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Makeover for European Insolvency Regulation: because it's worth it?

A proposal to update the EU Insolvency Regulation was announced in December with the intention of making it easier for viable businesses in financial difficulties to restructure. It is hoped that the proposal will stem the current loss of 1.7 million jobs and 200,000 firms which are going bust each year in the EU. A quarter of these businesses have a cross-border element. With those statistics in mind, we welcome the proposal which is aimed at giving distressed businesses an opportunity to restructure and given effect across Europe. Whether the proposed amendments will make a difference in practice, or whether they amount to no more than a superficial gloss, remains to be seen. For secured creditors, the status quo and safeguards contained in the current Regulation remain unaltered by the proposal. In this briefing we provide the initial views on the proposal from our insolvency specialists across our European network.

By way of reminder, the present European Insolvency Regulation, which has been effective since 2002, contains rules on jurisdiction, recognition and applicable law in relation to insolvency proceedings. The current focus is largely on the recognition of formal insolvency proceedings across Europe. Under the proposal there is a shift in emphasis to promote pre-insolvency and rescue procedures. There are also some welcome clarifications in terms of jurisdiction, in particular guidance on which court can commence proceedings. The proposal also recognises some of the practical challenges faced in cross-border insolvency cases and seeks to increase the extent to which insolvency office holders and courts should cooperate in those cases, including in a group company situation. In addition the proposal provides for the introduction of an internet register for insolvency proceedings and for there to be inter-connection between national registers.

Adrian Cohen partner in our UK insolvency practice comments: "*We always thought that the Regulation on the whole worked well. We suggested in our firm's response to the EU Consultation which sought to update the Regulation last summer that the revisions be used to simply iron out some of the uncertainties, rather than incorporating any wholesale change. In the main, the proposed amendments provide a step in the right direction, and rather than being too prescriptive they offer flexibility to those companies in need of restructuring. The really good news is that the safeguards for secured creditors which enable them to rely on*

Key issues

- Regulation to include pre-insolvency and rescue proceedings
- Secured creditor protections intact
- Centre of administration key for jurisdiction
- Location of assets rules clarified
- Co-operation between Member State courts and liquidators
- Central register for insolvency proceedings in the EU

their existing rights and security interests without interference from an insolvency process in another jurisdiction, remain intact. Although it may have been useful to have had some clarification on whether a secured creditor's underlying debt claim is protected, some of the more radical suggestions in the original consultation which may have undermined the certainty currently enjoyed by secured creditors have not been included in the proposal".

Pre-insolvency and rescue proceedings

In terms of extending the scope of the Regulation to include pre-insolvency and hybrid proceedings, it is important to note that individual Member States still retain the right to identify which particular insolvency procedures are to join the list of procedures covered by the Regulation.

Fabio Guastadisegni, partner in our Italian litigation practice comments: "*These proposals are very timely, as new reforms in Italy have recently been introduced which are designed to increase the range of pre-insolvency processes available to ailing Italian companies. The proposal recognises this Europe-wide shift towards encouraging and helping companies to overcome their financial difficulties with as little recourse to the formal and often, costly insolvency procedures as possible*".

Although the new proposals give the Commission the obligation to scrutinise the procedures to ensure they fit within the parameter of the Regulation, there is no suggestion that the Commission or other Member States can dictate which types of procedure should be included from other Member States. Our current understanding is that the UK Insolvency Service is not at present advocating the inclusion of schemes of arrangement, although it is due to consult stakeholders on the proposals imminently.

Which court can commence proceedings?

The amendments proposed retain the concept of centre of main interest (COMI) which effectively determines which court has the jurisdiction to open insolvency proceedings in the first place. The proposal clarifies the circumstances for satisfying the COMI requirement by stating that it is possible to rebut the "registered office presumption" if a company's central administration is located in another Member State. In this respect, it must be clear to a third party that the company's actual centre of management and supervision and the management of its interests is located in another Member State.

Inigo Villoria, partner in our insolvency and restructuring group based in Madrid comments "*Some practitioners who were looking for a more definitive solution to the uncertainty surrounding different Member States interpretation of the concept may be disappointed as the proposal stops short of a definition of COMI. In my view, however the approach to COMI in the proposal does provide useful guidance and builds upon the developed jurisprudence from the European Court, in cases such as Eurofood IFSC, Interedil Srl and Mediasucre"*.

The court which opens the main proceedings will be required to make a finding of COMI and, where there are circumstances which give rise to any doubt, the debtor and creditors will be approached for evidence or their views. In cases where there has been no court decision (i.e. Company Voluntary Arrangement or Creditors' Voluntary Liquidation) it will be for the liquidator appointed in those cases to specify the grounds upon which the jurisdiction is based to commence the process.

The amendments also provide that the law applicable to the main insolvency proceedings should have jurisdiction for actions which derive directly from the insolvency proceedings and are closely linked with them, such as avoidance actions (e.g. where there has been preferential treatment in relation to particular creditors, or transactions which lack valuable consideration). Flexibility is also provided to liquidators where an action is linked to ordinary civil and commercial proceedings against a defendant, where the liquidator can take action in the Member State where the defendant is domiciled, provided that court has jurisdiction.

Multiple Proceedings

Under the current regime, it is possible to have two separate insolvency proceedings in respect of the same debtor. This can give rise to significant complexity and cost. The proposal allows liquidators in the main proceedings to request that secondary proceedings are not commenced or should be postponed if those proceedings are not necessary to protect the interests of the local creditors, especially in cases where the liquidator of the main proceedings undertakes to treat local creditors as if the secondary proceedings had been opened.

Stefan Sax, partner in our German corporate practice comments: "*In our firm's response to the original EU Consultation back in the summer we advocated the introduction of a power enabling the liquidator in the main proceedings to be able to reflect local*

creditor priority rather than encouraging the commencement of secondary proceedings. It is heartening to see that this suggestion has been adopted in the proposal. It is important to note that the liquidator of the main proceedings, will not be able to abuse this right and cannot realise or relocate assets from the establishment jurisdiction with the purpose of frustrating interests of local creditors who would otherwise have been satisfied if secondary proceedings were opened later. This works both ways, as where secondary proceedings are opened, although they do not have to be winding up proceedings, they are still limited to the assets located in the establishment territory".

Importantly under the proposal, in the event that both main and secondary proceedings are opened in respect of the same debtor, the liquidators would be obliged to cooperate and communicate with each other, including (amongst other things) exploring the possibility of restructuring the debtor. The proposal also provides that secondary proceedings would no longer be limited to winding up. This will no doubt assist future cases. It also addresses one of the main complaints that at present, secondary winding up proceedings can frustrate a restructuring process which is proposed in the main proceedings. This is because winding up a business is at odds with attempts to restructure it.

Group Companies

A new chapter has been proposed to deal with the insolvency of members of a group. Reinhard Dammann, head partner of our French insolvency practice and member of the commission of experts that has advised the Commission on this proposal comments: "*It does not offer a complete solution to group insolvencies, nor does it promote a group-wide insolvency process but the proposal introduces an obligation on the part of the liquidators appointed to the separate group entities to communicate and cooperate with each other. It specifically refers to the use of protocols and promotes the concept of a group restructuring as a helpful alternative to insolvency. In practice this is something that liquidators in most cases try to do in any event. Also, the proposal confirms the solution reached in the Eurofood and Interedil cases; so that a group of companies that is highly integrated may still request a single jurisdiction to open a main insolvency proceeding to the benefit of all of its companies in order to favour either the implementation of a global reorganisation plan (as in the Eurotunnel case) or the coordinated sale of assets (as in the Collins & Aikman II case). The Commission was right in limiting its intervention to the recognition of such concentration and allowing the same liquidator to be nominated for all of these proceedings. In practice, it would have been difficult for the Commission to find a way to sanction the pre-eminence of one particular proceeding or jurisdiction to organise, or even impose, solutions to the entire group of companies under the unique jurisdiction of one Member State*".

In addition, the liquidators may agree to grant additional powers to the liquidators in one proceeding where such an agreement is permitted by the rules applicable to each of the proceedings. The proposal also provides a liquidator with a power to participate in proceedings opened in respect of any other companies in the group. This includes the ability to request a stay of the other proceedings for up to 6 months, to propose a rescue plan, composition or comparable measure to promote such a group rescue. The new chapter also allows the courts to cooperate with one another by using any appropriate means.

Adrian Cohen comments further, "*Some of the practical solutions offered in the proposal may be perceived as ambitious and whether they will be workable in practice, we will have to wait and see. In particular, it is unclear whether the English courts, which are in many respects very traditional in their approach, will consider themselves able to embrace the proposals to cooperate and communicate with other courts directly. Also, as we have seen in some of the recent cross border cases such as Lehman Brothers and Nortel Networks, cooperation between officeholders whilst strived for, is not always feasible*".

Where are the assets?

As already mentioned, from a secured creditor's perspective the protections under the Regulation remain intact. In addition to maintaining the safeguards, the proposal also expands the rules contained in the Regulation relating to where assets belonging to an insolvent debtor are located. We are pleased to see that our suggestion in the response to the consultation that new definitions regarding the location of assets have been taken on board. In addition to the present definitions it is proposed that the following are included (a) registered shares, to be located in the territory where the company who has issued the shares has its registered office; (b) financial instruments, title to

which is evidenced by entries in a register of account (book entry securities), to be located in the Member State in which the register or account is maintained; and (c) cash held in accounts with a credit institution, to be located in the Member State indicated in the account's IBAN. Steve Jacoby, partner in our Luxembourg office, comments "*These further definitions are a positive clarification*". Steve continues "*It should also be noted that according to the new proposal netting agreements are to be governed by the law provided for in the contract. Previously there was no express provision for this, so this should also assist in the risk analysis for parties entering into such transactions*".

Notification and claims

There are a number of proposed changes intended to streamline the practicalities involved in cross-border proceedings under the Regulation, including a standard notice of proceedings and a standard claim form for insolvency proceedings to be used by all Member States. As already mentioned Member States will also need to establish and maintain a register available to the public on the internet free of charge containing details of any insolvency proceedings opened. The Commission is then to establish a central public electronic access point for the information which acts as an inter-connection of the registers. Until the registers are established, the liquidator shall publish the notice of the opening of proceedings in any other Member State where there is an establishment, in accordance with the local publication procedures and register the decision in the relevant land register, trade register or other public register. This is a very practical solution to avoid a multiplicity of proceedings in respect of the same debtor. Jeroen Ouwehand, partner in our Amsterdam office, notes "*Whilst in The Netherlands we already have separate insolvency registers that are publicly available, this is not the case in all EU Member States. The proposal offers a comprehensive database with an interface for insolvency proceedings taking place across Europe. This will mean more visibility on the solvency status of counterparties when doing business and provides accessible information to insolvency professionals*".

Timing and process for the proposal to become law

The proposal for an amended Regulation is to be considered by the European Parliament and also the Council of the EU before it is adopted, even then, the current draft amending regulation suggests a lead in time of 2 years after the amending regulation becomes effective. Clifford Chance's restructuring practice will be monitoring its progress and participating in the national soundings that are to take place in the coming months.

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