The European Insolvency Regulation: Amendment proposals from the European Commission and the European Parliament – What next?

Chris Laughton, who sits on a UK government advisory committee on the Regulation, reports on the most recent news on the European Commission's proposals

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Proposals and Amendments

The Commission's proposals issued on 12 December 2012 were broadly welcomed throughout the EU. The Parliament's JURI committee (Committee on Legal Affairs) under the chairmanship of Klaus-Heiner Lehne, MEP for North Rhine-Westphalia and a partner in Taylor Wessing, drafted 62 amendments and 28 supplemental amendments in September and October 2013. These were reduced to 69 in the report submitted to the Parliament on 20 December 2013.

All but one of those amendments were adopted by the Parliament on 5 February 2014.

All the proposals are now being considered by the European Council, which is thought on balance to favour the Commission's approach.

Rejected Parliamentary Amendment

The notable rejection was of a change to the definition of "court". As the proposals now stand, in Article 2c

> '*"court" means* **in all articles except Article 3b(2)** *the judicial body or any other competent body of a Member State empowered to open insolvency proceedings, to confirm such opening or to take decisions in the course of such proceedings' [emphasis added].*

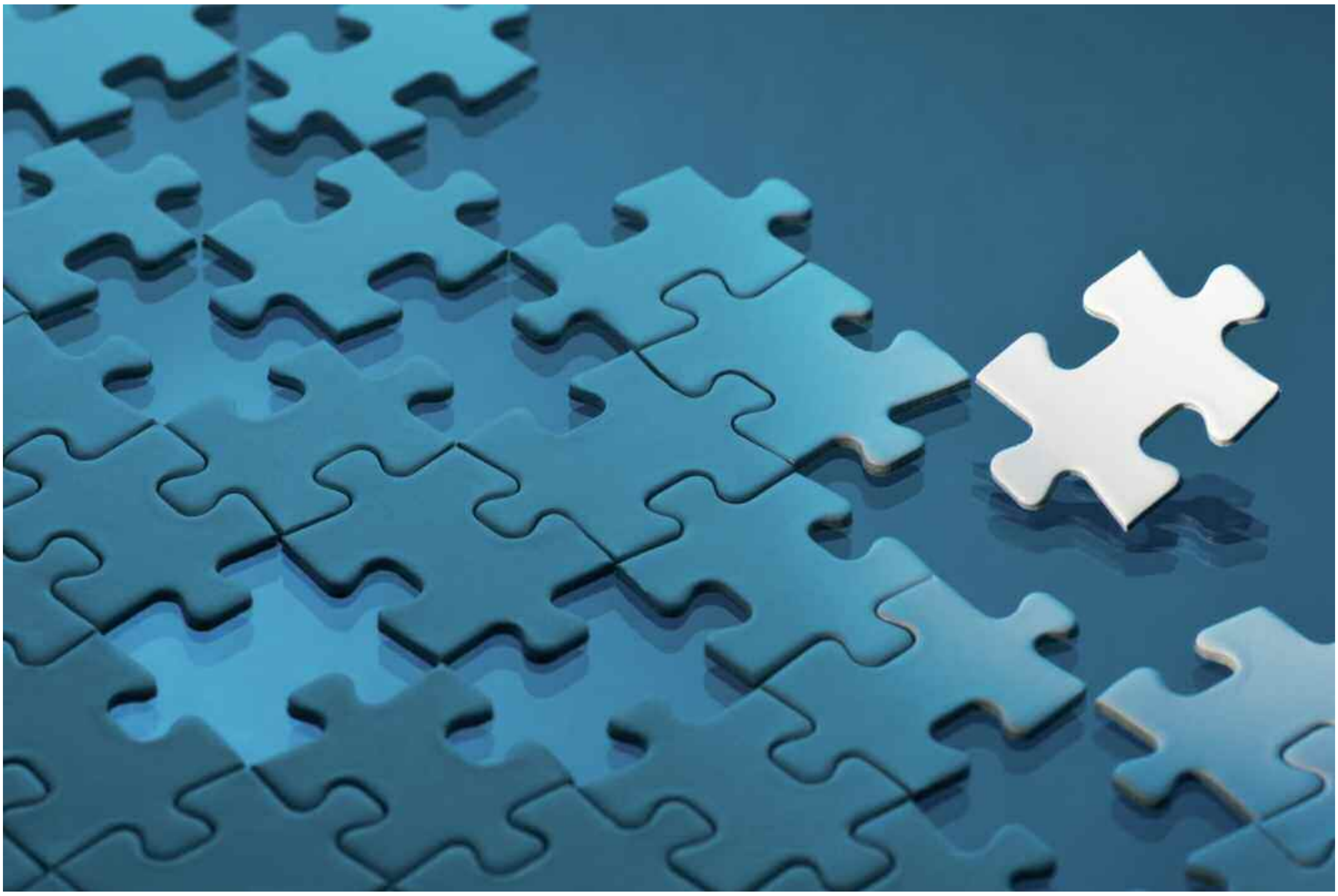
The Commission's proposals add the emphasised words to the existing Regulation to seek to clarify another Commission proposal (Article 3b(2)) requiring the liquidator to examine the COMI and specify the grounds for jurisdiction in out of court proceedings. However, as the Parliament's adopted amendments delete that requirement, the additional words may be otiose. If the liquidator is not to examine the COMI and specify the grounds for jurisdiction, they will fail to be examined and specified by the competent body opening the proceedings. That may not be satisfactory and it seems that – subject to the liquidator being appropriately accountable and demonstrably competent – the possibility of such examination of COMI by the liquidator may be allowed for.

The JURI committee's proposed amendment had been not only to delete the Commission's additional words in the definition, but also to delete the words "or any other competent body of a Member State". This would have taken out of court proceedings such as – amongst others – creditors voluntary liquidations and most administrations (which together constitute most corporate insolvencies in the UK), outside the Regulation and was clearly unacceptable to the Parliament.

There is likely to be further debate of this issue, but so long also as out of court proceedings are subject ultimately to court control (for example through an appeal against an insolvency practitioner's decisions), fears, which may have arisen through misunderstanding, of creditors' interests being prejudiced should be allayed.

Residual Parliamentary Amendments

Not entirely unsurprisingly for a legislative process, we now have a mish-mash of proposals. Some of the Parliament's amendments further cohesive development of the Regulation, but in several areas more amendment will be required.



Scope

Viability

A theoretical and potentially impractical emphasis was revealed in the Recitals to the proposals by the Parliament's stated intention, in the context of helping sound companies to survive and giving a second chance to entrepreneurs, of promoting the rescue of debtors *in severe financial distress*, rather than those that are *economically viable*.

Some debtors that are not viable need to fail.

Purpose

Limiting in Article 1(1) the scope of proceedings subject to the Regulation to exclude those based on a law relating to adjustment of debt and including only those based on a law relating to insolvency seems helpful from a UK perspective, because it would appear to remove any possibility of Companies Act Schemes of Arrangement being in Annex A.

However, including insolvency-related proceedings for the purpose of avoidance of liquidation in place of those for the purpose of rescue seems to be a retrograde step.

It is clearly sensible for a Regulation promoting business rescue to extend beyond insolvency, but, given the variety of existing procedures – especially hybrid and pre-insolvency procedures – across the EU, Member States are likely to want to retain the discretion to include their qualifying procedures in Annexe A.

It is important that proceedings falling under the Regulation are insolvency, pre-insolvency or hybrid, and not other types of proceedings not necessarily related to insolvency.

Debtor in Possession

The Commission's proposals sought to include debtor in possession proceedings by including the debtor in possession in the definition of liquidator (which is therefore extended beyond those persons and bodies listed in Annex C) in cases not involving the appointment of, or the transfer of the debtor's powers to, a liquidator. The Parliament's amendments instead specify (Article 2ba) that

> *"'debtor in possession' means a debtor in respect of whom insolvency proceedings have been opened which do not involve the complete transfer of the rights and duties to administer the debtor's assets to an insolvency representative and where the debtor therefore remains at least partially in control of his assets and affairs".*

This appears to limit the powers of debtors in possession (for example in relation to publication or the opening of secondary proceedings (Article 21 and 29). Such apparently unintended consequences may make further amendment

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necessary. It also appears to include, for example, UK voluntary arrangements within debtor in possession proceedings.

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Jurisdiction

Recital 10

The Commission’s proposal requiring the liquidator to examine and specify the COMI in out of court proceedings was controversial, but the JURI committee went too far in seeking to do away with out of court proceedings altogether. The Commission’s proposed amendment to Recital 10 (which sought to extend the scope of the Regulation to pre-insolvency proceedings – a concept endorsed by the JURI committee) was said by the JURI committee to have required deletion by Parliamentary amendment to align with deletion of Article 3b(2). That might have made sense if the Parliamentary amendment had deleted Article 10 altogether, but it doesn’t – Article 10 is left to stand as currently worded. Logically, given the Parliament’s rejection of the attempt to do away with out of court proceedings, Parliamentary Amendment 4 must be reversed.

Opening of Proceedings

In a purported attempt at alignment with Article 2d a Parliamentary amendment to Article 3(3) defines secondary proceedings by reference to the time of a judgment opening main proceedings being delivered. The time of opening insolvency proceedings is critical. Introducing an additional concept – the delivery of a judgment – given the variety of opening mechanisms in different Member States adds significant legal uncertainty. Although the delivery of a judgment may be thought to mean something akin to the pronouncement of the court’s decision to open proceedings, there could easily be a decision to open proceedings that is followed at a later stage by delivery of a judgment. Further amendment is required.

Three Month Relation Back Period

A significant Parliamentary amendment has been the introduction of an apparently arbitrary 3-month relation back period for the determination of COMI (Article 3(1)) and for the identification of an establishment (Article 2(g)), apparently in an attempt to avoid forum shopping. Regrettably, it ignores the fundamental principle of freedom of movement, which enables a debtor to move its COMI and should not be restricted if to do so does not harm the interests of creditors generally (“good” forum shopping); and it fails to address “bad” forum shopping, where the COMI-shift is harmful to creditors generally.

There are anomalies between the two provisions – “at least three months prior to the opening of insolvency proceedings” for COMI, compared to “in the three months prior to the request for the opening of the main insolvency proceedings” for establishment. Worse, each provision introduces significant legal uncertainty, not least because they seek to define the applicability of the Regulation by reference to a future event.

“At least three months prior” means at any time three months or more before. The provision as amended would allow the COMI to be determined as the place where the debtor had conducted the administration of his interests on a regular basis up to, say, four months prior to the opening of insolvency proceedings. It could at the same time allow the COMI to be determined as the place where the debtor had conducted the administration of his interests on a regular basis between four and three months prior to the opening of insolvency proceedings. This is untenable.

“In the three months prior” means at any time during the preceding three months. This would allow secondary proceedings in relation to a single establishment to be opened in more than one Member State if the establishment had moved from one Member State to another during the three months before the request for opening main proceedings.

The current provisions, which the Commission did not seek to change, provide far more legal certainty in this respect and the amendment, which indiscriminately disadvantages debtors seeking to move between

Member States, should be reversed.

Challenge

The Parliamentary amendment to Article 3b(3) requires publicly available registers accessible free of charge via the internet and would need transitional arrangements to be made as the registers are unlikely to be universally available at the time the revisions to the Regulation are brought into force. Also, it would be helpful to clarify, since the challenge to the decision to open main proceedings would be on grounds of international jurisdiction, that such a challenge would have to be in the courts of the State of the opening of proceedings.

Secondary Proceedings

Trustee to Enforce the Rights of Local Creditors

The Commission having introduced a proposal to amend Article 18 to allow the liquidator in main proceedings to give an enforceable and binding undertaking to recognise the distribution and priority rights that local creditors would have had if secondary proceedings had been opened, a Parliamentary amendment proposes (Article 29a(2c)) that the court seised of a request to open secondary proceedings may appoint a trustee with limited powers (including petitioning the court in the main proceedings) to ensure that the undertaking is duly performed and to "participate in its implementation". This additional layer of non-judicial supervision not only adds cost and complexity, but flies in the face of the principle that all officeholders in main and secondary proceedings act in the interests of all the debtor's creditors (to the extent that they are recognised in each officeholder's jurisdiction). Any undertaking given to a group of creditors (for example from a jurisdiction that may be susceptible to the opening of secondary proceedings in relation to the debtor) in the interests of creditors generally will be enforceable through the court that opened the main proceedings. This would be likely to be at significantly lower cost to the estates than through the additional involvement of the secondary jurisdiction court and a trustee.

Time Limits for Challenge

The Parliamentary amendment limiting the period for the main proceedings insolvency representative to challenge the opening of secondary proceedings to one week (Article 29a(4)) results in a period that is unnecessarily short.

Cooperation

A Parliamentary amendment restricts cooperation between insolvency representatives concerning the same debtor (Article 31(1)). Such cooperation should be restricted only by the requirement not to be incompatible with the rules applicable to each of the proceedings. Requiring it to be "appropriate in order to facilitate the effective administration of the proceedings" and not to "entail any conflict of interests" appears innocuous, but will create scope for disagreement and will limit cooperation, which is highly undesirable.

It is similarly contrary to cooperation principles to include the restriction "appropriate in order to facilitate the effective administration of the proceedings" in court to court cooperation (Article 31a(1) and in cooperation between insolvency representatives and courts (Article 31b(1a)). In the latter the additional restriction not to "entail any conflict of interests" should also be removed.

Groups

Group Coordination Proceedings

The introduction of group coordination proceedings is another controversy introduced by the JURI committee, allegedly to strengthen the restructuring of a group and/or its members without being binding on the individual proceedings. There is no readily available evidence about the experience of the members of the JURI committee in international group insolvencies, but it is a little surprising – and very definitely not in the interests of creditors – that the legislature should seek to introduce such a significant additional layer of cost and unnecessary complexity.

Most Crucial Functions

The complexity and risk of costly argument in different courts is highlighted by the amendment proposals (Article 42da) requiring courts to assess "the most crucial functions" on various bases such as economic significance and the taking and enforcement of decisions of strategic relevance, with the proviso that a race to the courts could prevail if that determination is too difficult! This does nothing to encourage the cooperation and communication on which the Regulation has been based and which is widely recognised throughout the insolvency profession, the relevant judiciary and academia as central to international coordination of insolvency proceedings.

Next Steps

During the next few months all these issues, and others, will continue to be considered and debated by the European Council (the governments of the Member States), which will then seek to agree with the Parliament (the MEPs) upon the proposed legislation. Progress is understood to be being made, but there is much work to be done by the Council. Various groups are endeavouring to steer the legislature to a constructive and workable conclusion to this exercise, but it seems unlikely that there will be an early meeting of minds between the Council and the Parliament. This will lead to further rounds of proposals. The likely timing of any implementation is not yet clear, but my own guess is not before 2016.

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