Chapter 7

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

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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

[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.

domestic law and the rise of the pre-insolvency procedure have become integrated within the proposed changes to the text.

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

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[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.

adopted, the text took no account of the development in national laws of pre-insolvency procedures.[9]

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

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

[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.

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 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

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[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.

procedures.[19] In 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

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[19] See G. Moss and C. Paulus, The European Insolvency Regulation - The Case for Urgent Reform (2006) 19 Insolv Int 1.

[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 Insolv Int 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].

would also need to be made in 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 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

[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).
[30] Ibid., at 25.

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 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

[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.
[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).

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 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]

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[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).

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

(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 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]

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[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.

[44] Ibid., at 6 (paragraph 3.1.2).

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,
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> (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…"

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]

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[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).

[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

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-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]

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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.

[52] Ibid., at 4.

(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 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]

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[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.
[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.

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 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]

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[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 ICR 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 ICR 346.

[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.

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.