 2012.[4]

Christianapol sp. z.o.o. ("Christianapol") is a wholly-owned subsidiary of a German company, which itself is for 90% owned by a French company. On 1 October 2008 the *Tribunal de commerce de Meaux* (France) opened main insolvency proceedings (*procédure de sauvegarde*) against Christianapol. Opening of these proceedings in France is possible on the ground that the debtor is not in

4 ECJ 22 November 2012; Case C-116/11 (*Bank Handlowy v Christianapol*).

a situation calling for cessation of payments, but that it would be in that situation if financial restructuring was not undertaken quickly. In June 2009, in Poland, Bank Handlowy, established in Warsaw (Poland), in its capacity as creditor of Christianapol, asked the Polish court to open secondary insolvency proceedings against Christianapol under Article 27 of the EIR. A month later, the French court approved a rescue plan for Christianapol. The court retained the appointment of representatives for the creditors' interests until the closure of the procedure for the verification of claims and the submission of a final report on the activities of those representatives. In its judgment it also appointed a person to oversee the implementation of the plan (*commissaire à l'exécution du plan*).

Following the approval of the rescue plan by the French court, Christianapol contended that the secondary insolvency proceedings should be discontinued, since the French main proceedings had closed. It also submitted that it was fulfilling its obligations under the plan approved by the French court, with the result that no pecuniary claims were outstanding against Christianopol under Polish law and that there were therefore no grounds supporting a declaration of insolvency in respect of it.

It should be noted that, in this case, the communication between the Polish and the French court was abominable. I quote:

> "The referring court [from Poland; Wess.] asked the Tribunal de commerce de Meaux whether the insolvency proceedings in France, ….., were still pending. The answer given by the French court did not provide the necessary clarification. The referring court then consulted an expert."

It is therefore no surprise that the Poznan Court (*Sąd Rejonowy Poznań-Stare Miasto w Poznaniu*) decided to stay the secondary proceedings and to refer questions to the European Court for a preliminary ruling.

The Court of Justice of the EU decided that the question whether the French proceeding was closed, is to be decided on the basis of the national law of the Member State, i.e. French law it continued by providing two interpretations of Article 27 of the EIR:

(i) that the court before which an application to have secondary insolvency proceedings opened cannot examine the insolvency of a debtor against which main proceedings have been opened in another Member State, even where the latter proceedings have a protective purpose.

(ii) that it permits the opening of secondary insolvency proceedings in the Member State in which the debtor has an establishment (in this case: Poland), where the main proceedings have a protective purpose. The European Court adds that it is upon the court having jurisdiction to open secondary proceedings, to have regard to the objectives of the main proceedings and to take account of the scheme of the EIR, in keeping with "the principle of sincere cooperation".

Principle of Sincere Cooperation

The first decision is no surprise, the second however brings into play a fundamental principle of EU law to close a gap in the system of the EIR. As the European Court observes, the fact remains that the opening of secondary proceedings, which must be winding-up proceedings:

> "… risks running counter to the purpose served by main proceedings, which are of a protective nature."

The basis for solving this clash lies in the intertwining/interweaving of the two proceedings for which the EIR provides a number of mandatory rules of coordination intended to ensure: "the need for unity in the Community", as recital no. 12 expresses. Based on the fact that main proceedings have a dominant role in relation to the secondary proceedings (see recital no. 20) the liquidator in the main proceedings has, in the words of the Court, several prerogatives at his disposal which allow him to influence the secondary proceedings in such a way that the protective purpose of the main proceedings is not jeopardised. See paragraph 3 above. The Court continues:

> "The principle of sincere cooperation laid down in Article 4(3) EU requires the court having jurisdiction to open secondary proceedings, in applying those provisions, to have regard to the objectives of the main proceedings and to take account of the scheme of the Regulation, which… aims to ensure efficient and effective cross-border insolvency proceedings through mandatory coordination of the main and secondary proceedings guaranteeing the priority of the main proceedings."

The European Court provides a wide interpretation of Article 4(3) of the EU Treaty, as in its texts the principle only refers to Member States. In this regard an independent court presumably is seen as an integral part of a State. This makes sense, although the practical implications seem rather uncertain. The recognition of insolvency judgements is based on the "principle of mutual trust" (recital 22) and it is not too great a step to recognize that this principle is derived from the concept of sincere cooperation (or: loyalty) as mentioned in Article 4(3), first sentence, EU Treaty, inciting not only Member States but also judges of these States to be guided by the aims and purposes of a given community measure, such as the EIR.

Promoting Judicial Cooperation in Cross-Border Insolvency Cases in the EU

During my presentation in Trier, I referred to the development of a set of Guidelines, tentatively called "EU Cross-Border Insolvency Court-to-Court Cooperation Guidelines". These would be the outcome of a programme of study, research, discussion and pilot-training of judges for which the Leiden Law School, in cooperation with Nottingham Law School, has been awarded a EU Action Grant 'Civil Justice'. The programme is funded by a grant from the European Committee, with third-party funding by the International Insolvency Institute (III). The programme will run to the end of 2014.[5] These (non-binding) EU Cross-Border Insolvency Court-to-Court Cooperation Guidelines will be developed for application in matters of cross-border communication and cooperation in insolvency cases between courts in the European Union. The result should:

(i) ensure as far as possible that the EIR works in practice, to efficiently and effectively deal with a debtor's estate;

(ii) fit the current environment where solutions have been developed based on models reflecting cooperation and communication; and

(iii) ensure to the best possible extent the organisation and conduct of a fair legal process, with a fair representation of stakeholders concerned in insolvency processes.

I must say that the grant was already rewarded prior to the *Bank Handlowy v Christianopol* case, but this case clearly supports the necessity of having such guidelines (in the programme limited to "court-to-court" cases) available.

The programme ("the JudgeCo-project") will further develop earlier initiatives, to which some of the invitees have already contributed. In 2007, under the aegis of INSOL Europe (generally representing the European insolvency community) the European Communication and Cooperation Guidelines for Cross-Border Insolvency were published. This initiative was jointly chaired by Professors Bob Wessels (University of Leiden, The Netherlands) and Miguel Virgós (University

5 In addition to myself, the project is led by a team which includes Professor Jan Adriaanse and Dr. Bernard Santen (Leiden Law School) and Dr. Paul Omar (Nottingham Law School).

Autonomá, Madrid, Spain). These Guidelines (also known as "CoCo Guidelines") have received attention both in legal literature as well as from judges and practitioners and were for instance taken into account in the June 2009 Global Cross-Border Insolvency Protocol for the Lehman Brothers Group of Companies. Direct and indirect court-to-court communication may enhance international collegiality that has emerged amongst judges in cross-border insolvency cases, a form of judicial globalisation that will lead to the development of more cross-border methodologies such as protocols and guidelines. This is of considerable interest to EU Member States that already have adopted (e.g. Poland, Romania, UK, Slovenia and Greece) or are considering adopting the UNCITRAL Model Law on Cross-Border Insolvency 1997, whose Article 27 provides a non-exhaustive list of how cooperation may be implemented including through communication between courts and office-holders as well as cooperation through co-ordinating concurrent proceedings.[6] Finally, in June 2012, the American Law Institute (ALI) and International Insolvency Institute (III) Global Principles for Cooperation in International Cases ('Global Principles') were published. These Global Principles include Global Guidelines for Court-to-Court Communications in International Insolvency Cases. These Global Principles and Global Guidelines were drafted by Professors Ian Fletcher (University College London) and Bob Wessels.[7]

The JudgeCo project is Underway

The JudgeCo project has three phases.

Workstream 1 (January 2013-September 2013) focuses on developing a draft text of EU Cross-Border Insolvency Court-to-Court Cooperation Guidelines. Two surveys will be developed and sent out to a representative group of experts – insolvency judges, senior insolvency court representatives, insolvency lawyers/ trustees/ practitioners, academics – based in the majority of EU Member States and some five non-EU jurisdictions. Based on further analysis and discussion (of the Global Principles, and the CoCo Guidelines) the draft-Guidelines will be reviewed by a Review & Advisory Group after which the Guidelines are to be presented to the general public. Workstream 2 (September 2013-July 2014) focuses on capacity building by inviting individual insolvency judges to participate in sidetracks of (already) planned conferences by the JudgeCo project's participating or invited partners. Workstream 3 (July 2014-November 2014) focuses on bringing together

6 The CoCo Guidelines are available at: www.insol-europe.org or www.bobwessels.nl .

7 The Global Guidelines are available at:
http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=85 or
http://www.iiiglobal.org/component/jdownloads/finish/557/5932.htm .

60 EU insolvency judges for a day and a half 'Cooperation Training' at three European universities (probably Leiden, Nottingham and a city in the Eastern-European region). The grant also covers costs of travel and overnight stay for these judges.

In the meanwhile, the Review & Advisory group for the project is established and will include some forty judges, practitioners and academics to allow an open-minded debate with the project team and to ensure that aspects of the project which may provide difficulties of transposition into the legal culture of a Member State can be addressed. The Review & Advisory Group acts as the project management sounding board and will be chaired by Professor Ian Fletcher, University College London.

Please let me know whether you are interested in following the project. A website is under construction which will contain links to the sources mentioned and we will periodically report about the progress of the project.

PART II
THE PARIS PAPERS

Chapter 5

Key Aspects of Intellectual Property Financing in the Work of UNCITRAL

Spyridon Bazinas

Introduction

Innovative ideas are typically the result of expensive and extensive research activities, constitute one of the cornerstones of economic development and are generally protected through intellectual property rights.[1] Yet, all over the world, the law relating to intellectual property financing is either under-developed or not sufficiently well coordinated with the law governing secured financing.

The Supplement on Security Rights in Intellectual Property ("the Supplement"), which the United Nations Commission on International Trade Law ("UNCITRAL") adopted in July 2010,[2] is intended to ensure a better coordination with a secured financing regime along the lines of the regime recommended in the UNCITRAL Legislative Guide on Secured Transactions ("the Guide"), which UNCITRAL adopted in December 2007.[3]

The overall objective of the Supplement is to make credit more available and at a lower cost to intellectual property right holders, thus enhancing the value of intellectual property as security for credit. At the same time, the Supplement seeks to achieve this objective without interfering with fundamental policies of intellectual property law,[4] taking intellectual property as it is defined by and if it may be encumbered under intellectual property law.

The purpose of this article is to briefly explain the key aspects of intellectual property financing under the Supplement and in particular coordination between security interests and intellectual property law, acquisition financing in an intellectual property context, law applicable to security interests in intellectual

1 This article is not intended to address the questions whether an idea is really innovative and, if so, whether it should be protected by an intellectual property right.

2 See Report of UNCITRAL on the work of its forty-third session, A/65/17, at paragraph 227. All the documents referred to in this chapter are available on the UNCITRAL website: http://www.uncitral.org .

3 See Report of UNCITRAL on the work of its resumed fortieth session, A/62/17 (Part II), at paragraphs 99-100.

4 See Supplement, paragraph 1 and recommendation 4(b).

property and the impact of insolvency of a licensor or licensee on a security interest in that party's rights.

Coordination between Security Interests and Intellectual Property Law

As already mentioned, the overall objective of the Guide is to promote secured financing. To achieve this objective, the Guide formulates a number of objectives, such as predictability, transparency, equal treatment of the various sources of credit and balancing the interests of all affected persons.[5] The Guide also reflects certain fundamental policies, including the comprehensive, integrated and functional approach to secured transactions. All these key objectives and fundamental policies apply equally to an intellectual property context. This means that the overall objective of the Supplement is to facilitate the extension of credit to intellectual property owners and other right holders, enhancing the value of intellectual property rights as security for credit.

The Supplement, however, seeks to achieve this objective in a way that does not interfere with the rights of owners and other right holders under intellectual property law, contract law or general property law. This means, for example that the Supplement does not affect the content or impede the protection of an intellectual property right. It also means that nothing in the Supplement diminishes the value of an intellectual property right or causes confusion as to the source of products or services. Furthermore, it means that nothing in the Supplement affects the terms and conditions of licence agreements.

According to the principle enshrined in recommendation 4, subparagraph (b), the Guide and the Supplement give way to intellectual property law (defined in a broad way to include national law and international treaties) if an issue is addressed in that law in an asset-specific and different way from the way it is addressed in the Guide.

Deference to intellectual property-specific rules dealing with security interests in intellectual property rights is certainly a limitation to the Supplement and its harmonization effect, but it is necessary in view of the need to facilitate the extension of credit to intellectual property right holders, without interfering with the fundamental policies of intellectual property law. This limitation, however, relates only to matters with respect to which an overlap and conflict between secured transactions and intellectual property law is possible, that is matters relating to the creation, third-party effectiveness, priority and enforcement of a security interest

5 See recommendation 1.

in an intellectual property right. Matters relating to the creation, effectiveness, priority and protection of an intellectual property right are exclusively matters of intellectual property law.

To the extent issues of coordination between secured transactions and intellectual property law would arise as a result of the principle of deference to intellectual property law approach (for example, whether a notice of a security interest may be registered in an intellectual property right registry to make the security interest effective against third parties), the Supplement deals with such issues with mild suggestions in the commentary as to how States enacting a secured transactions law based on the recommendations of the Guide and the Supplement might better coordinate their intellectual property law with their secured transactions laws.

The terminological clarifications made in the Supplement are also important for the coordination of security interests and intellectual property law, as some of the key common terms are understood differently in a secured transactions context from an intellectual property context. For example, under secured transactions law, the term "secured creditor" means a person that is not the owner unless it acquires the encumbered asset in the context of enforcement. To the contrary, under intellectual property law, the term "secured creditor" may include the owner or a person with the rights of an owner, for example, to renew registrations and pursue infringers.

Another such term is the term "encumbered asset". In a secured transactions context, an intellectual property right is just another intangible asset (of course, if it has economic value, but, while mentioned as an important practical issue, valuation is not addressed in the Supplement).[6] In an intellectual property context, an intellectual property right is next only to the Holy Grail! It is the heroic expression of intellectual effort and as such has to be handled with care and caution.[7] More seriously, the Supplement simply recognizes that determination of what exactly the asset is and whether it may be encumbered is a matter of intellectual property law, not secured transactions law.

Coordination is also achieved between the security interest registry and a specialized registry (e.g., a patent or trademark registry), if a State has such a specialized registry. The Guide and the Supplement address this issue in three ways. First, if intellectual property law provides that a security interest in intellectual property has to be registered in an intellectual property registry or has other provisions that

6 See Supplement, at paragraphs 33 and 34.

7 At one of the initial informal meetings, an intellectual property law expert remarked: "You cannot give a secured lender an intellectual property right. What would a gorilla do with a Stradivarius?!"

are inconsistent with the registration-related provisions of the Guide,[8] intellectual property law will prevail.[9]

The second way in which the Guide and the Supplement address the issue of coordination of registries is by way of a priority rule. Under the Guide, a security interest made effective against third parties by registration in an intellectual property registry has priority over a security interest made effective by registration in the general security interest registry, or by transfer of possession or control.[10]

The third way in which the Guide and the Supplement address the issue of coordination of registries is by suggesting ways in which the various types of registry may be made compatible or linked with each other. For example, an intellectual property registry system could allow the registration of notices relating to possible security interests in present or future intellectual property rights with third-party effects, establish and maintain both asset-based and name based-indices, and allow searches by both asset description and grantor identifier. Such a coordination of registries would certainly require that States review and revise not only their secured transactions laws but also their intellectual property laws.

Another way of coordination of registries discussed in the Guide and the Supplement is to link registries electronically in such a way that information entered in one registry will be appear in the others so that wherever a party searches he will be able to discover all security interests relating to certain assets or assets of a certain debtor (both asset- and debtor-based indices would be necessary). This is a matter discussed further in the UNCITRAL Guide on the Implementation of a Security Rights Registry (2013).[11]

Acquisition Financing

The Need for a Special Treatment of Intellectual Property Acquisition Financing

While the idea of a special regime for intellectual property acquisition financing is not unknown, its application has been rather limited. By establishing such a regime, the Supplement is intended to facilitate the extension of credit to persons that create and acquire intellectual property and licence rights.

The basic idea is that, as a retention-of-title seller of goods or a lender financing the acquisition of goods by the grantor of a security interest deserves a special

8 See recommendation 38.
9 See recommendation 4, subparagraph (b).
10 See recommendation 77, subparagraph (a).
11 See Registry Guide, at paragraphs 73-79.

priority status as without that acquisition financing the grantor could not acquire the goods, a financier financing the acquisition of intellectual property or a licence of intellectual property by a grantor deserves to be treated in the same way.

In essence, the Supplement implements the super-priority given to a retention-of-title seller or an acquisition money secured creditor in an intellectual property context. This is intended to support the acquisition of intellectual property and licence rights.

The Supplement provides specifically that an acquisition security interest in intellectual property held by the grantor for sale or licence in its ordinary course of business should be treated in the same way as an acquisition security interest in inventory; such a security interest in intellectual property used or intended to be used by the grantor for its personal, family or household purposes should be treated in the same way as an acquisition security interest in consumer goods.[12]

As a result, an acquisition security interest in intellectual property held by the grantor for sale or licence in its ordinary course of business has priority over a non-acquisition security right, provided that:

(a) before the grantor acquires the intellectual property right or the licence, a notice is registered with respect to the acquisition security interest in the general security interest registry; and

(b) a notice is sent to secured creditors with an earlier-registered non acquisition security interest.[13]

Similarly, an acquisition security interest in intellectual property held by the grantor for use in its own business has priority over a non-acquisition security right, provided that notice is registered with respect to the acquisition security interest in the general security interest registry not later than a short period of time (20 or 30 days) after the grantor acquired the intellectual property or licence.[14]

Priority of a Security Interest registered in an Intellectual Property Registry

The Guide and the Supplement do not interfere with specialized registration regimes, including intellectual property right regimes. This means that there is no acquisition security interest priority for acquisition security interests registered in

12 See recommendation 247, subparagraph (a).

13 See recommendation 180, subparagraph (b).

14 See recommendation 180, alternative A, subparagraph (a). For a discussion of the various alternatives or the unitary and non-unitary approach to acquisition financing, see the Supplement, Chapter IX.

an intellectual property registry. As already mentioned, a security interest made effective against third parties by registration in an intellectual property registry has priority over a security interest made effective against third parties by registration in the general security interest registry, irrespective of the time of registration.15

However, in many situations, the secured creditor of an owner of intellectual property subject to specialized registration will in essence have the priority position of an acquisition secured creditor. Where, for example, the intellectual property regime does not permit the registration of a security interest in future intellectual property, the secured creditor of a transferee or licensee of intellectual property can only register after the transfer or the licence. As a result, the owner's secured creditor will always have priority over the transferee's or licensee's secured creditor.

Priority of an Acquisition Security Interest in Proceeds of Intellectual Property

In line with the relevant rules that apply to an acquisition security interest in the proceeds of tangible assets, the Supplement provides that an acquisition security interest in the proceeds of intellectual property or licence held by the grantor in its own business has the same super-priority as the acquisition security interest in the encumbered intellectual property or licence.[16]

However, an acquisition security interest in the proceeds of intellectual property or licence held by the grantor for sale or licence in the ordinary course of business has the same super-priority as the acquisition security interest in the encumbered intellectual property or licence only if the proceeds are not cash proceeds.[17]

Law Applicable to Security Interests in Intellectual Property

Property Matters

The Guide and the Supplement do not deal with the law applicable to ownership in intellectual property. They deal though with the law applicable to the creation, third-party effectiveness, priority and enforcement of a security interest in intellectual property.

As there is no generally acceptable applicable law rule with respect to security interests in intellectual property, UNCITRAL took the time to discuss this issue at

15 See recommendations 77 and 78.

16 See recommendations 185, subparagraph (a), and 247.

17 See recommendations 185, subparagraph (b), and 247.

length and in depth.[18] Various alternatives were considered and their comparative advantages and disadvantages were discussed.[19] The outcome, which was considered to be a significant success, in particular, as it was agreed upon after a long and well informed discussion by consensus, may be briefly described as follows.

The Supplement discusses various options with their comparative advantages and disadvantages. One option is based on the law applicable to ownership in intellectual property. Under this approach, the law applicable to a security interest in intellectual property should be the law of the State in which the intellectual property is protected (*lex protectionis* or *lex loci protectionis*). The main arguments in favour of this approach are that it would be consistent with the approach followed in many intellectual property law conventions and would result in the application of one and the same law to transfers of ownership and to security interests in intellectual property.

Another option is based on the law applicable in the Guide to security interests in intangible assets, that is, the law of the grantor's location (the grantor's place of central administration or principal place of business).[20] The main arguments in favour of this approach are that it would result in the application of a single law, which, in the case of a security interest in a portfolio of intellectual property rights protected under the laws of several States, would result in significant time and cost savings to create and enforce a security interest, and a law that would usually coincide with the law governing matters in the grantor's insolvency (*lex fori concursus*).

A third option is based on a combination of the first two options referring some issues to the law of the grantor's location and other issues to the law of the State in which the intellectual property right is protected. The main argument for this approach is that it maximizes the advantages of both options and minimizes their disadvantages. More concretely, this approach allows parties to choose either the law of the protecting State or the law of the grantor's location as the law applicable to creation (effectiveness between the parties, not affecting third parties).

It refers third-party effectiveness and priority to the law of the protecting State, giving appropriate recognition to the principle of territoriality and the need to refer

18 The discussions included a representative of the Bureau of the Hague Conference on Private International Law. Informal discussions also took place with the European Max-Planck-Group for Conflict of Laws in Intellectual Property (CLIP): http://www.ip.mpg.de/ww/de/pub/mikroseiten/cl_ip_eu/home.cfm .

19 See A/CN.9/700 and Addenda 1-7. See also the report of the Commission at its 43rd session (A/65/17, at paragraphs 210-223).

20 See recommendation 208 and 219.

security interests in registrable intellectual property rights to the law of the State of registration. It also permits third-party effectiveness as against judgment creditors and insolvency administrators to be achieved under a single law (the law of the State of the grantor's location). Furthermore, this option refers enforcement (which involves several acts) to a single law (the law of the grantor's location), subject of course to the principle of the application of the *lex fori* to procedural matters and the *lex fori concursus* to certain insolvency-related matters (avoidance, ranking of claims and distribution of proceeds).[21] This is the recommended approach.[22]

Contractual Matters

The Guide provides that the law applicable to the mutual rights and obligations of the parties arising from their security agreement is the law chosen by the parties. In the absence of a choice of law by the parties, the applicable law is the law governing the security agreement as determined by the conflict-of-law provisions generally applicable to contractual obligations.[23]

The Impact of the Insolvency of a Licensor or a Licensee on a Security Interest in that Party's Rights

General

The UNCITRAL Legislative Guide on Insolvency Law (the "Insolvency Guide") deals with all issues that are typically dealt with in insolvency law, including the treatment of security interests in insolvency proceedings. The Guide in chapter XII contains a comprehensive, self-contained summary of the discussion in the Insolvency Guide of the treatment of security interests in insolvency proceedings.

Both Guides generally deal also with security interests in intellectual property, without placing much emphasis on all relevant issues at the intersection of secured transactions and insolvency law, on the one hand, and intellectual property law, on the other hand. The emphasis on those issues is given in the Supplement. Thus, chapter XII of the Supplement complements chapter XII of the Guide and deals with the impact of insolvency of a licensor or a licensee on a security interest in that party's rights under a licence agreement in a way that is consistent with the UNCITRAL Insolvency Guide.

21 See recommendation 223.

22 See recommendation 248.

23 See recommendation 216.

More concretely, the Insolvency Guide contains extensive discussion and recommendations with regard to the impact of insolvency proceedings on contracts that have not been fully performed by both parties. A licence agreement could fall in that category and the insolvency administrator may continue or reject it in order to maximize the value of the insolvency estate to the benefit of all creditors.[24] The Supplement discusses ways in which the counterparty of the insolvent debtor and secured creditors may protect their interests (of course, in line with the Insolvency Guide).

The Insolvency Guide also discusses at length contractual automatic termination clauses upon the occurrence of an event (such as insolvency) and provides that they should be unenforceable as against the insolvency administrator and the insolvent debtor.[25] The Supplement includes references contained in the Insolvency Guide to systems that uphold automatic termination clauses for creators of intellectual property to be able to control their property, for example, in situations where insolvency may affect not only the value of trademarked goods but also of the trademark itself.

Insolvency of the Licensor

Typically, under insolvency law, where a licensor becomes insolvent, the insolvency administrator may reject any contract that may not have been fully performed by both the insolvent debtor and its counterparty. If a licence agreement falls into that category and the licensor's insolvency administrator rejects it, a licensee and any sub-licensee will lose its rights.

In addition, a secured creditor of the licensor or licensee (or any sub-licensee) will lose its security. In the case of a chain of licensees that have invested in further developing and marketing the licensed products, this result can be catastrophic. To address this problem, the Supplement includes some discussion and makes mild suggestions as to how secured creditors and licensees may be protected by referring to approaches taken in various States.

For example, the secured creditor of the licensor may take a security interest in the intellectual property itself and, if the licensor's insolvency administrator rejects the licence agreement, the licensor's secured creditor may seek to enforce its security right in the intellectual property itself. Of course, as the intellectual property will be part of the estate, the security interest will be subject to the stay and the other limitations imposed in the case of insolvency proceedings (for example, avoidance, preferences).[26]

24 See the Insolvency Guide, recommendations 72 and 73.

25 See The Insolvency Guide, recommendation 71.

26 See Chapter XII of the Guide and the treatment of secured creditors under the Insolvency Guide, Annex I.

Similarly, to protect itself from the consequences of a rejection of the licence agreement by the licensor's insolvency administrator, the licensee's secured creditor may refuse to extend credit to the licensee unless the licensee obtains a security interest in the licensed intellectual property right. In such a case, if the licensor's insolvency administrator rejects the licence agreement, the licensee can enforce its security interest in the licensed intellectual property (subject, of course, to the limitations on the enforcement of security interests imposed by insolvency law).

Some States have introduced legislation to protect investments of licensees in the case of the licensor's insolvency. For example, in some States, a licensee may be given the right to continue to use the licensed intellectual property right even after rejection of the licence agreement by the licensor's insolvency administrator, provided that the licensee continues paying royalties and otherwise performing the licence agreement. This approach balances the interests of the insolvent licensor to avoid burdens under the licence agreement and the interest of the licensee to protect its investment in the licensed intellectual property.

In addition, in other States, licence agreements may not be subject to rejection under insolvency law because:

(a) they are excluded from the list of contracts that may be rejected;

(b) exclusive licences are treated as property rights that are not subject to rejection;

(c) licence agreements are not executory contracts subject to rejection as the licensee has performed its obligation by granting the licence; or

(d) they are registered in the relevant intellectual property registry.

In other States, the licence does not depend on the effectiveness of the underlying licence agreement (according to the so called "abstraction principle"). Thus, the licensee may retain the right to use the licensed intellectual property right at least until the insolvency administrator withdraws the licence based on the principles of unjust enrichment.

Insolvency of the Licensee

If a licensee becomes insolvent and the insolvency administrator decides to continue the licence, the licensee may retain the licence provided that it continues paying royalties as agreed and otherwise performs the licence agreement; and, if the licensor has granted a security interest in its right to payment of royalties, the licensor's secured creditor will continue to have that security interest.

If the licensee's insolvency administrator decides to reject the licence agreement and the licensee has granted a security interest in its rights under the licence agreement, the licence will cease to exist, the licensee will lose its right to use the licensed intellectual property right and the licensee's secured creditor will lose its security. If the licensor has also granted a security interest in its right to payment of royalties, the licensor's secured creditor will also lose its security. The secured creditor of the licensor or the licensee may protect itself by taking measures described above (see section 11.b. on the insolvency of the licensor).

The licensor needs either to receive its royalties and see the licence agreement performed or, at least, to be able to terminate the licence agreement. If the licence agreement is continued and the licensee defaults, the licensor may exercise rights under insolvency law related to curing the default. In addition, if a secured creditor of the insolvent licensee claims and obtains payment of the sub-royalties with which the licensee pays royalties to the licensor, it is important that the licensor has the right to terminate the licence agreement. The Supplement discusses the right of the licensor to seek relief from the insolvency court where there is discontinuation of payment of royalties because of priority given to secured creditors or other relief to protect the intellectual property right.

Conclusions

The Guide and the Supplement are designed to facilitate intellectual property financing, without interfering with intellectual property law. This result is achieved by commentary and recommendations that deal with the creation, third-party effectiveness, priority, enforcement (even within insolvency) of a security interest in intellectual property, as well as with the law applicable to such matters.

The commentary of the Supplement explains how the recommendations of the Guide and the Supplement would apply in the context of an intellectual property financing transaction. They do so in a way that ensures better coordination between secured transactions and intellectual property law. With the same goal in mind, the recommendations of the Supplement modify the general recommendations of the Guide as they apply to security interests in intellectual property.

The integrity of intellectual property law is preserved through a general rule that gives precedence to intellectual property law where it deals in an asset-specific and different way with a matter addressed in the Guide and the Supplement.

The Supplement breaks new ground by introducing a regime of intellectual property acquisition financing that should have a beneficial impact on the availability and cost of credit to intellectual property right holders and licensors of intellectual property, by suggesting ways in which the investment of licensors or licensees in intellectual property may be protected in the case of insolvency and by dealing with applicable law issues in a practical way that is also consistent with intellectual property law.

Chapter 6

Strengthening the Dominance of Main Proceedings: From *Bank Handlowy* to the Revision of the European Insolvency Regulation

Antonio Leandro

Introduction: The Coexistence of Different Insolvency Proceedings: Co-operation between Liquidators for Safeguarding the Purposes of Main Proceedings

It is well known that the European Insolvency Regulation allows for the opening of two kinds of proceedings: the main proceedings, to be opened in the Member State where the debtor has his centre of main interests ("COMI"), and secondary proceedings, to be opened in a Member State where the debtor (whose COMI is in another Member State) has an establishment.[1] Secondary proceedings may even be opened prior to main proceedings, in compliance with Article 3(4): in this case they are properly referred to as "territorial proceedings".

Given that the debtor in principle may have only one COMI and several establishments, the EIR allows for the coexistence, within a cross-border insolvency phenomenon related to the same debtor, of one main proceeding and several secondary proceedings. The main proceedings produce effects throughout the European territory, while the secondary proceedings' effects are restricted to the assets located in the Member State where they are opened.

In view of the efficient administration of the insolvency, the liquidators appointed within main and secondary proceedings (hereinafter, respectively, "main liquidator" and "secondary liquidator") move in compliance with the duty of co-operation which implies the duty to communicate information to each other (Article 21).

Such duties are directly governed by the EIR irrespective of the role, the tasks and the powers the liquidators are given by their "own" *lex concursus*. Indeed, the

1 For a recent characterization of the heads of jurisdiction, see *Interedil* (Case C-396/09) [2011] ECR I-9915, at paragraphs 41 ff. and 64.

liquidators take a distinct position with respect to the co-operation requirement due to the different scope and purposes characterizing main and secondary proceedings as well as to the general aim to "ensure the dominant role of the main proceedings" whenever the secondary ones have been opened:[2] as a matter of fact, the co-operation is based on the dominance of the main liquidator over the other.[3]

Thus, the secondary liquidator is called upon to give the main liquidator an early opportunity to submit proposals on the liquidation or use of the assets in the secondary proceedings (Article 31(3)). The main liquidator may ask the court which has opened the secondary proceedings to stay the process of liquidation in whole or in part if this is in the interest of creditors (Article 33; he may also apply to terminate the stay). He may propose to close the secondary proceedings without liquidation by means of alternative measures provided by the *lex concursus* (Article 34, which specifies that the closure of the secondary proceedings on the grounds of those measures shall become final either with the consent of the main liquidator or else without his consent if the measure at stake does not affect the interest of the creditors in the main proceedings). Lastly, whenever the liquidation in the secondary proceedings satisfies the claim lodged therein, the liquidator shall immediately transfer any remaining assets to the main liquidator (Article 35).

The duty of co-operation being referred to comes out even if the "secondary" proceedings are opened prior to the main proceedings (Article 36). Given that, in such a case, one could not know whether and when the main proceedings will be opened, Article 36 calls for the application of the provisions engendering the "dominance" of the main liquidator to the extent that the progress of the proceedings so permits.

The dominance of the main liquidator also arises clearly out of Article 37 which grants him the power to request the conversion of the territorial proceedings (which in the meantime have become secondary proceedings) into winding-up proceedings if this proves to be in the interest of the creditors whose claim has been lodged in the main proceedings. Such interest especially emerges when the claim has a rank in the proceedings such as to be better satisfied in case of transferring of the remaining assets from the secondary to the main proceedings according to Article 35.[4]

2 Recital no. 19, EIR.

3 See widely M. de Boer and B. Wessels, "The Dominance of Main Insolvency Proceedings under the European Insolvency Regulation", Chapter 8 in P. Omar (ed), *International Insolvency Law: Themes and Perspectives* (2010, Ashgate, Farnham) (185-208).

4 This transferring may occur only after the conversion of the secondary proceedings into winding-up proceedings. Analogous path has to be traced in relation to the measures set out in Articles 33 and 34.

The Amendments of the European Commission's Proposal for Reinforcing the Regime

The European Commission's Proposal for amending the EIR (hereinafter "Proposal")[5] intends to reinforce the role of the main proceedings as specific target of the wider purpose of improving the EIR efficiency in view of:

> "…ensuring a smooth functioning of the internal market and its resilience in economic crises."[6]

The first and foremost means to achieve such objective rests upon the choice *in se* to open the secondary proceedings whenever an insolvency administration is already managed by court and liquidator pertaining to the main proceedings.

It is stressed – as one of the main shortcomings affecting the EIR – how the opening of secondary proceedings "can hamper the efficient administration of the debtor's estate" given that the main liquidator "no longer has control over the assets located" in Member States different from that of the COMI. Furthermore, as above noted, secondary proceedings:

> "…currently have to be winding-up proceedings which constitutes an obstacle to the successful restructuring of a debtor."[7]

To this end, the Proposal logically does not amend the EIR where including the main liquidator among the persons empowered to request the opening of secondary proceedings, whatever the provisions of the *lex concursus* applicable to these latter (Article 29(*a*)).[8] The liquidator will keep discretionary powers in this regard as Article 29 refers to situations in which the opening of secondary proceedings "may be requested".

The liquidator will take into account, above all, whether it is more advantageous in the Member State of the establishment using the powers stemming from the *lex concursus* governing the main proceedings than opening the secondary

5 Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (COM (2012) 744 final), 12 December 2012.

6 Ibid., para. 1.2.

7 Idem. This shortcoming should be evaluated also in the light of the other purpose of introducing both the "pre-insolvency proceedings" (restructuring the debtor at a pre-insolvency stage) and the "hybrid proceedings" (leaving the management in place) in the new Regulation.

8 As examples of secondary proceedings opened at the request of the "main liquidator", see *Automold GmbH* (Amtsgericht Cologne 23 January 2004) [2004] *Zeitschrift für das gesamte Insolvenzrecht*, at 216; *Hettlage* (Landesgericht Innsbruck 11 May 2004) [2005] *Zeitschrift für Insolvenzrecht*, at 223. For views on the usefulness of the opening, see *Procureur de la République* v. *Segard, Rover France, Lomas, Hunt, Pearson* (Cour d'appel de Versailles, 15 December 2005, n. 05/04273).

proceedings therein. For instance, it may prove more fitting removing assets from the territory of that State.

Conversely, opening secondary proceedings therein would be suitable whenever the liquidator intends to liquidate the debtor's assets there located or the administration is so much complex to call for specific proceedings.[9] It seems also appropriate every time there are significant differences from State to State on the grounds of substantive law governing the effects of the proceedings on debtor and third parties.[10] It should be noted that the criteria of opportunity and convenience are placed by the preamble of the EIR at the outset of requesting the opening of secondary proceedings.[11]

Unlike the current regime, the Proposal enables the court of the establishment:

> "…to refuse or to postpone the opening of secondary proceedings if this is not necessary to protect the interest of local creditors."

The Proposal points out the case of an investor making an offer to buy an insolvent company on a "going-concern" basis and the offer appears more advantageous for the creditors than the liquidation of the company's assets.

When dealing with the request of opening filed by persons different from the main liquidator, the court of the establishment shall give notice to the latter and give him the opportunity to be heard before deciding. As a result the liquidator could plead for refusing or postponing the opening, on the one hand, and the court of the establishment will be wholly:

> "…aware of any rescue or reorganization options explored by the liquidator and [will be] able to properly assess the consequences of the opening"

prior to handing down its judgment, on the other.[12]

Such awareness may lead the court either to refuse the opening or to select proceedings different from those of winding-up nature: the envisaged amendment allows for the latter option even after the opening of main proceedings in another

9 The Proposal gives the example of a considerable number of employees to be laid off in the State of the establishment (at paragraph 3.1.3).

10 On the drawbacks triggered by those differences and for the need of an harmonization see, generally, but also as to the legal basis scrutinized, B. Wessels and I. Fletcher, *Harmonization of Insolvency Law in Europe* (2012, Deventer, Kluwer).

11 Recital no. 19, EIR, states that the main liquidator "may request the opening [...] when the efficient administration of the estate so requires."

12 Proposal, at paragraph 3.1.3.

Member State as opposite to the current regime allowing for it only beforehand (i.e. in case of territorial proceedings).[13] Elements such as the continuity between the rescue or restructuring carried out within the main proceedings (whose features the court of the establishment should be aware of after hearing the liquidator) and the secondary proceedings could suggest avoiding a winding-up system which may hinder the efficient management of the insolvency in the State of the establishment.

In line with the new and broaden role in evaluating whether and to what extent secondary proceedings might affect the centralized rescue or the administration of the insolvency, the Proposal enables the main liquidator to challenge the decision opening them (new Article 29(a)(4)).

The Proposal provides also that the liquidator gives the local creditors the undertaking:

> "…that the distribution and priority rights which [they] would have had if secondary proceedings had been opened will be respected in the main proceedings" (new Article 18(1)).

This undertaking should remove the local creditors' alarm of seeing themselves deprived of the interests and rights based on the local *lex concursus* by the opening of the sole main proceedings and by the applicability of the COMI's *lex concursus*. In other words, the Proposal introduces a sort of substantive rule according to which the main proceedings court should also apply the *lex concursus* of the Members States in which the establishments are located:[14] a new uniform rule applicable regardless of national provisions enabling the court to do so.

Assuming that secondary proceedings have been opened, the Proposal improves the coordination with the main ones by extending the co-operation requirement – as above said binding at present only the liquidators – to the courts involved (new Articles 31(a) and 31(b)):[15] every time all the proceedings opened aim at

13 Idem.

14 The Proposal takes inspiration from a practice followed in certain English *administrations* concerning group of companies. See e.g. *Collins & Aikman* [2006] EWHC 1343 (Ch). The English Court applied an *equitable principle* by virtue of which "if an officer of the Court is under an obligation of conscience, then the Court will direct the officer to fulfil that obligation." The *obligation of conscience* would arise for the administrators in relation to the local creditors' expectation to enjoy of their rights, interests and ranking laid down by the local *lex concursus* even though secondary proceedings were not open. As a result, the distribution decision in *Collins & Aikman* suggests a "model for the way to harmonize the need for centralization and simplicity, on the one hand, and the respecting of local priorities, on the other": G. Moss, "Group Insolvency – Choice of *Forum* and Law: the European Experience under the Influence of English Pragmatism" (2007) 32 *Brooklyn Journal of International Law* 1005, at 1018.

15 The European Economic and Social Committee marked the fact that a) secondary proceedings need not to be necessarily of winding-up nature; b) their opening may be refused; c) the interaction between main and secondary proceedings is extended to the courts as help to improve the regulation: see the opinion on the Proposal, at paragraph 5.4 (OJ 2013 C 271/55).

restructuring the debtor, such new co-operation could prop up efficient rescue plans by way of shared protocols.

Principles upheld by the ECJ for Preserving the Role of Main Proceedings: The *Bank Handlowy* Judgment

For the time being one cannot predict whether the amendments referred to will reach the final text of the new EIR.

Be that as it may, ECJ addressed the "main proceedings-reinforcing" issue in the *Bank Handlowy* judgment in such a way as to bring forward a sort of EIR reform as far as the coordination between main and secondary proceedings is concerned.[16] Actually such "reform" – if not well appraised as noted below – may engender certain problems in terms of certainty of law.

The preliminary ruling referred to the ECJ concerned the questionable coexistence of protective main proceedings (namely, a *procédure de sauvegarde*) and winding-up secondary proceedings with respect to the same debtor, a company governed by the Polish law. The main proceedings had been opened in France – where the court found the company's COMI – while the opening of the secondary proceedings was subsequently requested in Poland. After having deemed that the company was not in a situation calling for the cessation of payments and that it would have fallen into such situation without a prompt financial restructuring, the French court decided to open the *sauvegarde* proceedings. Afterward, it approved a rescue plan, appointed a *commissaire* for overseeing the execution thereof and enjoined the disposal of the debtor's assets.

In the meantime, a creditor filed before Polish courts an application to open a winding-up secondary proceeding. The debtor contended that the application was at odds with the objectives and nature of the main proceedings; subsequently to the approval of the rescue plan, the debtor also requested that secondary proceedings should have been discontinued alleging the closure of the main proceedings. Furthermore, the scheme of payment arisen from the rescue plan was being implemented.

The Polish court held to refer certain questions to the ECJ before ruling on the request. The questions in short addressed the characterization of the term "closure of insolvency proceedings", the examination of the insolvency of a debtor in respect of whom main insolvency proceedings have been previously opened in

16 *Bank Handlowy w Warszawie SA v Christianapol sp. z o.o.* (Case C-116/11) [2012].

another Member State and whether winding-up secondary proceedings might be opened notwithstanding both the previous opening of protective main proceedings and the fact that the measures related to (namely those preventing from disposing of the debtor's assets) already produced effects throughout the European territory pursuant to the principle of automatic recognition.

All the questions referred to the ECJ were strictly closed with each other. Nevertheless, that concerning the rapport between main and secondary proceedings deserves attention for the present chapter. In this regard, the ECJ's view may be resumed as it follows. The ECJ emphasized:

> "…that the Regulation provides for a certain number of mandatory rules of coordination intended to ensure [...] the need for unity in the Community."

Accordingly, it stressed that:

> "…main proceedings have a dominant role in relation to the secondary proceedings."[17]

If it is true that Article 27 allows for the opening of secondary proceedings irrespective of the nature and scope of the main proceedings, the Court held that this rule must be applied in compliance with the principle of sincere cooperation laid down in Article 4(3) of the EU Treaty. In particular, such principle requests the court having jurisdiction to open secondary proceedings, in applying the provisions concerning the opening and the coordination with the main proceedings:

> "[...] to have regard to the objectives of [the latter] and to take account of the scheme of the Regulation, which [...] aims to ensure efficient and effective cross-border insolvency proceedings through mandatory coordination of the main and secondary proceedings guaranteeing the priority of the main proceedings".[18]

The Ineptitude of the Current Regime to sustain a Condition for Opening Secondary Proceedings associated to the Nature and Purposes of Main Proceedings

Although the EIR permits the opening of secondary proceedings even if the main proceedings have a protective purpose,[19] *Bank Handlowy* judgment appears to set

17 Ibid., at paragraph 60.
18 Ibid., at paragraph 62f.
19 Ibid., at paragraph 57.

out certain uniform and autonomous grounds for accepting or refusing a request of opening secondary proceedings having regard to the main proceedings' features.

As a matter of fact, if the court having jurisdiction to open secondary proceedings has to take into account the objectives of the main proceedings and the scheme of the Regulation concerning the coordination between the different proceedings, in keeping with the principle of sincere co-operation, then it is logical to conclude that the same court should comply with those duties when assessing whether the opening *in se* of secondary proceedings is the appropriate decision.

Undoubtedly, given that the principle of sincere co-operation requests the court of the establishment to pay strong attention on the main proceedings' role, function, objectives and features in view of the efficient administration of the debtor's estate, it is naturally applicable once the two proceedings have been opened as guideline for the correct coordination between them.

Nonetheless such reasoning would lead to a paradox: the principle of sincere co-operation, as general principle of European Union law, would not be relevant at the crucial moment of deciding whether or not opening the secondary proceedings: in other words, it would be irrelevant when the first and foremost danger for the efficient insolvency administration the main proceedings aims at (i.e. the opening of secondary proceedings) comes up. This danger, as noted, is more appraisable whenever the main proceedings have protective and restructuring purposes taking into account that currently the secondary proceedings might reach only for winding-up purposes.

Moreover, the ECJ stressed that EIR «permits» the opening of secondary proceedings. This surely reveals that the court of the establishment is not bound to take account of the main proceedings' features when deciding to open or not to open the secondary proceedings. However this may also reveal that the opening could be refused even though the conditions for opening set forth by the *lex concursus* of the Member State of the establishment are fulfilled. Such possibility would encounter *inter alia* the exigency not to thwart the main proceedings' purposes especially when the request is lodged by persons not aware of them (such as the local creditors).

Given that we are concerned with the scheme in which main and secondary proceedings should be coordinated for the adequate administration of a cross-border insolvency falling into EIR, declining the request to open secondary proceedings also would be useful to achieve the *effet utile* of the EIR having regard again to the efficiency of the insolvency administration: *effet utile* to which – as well known – ECJ constantly pays attention as general approach followed when interpreting or "filling in the gaps" of the EIR.[20]

Indeed, from a different standpoint, the evaluation of the main proceedings' features and its dominance within the general framework of the insolvency administration at the outset of the decision concerning the opening of secondary proceedings would end up amounting to a new "condition for the opening". The court should carry out such evaluation when ascertaining need and opportunity underlying the opening of secondary proceedings.

So conceived, this condition would couple with other conditions having autonomous and uniform nature, i.e. a nature not depending on references to the law of the Member State such as the evaluation of local creditors' interests:[21] the court must take into account them when deciding whether to open the proceedings.[22] Analogous nature distinguishes by virtue of Article 27 the "debtor's insolvency" examined by the court of the main proceedings: this time, the secondary proceedings court should rely upon the examination done by the former.[23]

All these uniform conditions derogate the general rule laid down by the combination of Articles 4 and 28 according to which the conditions for opening the proceedings (irrespective of whether they are main or secondary) are determined by the *lex concursus* in conformity with the EIR's scope not related to substantive profiles of insolvency proceedings.[24]

That being said, if the autonomous and uniform nature of a condition for opening secondary proceedings would defend the uniform application of EIR regime within the European Judicial Space from the divergences among national laws and the

20 E.g. see *Christopher Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] ECR I-767 and, by this author, "*Effet utile* of the Regulation No. 1346 and *Vis Attractiva Concursus*: Some Remarks on the *Deko Marty* Judgment" (2009) *Yearbook of Private International Law* 469. See also S. Bariatti, "Filling in the Gaps of EC Conflicts of Laws Instruments: The Case of Jurisdiction over Actions Related to Insolvency Proceedings", in G. Venturini and S. Bariatti (eds), *New Instruments on Private International Law. Liber Fausto Pocar* (2009, Giuffré, Milan) (23-38).

21 *Bank Handlowy*, above note 16, at paragraph 58; Proposal, at Article 29(a).

22 See the amendment suggested in the Proposal, at Article 29(a)(2).

23 *Bank Handlowy,* above note 16, at paragraph 64 ff. It is noteworthy that in the ECJ's estimation the Polish court could not have ruled on the company's insolvency in the instant case notwithstanding the French court, because the *procédure de sauvegarde* does not need the debtor being insolvent, had not ruled on the issue. As for the Proposal, Article 29(a)(3) provides that the court of the establishment should decide what is the most appropriate proceedings "irrespective of whether any condition relating to the debtor's solvency are fulfilled."

24 The applicability of national laws permeates the EIR. ECJ stressed that when answering the question concerning the meaning of «closure of proceedings» and excluding an autonomous and uniform concept thereof: *Bank Handlowy*, above note 16, at paragraph 46 ff. The Court reminded that the principle whereby provisions of European Union law "must be given an autonomous and uniform interpretation, having regard to the context of the provision and the objective pursued by the legislation, holds true only for those provisions which make no express reference to the law of the Member State for the purpose of determining their meaning and scope" (at paragraph 49).

appraisal of the main proceedings would sustain the *effet utile* of the EIR, it cannot overlooked how the court requested to open secondary proceedings would be provide with a discretionary power when ascertaining:

(a) the main proceedings' features;

(b) the need and opportunity to open secondary proceedings; and

(c) the real interests of local creditors.

This raises the issue of whether such a discretionary power complies with (or affects) the legal certainty and the foreseeability of the law with regard to the opening of secondary proceedings.

Putting for a moment aside the objectives of main proceedings and the main liquidator's position, it is unquestionable that local creditors request the opening of secondary proceedings *merely* relying both on the head of jurisdiction provided by Article 3 of EIR and the conditions for opening (as well as the ranking of their claims) provided by the *lex concursus* of the Member State where the debtor has an establishment. It's worth noting that the same ECJ has weighed the secondary proceedings' aim to protect local interests with the other purposes which it serves, in coordination with the main proceedings, for an efficient administration of the estate.[25]

Nor have to be underestimated the problems related to the publicity of insolvency proceedings which amount to another shortcoming of the current regime according to the Proposal. In particular, given that it does not exist an European Insolvency Register, nor a mandatory rule as to the publication or registration of the decisions opening the proceedings, it may be that creditors and third parties are not aware that main proceedings have commenced (problem which *inter alia* prevent a creditor from lodging the claims) as well as of the objectives and nature thereof.

Concluding Remarks: The Necessity of achieving the Proposal Amendments for Balancing Efficiency and Certainty without Clouding the Role of Main Proceedings

As it currently stands, even after the *Bank Handlowy* judgment, EIR lacks devices for well balancing the aim of strengthen the efficiency of the main proceedings when a request for opening secondary proceedings is submitted by local creditors, on the one hand, with the interest of these latter to rely on as much clear and

25 Ibid., at paragraph 58.

predictable as possible grounds for seeing granted or rejected their request of opening, on the other. This gap comes into light in case of request subsequent to the opening of main proceedings.

Therefore, it is to be supported the Proposal where granting main liquidator the opportunity to be heard on said requests because he could explain why, in view of the efficient administration of the insolvency, the opening should be refused or postponed notwithstanding the conditions for opening set forth by the *lex concursus* are fulfilled in the instant case.

Moreover, the option of centralizing the insolvency administration in the main proceedings would be more attractive and persuasive for the creditors than the opening of secondary proceedings as a result of the undertakings given by the main liquidator according to new Article 18(1): they may trust the applicability of local *lex concursus* (the one pertaining to the Member State of the establishment) and hence the ranking (and priorities) determined by it despite that the determination of the claims and the distribution of the assets will occur within the sole main proceedings.

That is to say that the amendments concerning the liquidator's hearing (new Article 29(a)) and undertakings (new Article 18(1)) seem suitable means to compromise the certainty of the law and the local creditors' interests with the fact that an efficient cross-border insolvency administration undeniably should have its core in the main proceedings.

Chapter 7

Upstreaming Rescue: Pre-Insolvency Proceedings and the European Insolvency Regulation

Paul Omar

Introduction[1]

The concept of upstream rescue entered the vocabulary of the insolvency practitioner sometime in the 1980s. The simple idea is that rescue of the entity or its business should occur at a point much earlier than the moment in time it becomes susceptible to the formal procedures of insolvency, for which it would normally qualify by entering into a state of insolvency. This would tend to occur when the debtor ceased to be able to make payments to its creditors and meet those liabilities, which, once contingent and possibly unquantified, were now certain and had fallen due.[2] Rescue itself is a concept that first came to prominence in the 1970s with the enactment of Chapter 11 of the United States Bankruptcy Code in 1978 ("Chapter 11"), although disputes as to who may have "invented" rescue exist making claims to its earlier discovery.[3] In that light, although the European Insolvency Regulation ("EIR"),[4] which was adopted in 2000, makes provision for rescue-type proceedings, it does not mention their upstream versions, often referred to as "pre-insolvency proceedings". Since the EIR came into force, however, changes in the domestic law of member states have meant that pre-insolvency proceedings have now become the norm in many jurisdictions. In the light of recent proposals for amendments to the EIR, this article looks at how developments in domestic law and the rise of the pre-insolvency procedure have become integrated within the proposed changes to the text.

1 This chapter has also been published, under the same title, at [2014] 1 *International Company and Commercial Law Review* 14.

2 This is true in France, where the concept of "*cessation de paiements*" (cessation of payments) governs access to the procedures of *redressement judiciaire* (judicial rescue) and *liquidation judiciaire* (judicial liquidation), but not in the United Kingdom, where only entry to winding up is associated with formal insolvency being demonstrated. The former approach is more common in European insolvency laws.

3 A 1906 Qin Dynasty law in China, the South African judicial management procedure in the Companies Act 46 of 1926 and the French procedure of *règlement judiciaire* (judicial settlement), which appeared in the Decree-Law of 20 May 1955, are all championed as possible first attempts at a rescue law.

4 Council Regulation (EC) No. 1346/2000 of 29 May 2000. References below to Articles and Annexes of a regulation are to this regulation, unless otherwise stated.

Pre-Insolvency Procedures and the EIR: At the Beginning

One of the reasons for the initial exclusion from the EIR of pre-insolvency procedures was perhaps simply that not all of the European Union member states to which the text would apply possessed such procedures, albeit instances are known from an early date.[5] As such, the scope of the EIR was (probably deliberately) limited to those procedures that fell within the ambit of formal insolvency proceedings, with the definition in the text only mentioning:

> "collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator".[6]

Further guidance on what procedures would fall within this definition is provided in the Preamble, where the exclusion of:

> "insolvency proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings"

from the Brussels Convention 1968,[7] is referred to and which can be taken to mean the more formal procedures in existence in the laws of member states, whether these are liquidation or rescue in orientation. It could also be the case that, since the EIR, which itself is a by-product of the work that engendered the Brussels Convention 1968, took such a long time to be adopted,[8] the European authorities were not going to revisit its scope for fear that further delays would be introduced into the process. For whatever reason, the procedures that were mentioned in Annex A, the definitive list of what constituted a collective proceeding that fell within the scope of Article 1(1), contained mostly formal rescue and liquidation procedures. Indeed, despite their increased popularity by the time the EIR was adopted, the text took no account of the development in national laws of pre-insolvency procedures.[9]

5 In France, *règlement amiable* (amicable settlement), later retitled *conciliation*, was introduced in Law no. 84-148 of 1 March 1984. In the United Kingdom, corporate voluntary arrangements, modelled on the scheme of arrangements in company law, was treated as a formal rescue procedure by inclusion in Part I of the Insolvency Act 1986, although it shares similarities with the French procedure and could be described as "pre-insolvency" in nature.

6 Article 1(1), EIR.

7 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters 1968. This text has since been readopted in regulation form as Council Regulation (EC) No. 44/2001 of 22 December 2000 ("Brussels I Regulation"), itself recently revised and amended by *Regulation (EU) No. 1215/2012* of 12 December 2012.

8 An earlier attempt in the form of the European Bankruptcy Convention 1995 failed to come into force because the United Kingdom, for political reasons, did not adhere to the text during the period for which it was open for signature.

9 Hence the omission of French *règlement amiable* from Annex A, which only contained *redressement judiciaire* and *liquidation judiciaire*.

In fact, in the Virgos-Schmit Report,[10] the major debate referred to was that on inclusion of reorganisation in a paradigm, which was originally intended only to encompass winding up proceedings.[11] The maintenance of the requirement for partial or total divestment of the debtor, however, appears to rule out any rescue variant of the debtor-in-possession type. Nonetheless, there is a reference to the possibility that procedures are used both in an insolvency and non-insolvency context,[12] in which case only the insolvency aspect would be included within the scope of the text. This would require courts, when opening proceedings, to attach an "identification label" determining the grounds on which proceedings were based so as to attract (or not) the application of the text.[13] But of pre-insolvency proceedings, there is no mention. They are just not on the radar in the mid-1990s.

Changes in Domestic Laws and the Rise of New Forms of Rescue: Pre-Insolvency Processes and the Pre-Pack

In the period since the adoption of the EIR, however, pre-insolvency procedures have become more common. In some respects, their use may be described as having become "institutionalised" in the laws of many of the European Union's member states. In much the same way, debtor-in-possession type procedures, of which Chapter 11 is a prime example, have become more popular and, though not widespread in practice, have even been adopted in some national laws.[14] A further change in some countries has seen the introduction of the practice of the "pre-pack", the idea being to enable the combination of business or asset sales with the desirable effects of upstream rescue by confining formal processes to the end point

10 This report was written to accompany the European Bankruptcy Convention 1995 as a guide to its interpretation and has since been used to cast light on the contents of the EIR, which it resembles, most notably in the seminal case on jurisdiction of *Eurofood IFSC Limited* (Case C341/04) [2006] BCC 397.

11 Virgos-Schmit Report, at paragraph 51.

12 So-called "hybrid" procedures, such as schemes of arrangement, which have acquired a use in the near-insolvency context, as seen in *Re Drax Holdings Ltd; Re Inpower Ltd* [2004] 1 BCLC 10. This is the sense in which this report and the United Kingdom's later response to the European Commission reform proposals use the term, although, curiously, in the Vienna-Heidelberg Report (below note 35) and some of the European documentation noted later, the term seems to be used to describe (additionally) debtor-in-possession procedures associated with rescue. Whether this makes a real difference to how the changes towards a greater emphasis on non-traditional insolvency procedures (i.e. those not strictly rescue or liquidation following entry into an insolvent state) may be understood is doubtful.

13 Virgos-Schmit Report, at paragraph 49(b). This may explain the mention in Annex A for the United Kingdom of "voluntary arrangements under insolvency legislation" so as to distinguish the corporate voluntary arrangement from the equivalent scheme in company law, thus avoiding the labelling becoming necessary.

14 The United Kingdom has seemingly always preferred a practitioner-in-possession model, whether appointments are made by the company, the creditors or the courts, while the French, in adopting *sauvegarde* (preservation) in Law no. 2005-845 of 26 July 2005, have brought in a partial debtor-in-possession model.

of negotiations taking place *sub rosa*, principally to avoid reputational damage and potential loss of value and trading partners.[15]

Even the concept of rescue itself is being revisited, what with the way in which Chapter 11 is used seeing more and more resort to "[section] 363 sales" as the preferred option for disposal of the business or of substantial assets with a "stalking horse" used to benchmark the value to be achieved through the auction process. In the United Kingdom, the "enhanced liquidation" function of administration, present from the very beginning in the law,[16] has been seen more and more in use. In Canada, there is also the modern phenomenon of the "liquidating CCAAs",[17] which use a statute designed for reorganisation to carry out a sales plan (of the business or of a group of assets) that has the same effect as liquidation. The encapsulation of many of these developments within the framework of the EIR is only imaginable with some difficulty.[18] As such, the opportunity offered by the review of the EIR, mandated by Article 46 of the text, has enabled consideration of, amongst other things, whether the scope of the text should be extended, in particular so as to include pre-insolvency procedures currently outside its scope.

The EIR Reform Initiative: Moving the Debate from Procedural to Substantive Harmonisation

Ideas for reforming the EIR are almost as old as the text itself. Many of these looked to improving the workings of the text as it stood. For example, a paper by Moss and Paulus dealt with the centre of main interests ("COMI") definition, forum shopping avoidance, the need for a framework for court-to-court communications as well as a central register of insolvency judgments, accompanied by publication through an official website. They also questioned whether a special regime or default presumption for corporate groups should be created as well as the artificiality of the limitation in the case of secondary proceedings to winding up procedures.[19] In

15 The pre-pack was adopted in France in 2010 as the *sauvegarde financière accélérée* (accelerated financial preservation) procedure. In the United Kingdom, its conduct is subject to the Statement of Insolvency Practice No. 16, issued by the Joint Insolvency Committee, on which the professional bodies and the Insolvency Service are represented.

16 Paragraph (d) of old section 8 and, following the Enterprise Act 2002 reforms, paragraph (c) of Rule 3, Schedule B1, Insolvency Act 1986.

17 See J. Girgis, Corporate Reorganisation and the Economic Theory of the Firm, Chapter 8 in B. Wessels and P. Omar (eds), Insolvency and Groups of Companies (2011, INSOL Europe, Nottingham), at 108-9.

18 In fact, the legitimacy of France's inclusion of *sauvegarde* in Annex A was raised in *Bank Handlowy w Warszawie SA and another v Christianapol sp. z o.o.* (C-116/11) [2012] All ER (D) 300 (Nov). The court declined to question matters, holding, at paragraph 35, that the inclusion in Annex A was determinative of the fact that the procedure fell within the scope of the EIR.

19 See G. Moss and C. Paulus, The European Insolvency Regulation – The Case for Urgent Reform (2006) 19 *Insolvency Intelligence* 1.

responding to the Moss and Paulus piece, this author has recommended revisiting priorities and public policy issues, reviewing the cooperation paradigm in light of the use of anti-proliferation techniques (particularly through COMI-manipulation and the use of "synthetic secondaries"[20]) and assessing the articulation of the EIR with other international instruments such as the UNCITRAL Model Law on Cross-Border Insolvency 1997 ("Model Law").[21]

A later report by INSOL Europe,[22] presented to the European Parliament's Committee on Legal Affairs, made the case that the structure of the EIR encouraged forum-shopping and "bankruptcy tourism", thus impeding successful re-organisations. The report advocated consideration of substantive harmonisation, including in the areas of opening criteria for proceedings, stays of creditor action, procedural management rules, ranking and priority rules, the filing and verification of claims, responsibility for the rescue plan, scope and extent of the debtor's estate, avoidance actions, contract termination or continuation, director's liability, post-commencement financing availability, insolvency practice qualifications, provision of a database of judgments, scope of the European Insolvency Regulation itself as well as the co-ordination of proceedings involving corporate groups.[23]

While many of the above issues have subsequently made it into consideration during the reform initiative, the observation may be made that the focus of the suggestions has been almost overwhelmingly procedural. Given the procedural ambition of the EIR itself, this should not be surprising. What might be surprising is that the candidacy of pre-insolvency proceedings for inclusion within the scope of the EIR only emerges late following a discussion included within a response to the INSOL Europe report noted above. A report produced by the European Parliament towards the end of 2011 made a number of recommendations echoing the contents of the INSOL Europe report. It also appeared to initiate a debate in relation to the scope of the text by expressly referring to the desirability of including proceedings in which the debtor remains in possession or where a "preliminary liquidator" is appointed within the EIR. Amendments to Annex A would also need to be made in

20 A synthetic secondary occurs, as in the case of *Re Collins & Aikman Europe SA and others* [2006] EWHC 1343 (Ch), where the office-holders promise to respect the priorities the creditors would have had (had secondary proceedings been opened) in a bid to forestall precisely the proliferation of proceedings that could prevent a rescue synergy from developing.

21 See, by this author, Addressing the Reform of the European Insolvency Regulation: Wishlists or Fancies? (2007) 20 *Insolvency Intelligence* 7.

22 INSOL Europe is a Europe-wide body regrouping insolvency practitioners, academics and judges and is active in, *inter alia*, the development of best practice guidelines such as the European Communication and Co-operation Guidelines for Cross-Border Insolvency 2006.

23 See INSOL Europe, Harmonisation of Insolvency Law at EU Level (April 2010), copy available via the INSOL-Europe website at: http://www.insol-europe.org/download/file/2492 [last viewed 23 May 2013].

consequence of this recommendation.[24] The rationale for this is articulated, albeit obliquely, in the preamble, where reference to the phenomenon of "regulatory arbitrage" is made and by reason of which forum-shopping naturally arises, but is to be discouraged.[25] In light of the "progressive convergence" of member state laws,[26] a greater focus on rescue is noted in the approach to insolvency matters generally.[27] This is taken to be authority in the appended explanatory memorandum for recommending the inclusion of debtor-in-possession procedures within the EIR's scope so as to permit such a debtor a range of "mechanisms to restructure its business".[28] Although not explicitly referred to as such, it seems that opening up the discussion as to the scope has brought into consideration the place of pre-insolvency proceedings. It is certainly true that most of the documentation later in this process refers openly to the (by then) accepted wisdom that pre-insolvency procedures should be included within the text.

Despite the steps taken above, the initiative to reform the EIR, although mandated to be completed by 1 June 2012, overran that deadline and is unlikely to be completed till 2014. The intention appears to be that the process be concluded so as to avoid the European Parliamentary elections scheduled for that year, but it is entirely possible that work will continue after the elections and that a definitive text will not be ready to be adopted till late that year. In any event, it is unlikely to come into force till sometime in 2015-2016, depending on when it is ultimately adopted. The analysis that follows will take a view, in the sequence the documents being reviewed were issued, on the proposals they contained with respect to pre-insolvency proceedings.

(i) The Practitioners' View on Pre-Insolvency Proceedings: The INSOL Europe Report (June 2012)

Following up its earlier report to the European Parliament, INSOL Europe produced a lengthy exposition of its views in a text published in June 2012.[29] The text shares the view on the desirability of including pre-insolvency proceedings. As such, amendments would be made to the scope of the text under Article 1(1) to include "collective rescue, reorganisation and insolvency proceedings, conducted

24 See K-H. Lehne (Rapporteur), Report with Recommendations to the Commission on Insolvency proceedings in the context of EU Company Law (Document A7-0355/2011) (17 October 2011), at 11 (paragraph 2.1).

25 Ibid., at 3 (Preamble Clauses A-B).

26 Idem (Preamble Clause D).

27 Ibid., at 4 (Preamble Clause I).

28 Ibid., at 17.

29 See R. van Galen *et al.*, *Revision of the European Insolvency Regulation: Proposals by INSOL Europe* (2012, INSOL Europe, Nottingham).

under the supervision of a court", where the debtor is either unable to pay their debts or is likely to be unable to do so in the "foreseeable future".[30] The rationale is given as follows. As related directives on credit institutions and insurance companies have done so, there is no reason why the term collective proceedings should not also refer to rescue or reorganisation.[31] As a consequence, the criterion of insolvency will need to be adjusted to reflect this and to also ensure that there continues to be a clear delineation between the purviews of the EIR and the Brussels I Regulation. Care would also need to be taken to ensure that no procedures were left out of either text or, more problematically, would fall within the scope of both instruments.[32] The liquidity test most commonly used in European insolvency laws would serve to achieve this, while providing for an element of futurity would enable the inclusion of pre-insolvency proceedings.[33] At present, the text recites, these proceedings are not found in the annexes either because the member state concerned has not availed itself of the possibility of having the annexes amended or the procedures would not comply with the definition as it stood. While, at the time the EIR was first drafted, there may have been reasons why pre-insolvency proceedings were excluded from its scope, overall, the view is now taken that there is no longer any "overriding reason" why the exclusion should be maintained.[34]

(ii) The Academics' View on Embedding Pre-Insolvency Procedures within the Reform Initiative: The Vienna-Heidelberg Report (November 2012)

As part of the reform process, a study was commissioned from a consortium, jointly led by the Universities of Vienna and Heidelberg, which entailed an exhaustive survey of domestic laws and the production of national reports, on which the external evaluation was ultimately based. The evaluation produced by the consortium reported stakeholder views that national laws had evolved in the direction of restructuring and the avoidance of formal insolvency proceedings. As such, the orientation of many national laws in the decade prior was towards offering the debtor a fresh start. Consequently, there was a need to amend the EIR so as to include pre-insolvency and "hybrid" proceedings.[35] The reason for the need is stated to be the potential incompatibility between the development of these proceedings, which had been

30 Ibid., at 25.

31 Ibid. at 26 (paragraph 1.2).

32 Ibid., at 27 (paragraph 1.3).

33 Idem (paragraph 1.4).

34 Ibid., at 28 (paragraph 1.5).

35 See B. Hess *et al.*, External Evaluation of Regulation No. 1346/2000/EC on Insolvency Proceedings (Document no. JUST2011/JCIV/PR/0049/A4), at 10 (paragraph 2.2.1). The general lack of fresh start options was noted in an earlier report commissioned by the European Commission titled "Best Project on Restructuring, Bankruptcy and a Fresh Start" (September 2003), suggesting that a coherent approach to fresh starts did not become universally accepted until towards the end of the first decade of the Millennium.

adopted in a substantial number of member states, with the definition of those insolvency proceedings that could fall within the text.[36] Three specific problems are adverted to: firstly, the absence of mention in Annex A of these proceedings and consequent difficulties in terms of their recognition in other member states; second, the articulation of Anne A with the definition in Article 1(1), which creates two issues, namely whether the EIR can apply to a procedure not within the annex but nonetheless complying with the definition and, its opposite, whether a procedure in the annex, although not strictly complying with the insolvency definition, could fall within and utilise the framework provided by the text.[37] A related problem is the fact of amendments by national authorities of procedures within the annexes, but which may not be notified for inclusion to the European Commission. This leads to a problem with respect to whether the EIR should apply to these procedures.[38]

In this light, the formal recommendations of the evaluation are two-fold. First, the definition in Article 1(1) should be amended so as to encompass pre-insolvency rescue or reorganisation procedures within the scope of those insolvency proceedings subject to the text. Nonetheless, some conditions should apply, notably that the type of proceedings should involve only those debtors in grave financial difficulties and must be collective in nature as well as subject to the supervision of a court. As such, the EIR would be adapted to recent legal developments and enable the coordination of restructuring proceedings of this type by their inclusion within the framework of the text.[39] With a view to a proper coordination between the definition and proceedings noted in Annex A, the evaluation suggests the option of providing that the Article 1(1) definition should prevail over the inclusion (or otherwise) of a proceeding in Annex A. Moreover, an explicit statement should be included within the Article 2 reference to tie the definition of insolvency proceedings to the annex. Furthermore, the procedure for amending the annexes should be improved by giving the European Commission a delegated power to amend the annexes, at the initiative, of course, of the member state(s) concerned. However, perhaps more

36 Ibid., at 10-11 (paragraph 2.2.1.1), footnoting the existence of such procedures in Austria, Belgium, Estonia, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Malta, the Netherlands, Poland, Romania, Spain, Sweden and the United Kingdom. A detailed list appears at 14-15 (paragraph 2.3).

37 An example of the second situation is the *Bank Handlowy* case already referred to (above note 18).

38 Another problem related to this last issue is that, even where procedures are notified to the European Commission, it takes on average 18 months for the legislative process to secure an amendment to the annexes. The relative inefficiency of this process may preclude swift adaptation to changing circumstances at national level.

39 Hess *et al.*, above note 35, at 13 (paragraph 2.2.2.1). The associated footnote suggests that supervision by a court would include the approval of an arrangement between the debtor and creditors at the end of the insolvency process, but that negotiations with a view to reorganising debts could not of themselves be a bar to concurrent proceedings being opened in another member state, given that there is no formal opening of proceedings at the beginning of this process. While this caveat might affect the pre-pack, schemes of arrangement do feature an initial court order and would fall within the scope of these recommendations, as in fact the evaluation envisages by their being listed within the procedures enumerated at 14-15 (paragraph 2.3).

controversially, the evaluation suggests that the European Commission should also have a control power to determine whether the inclusion or exclusion of procedures by member states is warranted, with any disputes between any diverging points of view being resolved by the European Court of Justice.[40]

(iii) The Legislators' View and Reponses to the Recommendations: The European Commission's Perspective (December 2012)

Against the background of the Vienna-Heidelberg evaluation, it is not perhaps surprising that the recommendations of the European Commission, which appear towards the end of 2012,[41] should reflect many of its views, although there are still significant differences in opinion on some issues. The major thrust of the proposals here is to revise the definition in Article 1(1) so as to extend the scope of the EIR to out-of-court proceedings and debtor-in-possession proceedings, provided that these remain under the supervision of a court.[42] An express reference will be included to procedures whose purpose is rescue and/or the adjustment of debts, in order to encompass those proceedings that take place at the pre-insolvency stage, and so that these procedures may benefit from the recognition framework that the EIR creates. An interesting reference is also made to the need to ensure that the EIR framework comes more into line with the approach taken in the Model Law.

Despite the stated importance of ensuring the "efficient conduct" of pre-insolvency and "hybrid" proceedings by their inclusion within the EIR framework,[43] however, there is also a conscious reflection of a perceived need to avoid the inclusion of procedures that are deemed confidential in nature. The amendment proposal notes the existence of this new type of procedure in a number of member states, described as refinancing or reorganisation arrangements with certain creditors without information being made public, but with a "moratorium"-type "breathing space" being offered to debtors. However, its view is that the confidential nature of negotiations with view to developing a contractual solution to the debtor's problems may preclude the possibility of other creditors, including potentially creditors in other jurisdictions, discovering the pending nature of such proceedings until such time as they become public, when they may well involve a more formal procedure

40 Ibid., at 13-14 (paragraph 2.2.2.2).

41 The European Commission produced a set of documents including an Impact Assessment, an Executive Summary of the same, both accompanying a Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on insolvency proceedings. These will be referred to below as, respectively, the "Impact Assessment", "Executive Summary" and "Amendment Proposal".

42 Amendment Proposal, at 5 (paragraph 3.1.2).

43 Ibid., at 4 (paragraph 2), which does refer nonetheless to the lack of a consensus among stakeholders consulted for the production of the evaluation report on what procedures should be included under the headings of "pre-insolvency" and "hybrid" or on where court supervision should be required in each case.

that would attract the application of the EIR. Of interest in the amendment proposal is the explicit mention of no change being necessary to the notification procedure by which procedures are included in Annex A, but which will be tempered by making an oversight role available to the European Commission to scrutinise the compliance of any notified procedures with the EIR definition (as revised).[44]

As such, the text of the EIR itself is to be amended in the following way, which incidentally also complies with the subsidiarity and proportionality principles that govern the basis on which the European institutions have jurisdiction to act to amend the text.[45] The preamble to the amending regulation will have a clause that states explicitly the desirability of extending the scope of the EIR to procedures that "promote the rescue of an economically-viable debtor" so as to allow for the survival of what are termed "sound companies" and also to further the fresh start (or "second chance") initiative.[46] Subject to explicit mention are those procedures that allow for restructuring at the pre-insolvency stage and those leaving the management in place.[47] Much of the content of the preamble, echoing also the summary in the Amendment Proposal, will be served by the introduction of a new preamble clause into the EIR, which provides the rationale for the extension to the scope by the inclusion of pre-insolvency and debtor-in-possession proceedings. "Rescue" and "fresh starts" are the stated purposes, while a limitation is included by requiring these procedures to nevertheless remain under the control or supervision of the court.[48] The Article 1(1) definition is now to be (a text worth quoting in full):

> "This Regulation shall apply to collective judicial or administrative proceedings, including interim proceedings, which are based on a law relating to insolvency or adjustment of debt and in which, for the purpose of rescue, adjustment of debt, reorganisation or liquidation,
> (a) the debtor is totally or partially divested of his assets and a liquidator is appointed, or
> (b) the assets and affairs of the debtor are subject to control or supervision by a court…"

44 Ibid., at 6 (paragraph 3.1.2).

45 Ibid., at 10 (paragraph 3.3).

46 Similar language referring to "second chance[s]" for "honest entrepreneurs" is echoed in the political guidelines issued with respect to future work on the EIR by the Justice and Home Affairs Council Meeting on 6 June 2013.

47 Amendment Proposal, at 12 (Amending Regulation Preamble Clause 3). See H. Eidenmüller, A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond (2013) 20(1) *Maastricht Journal* 133, at 138, where the point is made that proper incentives should also be in place to persuade corporate management to undertake rescue efforts at an early stage, referring to the recommendation in the De Winter Report 2002 for action on a common wrongful trading-type rule across the European Union.

48 Ibid., at 15 (New EIR Preamble Clause 9a).

In relation to the above, Article 45 will also be replaced by two articles, the first providing for a delegated act procedure by which the European Commission will be empowered to amend the annexes at the initiative of the member states. The European Commission will also have an oversight role to examine the compliance of any notified procedure with the definition in Article 1(1) and, only where this is the case, may they proceed to amendment of the relevant annex. The second article simply sets out the conditions under which the delegation power may be exercised.[49]

Interestingly, some of the support for the rationale behind the proposed amendments is provided in the Executive Summary and Impact Assessment. The concern in the Executive Summary is that the updating of member state insolvency laws involving the introduction of new rescue-oriented procedures and which allow for fresh starts is not adequately reflected in the EIR framework, despite the "economic benefits [being] widely recognised". As such, the problem is that the lack of inclusion within the EIR framework prevents the recognition effect from coming into play and thus suspending individual enforcement. In this light, foreign creditors in particular can continue with enforcement outside any procedures taking place and have no incentive to take part in negotiations or adhere to plans agreed to by other creditors.[50] Although rogue creditors may, at worst, be simply a nuisance, since any negotiations or plans not involving the major creditors are unlikely to be successful, the fear is that job losses will occur where rescue is not achievable because of deficiencies within the current framework. This is a position apparently reflected in the responses to a public consultation initiated by the European Commission.[51] Some comfort for these views is provided by the recitation of the background economic statistics, which reveal an annual average loss of some 1.7 million jobs occurring as a result of the 200,000 or so annual insolvencies of companies in the European Union between 2009 and 2011. The estimate is that there are at least 5 million European companies with cross-

49 Ibid., at 34 (New EIR Articles 45 and 45a). A later-produced draft report by the European Parliament's Committee on Legal Affairs, issued on 11 September 2013 (2012/0360(COD)), has now suggested removing member state discretion in this process by requiring them to notify any insolvency procedures they may have that would comply with the Article 1 definition, it being then for the Commission to examine whether they should be included within Annex 1 (at 43).

50 Executive Summary, at 3 (paragraph 2.2.1). See also Impact Assessment, at 11-13 (paragraph 3.2.1), where further evidence is provided for the assessments in the Executive Summary, also giving the example of a Dutch-German cross-border case where the non-inclusion of debt reorganisation procedures within the EIR led to a Dutch cram-down not being recognised in Germany and the consequent liquidation of the debtor due to the plan being unable to have effect.

51 Ibid., at 3-4, where 51% of those consulted felt it a problem that pre-insolvency and/or hybrid procedures did not fall within the scope of the EIR, while 59% wanted the scope extended so as to include pre-insolvency proceedings.

border relationships, whether with customers, creditors or other business partners (including co-contractants such as suppliers, distributors etc.). Of the above number, the further estimate is that some 1% will be debtors and 2% creditors in cross-border insolvencies. These insolvencies are stated as particularly affecting large companies, which are more likely to engage in cross-border transactions and whose importance is especially acute because they provide 30% of all jobs within the European Union and some 41% of the "gross added value" in transactions. Knock-on insolvencies affecting the trading partners of these companies, including many SMEs, is a particular hazard the Executive Summary highlights.[52]

(iv) A National View on the Problems of "Hybrid" Procedures and Schemes of Arrangement: The United Kingdom Insolvency Service Consultation (February 2013)

The United Kingdom is required to opt into instruments proposed under Title V of the Treaty on the Functioning of the European Union given the conditional opt out it and the Irish Republic secured in the lead up to the adoption of the Maastricht Treaty 1997, allowing both countries to determine which texts introduced under the Area of Freedom, Security and Justice they wish to bind them. This it did on 10 April 2013, the date by which such notifications had to be received by the European Commission. As such, the United Kingdom will be able to vote during the negotiations and influence the shape of the final draft text. The Insolvency Service had, in fact, launched a Call for Evidence in February 2013 on whether the United Kingdom should opt in as well as the benefits of doing so measured against the background of the proposals in the draft text. The summary it provided of the scope issue asked three questions: (i) what impact would there be were the scope extended as suggested; (ii) what consequent benefit or otherwise would this have for United Kingdom based proceedings, creditors and businesses; and (iii) whether schemes of arrangement should specifically be introduced into Annex A.[53]

While the Insolvency Service's view was that there were unlikely to be any cost implications for the extension of scope and, furthermore, that there were likely to be benefits from the extension for United Kingdom creditors and businesses in terms of the rescue dynamic,[54] some controversy has arisen, however, in respect of whether schemes of arrangement should be added to Annex A.[55] Some practitioner bodies have expressed strong adverse views on the matter. In particular, the United Kingdom Insolvency Lawyers Association ("ILA") is opposed to the inclusion of

52 Ibid., at 4.

53 Insolvency Service, Call for Evidence (7 February 2013), at 8.

54 Ibid., at 20 (at paragraphs 10-12 of the accompanying Impact Assessment).

55 For the authors of the Vienna-Heidelberg report, the scheme of arrangement was an example of a "hybrid" procedure that should be included within the EIR, mentioned above note 36.

schemes within the purview of the insolvency framework, preferring instead the application of the Brussels I Regulation.[56] The ILA holds this view because of the functional difficulty in distinguishing between schemes applicable to solvent and insolvent debtors as well as the need in some instances for restructuring not to be equated to or identified with insolvency procedures.[57] For that reason, the ILA would prefer the status quo and leave it to member states to determine which procedures to include within Annex A.[58] Similarly, an amendment to the Brussels I Regulation could clarify that it did not cover those proceedings that fell within the ambit of the insolvency text.[59]

On balance, the argument may be advanced that a corporate law derived procedure should not be included within the scope of the EIR, even though it may be used by companies verging on insolvency as a technique for insolvency avoidance.[60] However, what may be more objectionable, certainly from the standpoint of some European practitioners and/or courts, is the wide jurisdictional basis on which reconstructions have been attempted of businesses that would perhaps have otherwise relied on home country turnaround or insolvency mechanisms.[61] The argument could be advanced for a compromise, should the desire be to remove schemes from the reach of the revised EIR, by tightening up the jurisdictional basis for schemes from the wide formulation to which the Companies Act 2006 refers.[62] This is so as to make clear that more than just an arguable connection or benefit for the creditors should ground the authority of the courts to sanction such schemes. Provided that this were amply evident, and that it was also apparent that schemes would fall within the recognition framework of the Brussels I Regulation,[63] then an appropriate structure would exist for the recognition of such schemes and the case for keeping them out of the EIR would be stronger. Alternatively, if the

56 See the Insolvency Lawyers' Association, Response to the European Commission's Consultation on the Future of European Insolvency Law, at 5.

57 Ibid., at 6.

58 Ibid., at 7.

59 Ibid., at 10. This may be very unlikely given the recent amendment to this regulation, for which see above note 7.

60 An example is the *Re Drax* case previously mentioned, above note 12.

61 Some examples may be seen in cases such as *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch); *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch). See J. Seelinger and A. Daehnert, International Jurisdiction for Schemes of Arrangement (2012) 9 *International Corporate Rescue* 243.

62 Section 895, Companies Act 2006 refers to a company liable to be wound up under the Insolvency Act 1986, extending the benefit of a scheme to potentially all companies. Certain other conditions have been imposed by the jurisprudence to establish a connection with the jurisdiction, but no COMI need be found for the application of the scheme provisions. In some jurisdictions, e.g. Jersey, scheme provisions are limited to companies formed under domestic legislation.

63 A German court has determined that a scheme is not an insolvency proceeding *per se*, but that orders sanctioning schemes might be regarded as sufficiently adversarial to fall within the Brussels I Regulation. See R. Tett and M. Knapp, German Federal Court Rules on the Equitable Life Scheme of Arrangement (2012) 9 *International Corporate Rescue* 346.

European Commission were not given any oversight powers in the revised EIR,[64] then the United Kingdom could simply omit to mention schemes of arrangement in Annex A, which exclusion could be immune from challenge.[65] In that light, the Parliament's proposals to reduce member state choice appear to put the Her Majesty's Government in a very difficult position indeed.[66]

Conclusion

The proposed extension of the EIR with respect to scope, particularly with view to the inclusion of pre-insolvency proceedings, may be regarded as especially useful. This is given the greater emphasis in recent times within the reform context on up-stream rescue and the utility of simpler workout type procedures when compared to more formal insolvency processes. This utility is, of course, greatly enhanced by the benefit of the recognition and enforcement regime contained within the EIR, which is invoked by the proper taking of jurisdiction and the issue of orders by a competent court. Consideration could also be given to what other procedures more closely identified with insolvency avoidance at an early stage would be useful to include within the remit of a revised EIR. The danger of pushing back the boundary currently existing between informal and formal proceedings, however desirable a step this may be, is that it may inadvertently capture turnarounds, informal workouts and pre-packs by too broad an interpretation of what constitutes a pre-insolvency procedure. Nonetheless, the likely benefits for businesses and creditors alike, were the scope of the EIR extended as suggested, is evident, with rescue synergy being potentially reached at an earlier stage within the text. Undoubtedly, this would enable both businesses and creditors to plan matters more clearly and to better understand what insolvency avoidance techniques could be used, by determining whether these would fall within or without the EIR, depending on the aims to be achieved. Although the text has some way to go before a final version is reached, undoubtedly the extension of its scope, as contemplated in the various proposals, reports and responses, is now a given. While there may remain disputes as to what procedures will ultimately be included and whether there is to be oversight of this process, overall the utility of this step appears evident to all.

64 See proposed new EIR Article 45 and text accompanying above notes 40 and 49.

65 This standpoint may receive some comfort from the view emitted by the European Court of Justice in the *Bank Handlowy* case, above note 18. In fact, Eidenmüller, above note 47, at 141, makes the point that leaving the initiative to member states may result in the status quo (non-inclusion in the Annexes) being maintained if there are perceived benefits for the member states concerned, e.g. higher costs for COMI-manipulation to bring foreign companies within the rules were schemes of arrangement brought within the EIR.

66 See above note 49.

Chapter 8

The Revision of the European Insolvency Regulation Revision from a German Perspective

Jessica Schmidt

Introduction

From the very beginning, the currently contemplated revision of the European Insolvency Regulation has attracted immense interest among German practitioners and scholars and the German legislator. Of course, all of the various individual reform proposals have already been discussed in great detail in Germany in numerous publications and at several special conferences.

However, there is one issue which is of a very special interest in Germany: The proposals with respect to groups of companies. The reason is that Germany is currently in the process of reforming its own insolvency law by introducing special provisions with respect to groups of companies. Therefore, my presentation today will focus on the proposed rules on group insolvencies and compare the respective provisions in the EIR revision draft[1] on the one hand and the German reform draft on the other hand.

A. Background: The German Insolvency Reform

I. The Reform in General

As most of you will know, in 2010, Germany started a comprehensive reform of its insolvency law. The overall goal is to correct weak points exhibited by

1 Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings, COM(2012) 744. See on this e.g. C. Brünkmans, "Auf dem Weg zu einem europäischen Konzernrecht. Zum Vorschlag der Europäischen Kommission zur Änderung der EuInsVO", *ZInsO* 2013, 797; "Die Sanierung von Konzernen in Europa – Zur Sanierung von Konzernen im Lichte der Europäischen Insolvenzverordnung und des aktuellen Reformvorschlags der Europäischen Kommission", *Der Konzern* 2013, 234; "Reform of EU Insolvency Law – Commission opts for Rescue", *Co. L. N.* 2013, 328, 1 at 5; M. Prager and C. Keller, "Der Vorschlag der Europäischen Kommission zur Reform der EuInsVO", *NZI* 2013, 57; S. Mock, "Das (geplante) neue europäische Insolvenzrecht nach dem Vorschlag der Kommission zur EuInsVO", *GPR* 2013, 156; P. Reuß, "Europäisches Insolvenzrecht 3.0 oder doch nur Version 1.1? Der Vorschlag der Kommission vom 12.12.2012 zur Reform der Europäischen Insolvenzverordnung", *EuZW* 2013, 165.

the financial crisis and to make sure that German insolvency law will be able to cope with future challenges. From the outset, the reform has been conceived in three stages:

- The first stage was the ESUG, the "Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen" ("Law on the Further Facilitation of the Restructuring of Enterprises"), which entered into force in 2012.[2]
- The second stage was the "Gesetz zur Verkürzung des Restschuldbefreiungsverfahrens und zur Stärkung der Gläubigerrechte" ("Law on the shortening of the discharge period and the strengthening of creditors' rights"), which focused on reforming consumer insolvency law.[3] Its integral parts will enter into force on 1 July 2014.
- The third – and final – stage pertains to group insolvencies. To this end, the German Federal Ministry of Justice published a discussion draft[4] in January of this year. At the end of August, the government has now presented an official draft[5] for a "Law for the facilitation of the handling of group insolvencies".

2 Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen v. 7.12.2011, BGBl. I, 2582; C. Thole and A. Swierczok, "Der Kommissionsvorschlag zur Reform der EuInsVO", *ZIP* 2013, 550; K. Wimmer, " Konzerninsolvenzen im Rahmen der EuInsVO – Aus-blick auf die Schaffung eines deutschen Konzerninsolvenzrechts", *DB* 2013, 1343.

3 Gesetz zur Verkürzung des Restschuldbefreiungsverfahrens und zur Stärkung der Gläubigerrechte v. 15.7.2013, BGBl. I, 2379.

4 Diskussionsentwurf des Bundesministeriums der Justiz Entwurf eines Gesetzes zur Erleichterung der Bewältigung von Konzerninsolvenzen, 3 January 2013, copy available at: http://zip-online.de/pdf/zip/Diskussionsentwurf-des-BMJ-zu-Konzerninsolvenzen.pdf . See on this e.g. D. Andres and A. Möhlenkamp, "Konzerne in der Insolvenz – Chance auf Sanierung? Zum Diskussionsentwurf des BMJ für ein Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen", *BB* 2013, 579; J. Blöse, "Dritte Stufe der Insolvenzrechtsreform: Erleichterung der Bewältigung von Konzerninsolvenzen", *GmbHR* 2013, R177; C. Brünkmans, "Entwurf eines Gesetzes zur Erleichterung der Bewältigung von Konzerninsolvenzen: Kritische Analyse und Anregungen aus der Praxis", *ZIP* 2013, 193; A. Commandeur and S. Knapp, "Diskussionsentwurf zur Erleichterung der Bewältigung von Konzerninsolvenzen – Ein Meilenstein auf dem Weg zu einer neuen Sanierungskultur?", *NZG* 2013, 176; P. Fölsing, "Konzerninsolvenz: Gruppen-Gerichtsstand, Kooperation und Koordination", *ZInsO* 2013, 413; M. Göb, "Aktuelle gesellschaftsrechtliche Fragen in Krise und Insolvenz – Dezember 2012/Januar 2013", *NZI* 2013, 243; M. Göb, "Aktuelle gesellschaftsrechtliche Fragen in Krise und Insolvenz – Februar/März 2013", *NZI* 2013, 430; P. Harder and M. Lojowsky, "Der Diskussionsentwurf für ein Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen – Verfah-rensoptimierung zur Sanierung von Unternehmensverbänden?", *NZI* 2013, 327; S. Leutheusser-Schnarrenberger, "Dritte Stufe der Insolvenzrechtsreform – Entwurf eines Gesetzes zur Erleichterung der Bewältigung von Konzerninsolvenzverfahren", *ZIP* 2013, 97; M. Nicht, "Rechtsrahmen für Konzerninsolvenzen - Diskussionsentwurf des BMJ", *Rechtsboard*, 4 Feburary 2013; C. Pleister, "Das besondere Koordinierungsverfahren nach dem Diskussionsentwurf für ein Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen", *ZIP* 2013, 1013; S. Ulrich, "Konzerninsolvenzrecht – wird jetzt alles anders?", *GmbHR* 2013, R69; Wimmer, above note 1, at 1346 et seq.; H. Zipperer, "Die einheitliche Verwalterbestellung nach dem Diskus-sionsentwurf für ein Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen", *ZIP* 2013, 1007.

5 Entwurf eines Gesetzes zur Erleichterung der Bewältigung von Konzerninsolvenzen, 30 August 2013, BR-Drs. 663/13.

II. In Particular: the Group Insolvencies Bill 2013

In a nutshell, the goal of this Group Insolvencies Bill 2013 is to ensure better coordination of the individual insolvency procedures on the basis of appropriate coordination mechanisms.[6] To this end, the draft pursues two dovetailing approaches:

- Firstly, it builds upon current practices and creates the legal bases for the coordinated handling of insolvencies in the group context which are currently not existing or at least not adequate.[7] To this end, it establishes rules for jurisdiction which are intended to make it possible to institute all proceedings at the same insolvency court.[8] If proceedings are conducted at several courts, the possibility of a referral is introduced.[9] Moreover, it creates legal bases for the cooperation of liquidators and courts.[10]

- Secondly, the Bill breaks fresh ground by establishing a coordination procedure.[11] Its aim is to improve the coordination of the individual procedures without questioning their autonomy.[12] The key elements of the coordination procedure are a coordination liquidator and a coordination plan.[13]

Thus, the German legislator deliberately ultimately takes a different path than the EIR revision draft.[14] In the following, I am going to outline the most important common features, similarities and differences of the two drafts.

B Comparison of the Rules on Group Insolvencies in the EIR Revision Draft and the German Reform Draft

I. Common Features and Similarities

1. <u>No Substantive Consolidation</u>

A fundamental common feature of both the EIR revision draft and the German reform draft is the deliberate rejection of the idea of substantive consolidation. Despite the fact that the UNCITRAL Legislative Guide on Insolvency Law

6 *Cf.* BR-Drs. 663/13, at 14.
7 *Cf.* BR-Drs. 663/13, at 14.
8 *Cf.* BR-Drs. 663/13, at 14.
9 *Cf.* BR-Drs. 663/13, at 14.
10 *Cf.* BR-Drs. 663/13, at 14.
11 *Cf.* BR-Drs. 663/13, at 14.
12 *Cf.* BR-Drs. 663/13, at 14.
13 *Cf.* BR-Drs. 663/13, at 14.
14 *Cf.* BR-Drs. 663/13, at 14.

provides for substantive consolidation at least in certain circumstances[15] and that a number of scholars had strongly advocated to introduce similar provisions in the European Insolvency Regulation, the Commission decided to maintain the entity-by-entity approach which has underlain the European Insolvency Regulation from the very beginning.[16]

The same holds true for the German legislator. The Explanatory Notes to the draft rightly point out that substantive consolidation would be incompatible with the fundamental principles of separate legal personality and limited liability.[17] It would be to the disadvantage of the creditors of group companies whose assets would result in a higher insolvency quota in case of isolated handling of the insolvency than in case of substantive consolidation.[18] Hence, substantive consolidation would frustrate the legitimate expectations of creditors.[19] Moreover, it must be feared that the costs for future loans would rise because creditors would not only have to examine and monitor the financial situation of the individual entity, but of the whole group.[20]

2. Cooperation Duties

A further common feature of both the EIR revision draft and the German reform draft is the explicit imposition of cooperation duties.

a) Cooperation of Liquidators

Firstly, both drafts lay down a duty of the liquidators of group companies to cooperate. Both art. 42a EIR draft[21] as well as § 269a InsO-draft[22] provide that

15 *Cf.* UNCITRAL Legislative Guide on Insolvency Law, recommendations 219-231.

16 *Cf.* COM(2012) 744, 3.1.5. See on this e.g. Brünkmans "Weg", above note 1, at 798; Brünkmans "Sanierung", above note 1, at 237 et seq.; Mock, above note 1, at 164; Reuß, above note 1, at 168; Thole and Swierczok, above note 1, at 556.

17 *Cf.* BR-Drs. 663/13, 13; Brünkmans "Weg", above note 1, at 798; Brünkmans, above note 4, at 194; Fölsing, above note 4, at 414; Leutheusser-Schnarrenberger, above note 4, at 98. See further also Andres and Möhlenkamp, above note 4, at 531. In addition, see already J. Schmidt, "Groups of Companies in German Autonomous Insolvency Law: The *lex lata*, its Application and Proposals for Reform", Chapter 4 in B. Wessels and P. Omar (eds.), *Insolvency and Groups of Companies* (2011, INSOL Europe, Nottingham/Paris), at 37 and 44 with further references.

18 *Cf.* BR-Drs. 663/13, at 13; Brünkmans, above note 4, at 194; Fölsing, above note 4, at 414; Harder and Lojowsky, above note 4, at 327; Leutheusser-Schnarrenberger, above note 4, at 98.

19 *Cf.* BR-Drs. 663/13, at 13; Brünkmans, above note 4, at 194; Fölsing, above note 4, at 414; Harder and Lojowsky, above note 4, at 327; Leutheusser-Schnarrenberger, above note 4, at 98.

20 *Cf.* BR-Drs. 663/13, at 13. See on this e.g. Brünkmans "Weg", above note 1, at 798; Brünkmans, above note 4, at 194; P. Fölsing, above note 4, at 414; Harder and Lojowsky, above note 4, at 327; Leutheusser-Schnarrenberger, above note 4, at 98.

21 See on this Brünkmans "Weg", above note 1, at 800 et seq.; Brünkmans "Sanierung", above note 1, at 242; Mock, above note 1, at 164 et seq.; Thole and Swierczok, above note 1, at 556 et seq.; Wimmer, above note 1, at 1345.

22 See on this e.g. Brünkmans, above note 4, at 199 et seq.; Fölsing, above note 4, at 418; Harder and Lojowsky, above note 4, at 328 et seq.; Leutheusser-Schnarrenberger, above note 4, at 101 et seq.; Wimmer, above note 1, at 1348.

liquidators of group-affiliated debtors shall cooperate and exchange information and both provisions contain similar limits on this cooperation duty.[23] Moreover, both drafts recognise the possibility of agreements and protocols between the liquidators (*cf.* art. 42(1) 2 EIR draft; § 269h(2) 3 no. 3 InsO-draft).

b) Cooperation of Courts

Secondly, both art. 42b EIR draft[24] and § 269b InsO-draft[25] provide that courts at which insolvency proceedings relating to group-affiliated debtors are pending shall cooperate and exchange information. Both also contain similar limits on this cooperation duty. Again, the provisions deviate with respect to certain details, including the examples given. But the general principle is the same.

c) Divergences in relation to Cooperation Duties

Nonetheless, there are also two points where the rules on cooperation duties diverge not only in detail, but on a more general level.

On the one hand, only art. 42c EIR revision draft specifically provides also for cooperation and communication between liquidators and courts.[26] The German draft does not contain any specific rules on such "cross-over-cooperation", although one may assume that such cooperation should be possible within the general framework of the law.

On the other hand, only the German draft in § 269c specifically provides for cooperation of the creditors' committees of group-affiliated debtors.[27] To this end, the court may establish a group creditors' committee in which each of the creditors' committees of the group-affiliated debtors, which are not evidently of minor importance for the group of undertakings as a whole, is represented by one person. The EIR revision draft does not provide for anything similar.

23 *Cf.* also Brünkmans "Weg", above note 1, at 799 et seq.

24 See on this Brünkmans "Weg", above note 1, at 801; Brünkmans "Sanierung", above note 1, at 243; Mock, above note 1, at 165; Wimmer, above note 1, at 1345.

25 See on this e.g. Brünkmans, above note 4, at 200; Fölsing, above note 4, at 418 et seq.; Harder and Lojowsky, above note 4, at 328 et seq.; Leutheusser-Schnarrenberger, above note 4, at 101 et seq.; Wimmer, above note 1, at 1348 et seq.

26 See on this Brünkmans "Weg", above note 1, at 802; Brünkmans "Sanierung", above note 1, at 243; Wimmer, above note 1, at 1346.

27 See on this e.g. Brünkmans, above note 4, at 200; Fölsing, above note 4, at 419; Harder and Lojowsky, above note 4, at 328 et seq.; Leutheusser-Schnarrenberger, above note 4, at 102; Pleister, above note 4, at 1016; Wimmer, above note 1, at 1349.

II. Differences and Divergences

1. Definition of Group

The differences and divergences between the EIR revision draft and the German reform draft already start with the very definition of a group. Art. 2(i) EIR draft defines "group of companies" as:

> "...a number of companies consisting of parent and subsidiary companies".

Art. 2(j) EIR draft then goes on to say that "parent company" means:

> "a company which:
> (i) has a majority of the shareholders' or members' voting rights in another company (a "subsidiary company"); or
> (ii) is a shareholder or member of the subsidiary company and has the right to:
> (aa) appoint or remove a majority of the members of the administrative, management or supervisory body of that subsidiary; or
> (bb) exercise a dominant influence over the subsidiary company pursuant to a contract entered into with that subsidiary or to a provision in its articles of association."

This definition is clearly modelled on the definition of "group" in art. 1(1) of the 7th EU Company Law Directive on Consolidated Accounts[28] (≙ art. 22(1) of the EU Accounting Directive 2013[29]).[30]

By contrast, § 3e of the German reform draft defines:

> "A group of undertakings consists of legally independent undertakings which have the centre of their economic activities within the territory of the Federal Republic of Germany and which are directly or indirectly linked with each other by:
> 1. the possibility to exercise a dominant influence or
> 2. a management on a unified basis."

28 Seventh Council Directive of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts, OJ of 18 July 1983, L 193/1.

29 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ of 29 June 2013, L 182/19. Transposition deadline: 20 July 2015.

30 *Cf.* Brünkmans "Weg", above note 1, at 799; Mock, above note 1, at 164 (very critical, advocating an insolvency-specific definition); Wimmer, above note 1, at 1344 et seq.

This definition also draws on the definition of "group" for accounting purposes.[31] In fact, the Explanatory Notes outline that the criterion of "possibility to exercise a dominant influence" is to be concretised by § 290(2) HGB (Handelsgesetzbuch [Commercial Code]), which in turn implements art. 1 of the 7th EU Company Law Directive on Consolidated Accounts.[32]

So at least the first limb of the German definition essentially corresponds with the definition in the EIR revision draft.[33] The second limb, on the other hand, does not have an equivalent in the EIR definition.[34] It is intended to cover so-called "Gleichordnungskonzerne" (horizontal groups). In the German government's opinion coordination mechanisms may also be sensible in such cases.[35] The reason that such horizontal groups are not included in the EIR definition is probably that the 7th EU Company Law Directive on Consolidated Accounts also only provides for an option for Member States to extend the group definition to them (art. 1(2) [(≙ art. 22(1) of the EU Accounting Directive 2013]).

Moreover, the two definitions also diverge in that the German definition naturally only encompasses entities which have their COMI in Germany, since the German legislator does not have the competence to legislate for those having their COMI outside Germany.

2. <u>Group Jurisdiction</u>

A second important difference between the two drafts is that only the German reform draft provides for a special group jurisdiction.

a) German Reform Draft

§ 3a(1) 1 of the German reform draft provides:

> "Upon application of a debtor who is a member of a group of undertakings within the meaning of § 3e (group-affiliated debtor), the court seized assumes jurisdiction for the insolvency proceedings against the other group-affiliated debtors (subsequent group proceedings) if there is an admissible request to open insolvency proceedings with respect to the debtor and the debtor is not evidently of minor importance for the group of undertakings as a whole."

31 *Cf.* Brünkmans "Weg", above note 1, at 799; Brünkmans, above note 4, at 195; Fölsing, above note 4, at 414 et seq.; Leutheusser-Schnarrenberger, above note 4, at 99 et seq.; Wimmer, above note 1, at 1347.

32 Above note 28.

33 *Cf.* also Brünkmans "Weg", above note 1, at 799 (however, he apparently fails to see – or at least to mention – the differences with respect to the second limb).

34 *Cf.* critically on this issue Reuß, above note 1, at 168.

35 *Cf.* BR-Drs. 663/13, at 28; Wimmer, above note 1, at 1347.

This jurisdiction is not exclusive; as § 3c(2) InsO-draft clarifies, it only is a concurrent jurisdiction with the jurisdiction pursuant to § 3(1) InsO (Insolvenzordnung [Insolvency Statute]) at the COMI.

With the establishment of a special group jurisdiction, the German reform draft follows the recommendations of numerous scholars.[36] However, whereas many scholars had advocated for an exclusive jurisdiction of the court having jurisdiction for the parent company,[37] the draft follows the priority principle.[38] In the opinion of the German government, tying jurisdiction to the parent company would not be appropriate in cases where the parent is not insolvent or where it has its COMI abroad.[39] The priority principle not only avoids these disadvantages, but provides an instrument for the management of the group and of the individual undertakings to plan the handling of the insolvency process in advance which is of fundamental importance for successful restructurings.[40] In the government's view, the dangers of abuse associated with the priority principle take a backseat compared to these advantages.[41] Moreover, in contrast to the cross-border context, where the applicable law is tied to the jurisdiction, the consequences of abusive forum shopping are perceived to be manageable in the domestic context.[42]

Only a group-affiliated debtor – or the respective liquidator, as the case may be – has the right to apply for group jurisdiction; the creditors do not have this right (*cf.* § 3a(1), (3)).

If a request for the opening of insolvency proceedings relating to the assets of a group-affiliated debtor has been filed at an insolvency court other than the court having group jurisdiction, § 3d provides that the court seized may refer the proceedings to the court having group jurisdiction. § 3c(1) provides that, at the court having group jurisdiction, the same judge shall have jurisdiction for all subsequent group proceedings.[43]

36 *Cf.* BR-Drs. 663/13, at 13.

37 As to this concept and its advantages and disadvantages *cf.* Schmidt, above note 17, at 46 et seq. It was advocated e.g. by: Andres and Möhlenkamp, above note 4, at 584-585; M. Jaffé and A. Friedrich, "Verbesserung der Wettbewerbsfähigkeit des Insolvenzstandorts Deutschland", *ZIP* 2008, 1849, at 1852; H. Vallender, "Plädoyer für einen Konzerninsolvenzgerichtsstand", in N. Weber and J. M. Schmidt (eds.), *Festschrift für Hans Peter Runkel* (2009, RWS, Cologne) 373, at 384 et seq.; L. Westphahl and R. Janjuah, "Zur Modernisierung des deutschen Sanierungsrechts", supplement to *ZIP* 3/2008, 1 at 7; see further already M. Lutter, "Der Konzern in der Insolvenz", *ZfB* 54 (1984) 781, at 787.

38 *Cf.* BR-Drs. 663/13, at 13.

39 *Cf.* BR-Drs. 663/13, at 13; Blöse, above note 4, at R178; Harder and Lojowsky, above note 4, at 328; Leutheusser-Schnarrenberger, above note 4, at 100.

40 *Cf.* BR-Drs. 663/13, at 13; Leutheusser-Schnarrenberger, above note 4, at 100 et seq.

41 *Cf.* BR-Drs. 663/13, at 13; Leutheusser-Schnarrenberger, above note 4, at 100.

42 *Cf.* BR-Drs. 663/13, at 13; Leutheusser-Schnarrenberger, above note 4, at 100; Wimmer, above note 1, at 1347.

43 This was introduced after the lack of such a provision in the discussion draft had been criticised, *cf.* e.g. Andres and Möhlenkamp, above note 4, at 585.

b) EIR Revision Draft

The EIR revision draft, by contrast, does not provide for a special group venue.[44] However, draft recital 20b sentence 1 explicitly points out that:

> "…the introduction of rules on the insolvency of groups of companies should not limit the possibility of a court to open insolvency proceedings for several companies belonging to the same group in a single jurisdiction if the court finds that the centre of main interests of these companies is located in a single Member State."[45]

3. <u>Appointment of a "Group Liquidator"</u>

Thirdly, the two drafts differ with respect to the question of the appointment of a "group liquidator".

a) German Reform Draft

§ 56b(1) of the German reform draft provides that the insolvency courts seized shall consult one another whether it is in the interests of the creditors to appoint only one person as liquidator. The consultation shall consider in particular whether this person can administer the proceedings relating to the group-affiliated debtors with the necessary independence and if potential conflicts of interests can be dispelled by the appointment of a special liquidator.

§ 56b(2) goes on to provide that the court can deviate from the proposal or the specifications of a provisional creditors' committee pursuant to § 56a if the provisional creditors' committee appointed for another group-affiliated debtor unanimously proposes another person suitable for the task.

The German government deliberately refrained from making the appointment of a single "group liquidator" mandatory.[46] One the one hand, such a rule would not be appropriate in cases where it is doubtful that a single "group liquidator" would be in the interests of creditors due to conflicts of interest.[47] On the other hand, the appointment of a single "group liquidator" doesn't make sense in cases where

44 See on this approvingly Brünkmans "Weg", above note 1, at 805 et seq.

45 *Cf.* also the Explanatory Memorandum, COM(2012) 744, 3.1.5.; Brünkmans "Weg", above note 1, at 801; Prager and Keller, above note 1, at 63.

46 *Cf.* BR-Drs. 663/13, at 18. Some scholars had advocated to provide at least that the courts should generally appoint the same person as liquidator in all proceedings, *cf.* e.g. Andres and Möhlenkamp, above note 4, at 585; Brünkmans, above note 4, at 198.

47 *Cf.* BR-Drs. 663/13, at 18.

there is only a loose corporate bond.[48] Therefore, it was felt to be best to leave the appointment of a single group liquidator to the discretion of the courts.49

b) EIR Revision Draft

The EIR revision draft, by contrast, does not contain any special provisions relating explicitly to the possibility of the appointment of the same person as liquidator for all group-affiliated debtors. However, this issue was specifically addressed in the Commission's Report on the Application of the EIR, which criticised that this possibility currently depends on the willingness of the respective insolvency practitioners and judges to cooperate.[50]

Against this background, at least draft recital 20b sentence 2 now explicitly states that if a court finds that it has jurisdiction to open insolvency proceedings with respect to several group companies because their COMI is located in the same Member State, it should also be able to appoint, if appropriate, the same liquidator in all proceedings concerned.[51]

Moreover, it is submitted that the option of the appointment of the same person as liquidator in all proceedings is encompassed by the "appropriate means" of cooperation between courts within the meaning of art. 42b EIR revision draft. Especially in light of the fact that art. 42b(3)(b) EIR revision draft specifically provides that such "appropriate means" include the "coordination of the administration and supervision of the assets and affairs of the members of the group", one may assume that such a coordination of the administration may also take the form of the appointment of the same person as liquidator in all proceedings.

4. <u>Different Models and Intensities of Cooperation Mechanisms</u>

Finally – and most importantly – although both the EIR revision draft and the German reform draft rely on cooperation mechanisms to tackle the problem of group insolvencies, their respective cooperation models differ significantly both with respect to their general concept as well as the intensity of the cooperation mechanism envisioned.

a) EIR Revision Draft

The key provision in this respect in the EIR revision draft is article 42d, which gives each liquidator standing in the proceedings concerning another member

48 *Cf.* BR-Drs. 663/13, at 18.

49 *Cf.* BR-Drs. 663/13, at 18. See further on this issue Zipperer, above note 4, at 1012.

50 *Cf.* COM(2012) 743, at 15.

51 *Cf.* also Brünkmans "Weg", above note 1, at 801.

of the same group and provides him with extensive and comprehensive rights of participation.

Firstly, he has the **right to be heard and participate** in any other group proceedings (art. 42d(1)(a)).[52] This includes, in particular, to attend creditors' meetings.

Secondly, he has the **right to request a stay** of proceedings opened with respect to any other group member (art. 42d(1)(b)).[53] A stay has to be granted if it is proven that it would be to the benefit of the creditors of such proceedings (art. 42d(2) 1). A stay may be ordered for up to three months and may be continued or renewed for the same period (art. 42d(2) 2). In order to guarantee the interests of the creditors in the respective proceedings, the court may require the liquidator to take any suitable measures, e.g. provide a guarantee (art. 42d(2) 3).[54]

Thirdly, each liquidator has the **right to propose a rescue plan,** a composition or a comparable measure for all or some members of the group and to introduce it into any of the proceedings in accordance with the law applicable to those proceedings (art. 42d(1)(c)).[55]

Finally, he has the right to **request any additional procedural measures** under the law applicable to the respective proceedings which may be necessary to promote rescue (art. 42d(1)(d)). This includes, in particular, the conversion of proceedings, e.g. from liquidation to reorganisation proceedings and *vice versa*.[56]

b) German Reform Draft

No Mutual Rights of Participation

The German government deliberately decided against stipulating such extensive and comprehensive mutual rights of participation.[57] In its view, such mutual rights of participation entail the danger that an uncoordinated use may result in a mutual logjam of the proceedings and thus in the exact opposite of the intended coordination.[58] In particular, it sees the danger that such participation rights are misused to lend weight to the attempt to enforce inappropriate demands and to

52 See on this Brünkmans "Weg", above note 1, at 802; Brünkmans "Sanierung", above note 1, at 243 et seq.

53 See on this Brünkmans "Weg", above note 1, at 803 et seq.; Brünkmans "Sanierung", above note 1, at 244 et seq.; Mock, above note 1, at 165; Prager and Keller, above note 1, at 63 et seq.; Thole and Swierczok, above note 1, at 557; Wimmer, above note 1, at 1346.

54 *Cf.* Brünkmans "Weg", above note 1, at 805; Brünkmans "Sanierung", above note 1, at 246.

55 See on this Brünkmans "Weg", above note 1, at 803; Brünkmans "Rescue", above note 1, at 344.

56 *Cf.* Thole and Swierczok, above note 1, at 557.

57 *Cf.* BR-Drs. 663/13, at 15.

58 *Cf.* BR-Drs. 663/13, at 15. *Cf.* also Brünkmans "Weg", above note 1, at 803 and 808 who warns against a detrimental "restructuring race" ("Sanierungswettrennen"); Wimmer, above note 1, at 1346.

induce parties willing to cooperate to pay a "vexation premium" to the disrupter for waiving such demands.[59]

Instead: Coordination Proceedings

Instead, the German reform draft, introduces new §§ 269d – 269i InsO which establish a special coordination procedure. As already pointed out, its aim is to improve the coordination of the individual procedures without questioning their autonomy.[60]

Coordination Court, § 269d InsO-Draft

Pursuant to § 269d(1) InsO-draft, the coordination procedure is conducted at the court having group jurisdiction pursuant to § 3a InsO-draft. This has the advantage that there may already be a number of group proceedings pending at that court and that this court also has jurisdiction for the establishment of a group creditors' committee pursuant to § 269c InsO-draft.[61]

An application for the opening of a coordination procedure may be made by each group-affiliated debtor – or the respective liquidator, as the case may be; in addition, an application may also be made by each creditors' committee or provisional creditors' committee of a group-affiliated debtor upon the basis of an unanimous decision (*cf.* § 269d(2) InsO-draft).

Coordination Liquidator

The first key element of the coordination procedure is the appointment of a coordination liquidator.[62]

(i) Appointment, § 269e InsO-draft

Generally, the coordination liquidator should be a neutral third person.63 § 269e(1) InsO-draft provides that he must be independent of the group-affiliated debtors and their creditors (sentence 1). Moreover, he should be independent of the liquidators and the *Sachwalter* (trustees) of the group-affiliated debtors (sentence 2). The appointment of a group-affiliated debtor is explicitly prohibited (sentence 3).

Appointing a neutral third person as coordination liquidator has the advantage that the coordination duties are exercised by a person not burdened with own interests

59 *Cf.* BR-Drs. 663/13, at 15.
60 *Cf.* BR-Drs. 663/13, at 14.
61 *Cf.* BR-Drs. 663/13, at 20; Wimmer, above note 1, at 1349.
62 *Cf.* BR-Drs. 663/13, at 20.
63 *Cf.* BR-Drs. 663/13, at 20.

with respect to a particular proceeding and who can thus moderate between the liquidators of the individual proceedings as a mediator.[64]

(ii) Tasks and position, § 269f InsO-draft

Pursuant to § 269f(1) 1 InsO-draft, the coordination liquidator shall provide for the coordinated conduct of the proceedings relating to the group-affiliated debtors insofar as this is in the interests of creditors. For this purpose, he may, in particular, submit a coordination plan (sentence 2).

In addition, there is a multitude of other possible coordination instruments.[65] He may, for example, initially set up an informal forum for the multilateral discussion and solution of problems which arise in all proceedings and the solution of which is simplified by a common method and approach.[66] Furthermore, he and the other liquidators may also resort to contractual instruments.[67]

Pursuant to § 269f(2) InsO-draft, the liquidators and the provisional liquidators of the group-affiliated debtors shall be duty bound to co-operate with the coordination liquidator. In particular, they shall, upon request, communicate to him the information which he requires for the appropriate exercise of his tasks.

Coordination Plan

The second key element of the coordination procedure is the coordination plan.[68] Conceptually, the coordination plan is conceived as a "cropped" insolvency plan: It contains only descriptive elements and does not contain a constitutive part.[69]

The right to submit a coordination plan is assigned primarily to the coordination liquidator; where such has not been appointed, the liquidators of the group-affiliated debtors may jointly submit a coordination plan, § 269h(1) 1 InsO-draft.

Since the coordination plan is merely descriptive in nature, the requirements for its content are not very strict.[70] § 269h(2) InsO-draft provides that all measures relevant for the coordinated conduct of the proceedings can be described. In particular, the plan may contain proposals for:

64 *Cf.* BR-Drs. 663/13, at 20.

65 *Cf.* BR-Drs. 663/13, at 20.

66 *Cf.* BR-Drs. 663/13, at 20 et seq.

67 *Cf.* BR-Drs. 663/13, at 21.

68 *Cf.* BR-Drs. 663/13, at 14; Wimmer, above note 1, at 1349.

69 *Cf.* BR-Drs. 663/13, at 40; Brünkmans, above note 4, at 201; Pleister, above note 4, at 1017; Wimmer, above note 1, at 1349.

70 *Cf.* BR-Drs. 663/13, at 41.

(1) the restoration of the economic viability of the individual group-affiliated debtors and the group of undertakings;

(2) the settlement of intra-group disputes; and

(3) contractual agreements between the liquidators.

If a group creditors' committee has been appointed, the coordination plan requires its assent, § 269h(1) 2 InsO-draft. In any case, the coordination plan has to be confirmed by the court. Pursuant to § 269h(1) 3 InsO-draft, the court shall *ex officio* reject the plan if the pro-visions regarding the right to submit a plan, the contents of the plan or the procedure regarding the plan have not been complied with and the submitters cannot or not within an appropriate period set by the court cure the defect.

The coordination plan functions as a "reference plan":[71] Its implementation is effected by way of the individual insolvency plans.[72] However, the coordination plan is not directly binding for the drafters of the individual plans.[73] Nonetheless, the draft provides for several mechanisms which make the coordination plan at least indirectly binding.

Firstly, § 269i(1) InsO-draft provides that a liquidator who wants to deviate from the coordination plan has to justify from which measures described in the plan he wants to deviate in the report meeting; hence, there is a sort of "comply or explain"-mechanism.

Secondly, according to § 269i(2) InsO-draft, the creditors' meeting may decide that the coordination plan shall form the basis of the insolvency plan to be drawn up by the liquidator.

Finally, a liquidator may be liable for damages to the other parties if he breaches his duty to ensure the best possible preservation and liquidation of the assets by thwarting a coordinated restructuring of the group.[74]

Conclusion

So which of the two models is the better one? The "European model" of mutual participation rights or the German model of a special cooperation procedure? Hard

71 *Cf.* BR-Drs. 663/13, at 14.

72 *Cf.* BR-Drs. 663/13, at 40; Brünkmans, above note 4, at 201; Wimmer, above note 1, at 1349.

73 *Cf.* BR-Drs. 663/13, at 40; Pleister, above note 4, at 1017; Wimmer, above note 1, at 1349.

74 *Cf.* BR-Drs. 663/13, at 40; Brünkmans, above note 4, at 201; Leutheusser-Schnarrenberger, above note 4, at 102; Pleister, above note 4, at 1017; Wimmer, above note 1, at 1349.

to say. The German governments' concerns that the extensive mutual participation rights of the EU model may actually result in a mutual logjam and thus in the very opposite of what they are intended to achieve may indeed be justified. At least they can certainly not be dismissed outright.

On the other hand, it is open to question whether a coordination procedure based on the German model would work in a cross-border context. Since one may already question whether the indirect enforcement mechanisms which this model relies on will work in the domestic context,[75] it is all the more questionable whether they would be effective in a cross-border context. In light of this, the direct mutual participation rights envisioned in the EIR revision draft indeed have some merit.

Ultimately, under both models much will depend on how they are implemented in practice and on the willingness of all parties involved to cooperate effectively.

75 *Cf.* Critically Andres and Möhlenkamp, above note 4, at 585; Commandeur and Knapp, above note 4, at 178; Fölsing, above note 4, at 413; Harder and Lojowsky, above note 4, at 329 et seq.; Nicht, above note 4; Pleister, above note 4, at 1017.

Chapter 9

The Insolvency of Members of a Group of Companies in the Proposal for Amendment of the European Insolvency Regulation

Giulia Vallar

Introduction: The *Status Quo*

On 12 December 2012, the European Commission presented to the European Parliament and to the Council a Proposal for a Regulation amending Council Regulation (EC) No. 1346/2000 on insolvency proceedings ("EIR"). Among the various innovations, it is undoubtedly noteworthy the introduction of provisions regarding insolvency of groups of companies.

It is well-known that the current version of the EIR does not regulate this issue,[1] with the consequence that, in principle, in case of an insolvency affecting a group of companies having their seats in different Member States, multiple proceedings would have to be opened in each of the States where the companies of the group have their center of main interests in accordance with Article 3(1) of the EIR. The center of main interests is:

> "…the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties."[2]

Said proceedings will be independent from and in some cases even unaware of one another: the EIR does not require any form of coordination whatsoever.

Over time, national courts have developed several mechanisms in order to bypass said lack of discipline and get the highest possible value from the restructuring or the liquidation of the companies of a group.

One of the stratagems consisted in interpreting broadly rules on jurisdiction so that the insolvency of all the companies of a group could have been handled by

1 See the Virgos-Schmit Report, at paragraph 76.

2 Recital 13, EIR.

the same court. The first and most famous attempt in this direction was made by the English courts, followed by other jurisdictions.[3] Besides some criticisms put forward by distinguished authors,[4] the European Court of Justice then intervened with its famous *Eurofood* decision, restraining the possibility to open an insolvency proceeding against a foreign subsidiary in the state where the mother company is incorporated.[5] The Court stated that:

> "…in the system established by the EIR for determining the competence of the courts of the Member States, each debtor constituting a distinct legal entity is subject to its own court jurisdiction…"[6]

in the state where its center of main interests is, which, for a company, is presumed to be the state where it has its registered office.[7] According to the Court, this presumption:

> "…can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect"[8]

but

> "…where a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by the Regulation."[9]

These principles were then upheld in the *Interedil* case.[10] In the light of the above, under the current version of the EIR, only the insolvency of highly integrated international groups, whose subsidiaries have their COMI in the parent company's state, can be resolved in an efficient manner.

3 The following cases are usually recalled: Crisscross Telecommunications Group, Enron Directo, Daisytek, Rover, Brac Rent-A-Car international, EMTEC and Eurotunnel, Cirio Del Monte and Parmalat, EMTEC.

4 See *e.g.* R. van Galen, "The European Insolvency Regulation and Groups of Companies", paper given at the INSOL Europe Annual Congress, Cork, Ireland (16–18 October 2003), copy available at: www.insol-europe.org (last viewed 15 June 2014).

5 *Eurofood IFSC Ltd* (Case C-341/04) [2006] ECR I-03813.

6 Ibid., at paragraph 30.

7 See Article 3(1), EIR.

8 *Eurofood*, above note 5, at paragraph 34.

9 Ibid., at paragraph 36.

10 *Interedil Srl, in liquidation v Fallimento Interedil Srl and Intesa Gestione Crediti SpA* (Case C-396/09) [2011] ECR I-09915, at paragraphs 45-52.

Another explored path consisted in appointing the same insolvency practitioner in all the proceedings or more insolvency practitioners who have successfully worked together in previous cases.[11] However, since everything in these cases depends on the willingness of the courts and of the insolvency practitioners to cooperate, it is submitted that the solution is not a satisfactory one.

The need for specific provisions within the EIR dealing with the insolvency of group of companies has been highlighted several times by distinguished scholars[12] as well as, more recently, by the participants to the consultation on the future of European insolvency law, held from 30 March to 21 June 2012.[13] According to more than a half of them, the EIR does not work efficiently and effectively for the insolvency of a multinational group of companies.[14]

Analysis of the Newly Proposed Provisions

Among the specific provisions on groups of companies proposed by the Commission, the new Article 2(i) needs to be recalled at first providing a definition of "group of companies" as a number of companies consisting of parent and subsidiary companies». In turn, Article 2(j) states that:

> "…"parent company" means a company which (i) has a majority of the shareholders' or members' voting rights in another company (a "subsidiary company"); or (ii) is a shareholder or member of the subsidiary company and has the right to (aa) appoint or remove a majority of the members of the administrative, management or supervisory body of that subsidiary; or (bb) exercise a dominant influence over the subsidiary company pursuant to a contract entered into with that subsidiary or to a provision in its articles of association."

Recital 7 of the Proposal further specifies that:

11 This is what happened, for example, in the *Nortel* case. See, in this sense, European Commission, Commission Staff Working Document – Impact Assessment accompanying the Document Revision of Regulation (EC) No 1346/2000 on insolvency proceedings, 12 December 2012, SWD(2012) 416 final, at note 31, a copy of which is available at: http://ec.europa.eu/justice/civil/files/insolvency-ia_en.pdf (last viewed 15 June 2014).

12 van Galen, above note 4. See also R. van Galen (ed), *Proposal by INSOL Europe for a Revision of the European Insolvency Regulation* (2012, INSOL Europe, Nottingham), at 91. For a thorough analysis of the various proposals put forward by the scholars in order to solve the problems related to reorganization or insolvency of multinational corporate groups, see B. Wessels, "The Ongoing Struggle of Multinational Groups of Companies under the EC Insolvency Regulation" (2009) 6(4) *European Company Law* 169.

13 See: http://ec.europa.eu/justice/newsroom/civil/opinion/120326_en.htm (last viewed 15 June 2014).

14 In particular, among the 111 participants, 53 answered in this sense, 31 answered the opposite and 27 did not answer the specific question.

> "…the definition of the term "group of companies" should be understood as being limited to the context of insolvency and should not have any influence on the company aspects regarding groups."

Coming now to the core discipline regarding insolvency proceedings against groups of companies, the proposed Recitals 20a and 20b outline two different procedures that can be hypothetically chosen. On the basis of the first, which is the default one, several insolvency proceedings are opened in any of the states where the companies of a group have their seats. On the basis of the second, on the contrary, several proceedings with respect to the companies of a group can be opened in just one state and in front of the same court, when the latter finds that the center of main interests of these companies is located in a single Member State.[15] The Proposal regulates in details the first hypothesis, while the second is presumably left to the autonomous regulation of each member state, except for the provision according to which:

> "…the court should also be able to appoint, if appropriate, the same liquidator in all proceedings concerned."[16]

Focusing now on the first hypothesis, the Proposal would add to the EIR a new Chapter IVa entitled «Insolvency of members of a group of companies», comprising Articles from 42a to 42d. These norms deal respectively with the duty to cooperate and communicate information between liquidators; communication and cooperation between courts; cooperation and communication between liquidators and courts; powers of the liquidators and stay of proceedings.

Starting from Article 42a, namely from the duty to cooperate and communicate information between liquidators, first of all it is to be stressed that liquidators are not required to cooperate and exchange information in any case but only to the extent that such cooperation:

(i) is appropriate to facilitate the effective administration of the proceedings;

(ii) is not incompatible with the rules applicable to such proceedings; and

(iii) does not entail any conflict of interests.

15 The Proposal, however, does not give a definition of the Group COMI. See P. Fazzini and M. Winkler, "La proposta di modifica del regolamento sulle procedure di insolvenza" (2013) 1 *Diritto del commercio internazionale* 141. According to the authors, the Proposal does not offer any definition of the Group COMI in order not to excessively interfere with Member States' sovereignty. However, such a choice is looked at as a peculiar one, given the high degree of integration that Member States have in the field of insolvency law.

16 See the proposed Recital 20b.

The provision mentions "agreements" and "protocols" as possible means of cooperation, without however specifying what differences there would be among the two. From a practical point of view, liquidators are required to immediately communicate to each other any information which may be relevant to the other proceedings, provided appropriate arrangements are made to protect confidential information; explore the possibilities for restructuring the group and, where such possibilities exist, coordinate with respect to the proposal and negotiation of a coordinated restructuring plan; coordinate the administration and supervision of the affairs of the group members subject to insolvency proceedings. Moreover, the possibility is foreseen for the liquidators to agree on granting additional powers to the liquidator appointed in one of the proceedings, where such an agreement is permitted by the rules applicable to each of them.

Turning to communication and cooperation between courts, the importance of Article 42b and the innovation that it brings along need to be underlined. Indeed, spontaneous cooperation among courts has always been the hardest to implement, in particular in civil law countries. Difficulties stem from the fact that courts are public law actors governed by procedural norms that, being designed to protect public interests and, in particular, the right to a fair process, cannot be waived by the parties. The proposed provision establishes a duty to cooperate for those courts before which a request to open proceedings concerning a member of the group is pending or which have opened such proceedings. Conditions under which such a duty exists are partially the same as those just considered with respect to cooperation among liquidators: cooperation should be appropriate to facilitate the effective administration of the proceedings and should not be incompatible with the rules applicable to them.

From a practical point of view, on the one side courts are allowed either to communicate with and to request information or assistance directly to each other or to appoint a person or body acting on their instructions; on the other side it is specified that cooperation can be achieved with any appropriate means including:

> "(a) communication of information by any means considered appropriate provided that such communication shall be free of charge and respect the procedural rights of the parties and the confidentiality of information;
>
> (b) coordination of the administration and supervision of the assets and affairs of the members of the group;
>
> (c) coordination of the conduct of hearings; and
>
> (d) coordination in the approval of protocols."

Article 42c deals, as already mentioned, with cooperation and communication between liquidators appointed in insolvency proceedings concerning a member of a group of companies and courts before which a request for the opening of proceedings with respect to another member of the same group is pending or which has opened such proceedings. Conditions for this kind of cooperation are exactly the same as those already seen with respect to cooperation among courts, namely that it is appropriate to facilitate the coordination of the proceedings and that it is not incompatible with the rules applicable to them. The provision under consideration, by stating that:

> "…the liquidator may request information from that court concerning the proceedings regarding the other member of the group or request assistance concerning the proceedings in which he has been appointed…"

seems to infer that the initiative should always come from liquidators. On the contrary, it is submitted that there are no valid reasons to prevent courts from taking the initiative.

Last but not least, Article 42d is as well particularly remarkable, again for its innovative character. It deals with two separate issues: the rights of the liquidators and the stay of proceedings. As to the first, a liquidator appointed in a proceeding involving a member of a group of companies shall have the right:

> "(a) to be heard and to participate, in particular by attending creditors' meetings, in any of the proceedings opened with respect to any other member of the same group;
>
> (b) to request a stay of the proceedings opened with respect to any other member of the same group;
>
> (c) to propose a rescue plan, a composition or a comparable measure for all or some members of the group for which insolvency proceedings have been opened and to introduce it into any of the proceedings opened with respect to another member of the same group in accordance with law applicable to those proceedings; and
>
> (d) to request any additional procedural measures under the law referred to in point (c) which may be necessary to promote rescue, including the conversion of proceedings."

A court in front of which a request to stay the proceedings has been filed, in the exercise of the right provided for under letter (b), shall grant it in whole or in part if it is proven that it would be to the benefit of the creditors. In any case, in order to protect the creditors' interests, the court has the power to require the liquidator to take any suitable measure. As far as duration is concerned, the stay can be ordered for up to three months and it can be continued or renewed for the same period.

Conclusion: Some Remarks on the Proposed Provisions

Two brief remarks need to be done with regard to the provisions just analyzed, in any case bearing in mind that, in principle, the introduction in the EIR of norms regarding insolvency of groups of companies is to be welcome.

The first remark relates to the approach adopted by the Proposal. Even if the new norms provide for important forms of cooperation, they maintain the entity-by-entity scheme which is the one already adopted under the current version of the EIR. After revision, the latter will therefore be just renewed but not modified within its fundamental principles. The newly proposed mechanism clearly benefits from the experience of cooperation developed by liquidators of main and secondary proceedings on the basis of Article 31 of the current version of the EIR. The other solution that was considered for adoption by the European Commission is the one called "procedural consolidation", according to which just one court would have had jurisdiction in relation to all the companies of a group and just one liquidator would have been appointed.[17]

Such a solution would have involved all those benefits which are traditionally linked to a universalist approach and that the Commission itself recognizes. Among these, in particular, an efficient handling of the insolvency proceedings, the avoidance of efficiency losses due to the opening of multiple proceedings and an overall positive economic impact on the insolvent companies. The shortcomings related to a possible deterioration, under the above described regime, of the position of creditors rather than under a territorial approach could have been cured through the adoption of measures that would guarantee the equal treatment of all creditors. Notwithstanding such reflections, in the end, no procedural consolidation has been implemented. The Commission explained its choice by stating that the first option was more adequate to the current situation and therefore more suitable to obtain a wider consensus.[18]

17 See Commission Staff Working Document, above note 11, at 31 and 34.

18 Ibid., at 42-43 and 46.

Indeed, coordination of proceedings is the most frequently adopted solution in the international arena, from the third part of the UNCITRAL Legislative Guide on Insolvency Law[19] to the Prospective Principles for coordination of multinational corporate group insolvencies of the International Insolvency Institute[20] and to the Principles for Effective Insolvency and Creditor/Debtor Regimes of the World Bank.[21] However such a system, promoting parties' autonomy, is entirely based on their capacities and willingness[22] and therefore, as it has correctly been observed, it would hardly work properly in cases involving a strong conflict of interests between creditors of different states.[23]

The second remark relates to one of the conditions to which Articles 42a, 42b and 42c subject cooperation. As it has already been underlined above, among said conditions all the three recalled provisions mention the compatibility of cooperation with the norms applicable to the pertinent proceedings. These norms have, at the current stage, a national origin and may well be based on different principles and values. For this reason, it is believed that the above mentioned norms, by setting forth such a condition, involve the severe risk of spoiling the new provisions of their apparent benefits, nullifying the apparent step forward.

19 Version dated 21 July 2010, a copy if which is available at: http://www.uncitral.org/pdf/english/texts/insolven/Leg-Guide-Insol-Part3-ebook-E.pdf (last viewed 15 June 2014).

20 Version dated June 2012, a copy of which is available at: http://www.iiiglobal.org/component/jdownloads/finish/362/5953.html (last viewed 15 June 2014).

21 Version dated 2011, a copy of which is available at: http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/ICRPrinciples-Jan2011[FINAL].pdf (last viewed 15 June 2014).

22 Fazzini and Winkler, above note 15.

23 L. Panzani, "Il progetto della Commissione europea di riforma del Regolamento 1346/2000", *Il Fallimentarista* (24 April 2013), at paragraph 9.

Chapter 10

The European Insolvency Regulation and the Reduction of Asset-less Insolvencies in Estonia

Signe Viimsalu

Introduction

A common perception is that Estonian bankruptcy proceedings last too long, creditors' claims are satisfied to a small extent and proceedings are too costly. To identify what is the actual situation regarding the efficiency of bankruptcy proceedings in Estonia, the Ministry of Justice of Estonia ordered a survey at the end of 2012. The survey, carried out by PricewaterhouseCoopers Advisors (hereinafter "PwC"), revealed that 58% of bankruptcy cases were completed with abatement before opening bankruptcy proceedings regarding corporate debtors. In 7% of cases bankruptcy proceedings were terminated with abatement during the bankruptcy proceedings and in only 35% of cases were the distributions to the creditors possible.[1] It appeared that the number of bankruptcy proceedings completed with abatement was smaller in the case of public limited companies than in other legal entities, because public limited liability companies require a higher equity and statutory reserve level. According to the survey, private limited companies established without equity contribution have a higher risk of breach of duty of care.[2]

PwC's survey also indicated that in the majority of cases there are insufficient funds to open and carry out the bankruptcy proceedings, which means that most of the problems, which might come up during the bankruptcy proceedings, and many of the associated potential economic crimes, actually remain unsolved. The outcome is that the business owners and management feel no responsibility and there is a lack of protection of creditors' interests.[3] Broadly, PwC tends to believe that there is a major problem with inefficiency of bankruptcy proceedings, which might cause a general stagnation of business ethics and corporate culture in Estonia and has negative effects on both domestic and foreign investors' investment decisions.[4]

1 PricewaterhouseCoopers Advisors, *Maksejõuetuse menetluse tõhususe uuring* (19 March 2013), at 7.

2 Ibid., at 10.

3 Idem.

4 Ibid., at 11.

The Ministry of Justice of Estonia found the outcome of PwC's survey concerning and initiated another research project in late spring 2013. The main purpose of this project was to reduce the number of asset-less insolvencies in Estonia by various appropriate means to be found. The main research questions proposed to THETA research team[5] were:

(1) how to influence the members of the management board to submit insolvency petitions on time;

(2) whether, and if yes, how to apply certain types of business injunction to the members of the management board;

(3) whether it is possible to define in laws the criteria for insolvency as a status and stipulate the moment when a legal entity should be presumed to be permanently insolvent.

In addition, it was required that proposed appropriate measures should have a larger impact on the entrepreneurial ecosystem and should be implemented in the most simple, efficient and effective way – in other words, preferably without allocating additional state funds for those measures to be implemented.

In this chapter, I will describe several prerequisites and various alternative measures found during this research project, and focus on some measures, which were considered appropriate to solve the problems related to the high number of asset-less insolvencies. In addition, certain aspects are shown relevant to take into account in the context of administration of cross-border insolvency proceedings regulated under the European Insolvency Regulation (hereinafter "EIR") in Estonia. However, it should be mentioned that this project is still pending and hopefully the final results will be demonstrated in Estonian legal acts next year.

Prerequisites for Implementing Different Measures in order to reduce Asset-less Insolvencies

It was found during the research project conducted by THETA that it is practically impossible to reduce the number of asset-less insolvencies in Estonia within the given research scope unless Estonia improves its entrepreneurial ecosystem as a whole. This could be achieved for instance by systematic identification and analysis of causes of insolvency, by determination of the exact moment in time when temporary and/or permanent insolvency of the corporate debtor occurs and

5 The THETA team consisted of three researchers: Signe Viimsalu, Ph.D; Mari Stamberg, MBA; Anne Veerpalu, LLM, MBA.

clarification of the severe mismanagement concept. The overall scope revised in the Bankruptcy Act[6] (hereinafter "BA") consisted of the following provisions:

§ 2 – objectives of bankruptcy proceeding;

§ 13 – debtor's bankruptcy petition and list of debts;

§ 23 – remuneration of interim trustee;

§ 28 – criminal offence and grave error in management;

§ 29 – abatement of bankruptcy proceedings without declaration of bankruptcy;

§ 30 – deposit for costs of bankruptcy proceedings; and

§ 91 – prohibition on business.

Cause of Insolvency

The BA § 2 third sentence stipulates as one of the objectives of bankruptcy proceedings in Estonia that in the course of bankruptcy proceedings the cause of the insolvency of the debtor shall be ascertained. This provision in the BA entered into force on 1 January 2010. Despite the legislature's reference to the cause of insolvency to be examined, in practice little attention is paid to that goal. Case law in Estonia is mostly limited to the formal sentences in the court decisions, which state that failure in business of the corporate debtor was not detected by signs of criminal offence or grave error in management. The reality seems to be that bankruptcy proceedings are costly and time-consuming.

Thus, the insolvency practitioner is not motivated to dig out all the details of the case in the preparation phase[7] of the bankruptcy proceedings when the court has appointed an interim trustee to examine whether to open bankruptcy proceedings or to terminate it with abatement due to the insufficiency of resources to proceed. On the other hand, it appears that creditors are not willing to pay a deposit[8] and cover the costs of the proceedings and the Estonian government has not been

6 RT I 2003, 17, 95, in force since 1 January 2004.

7 Note: Estonian bankruptcy proceedings are similar to German bankruptcy proceedings where after the petition to open insolvency proceedings has been filed, a temporary insolvency trustee will be appointed by the court and if there exist grounds to declare the debtor bankrupt, then the proceedings will be opened by the court. Usually, this interim period for investigation lasts for 1-2 months depending on whether the petition was submitted by the debtor or creditor.

8 Note: the court shall not terminate proceedings by abatement if the debtor, a creditor or a third person pays the amount ordered by the court for covering the costs of the bankruptcy proceedings into court (§ 29 (3) of the BA).

willing to allocate extra[9] state funds for examining the causes of insolvency. The outcome seems to be that there is no exhaustive information regarding the causes of insolvency and persons responsible for causing the insolvency may avoid punishment in Estonia.

The UNCITRAL Legislative Guide on Insolvency has indicated that where an insolvency law does not provide for exploratory investigations of insolvent companies with few or no assets, it does little to ensure the observance of fair commercial conduct or to further standards of good governance of commercial entities. Assets can be moved out of companies or into related companies prior to liquidation with no fear of investigation or the application of avoidance provisions or other civil or criminal provisions of the law. Mechanisms for pursuing the administration of such estates may include, as noted above, levying a surcharge on creditors to fund administration, establishing a public office or utilizing an existing office, establishing a fund out of which the costs may be met, or appointing a listed insolvency professional on the basis of a roster or rotation system.[10]

The latter systems are generally designed to ensure a fair and ordered distribution of all insolvency cases, whether with insufficient assets or otherwise, where the insolvency representative will be paid a prescribed stipend by the state or the costs will be borne directly by the insolvency representative and cross-subsidized by their clients generally (since, where they are a professional, their remunerative rates can be adjusted to take into account unremunerated work – this approach could not be taken where the insolvency representative is a government official).[11]

As mentioned above, causes of insolvency are still not regularly examined in a systematic way in Estonia, although there are some good examples of different institutions worldwide dealing with that topic, such as Finland with its independent public institution *The Office of Bankruptcy Ombudsman*,[12] Ireland

9 According to § 23 (3)-(5) of the BA, the maximum hourly wage of an interim trustee is EUR 96. If proceedings commenced on the basis of a petition of the debtor are terminated by abatement without declaration of bankruptcy and the assets of the debtor are insufficient to make the required payments, the court shall order the remuneration of an interim trustee payable and the expenses subject to reimbursement to be paid by the debtor but may order reimbursement thereof from the state funds. The amount of the remuneration and the expenses of an interim trustee reimbursed from state funds shall not exceed EUR 397 (including the taxes prescribed by law, except social tax). The court shall not order reimbursement of the remuneration and the expenses of an interim trustee from state funds if the debtor, a creditor or a third person has paid the amount ordered by the court to cover the remuneration of the interim trustee and the expenses subject to reimbursement into court.

10 UNCITRAL Legislative Guide on Insolvency, at 62 ff.

11 Idem.

12 Konkurssiasiamiehen toimisto: http://www.konkurssiasiamies.fi/index.htm . All websites noted below current as at 15 June 2014.

with *The Directorate of Corporate Enforcement*,[13] Canada with *The Office of the Superintendent of Bankruptcy* and Australia with a special type of fund.[14]

Moment of Truth – Insolvency

In order to improve the entrepreneurial ecosystem in Estonia, it was found during the research project that it is important to increase general awareness about what insolvency is, what are the main components of insolvency, what are the definitions and principles to be implemented in the different insolvency proceedings in Estonia, what is considered a grave management mistake, who can be held responsible for mismanagement, etc. As the Estonian legislator, the Riigikogu, has passed several new laws (such as the Reorganisation Act[15] for enterprises in 2008, Debt Restructuring and Debt Protection Act[16] for natural persons in 2011, and the Bankruptcy Act which has been in force since late 1992, but amended several times), there has been a paradigm shift in favour of the debtor during recent years, although it seems unclear to what extent. What is the scope of liability in insolvency cases?

Credit and different financial instruments have been used in Estonia for only 15 years and are not so well established in practice as in the more developed countries in the European Union. Despite the fact that the Bankruptcy Act uses both balance sheet and cash flow tests (§ 1 (2) and (3) of the BA), determining the exact moment of one's insolvency is still vague in practice. During the research project, it was found that there are some options to solving this problem. First, in order to increase public awareness, especially among the managing bodies of the legal entities, it was proposed to start with sharing some examples,[17] to work out some example tests,[18] to give some guidelines[19] and to organize awareness road-shows, more public workshops and seminars in Estonia. Second, § 13 (2) of the BA[20] should be supplemented in such a way that the corporate debtor is obliged to submit the latest financial reports with its petition. Third, it was found possible to define in the

13 Directorate of Corporate Enforcement: http://www.odce.ie/en-gb/functions/insolvency.aspx .

14 Asset-less Administration Fund: http://insolvencyexperts.com.au/assetless-administration-fund.html .

15 RT I 2008, 53, 296, in force since 26 December 2010.

16 RT I 06.12.2010, 1, in force since 05 April 2011.

17 For instance, in terms of natural persons there is a website called Minu Raha: http://minuraha.ee , but there is no similar website available in the case of legal entities in Estonia.

18 For instance: http://restructuringworks.com.au/is-my-company-insolvent.html .

19 For instance: http://www.odce.ie/en-gb/companylawyou.aspx .

20 § 13 (2) of the BA: "A debtor shall substantiate the insolvency thereof by annexing an explanation concerning the cause of the insolvency and a list of the debts to the bankruptcy petition. The list of the debts shall set out the names and seats or residences of the creditors of the debtor, the claims of the creditors and information concerning the assets of the debtor. The debtor shall sign the explanation and the list of the debts."

BA the criteria for insolvency as a status and stipulate the moment when the legal entity should be presumed to be permanently insolvent.

Puzzle of Liability

During this research project it was found that if general awareness about insolvency as such would fall into place in Estonia, then it would be possible to start talking about mistakes and liability of the members of the management. Although § 28 (2) of the BA stipulates that intentional violation of the obligations of a member of a management body of a debtor who is a legal person or violation of such obligations through gross negligence is deemed to be a grave error in management, and according to § 28 (1) of the BA, if it becomes evident that the debtor has committed an act with criminal elements due to becoming insolvent, the bankruptcy trustee or the court shall give notification thereof to the prosecutor or the police for deciding on the commencement of criminal proceedings, in practice imposing the liability on someone is much more complex. Violation of the obligations of a member of a management body is too vague concept in practice.

As the BA does not stipulate or define the activities, such as fraudulent trading, negligent trading, compulsory stoppage on percentage loss of capital, business misjudgements leading to insolvency, which can be deemed as management mistakes in other jurisdictions,[21] it is almost impossible to impose personal liability on the members of management bodies in Estonia. Thus, it was found during the research project that it would be recommended to revise the concept of personal liability of the members of managing bodies in the case of insolvency (§ 28 of the BA) together with the concept of prohibition on business (§ 91 of the BA) and supplementary punishments for offences (§ 49 and § 491 of the PC[22]) in order to reach a clear understanding about which activities or non-activities formulate personal liability under bankruptcy, civil or criminal law.

In terms of policy, there should be a common understanding of what principle of liability for causing the insolvency is adopted in Estonia. In addition, it would be

21 For instance, see the comparison of actions in different jurisdictions in: INSOL International, *Directors in the Twilight Zone IV* (July 2013).

22 Penal Code. RT I 2001, 61, 364. In force since 01 September 2002. § 49 of the PC: "Occupational ban. A court may deprive a convicted offender of the right to work in a certain position or operate in a certain area of activity for up to three years if the person is convicted of a criminal offence relating to abuse of professional or official status or violation of official duties." § 491 of the PC: "Violation of prohibition to engage in enterprise. (1) The court may impose the prohibition to engage in enterprise on a convicted offender for a term from one to five years if the person is convicted of a criminal offence relating to abuse of official status or violation of official duties or for a criminal offence provided for in this Code. (2) A person with respect to whom a court has imposed a prohibition to engage in enterprise shall not act as an undertaking, member of the management bodies of a legal person, liquidator or procurator of a legal person or participate in the management of the legal person in any other manner during the term specified by the court."

useful to supplement § 28 (2) of the BA with the list of activities and definitions. This revision of different offences and personal liability is found to be relevant also in the light of cross-border insolvency proceedings regulated by the EIR[23], which establishes the principle of automatic recognition of the judgments related to insolvency proceedings.[24] However, it should be noted that according to Article 25 (3) of the EIR the Member States are not obliged to recognize or enforce a judgment, which might result in a limitation of personal freedom or postal secrecy. In order to administrate cross-border insolvency proceedings efficiently it would be useful to revise the regulation in and established under § 91(5) of the BA[25] together with § 28 (2) of the BA, § 49 of the PC and § 491 of the PC.

Different Measures for the Reduction of Asset-less Insolvencies

The PwC survey indicated that approximately 50% of the legal entities each had in total less than EUR 1,000 of assets during their last year of business activities.[26] It is commonly known that bankruptcy proceedings in Estonia cost much more than EUR 1,000 per proceeding. One of the main questions raised during the research project was how to influence the members of the managing bodies of the legal entities to submit insolvency petitions on time[27] or even earlier in order to have the possibility to restructure the enterprise, if needed. During the brainstorming session among research team members several alternative measures were proposed, such as:

1. A debtor's duty to pay the deposit and/or cover the costs of the bankruptcy proceedings in case of abatement;
2. Raising stamp tax for the bankruptcy petition submitted by the debtor;

23 European Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings. Amended by Regulation No. 788/2008. In force since 31 May 2002.

24 Articles 16 and 25, EIR.

25 § 91 (5) of the BA: "The Minister of Justice of Estonia may establish, by a regulation, a list of foreign states the prohibitions on business imposed under whose legislation are recognized in Estonia. The recognized prohibitions on business shall have been ordered by court and the preconditions and content thereof shall be similar to the prohibitions on business imposed on the basis of Estonian law. The duration of recognized prohibitions on business is determined by the law of the corresponding foreign state, the scope of application thereof in Estonia is determined by Estonian law." The Minister of Justice of Estonia has established Regulation No. 17, 29 May 2009 (in force since 06 June 2009) concerning the prohibitions on business imposed in Finland stating that the Republic of Estonia recognizes the prohibitions on business imposed under Finnish legislation.

26 PricewaterhouseCoopers Advisors, above note 1, at 30.

27 § 180 (5^1) first sentence of the Commercial Code: "If a private limited company is insolvent and the insolvency, due to the company's economic situation, is not temporary, the management board shall promptly but not later than within twenty days after the date on which the insolvency became evident, submit the bankruptcy petition of the private limited company to a court."

3. Launch a state deposit system during the establishment of the new company;
4. Different types of business injunctions obligatory community work, temporary seizure of certain personal object, fines, etc.;
5. Strike-off from the business register;
6. Compulsory managerial courses for the members of the managing bodies;
7. Different awareness programmes.

Ideas worth considering

The Ministry of Justice of Estonia took under consideration the idea of establishing the duty to the members of the managing bodies of the legal entities to pay a deposit and/or cover the costs of the bankruptcy proceedings in the case of abatement, especially where there has been a 50% loss of capital in the company and appropriate measures have not been taken[28] for at least six months as of submitting the bankruptcy petition; it has not been possible within a period of two-three months to satisfy a claim in execution proceedings conducted with respect to the debtor due to lack of assets; or the debtor has not handed over the debtor's accounting and financial documents to the interim trustee appointed by the court. It was found fair that the persons who have caused insolvency and have not submitted the bankruptcy petition should cover the costs of the bankruptcy proceedings.

In 2006, the Ministry of Justice of Estonia launched an action plan to improve the entrepreneurial legal system in Estonia to promote its international competiveness, which among other topics consisted of the goal to revise the regulation concerning business injunctions imposed in Estonia.[29] Unfortunately, this topic has not yet been solved. However, hopefully with the good examples from Finland,[30] the

28 For instance, according to § 176 of the Commercial Code, if the net assets of a private limited company are less than one-half of the share capital, or less than the amount of share capital specified in § 136 of this Code or another minimum amount of share capital provided by law, the shareholders shall decide on: 1) a reduction or increase of share capital on the condition that the net assets would thereby form at least one-half of the share capital and at least the share capital specified in § 136 of this Code or other minimum capital provided by law; or 11) the implementation of other measures as a result of which the net assets of the private limited company would form at least one-half of the share capital specified in § 136 of this Code or other minimum capital provided by law; 2) dissolution, merger, division or transformation of the private limited company; or 3) submission of a bankruptcy petition.

29 P. Varul et al., Ettevõtja õigus. Tegevuskava ettevõtlusealase õiguskeskkonna rahvusvahelise konkurentsivõime parandamiseks, *Juridica* 2006/ IV, at 227-233.

30 Laki liiketoimintakiellosta 1985/1059, 13 December 1985, a copy of which is available at: http:/www.finlex.fi/fi/laki/ajantasa/1985/19851059 .

Netherlands,[31] Ireland[32] and the United Kingdom[33] it will be revised during next couple of years.

Ideas maybe not worth implementing

The Ministry of Justice of Estonia did not support the idea to raise stamp tax for bankruptcy petitions submitted by the debtors even though the situation is not equal at the moment. However, stamp tax for bankruptcy petitions submitted by the creditors is many times higher than in the case of bankruptcy petitions submitted by the debtors and in the latter case bankruptcy proceedings are much more complicated and require time, effort and work from the courts and insolvency practitioners.

In addition, the Ministry of Justice of Estonia was not in favour of launching a state deposit system during the establishment of the new company in Estonia. It should be noted that setting up a business in Estonia is presumed to be very simple. It is widely known that the establishment of a business association, a self-employed person or a non-profit association in Estonia is one of the fastest procedures in Europe – it takes approximately 15 minutes in the Commercial Register if all persons related to the legal entity have ID cards. Registration applications can be submitted via the Company Registration Portal[34] by persons having an Estonian, Portuguese, Belgian, Finnish or Lithuanian ID card. However, as there are a high number of asset-less insolvencies in Estonia, the THETA team demonstrated an Irish example where in the case of the establishment of a new company without capital contribution during registration process, the stamp tax required by the state is higher and in addition the state requires a deposit[35] for the potential breaches in the Companies Act.

Also, the Companies Act requires that a company should have one director resident in the European Economic Area (EEA) (the EU States plus Iceland, Liechtenstein

31 For instance, see the Dutch chapter in INSOL International, above note 21, at 289-300.

32 For instance, see the summary of the principal duties and penalties under the Companies Act in: http://www.odce.ie/en-gb/companylawyou/companiesdirectorssecretaries/individualbooklets.aspx . Persons convicted in the Circuit Court or higher of an indictable offence relating to a company or involving fraud or dishonesty are automatically disqualified for five years from acting as company officers (directors, secretary, auditor, liquidator, etc.) Also, if a person is disqualified in another state and fails to notify the Registrar of Companies on appointment as a director they are automatically disqualified. Where a person that is restricted acts except in the circumstances allowed (company is capitalized adequately) the person is guilty of an offence and if convicted can be disqualified. And a director who allows a company to be struck off the register of companies for failing to file annual returns and that company owes money can be disqualified.

33 Insolvency Act 1986 (as amended), Company Directors Disqualification Act 1986 (as amended) and Companies Act 2006 (as amended).

34 Company Registration Portal: http://www.rik.ee/en/company-registration-portal .

35 Companies Registration Office: http://www.cro.ie/ena/opening-deposit-account.aspx .

and Norway). If no director is resident in the EEA, the company must hold a bond to the value of EUR 25,395. If companies can prove they have a permanent place of business in the state they can also avoid this obligation.[36] THETA found that in the cases where a certain person has caused abatement of bankruptcy proceedings many times, the possibility to establish a new company should not be so simple anymore. Implementing modifications to the current regulation with the available ICT systems in Estonia should not be difficult.

Where a company defaults in performing its certain legal obligations, e.g. fails to file an annual return with the Registrar of Companies, the Registrar can strike the company off the register of companies in Ireland.[37] The same is applied in Estonia. However, a fundamental difference is that if struck off the register, ownership of a company's assets automatically transfers to the state in Ireland, where nothing happens and members of the managing bodies feel relieved with the fact that the company has been deleted from the register in Estonia. In Ireland, the ownership will remain with the state until such time as the company is restored to the register. While struck off, the liability of every director, officer and member of the company continues and may be enforced as though the company had not been dissolved in Ireland. Moreover, a director who allows a company to be struck off the register of companies for failing to file annual returns and that company owes money can be disqualified. THETA found the same approach also useful to consider in Estonia in the future.

Conclusion

The main purpose of this project was to reduce the number of asset-less insolvencies in Estonia by various appropriate measures, which should have a larger impact in the entrepreneurial ecosystem and should be implemented in the most simple, efficient and effective way. The reality in the current phase of the project appears to be that without allocating extra state funds for supporting the goal it is impossible. There are larger policy issues to consider before the real steps can be taken at legislative level.

36 Office of the Director of Corporate Enforcement. Directorship of a Company: http://www.odce.ie/en-gb/faq/directorshipofacompany.aspx .

37 The Principal Duties and Powers of Company Directors under the Companies Acts 1963-2009: http://www.odce.ie/Portals/0/Documents/Company%20law%20and%20you/Companies%20Directors%20etc/Individual%20Booklets/4.3%20Company_Directors.pdf .

Chapter 11

Transforming Global Insolvency Principles into a European Format

Bob Wessels

Introduction

With external funding,[1] the Leiden and Nottingham Law Schools[2] are cooperating in developing "guidelines" or "standards" for cross-border communication and cooperation in insolvency cases between courts in the European Union. The result should reflect the central principle of cross-border cooperation and coordination between concurrent insolvency proceedings and should lead to a set of Principles ("*EU Cross-Border Insolvency Court-to-Court Cooperation Principles*") and Guidelines ("*EU Cross-Border Insolvency Court-to-Court Cooperation Guidelines*"):

(i) ensuring as far as possible that the EU Insolvency Regulation works in practice, to efficiently and effectively deal with the debtor's estate;

(ii) fitting the current environment where solutions have been developed based on models reflecting cooperation and communication;

(iii) guaranteeing the organisation and conduct of a fair legal process and ensuring the fair representation of stakeholders concerned in insolvency processes.

These *EU Cross-Border Insolvency Court-to-Court Principles* and *Guidelines* should present a non-binding statement. Their aim is to cover all jurisdictions of the European Union, especially those Member States to which the European Insolvency Regulation ("EIR") applies.[3] To a large extent, these EU Cross-Border Insolvency Court-to-Court Principles and Guidelines build further on the *Global Principles for Cooperation in International Cases* ("*Global Principles*" or "*June*

1 From the European Commission (Action Grant Civil Justice-Programme) and the International Insolvency Institute (III).

2 For the Leiden Law School: Professor Jan Adriaanse, Dr. Bernard Santen and myself; for the Nottingham Law School: Professor Paul Omar.

3 Council (EC) Regulation no. 1346/2000 of 29 May 2000, which entered into force on 31 May 2002. The EIR does not apply to Denmark.

2012 Global Principles"), laid down in a report from June 2012, presented to the American Law Institute ("ALI") and International Insolvency Institute ("III"). These Global Principles were drafted by Professors Ian F. Fletcher (University College London, UK) and Bob Wessels (University of Leiden, the Netherlands). These Global Principles include a set of *Global Guidelines for Court-to-Court Communications in International Insolvency Cases*.[4]

The other important source for the text of these EU Cross-Border Insolvency Court-to-Court Principles is the *European Communication and Cooperation Guidelines for Cross-Border Insolvency* (also known as "*CoCo Guidelines*"). The CoCo Guidelines were developed under the aegis of INSOL Europe (generally representing the European insolvency community) and were published in 2007. This initiative was jointly chaired by Professors Bob Wessels and Miguel Virgós (University Autonomá, Madrid, Spain) and aimed to provide non-binding guidelines to supplement the framework of Article 31 of the EIR. This provision lays down the duty of a liquidator appointed in main insolvency proceedings and those liquidators appointed in secondary proceedings concerning to the same debtor to cross-border communicate and cooperate with each other.[5]

Finally, the *EU Cross-Border Insolvency Court-to-Court Principles* build on other regional and international initiatives to extend to the global level awareness of the fundamental need for cooperation and communication, adding to the consensus being seen in the area of cross-border insolvency. These Principles also include a set of *EU Guidelines for Court-to-Court Communications in International Insolvency Cases*. During the course of the work of developing these Principles and Guidelines, as further set out below, the name "JudgeCo project" was adopted. It therefore seems appropriate to refer to the Principles with the abbreviation "*EU JudgeCo Principles*", and to the Guidelines as "*EU JudgeCo Guidelines*".

Efficient and effective judicial cooperation in cross-border insolvency cases is vital for the rescue of businesses with employees, assets and operations in more than one EU Member State. The existing state of such cooperation is non-existent or

4 The full text may be seen at: http://www.iiiglobal.org/component/jdownloads/finish/557/5932.htm . Also referred to as: (June 2012) Global Principles Report. The Global Principles build further on the American Law Institute's Principles of Cooperation among the member-states of the North American Free Trade Agreement (the "ALI/NAFTA Principles"). These Principles were evolved within the American Law Institute's Transnational Insolvency Project, conducted between 1995 and 2000, for which the Reporter was Professor Jay L. Westbrook, with the objective to provide a non-statutory basis for cooperation in international insolvency cases involving two or more of the NAFTA states, consisting of the United States, Canada and Mexico.

5 The text may be viewed at the INSOL Europe website: www.insol-europe.org or at my website: www.bobwessels.nl . These CoCo Guidelines have received attention both in legal literature as well as from practitioners and judges and were for instance taken into account in the June 2009 Global Cross-Border Insolvency Protocol for the Lehman Brothers Group of Companies.

weak. Obstacles include formalistic and detailed national procedural law, concerns about a judge's impartiality, unfamiliarity with already existing tools and methods for cross-border cooperation, uneasiness with the use of certain legal concepts and terms, and, evidently language. The results of the EU JudgeCo project ("best practices", "guidelines" and training) further build on existing experience and tested resources, especially in cross border cases in North America.

Principles: Systematic Evaluation of the Global Principles in a European Context

The present status of the work (mid-December 2013) is that a first (non-public) draft of a text has been developed of the *EU Cross-Border Insolvency Court-to-Court Principles.* They cover as their core 27 recommendations for cross-border cooperation between courts in different Member States, involved in insolvency proceedings concerning the same debtor. These principles are based on the result of a research survey to establish the extent to which its respondents feel it is feasible to achieve a European acceptance of the June 2012 Global Principles, either in their existing form or, if necessary, with modifications or variations.

An important factor furthermore has been that the Principles to be developed should fit into the existing treaties of the EU, more specifically the EU's so called "Stockholm Programme" to create guidelines for a common policy on a group of topics within the area of "Freedom, Security and Justice". One of the core ground rules is that the judgments deriving from one Member State will be recognized in other Member States (except for Denmark) on the basis of "mutual trust". To a large extent in the field of insolvency such recognition is "automatic" (Articles 16 and 17 of the EIR). The interpretation of the accompanying legal rules should be exercised in a non-national, "European" way, with the purpose to create a better functioning internal market. See Recital 4 to the EIR.[6] The *EU Cross-Border Insolvency Court-to-Court Guidelines* contain in their first (non-public) draft 18 Guidelines. I will not explain these further here.

The chosen method to develop the *EU Cross-Border Insolvency Court-to-Court Cooperation Principles* has been a systematic evaluation of the possibility of adapting the June 2012 Global Principles.[7] The project's ultimate aim is to provide a standard (legally non-binding) statement of Principles and Guidelines suitable for

6 Text: "The proper functioning of the internal market requires that cross-border insolvency proceedings should operate efficiently and effectively and this Regulation needs to be adopted in order to achieve this objective which comes within the scope of judicial cooperation in civil matters…" within the meaning of Article 81 of the Treaty on the Functioning of the European Union ("TFEU").

7 See for the method adopted, the June 2012 Global Principles Report, at paragraph 1.4.2.

application within the specific EU context in cross-border insolvency cases. This specific EU context is generally reflected in six areas:

(1) consistency with international norms;

(2) goals of the EU;

(3) the existence of national procedural law;

(4) the existing EIR;

(5) ongoing case law; and

(6) developments within the EU legislature and the European Judicial community.

Consistency with International Norms

During the development of the Global Principles many of the publications related to "insolvency", by such organisations as UNCITRAL, EBRD, the World Bank and INSOL Europe have been taken into account.[8] It has been an integral part of the evaluation to identify core values and principles that respondents to the two questionnaires (sent out in May 2013 and July 2013) are aware of and which they feel should be considered in the evaluation of the present texts or in a proposal for a revised or a new "Principle" or "Guideline". These respondents do form a review and advisory committee to our drafting work and do consist of over forty experts, including some European judges. Consistency with international (non-binding) norms should enhance certainty in European insolvency practice and stability in the furthering of the EU JudgeCo Principles and Guidelines.[9]

Goals of the EU: Judicial Cooperation

As outlined above, within the EU cross-border judicial communication and cooperation is developed for the area "Freedom, Security and Justice". This requires a proper functioning of the internal market on the basis that cross-border insolvency proceedings should operate efficiently and effectively resulting in

8 See for a number of sources, the Global Principles Report, at 22.

9 Ibid., at 55, where it is furthermore explained that it has benefited from the experiences gained in (non-insolvency related) cross-border activities in the area of law and the recommendations made by judges and experts in some 50 jurisdictions, together with the European Commission, the International Association of Women Judges, as well as the Hague Conference on Private International Law (HCCH), with references to: J. Farley, "Good Practices in the Field of Cross-Border Insolvency Proceedings in Light of the Proposed Hague Draft General Principles for Judicial Communications", *The Judges' Newsletter on International Child Protection* (Vol. XV/Autumn 2009 Special Focus, Theme 3), available at: www.hcch.net , and the Report on Judicial Communications in Relation to International Child Protection (April 2011), drawn up by Philippe Lortie, First Secretary of the HCCH Permanent Bureau, and an accompanying Report of March 2011, which includes "Principles for Direct Judicial Communications in Specific Cases including Commonly Accepted Safeguards".

the goal that the Principles and the Guidelines should be efficient and effective, whilst actively aiming at the strengthening of confidence in the European judicial area. This is a challenge as it is acknowledged by several respondents that in some Member States the quality of judges is mediocre, the court's infrastructure and available means are poor, the knowledge of the Insolvency Regulation is insufficiently developed, the experience to deal with international insolvency cases or the mastering of a second language (for instance English, German or French) is lacking,[10] whilst the awareness of the impact of international business is not often understood.[11]

Existence of National Procedural Law

Article 81 paragraph 2 of the TFEU provides that in developing judicial cooperation in civil matters having cross-border implications, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt measures, particularly when necessary for the proper functioning of the internal market, aimed at ensuring:

> "…(f) the elimination of obstacles to the proper functioning of civil proceedings, if necessary by promoting the compatibility of the rules on civil procedure applicable in the Member States."

Several of the Global Principles aim to set non-binding rules related to matters regarding businesses that in many EU Member States form an integral part of national procedural law, many times in domestic legislation regarding civil procedure or insolvency procedural rules. In legal literature it is questioned whether Article 81(2)(f) TFEU may form the basis for an alignment of the civil procedural rules of the Member States irrespective of the national or international character of the litigation at hand.[12] Where many of these rules not only apply to businesses, but also to natural persons (consumers) the respondents to the survey have been asked to take this observation into account.

10 In general on this subject, see A. Sadler, "Practical Obstacles in Cross-border Litigation and Communication Between (EU) Courts" (2012) 5(3) *Erasmus Law Review*, copy available at: www.erasmuslawreview.nl .

11 It should be added that several respondents have also criticized the quality of persons acting in a role as insolvency office holder, their understanding of the EIR, their lack of expertise and their means to deal with foreign insolvency office holders and/or courts.

12 For this view, see C. van Ree, "Harmonisation of Civil Procedure: An Historical and Comparative Perspective", in: X. Kramer and C. van Ree (eds.), *Civil Litigation in a Globalised World* (2012, T.M.C. Asser Press, The Hague), 39ff., submitting that business will regard these as obstacles in their decisions where to produce, market or sell their products and services. Strong support for the view that differences in national procedural rules function as trade obstacles can be found in two articles by the Hon. J. Spigelman, who retired in 2010 as Chief Justice of New South Wales, Australia: "Transaction Costs and International Litigation" (2006) 80 *Australian Law Journal* 438; "Cross-Border Insolvency: Co-operation or Conflict?" (2009) 83 *Australian Law Journal* 44.

The Existing EIR

The EIR is binding in its entirety and directly applicable in the Member States in accordance with the Treaty establishing the European Union (Article 47 of the EIR). It is therefore nonsensical to test the possible application of Global Principles that would contradict the rules contained in the Regulation or those matters that clearly belong to the national domain of local procedural or insolvency law of the Member States. For this reason, out of the 37 Global Guidelines, 10 have been analysed and selected that would most certainly be against the text of the EIR or domestic law. These are Global Principles 7 (Recognition), 12 (Adjustment of Distributions), 13 (International Jurisdiction), 14 (Alternative Jurisdiction), 24 (Control of Assets), 26 (Cooperation), 32 (Avoidance Actions), 33 (Information Exchange), 34 (Claims) and 35 (Limits on Priorities). These Global Principles were left out of further study and research.

Ongoing Case Law

New case law applying the EIR or judgments from national (higher) courts has also been taken into account. An example is provided by the judgment of 22 November 2012 of the Court of Justice of the European Union in the matter of *Bank Handlowy w Warszawie SA, PPHU 'ADAX'/Ryszard Adamiak, V Christianapol sp. z o.o.* (Case C-116/11). Following the approval of a rescue plan (*procédure de sauvegarde*) by the French court in Meaux, the Polish court:

> "… asked the Tribunal de commerce de Meaux whether the insolvency proceedings in France, which were main proceedings for the purposes of the Regulation, were still pending. The answer given by the French court did not provide the necessary clarification. The referring court then consulted an expert."

The Polish court (*Sąd Rejonowy Poznań-Stare Miasto w Poznaniu*) then decided to stay the proceedings pending before it and to refer questions to the Court of Justice of the EU for a preliminary ruling, which led to the judgment that Article 27 of the EIR must be interpreted as meaning that it permits the opening of secondary insolvency proceedings in the Member State in which the debtor has an establishment, where the main proceedings have a protective purpose:

> "It is for the court having jurisdiction to open secondary proceedings to have regard to the objectives of the main proceedings and to take

account of the scheme of the Regulation, in keeping with the principle of sincere cooperation."[13]

Therefore, the principle of sincere cooperation laid down in Article 4(3) EU requires the court having jurisdiction to open secondary proceedings to address the challenge:

(i) to have regard to the objectives of the main insolvency proceedings; and

(ii) to take account of the scheme of the Regulation, which aims to ensure efficient and effective cross-border insolvency proceedings through mandatory coordination of the main and secondary proceedings guaranteeing the priority of the main proceedings.

This introduction to the EU JudgeCo Guidelines only signals the challenge for such a court to communicate with the liquidator in the main proceedings and to ensure that he will cooperate. The challenge resulting from the judgment for cross-border court-to-court cooperation is addressed in these Principles.[14]

Developments within the EU legislature and the European Judicial Community

On 12 December 2012, the European Commission published a Proposal for a Regulation amending the EU Insolvency Regulation [COM(2012)744], which includes a Report on the application of the EIR [Com(2012)743].[15] This latter Application Report summarises experiences reported by all Member States in the course of 2012, and provides (at page 14):

13 From the Court's arguments:
"59 As observed by the referring court, the fact remains that the opening of secondary proceedings, which, under Article 3(3) of the Regulation, must be winding-up proceedings, risks running counter to the purpose served by main proceedings, which are of a protective nature.
60 It should be noted that the Regulation provides for a certain number of mandatory rules of coordination intended to ensure, as expressed in recital 12 in the preamble thereto, the need for unity in the Community. In that system, the main proceedings have a dominant role in relation to the secondary proceedings, as stated in recital 20 in the preamble to the Regulation.
61 The liquidator in the main proceedings thus has certain prerogatives at his disposal which allow him to influence the secondary proceedings in such a way that the protective purpose of the main proceedings is not jeopardised. (…)
62 The principle of sincere cooperation laid down in Article 4(3) EU requires the court having jurisdiction to open secondary proceedings, in applying those provisions, to have regard to the objectives of the main proceedings and to take account of the scheme of the Regulation, which, …, aims to ensure efficient and effective cross-border insolvency proceedings through mandatory coordination of the main and secondary proceedings guaranteeing the priority of the main proceedings."

14 The JudgeCo project has taken into account developments in applying Article 31, EIR in court cases, the use of the CoCo Guidelines, scholarly literature regarding "liquidator-to-liquidator" communication and cooperation and initiatives to harmonise professional and ethical requirements for insolvency office holders. In the JudgeCo project, however, only those matters which have a bearing on court-to-court cooperation can be taken into account. The EU JudgeCo Guidelines relate to court-to-court cooperation; they do not address cross-border cooperation between courts and liquidators.

15 See: http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm .

> "The duties to cooperate and communicate information under Article 31 of the Regulation are rather vague. The Regulation does not provide for cooperation duties between courts or liquidators and courts. There are examples where courts or liquidators did not sufficiently act in a cooperative manner. These findings are confirmed by the results of the public consultation where 48% of the respondents were dissatisfied with the coordination between main and secondary proceedings."

In the Proposal itself, in Recital 20 to the EIR, it is expressed that main insolvency proceedings and secondary proceedings can only contribute to the effective realisation of the total assets if all the concurrent proceedings pending are coordinated. Then follows (the words underlined are new in comparison to the existing text):

> "(20) … The main condition here is that the various liquidators and the courts involved must cooperate closely, in particular by exchanging a sufficient amount of information. In order to ensure the dominant role of the main proceedings, the liquidator in such proceedings should be given several possibilities for intervening in secondary insolvency proceedings which are pending at the same time. In particular, the liquidator should be able to propose a restructuring plan or composition or apply for a suspension of the realisation of the assets in the secondary insolvency proceedings."

The Proposal is infused by the strengthening of the paradigm of communication and cooperation in cross-border cases. Examples are an extended draft Article 31 (Cooperation and communication between liquidators),[16] a new Article 31a

16 Extended Article 31 – Cooperation and communication between liquidators:
"1. The liquidator in the main proceedings and the liquidators in the secondary proceedings shall cooperate with each other to the extent such cooperation is not incompatible with the rules applicable to each of the proceedings. Such cooperation may take the form of agreements or protocols.
2. In particular, the liquidators shall:
(a) immediately communicate to each other any information which may be relevant to the other proceedings, in particular any progress made in lodging and verifying claims and all measures aimed at rescuing or restructuring the debtor or at terminating the proceedings, provided appropriate arrangements are made to protect confidential information;
(b) explore the possibility of restructuring the debtor and, where such possibility exists, coordinate the elaboration and implementation of a restructuring plan;
(c) coordinate the administration of the realisation or use of the debtor's assets and affairs; the liquidator in the secondary proceedings shall give the liquidator in the main proceedings an early opportunity to submit proposals on the realisation or use of the assets in the secondary proceedings."

(Cooperation and communication between courts),[17] and a new article 31b (Cooperation and communication between liquidators and courts).[18] Finally, in a new recital 20a, it is stressed that the amended Insolvency Regulation should ensure the efficient administration of insolvency proceedings relating to different companies forming part of a group of companies. Where insolvency proceedings have been opened for several companies of the same group, these proceedings should be properly coordinated and the various liquidators and courts concerned are under the same obligation to cooperate and communicate with each other as those involved in main and secondary proceedings relating to the same debtor (Article 42b of the Proposal). In the Proposal the final sentence of Recital 20 reads as follows:

> "In their cooperation, liquidators and courts should take into account best practices for cooperation in cross-border insolvency cases as set out in principles and guidelines on communication and cooperation adopted by European and international associations active in the area of insolvency law."

In the light of these developments, it has been submitted that within the EU, there is an open attitude towards 'best practices' such as those under review in the JudgeCo-project. Indeed, an endorsement to take into account the Global Principles follows from Commission Staff Working Document (Impact Assessment, SWD(2012) 416

17 New Article 31a – Cooperation and communication between courts
"1. In order to facilitate the coordination of main and secondary insolvency proceedings concerning the same debtor, a court before which a request to open insolvency proceedings is pending or which has opened such proceedings shall cooperate with any other court before which insolvency proceedings are pending or which has opened such proceedings to the extent such cooperation is not incompatible with the rules applicable to each of the proceedings. For this purpose, the courts may, where appropriate, appoint a person or body acting on its instructions.
2. The courts referred to in paragraph 1 may communicate directly with, or to request information or assistance directly from each other provided that such communication is free of charge and respects the procedural rights of the parties to the proceedings and the confidentiality of information.
3. Cooperation may be implemented by any appropriate means, including
(a) communication of information by any means considered appropriate by the court;
(b) coordination of the administration and supervision of the debtor's assets and affairs;
(c) coordination of the conduct of hearings,
(d) coordination in the approval of protocols."

18 New Article 31b – Cooperation and communication between liquidators and courts
"1. In order to facilitate the coordination of main and secondary insolvency proceedings opened with respect to the same debtor,
(a) a liquidator in main proceedings shall cooperate and communicate with any court before which a request to open secondary proceedings is pending or which has opened such proceedings and
(b) a liquidator in secondary or territorial insolvency proceedings shall cooperate and communicate with the court before which a request to open main proceedings is pending or which has opened such proceedings,
2. The cooperation referred to in paragraph 1 shall be implemented by any appropriate means including the means set out in Article 31a (3) to the extent these are not incompatible with the rules applicable to each of the proceedings."

final), at 24), where it is stated:

> "In order to ensure the coordination of proceedings opened in several Member States, the Regulation obliges insolvency practitioners to communicate information and cooperate with each other. Several guidelines for practitioners on cooperation and communication in cross-border insolvencies have been developed by associations of practitioners [51]."

Footnote [51] reads:

> "The most recent example are the Global Principles for Cooperation in international insolvency cases from the American Law Institute and the International Insolvency Institute, elaborated by Ian Fletcher and Bob Wessels (2012)."

These developments have led to the question to the respondents to allow themselves a forward-looking vision anticipating the challenges the judiciary in general faces.

By applying these elements as set out in paragraphs 2.2.1 – 2.2.6 the EU JudgeCo Guidelines – although being a non-binding statement – are in line with the European context as set out and with international developments and other attempts at developing modes of international cooperation in the area of international insolvency.

The EU JudgeCo Principles' Objectives

As indicated, the primary aim of the JudgeCo project is to develop "guidelines" or "standards" for cross-border communication and cooperation in insolvency cases between courts in the European Union as a result of a systematic evaluation of the possibility of adapting the June 2012 Global Principles.

A strong signal of the fact that the June 2012 Global Principles are capable of realising these goals and provide practical use and guidance comes from two courts in the UK and in the USA. The Supreme Court of the United Kingdom (*Conjoined Appeals in (1) Rubin & Anor v Eurofinance SA & Ors and (2) New Cap Reinsurance Corp Ltd & Anor v Grant and others*) [2012] UKSC 46 (24), has referred to:

> "…the modern approach in the primary international and regional instruments, the EC Insolvency Regulation on Insolvency Proceedings … and the Model Law, which is that the jurisdiction with international competence is that of the country of the centre of main interests

of the debtor (an expression not without its own difficulties). It is ultimately derived from the civil law concept of a trader's domicile, and was adopted in substance in the draft EEC Convention of 1980 as a definition of the debtor's centre of administration: see Report by M Lemontey on the draft EEC Bankruptcy Convention, Bulletin of the European Communities, Supp 2/82, p 58; American Law Institute, *Transnational Insolvency: Global Principles for Co-operation in International Insolvency Cases* (2012), Principle 13, pp 83 et seq."

Another reference to the June 2012 Global Principles has been made by the United States Court of Appeals for the Third Circuit (in *Re ABC Learning Centres*) on 27 August 2013. The Court made references to Global Principle 1, citing that it sets out:

> "…the overriding objective [which is to] enable … courts and insolvency administrators to operate effectively and efficiently in international insolvency cases with the goals of maximizing the value of the debtor's global assets, preserving where appropriate the debtors' business, and furthering the just administration of the proceeding."[19]

The secondary aim of the JudgeCo project is develop comprehensive training and tools to build capacity amongst judges/practitioners, chiefly in recent EU accession countries, to give full effect to the Insolvency Regulation, to develop uniform interpretation of insolvency terms and concepts, to enable familiarity with the developed EU JudgeCo Principles and Guidelines, and by doing so enhancing the efficiency and effectiveness of insolvency proceedings having cross-border effects which will provide greater certainty and predictability in the market.

Conclusion

Using non-binding principles, guidelines or recommendations is not new in European insolvency practice, but there is only limited experience. It is "new" for judges, though. The assumption is that closer approximation of national laws, especially insolvency laws, has always been seen as unattainable. Where political unanimity, as necessary under Article 81 of the TFEU, seems to be hard to achieve, "best practices" are seen as an alternative. The JudgeCo project combines existing

19 Another part of the June 2012 Global Principles Report is cited too by this Court of Appeal: "[T]he emphasis must be on ensuring that the insolvency administrator, appointed in that proceeding, is accorded every possible assistance to take control of all assets of the debtor that are located in other jurisdictions." Idem at comment to Global Principle 24.

expertise with a framework in which judges and other experts are able to be directly involved in the drafting process. The project is innovative as it aims to include the actors concerned in the development of certain rules, encouraging them to achieve greater convergence to the main EU goals. The strong European basis of the project is unique and well spread, but flows rather logically from the way existing networks especially of academics and practitioners have functioned for over ten years. However, insolvency is “global” and in other parts of the world principles and guidelines have been developed and used in cross-border cases for over twenty years.

In developing the European (soft law) instruments “EU Cross-Border Insolvency Court-to-Court Cooperation Principles” and “EU Cross-Border Insolvency Court-to-Court Cooperation Guidelines”, the project further builds on recent (non-European) results and warrants its consistency with international norms by organising input from judges located outside Europe, such as judges participating in a Members Advisory Committee of International Insolvency Institute. Also, the project’s results may be a well prepared step for certain measures to be taken by the European Commission (e.g. a “recommendation”?, an “opinion”?) or they may be used for the “approximation” of civil, procedural or insolvency laws of the Member States. In this way the efficiency and effectiveness of insolvency proceedings having cross-border effects will be enhanced and will provide greater certainty in the market.

To be continued.

Chapter 12

The Reform of the European Insolvency Regulation: Is there any Space for Private Autonomy?

Matteo Winkler

Introduction

In 2010, the Civil Division of the Court of the Hague (*Rechtbank 's-Gravenhage*) was involved in an interesting case regarding a Dutch businessman who had its main assets in Germany. While Dutch law allowed him to seize the local courts to obtain an order to compel dissenting creditors to a restructuring plan to abide by it if they had refused to adhere to the plan unreasonably, an institution commonly referred to as "*cram down*", German law did not provide such a remedy.[1]

Upon petition from the businessman, the Court of the Hague reasoned as follows:

> "The debt of debtor… consists entirely of claims of creditors resident in Germany. Also the dissenting creditors are located in Germany. The underlying application is thus in fact directed exclusively against German creditors and the judgment will be implemented in Germany upon express request. This presents a problem, because [...] the judgment is not subject to the automatic recognition pursuant to Article 16 of the Insolvency Regulation. Under Article 16 of the [Regulation], Member States must recognize automatically those procedures listed in Annex A. The [compulsory composition] scheme is not mentioned in Annex A. Therefore, there is no requirement for automatic recognition by the other Member States under Article 16 [of the Regulation]."[2]

In short, the Court rejected the debtor's request because, as the plan was not included in the European Insolvency Regulation ("EIR"), German courts would

1 Wholly considered, "German law [is] insufficiently restructuring-friendly": R. Bork, *Rescuing Companies in England and Germany* (2012, Oxford University Press, Oxford), at § 1.08.

2 Rechtbank 's-Gravenhage (Court of First Instance of the Hague, Civil Division), 10 June 2010, Case LJN BN9604. The decision can be read in Dutch at: http://jure.nl/ecli:nl:rbsgr:2010:bn9604 (last viewed 15 June 2014). The translation provided here comes from this text.

not recognize it under the EIR, and therefore the restructuring would have been ultimately unenforceable and completely ineffective in the place where it should have been instead. Accordingly, the businessman cannot but resort to liquidation, even if he could have easily restructured and redressed its situation, if the order had been granted.

The case illustrates one of the current flaws of the EIR that pushed the European Commission to elaborate significant changes in the EIR. It also makes clear that radical differences still exist between the national laws of Member States regarding the role of private autonomy in corporate restructuring. Sometimes companies are able to escape the liquidation mechanisms imposed by a country by moving to another one. This happened in 2007, for instance, in the case of Schafenacker, a car retail manufacturer incorporated in Germany that found itself in a situation of default. With the help of accountants and law firms, Schafenacker was able to move to the more restructuring-friendly England, where it entered into a restructuring agreement with its creditors.[3] Someone talked of "restructuring tourism" or "migration".[4] Besides the nomenclature, the question remains that regardless of its name the present era is characterized by a prominent role of private autonomy at a transnational level.

Private autonomy is the capacity of private actors to determine and obtain enforcement of their own legal preferences independently from collective or third parties' interests. Its relationship with bankruptcy and insolvency in general was and is problematic and controversial. Until recently, after insolvency had been officially declared, as a normal practice the debtor was divested of its assets, a representative (trustee) was appointed, and creditors may eventually enforce their claims only according to the principle of *par condicio creditorum*.[5]

This situation, however, has changed profoundly in the last three decades, leaving more space to the parties' freedom to remedy the debtor's troubles. Nowadays, the general purpose of insolvency proceedings is no longer dissolution but recovery, and insolvency laws assign private actors a significant statutory freedom, certainly

3 On the influence that globalization produced on law firm, bringing them to act globally by definition, see J. Flood, "Institutional Bridging: How Large Law Firms Engage in Globalization" (2013) 54(3) *Boston College Law Review* 1087.

4 See R. Mitchell, "The Lessons of Schafenacker" (August 2007), a copy of which is available at: www.globalturnaround.com (last viewed 15 June 2014).

5 This was true for many national laws for decades. For instance, in the United Kingdom until the enactment of section 425, Companies Act 1985: "…there were no specific rescue provisions in English law; the emphasis in insolvency proceedings was very much on liquidation. As far as statutory provisions were concerned, this emphasis remained pretty much the same for about 100 years, until the end of 1986." (G. Moss, "Comparative Bankruptcy Cultures: Rescue or Liquidation? Comparison of Trends in National Law—England" (1997) 15 *Brooklyn Journal of International Law* 115, at 115.

more significant than in the past. Today's keywords in insolvency amount to the "Three *R*s": Renegotiate, Reorganize, Restructure. They typically call into question private autonomy.

These pages are about private autonomy in cross-border insolvency law, with particular focus on the recent attempt to amend the EIR.[6] They proceed as follows. In the first part, I propose a very general and short commentary of the EIR's reform in respect of private autonomy. The second part deals with private arrangements and their circulation in the EU. The third part discusses the so-called "insolvency protocols", which the Proposal recognizes for the first time as an instrument of cross-border insolvency management. A concluding paragraph will follow at the end.

Private Autonomy in the Reform of the European Insolvency Regulation: General Aspects

On 12 December 2012, the EU Commission filed a Proposal for a Regulation amending the EIR.[7] The Proposal, which was preceded by an impact assessment,[8] is currently under discussion before the European Parliament and the EU Council, changes very much of the EIR in terms of spirit, scope and prospects of future implementation. The main amendments, which are specifically illustrated in a Report issued by the Commission on the same date[9] and by an Explanatory Memorandum that comes along with the text of the Proposal,[10] concern core issues of the Regulation that had been widely discussed by scholars and experienced by practitioners in the last decade.[11] From a general standpoint, the Proposal requires a shift in the EU's approach to the problem of cross-border insolvency in order:

6 Council Regulation No. 1346/2000 of 29 May 2000 on Insolvency Proceedings, OJEC L160 of June 30, 2000, at 1 ("EIR"). For a commentary, see G. Moss and T. Smith, "Commentary on Council Regulation 1346/2000 on Insolvency Proceedings", in G. Moss, I. Fletcher and S. Isaacs (eds), *The EC Regulation on Insolvency Proceedings. A Commentary and Annotated Guide* (2009, Oxford University Press, Oxford), at 225.

7 Proposal for a Regulation of the European Parliament and of the Council Amending Council Regulation No. 1346/2000 on Insolvency Proceedings, COM(2012) 744 Final (12 December 2012) (hereinafter "Proposal"), which is introduced by an Explanatory Memorandum of the Commission. For a commentary see H. Eidenmüller, "A New Framework for Business Restructuring in Europe: The EU Commission's Proposal for a Reform of the European Insolvency Regulation and Beyond" (2013) 20 *Maastricht Journal of European and Comparative Law* 133; P. Fazzini and M. Winkler, "La Proposta di Modifica del Regolamento sulle Procedure di Insolvenza" (2013) 27 *Diritto del commercio internazionale* 141, at 145.

8 See Commission Staff Working Document SWD(2012) 416 Final, Impact Assessment Accompanying the Revision of Regulation (EC) No. 1346/2000 on Insolvency Proceedings, COM(2012) 744 Final (12 December 2012) ("Impact Assessment").

9 Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the Application of Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings, COM(2012) 743 Final (12 December 2012) ("Report").

10 See Explanatory Memorandum to the Proposal, above note 7, at 1.

11 For a discussion on the policies of a reform the EIR, see F. Mucciarelli, "Not Just Efficiency: Insolvency Law in the EU and Its Political Dimension" (2013) 14(2) *European Business Organization Law Review* 175, at 192.

> "to meet the need for a modern and business-friendly environment."[12]

In particular, according to the Commission:

> "…the Regulation is functioning well in general, but […] it is desirable to improve the application of certain of its provisions in order to enhance the effective administration of cross-border insolvency proceedings."[13]

The Proposal reflects the reforms enacted by the legislatures of Member States in their domestic insolvency regulations. Generally, as mentioned before they have led liquidation to be no longer the exclusive outcome of insolvency proceedings, thus opening the door to restructuring. This change in the approach of domestic insolvency regimes could not but be mirrored by the EIR reform. Wholly considered, these domestic settings reveal in fact an increasing "*openness towards corporate rescue procedures*", even if they continue to show:

> "…substantial differences in policy considerations, in structure and in contents of these laws."[14]

Contrary to the past, national legislatures are nowadays more concerned with preventing economic and financial crises than with remedying them *ex post*, once they happened. As Bob Wessels pointed out in this respect:

> "…[t]he traditional 'post-mortem autopsy' approach is supplemented by instruments which allow for 'real time action' and domestic laws contain several proceedings which reflect different goals of a company in rescue."[15]

This aspect was fully recognized in the debate on the EIR's reform, since in 2011 the Commission of Legal Affairs of the European Parliament stated that:

> "…the objective [of a European uniform insolvency regulation] must be to preserve the entire economic entity, all tax-payers and all employers from the consequences of insolvency."[16]

12 See Report, above note 9, at 4. In particular, the Commission observed that "problems have been identified in relation to the scope of the Regulation, the rules on jurisdiction, the relation between main and secondary proceedings, the publicity of insolvency-related decisions and the lodging of claims. In addition, the absence of specific rules for the insolvency of members of a group of companies has been criticised."

13 Proposal, above note 7, Recital No. 2.

14 See B. Wessels, "Harmonization of Insolvency Law in Europe" (2011) 8(1) *European Company Law* 27, at 28.

15 See B. Wessels, "Europe Deserves a New Approach to Insolvency Proceedings" (2007) 4(6) *European Company Law* 253, at 255.

16 Rapport Contenant des Recommendations à la Commission sur les procédures d'insolvabilité dans le cadre du droit européen des sociétés, Commission des Affaires Juridiques, Rapporteur Klaus-Heiner Lehne, 2011/2006(INI) (17 October 2011), at 4.

In their evolution, European national laws tend to defer to the debtor-centered model of United States' Chapter 11.[17] In fact:

> "…[i]n examining their own corporate rescue laws the member states have paid substantial regard to the corporate rescue system in the United States."[18]

In adopting Chapter 11's model, as Professor Nathalie Martin pointed out, these domestic changes:

> "…do not arise from existing cultural conditions[, but] are transplanted from elsewhere and the cultural views are expected to change with the law."[19]

The legal transplant of Chapter 11, especially in Eastern Europe, brought to what one may call the "*Chapter 11-ization*" of major national insolvency laws.[20] And since the most prominent amendments concern the restructuring plans decided by the majority of creditors and the debtor-in-possession schemes, two institutions directly taken from U.S. laws, it can be reasonably argued that in such a transplant private autonomy represents not only one plant, but the seed. It came out with no surprise that the Commission wished this framework to be applied also to the EIR.

The New Scope of the European Insolvency Regulation *vis-à-vis* the Emerging Contractual Domestic Models

1. Extension of the Scope of the Regulation

Materially speaking, the Proposal covers five points:

(1) the inclusion of pre-insolvency and hybrid proceedings in the scope of the EIR;

(2) the delineation of the notion of debtor's center of main interests (COMI);

(3) the restructuring of the secondary proceedings' regime;

(4) the introduction of a supranational system of publicity of insolvency proceedings; and

(5) the setting of specific norms designed for multinational groups of companies.

17 See D. Ball, "Europe Builds Own Chapter 11" (Wall Street Journal, 5 April 2013).

18 See R. Parry, "Introduction", in K. Gromek and R. Parry (eds), *Corporate Rescue: An Overview of Recent Developments from Selected Countries in Europe* (2005, Kluwer Law International, The Hague) 1-18, at 5.

19 See N. Martin, "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" (2005) 28(1) *Boston College International and Comparative Law Review* 1, at 2.

20 We established this notion in Fazzini and Winkler, above note 7, at 142.

While all these points touch private autonomy by different ways, only three of them are of particular interest here. This part deals with the first of them: the enlargement of the scope of the EIR by including private arrangements.

In this respect, the Proposal focuses on the need to entitle private arrangements to gain cross-border recognition. If the parties decided to restructure under the law of a Member State, this decision would presumably deserve the same recognition in all Member States. According to the Commission:

> "…the fact that a national pre-insolvency proceedings is not covered by the EIR can prevent the successful rescue of business or reorganization of personal debt in cross-border situations."[21]

Hence, proceedings like the compulsory composition provided by Dutch law in the case described in the introduction have actually to be inserted in the scope of the EIR. The current text of Article 1, however, establishes that only proceedings that entail the debtor's divestment and the appointment of a liquidator be included in the EIR's scope.[22] At the time of the enactment of the EIR, in fact, liquidation was the rule and restructuring the exception. Nowadays to the contrary:

> "due to new trends and approaches in the Member States"[23]

as the Commission posits it, time has reversed such a relationship, and the EIR should adapt accordingly.

The new scope of the EIR covers both proceedings that permit the debtor to maintain control over its assets and affairs (so-called "hybrid proceedings") and those that allow it to restructure its business before insolvency is formally declared ("pre-insolvency proceedings"). The post-reform EIR would define the scope of the Regulation to extend to all proceedings that provide for the divestment of the debtor's assets and the appointment of a liquidator, *or* to those where:

> "…the assets and affairs of the debtor are subject to control or supervision of a court."[24]

21 Idem.

22 Article 1(1), EIR, pursuant to which "[t]his Regulation shall apply to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator"). Article 2(b) defines "liquidator" as "any person or body whose function is to administer or liquidate assets of which the debtor has been divested or to supervise the administration of his affairs. Those persons and bodies are listed in Annex C."

23 Report, above note 9, at 4.

24 Proposal, above note 7, at point 21, accompanying the new text of Article 1(b).

Here the word "court" is not limited to domestic judicial bodies, but includes "*any other competent body*" empowered by internal law to open an insolvency proceedings.[25]

In the view of the Commission, the EIR's new scope is dictated by the fact that, as they are not covered by the EIR, the effects of said proceedings are currently not recognized throughout the EU.26 This lack of cross-border recognition may produce devastating results on the restructuring plans that the debtor and the majority of its creditors are trying to enter into in a country. In particular, as the case from the Netherlands cited above patently demonstrates, the lack of recognition allows the dissenting creditors to continue enforcing their rights against the debtor's assets in another Member State (so-called "holding-out"), hence frustrating and preventing efficient restructuring plans from being even initiated. It is in light of problems like this that one appreciates the Commission's concern about the transnational circulation of restructuring plans.

It is nonetheless noteworthy that under the Proposal not all restructuring plans benefit from the freedom of circulation in the EU. Actually, pursuant to the definition contained in Article 1, supervision of a court must be present. It is so because the mutual trust between Member States unquestionably refers to the Member States' national courts, not to creditors, and therefore arrangements that are confidential in nature and have not received an *imprimatur* by a domestic court receive no automatic recognition on the other Member States.

On the other hand, the Commission nonetheless explains that such an arrangement might be recognized and therefore circulate "*as from the moment it becomes public*,"[27] hence casting a doubt on the fact that a court order be a universal requirement for cross-border recognition. If this is so, Bob Wessels' considerations about the progressive "*contractualization [...] accompanied by*

25 Ibid., in the new text of Article 2(c), defining "court" in all respects except for Article 3(b)(2) as "the judicial body or any other competent body of a Member State empowered to open insolvency proceedings, to confirm such opening or to take decisions in the course of such proceedings."

26 Wessels, above note 15, at 256.

27 Explanatory Memorandum, above note 7, at 6: "[w]hile the extension of the Regulation's scope is important to ensure the efficient conduct of pre-insolvency and hybrid proceedings in a cross-border context, it should not encompass insolvency proceedings which are confidential. There are indeed a number of national pre-insolvency proceedings where the debtor enters into negotiations with (certain) creditors in view of reaching an agreement on its refinancing or reorganisation but this information is not made public. These proceedings may entail a moratorium of individual enforcement proceedings or prevent creditors from filing for insolvency proceedings during a certain time period in order to give the debtor some 'breathing space'. While these proceedings may play an important role in some Member States, their contractual and confidential nature would make it difficult to recognise their effects EU-wide because a court or creditor located in another Member State would not know that such proceedings are pending. This does, however, not prevent such a procedure from being subsequently covered by the scope of the Insolvency Regulation as from the moment it becomes public."

de-proceduralization"[28] at the domestic level would receive an important stamp of approval by the EU.

2. Inclusion of Private Arrangements in the Regulation

Furthermore, the combination of the definitions under Article 1 and the Annex A of the EIR is subject to an important change under the Proposal. Originally, the coordination between Article 1's definition and Annex A was established under Article 2(a), that in turn defined the insolvency proceedings by referring to those proceedings listed in Annex A. Although the drafters of the Regulation, at least intuitively, acted:

> "…in order to provide for greater certainty in the application of the Regulation…"[29]

and provided that amendments to the Annex A took place through the EU Council and the initiatives of Member States,[30] the coordination with Article 1 proved nevertheless to be extremely difficult, as it was doubtful whether proceedings under Article 1 but not listed in Annex A could be covered by the Regulation, and vice-versa.[31]

The Proposal finds a compromise here: without modifying the definitional setting of the EIR, it establishes the power of the Commission to review the additions made by States to the list of insolvency proceedings contemplated by Annex A.[32] In this way, those proceedings that are inconsistent with the definition of Article 1 will be presumably barred from entering the scope of the EIR. This will be the way national proceedings opened to party autonomy may enter the EIR in the immediate future, and in this regard the intervention of the Commission would probably ensure coherency and respect of European common value, among which private autonomy certainly plays a considerable role.

28 See B. Wessels, "Insolvency Law", in J. Smits (ed), *The Elgar Encyclopedia of Comparative Law* (2006, Elgar Publ., Northampton) 294-311, at 307.

29 Moss and Smith, above note 6, at 232.

30 See Article 45, EIR.

31 According to the European Court of Justice, "once proceedings are listed in Annex A to the Regulation, they must be regarded as coming within the scope of the Regulation. Inclusion in the list has the direct, binding effect attaching to the provisions of a regulation." C.J.E.U., *Bank Handlowy w Warszawie SA et al. v. Christianapol sp. z o.o.* (Case C-116/11), para. 33 (unpublished). Vice versa, a proceedings not noted in Annex A, but included in the definition of Article 1(1), is not covered by the EIR. See in this respect C.J.E.U., *Ulf Kazimierz Radziejewski v. Kronofogdemyndigheten i Stockholm* (Case C-461/11), para 24 (unpublished), concluding that the EIR "applies only to the proceedings listed in that annex."

32 See Explanatory Memorandum, above note 7, at 6, noting that "the proposal introduces a procedure by which the Commission scrutinises whether a national insolvency procedure notified actually fulfils the conditions of the revised definition. This will ensure that only proceedings which fit the rules of the Regulation are listed in the Annex."

3. Circulation of Judgments Recognizing Private Arrangements

Another interesting topic concerning the reform of the EIR touches the freedom of circulation of private arrangements under the perspective of court judgments. In fact, the new text of Article 25 of the EIR would establish that the automatic recognition regime would cover also court orders regarding "*compositions approved by that court*."[33] Recognition indeed extends to "*judgments relating to the preservation measures*,"[34] hence including, for example, the automatic stay for all creditors' claims.

The problem that these norms raise altogether pertains to the cross-border recognition of court orders in which the court does nothing but simply ratify a private arrangement between the debtor and its creditors. Clearly, if the court exercises no control over the composition, the mutual trust between Member States would impose transnational recognition to the composition, but at the same time favour forum shopping – or "restructuring tourism" – to the States whose law provide for a totally de-proceduralized framework. This result seems in contradiction with the Commission's strike concern to avoid recognition of confidential agreements.

Emerging Practice: The Insolvency Protocols and Agreements

Following the suggestions of the European Parliament,[35] in the Proposal the Commission acknowledged the importance, in international practice, of the insolvency protocols, *i.e.* agreements between different nations' judicial and/or administrative authorities in charge with multi-jurisdictional insolvency proceedings, aimed at setting up a procedural framework to manage the proceedings in more efficient and effective ways. Regulatory in nature and technically binding upon the parties, the insolvency protocols reduce the costs of international litigation and enable the parties, as UNCITRAL posits it:

> "…to focus on the conduct of the insolvency proceedings, rather than on resolving conflict of laws and other similar disputes."[36]

33 Proposal, above note 7, at point 32, amending Article 25(1), EIR.

34 Idem.

35 In a 2011 report, the Commission of Legal Affairs of the European Parliament stated that "to facilitate and encourage different modalities of cooperation among jurisdictions in order to coordinate the insolvency proceedings" requires the legislature to evaluate and discuss "the negotiation, approval and implementation of agreements in the field of insolvency, concerning the coordination of proceedings." Cf. Rapport Contenant des Recommendations à la Commission sur les procédures d'insolvabilité dans le cadre du droit européen des sociétés, Commission des Affaires Juridiques, Rapporteur Klaus-Heiner Lehne, 2011/2006(INI) (17 October 2011), at 13.

36 UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (2010, UNCITRAL, Geneva), at 28.

They promote certainty and efficiency to multi-jurisdictional insolvencies and reduce the disputes among the actors involved.[37] Recital 20 of the Proposal expressly refers to the:

> "…principles and guidelines […] adopted by European and international associations,"[38]

thus recognizing the prominent position of scholars in this field, their play as a source of a modern and indeed renovated international insolvency law. There is an implicit reference here to the UNCITRAL's works and studies on the matter. What is noteworthy here is that the Proposal expressly recognizes the value of insolvency protocols as useful tools for restructuring or liquidating the debtor in a satisfactory and efficient fashion.

Despite this clear premise, however, the Proposal contains a chaotic and piecemeal legislation, even regarding terminology. First, the Proposal uses the word "protocol" to allude to either out-of-court compositions or to institutional instruments of cross-border cooperation between courts or liquidators. This overlap could generate some confusion. Second, the term is mainly used in the context of groups of companies, but it is nevertheless a tool available in all contexts where the cooperation among the liquidators of various procedures pending in different States is needed in order to achieve.

As an example of the first problem, the Commission states that cooperation and communication between main proceedings and secondary proceedings courts:

> "…can notably be crucial to ensure a successful restructuring, e.g. concerning the approval of a protocol setting out a rescue plan."[39]

Here the term refers to debtor-creditors compositions. In another part, the Proposal mentions the possibility for the actors involved in a cross-border insolvency to resort to:

> "…appropriate arrangements […] made to protect confidential information."[40]

Confidentiality is only one of the potential content of an insolvency protocol.[41]

37 Ibid., at 29.
38 See Proposal, above note 7, at point 13, reforming Recital 20, EIR.
39 Explanatory Memorandum, above note 7, at 8.
40 Proposal, above note 7, at point 35, amending Article 31(2)(a), EIR.
41 See UNCITRAL Practice Guide, above note 36, at 101.

As an example of the second kind, the Proposal stresses the need for courts involved in multi-jurisdictional insolvencies to cooperate, imposing the "*coordination in the approval of protocols*".[42] Given the above emphasized confusion, it is not clear whether here the Commission refers to compositions among creditors or to institutional protocols between courts or liquidators, or to both.

Finally, instead of providing general limits and conditions for the insolvency protocols, the Proposal establishes, only with regard to institutional cooperation, that they must be:

> "…not incompatible with the rules applicable to each of the proceedings."[43]

The question remains open as to the fate of the insolvency protocols that are entered into in the interest of an efficient restructuring but are still incompatible with the rules of one of the nations involved. More generally, the Proposal does not determine in any fashion the validity of the insolvency protocols *vis-à-vis* the capacity of the actors involved or the possibility for the court not to approve the protocols, a question that pertains, again, to the extension of private autonomy in the single legal systems.

Conclusion

With the reform of the EIR, the Commission made private autonomy play a paramount role in the regulation of cross-border insolvencies. This is an important step, maybe revolutionary indeed. It is the recognition of private autonomy as a value that the European legislature is entitled to pursue.

It would be nevertheless a mistake to think that the Proposal's substantial step towards private autonomy reflects the changes occurred in the last decade at the domestic level. It is not only that: it is indeed the acknowledgment that the global economic crisis can be remedied, through private autonomy, by sharing freedom and – at the same time – responsibility to all the subjects involved, signally the debtor and the creditors. The intensity and effectiveness of the courts' control on such private arrangements and the subsequent circulation of the related judgments throughout Europe are, in fact, questions that depend on the EIR's future implementation. Whether the *post*-reform EIR will be able to effectively prevent or remedy the crisis, is however another story.

42 Compare Proposal, above note 7, at point 36, regarding the new Article 31a(3)(d), with point 45, regarding the new Article 42b(3)(d).

43 Proposal, above note 7, at point 34, enacting a new Article 31(1).

PART III
THE YOUNG ACADEMICS' NETWORK PAPERS

Chapter 13

Social Policy and the Reform of the European Insolvency Regulation

Jennifer Gant

Introduction

Social policy is an element of modern European Union[1] legal culture which is commonly seen as running in parallel to discussions of insolvency systems, not to intersect in any meaningful way. Social policy legislation does, however, have an effect on how insolvency systems will function in practice. Ignoring social policy issues limits the perspective of legislators and reformers when considering how insolvency law and more particularly business rescue can be effective within the European Union when crossed with member state and EU requirements of employee protection legislation. While such a matter is not strictly the prevue of EU insolvency law in its current scope, there are practical matters affecting how a pan European rescue culture can function with the greatest efficiency where the conflicting goals of insolvency and the employment protection are not recognised and, to some extent, managed.

Underpinned by traditionally opposing socio political values, the juxtaposition of insolvency law and employment protection is difficult to reconcile. However, in these times of financial crisis and its slow recovery, business failures and unemployment are both at the forefront of economic concerns. The EU has made its mark in this area with the Acquired Rights Directive[2] which contains provisions dealing with the transfer of employment contracts in the event of a business transfer, including those transfers which occur during corporate rescue procedures. While implementation of the Directive was left to the Member States and a number of derogations were available, the application of employee transfer provisions in corporate rescue procedures has not failed to cause controversy over the 36 years since its initial implementation. Many EU and national cases have caused further complications.

1 Hereafter referred to as the “EU”.

2 Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses OJ L 82/16 (22 March 2001).

The cooperation of the Member States in matters of insolvency also has a long history. It has been a 40 year project evolving in complexity and cooperation as the EU has expanded and changed.[3] The culmination is the EU Insolvency Regulation[4] which deals with how cross border insolvency should be managed between the Member States. The amendments proposed by INSOL Europe[5] to the EIR are aimed at furthering the proper functioning of the Regulation by amending substantive aspects and improving technical rules. Among the fundamental issues to be resolved is the ease with which companies can "forum shop"[6] among Member States to identify a jurisdiction providing the most advantageous environment to commence insolvency proceedings. However, the EU goal of reducing forum shopping overall is not helped by the existence of divergent rules of employment protection.

While there are wide implications in relation to the interaction of employee protection regulations, the EIR and its reforms, for the purpose of this paper only the interaction between business rescue procedures and acquired rights provisions in the United Kingdom and France will be discussed.

Evolution of Modern Corporate Rescue

While the concept of bankruptcy has been around since ancient Roman magistrates were "breaking the benches" of traders who failed to repay their debts,[7] it has only been relatively recently that the concept of corporate rescue has been recognised as a legitimate aim of insolvency systems. Views on insolvency changed in the 1960s when it was realised that the economic benefits of the preservation of a company were an equally important consideration to the maximisation of creditor returns.[8]

The concept of corporate rescue in France arrived with the Law of 1967,[9] which provided for either a judicial settlement or a judicial liquidation. The former was chosen if the result of the process was likely to be a composition agreement with creditors while the debtor continued to trade, "rescuing" the business from liquidation. The latter was chosen if there was little likelihood of survival and

3 See P. Omar, *European Insolvency Law* (2004, Ashgate Publishing, Aldershot), at 49.

4 Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings OJ L160/1 (30 June 2000) (hereafter referred to as the "EIR").

5 Proposals are set out in R. van Galen et al., *Revision of the European Insolvency Regulation: Proposals by INSOL Europe* (2012, INSOL Europe, Nottingham).

6 Ibid., at 17: "...the transferring of assets or judicial proceedings from one Member State to another seeking to obtain a more favourable legal position...".

7 Omar, above note 3, at 3.

8 Ibid., at 11.

9 Law no. 67-563 of 13 July 1967.

resulted in the liquidation of the debtors assets. The Court would choose from these options based on their view of the viability of the business.[10] At the same time in the United Kingdom, the focus of insolvency legislation remained to a certain degree the maximisation of returns to creditors by replacing the chaotic pursuit of individual claims with a statutory regime suspending creditors' rights and providing a mechanism for the orderly collection and realisation of assets and their distribution to creditors through a scheme of distribution.[11] However, changes in the market, social policy, and the economic climate eroded this paradigm of British insolvency law,[12] resulting in the initiation of massive reforms to the insolvency laws in the UK.[13]

The prospective entry of the UK into the EU in the 1970s also demanded that it should be capable of negotiating with other Member States under a coordinated insolvency convention. This focussed the attention further on the need for reform, resulting in the formation of an advisory committee on the matter in 1973 and the publication of a report in 1976 (the "Cork Report") which stressed that a comprehensive review of insolvency was required not only for the purposes of negotiating with other Member States, but also due to the poor state of the law[14] which:

> "…has been tinkered with, patched and extended by false analogies so that today it is replete with anomalies, inconsistencies and deficiencies."

Further, the law was viewed at this time as no longer fulfilling its obligation to the demands of fairness and justice in a modern society.[15]

Business Rescue in the 1980s

Both England and France saw changes to their insolvency systems in the mid-1980s which shifted the focus from liquidation and creditor wealth maximisation to the rescue of companies and businesses. A more social approach to insolvency

10 See A. Sorensen and P. Omar, *Corporate Rescue Procedures in France* (1996, Kluwer Law International, London), at 24.

11 See R. Goode, *Principles of Corporate Insolvency Law* (2005, Sweet and Maxwell, London), at 5.

12 See J. Silkenat and C. Schmerler, *The Law of International Insolvencies and Debt Restructurings* (2006, Oceana Publications, Dobbs Ferry NY), at 387.

13 See M. Hunter, "The Nature and Functions of the Rescue Culture" (1999) *Journal of Business Law* 495.

14 See V. Finch, *Corporate Insolvency Law: Perspectives and Principles* (2009, Cambridge University Press, Cambridge), at 13-14.

15 See K. Cork, Sir, *Insolvency Law and Practice: Report of the Review Committee* (1982) Cmnd. 8558, at 10 (paragraph 9).

had developed among Western nations which left scope for, and indeed justified, rescue activities according to the individual values contained within the corporate rescue principles of each jurisdiction.[16]

France

In France, the law was reformed in response to the changing economic climate. An emphasis on social policy encouraged a move to the maintenance of businesses in the place of liquidation. The harmful effects of unemployment caused by business failures in recessionary times were an influence on the creation of a corporate rescue policy biased toward the protection of employment and the rehabilitation of the business.[17] The Law of 1985[18] was passed, having the objective of protecting employment at the risk of sacrificing creditors' rights. It envisaged three possible outcomes:

(1) a plan for continuing the business;

(2) a plan for its sale; or

(3) winding up with court supervision.[19]

The law reduced creditors' rights in favour of focusing on saving the business and the jobs associated with it at all costs.[20]

This approach was later viewed as too biased in favour of labour and unsuited to allowing the French economy to evolve in the highly competitive global market.[21] However, the focus on employment protection and business rescue has not been lost in subsequent reforms to the French insolvency code.

United Kingdom

The result of the Cork Report in the UK was the passage of a new Insolvency Act 1986,[22] preceded briefly by an Insolvency Act 1985,[23] which put into practice many of the suggestions published in the Cork Report. Cork's philosophy on the matter was, among other things, in favour of increasing the emphasis on rehabilitation of

16 Finch, above note 14, at 245-246.

17 Sorensen and Omar, above note 10, at 26.

18 Law no. 85-98 of 25 January 1985.

19 See P. Théry, "The Evolution of Insolvency Law in France", Chapter 1 in W-G. Ringe *et al.* (eds), *Current Issues in European Financial and Insolvency Law: Perspectives from France and the UK* (2009, Hart Publishing, Portland OR) (1-16).

20 Silkenat and Schmerler, above note 12, at 143.

21 Idem.

22 1986 c.45.

23 1985 c.65.

the company.[24] Thus in the Insolvency Act 1986, a procedure of administration was introduced which, initially, was a court based procedure designed specifically for corporate rescue rather than asset realisation and was focussed on the interests of unsecured creditors.[25]

Business Rescue Today

France

The French perspective on insolvency is as a collective procedure designed to distribute loss among all stakeholders in a company, subject to a certain hierarchy of distribution where employees are often privileged over creditors. The balance between the rights of employees and creditors has been a consideration in attempts to reform the insolvency code up to the reforms of 2005.[26] After a few revisions of the insolvency code in the nineties and early 2000s, a new insolvency text was passed: the Law of 2005.[27] In the period leading up to the promulgation of this law, it was observed that the previous insolvency code had, in many instances, failed to keep a company from falling into a terminal financial condition. Other pressures for reform included the coming into force of the EIR and a view that the French insolvency regime was too debtor friendly. Its effectiveness was further questioned in relation to the influence of the perennial French concern for employee job security.[28]

The Law of 2005 included an entirely new procedure of preservation (*sauvegarde)* which is available to debtor companies before the formal *cessation de paiements*[29] situation occurs. It was designed as an anticipatory debtor-in-possession rescue procedure where the business could benefit from a moratorium while conceiving of and proposing a plan to creditors with a view to restructuring the business.[30] This law was reformed by ordinance[31] in 2008 partly as a result of the poor utilisation of the *sauvegarde* procedure. In large part the ordinance addresses perceived inefficiencies in this procedure with the aim of enhancing the operation of this and other insolvency procedures.[32]

24 Finch, above note 14, at 15.

25 Ibid., at 21.

26 Omar, above note 3, at 129.

27 Law no. 2005-845 of 26 July 2005.

28 See C. Dupoux, "French Bankruptcy Law: Putting the Safeguards in Place" (2006) 3(4) *International Corporate Rescue* 207.

29 Suspension of payments.

30 See P. Omar, "Preservation and Pre-packs *à la française*: The Evolution of French Insolvency Law" (2011) 22(8) *International Company and Commercial Law Review* 258.

31 Law no. 2008-676 of 4 August 2008 on the Modernisation of the Economy.

32 Omar, above note 3, at 260.

United Kingdom

Insolvency law in the United Kingdom today remains based on the Insolvency Act 1986; however, changes were made to it through the Enterprise Act 2002.[33] The Enterprise Act phased out administrative receivership in favour of administration. The administration procedure was streamlined to make it easier and less expensive to use and also to give unsecured creditors more rights and a higher priority in distribution. One of its original purposes was to provide a means of rehabilitating a debtor company in financial crisis and protecting it from creditor claims. This was reinforced in the Enterprise Act[34] by the inclusion of Schedule B1 in the Insolvency Act which provided for three hierarchical objectives of administration:

(1) to rescue the company as a going concern;

(2) to achieve a better result for creditors in a winding up; or

(3) if the first two are not reasonably practicable, to realise property for the benefit of secured or preferential creditors.[35]

Employees

One area where France and England share a small commonality is the position of employees as preferential creditors, though the level of preference does diverge. In France, unpaid employees are creditors in an insolvency procedure but have certain additional benefits. Employees have a general lien over the employer's property which stands as a guarantee for six months' worth of wages and compensation in place of wages. They also have access to a guarantee fund where funds are not readily available to pay employee claims.[36] Employees also are given a super priority for a limited part of their claim. This priority ranks above all other claims including those of secured creditors and also affords employees the facility to avoid the disruption and waiting period of the proceedings so that they can be paid quickly.[37]

Employees in the United Kingdom also retain the status of preferential creditors.[38] Unpaid wages and accrued holiday pay are given preferential priority in the distribution. These are payable in advance of unsecured claims out of the assets of

33 2002 c.40.

34 Silkenat and Schmerler, above note 12, at 388.

35 Schedule B1, paragraph 3, Insolvency Act 1986.

36 *Association pour la Gestion du Régime d'Assurance des Créances des Salariés*.

37 See A. Tetley and M. Bayle, "Insolvency Law in France", in O. Lobo *et al.*, (eds), *World Insolvency Systems: A Comparative Study* (2009, Sweet and Maxwell, Toronto) (195-279).

38 Silkenat and Schmerler, above note 12, at 397.

the company. Employees are also able to claim against the state National Insurance Fund in respect of a number of unpaid debts associated with their employment. Unpaid employee pension contributions are also preferential for up to four months. Unpaid employer contributions are also preferential, but limited.[39] Discussion of employee pensions in insolvency, however, will have to be a discussion for another time as the matter is quite complex.

There is an inevitable tension between creditors' rights in insolvency and the rights of a company's employees.[40] If the goal of insolvency is to maximise the distribution to creditors from the debts owed to them by the debtor company, then preferring employee raises their claims above those of other creditors and effectively take funds out of the pool of assets to satisfy their claims in preference, creating a super priority which raises issues of fairness to the treatment of other creditors in insolvency.[41] Some view the TUPE Regulations[42] in the United Kingdom as having this effect, which raises the question of acquired rights generally and the social policy objectives it addresses.

There is also an argument, however, that the concept of corporate or business rescue brings with it parallel goals of a social nature, such as the protection of employment and job security, the effect business failure might have on a community and questions that go beyond the purely commercial outcomes of insolvency. European social policy has succeeded in applying its views on the importance of employment protection through the application of the Acquired Rights Directive on business transfers generally, but including those transfers occurring out of corporate rescue procedures.

Acquired Rights as Social Policy

European Social Policy was evolving on a similar theme in the 1970s to that of corporate rescue in Europe. The social dimension of the EU had begun to grow in importance, recognising that a philosophy of economic growth based on neoliberal ideology was not capable of addressing the social problems consequential to economic integration. An action programme was conceived with the intention of attaining full and better employment, improving working conditions, and increasing the involvement of management and labour in the economic and social

39 Finch, above note 14, at 756-757.

40 Goode, above note 11, at 52.

41 Finch, above note 14, at 754-779.

42 Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246).

decision making within the Community as well as in the life of the undertaking.[43] The emergence of both the rescue culture and modern EU social policy evolved to some degree out of these ideological changes throughout the EU.

The acquired rights legislation was born partly out of a growing concern about the absence of a "social face" to the Common Market[44] as well as the fact that the prevailing frameworks in both Germany and France had already provided acquired rights legislation and were consequently in a potentially disadvantageous competitive position with the rest of the EU lacking similar legislation.[45]

France had acquired rights legislation transferring employment contracts on the transfer of a business in place since 1928. The original law required that where there was a change in the juridical situation of an employer, such as the transfer of a business, all employment contracts would continue between the new employer and employees of that enterprise.[46] The failure of a business, except in cases of *force majeure*, would not free an employer from its obligation to respect the notice periods of its employees and provide an indemnity for any losses which may accrue.[47] Today the position is the much the same, though the new employer is not liable for the obligations encumbering the old employer if the transfer is being made through the *sauvegarde* procedure, *redressement* or judicial liquidation.[48]

In contrast, the first UK legislation conferring continuity of employment on a business transfer[49] would apply only if the employees were voluntarily retained by the purchasing firm. There was no concept of automatic transfer as this would conflict with the fundamental freedom of contract.[50] For this reason, it was not until the Labour party came to power in the UK in 1997[51] under the promise of social justice and inclusion that the UK accepted the Social Chapter of the Maastricht Treaty, bringing the UK at last under the influence of EU Social Policy.[52] As such, any directives passed under the Social Chapter would now require implementation.

When considering the needs of employees in the Common Market, it was surmised

43 See C. Barnard, *EC Employment Law* (3rd ed) (2006, Oxford University Press, Oxford), at 8-21.

44 Ibid., at 619.

45 See N. Adnett, "The Acquired Rights Directive and Compulsory Competitive Tendering in the UK: An Economic Perspective" (1998) 6(1) *European Journal of Law and Economics* 69, at 71.

46 Barnard, above note 43, at 620.

47 Article L. 122-12, Code du Travail, repealed by Ordonnance no. 2007-329 of 12 March 2007.

48 Ibid., Articles L.1224-1 and 2 (in Chapître IV: Transfert du contrat de travail).

49 Contracts of Employment Act 1963 (repealed).

50 See A. Baker and I. Smith, *Smith & Woods Employment Law* (2010, Oxford University Press, New York NY), at 541.

51 The Labour Government was in power from 1997-2010.

52 Barnard, above note 43, at 22.

that the encouragement of competition across borders would inevitably lead to corporate restructurings and, in some cases, the failure of companies which could not compete. It was acknowledged that competition could lead to reorganisations which would mean a loss of job security for employees subject changes accomplished through reorganisations, including business transfers.[53] Thus the Acquired Rights drama begins.

The implementation of the Acquired Rights Directives forced a change to the common law position in the UK in which employment contracts were personal and could not be transferred to another employer without the termination of the contractual relationship.[54] In administration procedures in England, employment contracts are deemed to have been adopted if they are continued for 14 days following the appointment of an administrator.[55] Thus the company retains the employment contracts in the event that it is decided to sell all or part of the business undertaking. Much case law has argued the point as to whether TUPE should apply in business transfers out of administration and many writers have argued that its application to such a situation would have adverse effects on the outcome of the procedure owing to the inevitable reduction in the intrinsic value of the business due to the cost of liability associated with the transferring employment contracts.

The first Acquired Rights Directive[56] did not expressly exclude business transfers on insolvency from its scope, but, following *Abels*,[57] the European Court of Justice said that it would not apply to transfers of undertakings which took place during the winding up of insolvent companies.[58] Thus employee contracts would not transfer if a business was sold without the intention to continue trading.[59] The effect was not so clear in relation to those insolvency procedures such as administration where one of the goals is to continue the business but an alternative outcome might be liquidation. Problems were recognised at an early stage in relation to the obligation to take over the liabilities associated with employment contracts in the context of rescue procedures as it was believed that this would act as a disincentive to the

53 Ibid., at 619.

54 Baker and Smith, above note 50, at 541.
See G. Pitt, *Employment Law* (2007, Sweet and Maxwell, London), at 305.

55 Schedule B1, paragraph 99, Insolvency Act 1986.

56 Council Directive 77/187/EEC of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses OJ L 061/26 (5 March 1977).

57 Case 138/83 *Abels v Bedrijfsvereniging voor de Metaalindustrie en de Electrotechnische Industrie* [1985] ECR 469.

58 See S. Hardy, "Some TUPE Implications for Insolvency Lawyers" (2001) 4 *Insolvency Law* 147.

59 See D. Pollard, *Corporate Insolvency: Employment and Pension Rights* (4th ed) (2009, Bloomsbury Professional Limited, Haywards Heath), at 316.

rescue of troubled businesses and would actually harm employees by not allowing their employer to be rescued from insolvency and protect at least some of the jobs.[60]

In *Abels*, the Commission argued that the interests of employees would be better served if the Acquired Rights Directive did not apply on an insolvent business transfer with a view to liquidation as it would likely result in a loss of job security and worker welfare, contrary to the purpose of the Directive. Further, the Directive might dissuade a potential transferee from acquiring an undertaking leading to a liquidation, which would mean that all jobs would be lost. Another reason for relaxing the rules was attributed to the special nature of insolvency laws, designed to weigh up the competing interests involved. It was accepted that insolvency rules could derogate at least in part from social policy. An express provision in the legislation applying acquired rights rules to insolvency situations would be required before it could apply to insolvent transfers.[61]

A distinction was drawn by the court in *Abels* between terminal and non-terminal insolvency proceedings. This was incorporated in the Acquired Rights Directive 1998[62] which was then consolidated under the Acquired Rights Directive 2001.[63] Article 5(1) states that unless provided otherwise by a member state, employee contracts will not transfer where the transferor is the subject of insolvency proceedings instituted with *a view to the liquidation*[64] of the assets of the company under the supervision of a competent public authority.[65] It was a choice available to each member state to apply this insolvency exception. The UK utilised this derogation but it did not fully solve the problem, rather due to a lack of specific definition, it complicated things.

The Problem with Acquired Rights (in the UK)

The train of European cases which clarify the position as to when the exclusion will apply in the UK is long and complex.[66] The basic position is that where proceedings

60 See M. Sargeant, "TUPE – The Final Round" (2006) *Journal of Business Law* 549, at 562.

61 Barnard, above note 43, at 647-648.

62 Council Directive 98/50/EC of 29 June 1998 amending Directive 77/187/EEC on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses OJ L 201/88 (17 July 1998).

63 Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses OJ L 082/16 (22 March 2001) ("ARD").

64 Emphasis added.

65 Article 5(1), ARD.

66 See, in addition to the previously mentioned *Abels*: Case C-319/*Dethier Equipement v Dassy 94* [1998] ECR I-1061; Case 362/89 *D'Urso v Ercole Marelli Elettromeccanica General* [1991] ECR I-4105.

are instigated with a view to resolving financial difficulty rather than liquidating the assets of the company, the employees of that company retain their acquired rights and transfer to any purchaser of the business of the company trying to avoid business failure.[67] A number of UK cases have entrenched this position in domestic law,[68] with the effect that in any business sale by a company in administration, employees will automatically transfer to the buyer of that business. According to the Court, due to its very nature, administration proceedings can never be instituted *with a view*[69] to liquidation,[70] so TUPE 2006 will always apply to business transfers out of administration. This position is regarded as having a potentially serious effect on the sales of businesses out of administration unless further jurisprudence or legislative amendment provides otherwise.[71] A consultation on TUPE 2006 was recently undertaken in the UK but its focus was not on the effect of TUPE in business rescues situations so nothing has changed in this area as a result of it.[72]

The consequences for business rescue could be significant in relation to the outcome of transfer negotiations once a purchase price is adjusted to reflect the increased risk exposure associated with transferring employees.[73] A recent survey performed in the UK by R3[74] was taken among 379 R3 members and showed that over 50% of insolvency practitioners have dealt with cases in a 12 month period where a buyer has either withdrawn or discounted its purchase price as a result of TUPE liability. 40% had seen cases where the purchaser had entered liquidation rather than being sold as a going concern. A further two thirds responded to a general query that the purchaser had withdrawn or reduced their purchase bid due to the impact of TUPE while the 1/3 remaining replied that liquidation was a consequence of the impact of TUPE.[75]

67 Barnard, above note 43, at 651; See W. Derbyshire and S. Hardy, *TUPE Law & Practice* (2nd ed) (2009, Spiramus Press Limited, London), at 57-58.

68 See *Oakland v Wellswood (Yorkshire) Ltd* [2009] EWCA Civ 1094; [2010] BCC 263; *OTG Limited v Burke & Others* [2011] UKEAT 0320/09; *Key2Law (Surrey) LLP vs Gaynor De'Antiquis and Secretary of State for Business Innovation and Skills* [2011] EWCA Civ 1567.

69 Emphasis added.

70 See Anon., "Transfer of Undertakings – No Exemption for Administrations" (2011) 94 *Technical Bulletin*, section 94.8.

71 See R. Carthew and C. Fallon, "Employment: An Insoluble Issue – The Insolvency Provisions of the Transfer of Undertakings (Protection of Employment) Regulations (TUPE)" (2010) September Corporate Briefing, at 2.

72 Department of Business Innovation and Skills, Consultation on the Transfer of Undertakings (Protection of Employment) Regulations 2006, copy available at: https://www.gov.uk/government/consultations/transfer-of-undertakings-protection-of-employment-regulations-tupe-2006-consultation-on-proposed-changes (last accessed 15 June 2014).

73 See S. Horne, "From a Question of Fact to An Absolute Rule" (2011) *Employment Law Journal* 2.

74 The Association of Business and Recovery, the leading organisation for insolvency, restructuring and turnaround specialists in the UK.

75 See A. Stephens and G. Palfrey, "TUPE and the Current State of Play" (2012 Autumn) *Recovery* 22.

France had a provision for contractual acquired rights in place well before the Directives were introduced. The EU social policy position was in fact influenced to some degree by what already existed in French law. Thus France has not suffered a resistance to acquired rights given that the concept was born in that jurisdiction. It is interesting to note, however, that in the more recent reforms, France has chosen to relieve the burden of employment liabilities for certain of their corporate rescue procedures. The UK, however, continues to struggle with its implementation of the Directive in relation to its effect on corporate rescue.

Considering the amount of cross border business and the insolvencies which have occurred during the financial crisis, a diversity of approaches to employment protection is not necessarily a benefit as it confuses the process by allowing employees of the same company to be treated differently if in different jurisdictions. However, little has been done to try to harmonise approaches due to the resistance of Member States to the interference of the EU in matters of national social policy. The same cannot be said for insolvency law and cooperation within the EU.

The Once and Future EIR

The EIR in its current state leaves the governance of employee contracts affected by business transfers solely to the applicable law of the Member State.[76] The proposed amended regulation retains the same wording and intent but proposes an additional provision in relation to acquired rights. INSOL Europe has recommended the inclusion of a second paragraph to the "Contracts of Employment", Article 10 of the EIR, which clarifies the legal jurisdiction governing employment contracts affected by business transfers occurring under secondary proceedings. The inclusion of this paragraph is aimed at addressing the fact that different jurisdictions have different approaches to insolvent business transfers and acquired rights owing to the derogation available under the directive. INSOL Europe's proposals therefore fail to assist in resolving the broader issue of equalising the application of acquired rights in corporate rescue.

The wide divergence of the application of acquired rights in business transfer situations creates an opportunity for another species of forum shopping. The differences in the systems in terms of transferability of employees could become a consideration in the choices made when group companies find themselves in financial difficulty and must choose to close down or sell off certain parts of their operation throughout the EU. As the proposals by INSOL Europe have been made

76 Article 10, "Contracts of Employment", EIR.

to try to reduce forum shopping, in addition to resolving a number of other issues, it is reasonable to consider how diverse approaches to the acquired rights directive will influence the efficiency of corporate rescue procedures throughout the EU.

Impact of Diversity of Approaches

The diversity of employment entitlements across the EU can affect the choices businesses make when deciding where to invest or divest. In those jurisdictions where employment regulation is more flexible, companies may develop labour intensive businesses to take advantage of the ease of changing employment contracts, dismissing employees, paying less in wages and social security. It may also be easier to shut down those businesses in times of financial difficulty.[77] Flexible employment protection facilitates capricious investment and could potentially create greater instability in economies because businesses are able to come and go with greater ease. This also affects communities where businesses are dissolved as it will lead to fluctuating levels of unemployment, placing a greater dependence on State social security systems.

Companies may also choose to close branches where it is least costly to do so. Costs of employee liability are a part of those considered costs. For example, in 2006 Peugeot closed down a plant at Ryton near Coventry in the UK. The company blamed the closure on high production and logistical costs. Unions criticised the UK government for having inadequate employment protection laws, believing that a comparable factory in France would not have been so easily shut down. They insisted that:

> "…weak UK labour laws are allowing British workers to be sacrificed at the expense of a flexible labour market…Job protection similar to that enjoyed by workers in France would give British employees the opportunity to compete for investment and work on important issues like productivity and efficiency."

This assertion was supported by London law firm Clifford Chance, which agreed that the cost of shutting down factories in France would cost nearly three times the amount as in Britain because of the highly protective French employment laws.[78]

77 See K-J. Bieback, "Harmonisation of Social Policy in the European Community" (1991) 32(4) *Les Cahiers de Droit* 913, at 926.

78 IRRU Warwick Business School, "Peugeot announces Closure of Coventry Plant" (2006) European Industrial Relations Observatory, a copy of which may be viewed at: http://www.eurofound.europa.eu/eiro/2006/05/articles/uk0605029i.htm (last viewed 15 June 2014).

If one considers choice of investment and divestment in different jurisdictions, more labour flexible economies are likely to remain more volatile places for employee job security. INSOL Europe's proposals seek in part to satisfy EU goals of maintaining a stable internal market by avoiding incentives for forum shopping in the attempt to secure more favourable legal position. The dissonance of applications of acquired rights interferes with this goal in so far as different jurisdictions will continue to attract different varieties of investment depending on the legal climate.

Conclusion: Harmony or Dissonance?

The EU Treaties have so far left the competence to regulate social policy to the Member States.[79] Even when drafting the first Treaties in the 1950s it was mainly France that sought to give more power to the European Community as it was then in the field of social policy so that it might raise the level of protection in other Member States to a level more equal to the system in France.[80] However, the tension between the goal of harmonization of social policy and the aim of the free market has to date made this difficult if not impossible.[81]

There are few Regulations in the EU which deal with social policy issues; most social policy rules are legislated through Directives which are only binding on states as to the results to be achieved. The Member States then have reasonable latitude to implement them through the means and methods that they see fit, often taking advantage of exclusions and caveats which not all Member States will apply.[82] As such, the European Employment Strategy has seen diverse implementation among the Member States as a result of a gap between the EU level aims and national policies.[83] While recently the importance of social policy has been strengthening in the EU, it remains a fractured subject among the Member States which will not be easy to coordinate.

The differences in labour flexibility among the states of the EU can cause instability in a jurisdiction and may arise to some degree where the application of employee acquired rights in business rescue is not so strict. This may also be an

79 Bieback, above note 77, at 916.

80 Ibid., at 913.

81 See C. Barnard and S. Deakin, "Negative and Positive Harmonisation of Labour Law in the European Union" (2002) 8 *Columbia Journal of European Law* 389, at 389.

82 See G. Barrett, "Deploying the 'Classic Community Method' in the Social Policy Field: The Example of the Acquired Rights Directive" (2009) 15(2) *European Law Journal* 198, at 198.

83 See P. Kettunen and C. Wolff, "Europeanisation through the Back Door: EU Social Policy and the Member States" (2010) 47(5) *Politička misao* 144, at 145.

argument for the harmonisation of labour laws across the EU generally. In order to avoid this species of social dumping, it may be necessary to remove distortions in competition, such as flexible versus inflexible labour regulation in this case. While most descriptions of social dumping indicate undervalued labour in the sense that employees are paid lower wages and have less employment rights,[84] it is reasonable that this concept could be applied to the rights of employees on business transfers as this also has an effect the cost of doing business in a jurisdiction. As mentioned in the R3 report cited above this can lead to a reduction in a price for a business transfer, the failure of a deal and potentially the failure of a rescue initiative, leading to liquidation and a far more debilitating loss of employment security.

As the future sees the slow meeting of minds among the European countries in relation to business orientated legislation under the umbrella of EU law such as the EIR, the position on social policy remains static. The creation of the Common Market was intended to foster trading across national boundaries and a functioning bankruptcy system forms a part of legal regime needed to support the market.85 While the reasons why a similar treatment has not been given to labour regulation are myriad, there remains an argument that an equalisation across the Member States might be best for all.

The question that remains is why two cultures which evolved in such close proximity with so much historical crossover have approached the same social and economic situations so differently and if this context will further elucidate a means by which employment protection and business rescue can be balanced across the EU in order to create a more level playing field between Member States as well as creating greater equality of treatment between employees of all EU countries. Such a balancing could have the effect of fostering greater stability across the EU and certainly in individual Member States whose legal regimes vary greatly. That, however, is a question for a much larger project.

84 See B. Hepple, *Labour Laws and Global Trade* (2005, Hart Publishing, Portland OR), at 14.
85 Omar, above note 3, at 49.

Chapter 14

The Integration of Pre-Insolvency Proceedings in the European Insolvency Regulation: A Comparative Analysis

Marie Padellec

Introduction

The different legislations have undergone numerous reforms to integrate the rescue of the company in their legislation. The European Insolvency Regulation (EIR) needs to be adapt of this objective and this is can be done in part with the integration of pre-insolvency proceedings for which the company is not in insolvency and the director keeps his power. As we know there is not one insolvency law, and the consequence is that there is not one kind of pre-insolvency proceedings. The interest of this topic is to have an analysis of two different pre-insolvency proceeding like the English Company Voluntary Arrangement and the French *procédure de conciliation* to see their integration in the new EIR suggested by the European Commission in December 2012.[1]

A Different Approach to Rescue in the Application of Pre-Insolvency Proceedings

The CVAs and the *procédure de conciliation* are two different kind of pre-insolvency proceedings. One presents more rigidity and the other flexibility and one is public when the other gives the opportunity the choice to keep the confidentiality or not.

English Rigidity and French Flexibility

Different kinds of measure are taken under French and English insolvency law to achieve the rescue through pre-insolvency proceedings. It is possible to deduce from these two tools a big flexibility under French Law in opposition to English law, which is stricter. Indeed, this ultimate law imposes on the company in

1 Available at: http://www.europarl.europa.eu/registre/docs_autres_institutions/commission_europeenne/com/2012/0744/COM_COM%282012%290744_FR.pdf (last viewed 15 June 2014).

difficulty a requirement to follow a strict process contrary to the former which leaves more liberty to the company.

The Obligation for the English Company to follow a Determined Process

A part of the difficulty of pre-insolvency proceedings lies in the limitation of creditors who can vote for agreements and with whom the companies want to find an agreement and the formalism creates by the legislator to set it up it.

(a) The Limitation of Creditors in the Adoption of the Agreement

In the case of the CVA, the company in difficulty does not have the choice of designating the creditors with which it wants find an agreement.[2] The CVA obliges the company in difficulty to find an agreement with unsecured creditors which will be binding all creditors. Indeed, the proposal needs to be approved by 75 per cent of creditors voting in person or by proxy by reference to the value of their claims. It also requires the approval of 50 per cent in value of the members/shareholders present at a shareholders' meeting. This notion of creditor does not include preferential creditors, creditors with security interest.

(b) The Obligation to Organise a Creditors' Meeting

The English rigidity is also developed by the obligation to summon a meeting to set up the agreement. Section 2 of the Insolvency Act 1986 gives the possibility to the company's directors in difficulty to nominate a nominee, who is an insolvency practitioner. The directors have to submit with the help of the IP a proposal for the CVA with a state of his business. The person nominated to act in a CVA as a supervisor must, within 28 days (or longer if the court allows) of notice of the proposal for a CVA, report to the Court, stating whether, in his opinion, meetings of company should be summoned to consider the proposal.

In the case of positive advice from the supervisor, that means in the case he judges that the proposal "*has a reasonable prospect of being approved and implemented*",[3] he has to summon meetings of creditors and shareholders. The proposal has to be serious and viable.[4] The nominee must send his advice about the meeting including a copy of the proposal and the state of the business to the court. If approved, the scheme becomes operative and binds the company and all creditors who were

2 *Re T & N Ltd and Others* [2006] 3A11 ER 697.

3 Schedule 2(2), Insolvency Act 1986.

4 See *Cooper v Fearnley* [1997] BPIR 20.

entitled to vote at the meeting or would have been so entitled if they had notice of it, and also creditors who did not approve the proposal.[5]

A Bigger Liberty for a French Company in Difficulty

In opposition to English law, the company in difficulty under the French law has more liberty in the application of pre-insolvency proceeding. French law authorises a company in difficulty to choose the creditors with whom it wants to find an agreement. Besides, it does not exist an equivalent in French law to the English formalism.

(a) The Opening of French Pre-Insolvency Proceedings to usual Co-contractants

In the case of the *procédure de conciliation*, the *conciliateur* has a mission to:

> "…facilitate the conclusion [of an agreement] between the debtor and his principal creditors, usual co-contractants…"

This has the objective to being an end to the company's difficulty.[6] The *Code de commerce* gives the opportunity to find an agreement, not only with principal creditors (which means creditors in quantity or quality), but also with other persons with whom he has the habit to make business (suppliers, clients, and partners).[7] French law extends the scope of pre-insolvency proceedings and particularly the *procédure de conciliation* to persons who are not necessarily creditors of the company. Besides the opportunity provided by French law, it is important to add that French law does not impose, unlike English law, a particular formalism to adopt an agreement.

(b) The Absence of a Binding Procedure to Form an Agreement under French Law

In case of a *procédure de conciliation*, the debtor applies to court by a written and simple request for the opening of the *procédure de conciliation*.[8] The President of the Court will summon the debtor to receive his explanations. Once seized, the studies the request and takes a decision to appoint or not a *conciliateur*. The *conciliateur*'s mission is to make proposals relating to the rescue of the company.[9]

5 Schedule 1, paragraph 5, Insolvency Act 1986.

6 Article L.611-7, *Code de commerce*.

7 J. Theetten, "Traitement Juridique des Entreprises en Difficulté" (October 2006), at 9, a copy of which is available at: http://droit.univ-lille2.fr/fileadmin/user_upload/enseignements/formation_continue/resumes/entreprises_en_difficulte_cours.pdf (last viewed 15 June 2014).

8 Article L.661-6, *Code de commerce*. The application is made to the President of the Commercial Court if the debtor is a commercial company or an "*artisanale*" (craft) company and, in other cases, to the *Tribunal de Grande Instance*.

9 For more information, see JCP E 2004, act. 184.

He has to report the state of progress of his mission. In the absence of agreement, he will have to say it and the president of the Court will end his mission. The mutual agreement concluded between the debtor and his creditors is notified in an *Ordonnance* of the President of the Commercial Court or approved. The "*accord constaté*" is not published, whereas the "*accord homologué*" is notified to third parties. Unlike in English law, the summoning of a meeting to adopt a scheme does not exist. It is only an agreement between the debtor and creditors at the individual level and does not bind any creditor who does not want to be part of the scheme.

Between Secrecy and Transparency to Save the Company: A Further Step for French Pre-Insolvency Proceedings?

The French and English legislators know that it is necessary that they intervene in these proceedings to invite creditors and companies to find an agreement and this in an early way to favour the rescue of the activity. The opposition of the formalism and the flexibility of the English law and the French law goes beyond the material rules. It is more a question of advancing two different policies of rescue: one is the transparency of the English law and the other the secret under the French law to save the company. The biggest problem for companies is the knowledge by the creditors of their difficulty. The creditors and/or the co-contracting parties can lose the confidence which they had in the company. The decision-making by the director to ask for a pre-insolvency proceeding is not easy. They are often afraid of the consequences which could arise because of the opening of such proceedings.

What are the possible solutions to reach the rescue of the company? Should we and can we hide the opening of pre-insolvency proceedings such as in the French experience or do we have to make transparency prevail in their implementation such as is provided for by English law?

<u>The Choice of Transparency under English Insolvency Law</u>

The English legislator has chosen in a very clear way that the pre-insolvency proceedings are transparent to inform mainly all the creditors about the economic situation of the company. This transparency is mainly seen in two practices: publicity, which has at the same time advantages and inconveniences, and the possibility for the company to ask for the benefit of a moratorium within the framework of the CVA.

(a) Publicity: An Asset and a Burden for Rescue of the Company

The choice of the English law is clear. There is no secret pre-insolvency proceeding. The CVA is a proceeding in which the company is subjected to publicity: by the summons of the creditors to the meeting, by the registration in the register of the companies of the opening of the pre-insolvency and by the imposition of the agreement to the creditors in particular. The interest of the publicity for the company benefiting from English measures is to see the arrangement which it takes with her creditors binding all creditors. Although publicity was chosen in the interest of companies by the English legislator, it also involves a lot of negative effects. On one hand, it can compromise the company with regard to her creditors. The company could have more difficulty to assert its position, particularly in respect of financial institutions. In the same light, the fact of leaving the management of the activity to the same directors during the pre-insolvency proceedings can make the creditors think that the mismanagement having led to this situation will continue after the implementation of the plan.

From another point of view this publicity allows the creditors to make an appeal easily if the agreement causes them harm.[10] On the other hand, the formalism required by the English law to set up a plan, in particular the need to summon all creditors, to convene a meeting of the unsecured creditors within the framework of the CVA involves an enormous cost for an activity which is already in trouble. In particular, it can be one of the arguments that most matter when discussing whether small firms do or do not require the opening of these procedures.11

(b) Transparency, An Asset for the English Company: The Possibility of a Moratorium

The transparency organized by the legislator encourages English companies and has a part to play in the decision to open pre-insolvency proceeding. To counterbalance this position, English law has recently introduced into its legislation, and particularly within the framework of the CVA, a moratorium to mainly prevent the company from experiencing individual pursuit by the creditors. Within the framework of the CVA, the small-sized company can have the benefit of the moratorium so getting itself shielded from any pursuit by the creditors. It was introduced by the English Parliament in February 2000 into the Insolvency Bill. It received Royal Assent on 30 November 2000 and the measures concerning the moratorium came into effect on 1 January 2003.

Actually, this study aims to develop these rules relative to the moratorium in the medium-sized and large companies. It is all about a necessary asset favouring the

10 See *Re Trident Fashions* [2004] 2 BCLC 35.

11 See D. Milman and F. Chittenden, "Corporate Rescue: CVAs and the Challenge of Small Companies" (ACCA Research Report 44) (1995, ACCA, London).

rescue of the company. By the same token, without using the same rule, French law also has measures to protect the company.

(i) An Asset Encouraging Rescue of the Company

English law gives the possibility for companies in difficulty to ask for the application of a moratorium. The effects of the moratorium are to offer protection against petitions for winding up or administrations order, meetings of the company, winding-up resolutions, appointments of receiver and other steps:

> "…to enforce security over the company's property or to repossess goods in the company's possession under any hire purchase agreement except with the leave of the court."

No other proceeding or execution or legal process or distress can be commenced, continued or levied against the company except by court leave, nor can a landlord forfeit the lease of a company's premises by means of peaceable re-entry.[12] For the practitioners and in academic commentary, this measure is one of the essential elements allowing the rescue of the company.

An English company can use this measure under certain conditions:[13] A company is eligible if in the year before filing for a moratorium or the prior financial year, it has satisfied two or more of the requirements for constituting a small company under section 382(3) of the Companies Act 2006. This means that moratoria will only be available to companies with at least two of the following requirements: a turnover of not over GBP 6.5 million per annum; fewer than fifty employees; and a balance sheet total which does not exceed GBP 3.26 million. This means that the moratorium is at the disposal of only small companies.

Nevertheless, this measure is criticized in England.14 Indeed, some authors raise the difficulty according to which, by the implementation of this moratorium, the creditors can believe that the company requires this measure because of a lack of liquidity. By this means, this measure give to the director the possibility of abusing his situation (the company being in difficulty) by imposing on the creditors a situation in which they cannot cover their claims any more. Finally, they also consider that this measure favours the development of the CVAs which are

12 See V. Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd ed) (2009, Cambridge University Press, Cambridge).

13 Section 382(2), Companies Act 2006; see also DTI, *The Insolvency Act 1986: Company Voluntary Arrangements and Administration Orders: A Consultative Document* (1993, DTI, London).

14 See J. Tribe, "*Company Voluntary Arrangements and Rescue: A New Hope and a Tudor Orthodoxy"* (*2009*) *Journal of Business Law 454.*

expensive for companies (in particular by the need to summon various meetings) and inevitably not that favourable to firms failing financially.

In spite of the criticism of some commentators, others propose and develop in particular the idea to widen the moratorium in the case of medium-sized and large companies.[15] The interest of this measure regarding rescue is clear. Some people can blame the French legislator for not having planned such a measure, but the latter does not leave the failing firm without tools of defence either against creditors who want to get back what is owed them.

(ii) A French Insolvency Law which does not leave the Company without Protection

In French law, under the aegis of the Law of 10 June 1994, the President of the Court could order the suspension of proceedings of the creditors within the framework of the *règlement amiable*. The Law of 2005 eliminated this measure. It went against the principle of confidentiality planned by the implementation of the procedure conciliation. The French law does not leave the company without protection against its creditors.

The law allows the debtor to ask the judge for the application of the famous "*délai de grâce*" set out in Articles 1244-1 and 1244-3 of the *Code civil* as anticipated in Article L.611-7 of the *Code de commerce*. This "*délai de grace*" indicates the postponement of the term of the debt or the rescheduling of the terms which the judge or the creditor can grant. Since the *Ordonnance* of 2008, Article L.611-7 of the *Code de commerce* provides that the judge can be seized to this end by a simple formal demand (*mise en demeure*) by the creditor, without waiting for possible legal proceedings. It is about claims falling "*normalement*" (normally) under the terms of the measures within the *Code civil* as well as fiscal claims. The doctrine advocates a wide application of these measures. The "*délai de grace*" also concerns pursuits initiated even before the opening of a conciliation procedure.[16]

On the other hand, the judge who decides to approve the agreement according to Article L. 611-8 of the *Code de commerce* cannot any more in the judgment/order of "homologation" impose to the creditors not party in the agreement any additional payment times under Articles 1244-1-1244-3 of the *Code civil*. The agreement simply noted by the President of the Court sees itself strengthened. More generally, the company in financial difficulty, throughout the execution of the

15 See J. *Tribe,* "The *Extension of Small Company Voluntary Arrangements:* A *Response to the Conservative Party's Corporate Restructuring Proposals*", Chapter 8 in P. Omar (ed), *International Insolvency Law: Reforms and Challenges* (2013, Ashgate, Farnham) (193-227).

16 CA Versailles, 13ème chambre, 19 October 2006, RG n° 06/01788, *Redistribution c/ Fortis Banque France*: RTD com. 2007.830.

"*accord constaté*" or "*accord homologué*", obtains the suspension of proceedings introduced against it, the subject of which are the payment of the claims.17

It is clear that English law, in trying to favour the rescue through transparency, does not today satisfy one of the essential pre-requisites of a company in difficulty, which is to reduce as much the costs and those in particular of a pre-insolvency proceeding. It seems very difficult for the company to find good financial conditions in a situation in which it finds itself forced to form a solution with a majority of its creditors. It is in all the interest of French law to allow a free choice to the company to choose between transparency or secrecy of its agreements.

The French Option of Transparency or Secrecy of the Agreement

The originality of the French law on the subject is an element necessary for the rescue of the company. The opportunity left to the director and his creditors to choose to publish an agreement or preserve its secrecy through the *procédure de conciliation* is a disproportionate advantage. It allows the company in difficulty to estimate the consequences that could result from the publicity of the benefit of the opening of pre-insolvency proceedings, which means the recognition by the business world and, more particularly, by its creditors of the difficulty. Beyond this choice offered to the company, the French law, by a unique measure within the European Union, the "*privilege de conciliation*", encourages the creditors to find an agreement with the company and by the same favours the rescue of the latter.

(a) Liberty given to the Company

The *procédure de conciliation* allows the company in difficulty to find an arrangement with her creditors in a confidential way. For some authors, this confidentiality is the key of the rescue of company in difficulty. As stated by Françoise Pérochon:

> "…what makes the success […] of the conciliation it is that they are simple, flexible and confidential procedures. The request can be a simple letter, the mission is going to be defined according to every case, it is of the custom-made product and the confidentiality required by Article L.611-15 is the key to the success."[18]

17 Article L.611-10-1, *Code de commerce*.

18 F. Perochon, "Table ronde" (2010) *Revue des procédures collectives*, at 51: "Ce qui fait le succès […] de la conciliation c'est que ce sont des procédures simples, souples et confidentielles. La requête peut être une simple lettre, la mission va être définie en fonction de chaque cas, c'est du sur mesure et la confidentialité exigée par l'article L. 611-15 est la clé du succès."

So the opening of the *procédure of conciliation* is communicated only to the prosecutor (*ministère public*) and when the debtor is subjected to the legal control of his accounts, to the statutory auditor. If the professional is part of a regulated liberal profession, s/he also has to inform the professional order or the competent authority which supervises him/her. Furthermore, the Article L.611-15 of the *Code de commerce* provides that the conciliator is also bound to confidentiality.

It is only when the company forms an agreement with her creditors that it can choose whether to publish this information or not. It is up to it to estimate the effects of publication. If it chooses to keep it secret, the judge simply notes the agreement. On the other hand, if the company wishes, together with its creditors, for the agreement to be published, it is approved (*homologué*) by the judge and published twice (in the BODACC and in the legal gazette). It can be approved (*homologué*) only if the debtor is not in *cessation des paiements* or if the agreement that has been reached puts an end to it, if the terms of the agreement can assure the continuity of the activity of the company and if the agreement does not strike a blow at the interests of non-signatory creditors. The "*homologation*" allows the creditors that are signatories to the agreement to benefit from the privilege of new money (see below). Furthermore, even in the case of publication, the approving judgment (*homologuant*) does not reproduce all of the terms of the agreement. It mentions only guarantees and privileges that have been entered into to ensure the execution of the agreement.

The fear raised by this option is the protection of the interests of the creditors not party to the agreement. This fear is mainly avoided by a measure common to the English and French law, which is the "*période suspecte*". From a more general point of view and always in the spirit of rescue of the company, these French mechanisms present a major advantage in requiring little expense by the absence in particular of the formalism as required in English law, such as the summons of a meeting.

(b) Legislation Encouraging Creditors to Form an Agreement with the Company: A Unique System

The significant asset offered by the French law regarding rescue is the existence of measures encouraging the creditors to find an agreement with the company. Besides the interest for the creditor to obtain more quickly a greater amount of its claim by participating in the rescue through the pre-insolvency proceeding, other measures can also encourage the creditors to reach an agreement. Thus, if a company is subjected to the French law regarding prevention of its difficulties, the creditors will be allowed, under certain conditions, to benefit from the "*privilège de conciliation*".

A privilege of "*new money*" is granted to the creditors who agree, within the framework of the "*accord homologue*", an inflow of new capital.[19] In case of the opening of a (subsequent) *procédure de sauvegarde*, *redressement judiciaire* or *liquidation judiciaire*, they will be preferential debts before all the claims that arose before the opening of the *conciliation*. This privilege is subject to two conditions: on one hand the agreement with the creditor must be made for the pursuit of the activity of the company and its sustainability, and on the other hand, that there is homologation of the conciliation.

It is a measure useful and favourable to the rescue of the company:

> "…because very often the ratification is asked because of the privilege which we want to obtain, it is not still the debtor who asks for it, but the bankers, the credit institutions"[20] and
>
> "…In the negotiations with financial partners of the company, this privilege of conciliation allows, even in very difficult situations, to obtain the new financing, and constitute of this fact one of the key measures of the *Procédure de conciliation*."[21]

Initially this privilege was only intended for the contributors of new money. Since the *Ordonnance* of 2008, it has been extended to persons having agreed to new financial contributions (except in terms of payment times) and to persons supplying new goods or services. Nevertheless, this privilege is limited to the amount of the contribution. The creditors have no obligation to subject the whole amount of their claims to the agreement.[22] It can be practicable only if the company in difficulty has enough assets to satisfy the agreement.

Besides, the *Ordonnance* of 18 December 2008 allows to any individual guarantors or persons jointly liable with the debtor to take advantage of measures of any agreements that have been "*constatées*" or "*homologues*" by the court.[23] It is obvious that this practice of the *privilège de conciliation* favours the conclusion of an agreement between the debtor and its creditors. It is a key measure encouraging the creditors to rescue the company.

19 Article L.611-11, *Code de commerce*.

20 See J-B. Drummen, "Table ronde" (2010) *Revue des procédures collectives*, at 51.

21 See D. Zwerger, "Table ronde" (2010) *Revue des procédures collectives*, at 51.

22 Cassation commerciale, 13 October 1998, Bull. civ. 98, IV, n°235.

23 Article L.611-10-2, *Code de commerce*.

Summary

The choice of the transparency or secrecy of pre-insolvency proceedings is all important in the rescue of the company. English law takes up, as in the rest of its insolvency procedures, the choice of a greater transparency to allow the creditors in particular to know the situation of the company. This could be fatal for the company and harm its financial situation even when it is not in a situation of insolvency. However, English law knowing the effect which transparency may have on some debtors allows for some companies (of small size at the moment) to benefit from a moratorium protecting them from actions that may be engaged by the creditors. French law seems to provide the most just answer to the rescue of the company by granting it the choice of transparency or secrecy and so by allowing it to estimate the positive and negative effects of such publicity while being able to protect itself. The French law also opens negotiations beyond creditors to the usual co-contracting parties.

The Exclusion of the "*Procédure de Conciliation*" and CVAs in the Revision of the EIR

The integration of pre-insolvency proceedings in the revision of the EIR is passed over by a new definition of insolvency proceedings in the EIR. The preservation of collective conditions (for insolvency proceedings) excludes pre-insolvency proceedings.

Analysis of a New Definition of Insolvency Procedures

It is necessary to have a revision of the first article of the EIR to integrate pre-insolvency proceedings. Professor Jean-Luc Vallens has already made a proposal in this regard. He proposed a re-writing of the first article to cover proceedings:

> "…established on the existence of economic difficulties requiring the control of a jurisdiction or an authority authorized by the law, entailing a supervision (*surveillance*) of the affairs of the debtor or the transfer of its powers to an administrator appointed to this end and intended to allow a recovery of the company or the liquidation of its goods."[24]

The European Commission chose another definition but with the same spirit which is:

24 See J-L. Vallens, "Réviser le règlement communautaire CE 1346/2000 sur les procédures d'insolvabilité" (2010) *Revue des procédures collectives* n° 3 (Mai), étude 13.

> "This Regulation shall apply to collective judicial or administrative proceedings, including interim proceedings, which are based on a law relating to insolvency or adjustment of debt and in which, for the purpose of rescue, adjustment of debt, reorganisation or liquidation, (a) the debtor is totally or partially divested of his assets and a liquidator is appointed, or (b) the assets and affairs of the debtor are subject to control or supervision by a court. The proceedings referred to in this paragraph shall be listed in Annex A."

So, this definition includes several conditions: a proceeding based on a law relating to insolvency or adjustment of debt; the assets and affairs of the debtor are subject to control or supervision by a court; and the proceedings have for their objective the rescue, adjustment of debt, reorganisation or liquidation.

<u>A Proceeding Based on a Law Relating to Insolvency or Adjustment of Debt</u>

The European Commission opens the scope to administrative, judicial or interim proceedings. It only requires that the proceeding has to be based on a law relating to insolvency. The *procédure de conciliation* and CVAs are organised by an insolvency law. The *procédure de conciliation* is contained within the Livre VI of the *Code de commerce* called "*Des difficultés des entreprises*" and the CVAs are contained within Part I of the Insolvency Act 1986. With this condition, the European Commission removes the financial condition: the insolvency condition. It leaves to the national law all the opportunity for defining insolvency proceedings or pre-insolvency proceedings.

Article L 611-4 of the French *Code de commerce* contains:

> "…a *procédure de conciliation* from which may benefit debtors exercising a commercial or artisanal activity who are undergoing a legal, economic or financial difficulty, actual or predictable and who have not been in suspension of payments for more than forty-five days."[25]

The conditions required by the *Code de commerce* for the opening of the collective procedure meet the requirements of economic difficulties of the definition suggested by Jean-Luc Vallens.

25 "*...une procédure de conciliation dont peuvent bénéficier les débiteurs exerçant une activité commerciale ou artisanale qui éprouvent une difficulté juridique, économique ou financière, avérée ou prévisible, et ne se trouvent pas en cessation des paiements depuis plus de quarante-cinq jours*."

The Insolvency Act on 1986 does not require a situation of insolvency for the opening of the CVA. It is only specified that the opening of the CVAs has, for its main objective, to save the company. This indicates indirectly that the company has to have some difficulty. The CVAs thus realizes the condition of the economic difficulties.

<u>The Assets and Affairs of the Debtor are subject to Control or Supervision by a Court</u>

The European Commission had a second condition which is the assets and affairs of the debtor are subject to control or supervision by a Court. We exclude the first option which is where the debtor is totally or partially divested of his assets and a liquidator is appointed which concerns strictly only insolvency proceedings. The European Commission takes up the idea of Jean-Luc Vallens for a control by a jurisdiction or an authority authorized by the law. The European Commission opens the scope of the European regulation in the procedures not requiring the appointment of a liquidator like for insolvency proceedings.

By this definition, it allows for the inclusion in the regulation of any procedures in which the debtor is responsible for his affairs and the appointment of a liquidator is not an obligation. It could involve in this case, for example, the *procédure de conciliation* in which there is no appointment of liquidator but oversight of the procedure by the President of the Court.[26] The conciliator only has the role of communicating between the debtor and its creditors.[27]

Nevertheless, the European Commission does not give the definition of supervision: the opening of the procedure involves the supervision of the affairs of the debtor. Indeed, it is necessary here to determine what the notion of supervision of affairs means. It is a wide and abstract notion.

Supervision is defined in France as:

> "…an action to stay up a person or a thing in its interest, or to supervise a person or an operation for the protection of other interests";[28] or

> "…preventive action which is based on the diligence of the one who supervises (marked by acts of check and control) and which applies to

26 Article L.611-8, *Code de commerce.*

27 Ibid., Article L.611-7.

28 Le Robert Dictionary: "Action de veiller sur une personne ou sur une chose dans l'intérêt de celle-ci, ou de surveiller une personne ou une opération pour la sauvegarde d'autres intérêts."

> the action of others in the time in the development [and to] the future of what is supervised."[29]

It is a wide definition including in the scope of the regulation the *procédure de conciliation*. Indeed, Article L.611-6 of the *Code de commerce* provides that:

> "…the President of the Court has at his disposal the powers which are attributed to him by Article L.611-2. Furthermore, he can ask an expert of his choice to establish a report on the economic, social and financial situation of the debtor and, in spite of any contrary legislative or statutory measure, to obtain from banking or financial institutions any piece of information to give exact information about the economic and financial situation of [the debtor]."[30]

The *Ordonnance* of 2008 brings to this article the essential points allowing for the *procédure de conciliation* to be a part of the scope of the EIR through the new re-writing of the first article proposed by Jean-Luc Vallens and by the European Commission. It specifies that it is possible for the President of the Court to appoint an expert to establish an economic situation of the company and he can ask, at any time after the opening of the *procédure de conciliation*, for information on the financial and economic situation of the company from the relevant financial institutions.

The President of the Court has a role of supervision of the economic situation of the company (by the appointment of the expert or by the request of information for financial institutions) and for its affairs generally (by the appointment of an expert to establish a report on the economic, social and financial situation of the debtor).

CVAs also approach this condition. Within the framework of this pre-insolvency proceeding, the insolvency practitioner, from the moment he has to express his opinion to the court as to the success of the implementation of an arrangement, is involved from day to day in the affairs of the company and consequently has to inquire significantly. As the commentary states:

> "[the] CVA operates under the aegis of the court but without the need for the court involvement unless there is a disagreement requiring judicial resolution."[31]

29 See G. Cornu, *Vocabulaire juridique* (4th ed) (2003, PUF Quadrige, Paris), at 868: "Action préventive qui fondée sur la diligence de celui qui surveille (marquée par des actes de vérification et de contrôle) s'applique à l'action d'autrui dans le temps (au développement, au devenir de ce qui est surveillé)."

30 Article L.611-6, *Code de commerce*.

31 *Re Pinson Wholesale Ltd* [2008] BCC 112; see also Finch, above note 12, at 489.

For the European Commission, the definition of control as follows is stated in its Preamble 9 *bis*:

> "In the present context, the term "control" has to apply to the situations in which the jurisdiction intervenes only on appeal of a creditor or an interested party."

This mean that CVAs fulfil this condition because of the intervention of the court if it is required.

Proceedings have as an Objective the Rescue, Adjustment of Debt, Reorganisation or Liquidation

The Commission adds to these first three conditions another one indispensable to the protection of the company where the proceedings have for their objective the rescue, adjustment of debt, reorganisation or liquidation. Also, this condition takes up the proposition made by Jean-Luc Vallens who suggested in his definition two main objectives of the procedures, which are either the recovery of the company or the liquidation of the goods, where the first cannot be satisfied.

By this condition, the European Commission allows for the introduction of pre-insolvency proceedings. Indeed, as previously seen, the various pre-insolvency proceedings of English law or French law have for their objective the recovery or rescue of the company. Nevertheless, the *procédure de conciliation* presents some difficulties when compared to the new proposal by the European Commission.

The Exclusion of CVAs and Procedure de Conciliation by the "Collective Proceedings" Condition

The introduction of pre-insolvency proceedings in the EIR was much awaited by the French. In reality, by its new proposals, the Commission has reduced the objective of the integration by imposing two conditions: publicity and the preservation of the condition of a "collective proceeding".

The Difficulty of Integrating the "Procédure de Conciliation" by the Requirement for Publicity

The European Commission in its proposal specifies that the extension of the European Regulation to the pre-insolvency proceedings and in particular those that are confidential, such as the *procédure de conciliation*, are not included but:

> "It does not prevent such proceedings from falling within the scope of the regulation concerning insolvency proceedings once they become public."[32]

So in the proposal, the *procédure de conciliation* which ends with an "*accord constaté*" is excluded from the EIR, but the *procédure de conciliation* which ends with the "*accord homologué*" is included.

(a) Exclusion of the "*Accord Constaté*"

The exclusion of the "*accord constaté*" of the *procédure de conciliation* can be justified for two reasons. First, because of the obligation of publication of the opening of the proceeding suggested by the Commission. The Commission suggested in a new Article 20 *bis*[33] the creation of a European Register of insolvency proceedings. As we saw before, the particularity and the interest of the "*accord constaté*" is the lack of publicity. So, it is impossible to register the opening of the *procédure de conciliation* for this first reason.

The second reason is the obligation to inform the creditors of the opening. For the scope of the *procédure de conciliation* in case of an "*accord constaté*", the creditors are not informed so as to preserve secrecy. Article 40 of the EIR states:

> "As soon as insolvency proceedings are opened in a Member State, the court of that State having jurisdiction or the liquidator appointed by it shall immediately inform known creditors who have their habitual residences, domiciles or registered offices in the other Member States."

(b) The Integration of the "*Accord Homologué*"

The solution should be different if the *procédure de conciliation* ends with an "a*ccord homologue*". The new proposal by the European Commission excludes the integration of the *procédure de conciliation* in the EIR except if such proceedings fall within the scope of the text once they become public. This proposal seems to open the opportunity for French law to insert the *procédure de conciliation* in the EIR. The *procédure de conciliation* can be public if the creditors and the debtor are agreed. But it will be public only when they find an agreement. Nevertheless, the Commission does not give an answer to the consequences of a lack of publicity for the opening of these proceedings.

32 Proposal from the European Commission, a copy of which is available at: http://www.europarl.europa.eu/registre/docs_autres_institutions/commission_europeenne/com/2012/0744/COM_COM%282012%290744_FR.pdf , at 6-7 (last viewed 15 June 2014).

33 Ibid., noting the new Article 20 *bis*.

Also, and this is the most important, the Commission keep in the new definition of insolvency proceedings the condition of "collective proceedings". The hesitation about the introduction of the French *procédure de conciliation* is clarified: if there is no change in this condition, the *procédure de conciliation* and also the CVA have to be excluded from the EIR.

<u>The Preservation of the Condition of "Collective Proceedings"</u>

The Commission suggests in the new version of the first article:

> "This Regulation shall apply to collective judicial or administrative proceedings, including interim proceedings."[34]

The collective condition of a proceeding imposes the protection of a creditor's interests against individual enforcement by any one of them.[35] In other words, it is necessary that the rights of all of the creditors has been examined at the same time and consequently that individual enforcements are suspended.

On the one hand, the Commission excludes from the scope of the EIR the French *procédure de conciliation.* In effect, the *procédure de conciliation*, as we have seen, can be concerned only with some creditors or usual co-contractants. It does not suspend individual enforcements. It is only in the case of an "*accord homologué*" that there is suspension, during its execution/implementation phase, all judicial actions or individual enforcement with the view to obtaining the payment of debts that are the object of any agreement.

On the other hand, the preservation of the collective condition excludes the English CVAs from the EIR because the agreement concerns only the unsecured creditors. Furthermore, in pre-insolvency proceedings, the moratorium does not, in principle, exist. So, it is possible for the creditors to ask for the payment of the debt if the debtor has not made a payment.

Summary

The preservation of the collective condition has disappointed commentators because this condition excludes numerous technical or rescue proceedings, such as the English scheme of arrangement which is organised by class of creditors and also the *procédure de conciliation*, and other pre-insolvency proceedings, such as the *sauvegarde financière accélérée* which concerns only financial creditors.

34 Available via the website: http://ec.europa.eu/civiljustice/bankruptcy/bankruptcy_ec_fr.htm (last viewed 15 June 2014).

35 UNCITRAL Legislative Guide, at 92.

Conclusion

As we see, French and English Insolvency Law give two different points of view of the rescue of companies in pre-insolvency proceedings: rigidity and publicity or secrecy and flexibility. The integration of pre-insolvency proceedings in the EIR has been the subject of recurrent requests by academics and practitioners. The European Commission has not missed the opportunity in the revision of the EIR to suggest their integration. However, as a consequence, a new definition of "insolvency proceedings" in the text has to be made. To satisfy a maximum of member states and the needs of different legislative texts, the Commission proposes also the integration of some proceedings that can be confidential if they are the subject of publicity at the end of the procedure.

Nevertheless, the preservation of the condition of collective proceedings excludes two important pre-insolvency proceedings contained within French and English Insolvency Law. Furthermore; it is difficult to think about the future of some proceedings, like the *sauvegarde financière,* in the EIR because it is not a collective proceeding. With this definition, it seems that the Commission has taken a step back from the integration of pre-insolvency proceedings and also for new types of proceedings, such as prepacks.

Chapter 15

The Gap in the European Union Legal Framework addressing the Subsidiaries of Financial Institutions

Chindar Teo

Introduction*

This year marks the five year anniversary of the financial crisis, and the fourth year anniversary of the Eurozone crisis. Since then, it has been shown that the *pari passu* principle is an ideal rather than a reality in cross-border bank insolvency. One of the major features of the European Union Directive on the Winding-Up and Reorganisation of Credit Institutions[1] is the principle of the equal treatment of creditors in the Member States. This paper argues that this is not entirely achieved by the Directive. The impact of not addressing subsidiary insolvency is that operationally integrated subsidiaries complicate the insolvencies through home and host jurisdictional conflicts.[2] This contributes to a less than optimal cross-border insolvency regime to resolve banking groups.[3]

The shortcomings of the Credit Institutions Directive in terms of its scope include its exclusion of subsidiaries of banking groups as well as failings in substance such as the disparity that exists at national level in the form and substance of insolvency law.[4] Large, complex financial institutions with numerous branches and operationally integrated subsidiaries complicate the insolvencies.[5] There is an absence of adequate mechanisms in the EU legal framework to deal effectively and efficiently with cross-border aspects of banking groups and consequently, it

* The author would like to express her gratitude to Professor Bruno Zeller, principal supervisor of my doctoral dissertation on “The Cross-Border Insolvency of International Banks”, for his critique and comments towards this paper and for supporting this research.

1 Council Directive 2001/24/EC on the Reorganisation and Winding-up of Credit Institutions (in force 5 May 2001) (the “Credit Institutions Directive” or “Directive”).

2 See A. Coleton, “Bank Insolvency Regimes and Cross-Border Banks – Complexities and Conflicts: Is the Current European Framework Efficient and Robust enough to effectively resolve Cross-Border Banks, Can there be a One-Size Fits All Solution?” (2012) 27(2) *Journal of International Banking Law and Regulation* 63, at 74.

3 Idem.

4 Idem.

5 Idem.

results in hampering the effectiveness and efficiency of resolution. At the EU level, the gap in the Credit Institutions Directive to include subsidiaries within its scope:

> "…is a limitation that greatly inhibits its effectiveness as a cross-border instrument."[6]

The European Commission has stated that:

> "Existing EU measures aimed at resolving a failing bank are minimal in scope and substance. They address only supervisory intervention and the mutual recognition of insolvency proceedings for cross-border bank branches. Cross-border banking groups, composed of a parent company with subsidiaries in other Member States are not covered by this Directive."[7]

The Credit Institutions Directive aims for the resolution of a distressed financial institution and its branches as one entity applying the principles of unity and universality. The single entity approach inherent in the Directive results in the winding-up of a bank as one legal entity, ensuring that there is only one set of insolvency proceedings. The Directive relies on the universality approach to ensure the objective of equal treatment for creditors, as well as the mutual recognition of the home country's reorganization measures and winding up proceedings.[8] The Directive's Article 3(1) provides exclusive international regulatory authority to the home Member State's administrative or judicial authorities to decide on the implementation of one or more reorganization measures. Recital 10 states that:

> "Only the competent authorities of the home Member State should be empowered to take decisions on winding-up proceedings concerning insurance undertakings (principle of unity). These proceedings should produce their effects throughout the Community and should be recognised by all Member States. All the assets and liabilities of the insurance undertaking should, as a general rule, be taken into consideration in the winding-up proceedings (principle of universality)."[9]

6 Ibid., at 67.

7 Communication from the Commission: An EU Framework for Cross-Border Crisis Management in the Banking Sector, copy available at: http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=EN&type_doc=COMfinal&an_doc=2009&nu_doc=561 (last viewed 15 June 2014).

8 Text of the Directive. See also Commission Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM (2012) 280, at section 4.4.17.

9 Text of the Directive.

While the Directive addresses judicial and regulatory cooperation, in its omission of subsidiaries of banking groups, it has been argued that:

> "…it does not address the heart of the law governing insolvency'.[10]

In 2007, the Commission reviewed the Directive following a public consultation. In crisis resolution, the Commission was:

> "…invited to assess the possible extension of the scope of the present EU Directive on Winding-up and Reorganisation to include insolvent subsidiaries with the objective to increase the efficiency, the optimal reorganisation and winding up of cross-border banking groups taking due consideration of all the stakeholders concerned."[11]

The increasing significance of subsidiaries of banking groups is shown by the subsidiaries operating in the new Member States dominating important shares of the host country's domestic market. Some of these are systemic. On average, the market share of foreign banking groups in new Member States is around 70% of bank assets.[12] The profound consequences in the treatment of creditors in different jurisdictions within the EU is significant in addressing this issue,[13] as it may help find global solutions.

At the European level, there are three elements that form the basis of financial supervision:

(i) the element of home country control;

(ii) compliance with some fundamental rules; and

10 Coleton, above note 2, at 67.

11 See European Commission, Summary of the Public Consultation on the Reorganisation and Winding-Up of Credit Institutions (December 2007), at 2, a copy of which is available at: http://ec.europa.eu/internal_market/bank/docs/windingup/spc_en.pdf (last viewed 15 June 2014).

12 See European Finance Convention, Speech by H. Bauer and F. Allen, "CEBS and Basel II in an Expanded EU", a copy of which is available at: http://www.eba.europa.eu/documents/10180/27581/SP09.pdf (last viewed 15 June 2014); T. Beck *et al.*, "Cross-border banking in Europe: Implications for Financial Stability and Macroeconomic Policies" (2011, Centre for Economic Policy Research, London); Vienna 2 Initiative, Working Group on the European Banking Union and Emerging Europe (April 2013), a copy of which is available at: *ec.europa.eu/economy_finance/.../eif/.../vi2_bu_wg_april_2013_en.pdf* (last viewed 15 June 2014); European Central Bank, Speech by J. Gonzalez-Paramo, "Cross-Banking in the EU: Developments and Cross-Border Issues" (24 February 2006), a copy of which is available at: http://www.ecb.europa.eu/press/key/date/2006/html/sp060224.en.html (last viewed 15 June 2014).

13 See P. Omar, "The Landscape of International Insolvency Law" (2002) 11 *International Insolvency Review* 173, at 198. See also P. Omar, "Diversity in unitary proceedings: use of the stay jurisdiction in the European Insolvency Regulation" (2012) 23(9) *International Company and Commercial Law Review* 283, at 286.

(iii) the reciprocal acceptance of decisions issued in different Member States.[14]

The assets of the bank in its home State jurisdiction are encompassed in the liquidation, including the assets of branches in a host State jurisdiction.[15] All worldwide creditors can prove their claims in the unified proceeding, to which the *lex concursus* of the opening Member State applies.[16] The Directive does not permit the possibility of the opening of secondary proceedings. In the case of insolvent subsidiaries, there is still the chance that insolvency proceedings can be brought in every jurisdiction where a failed bank maintains an establishment. In cross-border bank insolvency, there is the chance that separate legal proceedings can be commenced in each Member State where the bank is operating.[17]

If the financial institution is operating in more than one country within the EU, is under financial distress and requires either a reorganisation procedure or a winding-up proceeding, multiple legal proceedings can be commenced in each Member State of operations. As a consequence, the possibility of equal treatment of creditors is hindered from becoming a reality.[18] Although the *pari passu* principle is said to be:

> "…the foremost principle in the law of insolvency around the world',[19]

its pervasiveness in cross-border bank insolvency has shown limitations. As much of the recent cross-border expansion in European banking markets has been through subsidiaries, there is the significant potential for jurisdictional conflicts to occur. When a large, complex financial institution has numerous branches and operationally-integrated subsidiaries, matters are intensified.[20]

The first section of the paper will discuss how the gap in the Credit Institutions Directive in addressing subsidiaries of cross-border banking groups impacts home and host jurisdictional conflicts. The second section will develop this discussion to introduce the issue of multiple proceedings that can ensue when

14 See L. Bolger, "No Frontiers: An Analysis of the EC Regulation and the UNCITRAL Model Law on Cross-border Insolvency" (July 2012), a copy of which is available at: http://www.consulegis.com/wp-content/uploads/2013/06/Laura.Bolger_Paper.pdf (last viewed 15 June 2014).

15 Ibid, at 305.

16 Ibid, at 306.

17 See A. Campbell, "Issues in Cross-Border Bank Insolvency: The European Community Directive on the Reorganisation and Winding-Up of Credit Institutions" (International Monetary Fund Seminar on Current Developments in Monetary and Financial Law, 7-17 May 2002), at 16.

18 Ibid.

19 See A. Keay and P. Walton, "The Preferential Debts Regime in Liquidation Law: In the Public Interest?" (1999) *Company Financial and Insolvency Law Review* 84, at 85.

20 See M. Cihak and E. Nier, "The need for special resolution regimes for financial institutions- the case of the European Union" (September 2009) International Monetary Fund Working Paper WP/09/200, at 24.

an international bank with numerous branches and operationally integrated subsidiaries becomes insolvent.

Home and Host Jurisdictional Conflicts

As the Credit Institutions Directive does not cover cross-border banking groups of a parent company with subsidiaries within its scope, national authorities still dominate regulation.[21] The principles of home State control and mutual recognition imply that the subsidiaries of financial institutions are subject to the insolvency procedures in their State of incorporation. There is no common insolvency regime to address in particular, a cross-border banking group.[22] The limited scope of the Directive does not permit the consideration of synergies within a cross-border banking group which if considered, may benefit all creditors in the case of reorganisation. Within the Directive, the lack of a group-wide approach to account for subsidiaries to winding-up and reorganisation has the potential to lead to the failure of subsidiary companies of the banking group or even the entire banking group, which otherwise, would have had the chance to remain solvent wholly or partially.[23]

As matters become very complex for a large, complex financial institution with numerous branches and operationally-integrated subsidiaries, it may be argued that it is imperative for the Credit Institutions Directive to consider the integration of this cross-border aspect of banking groups. When an international bank is financially distressed, multiple resolution authorities from various jurisdictions are involved in the resolution.[24] During the most recent financial crisis, there was a proliferation in the resolution of large, complex-cross border financial institutions that magnified jurisdictional conflicts. When a cross-border bank is separated into many legal entities, many foreign banking authorities applying resolution measures in their own jurisdiction creates significant conflicts.[25] In times of crisis, separate insolvency procedures may be conducted for each subsidiary as to the laws of its state of incorporation, including ring-fencing of assets at the level of

21 Coleton, above note 2, at 73.

22 See G. Ferrarini and F. Chiodini, "Regulating Multinational Banks in Europe: An Assessment of the New Supervisory Framework" (May 2010) ECGI Working Paper No.158/2010, at 51.

23 See G. Garcia *et al*., "Bankruptcy and Reorganisation Procedures for Cross-Border Banks in the EU: Towards an Integrated Approach to the Reform of the EU Safety Net" (2009) 17(3) *Journal of Financial Regulation and Compliance* 240, at 252.

24 See L. Giani, "The Complementarity between Financial Supervision and Crisis Resolution: A Gap in the EU Framework at the Time of the Crisis" (2010) *Law and Financial Markets Review* 421, at 422.

25 Coleton, above note 2, at 74.

subsidiaries.[26] This is exacerbated when national laws diverge to the extent in which parent companies can support their subsidiaries.[27]

In recent EU legislation, the principles governing supervision and those that apply to company and insolvency law are not congruent,28 further complicating the insolvency of operationally integrated subsidiaries of banking groups. In international bank insolvency, the universality principle may itself create jurisdictional conflicts. The universality principle deems that the home country of a bank has jurisdiction over a single insolvency proceeding. However, in international bank insolvency, this approach cannot be enforced without adequate international agreement. International agreement may be hindered as home country supervision can create difficulties with systemically damaging implications for the host country with national territorial sovereignty.[29] When national interests are at stake, national boundaries become more significant. The home country supervisory authorities may apply conflicting measures and interests to host countries of foreign subsidiaries that impede cooperation efforts. This mitigates the assurance that there is equal treatment towards creditors.[30] Furthermore, this misalignment is deepened with the wide disparity in the treatment of such subsidiaries at national level, arising from differences which exist between each Member State in terms of deposit guarantee schemes, and conditions and powers for governance.[31]

During the most recent financial crisis, the misallocation of responsibilities between home and host country supervision was evidenced through the jurisdictional conflicts that ensued in many international bank insolvencies. Furthermore, the allocation of responsibilities was not reflective of:

> "…the complexity of group functions and structures, and did not adequately reflect the economic reality of international banks which operate across business lines."[32]

One such conflict was illustrated by the Icelandic banking crisis whereby jurisdictional conflicts prevailed when there was a lack of international cooperation

26 Campbell, above note 17, at 13.

27 See E. Hupkes, "Form follows Function – A New Architecture for Regulating and Resolving Global Financial Institutions" (2009) 10(3) *European Business Organisation Law Review* 369, at 378.

28 Idem.

29 See J. Goddard and P. Molyneux, "The Financial Crisis in Europe: Evolution, Policy Responses and Lessons for the Future" (2009) 17(4) *Journal of Financial Regulation* 362, at 376.

30 Idem.

31 Idem.

32 Bolger, above note 14, stating that: "…home supervisors of cross-border banks centralize supervision to a greater extent when a branch structure is in place. This does not reflect economic reality…".

and agreement. The Icelandic banking crisis also illustrated that the universalism approach failed to support coordination efforts.

The Icelandic banking crisis illustrated the key problem with universalism in the resolution of a systemically important financial institution is that national territorial sovereignty creates conflicts with the universalism ideal. When the Iceland government decided that its taxpayers deserved priority over the external and domestic creditors (except the insured depositors) of the banks,[33] this exacerbated the failure to coordinate the resolution with the jurisdictions in question.[34] As applied to international corporate groups such as financial institutions, universalism may lead to "anomalous results".[35] The recent banking crisis in Europe has also highlighted the significant obstacles in the current regime when effective cooperation and coordination among national regimes has not occurred. Although the Capital Requirements Directive was amended to increase host country participation in the supervision of a significant branch, it has been argued that international recommendations still remain branch based,[36] and fail to address the heart of the problems that emerged during the financial crisis in cross-border financial institutions that are set up as subsidiaries.

> "Home country control gives home country authorities power in host country financial markets, which…are not matched with accountability arrangements towards their country. This coupled with the fact that the host country is dependent on the home country's deposit guarantee scheme, fiscal resources and crisis management means that resolution decisions are extremely problematic."

Internationally, the *Lehmans* insolvency illustrated that solvent subsidiaries cannot survive when a major subsidiary is in financial distress. Healthy, viable subsidiaries are inevitably, impacted by their fellow "bad apple" subsidiaries and subsequently, the parent banking group may abandon both subsidiaries. In 2007, the non-US subsidiaries of Lehman Brothers were responsible for over 50% of global revenue produced. When the Lehman Brothers Holding Company filed for Chapter 11 protection in the United States, some of Lehman's constituent legal entities were

33 Ibid., at 2.

34 Idem.

35 See L. LoPucki, "The Case for Cooperative Territoriality in International Bankruptcy" (2000) 98 *Michigan Law Review* 2216, at 2230.

36 Cihak and Nier, above note 20, stating that: "Article 42(a) of the Capital Requirements Directive was amended to increase host country participation in the supervision of a "significant branch", in particular through participation in the supervisory college and close involvement in emergency situations. The Turner Review recommended a combination of greater host country control and revised deposit guarantee arrangements for branch-based cross-border operations in Recommendation 28."

immediately put into insolvency or an equivalent procedure in other jurisdictions, thereby creating international conflict.[37] Each subsidiary of Lehman's former entities engaged in ring-fencing to defend their own assets when the complexity of its structure proved too difficult to contend with.

The reorganization of a complex cross-border bank might also be difficult in the absence of clear agreements between national authorities regarding the resolution of foreign subsidiaries.[38] This illustrates the extent that national laws diverge to which parent companies can support their subsidiaries.[39] As indicated, the interests of domestic and foreign authorities may not be aligned, and can limit the ability of a national authority to effectively resolve the failure of the foreign subsidiary.[40] These issues complicate the resolution of parent and subsidiary banking groups in a fair and equitable manner. The difficulties created by international conflict instigated by the subsidiaries of the parent banking group may contribute to the shortfall in creditor claims. The legal separateness of the subsidiary may permit the parent bank to abandon the subsidiary in financial difficulties, irrespective of the impact on the host country's economy.[41] The disparity increases among national regimes when many foreign banking authorities apply conflicting resolution measures in their own jurisdiction.[42]

In a banking crisis, when the interests of domestic and foreign authorities are not aligned, the ability of a national authority to effectively resolve the failure of the foreign subsidiary is limited.[43] Furthermore, when subsidiaries are unable to separate completely from the rest of the group, the chance of a local rescue in the event of bank insolvency is minimized.[44] Healthy subsidiaries that operate independently of the parent may, in principle, be better able to survive the failure of the parent or other affiliates. In the event of a restructuring of a banking group, healthy subsidiaries can be spun off from the parent and operate on a stand-alone basis, sold, or placed into conservatorship by host country authorities.[45]

37 Idem.

38 See B. Wessels, "The Changing Landscape of Cross-Border Insolvency Law in Europe" (2007) *Juridica International, Nbr. XII,* at 116-124.

39 Hupkes, above note 27.

40 Bolger, above note 14, at 9-10.

41 Ibid., at 8.

42 Coleton, above note 3.

43 Bolger, above note 14, at 9-10.

44 Coleton, above note 3, at 74.

45 See J. Fiechter *et al.,* "Subsidiaries or Branches: Does One Size fit All?" International Monetary Fund Staff Discussion Note, (7 March 2011), at 4.

Historically, banking regulation developed as a response to crises resulting from the nature of banking business as a fractional reserve system based on the management of credit and duration risks. In today's economy, this risk is increased as bank, capital and other financial markets become increasingly connected to a broader financial system than ever before.[46] Some economists argue that regulation is necessary only in the presence of market failure or deficiencies.[47] The magnitude of recent crises and evidence of banking systems on economic growth has generated proposals for reforms in banking regulation and supervision.[48] However, there is a lack of international regulation in dealing with cross-border issues in banking law.[49] The existing legal and regulatory arrangements are not designed to resolve problems in banking groups that operate through multiple, separate entities.[50] Throughout international bank insolvency cases, this remains a common theme. At present, and similarly, the Credit Institutions Directive does not have adequate mechanisms to deal effectively and efficiently with the subsidiaries of banking groups and consequently, this results in hampering the effectiveness and efficiency of the resolution of the abovementioned issues.

Many More Proceedings?

Since the onset of the recent financial crisis, the limited scope of the EU Directive to deal with the subsidiaries of a cross-border banking group has been a significant gap in the EU legal framework in particular, when subsidiary insolvency ensues in the opening of multiple insolvency proceedings. The European cases relating to applying the concept of COMI[51] all involve subsidiaries of corporate groups indicating how significant the problem is.[52] Furthermore, the landmark European

46 See D. Arner and J. Norton, "Building a Framework to Address Failure of Complex Global Financial Institutions" (2009) 39(1) *Hong Kong Law Journal* 95, at 116.

47 See N. Astem, "What works best for Banking Regulation: Market Discipline or Hard-Wired Rules?" International Centre for Financial Regulation (24 February 2010), a copy of which is available at www.iccffr.org (last viewed 15 June 2014).

48 See J. Barth *et al.*, "Bank Regulation and Supervision: What works Best?" (2004) 13(2) *Journal of Financial Intermediation* 205.

49 See T. Schobel, "Telos versus Unilateralism: Cross-Banking Business and International Applicability of Domestic Banking Law" (2009) 63 *Consumer Finance Law Quarterly Report* 177, at 182.

50 Bank of International Settlements, Report of the Contact Group on the Legal and Institutional Underpinnings of the International Financial System, Appendix A: Cross-border Aspects of Insolvency: *Insolvency Arrangements and Contract Enforceability* (December 2002), at 4.

51 The examination of COMI falls outside the scope of the paper. COMI in cross-border insolvency is still subject to different and competing interpretations between legal regimes.

52 See J. Westbrook, "Multinational Financial Distress: The Last Hurrah of Territorialism" (2006) 41 *Texas International Law Journal* 321, at 326.

cases of *Enron Directo Sociedad Limitada*,[53] *Eurofood IFSC Ltd*[54] and *Daisytek*[55] illustrate the difficulty in applying the concept of COMI involving subsidiaries in corporate groups.

The current EU legal framework law is based on the presumption that it is dealing with a single company with operations in various parts of the world. If a financial institution is operating in more than one country within the EU, is in financial difficulties and requires the chance of either a reorganisation procedure or a winding-up proceeding, there is the possibility that separate legal proceedings can be commenced in each Member State where the bank is actually operating. This will lead to the inevitable consequence of delays, conflicts, increased costs, and the possibility that not all creditors will receive equal treatment.[56] The universalism approach does not apply to the case where a bank has wholly-owned subsidiaries in a different country other than the EU. Such a subsidiary is viewed as a legally separate entity with a separate license.[57] As indicated, in the case of subsidiaries, insolvency proceedings can be brought in every jurisdiction where a failed bank maintains an establishment. The *Lehman*s insolvency illustrated that multi-jurisdictional conflicts can ensue with subsidiary insolvency crosses multiple jurisdictions.

> "In May 2009, nearly 80 different insolvency proceedings commenced in more than 16 different jurisdictions, each of which has to be treated separately and each of which will differ in its form and scope, in accordance with the applicable law."[58]

At the EU level, the multijurisdictional conflicts can occur when secondary proceedings can be opened in different jurisdictions where there are many subsidiaries of a cross-border banking group. The varied interpretations of the Regulation become more apparent when dealing with a group structure. When a holding company and its subsidiaries become insolvent, there is also the expectation that main proceedings would be commenced in the Member State in which each company's centre of main interests is located, therefore creating the need to apply the provisions of the Regulation for co-operation and co-ordination of proceedings. The domestic courts in the European Union have tended to interpret

53 *Enron Directo Sociedad Limitada* (unreported case and judgement).

54 *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

55 *Re Daisytek* [2003] BCC 562.

56 Campbell, above note 17, at 16.

57 Cihak and Nier, above note 20, at 20.

58 See J. Clift, "Developing an International Regime for Transnational Corporations: The Importance of Insolvency Law to Sustainable Recovery and Development" (2011) 20(1) *Transnational Corporations* 117, at 131.

the Regulation in a manner which effectively fills in the gaps that the Regulation itself failed to address in respect of co-ordinated corporate group insolvencies.[59] In this context, the problem becomes manifest in the group COMI approach where most or all of the assets of the local subsidiaries are located in a different jurisdiction than the jurisdiction where the main proceedings have been opened and where coordination of proceedings is paramount. In practice, this implies that the main proceedings have no or limited effect against secured creditors of the local subsidiary.[60] Furthermore:

> "…if the COMI of a local subsidiary is deemed to be located in a different jurisdiction than where its main economic activities and assets are located, the subsidiary will most likely be deemed to have an "establishment" in the country where it carries out its operations, allowing secondary proceedings to be opened."[61]

The opening of secondary proceedings can result in multiple office-holders and cause the office-holder in the main proceeding to lose its grip on the foreign assets and operations.[62] In international bank insolvency, this presents a significant obstacle to resolve cross-border bank insolvencies expediently and in accordance with the principle of *pari passu*. The approach of placing all the COMI's of local subsidiaries into a single jurisdiction can severely prejudice the rights of interested parties.[63] The vast majority of European jurisdictions have interpreted Article 3(1) of the European Insolvency Regulation as that the COMI of a corporate group can be located at the registered office of the parent company if this parent company is directly involved in the management of its subsidiaries. The subsequent case law has been severely criticized:

> "…as it is accused of triggering forum and law shopping, legal uncertainty for third parties and conflict of jurisdictions."[64]

In accordance with the Regulation, the relationship of a parent company and a subsidiary, i.e. relations within a group (not only relations between controlled and controlling entities), need to be regarded, as a rule, in the manner corresponding to the

59 See A. Kastrinou, "Cross-Border Insolvency and the Effect of the EC Regulation on Insolvency Proceedings" (2012) 23(1) *International Company and Commercial Law Review* 1, at 10-11.

60 See N. Tollenaar, "Dealing with the Insolvency of Multinational Groups under the European Insolvency Regulation" (2010) 23(5) *Insolvency Intelligence* 65, at 67.

61 Ibid, at 65.

62 Ibid, at 66.

63 Ibid, at 68-69.

64 See M. Menjucq, "EC Regulation No 1346/2000 on Insolvency Proceedings and Groups of Companies" (2008*) European Company and Financial Review* 135, at 138.

European continental understanding of separate legal entities.[65] The Credit Institutions Directive largely does not affect the rules of priority claims which continue to be widely divergent across jurisdictions.[66] In the absence of automatic rules on procedural or substantive consolidation, the COMI inquiry becomes even more acute in the case of groups of companies, leading to de facto consolidation through the manipulation of the threshold test for subsidiaries.[67] The banking crisis has exposed and magnified the gaps in the existing EU legal framework and has shown that the Winding-Up Directive has not yet met its objective of equal treatment of creditors in consideration of subsidiary insolvency and its economically detrimental consequences.

Finally, future developments in EU laws:

> "…must consider the composition of cross-border banking groups and effective regimes for subsidiaries."

It must consider the potential of multiple proceedings being opened with subsidiary insolvency, and the opportunity to develop a more resilient, robust, and holistic framework that can align with the advancing pace of cross-border bank insolvencies. Most importantly, certain subsidiaries may be critical to their host country's financial system. The cross-border aspect of banking groups in subsidiary insolvency needs to be explicitly addressed in the Directive in order to mitigate adverse consequences on host country financial systems, and the ensuing of multiple insolvency proceedings. The legal separateness of the subsidiary may permit the parent bank to abandon the subsidiary in financial difficulties, irrespective of the impact on the host country's economy.[68] In recent international bank insolvencies, the long-term effects of this impact remain evident in financial systems throughout the world today. It has been argued that a revised Credit Institutions Directive to cover banks with a provision, in exceptional circumstances, to cover systemically important financial institutions and that extends the resolution power to all EU subsidiaries is one way to resolve cross-border bank issues.[69]

In order to resolve cross-border conflict between home and host supervisory authorities, it may be argued that a possible solution is the harmonization of rules, powers and sanctions in supervisory regimes.[70]

65 See A. Belohlavek, "Center of Main Interest (COMI) and Jurisdiction of National Courts in Insolvency Matters (Insolvency Status)" (2008) 50(2) *International Journal of Law and Management* 53, at 67-68.

66 See D. Evanoff and G. Kaufman (eds), *Systemic Financial Crisis: Resolving Large Bank Insolvencies* (2005, World Scientific Publishing Company Inc., Singapore), at 226.

67 Omar, above note 13, at 198.

68 Bolger, above note 14, at 8.

69 Ibid., at 25.

70 Ibid, at 50.

Conclusion

In conclusion, the scope of the Credit Institutions Directive needs to encompass the cross-border dimension of banking groups, and address the gap in the EU legal framework of subsidiary insolvency. In the recent financial crisis, and the banking crisis in Europe, the issues often came when they were so far gone, and the consequence was so big that there was nothing to fill it. At present, the biggest advantage is that there is still the time and opportunity, and most importantly, the foresight to address these pertinent issues. History need not repeat itself.

Chapter 16

When is a Company Unable to pay its Debts? An Assessment of the Tests for Corporate Insolvency

Vincenzo Volpe

Introduction

Insolvency is generally interpreted as a financial condition determined by someone's "inability to pay debts".[1] Hidden behind such mystifyingly simple language, the meaning of insolvency has historically been a "vexed and difficult one".[2] This chapter investigates recent developments in the interpretation of "inability to pay debts" and their impact on creditors' capacity to access insolvency proceedings. The first part is dedicated to the analysis of "cash-flow" insolvency and focuses on the decision of *Re Cheyne Finance Plc*.[3] The second part considers balance-sheet insolvency as interpreted by the Supreme Court in *BNY Corporate Trustee Services Ltd v Eurosail-UK*.[4] A final part illustrates the circumstances in which section 123 of the Insolvency Act 1986 can be triggered by cross-border insolvencies under the European Insolvency Regulation.[5] Conclusions then follow.

The Cash-Flow Test

The Formulation of the Test

The cash-flow test is mostly applied under section 123(1)(e) of the Insolvency Act 1986.[6] According to this provision, a body corporate is insolvent if it is proved to the satisfaction of the court that:

> "…it is unable to pay its debts as they fall due."

1 See A. Kornberg, "Insolvency in the UK and the US", in N. Segal and L.C. Ho, *Debt Restructuring* (2011, OUP, Oxford), at paragraph 1.04.

2 See J. Farmer, *Creditor and Debtor Law in Australia & New Zealand* (3rd ed) (1986, CCH Australia, Sydney), at 253.

3 [2008] BCC 182 ("*Cheyne*").

4 [2011] EWCA Civ 227 ("*Eurosail CA*"); [2013] UKSC 28 ("*Eurosail SC*").

5 Council Regulation (EC) No 1346/2000 of 29 May 2000 ("EIR").

6 But it can also apply under section 123(1)(a) and (b), Insolvency Act 1986, discussed below.

When this test applies alone, it is irrelevant whether a company's assets exceed its liabilities.[7] The crucial consideration is a *present* inability of the debtor to meet current obligations as they mature in the ordinary course of business.[8] The focus on easily ascertainable liabilities represents the key character of this test, which is specifically designed to allow for an early activation of insolvency proceedings and minimise a potential dissipation of assets.[9]

Present versus Future Liabilities

If the test was solely concerned with liabilities present and due, the court would simply look at whether the company is paying its debts upon maturity and, if it is not, make an assumption of insolvency.[10] This was the approach taken in *Highberry Limited v Colt Telecom Group Plc*.[11] The more recent authority of *Cheyne*[12] offers a different view. Following Professor Goode's approach,[13] Brigg J. turned to Australian case law and held that the dynamic character of the words "as they become due" suggests that the test "looks to the future".[14]

The Cheyne Controversy

The decision in *Cheyne* is controversial on a number of aspects. Firstly, it does not mirror the separation brought by the Insolvency Act 1985 between cash-flow and balance-sheet insolvency. Professors Sealy & Milman argue that the definition of insolvency under section 518(1)(e) of the Companies Act 1985 was "unhelpful" as it collapsed commercial insolvency with a wider assessment of the company's future liabilities. In their opinion the aim of the 1985 legislative amendments was exactly that of circumscribing any valuation exercise to section 123(2).[15] On similar grounds, Professor Andrew Keay accepts that it is wrong "in principle" to take into account future liabilities in evaluating a company's position under the cash-flow test.[16]

7 See I. Fletcher, *The Law of Insolvency* (4th ed) (2009, Sweet & Maxwell, London), at 307.

8 See R. Goode, *Principles of Corporate Insolvency* (4th ed) (2011, Sweet and Maxwell, London), at 112; A. Keay, *McPherson's Law of Company Liquidation* (2nd ed) (2009, Sweet and Maxwell, London), at 84; J. Honsberger, "Failure to Pay One's Debts Generally as They Become Due: The Experience of France and Canada" (1980) 54 *American Bankruptcy Law Journal* 153, at 153-4. (emphasis added).

9 UNCITRAL Legislative Guide on Insolvency Law (2005, United Nations Publication, New York), at 46.

10 A. Keay, "The Insolvency Factor in the Avoidance of Antecedent Transactions in Corporate Liquidations" (1995) 21(2) *Monash University Law Review* 305, at 307.

11 [2002] EWHC 2815.

12 *Cheyne*, above note 3.

13 Ibid., at paragraph 39.

14 *Bank of Australasia v Hall* (1907) 4 CLR 1514, at 1527 (*per* Griffith J.); see also at 1554 (*per* Higgins J.)

15 See L. *Sealy* and D. *Milman*, *Annotated Guide to the Insolvency Legislation* [*2006/2007*] (*9th ed)* (2006*, Sweet* and *Maxwell, London),* at 149.

16 See A. Keay and B. McPherson, *McPherson*'*s Law of Company Liquidation* (2001, Sweet & Maxwell, London). See also in support of the principle: *Re Bryant Investment Co Ltd* [1974] 2 All ER 683.

The court's reliance on Australian jurisprudence is understandable in light of the contrasting academic views on the subject and the similar wording adopted by the legislation.[17] However, considering future debts is only necessary and commercially sensible in an environment:

> "…shorn of any balance sheet test of insolvency."[18]

Requiring a much longer analysis, the approach defined in *Cheyne* may provide a more comprehensive analysis of the company's financial status. However, working as a short-sighted version of the balance-sheet test, this approach may excessively delay access to insolvency proceedings in cases where inability to pay is not as clear-cut. Indeed, Brigg J. accepted that in relation to a trading company where there is uncertainty as to the profile of its future cash-flow:

> "…an appreciation that section 123(1)(e) permits a review of the future will often make little difference."[19]

The reason for this is that in most cases:

> "…the alternative balance sheet test will afford a convenient alternative means of proof of a deemed insolvency."[20]

Importantly, the reasoning in *Cheyne*[21] does not affect the principle that failure by a company to satisfy a due and undisputed debt after demand has been made[22] is sufficient evidence of inability to pay under section 123(1)(e).[23] The authority of *Cornhill Insurance Plc v Improvement Services Ltd*[24] illustrates that this "salutary rule"[25] also applies in the context of a single debt, and it reflects the view that:

> "…a company which is able to pay an undisputed debt and chooses not to do so has only itself to blame if the inference is drawn that it is unable to pay."[26]

17 See K. Baird and P. Sidle, "Cash-Flow Insolvency" (2008) 21(3) *Insolvency Intelligence* 40, at 42.

18 *Cheyne*, above note 3, at paragraph 51.

19 Ibid., paragraph 57.

20 Idem.

21 Followed by Lord Hodge in Macplant Services Ltd, v Contract Lifting Services (Scotland) Ltd [2008] CSOH 158, at paragraph 67.

22 If the debt cannot reasonably be disputed, insolvency may be inferred even if no demand has been made: *Purewal Enterprise Ltd, Petitioner* [2008] CSOH 127.

23 *Mann and Another v Goldstein and Another* [1968] 1 WLR 1091, at 1103 (*per* Ungoed-Thomas J.); *Byblos Bank SAL v Al-Khudhairy* [1987] BCLC 232, at 247 (*per* Nicholls L.J.).

24 [1986] 1 WLR 114.

25 Goode, above note 8, at 128.

26 Goode, above note 8, at 118. See also Fletcher, above note 7, at paragraph 1.002.

Conversely, the opposite inference should be drawn that a company paying a debt upon maturity is cash-flow solvent even if it is unluckily to have sufficient liquidity to satisfy other debts in the near future. This approach guarantees a remedy to a creditor whose debt is due, but also prevents other creditors from underestimating the seriousness of an allegation of insolvency. The mere serving of a petition may put the company's goodwill at risk and negatively affect the price and marketability of its shares.

The Balance-Sheet Test

The Formulation of the Test

Pursuant to section 123(2) of the Insolvency Act 1986[27] a company is unable to pay its debts if:

> "The value of its assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities."

The reference to *liabilities*, as opposed to *debts*, should be noticed immediately. The two terms are defined together by Rule 13.12 of the Insolvency Rules 1986.[28] The provision includes most forms of liability,[29] but it disregards executory contracts, as well as projected losses and expenditures not arising by virtue of a purely legal obligation.[30] These "commercially unavoidable"[31] liabilities are considered by accounting standards,[32] where the valuation exercise focuses on economic substance rather than legal title.[33] As the balance-sheet test is concerned with *net* assets and liabilities, the legal and accounting interpretations of a company's balance-sheet will generally point in the same direction.[34] Major discrepancies tend to arise when the company risks losing its assets as a result of a breach of contract without a corresponding reduction in its liability. Here, a legal approach to valuation may better explain the company's net asset position.[35] There is clear authority,[36] however, that legal niceties should not cast a shadow over commercial

27 A similar version of the test is adopted in the context of wrongful trading under section 214(6), Insolvency Act 1986 and directors' disqualification under section 6(2), Company Directors Disqualification Act 1986.

28 Rule 13.12, Insolvency Rules 1986.

29 Ibid., Rule 13.12(3).

30 Goode, above note 8, at 132.

31 Idem.

32 Executory contracts are only considered when onerous: FRS 12, Provisions, Contingent Liabilities and Contingent Assets, at 14 (paragraph 3), a copy of which is available at: www.frc.org.uk (last viewed 15 June 2014).

33 Kornberg, above note 1, at 12.

34 *Eurosail SC*, above note 4, at 63 (emphasis added).

35 Goode, above note 8, at 134.

36 *Cheyne*, above note 3; *Eurosail CA*, above note 4, at paragraph 80; *Eurosail SC*, above note 4, at 62.

substance. Rather, the court should adopt a "firm eye on commercial reality and commercial fairness" so as to avoid the impracticality of section 123(2) being satisfied every time a company's liabilities exceed the value of its assets.[37]

The Valuation of Prospective and Contingent Liabilities

There is currently no statutory definition of "contingent liability", and judicial authority is divided. According to Lord Hodson's dissenting judgment in *Re Sutherland deceased*, a true contingent liability can only draw its life from an existing legal obligation.[38] This argument was rejected by the majority of the House of Lords which held it capable of defeating the very essence of a contingent debt: that is one which may never become an existing legal liability.[39] More recently in *County Bookshops Ltd v Grove*, Mr Justice Neuberger held that:

> "…contingent liabilities is not a term of art and that its precise meaning will depend on its context."[40]

While this approach may prove commercially sensible,[41] the lack of a clear legal definition brings uncertainty to the valuation process. By restricting the valuers' analysis to obligations arising from *past events*,[42] the FRS 12 definition of contingent liabilities maintains a flexible character, without necessarily including:

> "…everything that a prudent business man would think it proper to provide against."[43]

A prospective debt is one:

> "…which will certainly become due in the future either on some date which has been already determined or on some date determinable by reference to future events."[44]

Crucially, the liability must arise out of a current transaction or obligation.[45] The need to analyze contingent and prospective liabilities is in line with the Cork

37 See P. Walton, "Inability to Pay Debts": Beyond the Point of No Return?" (2013) *Journal of Business Law* 212, at 232*; Eurosail CA*, above note 4, at 33 (*per* Lord Neuberger MR).

38 *Re Sutherland deceased, Winter v IRC* [1963] AC 235, at 258.

39 Ibid., at 251 (*per* Lord Reid).

40 *County Bookshops Ltd v Grove* [2003] 1 BCLC 479, at paragraph 49 (*per* Neuberger J.).

41 Goode, above note 8, at 134.

42 FRS 12, above note 32, at 12.

43 *Winter v Inland Revenue Commissioners* [1963] AC 235, at 249 (*per* Lord Reid).

44 *Stonegate Securities Ltd v Gregory* [1980] Ch 576, at 579 (*per* Buckley J). See also *Re Sutherland*, above note 38, at 263 (*per* Lord Guest).

45 *Burford Midland Properties Ltd v Marley* [1994] BCC 604, at 609 (per H.H. Judge Roger Cooke). See also Re British Equitable Bond and Mortgage Corp [1910] 1 Ch 574; *Re European Life Assurance Society* (1869–70) LR 9 Eq 122.

Report recommendations.[46] Unfortunately, the method to calculate these liabilities remains unclear.[47] The Supreme Court has recently ruled in *Eurosail*[48] that taking into account contingent and prospective liabilities does not mean adding their face value to that of existing liabilities.[49] If section 123(2) would be automatically satisfied on such a "mechanistic and artificial" calculation, numerous viable and creditworthy companies would be prematurely thrown into insolvency.[50] On the other hand, any other estimation is bound to be imprecise particularly in relation to existing unquantified liabilities and contingent liabilities. Liquidation expenses are an example of the former type:[51] they will certainly arise but their precise amount cannot be predicted. The court will have to look at the facts of each case and ultimately exercise its discretion on the basis of the available evidence.[52]

The valuation process is even more complex in the case of contingent liabilities, where the question is not just the amount of the liability, but also its prospects of occurring. Professor Goode suggests that where the contingency is particularly remote and the creditor's interest is secured, the liability may not be calculated at all.[53] This approach is supported by the reasoning in *Eurosail*,[54] and endorsed to the extreme by accounting standards, which do not recognize contingent debts at all.[55] When the chances of accrual of the liability are "more than even", one approach to valuation is to take the liability at face value with a discount reflecting the futurity of the payment obligation.[56]

The Valuation of Assets

Whether a company is unable to pay its debts on the balance of probabilities will largely depend on its assets.[57] The principle that only present assets can be considered under the balance-sheet test was applied in *Eurosail*.[58] Accounting standards exclude contingent assets from the balance-sheet. However, considering the lack of a statutory link between section 123(2) and section 393(1) of the

46 The Report of the Review Committee, Insolvency Law and Practice (1982) (*Cmnd 8558)*, at paragraph 535(c).

47 Walton, above note 37, at 220.

48 *Eurosail SC,* above note 4.

49 Ibid.*,* at paragraph 39.

50 Ibid.*,* paragraph 47.

51 Only when liquidation is involved. See Goode, above note 8, at 137, 145. See also section 214(6), Insolvency Act 1986; section 6(2), Company Directors Disqualification Act 1986.

52 *Eurosail SC*, above note 4, at 39.

53 Goode, above note 8, at 145.

54 *Eurosail SC*, above note 4, at 39.

55 FRS 12, above note 32, at paragraphs 27-8.

56 Goode, above note 8, at 147.

57 *Eurosail SC*, above note 4, at 39.

58 Ibid., at 37, 39.

Companies Act 2006, the accounting definition of "balance-sheet" should not be taken literally.[59]

Even in relation to a company's current assets, valuation is not an exact science.[60] There are numerous sources of uncertainty. Some are of a "strategic" nature and highlight the different economic interests of creditors at the onset of corporate distress.[61] Other factors are "structural" and may include the state of the market in a particular industry, the degree of competition, etc.[62] Ultimately, the appropriate method of valuing a company will depend on whether its business is essentially viable.[63] If a company is *economically* distressed, assets will be ideally disposed of at market value. This requires a process of advertising aimed at identifying potential purchasers and obtain the maximum return possible.

If a company is *financially* distressed, its business may still be strong and viable. In such circumstances the valuation of assets for the purposes of the balance-sheet test should take account of the company's going concern or enterprise ("*EV*") value.

Inability to Pay Debts and the European Insolvency Regulation

The notion of "inability to pay debts" becomes even more abstruse in the context of cross-border insolvencies. Where the EIR applies, jurisdiction to open proceedings is given to the courts of the Member State within the territory of which the company has its COMI or establishment.[64] Pursuant to Article 3 of the EIR, a foreign business incorporated in the UK will be presumed to have its COMI in this country.[65] If the presumption is not rebutted, the opening of insolvency proceedings will be determined under section 123 of the Insolvency Act 1986, as it would for any other company registered under the Companies Act 2006.[66] Inability to pay debts would also become relevant where a company's place of incorporation is abroad but COMI has been identified in the UK on an "operational headquarters" approach.[67] When main proceedings are started in the UK on this basis, the valuation exercise becomes even more problematic. As far as assets are

59 Ibid., at 1; see also in earlier proceedings: [2010] EWHC 2005, at 34 (*per* Morritt C).

60 Goode, above note 8, at 115.

61 See M. Crystal and R. Mokal, "The Valuation of Distressed Companies: A Conceptual Framework (Part I)" (2006) 3(2) *International Corporate Rescue* 63, at 66.

62 Idem.

63 See R. Mokal, *Corporate Insolvency Law – Theory and Application* (2005, OUP, Oxford), at 194-195.

64 Article 3(1)-(2), EIR.

65 *Re BCCI SA (No 10)* [1997] 2 WLR 172; *Eurofood ISFC Ltd* (C-341/04) (2006) ECR I-3813.

66 Section 73, Insolvency Act 1986; Article 4(2), EIR.

67 See I. Mevorach, "The "Home Country" of a Multinational Enterprise Group Facing Insolvency" (2008) 57(2) *International and Comparative Law Quarterly* 427, at 440.

concerned, informational asymmetries and structural barriers to integrated capital markets may lead to differential outcomes.[68] The market value of intangible assets may become difficult to ascertain, particularly when their future economic benefit is not within the control of the corporate entity, but rather depends on the exercise of cross-border legal relationships with third parties.

In the context of multinational enterprise groups, the identification of assets and liabilities could be facilitated through substantive consolidation. This procedure allows for the elimination of inter-company liabilities and the creation of a common pool of assets from which third party claims are satisfied. In light of the veil-lifting exercise inherent to this "contentious mechanism",[69] the professional association for European restructuring and insolvency specialists (INSOL) proposed that it should only apply when it is *impossible* to disentangle the businesses of the relevant group members.[70] Ascertaining whether disentangling is "impossible" may in itself require a costly valuation. Rather, as Irit Mevorach suggests, substantive consolidation should be excluded where the expenses and delay of disentangling would be "disproportionate".[71] The latter formulation seems to widen the scope of the procedure but it maintains a highly discretionary character.

Even where a group's COMI is identified outside of the UK, access to insolvency may still be tested under section 123 if secondary proceedings are opened in relation to a UK "establishment".[72] The effect of these proceedings must be limited to the assets of the debtor located in that territory,[73] therefore the valuation exercise is more circumscribed than in the context of main proceedings. However, locating certain intangible assets may still be problematic, particularly if their ownership is shared between domestic and foreign corporate entities.[74]

68 See D. Kuipers *et al.*, "The Legal Environment and Corporate Valuation: Evidence from Cross-Border Takeovers." *Texas Tech University, Indiana University, and Wake Forest University Working Paper* (2003), at 13.

69 Idem.

70 Revision of the European Insolvency Regulation, Proposal by INSOL Europe (May 2012), at 92 (emphasis added).

71 See I. Mevorach, "Is the Future Bright for Enterprise Groups in Insolvency? – An Analysis of UNCITRAL's New Recommendations", Chapter 14 in P. Omar (ed) *International Insolvency Law: Reforms and Challenges* (2013, Ashgate, Farnham).

72 An approximate number of 10,451 companies registered an establishment in the UK between 2012 and 2013. Data from Companies House, Statistical Tables on Companies Registration Activities 2012/2013, at 27, a copy of which is available at: www.companieshouse.gov.uk (last viewed 15 June 2014).

73 Article 3(2), EIR.

74 Intellectual property rights are an example. For a more detailed analysis of their valuation, see R. Kaplan and D. Norton, "Measuring the Strategic Readiness of Intangible Assets" (2004) 82(2) *Harvard Business Review* 52.

Conclusion

If there is so much confusion as to the definition of "insolvency" itself, achieving a transparent and accessible insolvency regime seems at least ambitious. As far as the cash-flow test is concerned, the decision of *Cheyne* is out of line with previous authority and with the historical understanding of commercial insolvency. The balance-sheet test is doomed to uncertainty because of valuation. The lack of precise definitions of assets and liabilities results in "unsupportable and unrealistic"[75] financial statements which fail to reflect a firm's adaptation to changing market conditions.[76]

There is also a clear overlap between the two tests which could have not been intended by Parliament. Transparency and certainty are key requirements of "commencement features" in insolvency law,[77] and further study should be conducted to develop the two tests, clarify the valuation method(s) to be used, and review the relevance of the going concern concept.[78]

In the ultimate analysis, the difficulties encountered in this area originate from an admirable effort to safeguard competing and irreconcilable interests. While an inflexible regime would inevitably depress business confidence and its positive influence on social prosperity,[79] the need for a higher degree of legal certainty remains undeniable in this area.

75 See J. Margret, "Insolvency and Tests of Insolvency: An Analysis of the 'Balance Sheet' and 'Cash-flow' Tests" (2002) 12(2) *Australian Accounting Review* 59, at 61.

76 See D. Vickers, "The Marginal Efficiency of (Money) Capital" (1981) 8(2) *Journal of Business Finance and Accounting* 165, at 174.

77 UNCITRAL Legislative Guide on Insolvency Law, above note 9, at 45 (paragraph 21).

78 Report of the High Level Group of Company Law Experts on a Model Regulatory Framework For Company Law in Europe ("De Winter" Report) (4 November 2002), Chapter IV, at 16.

79 Fletcher, above note 7, at paragraph 1.004.

PART IV
THE EDWIN COE LECTURE

The Academic Forum would like to thank its sponsors Edwin Coe LLP for enabling the delivery of this lecture at the Paris Conference.

Chapter 17

Spreading the Gospel: The Mission of Insolvency Law, and the Insolvency Practitioner, in the early Twenty-First Century

Ian Fletcher QC

Introduction

In this lecture, I will present a personal assessment of the state of insolvency law, and insolvency practitioners, at this still early point in the 21st century. After more than 40 years spent mainly writing and thinking about insolvency matters, this seemed an appropriate moment to review past experience and to venture some thoughts about the future direction and destiny for the subject and for those who profess it. In embarking on this task it may be appropriate to invoke the words inscribed on a celebrated painting by the French artist, Paul Gauguin:

"*D'où venons nous? Que sommes nous? Où allons nous?*"[1]

I start with some reflections on "Where do we come from?"

The Historic Background – Myth and Reality

When I began to make a serious study of insolvency law – in the early 1970s – the picture, both in terms of English domestic law and at the international level, was one in which time appeared to be frozen, and the inhabitants of the landscape (rather like Gauguin's subjects caught in their dream-like Netherworld) seemed to dwell in a curious limbo in which the law's archaic substance wholly failed to address contemporary conditions and actual social needs. English insolvency law, both individual and corporate, had remained essentially unchanged throughout the first seven decades of the 20th century, and the legislative frameworks established by nineteenth century statutes were essentially still operative, although contained

1 *This is a revised version of the Edwin Coe Lecture delivered by the author on 26 September 2013 at the INSOL Europe Academic Forum Annual Conference in Paris.
"Where do we come from? What are we? Where are we going?" The painting, dating from 1897/8, hangs in the Museum of Fine Arts, Boston, Massachusetts. Intriguingly, there are no question marks on the inscription painted onto the canvas by the artist.

in legislation of somewhat more recent vintage.[2] At the international/cross-border level there was a similar lack of any serious progress towards overcoming the traditionally fragmented approach to the special problems encountered when an insolvency case contains multi-jurisdictional features.

Notably, by 1970, the original 6 Member States of what was then known as the European Economic Community were encountering the first of a series of intractable setbacks in the attempt to negotiate a convention aimed at regulating the conduct of insolvency cases within the frontiers of the self-styled "internal market". The first draft of a proposed "EEC Bankruptcy Convention", when first made available for external scrutiny in 1970, proved to be an unworkable blend of high-minded, academic proclamations of allegiance to the twin principles of unity and universality, instantly undermined within the same text due to the complete inability of the national negotiators to accept the logical consequences of applying those principles in circumstances where the national insolvency laws, together with the related national regimes of property and security law, remained unharmonised.[3]

So began a 30-year saga marked by repeated failures and recriminations until, at long last, sanity managed to prevail with the adoption in May 2000 of the European Insolvency Regulation ("EIR"), which succeeded in squaring the circle by embracing the pragmatic principle of *modified* universalism. This compromise solution affords a limited accommodation to those who might otherwise experience a less favourable outcome through the application to their claim of the law of the debtor's centre of main interests ("COMI"). Although it is always possible to point to technical or practical shortcomings in the final text of the EIR as currently in force, it is notable for its commercial realism and for delivering tangible benefits in terms of value preservation and greater efficiency in the conduct of cross-border insolvencies. It is also capable (in the right professional hands) of facilitating the restructuring of businesses and preservation of employment.

My early investigations into the world of insolvency convinced me of the need to break out of the academic ivory tower and to become acquainted with the real workings of the law "on the ground", and then to be prepared to identify and denounce whatever shortcomings were uncovered. In the English experience, the

2 In the 1970s, the principal legislative provisions relating to individual and corporate insolvency respectively were contained in the Bankruptcy Act 1914 and the Companies Act 1948.

3 For a critical account of the Preliminary Draft Convention as published in 1970, see I. Fletcher, in K. Lipstein (Ed) *Harmonisation of Private International Law by the EEC* (1978, Chameleon/IALS, London), at 119, also published in (1977) 2 *European Law Review* 15. The subsequent, revised Draft, published in 1980, is the subject of further critical analysis in I. Fletcher, *Conflict of Laws and European Community Law* (1982, North-Holland Publishing Company, Amsterdam), in Chapter 6 (pp. 187-249).

grave deficiencies in the law had been publicly exposed in the 1957 Report of the Blagden Committee, who concluded:

> "Practical experience has shown that the present law fails and, it is suggested, fails badly in all these primary objects."[4]

Significantly, but alas all too typically of the fate of constructive proposals for the reform and improvement of insolvency law, no legislative initiative was pursued by the government of the day to translate the Blagden committee's numerous recommendations into law.

So the scandalous inadequacies of English insolvency law were perpetuated for two more decades until, in 1976, the Cork Committee was established by the Labour government of the day, largely in response to two documents which made an especially cogent case for such reform. These were, in 1975, the report by Justice entitled "Bankruptcy",5 and in 1976 the *Report of the Advisory Committee on the EEC Preliminary Draft Convention on Bankruptcy*.[6] The chairman of the Advisory Committee, Kenneth Cork, was immediately re-engaged to chair a Review Committee on Insolvency Law and Practice, with a remit to review the entire law of insolvency, individual and corporate, in England and Wales, and to propose whatever reforms might be necessary or desirable. Despite the serious intentions with which the Review was launched, the committee was not given the full resources necessary to undertake a thorough, scientific study of the law and its working as a prelude to formulating its proposals.

This was in marked contrast to the approach being taken contemporaneously in the USA in the well-resourced process which culminated in the Bankruptcy Reform Act of 1978. Nevertheless by 1982 the Cork Committee did succeed in producing a convincingly argued Report advocating wholesale reform of the English law of insolvency.[7] But with a different political party by then in government the Cork Report was initially ignored until 1984, when the groundswell of public opinion, fuelled by repeated financial scandals, led to the hasty resurrection of the Cork proposals in a Bill which ultimately became the Insolvency Act 1986.

4 *Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment* (Chairman, His Honour Judge Blagden) Cmnd. 221 (July 1957, HMSO, London).

5 *Bankruptcy – A Report by Justice* (1975). The report was produced by a committee chaired by Allan Heyman QC.

6 Cmnd. 6602 (1976, HMSO, London). This report is usually known as the "Cork I" report to distinguish it from the subsequent report of the Review Committee, also chaired by Sir Kenneth Cork.

7 *Insolvency Law and Practice. Report of the Review Committee* (Chairman, Sir Kenneth Cork) Cmnd. 8558 (June 1982, HMSO, London).

A "Mission to Explain"

The unedifying spectacle of the process of domestic insolvency law reform between 1976 and 1986 convinced me of the need for those who possess a technical understanding of the law and its actual working to establish effective channels of communication with legislators and with policy-makers in government, in order to ensure that there is a proper appreciation of the vital impact that this complex and much-misunderstood area of law has upon the totality of social well-being in a modern, credit-based society. Therefore it is an important aspect of the "mission" of insolvency practitioners to improve awareness, both on the part of the wider public and within the corridors of government, of the realities of insolvency law and practice, and to do so in a way that earns public confidence and respect rather than functioning merely as special pleading on behalf of the vested interests of those "in the business". The "mission to explain", as I call it, needs to be based on authentic and verifiable demonstrations of how the shortcomings of the current law have contributed to loss of value and the needless destruction of viable businesses, complemented by constructive proposals for the progressive improvement of law and practice. I shall return to this theme in a later part of this lecture.

Professional Regulation – A *Sine Qua Non*

When the Cork Committee's proposals were belatedly made the basis of legislative reforms, a number of elements were omitted from the Act as finally passed by Parliament, notably in relation to corporate rescue and the predicament of what we nowadays term "consumer debtors". These omissions have had to be re-visited in subsequent years, and it must be acknowledged that in a number of respects we in the UK have still not managed to achieve a satisfactory balance – the genesis of a "rescue culture" is still a work in progress. However, one keystone proposition in the Cork Report happily bore fruit, namely that all office holders in insolvency proceedings must be suitably qualified, professionally organised and properly regulated, so as to be fully accountable for their stewardship and conduct of the cases in which they act. A robust, statutory framework to ensure the competence and integrity of those acting as insolvency practitioners ("IPs") was seen by Cork as a *sine qua non* of a soundly-run insolvency law, a conviction with which I respectfully concur.

The emergence in the UK, post-1986, of a regulated sub-profession of insolvency practitioners has in my view been the single most important advance in the operation of insolvency law in my country since the 19th century, and I believe it can furnish a model and example for other systems in and beyond Europe. For let us be in no doubt: however well-crafted the enacted, black-letter provisions of an Insolvency Act or Code may be, they are relatively impotent and devoid of value unless they are administered and applied by office holders, judges and regulators whose competence and integrity are systemically assured. Without a proper institutional infrastructure based on firm ethical standards – which cannot be simply wished into existence overnight – public trust and confidence in the system will be progressively destroyed. One has only to look back on the notorious state of disarray and corrupt practices that characterised the pre-Cork era to realise how far we in the UK needed to come, and to appreciate the need to avoid ever lapsing into a complacent belief that "all is now perfect". Instructive accounts of the scandalous goings-on in former times, have been chronicled by Stephen Aris in his book "*Going Bust*",[8] and by Sir Kenneth Cork himself in his memoire "*Cork on Cork*".[9]

In the UK since 1986 there has existed a statutory regime for the regulation of every person who "acts as an insolvency practitioner" by taking appointment in relation to any of the formal types of insolvency proceeding (including administrative receivership under a floating charge). The regulatory regime established by Part XIII of the Insolvency Act 1986 (sections 388-398), together with several pieces of secondary legislation,[10] is designed to control access to the provision of IP services by imposing an exacting series of "entry criteria" involving education, training and experience, combined with the somewhat intangible quality of being a "fit and proper person" to undertake the functions of an IP. The entry criteria go well beyond the "mere" possession of a professional qualification as a lawyer or accountant, although membership of a "recognised" professional body is in most cases the initial platform for acquiring eligibility to practice as an IP. Each of the recognised professional bodies has obtained specific ministerial recognition granting it authority to confer a license to practice as an IP upon those of its members who satisfy the requisite criteria. To become a "recognised professional body" ("RPB") – there are currently seven of them,[11] purpose-designed internal structures, acceptable to the minister, must be in place both for conferring a licence in the first instance, and for the regulation of those IP's who are licensed by the

8 See S. Aris, *Going Bust* (1985, HarperCollins, London), especially in Chapters 6, 7 and 9.

9 See K. Cork, *Cork on Cork* (1988, Macmillan, London), especially in Chapters 2-6 and 10.

10 See especially: Insolvency Regulations 1994 (SI 1994/2507); Insolvency Practitioners Regulations 2005 (SI 2005/524); Insolvency Practitioners (Recognised Professional Bodies) Order 1986 (SI 1986/1764); Insolvency Practitioners Tribunal (Conduct of Investigations) Rules 1986 (SI 1986/952); Insolvency Practitioners and Insolvency Services Account (Fees) Order 2003 (SI 2003/3363) (all as amended by subsequent SIs).

11 Insolvency Practitioners (Recognised Professional Bodies) Order 1986 (SI 1986/1764). The seven RPBs are: The Chartered Association of Certified Accountants; The Institute of Chartered Accountants in England and Wales; The Institute of Chartered Accountants in Scotland; The Institute of Chartered Accountants in Ireland; The Insolvency Practitioners' Association; The Law Society of Scotland; The Law Society.

RPB in question. These rules and structures must be reinforced by suitably rigorous disciplinary procedures.

As though it were not already sufficiently complicated, the UK system superimposes an additional layer of regulatory oversight by making the RPB's themselves subject to the scrutiny and oversight of the Insolvency Service, effectively acting on behalf of the government. As the annual reports of the Insolvency Service make clear, these regulatory functions are an important aspect of the role of the Service in ensuring that public confidence can be maintained.[12] But the complexity does not end there. Particular aspects of practice are the subject of "statements of insolvency practice" ("SIPs") issued by one of the RPBs, the Insolvency Practitioners Association ("IPA") in conjunction with the other six, giving their members detailed guidance on matters of practice which are seen to be of particular concern (e.g. SIP 16, concerning pre-packaged administrations).[13] As if all this were not enough, there is one further element in the UK edifice of professional oversight, namely the *Insolvency Code of Ethics*, agreed between all the RPB's, drawn up by the Joint Insolvency Committee which serves as a vehicle for coordination and discussion between the seven RPB's and the Insolvency Service.[14]

The UK system may appear over-elaborate, complex and somewhat unwieldy. Bearing in mind that it was virtually created from scratch after 1986 its somewhat prolix structure can be said to have come about by accident rather than design, and to reflect the historic subdivisions between and within the respective professions of accountants and lawyers in England and Wales, in Scotland and in Northern Ireland. One would not therefore advocate the adoption of the actual UK structure as an international model for exportation. But what can be said in its favour is that it amounts to a very serious attempt at ensuring that, in substance, the regulatory mechanism is a robust and dynamic one, and that there is even a layer of oversight

12 "(*IP regulation): The service is the oversight regulator of IP's and ensures that the 7 RPBs permitted by the Secretary of State to authorise their members as IP's regulate them effectively*.": Annual Report of the Insolvency Service 2011-12, at 12, which can be viewed (together with reports for some other years) on the Insolvency Service website at http://www.bis.gov.uk/insolvency/Publications (last viewed 15 June 2014). Further information about the regulatory functions of the Insolvency Service can be found at: http://www.bis.gov.uk/insolvency/insolvency-profession/Regulation (last viewed 15 June 2014).

13 The collected texts of the SIPs (currently 17 in number) can be viewed at the website of R3 (the Association of Business Recovery Professionals) at: http://www.r3.org.uk/index.cfm?page=1380 (last viewed 15 June 2014) and at the individual websites of the Recognised Professional Bodies.

14 The Joint Insolvency Committee (JIC) is made up of eight representatives from each of the Recognised Professional Bodies and from the Insolvency Service. More information can be viewed at: http://www.bis.gov.uk/insolvency/insolvency-profession/Regulation/recognised-professional-bodies/JIC (last viewed 15 June 2014). The most recent version of the Code of Ethics can be viewed at: http://www.bis.gov.uk/insolvency/insolvency-profession/Professional%20conduct/code-of-ethics (last viewed 15 June 2014).

of the regulators themselves, thus responding to the familiar rhetorical query *Quis custodiet ipsos custodes?*.[15]

But it remains essential at all times to avoid lapsing into a sense of complacency. For example, a reputational challenge for the profession has emerged in the wake of the development, particularly since 2002, of pre-packaged administrations. I do not intend here to discuss the actual mechanics of pre-packs, nor to assess their merits or demerits. Rather I wish to call attention to the evident fact that certain features of their development bear an uneasy resemblance to such malpractices as "phoenixism" and "Centrebinding", which many assumed had been consigned to history by the combination of reforms enacted in 1986. But when it becomes something of a routine practice to utilise administration as a vehicle for concluding a rapid sale of assets and businesses to internal buyers without any open marketing, and without the necessity of obtaining prior endorsement of the creditors, many of whom are destined to go uncompensated, questions are bound to be asked regarding the professional judgment and probity of the IP selected to serve as administrator. Particularly when, as is so often the case, the administrator is selected and appointed by the very persons who are destined to acquire the assets at a price previously agreed with the selfsame IP prior to being clothed with the powers of office.

Quite understandably, the unsecured creditors who are left behind by the process – and likewise any holders of equity in the Oldco who are not destined to become involved in the new venture – can be left with the impression that something disreputable has taken place. That is a problem with which we in the UK are still cautiously trying to come to grips, for there is the very real risk that in trying to devise some mechanism to allay popular concern about the integrity of the prepack process, particularly where insiders are involved, over-engineered solutions may be introduced which will simply kill off the rescue culture and deprive potentially viable businesses – and those employed in them – of any chance of escaping the inevitable alternative of liquidation.[16]

15 The Latin maxim is translatable as "Who will guard the guards themselves?"

16 Following a period of consultation commenced in March 2010 seeking proposals for improving the transparency of, and confidence in, pre-packs, the Insolvency Service initially announced in March 2011 that additional legislative measures would be forthcoming. Subsequently, on 26 January 2012, a Ministerial statement was issued indicating that no such measures were in contemplation for the immediate future. But in July 2013, a fresh initiative was launched, involving further consultations to assess the working of pre-packs, with the intention that a report will be published in Spring 2014. See http://www.bis.gov.uk/insolvency/insolvency-profession/Pre-pack%20administration%20review (last viewed 15 June 2014). Documentation concerning the previous consultation between 2010 and 2012 can be viewed at:
http://www.bis.gov.uk/insolvency/Consultations/PrePack?cat=closedwithresponse (last viewed 15 June 2014), archived under the heading: "Consultation/Call for evidence Improving the transparency of, and confidence in, pre-packaged sales in administrations."

I therefore reaffirm my conviction that the UK experience bears out the proposition that effective and proportionate regulation is a *sine qua non* of a healthy and socially beneficial insolvency law. Proportionality is crucial, because over-regulation can produce negative consequences which can also be detrimental to the public interest. I would add that I am not persuaded that there is one single, ideal model of regulation which can be applicable to all societies in a uniform manner. The model for regulation has to be tailored to match the needs and circumstances of the community and system in which it is to function. And it needs to be kept under review, and be adaptable to match changing conditions. Notably, the UK Insolvency Service has recently conducted a study of our own regulatory machinery.[17] One welcome consequence of that review, implemented from 5 June 2013, is the introduction of a single gateway for complaints against insolvency practitioners in place of the labyrinthine structure that was previously in operation. The would-be complainant now merely has to access a single avenue for making a complaint, in place of having to ascertain which of 8 possible avenues was the correct one to use in relation to the IP in question.

At the European Level

When we move to the European level and ask the questions "where have we come from?", and "what are we?" the initial impression is somewhat encouraging, as we reflect on (currently) 11 years during which the European Insolvency Regulation (EIR)[18] has occupied a central place in the practice of insolvency in 27 of the (currently) 28 Member States of the EU. But our enthusiasm must be qualified as we recognise that there are many practical issues which are, or can be, a source of dissatisfaction and mistrust. One must acknowledge the potential for such negative experiences which can result from the lack of harmonisation and standardisation, both in the substance of the national insolvency laws as well as in the procedures and processes available state by state. Further obstacles are caused by disparities between the nature and standards of national organisation, training and regulation of the professionals and courts engaged in the insolvency process in their respective ways. The prospective emergence of an atmosphere of mistrust is especially unfortunate, and potentially fatal, in relation to the functioning of the EIR itself, whose very operation is ultimately (and explicitly) dependent on there being "mutual trust" between the Member States, and between the respective

17 Documentation concerning the Insolvency Service Consultation on reforms to the regulation of insolvency practitioners, conducted in 2011, can be viewed at: http://www.bis.gov.uk/insolvency/Consultations/category/closedwithresponse (last viewed 15 June 2014).

18 Council Regulation (EC) No.1346/2000 of 29 May 2000 on insolvency proceedings, OJ L160/1 (30 June 2000), which entered into force on 31 May 2002 (Article 47).

national courts and nationally-established professionals. As last year's Edwin Coe lecturer, Professor Bob Wessels, so forcefully reminded us by means of a quotation from the EU Commission Action Plan Implementing the Stockholm Programme:

> "The European judicial area and the proper functioning of the single market are built on the cornerstone principle of mutual recognition. This can only function effectively on the basis of mutual trust among judges, legal professionals, businesses and citizens. Mutual trust requires minimum standards and a reinforced understanding of the different legal traditions and methods."[19]

In the current text of the EIR, the "principle of mutual trust" is invoked in Recital (22), which concerns the immediate and automatic recognition of judgments concerning the opening, conduct and closure of insolvency proceedings. It supplies the main rationale for the proposition that:

> "…grounds for non-recognition should be reduced to the minimum necessary."

So a great deal is staked on there being general acceptance of this "principle of mutual trust" across the EU. A central aspect of the scheme of the EIR is that national insolvency laws and practices remain essentially untouched and intact, while at the same time the EIR has the effect of superimposing the law of the state of opening of main proceedings upon all assets, and all claims, which are otherwise grounded in the laws of other states (except where secondary proceedings can be and actually are opened). This state of affairs has the very real capability of creating perverse incentives for interested parties to engage in forum-shopping tactics in the quest for some personal advantage obtainable under the insolvency laws of another state (a tendency which has become known as "bankruptcy tourism").

With their growing experience of the operation of the EIR, UK courts have become increasingly vigilant to identify instances where the debtor's claim to have accomplished a transfer of COMI to the UK is not borne out by the discoverable facts.[20] There are also commendable examples of principled conduct by insolvency practitioners themselves, such as in the *Hans Brochier* case.[21] There, English

19 European Commission, COM (2010) 171 Final, 20 April 2010, in Section 4, "Strengthening confidence in the European judicial area", opening paragraph. The Action Plan can be viewed at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0171:FIN:EN:PDF (last viewed 15 June 2014).

20 For examples in the area of personal bankruptcy see, e.g. the cases of *Mitterfellner* [2009] BPIR 1075*; Eichler (No.2)* [2011] BPIR 1293*; Quinn* [2012] BCC 608; *O'Donnell* [2012] EWHC 3749 (Ch); [2013] ILPr 16.

21 *Hans Brochier Holdings Ltd v. Exner* [2006] EWHC 2594 (Ch); [2007] BCC 127.

IP's had been induced to accept out-of-court appointment as administrators of a German company upon the assurance that its COMI had been transferred to the UK. Upon discovering that the true facts were otherwise they promptly took steps to notify the English court, and they sought (and were granted) immediate release from office. In calling attention to these documented examples of the efforts made by English courts and IPs to adhere to the spirit as well as the letter of the European Insolvency Regulation's ambitious scheme for applying the principle of universalism despite the significant disparities between the domestic laws of the Member States, I wish to emphasise once again the heavy reliance which is placed on the integrity of the individual practitioner, and also upon the discernment of the national judge. If the principle of "mutual trust" is ultimately found to be based upon a false premise in relation to the behaviour of certain constituent members, this experiment in applied universalism risks falling into disrepute.

Where are we now? Where *should* we go?

My personal assessment of the current state of affairs ("*Que sommes nous?*"), both at the national and at the EU level, is that while much has been accomplished since the "Wild West" era prior to the 1980s, much still remains to be done. Let me offer some thoughts on where we *need* to go (rather than try to prophesy where we are going to go).

First, the disparity between national insolvency laws needs to be addressed. This cannot be resolved overnight, but we need to start to tackle the more egregious anomalies, and identify areas where convergence can be realistically, and beneficially, attempted. Of course, proposals for a "European insolvency law" have been made in recent years, both by INSOL Europe and by the European Parliament.[22] On 5 July 2013, the Commission launched a *Consultation on a new European approach to business failure and insolvency*, conducted by means of an on-line questionnaire which includes a section inviting responses on areas to be selected for resolving the divergence between national insolvency laws.[23] The indications are that a gradualist approach is being prepared whereby selected

22 See the European Parliament, Committee on Legal Affairs, Report with Recommendations to the Commission on Insolvency Proceedings in the Context of EU Company Law (the "Lehne Report"), (6 June 2011, 2011/2006 (INI), PE467.008v02-00). See also the European Parliament, Directorate General for Internal Policies, "*Harmonisation of Insolvency Laws at EU Level*", PE 419.633 (April 2010) (the report was prepared for the European Parliament by a committee of INSOL Europe). Further proposals for harmonisation of selected rules of insolvency law were included in the Proposals by INSOL Europe, "*Revision of the European Insolvency Regulation*" (May 2012), Drafting Committee Chairman, Robert van Galen. Both the INSOL reports can be viewed on the INSOL Europe website at: http://www.insol-europe.org (last viewed 15 June 2014).

23 The EU Commission consultation was formerly available on the Europa website at: http://ec.europa.eu/yourvoice/ipm/forms/dispatch?form=InsolvencyTwo . The consultation period has expired.

aspects of the law will be explored and targeted for harmonisation. This is a far more realistic course of action than any grandiose attempt to devise a single, comprehensive insolvency code for the whole of the EU.

Aspects which seem to be suitable for early exploration include the test or tests of insolvency which are to be employed in determining whether proceedings can be opened; other criteria, such as time periods, which may be employed in relation to the opening of proceedings, and also the relevant time periods utilised in the operation of typical remedies for transaction avoidance. The subject of directors' liability for their conduct of company affairs would be another obvious candidate for attention, and likewise the basis for imposing disqualification on delinquent directors (with the important additional need to ensure that the effects of disqualification under the law of one Member State will be recognised and enforced in all other EU States). But the above are, of course, merely the first steps in what is likely to prove the equivalent of the proverbial thousand-mile journey – the "Long March" towards eventual harmonisation of insolvency laws and procedures within Europe. What are the prospects for such a project being accomplished, and how best should the task be approached?

Harmonisation – *Festina Lente*

Some comments on the theme of harmonisation can be included here based on recent personal experience. In 2012, Professor Wessels and I produced a Report, "*Harmonisation of Insolvency Law in Europe*", commissioned by the Netherlands Association for Civil Law.[24] In drawing up our conclusions, we were struck by the enormous sensitivity surrounding the use of the very term "harmonisation", and indeed in our researches into the literature we detected an aversion to the very use of the "H" word. Reviewing the prospects for "harmonisation of insolvency law" with as much academic objectivity and dispassion as we could muster, we discerned several meritorious arguments in favour of the adoption of a cautious, incremental approach towards the task of harmonisation.

One quite fundamental – and also very practical – proposition which commended itself was that in order to formulate a single set of principles and procedures for uniform application EU-wide one must first establish community-wide agreement as to the policy goals and objectives which the insolvency laws are intended to promote. Such unity of vision is yet to be achieved across the 28 Member States, and it may take some time, and much patient effort, before consensus can emerge.

24 See I. Fletcher and B. Wessels, *Harmonisation of Insolvency Law in Europe* (Preadviezen Nederlandse Vereniging voor Burgerlijk Recht 2012/Reports of the Netherlands Association for Civil Law 2012) (2012, Kluwer, Deventer).

Therefore we must be prepared to commit ourselves to the long-term view that by regular and sustained discussion we may arrive at agreement on the fundamentals on which European insolvency law is ultimately to rest.

In the meantime, we can take encouragement from the fact that a dynamic process of evaluation and reform is operating in many of the Member States, as they observe the fruits of alternative solutions which have been adopted in sister states. Although there is always the danger that inter-state competition will degenerate into a "race to the bottom" (sometimes castigated as the "Delaware syndrome"), as has been experienced at times within the federal system of the USA,[25] Bob Wessels and I considered that there was force in the argument that in the present age, when new solutions are still being devised in response to rapidly-changing social and commercial challenges, it would be premature to attempt to formulate one single model of insolvency law, and to seek to impose it in a top-down manner by means of an EU Regulation, as this could well stifle the innovation and creativity being exhibited by law makers and practitioners in individual states. Preferably, piecemeal harmonisation could be carried out by means of EU Directives, which have the additional feature that each Member State is able to adopt the most suitable means of transposing the measure into its domestic law, respecting the particular characteristics of the national system.[26]

I am therefore of the opinion that, at the EU level, the mission for insolvency law, and for those who formulate and enact it, is to seek common ground wherever possible and not to lose sight of the fact that complex factors within the social history of the separate Member States have contributed to the current pattern of diversity. The watchword must therefore be "*Festina lente*" (make haste slowly). A reasoned case should be put, building on the proposition that up to date insolvency laws, embodying current best practices, can be a means of ensuring the preservation of value and the maintenance of employment to an extent that cannot be achieved through the retention of antiquated laws and unreconstructed professional practices. As always, prudent regulatory oversight is crucial. I revert to my previous assertion: an insolvency law, however modern and finely crafted its provisions, is only as effective as the quality and competence of those administering it enable it to be.

25 For a vivid account of such experiences, see L. LoPucki, *Courting Failure* (2005, University of Michigan Press, Ann Arbor MI).

26 See Fletcher and Wessels, above note 24, in Chapter 7.

Promoting Cooperation in Cross-Border Insolvency Cases

In the concluding part of this lecture I wish to offer some further thoughts on how the quality of insolvency law, and also the professional ethos and commitment of those who administer and apply it in practice, can be steadily enhanced. First, I will address the question of cross-border cooperation, which has been of particular concern for some time and which is now especially topical in view of the EU Commission's proposals, published in December 2012, for reform of the EIR.[27]

If the EIR amendments proposed by the EU Commission are enacted in more or less their current form there will undoubtedly be an increase in the flow of communications between courts, and between liquidators, and also in the incidence of applications and requests between liquidators and courts, during the course of proceedings within the EU. In tomorrow's world, there will be a growing need to ensure that these cross-border communications, and appearances and applications before foreign courts by liquidators appointed in other states, can be conducted in an environment where the essential factor of "mutual trust" can be nurtured and respected. The need to take active steps to promote cross-border cooperation at a global level was also one of the key objectives in the project conducted between 2005 and 2012 on behalf of the American Law Institute and the International Insolvency Institute, for which Bob Wessels and I served as Joint Reporters.

Although our Report, which contains Principles and Guidelines for Cooperation in International Insolvency Cases,[28] is an example of what is generally known as "soft law", we venture to hope that the dissemination programme currently being developed by a steering committee established by the III will bring the Report to the notice of judges, legislators and practitioners across the world, and there are already indications that its contents are beginning to make an impression on judicial thinking.[29] Producing an appropriate response to the challenge of nurturing

27 European Commission, *Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on insolvency proceedings*, Strasbourg 12 December 2012, COM(2012)744 final, 2012/0360 (COD). A Draft Report by the European Parliament's Committee of Legal Affairs, in response to the Commission's Proposal, was published on 11 September 2013: PE519.445v01-00.

28 The American Law Institute and the International Insolvency Institute, *Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases* (2012), Reporters: I. Fletcher and B. Wessels. The text of the Global Principles Report can be viewed on the website of the International Insolvency Institute at: http://www.iiiglobal.org/component/jdownloads/viewdownload/36/5897.html (last viewed 15 June 2014). Hard or soft copies of the Report can be ordered from the American Law Institute at: http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=85 (last viewed 15 June 2014).

29 As examples: the text and commentary of Global Principle 13, on international jurisdiction, was cited with approval by Lord Collins delivering the leading judgment of the UK Supreme Court in *Rubin v. Eurofinance SA* [2012] UKSC 46; [2012] 3 WLR 1019, at paragraph 13 of the judgment. Global Principle 1.1, and the Comment to Global Principle 24, were cited with approval by the U.S. Court of Appeals for the 3rd Circuit in its judgment in *Re ABC Learning Centres Ltd* (27 August 2013, not yet reported) (Scirica, Circ.J), at 8-9.

a culture of international cooperation among judges and practitioners forms an important part of the "Mission" which I shall now proceed to delineate.

The Mission

Insolvency Office Holders

Starting with the challenge indicated above, of securing appropriate conditions for "mutual trust" to operate within the EU, we can note that presently the EIR allows the title of "liquidator" to be claimed by the person who has been appointed to an office listed in Annex C in relation to the Member State in which an insolvency proceeding (as listed in Annex A) has been opened. The criteria for eligibility to be appointed to such a listed office remain entirely a matter for the national laws of the state in question, and there is clearly a great difficulty in evaluating the equivalence of entry qualifications applicable to all the relevant professions established under the laws of the 28 Member States. Although the formal policy of the EU is to promote the mutual recognition of professional qualifications obtained in other Member States, in reality a judge in any of the EU states experiences a genuine predicament when faced with a request to release assets possibly worth millions of Euros into the custody and control of a foreign liquidator claiming to be in sole command of the insolvency process according to the regime of the EIR. How far can it be safely assumed that this foreign-qualified liquidator possesses the same order of skills and competence, and is subject to equivalent ethical and regulatory standards, as an IP whose license to practise has been conferred under domestic law?

It seems rather obvious (to this commentator at least) that the level of trust could be considerably enhanced if a standardised, internationally recognised and accredited qualification to provide the services of an IP at international level could be developed and administered. The INSOL Global Insolvency Practice Course offers a possible foundation for such a qualification. Though presently designed (as its title indicates) for participants who aim to practice at a global, rather than purely European, level, the GIP course could be adapted and extended to provide purpose-designed training to equip its graduates with competence and standing to practice in an international mode under the regime of the EIR. This could be a project for INSOL Europe to explore in collaboration with the main INSOL organisation, and might pave the way for eventual harmonisation of IP qualifications across Europe.

Judges and Other Participants in the Insolvency Process

I should also like to acknowledge here the important role played by organisations such as INSOL Europe, and also INSOL International, in facilitating the development of international relationships of a personal nature, between IP's, judges, regulators, academics and others. Such relationships can provide a further basis for the building up of the levels of trust and understanding which are so vital to the smooth functioning of international insolvency business. This can be seen in the steady expansion, from tentative beginnings a little more than two decades ago, of the practice of judge-to-judge communication for the purpose of exploring the optimum ways in which to manage a case in which the respective courts are actively engaged.

When the first initiatives in the convening of international colloquia for judges took place in the mid-nineteen nineties under the auspices of INSOL International and UNCITRAL, the first-hand testimonies of justices Brozman and Hoffmann of their experience in the Maxwell case, and of their sense of frustration at the lack of any mechanism or precedent for a direct transatlantic contact to be made between judges, made a powerful impression on those present.[30] At that stage, a number of judges from other jurisdictions around the world expressed various degrees of misgivings about such inter- judicial communication, up to and including downright opposition to the very notion of such activity taking place. Yet within a few short years, many of the doubters had been won round and were actively championing the practice, and the UNCITRAL Model Law was well on its way to being concluded in record time.

Attitudes had been transformed, in considerable part, by the very experience of those judges in meeting their counterparts from other jurisdictions, and in coming to realise that they shared similar ideals and common objectives, and hence cooperation could be based on trust. But of course, the forging of such personal contacts is largely a matter of chance encounter through attendance at international conferences and colloquia. A more systematic programme of judicial training and confidence building is therefore required if the requisite "critical mass" of mutual trust and understanding is to be attained.

Within the EU, just such a programme is currently being developed with the financial and moral support and of the EU Commission together with the III. Once again, the central figure and moving force behind this venture is Professor Bob Wessels, who has conceived an innovative project aimed at promoting judicial

30 See the edited transcript of the proceedings of the Colloquium on Cross-Border Insolvency convened in Vienna on 17-19 April 1994, jointly organised by INSOL International and UNCITRAL. The transcript is published in the Special Conference Issue of the *International Insolvency Review* (Volume 4, 1995). The comments of Judge Brozman are reproduced at 16-29, and those of Hoffmann LJ at 97-102. Reports (including edited transcripts and supporting documentation) of two subsequent INSOL/UNCITRAL Judicial Colloquia, held in Toronto (22-23 March 1995) and in New Orleans (23-24 March 1997) are respectively published in (1996) 5 *International Insolvency Review* at 140-169 and in (1997) 6 *International Insolvency Review* at 139-144 and 236-251.

cooperation in cross-border insolvency cases in the EU. This project, whose abbreviated name is "the JudgeCo Project", was conceived as a natural extension of the Global Principles and Guidelines Report previously mentioned,[31] with the more targeted purpose of producing a purpose-designed set of principles for judicial cooperation in cases falling within the scope of the soon-to-be revised EIR. The initial task of formulating the JudgeCo principles is being performed as a comparative exercise involving expert consultants from across the EU and some outside states. When finalised, the principles themselves will become the subject of a training programme for insolvency judges drawn from all EU states, expected to take place in 2014. If this venture is judged to be a success, it is hoped that the programme of training can be placed on a permanent footing with financial support from the Member States as well as from the EU centrally.

It may seem a distant prospect, but perhaps one day the European insolvency network will spawn an organisation comparable to the National Conference of Bankruptcy Judges which has flourished since 1926 in the USA.[32] In the meantime, it is appropriate to acknowledge the achievements of both INSOL Europe and its international counterparts (INSOL International and III) in nurturing contacts and engagement with and between judges as an integral aspect of their activities.

Europe – Where do we go Next?

My concluding thoughts, formed in the light of the developments I have just outlined, are about the future: where should European insolvency law, and its insolvency practitioners, go next? The existing organisations, and their various programmes, will certainly continue to play a constructive part in the progressive improvement of the law in substance and in practice. But in my personal vision, the European level would also be the context in which a more transcendent venture could be undertaken. Once again, it must be conceded, the example and the precedent are taken from the United States. Very recently, in June 2011, we saw the foundation of the European Law Institute, modelled upon that distinguished American institution the ALI, and with a mission:

> "…as an entirely independent organisation … to improve the quality of European law, understood in the broadest sense."[33]

31 See above. The coordinators for the JudgeCo Project, together with Professor Wessels, are Professor Jan Adriaanse, Leiden Law School and Professor Paul Omar, Nottingham Law School.

32 See the website of the NCBJ at: http://www.ncbj.org/ (last viewed 15 June 2014).

33 See the website of the European Law Institute at: http://www.europeanlawinstitute.eu/ (last viewed 15 June 2014). The website of the American Law Institute can be viewed at: http://www.ali.org/ (last viewed 15 June 2014).

The ELI will undoubtedly involve itself from time to time in matters pertaining to insolvency, but that will be but one aspect of a far more extensive programme of activity. By no means all of the ELI's membership at any given time will have a close interest in insolvency law. I believe that there is a need for a stand-alone organisation dedicated to the development of insolvency matters within Europe.

A European Insolvency Academy?

I therefore propose that serious consideration should be given to the formation of a separate, specialist organisation devoted exclusively to insolvency and insolvency-related issues, constituted as an independent, self-sustaining organisation capable of formulating authoritative opinions and advice concerning the improvement of the insolvency laws of the European states, including their progressive convergence over time. The organisation should be independent of governmental or EU official patronage, and should also be separately constituted from any professional organisations to which its members would, almost inevitably, simultaneously belong in their individual capacity.

Membership should be by elective process, and should be limited in number, so that election would be seen as a badge of distinction carrying corresponding duties to serve the general public good, rather than purely sectional, or partisan, interests. Its collective authority should be such as to make it the obvious point of reference for national legislators and policymakers, as well as being a source of expert advice for the EU institutions. In the USA, such an organisation has existed since the 1930s in the form of the National Bankruptcy Conference, whose website describes it as:

> "…a voluntary organisation composed of persons interested in the improvement of the bankruptcy laws of the United States and their administration."[34]

For several years during the 1990s, I was privileged to observe the proceedings of the NBC at first hand, in the capacity of an invited international correspondent. I was particularly impressed by the exceptional level of expertise of those participating (some 60 or so in number), and by the diversity of their backgrounds – attorneys; academics; judges from all corners of the USA – all aspiring to the higher ideal of making a contribution to the improvement of the law for the benefit of their fellow citizens, based on objective, rational and non-partisan discussion

34 The website of the National Bankruptcy Conference can be viewed at: http://www.nationalbankruptcyconference.org (last viewed 15 June 2014).

concerning the topical issues of the moment. A maxim that was several times invoked in my hearing neatly sums up the philosophy of the organisation:

> "When we enter the meeting, we check our clients at the door."

Having originally come into existence as an ad hoc group invited to advise Congress and the Administration during the Depression years of the 1930s, the NBC evolved into an established, self-funding institution whose expertise was and is still regularly drawn upon in the process of law reform. It has had a distinguished consultative role in every major piece of bankruptcy legislation since the 1940s, including the 1978 Bankruptcy Reform Act and subsequent revisions and reforms. My closing question – challenge even – is therefore: can Europe create a similar institution, drawing its membership primarily from across the current 28 EU states? I believe that the benefits could be significant, and the existence of such a body need not cut across the excellent work being done by existing organisations such as INSOL Europe.[35] Let it be our mission, then, as practitioners of insolvency here in Europe, to consider how best to develop a suitable vehicle to harness the skills and experience of the leading members of our community, and to enable them to work together for the general good.

35 Possible names for such a body might be: the "European Academy of Insolvency Law" or (somewhat more modestly) the "European Insolvency Forum".