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Briefing note December 2014

Final text for the Amended EU Regulation on Insolvency proceedings

The process to update and extend the existing European Regulation on Insolvency Proceedings (EUIR) was commenced almost 2 years ago to the day, now the final text for Amended Regulation has been published. The final text is the result of much wrangling between the EU Commission, the Council of the EU, and the EU Parliament as to what form and how far the amendments should go. There has also been much lobbying by Member States to get the amendments to address their individual concerns regarding cross border insolvency cases and ensure that there is a level playing field.

In this briefing paper, we ask experts from our European network what impact the amendments will have, and what their observations are on the changes that appear in the final text.

But first a brief reminder about the purpose of the EUIR and an overview of the amendments in the final text of the Amended Regulation.

A brief reminder: EUIR

The EUIR has been in operation since May 2002. Its primary purpose is to ensure the proper functioning of the European market in relation to cross border insolvency proceedings and to deter parties from forum shopping. It does not provide any uniform substantive insolvency law, but instead, contains procedural rules on jurisdiction, recognition and the applicable law in relation to insolvency proceedings.

The Amended Regulation

The Amended Regulation is designed to improve the efficiency and effectiveness of cross border insolvency, benefit creditors and debtors, facilitate the survival of businesses and present a second chance for entrepreneurs.

What are the main changes?

Extended scope

- Extending the scope of the present EUIR so that pre-insolvency and rescue proceedings are included.

COMI

- Where the debtor wants to rely on the registered office/principal place of business presumption regarding its COMI, it cannot have moved its registered office/principal place of business to another Member State within a 3-month period prior to the request for the opening of the insolvency proceedings (extended to 6 months for individuals who do not conduct business).

Key issues

- Will apply to pre-insolvency and rescue proceedings, including where the debtor remains in possession
- Schemes of arrangement not included
- Secured creditor protections remain intact
- Netting agreements not expressly carved out
- More prescriptive rules on centre of main interest (COMI)
- Introduction of coordination proceedings for groups of companies
- Application (for the most part) 2 years after publication in the Official Journal anticipated in April or May 2015

Jurisdiction

- Obliging the court or insolvency practitioner to examine and be satisfied as to jurisdiction.

Secondary proceedings

- Historically these were limited to liquidation, but under the Amended Regulation may now include rescue procedures.
- Allowing insolvency practitioner in main proceedings to provide an undertaking to avoid secondary proceedings being opened.

Stay of realisation

- Insolvency practitioner in one process can (subject to certain conditions) request a stay of realisation of assets in relation to another group company which is also in an insolvency process. The conditions are:
  - it has a restructuring plan for the group which has a reasonable chance of success;
  - the stay is necessary for the implementation of the plan;
  - it is of benefit to creditors; and
  - there is no formal group coordination process.

Group coordination proceedings

- Introduction of group coordination proceedings, to apply subject to:
  - support given by the insolvency practitioners of individual companies in the group;
  - if insolvency practitioners object, they are not included;
  - even where the insolvency practitioner elects to participate in the coordination proceedings, they can choose not to follow the plan at any time.

Registers

- Publicly accessible insolvency registers to be established and interconnected via the EU portal.

Standardisation of notices and claims

- Standard notices and claim forms for all proceedings irrespective of where proceedings are commenced. There is a minimum 30-day period to be allowed for creditors to lodge their claims.

No exemption for netting agreements

- The original proposal to carve out netting agreements from the effect of the insolvency law was welcomed by many practitioners. The final text however does not include any express exemption. To a certain extent, this has been alleviated by the application of the EU directive on financial collateral arrangements where a netting provision related to a financial collateral arrangement or an arrangement of which financial collateral forms part is immune from the effects of the insolvency proceedings.

What sort of proceedings do they apply to?

The extended scope includes proceedings and interim proceedings (i.e. where there is a temporary stay on enforcement to allow a debtor to negotiate with its creditors) based on rescue, adjustment of debt, reorganisation and liquidation, where a debtor is supervised by the court or the appointed insolvency practitioner. Court supervision includes proceedings where the debtor remains in possession. Debtor in possession means, for these purposes, where a debtor remains totally or at least partially in control of his assets and affairs (more fully set out in Article 2 of the Amended Regulation). This includes debtor in possession proceedings and debt discharge mechanisms applicable to individuals, even where they don't include the involvement of an insolvency practitioner.

The types of proceedings are listed in Annex A to the Amended Regulation, which is an exhaustive list. The proceedings are to be derived from insolvency law and involve the total or partial divestment of a debtor from its assets. They do not extend to confidential procedures, for example *mandataire ad hoc* or *conciliation* in France.

What will this mean in practice?

Extending the scope will mean that more proceedings will benefit from automatic recognition and effect throughout the EU. It also recognises the international trend to promote debtor in possession rehabilitation processes which have been a feature of many of the developing national laws in EU Members states, most recently France and Spain.

When will the amendments take effect?

For the most part, the changes do not come into effect for at least 2 years from the date that they are published in the Official Journal. The approved amendments are to be put before the Council of Ministers in March 2015 for formal adoption, and then the EU Parliament's Legal Affairs Committee and Plenary in April or May 2015 for formal adoption. There is a shorter period of 12 months relating to Member States submitting information about their procedures and insolvency legislation for publication by the EU Commission. Other aspects have an

even longer lead in time: Member States have 36 months to establish insolvency registers and 48 months to confirm they are able to ensure that the registers form part of an interconnected EU Portal. The amendments will not apply to any proceedings that are commenced before the Amended Regulation becomes operational, so for a time there will be a twin system in operation, as proceedings commenced under the original regime work their way through to a conclusion under that regime.

How will the amendments become effective?

Due to the fact that the changes are by way of Regulation, they will have direct effect in each of the Member States (except Denmark).

What do we think about the changes?

Views from England and Germany - exclusion of English schemes of arrangement

From the English law perspective, **Philip Hertz,** co-head of the London Restructuring Practice, believes that the exclusion of schemes from the scope of the final text is appropriate. Philip says: "*this was one of our key concerns - schemes are often used as a restructuring tool, even though they are contained within the companies' legislation and are also used for non distressed situations. Schemes have been especially useful in restructuring international groups where no COMI test is required. Instead, the English Court has been innovative in using its discretion to exercise jurisdiction on the basis of English governing law alone* ".

Philip's remarks in this regard are echoed by **Stefan Sax,** partner in our restructuring and insolvency practice in Frankfurt. Stefan makes the point that the use of schemes for international restructurings makes a significant contribution to assisting distressed business. "*The latest significant example of the use of an English scheme was in the case of the international group APCOA, where a change in the governing law in the main finance documents from German to English law provided the English court with sufficient jurisdiction to restructure companies in the group. Had schemes of arrangement been included in the scope of the EUIR, it is unlikely that this change in law would have been sufficient basis for founding jurisdiction. Taking the recent example of the APCOA Group, this would have most likely entered into formal insolvency processes in Germany and other Member States causing many job losses and also great losses to the creditors*."

Group companies

Adrian Cohen, coordinator of our European restructuring and insolvency practice**,** notes that "*while a whole new chapter has been dedicated to a coordinated approach to resolving group companies, it remains to be seen whether formal group coordination proceedings, as prescribed by the Amended Regulation, will offer a real practical solution to the resolution of group companies in distress. While we recognise that the Commission was limited in what they could do to impose solutions from one Member State to proceedings taking place in other Member States, the result is that such proceedings lack any real force.*

The Amended Regulation gives the individual insolvency practitioners the ability to simply opt out, both at the commencement stage and also later on if they don't like the group proposals. While we would not advocate the ability of the court and the group coordinator to be able to impose its will on other insolvency practitioners and companies in the group, the suggested amendment is unlikely to be particularly helpful, as it lacks certainty and predictability from start to finish.

We believe that the fact that there is also a 6 month stay available to the coordinator to impose on individual company member's proceedings while the group coordination proceedings are being pursued, acts as a real deterrent for supporting any group rescue proposal. Individual group companies could choose not to opt in, simply to avoid the stay applying, as the stay is expressed not to apply to those companies who have not agreed to support the group coordination proceedings.

Another sticking point is that the costs of the group coordination proceedings which are to be met by participating companies in the group, but only to be paid for at the end of the proceedings, may leave the coordinator exposed where the individual companies and their appointed representatives delay or dispute payment at a time when they may no longer have any have any interest in the coordination proceeding.

There are some less prescriptive ways which are included in the Amended Regulation for resolving group companies where courts and insolvency practitioners are generally encouraged to cooperate, including by way of agreement or protocols and consider the appointment of common

officeholders, which in our opinion are more likely to be effective in practice.

Of course, only time will tell as to how much these mechanisms will be used in practice."

It should be noted that the group coordination proceedings are to be reported upon and reviewed 5 years after their implementation.

Spanish perspective on extended scope and simplified notice and claims procedures

Inigo Villoria, head of restructuring and insolvency in our Madrid office, notes: "*With the expansion of new pre-insolvency procedures in Spain, we welcome the extended scope of the Amended Regulation. We also like the new rules on standardisation of notification of proceedings and the claims forms. These should simplify and make the process for creditors more cost effective. In addition, the amendments also provide that legal representation in the filing of the claims is not a requirement. This will ease the burden on creditors who are already out of pocket and may not in the past have wanted to engage lawyers but were required to do so in certain jurisdictions because of the procedural requirements in operation*."

Reflections from France on synthetic secondary proceedings

Reinhard Dammann, partner in our Paris office who has assisted the Commission in its approach to the amendments, sees the fact that secondary proceedings are no longer limited to judicial liquidation as a positive development. In addition the introduction of a mechanism for the insolvency practitioner of the main proceedings to provide an undertaking to avoid secondary proceedings (i.e. synthetic secondary proceedings) can also be seen as a step in the right direction, although the process for implementing such proceedings appears to be quite complicated. In this respect, Reinhard notes "*there is not only the possibility of a synthetic secondary proceedings in case of a sale of the ongoing business, thus avoiding the opening of a secondary, but there is also the possibility to get a stay of 3 months for the opening of secondary proceedings to work out a debt restructuring plan, which is very interesting for the fast track French accelerated (financial) safeguard proceedings."*

View from the Czech Republic – forum shopping and jurisdictional questions

Tomáš Richter, of counsel in our Prague office who assisted the Commission as an expert in the amendment process, thinks that the introduction of the court's obligation to examine that it has jurisdiction of its own motion and expressly set out the grounds for jurisdiction in the opening decision will act as an important safeguard in the application of the Regulation. "*It is reassuring to see that the final text seeks to strike a balance between providing flexibility to EU debtors legitimately seeking the most advantageous insolvency regime and ensuring that existing creditor and other rights are protected from abusive forum shopping*". Tomáš comments: "*while the imposition of a 3 month minimum period for the location of the debtor's registered office/place of business in order to benefit from the COMI presumption may be viewed by some as being overly prescriptive, for most cases it should not present any real issues in practice, including those cases where there is a genuine change. One should also note that the Amended Regulation explicitly makes any opening decision subject to review on jurisdictional grounds – this will reinforce creditor rights on the one hand, but may of course create space for tactical manoeuvre on the other*".

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