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The recast EC Insolvency Regulation – progress so far and next steps

INTRODUCTION

Council Regulation (EC) 1346/2000 on insolvency proceedings ('**ECIR**') came into force in all member states except Denmark in May 2002. Its principal purpose is to improve the efficiency and effectiveness of insolvency proceedings with a cross-border dimension. It aims to do this by establishing a framework, based on the principles of mutual recognition and enforcement, within which the different insolvency regimes of individual member states can interact more effectively. Three years ago a review of its content was begun. This stems from a requirement set out in Article 46 of the ECIR that, no later than 1 June 2012, and every five years thereafter, the European Commission ('**Commission**') must present a report on the application of the ECIR to the European Parliament ('**Parliament**'), the Council of the European Union and the Economic and Social Committee. The report should be accompanied, if need be, by a proposal for adaptation. In the event, the Commission chose to institute a consultation rather than a report, from which the current amendments have been formulated. The consultation noted that, after ten years in operation, important developments in national insolvency law and considerable changes in the economic and political environment required a reappraisal of the ECIR. The Commission's proposals for a regulation amending the ECIR, presented in December 2012, were designed to address this and the proposed changes affecting corporate entities reflect the gradual shift from 'traditional' insolvency proceedings, aimed at liquidating the company, to restructuring and pre-insolvency processes, intended to rescue it.

The proposed changes were duly considered by the Parliament, which responded in the autumn of 2013 with a draft report proposing substantial amendments. After protracted discussions, the Parliament approved, by an overwhelming majority, an amended version of the proposals on 5 February 2014. Member states in the Council (whose approval of the proposal is required for it to become law) also reached agreement on the draft law, both among themselves and with the Parliament, and consensus between the Commission, Council and Parliament was finally reached at the end of 2014. Since then, a draft of the recast ECIR has been formally adopted by the Council in March 2015 and approval from the Parliament is expected to follow without further substantive debate in May or June 2015.

This chapter considers the key changes anticipated by the recast ECIR as they will affect corporate insolvencies (the references to recitals and articles are to those found in the version dated 26 February 2015). It also briefly examines the amendment intended to clarify the relationship between the ECIR and Council Regulation (EC) No 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the '**Judgments Regulation**').

SCOPE

The scope of the ECIR is to be extended to pre-insolvency and rescue proceedings, including where the debtor remains in possession. A debtor-in-possession for the purposes of the revised ECIR is a debtor in respect of which insolvency proceedings have been opened that do not necessarily involve the appointment of an insolvency practitioner or the complete transfer of the rights and duties to administer the debtor's assets to an insolvency practitioner and where, therefore, the debtor remains totally or at least partly in control of its assets and affairs. The proceedings to which the ECIR will apply are listed exhaustively in Annex A to the ECIR. It will not apply to proceedings that are based on general company law and that are not designed exclusively for insolvency situations. Thus, for example, UK schemes of arrangement, although they can be used in an insolvency and restructuring context, are not included in Annex A as they derive from company law.

COMI AND ESTABLISHMENT

The ECIR currently provides that a company's centre of main interests ('**COMI**') should correspond to the place where it conducts the 'administration of its interests' on a regular basis, and is therefore objectively ascertainable by third parties. There is a rebuttable presumption that, in the case of a company or other legal person, the COMI is in the same place as the registered office. Recital (4) states that a COMI shift to another member state in an attempt to find a more suitable jurisdiction in the EU in which to file for insolvency or to effect a restructuring (known as 'forum shopping') is to be discouraged. The revised ECIR impliedly acknowledges the difference between 'good' forum shopping (where creditors are not disadvantaged) and 'bad' forum shopping, which are carried out for fraudulent or abusive purposes, and introduces safeguards to prevent the latter. The safeguards include disapplying the presumption that a company's COMI is in the place of its registered office, in cases where the company has relocated its registered office in the three months before requesting the opening of insolvency proceedings. This is unlikely to have a significant impact on sophisticated restructurings that lack malevolent intent, as a well-advised company that decides to shift its COMI for the purposes of entering an insolvency process will not necessarily change its registered office and is likely to take sufficient steps to ensure that it is able to demonstrate that it has successfully relocated its COMI. The revised ECIR also emphasises the rebuttable nature of the presumption as to the location of COMI, and requires the court (or insolvency practitioner, in the case of out-of-court proceedings) to assess carefully whether the COMI is genuinely located in the member state in question, taking into account what is ascertainable by third parties. This is in line with the approach the UK courts already tend to take.

The definition of 'establishment', which forms part of the test for opening secondary proceedings, has also been amended, and now includes the express requirement that an establishment will exist if it existed three months prior to the opening of main proceedings.

EXTENDING THE SCOPE OF SECONDARY PROCEEDINGS

At present, and in line with the original aims of the ECIR, secondary proceedings must be winding-up proceedings, as opposed to reorganisation or restructuring proceedings. However, in response to concerns that the opening of secondary proceedings may, in some cases, have an adverse effect on the main proceedings (for example, where the preferred strategy of the insolvency practitioner in the main proceedings is to continue trading, obtain funding, and enter into a sale process on a group-wide basis), this restriction has been abolished. Thus, when the revised ECIR comes into force, any appropriate insolvency proceedings may be opened as secondary proceedings. This will result in a greater number of proceedings benefiting from automatic recognition in other EU member states and will favour greater use of debtor-in-possession rescue processes that are finding favour under new insolvency legislation being enacted in some member states.

INTRODUCTION OF 'SYNTHETIC' SECONDARY PROCEEDINGS

Article 36 of the revised ECIR permits 'synthetic' or 'virtual' secondary proceedings. Such proceedings avoid the need to open secondary proceedings by allowing the insolvency practitioner in the main proceedings to give an undertaking that he will distribute the assets in the jurisdiction in which secondary proceedings could have been opened in accordance with the local laws of distribution and priority. This removes the need for local creditors to commence proceedings.

The undertaking must be approved by the known local creditors. Article 36 (5) provides that 'the rules on qualified majority and voting that apply to the adoption of restructuring plans under the law of the member state where secondary proceedings could have been opened shall also apply for the approval of the undertaking'. Recital (42) clarifies that, where there are different procedures for the adoption of restructuring plans under national law, member states should designate a specific procedure.

Where an undertaking has been approved, requests for the opening of secondary proceedings can only be made within 30 days of receipt of notice of the approval (Article 37 (2)) and the court shall, if the insolvency practitioner in the main proceedings requests, decline to open secondary proceedings if it is satisfied that the undertaking 'adequately protects the general interests of local creditors' (Article 38 (2)).

Virtual secondary proceedings have already been used, with the sanction of the court, in the context of UK administrations involving large multinational group companies and the proposed change may facilitate a wider uptake across Europe.

COOPERATION AND COMMUNICATION BETWEEN GROUP COMPANIES

The existing ECIR requires communication and cooperation between the insolvency office holder in the main proceedings and the liquidator in the secondary proceedings, subject to the rules applicable to those proceedings. These requirements have been enhanced and expanded in the revised ECIR; for example, in Article 41 (c) they extend to exploring the possibility of restructuring the debtor, and coordinating a restructuring plan where such a possibility does exist.

The revised ECIR also provides for cooperation between insolvency practitioners appointed to group companies, to the extent compatible with the rules applicable to each proceeding (Article 56). The types of cooperation envisaged include communicating relevant information, coordinating the administration and supervision of the affairs of group companies, and implementing coordinated restructuring plans. Similarly, Articles 57 and 58 provide for cooperation and coordination between courts involved in group insolvencies, and between insolvency practitioners and other courts. This includes the ability for courts to coordinate the appointment of insolvency practitioners, to communicate directly with each other or to request information or assistance directly from each other, provided that procedural rights of parties, and confidentiality of information, are respected. If a group restructuring plan is being coordinated, Article 60 allows the insolvency practitioner to request a stay of the realisation of assets in proceedings relating to another group member, again if compatible with the rules of the relevant proceeding.

COORDINATION OF GROUP PROCEEDINGS

Section 2 of the revised ECIR introduces a new concept of 'group coordination proceedings'. The procedure, set out in Articles 61 – 77, involves the appointment of a 'group coordinator' to oversee the coordination of the insolvency or restructuring across a group of companies and to facilitate a group coordination plan. Group coordination proceedings may be requested by any insolvency practitioner appointed to a group company but individual group members are free to opt out if they do not wish to participate. To do this, they are required by Article 64 to lodge an objection with the court in which the request to open group proceedings was made within 30 days of receipt of the notice of request. Article 69 provides that they can also ask to be included at a later stage if they originally opted out or if the company entered insolvency proceedings after the coordinator was appointed.

The coordinator must propose a group coordination plan setting out an integrated approach to the resolution of the group members' insolvencies. In particular, the plan may propose agreements between the insolvency practitioners of the group members and measures to rescue the group and/or settle intra-group disputes (Article 72). The coordinator may also request a stay of up to six months of the proceedings opened in respect of any group member who has not opted out, if necessary for the proper implementation of the plan.

Article 70 provides that all participating insolvency practitioners must consider the recommendations of the group coordinator and the content of the group coordination plan but are not obliged to follow them. The rules governing national insolvency proceedings are not themselves altered by the new procedure; therefore, the group coordination plans will need to be compatible with local laws and rules.

The revised ECIR also provides for enhanced cooperation between insolvency practitioners appointed to group companies where the group coordination procedure is not being used, to the extent compatible with the rules applicable to each proceeding.

The revisions are consistent with the trend towards encouraging more dialogue and cooperation between insolvency practitioners. This has already been attempted, with varying degrees of success, through the use of informal cross-border insolvency and restructuring protocols. However, the extent to which this focus on coordination and cooperation will succeed in practice remains to be seen and past cases have shown that, upon the failure of a group, some of the most difficult issues occasioning litigation are those between group companies.

INTERCONNECTED ELECTRONIC INSOLVENCY REGISTER

In order to improve the provision of information to relevant creditors and courts and to prevent the opening of parallel proceedings, member states will be required to publish information on insolvency cases in a publicly accessible electronic register. The national registers will be interconnected at EU level so that there is a single, central access point. A pilot project, interconnecting the insolvency registers of seven member states, not including the UK, was launched in July 2014. The period for implementing interconnection is expected to be four years from the date the revised ECIR comes into force.

RELATIONSHIP BETWEEN THE ECIR AND THE JUDGMENTS REGULATION

Recital (7) to the revised text of the ECIR acknowledges the difficulties that have been encountered by the courts when determining whether their jurisdiction should derive from the ECIR or the Judgments Regulation. The two regulations are intended to be mutually exclusive while providing a unified system between them for the recognition and enforcement of judgments to which they apply respectively. The original wording in the ECIR provides that insolvency proceedings relating to the winding-up of insolvent companies or other legal persons,

judicial arrangements, compositions and analogous proceedings are excluded from the scope of the Judgments Regulation. In an apparent attempt to clarify the position, the recital now contains additional wording stating that such proceedings should be covered by the ECIR, whose interpretation 'should as much as possible avoid regulatory loopholes between the two instruments', and the mere fact that a national procedure is not listed in Annex A to the ECIR should not imply that the procedure is covered by the Judgments Regulation. This supports the earlier analysis found in the Schlosser Report on the Brussels Convention (superseded by the Judgments Regulation), which states that the Brussels Convention and the intended Bankruptcy Convention (which formed the basis of the ECIR) were 'intended to dovetail almost completely with each other'. This analysis was echoed by Virgos and Garcimartin in their commentary on the ECIR.

EFFECTIVENESS OF THE REFORMS

In general, the reform package appears sensible and moderate. The decision to expand the scope of the ECIR to include more restructuring and pre-insolvency processes, while ensuring that procedures such as schemes of arrangement (which sit within UK company law but may be used in a restructuring context) are not inadvertently included seems to strike an appropriate balance.

The extent to which the 'group coordination proceedings', which form an entirely new chapter in the revised ECIR, will be effective remains to be seen. In addition to adding another layer of procedure and expense (with costs only payable at the end of the process), there is a risk that the proceedings will present a number of practical hurdles. The fact that individual insolvency practitioners are able to opt out of the plan at any stage if they do not agree with the proposals lends uncertainty and unpredictability to the process. Similarly, the ability for the coordinator to have individual group members' proceedings stayed for up to six months while group coordination proceedings are afoot is likely to act as a deterrent to supporting a rescue proposal. In addition, as the group coordination plan will not be binding, the process may lack teeth. However, if it facilitates simpler cross-border cooperation in the circumstances where insolvency practitioners would currently seek to pursue it on a voluntary basis, then it may prove helpful and more effective than the cross-border protocols that are currently relied upon. If it is used on a wide enough scale, it is possible that, in the long term, it may pave the way for incremental changes to national laws that would make cross-border cooperation easier.

NEXT STEPS...

Once the revised text has been considered by the EU Parliament's Legal Affairs Committee and Plenary, probably towards the summer of 2015, it is likely to be adopted. It will then be published in the Official Journal and will enter into force 20 days later and, pursuant to Article 92, the revised text will, for the most part, be applicable 24 months later (with longer time periods in place for establishing insolvency registers). Thus, according to the projected timetable, the ECIR in its amended form will apply to insolvency proceedings commencing in the middle months of 2017.

The recitals to the revised ECIR indicate that at the next review it will be necessary to identify further measures to improve the preferential rights of employees at European level. The Commission is also due to report on the application of the group coordination proceedings five years after the revised ECIR has entered into force, accompanied by a proposal for adaptation, if required.

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