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ARTICLE

European Insolvency Regulation: Where Does It Go Next?

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This article contains largely the personal views of the author. Although the author was a member of the drafting Committee formed by INSOL Europe with regard to considering a revision of the EC Insolvency Regulation, it is only fair to say that there are obvious grounds for stating that many of the recommendations made in the published proposal, published in booklet form earlier this year, are clearly contentious and justify the taking of many views which are not necessarily those of the drafting Committee itself.

The EC Regulation on its face is to be reviewed every five years. The INSOL Europe recommendations are numerous. Only the principal ones need be mentioned here. With regard to Article 1, it is suggested that the liquidity test be included in order to promote further harmonisation of the substantive insolvency laws in the Member States. This does no more than echo a prior report issued by INSOL Europe with regard to possible harmonisation of major insolvency laws across the European Union.

The definition of COMI in Article 2 is addressed. COMI is expanded so as to mean the place of the registered office except where the operational head office functions of the relevant company or of any legal person are carried out in another Member State. Moreover that other Member State must be ascertainable to prospective creditors as the place where such operational head office functions are carried out. In such a case, it shall mean and refer to the Member State where such head office functions are carried out. The mere fact that economic choices and decisions of a company are, or might be controlled by a parent company in a Member State other than the Member State of the original office, will not cause a centre of main interests to be located in this other Member State.

Of much more importance however is the suggested insertion in the EC Regulation of a chapter on the insolvency of groups of companies. There are suggested definitions of the following expressions, namely, 'group of companies', 'parent company', 'subsidiary', and 'group main proceedings', those definitions being included in a draft amended Article 2. Furthermore, there is an inclusion of the definition of, amongst other things, 'non-EU proceedings', 'non-EU main proceedings' and similar associated definitions in view of a new suggested Chapter VII regarding provisions on insolvency proceedings opened outside the European Union.

Although the insolvency of groups of companies has been for many years a contentious, or at least a much debated, area, the Report also addresses an equally contentious area, namely a look-back period with regard to COMI itself. A new suggested Article 3(1) provides that if a company has moved its COMI less than one year prior to the request for the opening of the insolvency proceedings, only the courts of the Member State where the COMI was located in that one year prior to the request will have jurisdiction to open insolvency proceedings. That will be the case if the debtor has left unpaid liabilities caused at the time when its centre of main interests was located in this Member State unless all creditors agree in writing to the transfer of the COMI out of that Member State.

There are also far reaching suggested reforms to Article 5(1). The Report took the view that the discrepancy of the treatment of security rights depending on whether insolvency proceedings had been actually opened in the Member State where the assets were located had also been the cause of much debate. It was felt that in general terms such a distinction was no longer justified even though it had historical justification. The suggested amended Article 5(1) in effect means that the effects of insolvency proceedings on the rights in rem of creditors or third parties in respect of tangible or intangible assets belonging to a debtor and which are situated within the territory of another Member State at the time of the opening of proceedings shall be governed solely by the law of the Member State within which those assets are situated.

With regard to Article 13, INSOL Europe took the view that it appeared to be undesirable that a legal act could be made 'avoidance proof' by selecting the law applicable to the contract. However, it was also to be observed according to the Report that a relocation of the COMI might be detrimental to the other party to an agreement if under the law of the new COMI, an avoidance action might be easier to institute. The amended suggested wording was to the effect that Article 4(2)(m) should not apply if the law of the Member State where the COMI of the debtor was situated at the time of the legal act did not allow any means of challenging that legal act in the relevant case. Similar analogous amendments were suggested with regard to Article 14 and Article 4(2)(f). Other principal suggested changes address Articles 20, 21, 27 and 33. With regard to

Article 20, it was suggested if administrative expenses had been incurred during the course of insolvency proceedings and had been caused by the liquidator or by a court, such costs should be borne in proportion to the proceeds which had been realised in each of the insolvency proceedings and which have to contribute to the payment of administrative expenses from those proceedings.

In the proposed Article 21(3), the Report suggested that there should be an additional provision to the effect that a liquidator should take all necessary steps to ensure publication of the judgment opening insolvency proceedings in all other Member States in the event that that liquidator considered such publication to be necessary. With regard to Article 27 and mindful of what clearly has been an extensive debate on the question whether the possibility of secondary proceedings is desirable, the Report proposes that the court which has jurisdiction under Article 3(2) should have discretionary powers to appraise and assess the need for secondary proceedings in view of the interests of one or more creditors and an adequate administration of the estate.

With regard to Article 37, the Report takes the view that there is simply no compelling reason why secondary proceedings cannot be reorganisation proceedings. That meant that there could be no reason why the last sentence of Article 3(3) reading: '*These latter proceedings must be winding up proceedings*' could be deleted. In turn, that meant that the liquidator of the main proceedings should have the same conversion rights with respect to the secondary proceedings as the liquidator of the secondary proceedings themselves.

Reverting to what has been said above, Chapters V and VI introduce substantive suggested changes with regard first to the insolvency of groups, and secondly with regard to what is called in the Report, a European Rescue Plan.

As indicated above, there is no doubt that the occurrence of substantial group company liquidations and insolvencies has become a frequent phenomenon in effect crying out for rules on coordination. It may well be that in practice the European Commission will, in the event, take some steps in terms of addressing this particular issue, i.e. that of coordination and cooperation, without turning to any more substantive changes within the EC Regulation itself. In such a case the Report's suggestions may have a positive and tangible outcome. It is suggested in the Report that if a subsidiary and its ultimate parent company both enter into insolvency proceedings, the liquidator of the parent be given powers similar to those which a liquidator in main proceedings has as regards secondary proceedings. This still however may be a step too far for the European Commission.

However, the centrepiece of the Report which may again be a few more steps too far for the European Commission, is the possibility of proposing a plan covering one or more group companies. In essence, this Rescue Plan is designed to provide for a restructuring mechanism which on the one hand ensures that each creditor should at least receive value which equals the distribution in the case of a winding up of its debtor, and on the other, procures that conglomerates are saved and do not fall victim to a lack of coordination in an international setting.

It is important to note that the suggested European Rescue Plan is in no way meant to replace any legislation of or within the Member States themselves with regard to compositions and rescue plans. It said that it is simply an additional instrument for the adoption of cross border rescue plans involving groups.

Finally, again, as hinted at above, the Report took the view that as to the recognition of insolvency proceedings opened outside the European Union, the UNCITRAL Model Law provides a workable system supported by the global community which created it. Contrary to the Regulation, as is well known, it is not based on a similar principle to that of community trust. The effect of foreign proceedings within a receiving State is therefore much less pronounced. There are in addition more elaborate reviews than under the EC Regulation. The best example of the latter is the absence of any automatic recognition of the powers of a foreign liquidator. Instead, the Model Law provides for a two tier review system.

The Report took the view that it was desirable that these provisions be incorporated within the EC Regulation.

Pausing here, there has been much debate about the overall merit of these proposals. Only the main ones need be noted for the purposes of this review. It may be appropriate to deal with the question of groups first since, on any basis, this is an important issue of principle. In effect, the opponents to any form of regime addressing cross border insolvency and groups of companies point to the fact the present system cannot be said to work badly, let alone in any deficient manner. It could be said with some force that addressing group companies insolvency across the European Union has in fact worked by and large reasonably satisfactorily. Some aspects have been clarified by case law. Where there has been ambiguity, it might make sense to legislate, but only perhaps to some degree at most to make the respective intentions clear. This school of thought justifies the argument that there is simply no need to go quite to the lengths proposed by the Report. The Regulation as a whole is a compromise. What is important to recognise is the fact that the EC Regulation, as it has been implemented, if anything could be said to be biased somewhat in favour of debtors and creditors, rather in favour of counterparties. The real impact of the Report's proposals could be said to upset that balance.

Turning next to the look-back period with regard to a one year period in which the question of COMI can be

readdressed as proposed in the amended Article 3(1), the counter-arguments could be seen to be relatively weighty. The first criticism is that the one year period is totally arbitrary. Second, and by way of a more serious criticism, is that it fails perhaps to deal with the real issue, namely whether a particular case involves so-called good forum shopping or bad forum shopping. Recital 4 as it stands specifies that it is necessary for the proper function of the internal market to avoid incentives for parties who transfer assets in judicial proceedings from one Member State to another in order to obtain a more favourable legal position, i.e. the well-known and well recognised phenomenon of forum shopping. Recent European Court of Justice pronouncements, particularly in the forms of opinions by the Advocates General in the well-known *Staubitz-Schrieber* and *Seagon* cases could be said to confirm that view. Reference was made in those cases, it could be said, to the Recital, but only in the sense of referring to what could be called fraudulent shifts of COMI designed to disadvantage or prejudice creditors. Moreover, the suggested reforms by the Report might be said to ignore well publicised and recent successful shifts of COMI in corporate cases. These shifts are, on any basis it could be said, designed largely to benefit creditors by enabling a more beneficial reorganisation. So, the argument runs, one can recognise good as distinct from bad forum shopping when one sees it. There is no need in those circumstances to tamper with the regime as it presently stands, let alone by inserting what can be said to be an arbitrary time limit. Moreover, issue is taken with the fact that reliance can be placed on creditors agreeing to a case where there might be an exception for a shift of COMI. This is a practical issue. The question is raised as to whether or not it would ever be possible to get all creditors to agree in the way contemplated by the suggested reform.

In other words, the courts, it could be said, are very used to spotting problem areas in this respect. Each case should ideally be treated on a case by case basis. An analogy could be drawn by looking at the present drafting of Article 4(2)(m) which refers to 'the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors'. It has been argued in a number of serious commentaries on the EC Regulation that in this context, the phrase 'all the creditors' means the creditors as a whole or as it is generally put 'general body of creditors'. With regard to Article 13 and the proposed change that Article 4(2)(m) should not apply, if the law of the Member State where the COMI of the debtor was situated at the time of the legal act did not allow any means of challenging that legal act in the relevant case, it could be said that the proposed change suggested by the Report, again, tends to favour the creditors and upset the balance on which the Regulation itself is based, i.e. striking a fair balance between creditors and counterparties.

Criticisms have also been levelled against the proposed changes to Article 27. Here, the Report, as hinted at above, proposes that there should be a limit to the ability to open secondary proceedings in situations where it is 'justified by the interests of one or more creditors or an adequate administration of the estate'. Against that proposal, it is claimed that Article 27, particularly taken along with Article 3(2), represents a compromise between the ideal of universalism and the principle of territoriality. Allowing secondary proceedings by way of exception to the general universal rule protects the creditors. Rather than the proposal put forward by the Report, it might be better, it is said, that the interests of creditors means in effect the interests of the general body of creditors as already referred to above. The concept of creditors did not mean in essence 'one or more creditors' as appears to be the necessary inference drawn from the Report's proposals.

The question of groups and possible reform is equally contentious. Opponents to any form of real change, either along the lines suggested by the Report or otherwise, point to the absence of any formal or comprehensive regime dealing with groups outside insolvency. In the Virgos-Schmit Report, particularly at paragraph 76, there was a clear indication that insolvency law should in principle follow the general corporate law structure. Thus, however desirable it might be to have a code of rules designed to address group insolvencies, it would be difficult to see how that would operate in the absence of any cogent set of principles or well established practice regarding solvent groups. In the light of that dichotomy, it is questionable whether the liquidator of a parent company should be given any sort of power, let alone that suggested by the proposals, similar to the powers enjoyed by a liquidator in main proceedings, vis-à-vis secondary proceedings. If there was to be an insolvency of a subsidiary, particularly if the latter was a substantial trading company, the parent company of the liquidator could really have no stake or interest in the insolvency of the trading subsidiary. Quite the contrary, it would in such a case, it is claimed, make more sense for the liquidator of the subsidiary to have powers similar to the liquidator in main proceedings in relation to a pure holding company parent.

Much the same approach and analysis is brought to bear upon criticisms levelled against the suggested European Rescue Plan. Even on the basis of the present EC Regulation, and indeed domestic law in general, insolvency pleadings are based on an entity principle and not on a group basis. It is claimed therefore that if anything, the suggested proposals with regard to a Rescue Plan, smack off a Chapter 11 type of proceeding. This in turn it is claimed would also shift the balance of power underlying the present EC Regulation from one tending to favour creditors to one favouring the debtor and again, might be said therefore to upset the balance which the EC Regulation was designed to exhibit and has in fact demonstrated since its inception.

These are difficult issues. It may well be that none of the major reforms proposed come anywhere near to

seeing the light of day, at least in the foreseeable future. However, there is cause for thinking that at least three areas need to be addressed. One of them may well find some echo in the near future, either in terms of a formal amendment to the EC Regulation, or in some other way, thereby attracting some degree of adherence to principle with regard to cross border insolvency within the European Union.

This first case where there may well be said to be justification for action of some sort concerns the coordination of insolvency cases, or if not, communication between courts and judges across the Union. Many practitioners already believe that the EC Regulation should be modified to augment the obligations between the courts, as well as between officeholders and courts, in order to take into account the better coordination of cases in different countries. Article 31 is particularly important. It imposes a series of obligations on the liquidator in the main proceeding and upon a liquidator in a secondary proceeding to communicate information to each other. It could be said with some force that much more is needed with regard to this type of communication and coordination. There is some echo of the need to impose coordination and cooperation in the context of the Model Law. The EC Regulation does not impose a duty on liquidators to inform the relevant courts of relevant developments in corresponding cases in other countries. However, it is clear that there is some importance attached to the need for a judge to whom a main proceeding has been assigned to be informed of developments that might be said to be relevant in a secondary proceeding. This is but one example of how coordination and cooperation should be addressed with rather more vigour than it has been so far.

Next, there is no corresponding duty, or even mandate, within the EC Regulation for judges administering main and secondary proceedings to communicate with each other. There is clearly a reluctance to do this across many parts of the European Union, not least in England and Wales. However, other major jurisdictions, especially involving United States and Canadian courts, have shown that court to court communication is a valuable contribution to the proper progress of closely related insolvency cases. It is a difficult question as to whether, and if so to what extent, that degree of cooperation and communication can in any way be transplanted, not simply into England and Wales, but also across the Union as a whole.

The use of protocols however has become rather more widespread. A protocol generally speaking is a document prepared on a case by case basis to provide for the coordination of specific international cases. Invariably, there will be some form of schedule for the progress of the related international cases, together with some form of allocation and responsibility between the parties, the various groups of officeholders and the respective courts. Again, there seems no reason why something should not emerge from these discussions, both within the Commission or outside, along these lines with a view to improving coordination generally. At most, although the same is unlikely, the EC Regulation itself could be revised to include a provision specifically approving the use of protocols, but something with lesser force than this may well emerge in the coming years.

These are no more than isolated thoughts in a very complex area. Just as the EC Regulation itself took many years to emerge after a series of frustrated and frustrating prior international regimes which never saw the light of day, so too it may well be that even the most modest accretions to the Regulation will not see the light of day for quite a while. This is not to say however that the debate should not go on.

International Corporate Rescue

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