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Topical issues

The revised EC Regulation on insolvency

How significant are the changes which will come into force in 2017?

Current status of proposed amendments to the EIR

The European framework for dealing with cross border insolvencies, known as Council Regulation No 1346/2000 on Insolvency Proceedings (EIR), has been subject to a long-running review process. This process has now effectively come to an end, with a revised version of the EIR having been approved by the EU Council, with a view to it being formally adopted by the EU Parliament in either May or June this year. The revised regulation will, for the most part, come into force in the middle of 2017.

This memo considers how significant the agreed changes are, and to what extent they are likely to make a practical difference to the way in which cross border restructurings and insolvencies are currently conducted.

The five key issues that the amendments seek to address

The Commission's original proposals, issued in December 2012 following a wide consultation exercise, sought to address five key issues relating to corporate insolvency:

> Scope of the EIR: The need to extend its current scope, in order to include procedures under which a company's debts are restructured at a pre-insolvency stage;

> COMI: A desire to resolve possible uncertainties that may be encountered when identifying where a company's 'centre of main interests' (COMI) is located, and to make it harder to move a company's COMI from one jurisdiction to another;

> Group insolvency proceedings: An identified need for greater cooperation and coordination when cross border insolvencies involve groups of companies;

> Secondary proceedings: Problems caused by opening 'secondary' insolvency proceedings; and

> Procedural issues: Practical concerns surrounding publicising insolvency proceedings and lodging claims.

Scope of the EIR

Many national insolvency laws provide for 'pre-insolvency and hybrid proceedings' which are aimed at encouraging companies to restructure their debts before matters become critical. Such procedures, including *sauvegarde financière accélérée* in France and the *procedimiento de homologación de acuerdos de refinanciación* in Spain, currently fall outside the scope of the EIR. As such, they do not currently benefit from automatic recognition in other EU member states.

Such pre-insolvency procedures will, going forward, fall within the scope of the amended EIR, as long as their purpose is to 'avoid the debtor's insolvency'.

Crucially from a UK perspective, Schemes of Arrangement are not listed in the revised Annex A, which contains an 'exhaustive list' of the procedures which fall within the scope of the amended EIR. It will therefore not be necessary to move a company's COMI to the UK in order for it to propose a Scheme.

COMI and main proceedings

Main insolvency proceedings may only be opened in the jurisdiction where the debtor has its COMI. When the EIR came into force there was some uncertainty regarding how a company's COMI would be ascertained. A large, and generally consistent, body of case law has, however, since evolved, including the ECJ '*Eurofood*' and '*Interedil*' decisions which provide clear guidance in relation to this question.

The amended EIR codifies the generally understood COMI concept by introducing a revised Article 3(1), which links COMI to the jurisdiction where creditors consider that the company "conducts the administration of its interests on a regular basis" (tracking the current Recital 13).

Recital 28 to the amended EIR goes on to suggest that "this may require, in the event of a [COMI shift], informing creditors of the new location from which the debtor is carrying out its activities in due course, for example by drawing attention to the change of address in commercial correspondence". This requirement is consistent with what an English court would currently expect to see happen, in order to be satisfied that a company had moved its COMI.

COMI shifting

The revised EIR attempts to limit 'abusive forum shopping', for example by imposing a specific requirement on the court opening main proceedings to examine whether the debtor's COMI is really located in that jurisdiction, but such attempts have been significantly watered down from the original proposal that any COMI shift should be completed at least three months before the opening of insolvency proceedings.

Now there is simply a statement in Article 3(1) that the presumption that a company's COMI is at the place of its registered office does not apply where the company relocated its registered office within three months of the opening of insolvency proceedings. It is difficult to imagine circumstances in which this would be relevant, as moving a company's registered office to another jurisdiction would generally be an extremely expensive and cumbersome process.

Groups of companies

The Commission considered a range of possible solutions aimed at maximising recoveries where a group of companies go into an insolvency process, concluding that the most appropriate solution would be to retain independent insolvency proceedings for group companies, but to encourage better communication and cooperation between the relevant insolvency officeholders and courts. The EU Parliament amended this concept, by introducing the idea that a court should also be allowed to commence 'group coordination proceedings'.

The agreed EIR therefore contemplates the appointment of an independent 'group–coordinator', who would have the power to propose a group-wide coordination plan, mediate disputes between the insolvency representatives of group companies, and request that insolvency proceedings involving any group member be stayed for up to six months. This might appear to have significant implications when restructuring groups of companies, but the appointment of a 'group coordinator' may, in practice, be the exception rather than the rule, as:

> the insolvency of a group of companies does not always result in each of those companies entering into separate insolvency procedures. In many cases, attempts will be made to preserve value by keeping operating companies out of a formal insolvency process, particularly where all or most of the debt is at holding company level;

> the revised EIR does not allow the court to appoint a group coordinator if that court considers that any "creditor of any group member expected to participate in the proceedings is likely to be financially disadvantaged by the inclusion of that member in such proceedings";

> the insolvency officeholder of any group company can effectively opt-out of the process. Realistically, they would probably always do so, unless the group co-ordinator's plan offered the relevant company's stakeholders a better recovery than under any company-specific strategy; and

> insolvency officeholders are not "obliged to follow in whole or in part the co-ordinator's recommendations or the group co-ordination plan".

The new provisions may therefore be used primarily in unplanned cross border insolvencies where events overtake any planned stakeholder strategy.

Secondary proceedings

While main insolvency proceedings have effect throughout the EU, it is possible to open secondary proceedings in another member state where the debtor has an establishment, the effect of such secondary proceedings being restricted to the debtor's assets situated in that state. Such proceedings must currently result in the liquidation of the debtor (or at least the liquidation of its business and assets in the state where secondary proceedings are opened).

It is generally accepted that the existing secondary proceedings regime has proved unsatisfactory, as the opening of a local winding-up procedure can have a destabilising effect on the restructuring of a multi-national company with integrated operations. In addition, the current position can result in increased costs, with additional insolvency officeholders charging fees and incurring expenses for potentially duplicative or unnecessary work.

An attempt has therefore been made in the amended EIR to make it harder to open secondary proceedings, with a new Article 36 recognising the concept of 'synthetic secondary proceedings'. Under this structure:

> the liquidator in main proceedings can give an undertaking to recognise the priority rights that local creditors would have had, if secondary proceedings had been opened; and

> courts are expressly permitted to refuse to open secondary proceedings where such an undertaking has been provided and it has subsequently been approved by "a qualified majority of local creditors".

This may not sound revolutionary from an English law context where similar undertakings were given in *MG Rover* and *Collins & Aikman*, but giving such an undertaking would not be possible under the existing laws of many member states. Permitting this, and thereby overriding local insolvency legislation, marks a subtle step towards the harmonisation of EU insolvency law.

In practice, however, the combination of increased powers given to the insolvency officeholder in main proceedings and the significant procedural requirements involved in having an undertaking approved may mean that the 'synthetic secondary proceedings' option is only used very occasionally.

In cases where it is still necessary to open secondary proceedings, the amended EIR requires greater cooperation between the relevant courts, and helpfully states that secondary proceedings should not have to be winding-up proceedings when a more suitable rehabilitation procedure was available.

Publication of proceedings

The initial consultation process highlighted the need for a court opening insolvency proceedings to know whether the company in question was already subject to insolvency proceedings in another member state, in order to avoid the risk of two separate 'main' proceedings being inadvertently opened, as occurred in *Daisytek*.

The amended EIR seeks to address this concern by requiring member states to publish information in relation to cross border cases in a 'publically accessible electronic register' and to establish a central 'European e-Justice Portal' linking such registers, so as to allow people to search for details of corporate insolvency proceedings commenced within member states. These should be a useful tool if they work efficiently and the technical and linguistic challenges involved in setting them up can be overcome.

A missed opportunity?

While the amended EIR has almost doubled in size, growing from 47 Articles to 92, a number of key issues remain unaddressed. Those responding to the initial consultation recommended that three provisions – the current Article 5 (*rights in rem*), Article 6 (*set-off*) and Article 13 (*detrimental acts*) – could usefully be clarified to make them operate more effectively, but these concerns have not been addressed. This seems a missed opportunity to address areas of uncertainty, which may now have to be referred to the European Court of Justice for determination.

But not the end of the story…

While the current round of amendments to the EIR has effectively been completed, aspects of it will remain subject to ongoing review. Article 90 of the EIR, for example, requires the Commission to prepare reports on "the issue of abusive forum shopping" within three years and on "the application of group co-ordination proceedings" within five years, the latter being "accompanied where necessary by a proposal for adaptation of this Regulation".

In addition, while the EIR sets out a framework for dealing with cross-border insolvencies, other initiatives are currently under way to harmonise substantive insolvency legislation. One recent example is the Commission's March 2014 recommendation, encouraging member states to incorporate proposed minimum standards into their domestic insolvency legislation to assist "the efficient restructuring of viable enterprises in financial difficulty" and to give "honest entrepreneurs a second chance". The push for further change continues…

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