INSOL INTERNATIONAL

FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

Module 2B Guidance Text

The European Insolvency Regulation

2023 / 2024

CONTENTS

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IN INTERNATIONAL INSOLVENCY LAW

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1. INTRODUCTION TO THE EUROPEAN INSOLVENCY REGULATION

Welcome to **Module 2B**, dealing with the **European Insolvency Regulation**. This Module is one of the compulsory module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of the European Insolvency Regulation;
- a relatively detailed overview of the different parts of the European Insolvency Regulation; and
- a relatively detailed overview of the practicalities in applying the European Insolvency Regulation as illustrated by appropriate case law.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please Note

If you have selected this module as one of your **compulsory modules**, the formal assessment for this module must be submitted by **11 pm (23:00) GMT on 1 March 2024**.

If you have selected this module as one of your **elective modules**, you have a choice as to when you must submit the assessment. You may either submit the assessment by **11 pm (23:00) GMT on 1 March 2024**, or by **11 pm (23:00) BST (GMT +1) on 31 July 2024**. However, if you elect to submit your assessment on 1 March 2024, you may not submit the assessment again on 31 July 2024 (for example, to obtain a higher mark).

Please consult the Foundation Certificate in International Insolvency Law web pages for both the assessment and the instructions for submitting the assessment via the course web pages. Please note that **no extensions** for the submission of assessments beyond 1 March 2024 (or 31 July 2024, depending on whether you have taken this module as a compulsory or elective module) will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of the European Insolvency Regulation (EIR):

- the background and historical development of the EIR;
- the purpose of the EIR;
- the general provisions of the EIR;
- scope and framework of the EIR;
- rules on applicable law;
- recognition and enforcement of insolvency and related judgments under the EIR;
- creditors' rights and protection under the EIR;
- communication and co-operation in European insolvency cases;
- prevention of secondary proceedings under the EIR; and
- insolvency of groups of companies under the EIR.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of the EIR; and
- be able to answer questions based on a set of facts relating to the EIR.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. RECOMMENDED READING (NOT COMPULSORY)

- B Wessels and I Kokorin, *European Union Regulation on Insolvency Proceedings: An Introductory Analysis*, American Bankruptcy Institute, 4th edition, 2018.
- R Bork and K van Zwieten (eds), *Commentary on the European Insolvency Regulation*, Oxford University Press, 2nd edition, 2022

- R Bork and R Mangano, *European Cross-Border Insolvency Law*, Oxford University Press, 2016.

4. THE EUROPEAN INSOLVENCY REGULATION: BACKGROUND AND HISTORICAL DEVELOPMENT

The object of this module is the regulation of insolvency proceedings at the level of the European Union (EU). The major legal instrument in this area is the currently applicable Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (EIR Recast).[1] It entered into legal force on 26 June 2017. The term "recast" expresses that this regulation is in its core a revision of a previous regulation on insolvency proceedings, which entered into force in 2002, to better address the needs of the growing cross-border investment and trade. We will discuss some of the most important developments in this area and several provisions of the EIR Recast in the sections that follow. This section looks at the historical developments leading to the adoption of the text of EIR Recast in 2015.

Four decades ago, the EU[2] lacked any law addressing issues of cross-border insolvencies. This meant that each country within the Union followed its own national provisions in deciding, *inter alia*, whether it had jurisdiction to open insolvency proceedings, which law should govern such proceedings, whether an insolvency proceeding originating from another EU Member State shall be recognised and what the consequences of such recognition should be. This regulatory incoherence harmed legal certainty for the debtors conducting business across various Member States, as well as their creditors, who every time had to exercise due diligence to calculate the insolvency-related risks. The discrepancy in national laws also contributed to abuses and inefficiencies. Absent any mandatory rules on automatic recognition of insolvency proceedings, commencement of such proceedings in one Member State would not necessarily stop (foreign) creditors from enforcing their claims in other Member States if their debtor had assets located there. As a result, the integrity of the insolvency estate could be breached and the principle of *paritas creditorum* (equality of creditors) violated. Besides, several parallel proceedings against the same debtor could be opened, which led to the rise of transaction costs, as well as difficulties in administering and selling the insolvency estate as a single economic unit (going concern sale), or restructuring the debtor's business in a centralised manner.

4.1 Early attempts of harmonisation, 1960s - 1980s

In contrast to insolvency, the matters covering jurisdiction and the enforcement of judgments in civil and commercial matters became harmonised with the adoption of the Brussels Convention

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1 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), available at: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32015R0848.

2 The European Union was preceded by the EC (European Community). The EC was dissolved into the European Union by the Treaty of Lisbon in 2009, with the EU becoming the legal successor to the Community. The term EU aims to express the strengthening of a geographical area of (presently) 27 Member States, all forming one internal market.

in 1968[3] (in force from 1 February 1973, subsequently replaced by the Brussels I Regulation).[4] As follows from the preamble to this convention, it was adopted by Member States "to determine the international jurisdiction of their courts, to facilitate recognition and to introduce an expeditious procedure for securing the enforcement of judgments, authentic instruments and court settlements". However, as clearly stated in Article 1 of the Convention, it did not apply to "bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings". The reason for such an exclusion is simple. Because of the special problems presented by insolvency, it was decided that a separate bankruptcy convention was necessary to ensure market efficiency at the European level.[5]

Work on the drafting of such convention commenced in 1963 and resulted in the publication of the Preliminary Draft Convention in 1970 (1970 Convention).[6] The 1970 Convention was ambitious and provided for a single set of insolvency proceedings across the Union (principle of "unity") encompassing all debtor's assets (principle of "universality"). Thus, under the 1970 Convention, the initiation of insolvency proceedings in one Member State would prevent the opening of insolvency proceedings in all other Member States. The exclusive international jurisdiction was linked to the debtor's "centre of administration", described as the "place where the debtor usually administers his main interests". It was presumed that such a place coincided with the jurisdiction of the debtor's registered office. As to the applicable law, the 1970 Convention prescribed that the law of the insolvency forum (the law of the country the court of which would open insolvency proceedings, or *lex concursus*) should govern insolvency proceedings. This law would determine conditions for the opening of proceedings, their conduct and closure, as well as effects on the debtor, creditors and third parties. However, the primacy of the *lex concursus* of the insolvency forum was far from absolute. As a compromise, the 1970 Convention provided for a range of alternative rules to protect the interests of particular types of creditors (against the effect of the *lex concursus*). For instance, the rights of preferential creditors (security interests, privileges and priority claims) remained to be regulated by local preference (ranking) rules, effectively leading to the break-up of the insolvency estate into national "sub-estates". Additionally, uniform substantive rules were proposed in such matters as transaction avoidance, various aspects of set-off, reservation of title arrangements and directors' liability.

The adoption of the 1970 Convention was complicated by the accession to the European Economic Community (EEC) of three states in 1973, the United Kingdom (UK) and Ireland – countries with distinct common law systems, and Denmark – part of the Scandinavian legal

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3 1968 Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters (Consolidated version CF 498Y0126(01)).

4 Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. This regulation has been repealed by the Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. The latter is commonly referred to as Brussels I Recast.

5 For instance, one debtor may have many creditors located in several countries: which country's court would have international jurisdiction? Would recognition of an insolvency judgement have the same effect in all countries?

6 EEC Preliminary Draft Convention on Bankruptcy, Winding-up, Arrangements, Compositions, and Similar Proceedings (1970).

tradition.[7] Following years of negotiations, a new Draft Convention was finalised in 1980 and published in a 1982 edition of the Bulletin of the European Communities (1980 Convention).[8] Unlike the 1970 Convention, the 1980 draft lacked major provisions related to substantive harmonisation of insolvency laws, including rules on transactions avoidance and directors' liability. However, it kept the "unity" and "universality" principles at its core.[9] States were not allowed to open parallel insolvency proceedings, but local interests remained protected by the application of national insolvency rules with respect to assets located in each Member State. So the approach of forming "sub-estates" was inherited from the 1970 Convention. This resulted in a perplexing and cumbersome arrangement. According to Fletcher, "[t]he sheer complexity of the exercise was truly horrifying, and would have resulted in much wasteful expenditure of administrative resources".[10]

After the review by the EC Council Working Party lasting from 1982 until 1985, the work on the 1980 Convention was suspended for lack of sufficient consensus.

4.2 Insolvency harmonisation attempts of the 1990s

Meanwhile, the leadership in the development of an international insolvency instrument passed to the Council of Europe. The Council of Europe and the EU share the same fundamental values – human rights, democracy and the rule of law – but are separate organisations which perform different, yet complementary, roles.[11]

In the late 1980s, the Council of Europe had begun its own project in the area of international insolvency law, which resulted in the European Convention on Certain International Aspects of Bankruptcy, signed in Istanbul on 5 June 1990 (Istanbul Convention).[12] The Istanbul Convention was drafted by a committee of experts subordinate to the European Committee on Legal Co-operation. It was signed by eight countries (Luxemburg, Turkey, Italy, Greece, Germany, France, Cyprus and Belgium), but ratified only by Cyprus. It never entered into force, as this would have required ratification by at least three countries. Nevertheless, it is important to highlight the major differences between the Istanbul Convention and the documents mentioned in the previous section.

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7 The EU, since its inception, went through several expansions, to include new states as Member States. In 1973 the first expansion took place.

8 Draft Convention on bankruptcy, winding-up, arrangements, compositions and similar proceedings. Report on the draft Convention. Bulletin of the European Communities, Supplement 2/82 (1982), available at http://aei.pitt.edu/5480/1/5480.pdf.

9 "Unity" means a single set of insolvency proceedings controlled by one insolvency forum. "Universality" means that insolvency proceedings have a global scope and are aimed at encompassing all the debtor's assets. The two concepts are closely linked to each other, but are not synonymous.

10 I F Fletcher, "Historical Overview: The Drafting of the Regulation and its Precursors", in G Moss, I F Fletcher, S Isaacs (eds), *Moss, Fletcher and Isaacs on the EU Regulation on insolvency proceedings*, Oxford University Press, 3rd ed, 2016.

11 As opposed to the EU with its 28 members, the Council of Europe has 47 members, including Russia, Turkey, Georgia and Azerbaijan.

12 European Convention on Certain International Aspects of Bankruptcy, Istanbul, 5.VI.1990, available at https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=090000168007b3d0.

According to its preamble, the Istanbul Convention aimed at achieving a minimum of legal co-operation by dealing with certain international aspects of bankruptcy. Similarly to the 1970 and 1980 Conventions, it mandated that the courts or other authorities of a state in which the debtor had the centre of his main interests shall be considered as being competent for opening the bankruptcy (Article 4). For companies and legal persons, the place of the registered office was presumed to be the centre of their main interests. However, the Istanbul Convention did not go as far in harmonising insolvency rules and "centralising" insolvency proceedings.

Firstly, it authorised the opening of other (secondary) proceedings in states in whose territory the debtor had an establishment (Article 17). Thus, the Istanbul Convention effectively abandoned the unity model (one single proceeding), prescribed by the preceding Conventions, in favour of the plurality model (several proceedings against the same debtor). Secondly, its Article 40 offered states an opportunity to make reservations with regard to its Chapter II (entitled "Exercise of certain powers of the liquidator") and Chapter III (entitled "Secondary bankruptcies") – some of the most significant provisions of the Istanbul Convention. By opting-out of Chapter II, a state would be free to refuse the exercise of the powers of a foreign liquidator and shield the debtor's assets located within its territory from such a liquidator. With reservation on Chapter III, a state could refuse to treat its insolvency proceedings as secondary, leading to duplication (plurality) of unco-ordinated proceedings. In other words, the Istanbul Convention allowed for different rules to apply in different states, which could have evidently resulted in a substantial hindrance to its effective and harmonised application. While the EEC Conventions were regarded by some commentators as over-ambitious, the Istanbul Convention was clearly not ambitious enough. This is understandable, considering the drastically different insolvency rules of the Council of Europe member states and the resulting difficulty of finding a consensus. Notwithstanding, the text of the 1990 Istanbul Convention remains important since it introduced more flexibility into the underlying principles of unity and universality.[13]

By the time the Istanbul Convention was released, a working group had been convened under the auspices of the EEC and chaired by a German lawyer, Dr Manfred Balz. By late 1995, this working group prepared the text of the European Union Convention on Insolvency Proceedings (EU Convention).[14] The EU Convention was accompanied by an authoritative explanatory report drafted by Professor Miguel Virgós and Etienne Schmit (Virgós-Schmit Report). Both the EU Convention and the Virgós-Schmit Report played a crucial role in the formation of the modern EU approaches towards international insolvency law. In particular, the EU Convention was for a large part almost *verbatim* adopted by the Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (EIR 2000),[15] the predecessor of the current EU regulation in the area of insolvency law (EIR Recast).

The EU Convention was a compromise between the "unity" and "universality" of the early EEC Conventions and the mode of plurality of the Istanbul Convention. Like the Istanbul Convention,

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[13] M Virgós and E Schmit, *Report on the Convention on Insolvency Proceedings*, Brussels, 3 May 1996, available at http://aei.pitt.edu/952/.

[14] *European Union Convention on Insolvency Proceedings*, 23 November 1995, available at http://aei.pitt.edu/2840/.

[15] Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, available at https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32000R1346.

the EU Convention enabled the opening of several insolvency proceedings against the same debtor. The insolvency proceeding at the place of the debtor's centre of main interests was called "main insolvency proceedings" and all rival proceedings opened at the place of the debtor's "establishment"[16] were characterised as "secondary". Main insolvency proceedings enjoyed universal scope, covering the totality of the debtor's assets in the whole geographic region of the EU. In contrast, secondary proceedings had a limited territorial scope. The effects of such proceedings were restricted to the assets situated in the territory of the state where these secondary insolvency proceedings had been opened.

Compared to the Istanbul Convention, the scheme of main and secondary proceedings, prescribed in the EU Convention, was much more structured, predictable and efficient. Under the latter, main proceedings enjoyed much stronger extra-territorial effects, allowing the extension of its *lex concursus* throughout the Union and granting the liquidator in main insolvency proceedings extensive powers to act in other Member States, including the power to remove unsecured assets. In this respect, the EU Convention was close to achieving centralisation (universality) of insolvency proceedings, envisaged in the 1970 / 1980 Conventions. With a few exceptions, the realisation and distribution of the debtor's assets were to be performed in a single forum under a single *lex concursus*. However, unlike the EEC Conventions, the EU Convention limited the universality and unity of (main) insolvency proceedings by permitting the opening of secondary proceedings. This was done to safeguard local interests and protect parties' expectations with regard to applicable insolvency law and its distributional rules. This is how the Virgós / Schmit Report (at paragraph 5) puts it:

> "The parallelism between the main proceedings (recognised elsewhere) and the secondary proceedings (enabling creditors in another Contracting State to invoke a local instrument in order to safeguard their interests) has made it possible to avoid over-rigid centralization, which hitherto appeared to be unacceptable to some Member States. Mandatory rules of coordination with the main proceedings guarantee the needs of unity in the Community."

Secondary proceedings divided (parcelled) the otherwise universal insolvency estate and created an exemption from the extension of *lex concursus* of main insolvency proceedings. The compromise between universality and territoriality (also sometimes referred to as modified or limited universalism, highlighting a universalist element at its core) received extensive support among the EU Member States (all of which except the UK signed it). The reasons for the UK's refusal to sign the EU Convention were purely political and did not concern its content.[17] Nevertheless, as the EU Convention required unanimity (Article 49), the failure by the UK to join it meant that it could not be adopted. In the meantime, the legal basis for the European

[16] "Establishment" was defined as "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods" (EIR 2000, Art 2(h)). The mere presence of assets (eg, just a bank account in another Member State) was not enough to create an establishment. The requirement of an establishment evidently limited the possibility of opening secondary proceedings, further supporting the primacy of one main proceeding.

[17] Two reasons are usually given. The first involves the protest of the UK against the refusal by the European Commission to lift the ban on the export of British beef to the European continent due to fears of mad cow disease. The second refers to the long-lasting dispute around the sovereignty of Gibraltar, a British overseas territory located at the southern end of the Iberian Peninsula at the entrance to the Mediterranean.

insolvency law had changed, as the European Union received the power to make provisions in the field of judicial co-operation in civil matters having cross border implications "in so far as necessary for the proper functioning of the internal market".[18] A few years after the failure of the EU Convention project, in 1999, by a joint initiative of Germany and Finland the adoption of the EU regulation was proposed, borrowing the majority of the provisions from the EU Convention. The change of the status from a convention to a regulation meant that there was no longer a need for ratification by all Member States. A regulation, as an EU-measure, directly binds Member States. It also had the effect of granting the European Court of Justice (ECJ), the judicial authority of the EU, with the power to interpret the legislative provisions to ensure uniformity in their application. Since 2009 the ECJ is called the Court of Justice of the European Union (CJEU).

On 29 May 2000, the European Council adopted the EIR 2000, which entered into force on 31 May 2002. It was binding in its entirety and directly applicable in all EU Member States with the exception of Denmark, which decided to opt out. It contained uniform rules on international jurisdiction, recognition of insolvency judgments, applicable law in insolvency matters and co-operation between insolvency practitioners (IPs). The adoption of the EIR 2000 signified the end of the long and somewhat irregular process of negotiating a binding EU instrument in the area of insolvency law. The rationale for its adoption is clearly stated in its recitals:

> "The activities of undertakings have more and more cross-border effects and are therefore increasingly being regulated by Community law. While the insolvency of such undertakings also affects the proper functioning of the internal market, there is a need for a Community act requiring coordination of the measures to be taken regarding an insolvent debtor's assets."[19]

Due to the fact that the EIR 2000 has been replaced by the new regulation, EIR 2015 (in force since 26 June 2017) and in light of multiple similarities between the two instruments, we will not study the EIR 2000 on a stand-alone basis. Instead, we will analyse the currently applicable the EIR 2015 and compare it with the EIR 2000, when necessary, to highlight the evolution of the European insolvency law.

Self-Assessment Exercise 1

Question 1

Name the main legal documents addressing insolvency issues at European level that preceded the adoption of the EIR 2000.

Question 2

What were the major differences in the approaches taken by each of these legal documents towards "unity" and "universality" of insolvency proceedings?

[18] Article 65 of the Treaty establishing the European Community.
[19] EIR 2000, Recital 3.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. THE EUROPEAN INSOLVENCY REGULATION: SCOPE AND FRAMEWORK

5.1 From EIR 2000 to EIR Recast

The EIR 2000 mentioned above became the first major binding instrument dealing with cross-border insolvencies in the EU. It took over 30 years for the European Union to agree on the harmonised regulation of cross-border insolvencies. The adoption of unified rules on such matters as international insolvency jurisdiction, applicable law and the recognition and enforcement of foreign insolvency judgments was determined by the need to improve the efficiency and effectiveness of insolvency proceedings having cross-border effect, ensure equal treatment of creditors (*paritas creditorum* principle) and protect legitimate expectations and the certainty of transactions.

The overall idea behind the EIR 2000 was similar to the one underpinning the EU Convention: modified universalism. Most importantly, it established that (main) insolvency proceedings could be initiated at the place of the debtor's centre of main interest, or COMI (Article 3(1) of the EIR 2000). Such proceedings had universal scope and encompassed all debtor's assets throughout the EU. The EIR 2000 also prescribed that the law of the state of the opening of insolvency proceedings, the *lex concursus*, determines the effects of such proceedings (Article 4 of the EIR 2000). This law governed, *inter alia*, the respective powers of the debtor and the liquidator, ranking of creditors' claims, the effects of insolvency proceedings on current contracts, and creditors' rights after the closure of insolvency proceedings. However, the system of the EIR 2000 was not purely universal, as it provided for the possibility of opening secondary (territorial) proceedings in a Member State where the debtor had an establishment, and for co-ordination between main and secondary proceedings. Unlike main insolvency proceedings, secondary proceedings could cover only assets falling under their limited geographical scope. Importantly, the EIR 2000 prescribed the automatic recognition of judgments opening insolvency proceedings and their effects (*lex concursus* to be applied in the country of recognition) as well as judgments concerning the course and closure of insolvency proceedings (Articles 16, 17 and 25 of the EIR 2000).

According to Article 46 of the EIR 2000, on no later than 1 June 2012 the European Commission had to present a report on the application of the EIR 2000 with a proposal for its adaptation (if necessary). Despite the general acknowledgement of the EIR 2000's success, after 15 years of its existence it had become clear that some of its provisions needed adjustment, while other developments required totally new rules. As a result, a new insolvency regulation was adopted in 2015, the EIR Recast. This new EIR Recast entered into force on 26 June 2017, replacing the original EIR 2000. Compared to the EIR 2000, the EIR 2015 responded to the need of insolvency practice (broadening scope to restructuring proceeding, stronger rules for co-operation between insolvency practitioners and courts, possibility of proceedings with regard to members

of the same group of companies), improvement of creditor information (interconnectivity of insolvency registers) as well as general modernisation of the legal rules (data-protection).

The EIR 2000 contained 33 Recitals, 47 Articles (in 5 Chapters) and three Annexes which formed an integral part of the old EU insolvency regime. The aim of the Annexes was to facilitate the application of the EIR 2000. They served to provide liquidators (in the EIR Recast renamed as "insolvency practitioners") and courts with a simple method to verify whether an insolvency proceeding in question, or a liquidator, fall within the scope of the EIR 2000. The text of the EIR Recast is twice as long as the original. It contains 89 Recitals, 92 Articles (in 7 Chapters) and four Annexes.

When interpreting provisions of the EIR Recast, regard must be had to the jurisprudence of the CJEU, an EU institution ensuring that European Union law is interpreted and applied in the same way in every Member State. Its authoritative interpretation of the EIR 2000 continues to be relevant for the application of the EIR Recast. This is why references to the CJEU case law are provided throughout this guidance text. For convenience, next to every case reference we indicate the European Case Law Identifier (ECLI), which has been developed to facilitate the correct and unequivocal citation of judgments from European and national courts. With ECLI one can easily find the text of the needed CJEU judgment in the Curia database at http://curia.europa.eu/juris. For judgments of the European Court of Human Rights (ECtHR), we provide an application number, which can be used to search for its case law at https://hudoc.echr.coe.int.

In addition to case law, references are made to the Virgós-Schmit report. Despite its non-binding status, judicial opinion and legal scholars consider this document to be of significant value and authority in interpreting both the EIR 2000 and the EIR Recast.

5.2 Scope of EIR Recast

Similarly to its predecessor, the EIR Recast is an EU instrument of private international law, governing (international) jurisdiction for opening insolvency proceedings and actions directly deriving from them. It also contains provisions on the recognition and enforcement of judgments issued in such proceedings and norms governing law applicable to insolvency matters (Recital 6 of the EIR Recast). Being an instrument of a (mostly) procedural nature, it co-exists with other European instruments. For example, the EIR Recast co-exists with, most notably, the already mentioned Regulation (EU) Number 1215/2012 of 12 December 2012 (Brussels I Recast), which deals with jurisdiction and recognition and enforcement of judgments in civil and commercial matters. According to Article 1(2)b of the Brussels I Recast, it does not apply to bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings. Such matters fall under the ambit of the EIR Recast, provided that conditions for its application are met. Thus, the EIR Recast presents a carve-out from the more general and extended scope of Brussels I Recast. It occupies a specific niche, dealing exclusively with matters of insolvency (or insolvency-related) law.

The EIR Recast also co-exists with the newly introduced Directive on Preventive Restructuring (2019/1023).[20] The Directive establishes a set of minimum standards for preventive restructuring procedures across Member States to enable debtors in financial difficulty to restructure at an early stage to avoid insolvency. Its aims are to (i) enhance the efficiency of early restructuring, (ii) improve the negotiation process, (iii) facilitate the continuation of the debtor's business while restructuring, (iv) prevent dissenting minority creditors and shareholders from jeopardising the restructuring effort, while also safeguarding their interests, and (v) reducing the costs and length of restructuring procedures.

5.2.1 Material scope

The EIR Recast regulates the opening and extraterritorial effects of insolvency proceedings in Member States, with the overall objective of ensuring the efficiency and effectiveness of these proceedings in cross-border cases. Article 1 of the EIR Recast, read in conjunction with Article 2 and Annex A, determines which national insolvency proceedings are subject to its regulation. In other words, these provisions determine which insolvency proceedings fall within the scope of the Regulation.

According to Article 1 of the EIR Recast (entitled "Scope"), the EIR Recast applies to public collective proceedings, including interim proceedings, which are based on laws relating to insolvency and in which, for the purposes of rescue, adjustment of debt, reorganisation or liquidation: (a) a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed, (b) the assets and affairs of a debtor are subject to control or supervision by a court, or (c) a temporary stay of individual enforcement proceedings is granted by a court or by operation of law, in order to allow for negotiations between the debtor and its creditors. The proceedings referred to in Article 1 are listed in Annex A to the EIR Recast.

First of all, it is evident from the wording of Article 1 that the EIR Recast extends not only to "traditional" liquidation-oriented procedures, but also to proceedings aiming at rescuing economically viable but financially distressed businesses, including those providing for a stay of individual creditors' actions for the sake of protecting the general body of creditors. It should, in particular, extend to proceedings which provide for restructuring of a debtor at a stage where there is only a likelihood of insolvency, and to proceedings which leave the debtor fully or partially in control of its assets and affairs (Recital 10). This emphasis on restructuring is a noticeable innovation of the EIR Recast, as the EIR 2000 mentioned only proceedings entailing partial or total divestment of a debtor and the appointment of a liquidator (see Article 1 of the EIR 2000). The broadened coverage of the new regulation is in line with a general European trend of promoting effective restructuring tools to maximise value for creditors, increase investment and job opportunities in the single market.[21]

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[20] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L1023]).

[21] See, eg, Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency

Secondly, the role of Annex A should be explained since proceedings not listed in Annex A do not fall within the scope of the EIR Recast. Annex A (entitled "Insolvency proceedings referred to in point (4) of Article 2") provides a list of names of insolvency proceedings for all 27 countries covered by the EIR Recast. No less than 112 procedures have been included in Annex A.

Under Recital 9 of the EIR Recast, in respect of the national procedures contained in Annex A, it is explained that the EIR Recast should apply without any further examination by the courts of another Member State as to whether the conditions set out in the regulation are met.[22] National insolvency procedures not listed in Annex A are therefore not covered by the EIR Recast. It is clear that should a proceeding be mentioned in Annex A, it automatically (with no further examination) falls within the material scope of the EIR Recast. The opposite is also true: if a proceeding is not listed in Annex A, it does not trigger the application of the EIR Recast. For instance, the UK's scheme of arrangement (Part 26 of the Companies Act 2006 and formerly section 425 of the Companies Act 1985) is deliberately left outside the scope of the EIR Recast and is missing from Annex A. This means that it does not enjoy the benefits of automatic recognition in other Member States based on the EIR Recast (Article 19).

With Annex A being a determinative factor for application of the EIR Recast, the definition of an insolvency proceeding in Article 1 loses its salience and becomes a guidance for national policy makers to consider introducing new national insolvency proceedings to Annex A. This Annex-based-system, although rigid and somewhat inflexible, supplies efficiency, clarity and respect to the sovereignty of the EU Member States.

5.2.2 Temporal scope

The EIR Recast repeals and replaces the EIR 2000. With some small exceptions, the EIR Recast applies from 26 June 2017 (Article 92 of the EIR Recast). Provisions of the EIR Recast shall apply only to insolvency proceedings opened after the indicated date (Article 84(1) of the EIR Recast). Proceedings opened before this date shall be governed by the EIR 2000.

The "time of the opening" of insolvency proceedings means the time at which the judgment opening insolvency proceedings becomes effective, regardless of whether the judgment is final or not (Article 2(8) of the EIR Recast). The EIR Recast defines the "judgment opening insolvency proceedings" as the decision of any court to open insolvency proceedings or to confirm the opening of such proceedings, or the decision of a court to appoint an insolvency practitioner (Article 2(7) of the EIR Recast).

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of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

[22] The decisive role of Annex A was previously confirmed by the CJEU in Case C-116/11, *Bank Handlowy w Warszawie SA v Christianapol sp. z o.o.*, ECLI:EU:C:2012:739 (Nov 22, 2012), where the court noted that "… once proceedings are listed in Annex A to the Regulation, they must be regarded as coming within the scope of the Regulation. Inclusion in the list has the direct, binding effect attaching to the provisions of a regulation".

5.2.3 Personal scope

The EIR Recast applies to insolvency proceedings which meet the conditions set out in it, irrespective of whether the debtor is a natural person or a legal person, a trader or a consumer (Recital 9). In addition to insolvency proceedings that undoubtedly fall under the scope of the EIR Recast, the latter equally extends to proceedings providing for a debt discharge or a debt adjustment in relation to consumers and self-employed persons (Recital 10). This comprehensive approach has been inherited from the EIR 2000 (Recital 9). Ultimately, however, as explained above, the application of the EIR Recast extends only to those proceedings that are adopted in Member States and subsequently included in Annex A.

Some entities are explicitly excluded from the personal scope of the EIR Recast. Thus, according to Article 1(2) of the EIR Recast, it does not apply to proceedings that concern: (a) insurance undertakings, (b) credit institutions, (c) investment firms and other firms, institutions and undertakings to the extent that they are covered by Directive 2001/24/EC, or (d) collective investment undertakings. The listed entities are subject to special arrangements and national supervisory authorities have wide-ranging powers of intervention in the event of their insolvency (Recital 19 of the EIR Recast). This is dictated by the importance of such institutions for the EU financial system as a whole and the need for special measures to minimise the negative effects of their failures, particularly acute in the wake of the global financial crisis.

5.2.4 Territorial scope

The EIR Recast is a binding piece of EU legislation and it is therefore directly applicably in all Member States, with the exception of Denmark.[23] However, it does not offer clear rules related to its geographical application. Recital 25 contains a key provision under which the Regulation shall apply to proceedings in respect of a debtor whose centre of main interests (COMI) is located in the EU. Before opening insolvency proceedings, the competent court is under an obligation to examine of its own motion whether the centre of the debtor's main interests is actually located within its jurisdiction (Recital 27). When the debtor's COMI is located outside the EU or in Denmark, the EIR Recast does not apply. In such a case, national conflict of laws rules and insolvency laws of the EU Member States will determine jurisdictional outcomes (for example, whether insolvency proceedings can be opened absent the debtor's COMI).

It has long been regarded that the territorial framework of the EIR 2000 covers only intra-community effects of insolvency proceedings and that its provisions are restricted to relations between Member States.[24] However, in *Ralph Schmid v Lilly Hertel*,[25] the CJEU took the opposite view. The case dealt with an action brought by Mr Schmid, a liquidator of the assets of a German debtor, against Ms Hertel, living in Switzerland, to have a transaction set aside and seeking recovery of approximately EUR 8,000. Previously, in *Christopher Seagon v Deko Marty Belgium NV*,[26] it was decided that the courts of the Member State within the territory of which insolvency

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[23] Unless otherwise indicated, all references to the Member States in this guidance text shall refer to all EU Member States with the exception of Denmark.

[24] Virgós-Schmit Report, para 44.

[25] Case C-328/12, ECLI:EU:C:2014:6 (Jan 16, 2014).

[26] Case C-339/07, ECLI:EU:C:2009:83 (Feb 12, 2009).

proceedings have been opened have jurisdiction to consider an action to set a transaction aside that is brought against a person whose registered office is in another Member State. The problem here was that Ms Hertel resided in Switzerland, which is not part of the EU and hence not a Member State.

Nevertheless, guided by the principles of foreseeability as regards bankruptcy and liquidation jurisdiction and the universal character of (main) insolvency proceedings encompassing all debtor's assets, the CJEU extended the scope of the EIR 2000 (and equally the EIR Recast) to embrace actions against a person whose place of residence was in a third country.

Self-Assessment Exercise 2

Question 1

What is the scope of the EIR Recast? Draft a step-by-step plan (guide) for checking whether the EIR Recast applies.

Question 2

Please read the facts of the hypothetical case below and answer whether the EIR Recast applies to the opened insolvency proceedings. Use your step-by-step plan and record each step taken in deciding on the application of the EIR Recast.

Creative Tech BV is a company, registered in Rotterdam (the Netherlands) with the centre of main interests (COMI) in the Netherlands. It was founded in 2016 for the purposes of developing new technology solutions for the agricultural industry, involving artificial intelligence (AI) and the blockchain technology. It managed to attract over EUR 1 million from a venture capital fund in Germany and over EUR 1.5 million in loans from a Dutch bank.

Despite initial swift progress, Creative Tech GmbH failed to produce any marketable product and faced financial crisis in early 2017. This situation became even worse, when its main competitor from Germany entered the Dutch market in February 2017. Having failed to secure additional funds necessary for continued operations, on 30 June 2017, the director of Creative Tech GmbH filed an insolvency application with the court in Rotterdam, which opened the suspension of payments proceedings (*De surséance van betaling*) on 7 July 2017 and appointed the administrator (*De bewindvoerder in de surséance van betaling*).

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

5.3 International insolvency jurisdiction under the EIR Recast

The EIR Recast creates a developed regulatory system (framework) for resolving insolvencies in the EU. Even though national legislatures retain considerable powers to decide on the content

of insolvency proceedings (for example, the ranking of claims, rules on directors' liability, available restructuring options), the matters of international jurisdiction, applicable law, enforcement and recognition, and co-operation and communication between IPs and courts, are largely harmonised through the mandatory EU law, laid down in the EIR Recast. In this section of the guidance text, we will describe the major characteristic elements of this centralised regulation, paying particular attention to the realisation in practice of the idea of modified universalism.

Just like the EIR 2000, the EIR Recast defines international jurisdiction for insolvency cases within the EU, that is to say, it designates the Member State the courts of which may open insolvency proceedings (Recital 26). Territorial jurisdiction within that Member State itself is not a matter for EU law and is established by national (domestic) law of the Member State concerned. For instance, while the EIR Recast may designate the Netherlands (as a country) for the opening of insolvency proceedings, it is Article 2 of the Dutch Bankruptcy Act (*Faillissementswet*) of 1896 that defines the competent national court (that is, one of the 11 courts of first instance in that country) to open such proceedings.

Article 3 is the provision in the EIR Recast defining the standard criteria for allocating international jurisdiction for the opening of insolvency proceedings failing within the Regulation's scope. The provision is divided into rules applying to "main" insolvency proceedings and "secondary" insolvency proceedings (also known as "territorial" proceedings).

Article 3(1) of the EIR Recast states that the courts of the Member State within the territory of which the centre of the debtor's main interests is situated, shall have jurisdiction to open insolvency proceedings (main insolvency proceedings). Such proceedings have universal scope and aim at encompassing all the debtor's assets. At the same time, following in the footsteps of the EIR 2000, the EIR Recast allows for the opening of secondary proceedings, which run in parallel to main insolvency proceedings and produce effects only on assets situated within a state of secondary proceedings (Recital 23). Secondary proceedings, being territorial in nature, protect the diversity of interests, promote effective administration of complex insolvency estates and mitigate difficulties arising from divergent national laws (Recital 40).

While main insolvency proceedings are linked to the COMI of an insolvent debtor, secondary proceedings can be opened in any country in which this debtor has an establishment (Article 3(2) of the EIR Recast). A debtor can have only one COMI and thus only one main insolvency proceeding can be opened. At the same time, there could be as many secondary proceedings as there are establishments of the debtor across Member States (ie, one main insolvency proceeding and a maximum of 26 secondary insolvency proceedings). As in the Istanbul Convention and the EU Convention, the term "establishment" entails the debtor's operational activities in a Member State, other than the COMI state. The term "COMI" is explained in more detail below. Consequently, several proceedings in relation to the same debtor, running under different national insolvency laws, are frequently encountered in practice. This creates a complex system with one main proceeding dominating the course of the debtor's insolvency and one or more secondary proceedings. As a result, compared to the 1970 and 1980 Conventions, which favoured the ideals of unity and universalism, the EIR Recast chooses the middle ground of modified universalism.

5.3.1 Main insolvency proceedings and COMI

As highlighted above, main insolvency proceedings are intrinsically connected to the debtor's centre of main interests. Such proceedings can only be opened in a jurisdiction of the debtor's COMI. The EIR 2000 did not contain a definition of COMI; it however provided some guidance in its Recital 13. By contrast, the EIR Recast mandates that the centre of main interest shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties (Article 3(1) of the EIR Recast). These words are almost identical to those provided in said Recital 13 of the EIR 2000. By including them in the main text of the regulation the definition gains authority, since a recital itself is not enforceable and rather provides guidance for interpretation by the courts. The definition adopted in the EIR Recast is backed by the settled case law of the CJEU.

In one of the most important cases on interpretation of the EIR 2000, *Eurofood IFSC Ltd*,[27] the court stressed that the concept of COMI is peculiar to the regulation. It has an autonomous meaning and must therefore be interpreted in a uniform way, independently of what a similar term may mean in national legislation (paragraph 31). The case concerned Eurofood IFSC Ltd (Eurofood) with its registered office in Ireland. It was a wholly owned subsidiary of Parmalat SpA, a company incorporated in Italy. Eurofood's principal objective was the provision of financing facilities for companies in the Parmalat group. In December 2003, Parmalat SpA was admitted to extraordinary administration proceedings in Italy. In January 2004, an application was made to the High Court of Ireland for compulsory winding up proceedings to be commenced against Eurofood and a provisional liquidator was appointed. Despite this, in February 2004 the District Court in Parma (Italy), taking the view that Eurofood's COMI was in Italy, held that it had international jurisdiction to decide on Eurofood's insolvency. In March 2004 the Irish High Court confirmed Eurofood's COMI to be in Ireland and refused to recognise the judgment of the Italian court.

When resolving this jurisdictional conundrum, the CJEU (then still named the European Court of Justice or ECJ) first highlighted the autonomous meaning of the term COMI and then emphasised that it must be identified by reference to criteria that are both objective and ascertainable by third parties (paragraph 33). The autonomous meaning of COMI facilitates legal certainty across the EU as, in principle, its application must be uniform in all Member States. Legal certainty and foreseeability for all stakeholders dealing with the debtor, if it goes insolvent, is further encouraged by the objectivity and ascertainability of the place of COMI. In order to make COMI even more predictable, the EIR Recast contains a registered office presumption, namely that the insolvent company's COMI is presumed to be the jurisdiction (of the country) where such company has been registered. This presumption can be rebutted only if the objective factors indicate that the administration of the debtor's interest happens in a state different from the state of the registered office (for example, in the case of a "letterbox" company).

Ascertainability or visibility by third parties (mainly creditors) is closely related to the time factor. In other words, the activity of the debtor in a particular Member State should be regular and

[27] Case C-341/04, ECLI:EU:C:2006:281 (May 2, 2006).

lasting to create COMI. This criterion is crucial to combat the practice of abusive forum shopping, when a debtor moves its assets, personnel or registered office to a different Member State, seeking to obtain a more favourable legal position in insolvency to the detriment of the debtor's general body of creditors. Notably, the EIR Recast does not address insolvency forum shopping as such, but only its harmful or abusive forms, causing damage or disadvantage to the debtor's creditors (Recital 29). The change of the insolvency venue for the benefit of having a successful restructuring or a streamlined and advantageous sale of business is not *per se* prohibited.[28]

5.3.2 COMI presumptions

To make COMI determination more predictable, the EIR Recast did not introduce a stricter definition of COMI; rather it offered several presumptions indicating its location. One of the main presumptions relating to COMI is the registered office presumption. In the case of a company or a legal person, the place of the registered office shall be presumed to be the place of COMI (Article 3(1) of the EIR Recast). However, this presumption shall only apply if the registered office has not been moved to another Member State within the three-month ("suspect") period prior to the request for the opening of insolvency proceedings. The introduction of the suspect period is an innovation of the EIR Recast and creates a safeguard against fraudulent manipulation of the insolvency forum (and "forum shopping") shortly before the actual insolvency filing. Thus, if the registered office has been moved within the suspect period, the court shall disregard this change in registration for the purposes of determining COMI, as if no such change had occurred.[29]

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[28] The possible beneficial effects of insolvency forum shopping have been recognized in a case which is not covered by the EIR Recast: *In re Ocean Rig UDW Inc*, 570 B.R. 687 (Bankr SDNY 2017). In this case the New York court concluded that forum shopping was acceptable, as it was done in good faith, particularly with a view to maximising chances of business rescue or enhancing recovery by the creditors. Nevertheless, in Europe the public perception of pre-insolvency COMI replacements or shifts remains generally negative, encouraging some Member States to exclude certain procedures from the scope of the EIR Recast (eg, UK schemes of arrangement). Notably, non-insolvency related forum shopping for company law, ie the transfer of the registered office of a company within the EU with a change of applicable company law, is treated favourably. In Case C-106/16, *Polbud – Wykonawstwo sp. z o.o.*, ECLI:EU:C:2017:804 (Oct 25, 2017), the CJEU stated that the transfer of a registered office to acquire the benefit of more favourable (company) legislation without change of the real head office enjoyed the protection of the freedom of establishment and did not constitute abuse.

[29] This approach is a logical continuation of the *perpetuatio fori* doctrine, adopted by the CJEU in Case C-1/04, *Susanne Staubitz-Schreiber*, ECLI:EU:C:2006:39 (Jan 17, 2006). The case concerned Ms. Staubitz-Schreiber, who operated a small telecommunications equipment and accessories business as a sole trader in Germany. On 6 Dec 2001 she requested the opening of insolvency proceedings regarding her assets before a first district court in Germany. On 1 Apr 2002, she moved to Spain to live and work there. The question arose as to whether the German court still had jurisdiction to open insolvency proceedings in a situation where the applicant had moved her COMI to a different Member State. The need to ensure efficient operation of the EU cross-border insolvency regime, to assure respect of creditors' expectations and to resist forum shopping, led the CJEU to conclude that the court of the Member State within the territory of which COMI was situated at the time when the debtor lodges the request to open insolvency proceedings (ie, the German court) retained jurisdiction to open those proceedings if the debtor moved COMI to the territory of another Member State after lodging the request but before these proceedings were opened. This reasoning has ultimately resulted in the "suspect" periods, or "safeguard" periods, introduced in Art 3(1) of the EIR Recast, restricting the applicability of COMI presumptions.

The issue of COMI presumptions was further dealt with by the CJEU in *Interedil Srl v Fallimento Interedil Srl*.[30] The facts of the case are as follows.[31] Interedil Srl was a legal entity originally registered in Italy but subsequently relocated to London and entered into the UK register as a foreign company. Despite this, a petition to open in Italy bankruptcy proceedings (*fallimento*) was filed with an Italian court. Interedil Srl, by that time already liquidated, challenged the jurisdiction of the Italian court claiming that because of the transfer of its registered office to the UK, only English courts had jurisdiction to open insolvency proceedings. Nevertheless, the Italian court accepted its jurisdiction, arguing that the registered office presumption was rebutted as a result of various circumstances, namely the presence of immovable property in Italy owned by Interedil Srl, the existence of a lease agreement in respect of two hotel complexes, a contract concluded with a banking institution, and the fact that the Italian register of companies had not been notified of the transfer of Interedil's registered office.

In this case, the CJEU ruled that when the bodies responsible for the management and supervision of the debtor are in the same place as its registered office, and the management decisions of the company are taken in that same place in a manner that is ascertainable by third parties, the registered office presumption is irrefutable.[32] The presumption can be rebutted when, from the viewpoint of third parties, the place in which the company's central administration (actual centre of management and supervision and of the management of its interests) is located, does not coincide with the jurisdiction of its registered office. This requires a comprehensive assessment of all the relevant facts. The guidance provided by the court has now been repeated (almost) *verbatim* in Recital 30 of the EIR Recast. What is clear from the arguments put forward by the court and the wording of the EIR Recast, is that the mere presence of some assets (for example, bank accounts, movable or immovable assets) will not be sufficient to rebut the registered office presumption (paragraph 53).

In addition to rules related to legal entities, the EIR Recast contains presumptions applicable to individuals exercising an independent business or professional activity (entrepreneurs or sole traders) and other individuals (consumers). For the former, COMI is presumed to be the principal place of business. This reflects the idea that COMI should be ascertainable by third parties, most importantly the debtor's creditors (lenders, supplies, subcontractors, etc.). The principal place of business presumption shall only apply if the individual's principal place of business has not been moved to another Member State within the three-month period prior to the request for the opening of insolvency proceedings.

The third presumption relates to any other individual. In a case of such an individual (consumer), COMI shall be presumed to be the place of the individual's habitual residence in the absence of proof to the contrary. It should be possible to rebut this presumption, for example where the major part of the debtor's assets is located outside the Member State of the debtor's habitual

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30 Case C-396/09, ECLI:EU:C:2011:671 (Oct 20, 2011).

31 The facts of *Interedil* are rather confusing. Registration as an overseas (foreign) company in the UK is necessary for setting up a place of business in the UK. It does not amount to incorporation. Thus, removal of Interedil from the UK register of foreign companies could not have amounted to dissolution. For further discussion on this, see G Moss, "Group Insolvency - Forum - EC Regulation and Model Law under the Influence of English Pragmatism Revisited", 9 *Brook. J Corp Fin & Com L* (2014), pp 250-267.

32 See para 50 of the judgment.

residence, or where it can be established that the principal reason for relocation was to file for insolvency proceedings in the new jurisdiction ("bankruptcy tourism") and where such filing would materially impair the interests of creditors whose dealings with the debtor took place prior to the relocation (Recital 30). Besides, the presumption only applies if habitual residence has not been moved to another Member State within the six-month period prior to the request for the opening of insolvency proceedings. This extended "suspect" period can be explained by the relative ease with which individuals can change their habitual residence in the EU.

In terms of policy, COMI was selected for several reasons. According to the EU Commission, the concept ensures that cases are handled by a jurisdiction with which the debtor "has a genuine connection rather than in the one chosen by the incorporators".[33] This supports the view that both jurisdiction and applicable law should match what most creditors expect or are familiar with.[34] In the view of the Virgos-Schmit Report, this enables creditors to better foresee the legal risks of their debtor's insolvency and to achieve a more accurate pricing of the risk.[35] Involuntary creditors, mal-adjusting creditors and weak creditors (such as employees) may also benefit from the COMI approach. They are more likely to reside in the same Member State as the debtor's COMI, since the COMI signals the debtor's involvement in a particular Member State (assuming that COMI does not shift after these obligations are incurred). These creditors will be more familiar with the legal system in this jurisdiction. The COMI criterion also mirrors the one adopted by international instruments, such as the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency 1997 (Model Law).

There was, however, a constant and rising stream of criticism leading up to the 2015 reform of the EIR Recast. The COMI concept was criticised as vague and the interpretations of it did not provide enough guidance to provide a reliable practical test. This could jeopardise legal certainty and predictability, contrary to its objectives.[36] This criticism has been levelled against various variants of the "real seat theory" in international company law for a long time. Creditors may price in risk and uncertainty when dealing with insolvency, resulting in higher capital costs. In addition, critics of the concept contend that the COMI concept, as envisioned in the EIR Recast, is open to arbitrage and manipulation. More generally, it has been contended that the COMI may be difficult to assess and to determine by creditors. This argument has since been addressed by the interpretation of the COMI test following *Eurofood IFSC Ltd* and *Interedil*.

5.3.3 Secondary insolvency proceedings and establishment

Alongside main insolvency proceedings, the EIR Recast allows for a second type of procedure, so-called "secondary" or "territorial" insolvency proceedings. According to Article 3(2), these are permissible in a Member State where the debtor has an "establishment" rather than its COMI. Unlike main insolvency proceedings which have universal scope, secondary ones are

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[33] Commission Proposal COM(2012) 744, 6; Commission Impact Assessment accompanying the EIR revision, SWD(2012) 416, Section 3.4.1.1.

[34] Virgós–Schmit Report, para 75.

[35] *Ibid*.

[36] For further reading, see H Eidenmüller, "Free Choice in International Company Insolvency Law in Europe", (2005) 6 *European Business Organization Law Review* 423; and G McCormack, "Jurisdictional Competition and Forum Shopping in Insolvency Proceedings", (2009) 68 *Cambridge Law Journal* 169.

restricted to the assets of the debtor located in the territory of the particular Member State where they are opened. Therefore, secondary proceedings are an important exception to the universalist approach of the EIR Recast. They fulfil a crucial role of creditor protection in the Member State(s) where the debtor has an establishment by allowing for the possibility of local proceedings governed primarily by the *lex fori concursus*.

The opening of secondary insolvency proceedings leads to the creation of a separate insolvency estate and the application of a separate *lex concursus*, namely the law of the Member State where the establishment is located (*lex concursus secundarii*). In other words, the opening of secondary proceedings limits the otherwise universal scope of main insolvency proceedings. As noted above, secondary proceedings serve to protect local interests and enhance the handling of complex insolvency estates. As explained by the Virgós-Schmit Report, the opening of secondary proceedings:

> "makes sense for creditors who cannot rely on the recognition of their rights (or their preferential rank) in proceedings in another … State. Further, it also makes sense for creditors who cannot count on the application of the law of another … State (for instance, small creditors who participated only in domestic transactions with the local establishment of an undertaking of another … State." (paragraph 32).

At the same time, secondary proceedings have a supportive function to the main insolvency proceedings. This is why they can only follow in time after the opening of main insolvency proceedings. In exceptional circumstances, the EIR Recast permits the opening of the so called "territorial" insolvency proceedings prior to the opening of main insolvency proceedings (Article 3(4) of the EIR Recast).

The concept of an "establishment" is essential to the opening of secondary proceedings, as such proceedings can only be opened in a Member State in which the debtor has an establishment. According to Article 2(10) of the EIR Recast, "establishment" means any place of operations where a debtor carries out or has carried out in the three-month period prior to the request to open main insolvency proceedings a non-transitory economic activity with human means and assets. This definition is almost identical to the one found in Article 2(h) of the EIR 2000, with only the addition of the relevant time period. Another crucial improvement brought by the EIR Recast is the abolition of the requirement that secondary proceedings must be winding-up proceedings, previously contained in Article 3(3) of the EIR 2000. The latter limitation significantly hindered attempts to restructure businesses spanned across Europe with several establishments located in different Member States.

Whereas main insolvency proceedings are dependent on the debtor's COMI, secondary proceedings are inextricably linked to a debtor's establishment. Following the steps of the EIR 2000, the EIR Recast adheres to the autonomous interpretation of the concept of establishment. In *Interedil* the CJEU examined the concept and concluded that the fact that the definition connects the pursuit of an economic activity to the presence of human resources, shows that a minimum level of organisation and a degree of stability are required. It follows that, conversely, the presence alone of goods in isolation or bank accounts does not, in principle, satisfy the

requirements for classification as an "establishment" (paragraph 62). The rationale behind the introduction of the establishment characteristics is similar to the one of COMI – ensuring legal certainty and foreseeability concerning the court authorised to open insolvency proceedings. "Non-transitory economic activity with human means and assets" puts forward objective factors which are assumed to be ascertainable by third parties.

The non-transitory character of the debtor's activities indicates a certain degree of continuity and stability. A purely occasional place of operations cannot be classified as an establishment. The negative formula ("non-transitory") aims to avoid minimum time requirements. The decisive factor is how the activity appears externally, in the perception of third parties, and not the intention of the debtor (paragraph 71 Virgós-Schmit Report). The presence of human means and assets is another criterion for determining the establishment. It shows that the debtor shall conduct its activities with the involvement of human resources (people) and assets, which together demonstrate the organisational presence in the forum. The EIR Recast does not require the establishment to have any official (corporate) form, for example, a branch or a representative office. In this respect the organisational presence can imply any form of external business activity by the debtor, as long as it is ascertainable by third parties and meets the definition of Article 2(10) of the EIR Recast.[37]

Pursuant to the definition of establishment, it must be scrutinised as of the moment of the filing for the opening of secondary insolvency proceedings (Article 2(10) of the EIR Recast). If the necessary criteria are not met at that moment, the court must look at whether there was an establishment in the three-month period before the filing. If this is the case, the court has jurisdiction to open secondary proceedings. This rule is a novelty of the EIR Recast and has been introduced to guarantee protection of local creditors in the event of pre-insolvency forum shifts or cessation of the establishment's operations.

Self-Assessment Exercise 3

Question 1

What is the difference between main and secondary proceedings under the EIR Recast?

Question 2

Study the basic aspects dealt with under the previous heading and write a brief essay providing arguments in favour and against the system of main and secondary proceedings, as established by the EIR Recast.

[37] In Case C-327/13, *Burgo Group SpA v Illochroma SA*, ECLI:EU:C:2014:2158 (Sep 4, 2014), the CJEU decided that where main insolvency proceedings concerning a legal person have been opened in a Member State other than that of its registered office, it should be possible to open secondary insolvency proceedings in the Member State of its registered office, provided that in that state the debtor is carrying out an economic activity with human means and assets in that state. This instruction is now reflected in Recital 24 of the EIR Recast.

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

5.3.4 Actions falling under jurisdiction of courts, related actions

The general scope of the EIR Recast and the provisions concerning international jurisdiction for the opening of insolvency proceedings (both main and secondary) have been described above. However, insolvency cases are usually of a complex nature and involve various actions and claims, governed by insolvency or other relevant laws. The EIR Recast clearly covers judgments concerning the opening, conduct and closure of insolvency proceedings, including those related to the divestment of a debtor and the appointment of an insolvency practitioner, the admission and verification of claims, a confirmation of a composition (restructuring) plan, the liquidation of debtor's assets and the subsequent distribution of proceeds among its creditors.

Additionally, jurisdiction of the courts opening insolvency proceedings (whether main or secondary) extends to the so called "related actions". According to Article 6 of the EIR Recast, the courts of the Member State within the territory of which insolvency proceedings have been opened in accordance with Article 3, shall also have jurisdiction for any action which derives directly from the insolvency proceedings and is closely linked with them, such as avoidance actions. The rationale behind such an extension of the insolvency jurisdiction comes from considerations of procedural and material efficiency – "certain applications or disputes are so closely connected to the insolvency proceedings and to the policies of insolvency law [collective enforcement] that it is advisable for them to fall within the jurisdiction of the courts of opening".[38]

The ideas underpinning the treatment of related actions under the EU insolvency regime had begun crystallising long before the adoption of the EIR 2000 and the EIR Recast. In *Henri Gourdain v Franz Nadler*,[39] the CJEU had to decide on the application of the Brussels /Convention to enforcement of a wrongful trading claim launched by the liquidator Mr Gourdain against the *de facto* director Mr Nadler. The court then noted that the action in question was launched for the general benefit of creditors and was based solely on the provisions of the law of bankruptcy. In light of these findings, the court concluded that the action was given in the context of bankruptcy and therefore did not fall under the application of the 1968 Convention. Thirty years later, the CJEU confirmed this approach in *Christopher Seagon v Deko Marty Belgium NV*, referred to above. It noted that concentrating all the actions directly related to the insolvency before the courts of the Member State with jurisdiction to open insolvency proceedings is consistent with the objective of improving the effectiveness and efficiency of insolvency proceedings having cross-border effects and of countering abusive forum shopping (paragraphs 22 and 23). Article 6(1) of the EIR Recast builds further on this case law. It explicitly names avoidance actions (also called *actio Pauliana* claims) as an example of such a related action.[40] Recital 35 adds that such actions should also include actions concerning obligations

[38] M Virgós and F Garcimartín, *The European Insolvency Regulation: Law and Practice*, Kluwer Law International, 2004, p 60.

[39] Case C-133/78, ECLI:EU:C:1979:49 (Feb 22, 1979).

[40] In the recent Case C 296/17, *Wiemer & Trachte GmbH, in liquidation v Zhan Oved Tadzher*, ECLI:EU:C:2018:902 (14 Nov 2018), the CJEU determined the exclusive jurisdiction of a court in main (or secondary) proceedings to

that arise in the course of the insolvency proceedings, such as advance payment for costs of the proceedings.

In contrast, actions for the performance of the obligations under a contract concluded by the debtor prior to the opening of proceedings do not derive directly from the insolvency proceedings (Recital 35). Thus, claims of the insolvent debtor against its own debtors usually escape attraction by the insolvency forum. For example, in *Nickel & Goeldner Spedition GmbH v "Kintra" UAB*,[41], the IP of Kintra (a Lithuanian company) applied to the Lithuanian court for an order to have its debtor, German registered Nickel & Goeldner Spedition, pay off its debt. The debt had arisen in respect of services comprising the international carriage of goods provided by Kintra for Nickel & Goeldner Spedition, *inter alia* in France and Germany. The CJEU concluded that the claim in question was not an action related to insolvency – it could have been brought by the creditor (insolvent company) itself before the opening of insolvency proceedings. In that situation, the action would have been governed by the rules concerning jurisdiction applicable in civil and commercial matters. It is the nature of the claim and its legal basis (ie, common rules of civil and commercial law or the derogating rules specific to insolvency proceedings) which were given the determinative force.

In other judgements, the CJEU ruled that the action brought on the basis of a reservation of title clause against an IP had only an insufficiently direct and insufficiently close link with insolvency proceedings on the ground, in essence, that the question of law raised in such an action was independent of the opening of insolvency proceedings.[42] Similarly, an action brought by an applicant on the basis of an assignment of claims granted by an IP and relating to the right to have a transaction set aside conferred on the latter by the German insolvency law, was considered to be not closely connected with the insolvency proceedings. The Court noted in that respect that the exercise of the right acquired by an assignee was subject to rules other than those applicable in insolvency proceedings.[43] A more recent example of a non-related claim includes an action for damages for unfair competition by which the assignee of a part of the business acquired in the course of insolvency proceedings was accused of misrepresenting itself as being the exclusive distributor of articles manufactured by the debtor. The court noted that the claim at issue did not challenge the validity of the assignment carried out in the course of the insolvency proceedings. Instead, it was aimed at establishing the liability of the assignee of a part of the insolvent business arising from its allegedly tortious act.[44]

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adjudicate insolvency related *actio Pauliana* claims. The question was whether the liquidator could instead of the insolvency forum (alternatively) file at the defendant's domicile. The CJEU answered in the negative. Concentration of all insolvency-related actions in one jurisdiction was recognised to be both efficient and conducive to combatting abusive forum shopping.

41 Case C-157/13, ECLI:EU:C:2014:2145 (Sep 4, 2014).

42 Case C-292/08, *German Graphics v Alice van der Schee*, ECLI:EU:C:2009:544 (Sep 10, 2009).

43 Case C-213/10, *F-Tex SIA v Lietuvos-Anglijos UAB "Jadecloud-Vilma"*, ECLI:EU:C:2012:215 (Apr 19, 2012).

44 Case C-641/16, *Tünkers France and Tünkers Maschinenbau GmbH v Expert France*, ECLI:EU:C:2017:847 (Nov 9, 2017).

6. THE EUROPEAN INSOLVENCY REGULATION: RULES ON APPLICABLE LAW

6.1 General rules on law applicable to insolvency proceedings and their effects

In the previous section of this guidance text we described the framework laid down by the EIR Recast determining the issue of international insolvency jurisdiction for insolvency and related actions. However, the regulation of insolvency proceedings within the EU would have been incomplete without the unification of rules on applicable law. Once it has been decided that the EIR Recast applies and the court competent to consider the insolvency case has been identified, the question naturally arises – which law applies to such insolvency proceedings and the effects of such proceedings? In this regard Article 7(1) of the EIR Recast provides for the general rule, according to which the law applicable to insolvency and its effects shall be that of the Member State within the territory of which such proceedings are opened (*lex fori concursus* or simply *lex concursus*). This approach has been inherited from the EIR 2000 (see Article 4 of the EIR 2000). The general rule of Article 7 is followed by several exceptions or specific scenarios in Articles 8 to 18 of the EIR Recast. We will first present the general framework for applicable law (or "conflicts of laws") and then review the selected cases, deserving particular attention and explanation.

As noted above, the EIR Recast sets out uniform rules on conflict of laws which replace national rules of private international law. This uniformity is vital for the predictable and efficient treatment of cross-border insolvencies, respecting parties' legitimate expectations while at the same time resisting abusive forum shopping.

The rule laid down in Article 7(1) of the EIR Recast is valid both for the main proceedings and for secondary (territorial) proceedings. The law applicable to secondary proceedings, also known as *lex fori concursus secundarii*, or *lex concursus secundarii*, governs secondary (territorial) proceedings – their opening, conduct, closure and effects.[45] Thus, in the absence of secondary (territorial) proceedings and save for the exceptions discussed below, *lex concursus* of the debtor's COMI is predominant in its legal reach and effects, both procedural and substantive.

The prevalence of main insolvency proceedings and their *lex concursus* has been confirmed by the CJEU in the case of *ENEFI Energiahatékonysági Nyrt*, referred to above. In this case, the CJEU was asked to clarify whether *lex concursus* could provide for the forfeiture (or the loss) of a creditor's right to pursue a claim (including by initiating secondary insolvency proceedings) if such a creditor had not taken part in the main insolvency proceedings. In view of the dominant role of main insolvency proceedings, the CJEU held that it was entirely consistent that the *lex concursus* could, on the basis of the forfeiture of the claims lodged outside of the time limit prescribed, exclude all requests brought by the person holding those claims seeking the opening of secondary insolvency proceedings, given that the opening of such proceedings would make it possible to circumvent the forfeiture provided for by *lex concursus*. Furthermore, such legislation prevents a creditor who did not participate in the main insolvency proceedings from being capable of frustrating a composition or any of the debtor's comparable restructuring

[45] See also the Virgós-Schmit Report, paras 87-90.

measures adopted in the context of that procedure by requesting the opening of secondary insolvency proceedings.[46]

The boundaries of what constitutes applicable law within the meaning of Article 7 of the EIR Recast can be drawn from the phrase "the law applicable to insolvency proceedings and their effects". The EIR Recast is silent on this matter and does not provide guidance on what the term "law applicable to insolvency proceedings" should mean or what the term "effects" entails. For instance, in *Simona Kornhaas v Thomas Dithmar*,[47] the CJEU had to decide whether liability for the failure to timely file for insolvency, integrated in German company law, nevertheless fell within the applicable law provision of Article 4 of the EIR 2000 (the predecessor of Article 7 of the EIR Recast). The case involved a debtor company registered in the UK that went into insolvency in Germany (COMI jurisdiction). Mr Dithmar, appointed as a liquidator, claimed that during the time the company had been insolvent, its director, Ms Kornhaas, had authorised payments borne by that company exceeding EUR 110,000. According to the German Law on Limited Liability Companies (GmbHG), upon a company's insolvency, its managing director is in certain circumstances obliged to apply for insolvency proceedings to be opened. Otherwise, the managing director must reimburse the company with any payments made after the company became insolvent. Having considered the nature of the respective rule and its aim, the court found that it had to be characterised as a rule of insolvency law (and not the company law of the place of incorporation). This conclusion was reached despite the fact that the debtor company was registered in a different Member State. Having failed to file for insolvency within the time period prescribed by German insolvency law, Ms Kornhaas had to bear the negative consequences dictated by such law.

The law of the state of the opening of proceedings determines all the effects of the insolvency proceedings, both procedural and substantive, on the persons and legal relations concerned. Article 7(2) of the EIR Recast contains a number of subject matters expressly falling within the boundaries of *lex concursus*. These matters are largely similar to those listed in Article 4(2)(a)-(m) of the EIR 2000. *Lex concursus* shall determine:

(a) the debtors against which insolvency proceedings may be brought on account of their capacity;

(b) the assets which form part of the insolvency estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings;

(c) the respective powers of the debtor and the insolvency practitioner;

(d) the conditions under which set-off may be invoked;

(e) the effects of insolvency proceedings on current contracts to which the debtor is a party;

[46] At para 27 of the judgment.
[47] Case C-594/14, ECLI:EU:C:2015:806 (Dec 10, 2015).

(f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of pending lawsuits;

(g) the claims which are to be lodged against the debtor's insolvency estate and the treatment of claims arising after the opening of insolvency proceedings;

(h) the rules governing the lodging, verification and admission of claims;

(i) the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right *in rem* or through a set-off;

(j) the conditions for, and the effects of closure of, insolvency proceedings, in particular by composition;

(k) creditors' rights after the closure of insolvency proceedings;

(l) who is to bear the costs and expenses incurred in the insolvency proceedings; and

(m) the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors.

The following paragraphs of this guidance text deal with various exceptions to the general rule, dictating the application of the *lex concursus*. These exceptions are based on divergent policy considerations, such as protection of vulnerable parties (for example, employees), defence of legitimate expectations (for example, in the validity of rights subject to registration), promotion of efficient markets for credit (for example, through security of rights *in rem*) and trust in the financial markets (for example, by limiting *lex concursus* effects on payment and settlement systems).

The exceptions to Article 7 are covered in Articles 8 to 18 of the EIR Recast. There are two exceptions here: (i) Articles 8 to 10 of the EIR Recast state that the opening of insolvency proceedings "shall not affect" the legal topics dealt with therein, while (ii) Articles 11 to 18 provide that the effects of the insolvency proceedings shall be determined by another law. Group (i) results in exclusions from the *lex concursus*, whereas group (ii) makes an explicit choice for another conflict of law rule; for example, in Article 11 (entitled "Contracts relating to immoveable property") a choice for the law of the Member State within the territory of which the immoveable property is situated, or in Article 13 (entitled "Contracts of employment") a choice for the law of the Member State applicable to the contract of employment.

Due to the limitations imposed on the size and scope of this guidance text, only a selected number of exceptions have been selected for discussion. These selected exceptions serve as examples for the operation of the EIR Recast regime.

6.2 Exceptions to the application of lex concursus

6.2.1 Third parties' rights in rem

Article 8 of the EIR Recast is identical to Article 5 of the EIR 2000. It provides an exception to the general rule of application of *lex concursus*. Under this exception, the opening of insolvency proceedings shall not affect the rights *in rem* of creditors or third parties in respect of tangible or intangible, movable or immovable assets, both specific assets and collections of indefinite assets as a whole which change from time to time, belonging to the debtor and which are situated within the territory of another Member State at the time of the opening of proceedings. Thus, rights *in rem* are entirely insulated from the effects of the opening of insolvency proceedings. The proprietor of a right *in rem* should therefore be able to continue to assert its right to segregation or separate settlement of the collateral security (Recital 68 of the EIR Recast). Such a right can still be affected, however, by the opening of secondary insolvency proceedings.

The rationale behind Article 8 can be found in Recital 68, which stresses the importance of rights *in rem* for the granting of credit. Legal certainty regarding the law applicable to these rights and protection of parties' expectations ensures efficient credit relations and less expensive credit in general. The Virgós-Schmit Report further argues that the fundamental policy behind the protection afforded to rights *in rem* is to protect trade in the state where assets are situated and legal certainty of the rights over them. The provisions insulate the holders of these rights against the risk of insolvency of the debtor and the interference of third parties.[48]

The first question that has to be addressed is the scope of Article 8 of the EIR Recast – what is a right *in rem*? Just like the EIR 2000, the EIR Recast does not provide a definition of a right *in rem*. This could be explained by the great divergence of such rights across Member States. The Virgós-Schmit Report contends that the characterisation of a right as a right *in rem* must be sought in the national law which, according to the normal pre-insolvency conflict of law rules, governs rights *in rem* (in general, the *lex rei sitae* at the relevant time).[49] Recital 68 of the EIR Recast also makes it clear that the basis, validity and extent of rights *in rem* should normally be determined according to the *lex situs* and not be affected by the opening of insolvency proceedings. This means that most often the attributes of a right *in rem* will follow the law of the location of the property.

It is true that the classification of rights *in rem* is largely left in the hands of national courts applying national law. The EIR Recast does not define the notion of a "right *in rem*". It does,

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[48] See the Virgós-Schmit Report, para 97.

[49] *Idem*, para 100. The Virgós-Schmit Report warns against the unreasoned extension of what is deemed an exception. It offers a two-step characterization of a right *in rem*, which shall have 1) a direct and immediate relationship with the asset it covers which remains linked to its satisfaction and 2) the absolute (*erga omnes*) nature of the allocation of the right to the holder, who enjoys a privilege in collective insolvency proceedings (para 103 of the Virgós-Schmit Report). A similar test was used by the CJEU in Case C-195/15, *SCI Senior Home v Gemeinde Wedemark, Hannoversche Volksbank eG*, ECLI:EU:C:2016:804 (Oct 26, 2016). The right in question concerned a public charge on real property created by the operation of German tax law in case of a failure to pay the relevant taxes. The CJEU held that this right constituted a right *in rem* within the meaning of the EIR 2000. It reasoned that the charge directly and immediately encumbered taxed real property and the owner of the real property had to accept enforcement against that property.

however, provide an explanation through a number of examples of rights described in the EIR Recast as rights *in rem*. These examples are to be found in Article 8(2) of the EIR Recast and include the right to dispose of assets and to obtain satisfaction from the proceeds, in particular by virtue of a lien or a mortgage. Article 8(3) provides more guidance, stating that the right, recorded in a public register and enforceable against third parties, based on which a right *in rem* may be obtained, shall be considered to be a right *in rem*.

For Article 8 of the EIR Recast to have an effect it is material that (i) the respective right exists at the time of the opening of insolvency proceedings and (ii) that the encumbered asset is situated in a Member State, different from the State of the opening of insolvency proceedings.[50] If the right is established post the opening of insolvency proceedings, or the asset is located in the same Member State as the insolvency forum (whether main or secondary), Article 8 is inapplicable. The question arises as to what happens if the asset is located in a third state not being a Member State? The EIR Recast does not explicitly address this issue, opening the gates to divergent interpretations. While the Virgós-Schmit Report speaks in favour of the narrow interpretation of the EIR predecessor, the EU Convention, making it applicable only in intra-communal relations, the CJEU in *Ralph Schmid v Lilly Hertel* seems to have abandoned such a limited approach. Indeed, the ultimate goal of protecting legitimate expectations and the certainty of transactions does not discriminate between Member States and non-Member States. Therefore, the "right *in rem*" exception may in principle apply if the encumbered asset is located in a non-Member State.

6.2.2 Detrimental acts

The basic rule of the EIR Recast is that the law of the state of the opening of insolvency proceedings governs the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors (Article 7(2)(m) of the EIR Recast).[51] This same law determines the conditions to be met, the manner in which the nullity and voidability function (for example, automatically, by allocating retrospective effects to the proceedings or pursuant to an action taken by the liquidator) and the legal consequences of nullity and voidability.[52] In this respect, Article 16 of the EIR Recast (similarly to Article 13 of the EIR 2000) introduces an exception to the otherwise applicable *lex concursus*.

According to Article 16 of the EIR Recast, Article 7(2)(m) shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that:

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[50] To assist courts in determining the location of assets, Art 2(9) of the EIR Recast contains eight asset-localization rules. For example, the location of registered shares in companies is linked to the Member State where the company having issued the shares has its registered office. Book entry securities are deemed to be located in the Member State in which the register or account in which the entries are made is maintained. Cash held in accounts with a credit institution is linked to the Member State indicated in the account's international bank account number (IBAN), or in the absence of IBAN, the Member State in which the credit institution holding the account has its central administration or a branch. Claims against third parties other than those relating to cash held in bank accounts are localised through the COMI of the debtor.

[51] See para 5.4 above.

[52] Virgós-Schmit Report, para 135.

(a) the act is subject to the law (*lex causae*) of a Member State other than that of the state of the opening of proceedings; and

(b) the law of that Member State does not allow any means of challenging that act in the relevant case.

The aim of Article 16 of the EIR Recast is to uphold legitimate expectations of creditors or third parties about the validity of the act in accordance to the normally applicable national law (*lex causae*), against the interference from a different and at times less predictable *lex concursus*. Precisely because of this reasoning, transactions concluded *after* the opening of insolvency proceedings, do not, in principle, merit the protection of Article 16. We can reasonably assume that as from the opening of insolvency proceedings, creditors of a debtor are able to predict the effects of the application of the *lex fori concursus* on the legal relations which they maintain with that debtor.[53] Two further comments should be made.

First, as follows from the wording of Article of the 16 EIR Recast, the burden of proof of the unchallengeable character of the disputed act rests with the defendant. The defendant must convincingly demonstrate that the law governing that act does not allow for that act to be challenged.[54] In *Hermann Lutz v Elke Bäuerle*, the CJEU clarified that the defence established by Article 13 of the EIR 2000 (now Article 16 of the EIR Recast) also applies to limitation periods or other time-bars (whether procedural or substantive) relating to actions to set aside transactions under the law governing the act challenged by the liquidator. Hence, if the action for setting aside is time barred under *lex causae*, it most certainly will fall within the protection of Article 16 of the EIR Recast.

Second, the *lex causae* must not allow any means of challenging the act at issue. In this respect the CJEU held that the aim of protecting legitimate expectations and the need for all the circumstances of the case to be taken into account require Article 13 of the EIR 2000 (now Article 16 of the EIR Recast) to be interpreted as meaning that a person benefiting from a detrimental act must prove that the act at issue cannot be challenged both on the basis of the insolvency provisions of the *lex causae* and on the basis of the general provisions and principles of that law, taken as a whole.[55] This makes it more difficult to argue for the non-avoidable character of legal acts subject to avoidance challenge.

6.2.3 Contracts of employment

Another exception to the general rule of applying the *lex concursus,* in the form of an exclusive application of another law*,* can be found in Article 13 of the EIR Recast (entitled "Contracts of employment"), which states that the effects of insolvency proceedings on employment contracts

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53 Para 35 of Case C-557/13, *Hermann Lutz v Elke Bäuerle*, ECLI:EU:C:2015:227 (Apr 16, 2015).

54 However, should the defendant provide sufficient evidence of non-voidability under the *lex causae*, the burden of proof may shift to the claimant. If this is the case, the claimant (eg, the insolvency practitioner) will need to demonstrate the existence of a provision or principle of *lex causae* on the basis of which that act can be challenged (para 42 in Case C-310/14, *Nike European Operations Netherlands BV v Sportland Oy*, ECLI:EU:C:2015:690 (Oct 15, 2015).

55 *Nike v Sportland*, para 36.

and relationships shall be governed solely by the law of the Member State applicable to the contract of employment (*lex contractus*). This is an exception to the rule contained in Article 7(2)(e) of the EIR Recast, which attributes the effects of insolvency proceedings on current contracts to the *lex concursus*. The reasoning behind this special treatment of employment contracts is to protect employees and jobs (Recital 72 of the EIR Recast). The Virgós-Schmit Report originally also held that such protection is granted from the application of a foreign law, different from that which governs the contractual relations between employer and employees. Therefore, the effects of the insolvency proceedings on the continuation or termination of the employment relationship and on the rights and obligations of each party under such relationship, are to be determined by the law applicable to the contract under the general conflict of laws rules.[56] In the EU, these rules appear in Regulation Number 593/2008 of 17 June 2008 (Rome I Regulation).

Several problems may arise in applying Article 13 of the EIR Recast (which is similar to Article 10 of the EIR 2000). Firstly, the EIR Recast does not define an "employment contract". The question arises whether such a term should be determined with a reference to national legal systems of Member States or whether an autonomous meaning or interpretation shall instead prevail. We argue for the latter, as it would facilitate the harmonised application of the EIR Recast, thus improving legal certainty and predictability. The CJEU has held that the "essential feature of an employment relationship […] is that for a certain period of time a person performs services for and under the direction of another person in return for which he receives remuneration".[57] Indispensable traits of the employment relationship are therefore: (i) the lasting character of relations, (ii) subordination (under instructions of another person) and (iii) remuneration.

Secondly, after determining the existence of the employment relationship one needs to define the legal effects stemming from Article 13 of the EIR Recast. In this respect, Recital 72 specifies that the law applicable to the relevant employment agreement should govern the effects of insolvency proceedings on the continuation or termination of employment and on the rights and obligations of all parties to such employment. The *lex contractus* governs, *inter alia*, the power of the insolvency practitioner to modify or terminate employment contracts and the rights of employees arising from such modification or termination. Any other question relating to the law of insolvency, such as whether remuneration includes vacation allowance or whether the employees' claims are protected by preferential rights and the status such preferential rights may have, should be determined by the law of the Member State in which the insolvency proceedings (main or secondary) have been opened (*lex concursus* and *lex concursus secundarii*). The *lex concursus* will also govern procedure for filing, verification and admission of employees' claims in insolvency.

6.2.4 Pending lawsuits or arbitral proceedings

The *lex concursus* determines the effects of insolvency proceedings on proceedings brought by individual creditors, with the exception of pending lawsuits (Article 7(2)(f) of the EIR Recast). This exception is dealt with in Article 18 of the EIR Recast. It prescribes that the effects of insolvency

[56] Virgós-Schmit Report, para 125.
[57] Para 17 of Case 66/85, *Lawrie-Blum v Land Baden-Württemberg*, ECLI:EU:C:1986:284 (July 3, 1986).

proceedings on pending lawsuits or pending arbitral proceedings concerning an asset or a right which forms part of the debtor's insolvency estate, shall be governed solely by the law of the Member State in which the lawsuit is pending or in which the arbitral tribunal has its seat.

Initiation of insolvency proceedings against a party to arbitral or state court litigation proceedings can have significant procedural consequences on the latter. For instance, the *lex concursus* may order termination or suspension of all pending lawsuits against the insolvent debtor. In order to avoid such unpleasant and unexpected surprises, Article 18 EIR Recast subjects the effects of insolvency to the law of the Member State in which the lawsuit is pending (*lex fori processus*) or in which the arbitral tribunal is seated (*lex loci arbitri*). This law will decide on various procedural measures, such as suspension or termination of a lawsuit, representation by the insolvency practitioner (as the case may be) and the award of litigation or arbitration costs. Notably, the EIR 2000 did not mention arbitral proceedings, which in practice led to contradictory judgments. The EIR Recast now explicitly equates arbitration with state court litigation in the matter of assigning the law determining the effects of insolvency on them.

Article 18 of the EIR Recast applies if the following conditions are met. Firstly, the lawsuit or arbitral proceedings should be pending. In other words, such proceedings should be underway at the moment of the opening of insolvency proceedings, regardless whether the insolvent company acts as a claimant or defendant. Secondly, the proceedings should relate to an asset or a right of the debtor. This part of the test is relatively easy to pass, as almost any claim whether filed by the debtor or against it will have an effect on its estate.[58] Thirdly, as a general rule, proceedings brought by individual creditors by means of *enforcement* proceedings should not be carved out from the effects of the *lex concursus*. At the same time, actions for a declaration of monetary obligations which merely determine the rights and obligations of the debtor, without involving their realisation and which, therefore, unlike individual enforcement proceedings, do not risk undermining the principle of equal treatment of creditors and the collective resolution of insolvency proceedings, fall within the scope of application of Article 15[59] (now Article 18 of the EIR Recast). The ascertainment of assets falling under the debtor's insolvency estate must be made under the *lex concursus* (*lex concursus secundarii*) and not the *lex fori processus* or the *lex loci arbitri*. Fourthly, a jurisdiction in which the lawsuit is pending, or where the arbitral tribunal has its seat, shall be that of the Member State.

To reiterate, Article 18 deals only with litigation or arbitration on the merits of the case and does not touch upon the issue of these proceedings' enforcement. For instance, the *lex fori processus* may allow continuation of litigation despite the defendant's insolvency. This does not mean that the successful outcome for the claimant will lead to enforcement against the debtor's assets. The effects on individual enforcement actions remain to be governed by the law of the state of the opening of insolvency proceedings, so that the collective insolvency proceedings would

[58] This broad interpretation of the concept "asset or a right of the debtor" does not clearly follow from a textual interpretation. However, this was confirmed in 2018 by the CJEU as applied to EIR 2000, Art 15 (now EIR Recast, Art 18) in Case C-250/17, *Virgílio Tarragó da Silveira v Massa Insolvente da Espírito Santo Financial Group SA*, ECLI:EU:C:2018:398 (June 6, 2018). The court clarified that the concept of "assets or rights" refers not only to the specific assets or rights of the debtor, but rather covers the debtor's insolvency estate as a result of the opening of insolvency proceedings.

[59] Para 33 of the *Virgílio Tarragó* case.

usually stay or prevent any individual enforcement action brought by creditors against the debtor's assets.[60] This rule ensures the efficient administration of the insolvency estate and prevents piecemeal liquidation that would impede attempts to restructure the debtor's business or sell it as a going concern.

Self-Assessment Exercise 4

Question 1

The EIR Recast provides for a number of exceptions to the general rule on the application of the law of the insolvency forum (*lex concursus*). Give two examples of such exceptions and explain the rationale behind them.

Question 2

Solar Panels Srl (debtor) is a company registered in Bari (Italy). Its main line of business consists of manufacturing solar panels (mainly in Italy) and their distribution in other parts of Europe. In June 2017, it had to cease operations due to a lack of raw material availability. As a result, the company suffered a liquidity shortage and had to file for insolvency. By judgment of 15 July 2017, the *Tribunale di Bari* opened insolvency (*fallimento*) proceedings against Solar Panels Srl.

Among the assets owned by the debtor is a plot of land of 500 m² located near Amsterdam (the Netherlands). This land plot was mortgaged in favour of DutchBank (creditor), which financed operations of Solar Panels. Since the debtor entered into default on its obligations in August 2017, DutchBank decided to foreclose on the mortgaged asset in the Netherlands. Can DutchBank do so? When answering the question, please refer to the relevant provisions of the EIR Recast and relevant national law (if necessary).[61]

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

7. RECOGNITION AND ENFORCEMENT OF INSOLVENCY AND RELATED JUDGMENTS UNDER THE EUROPEAN INSOLVENCY REGULATION

We know which court has international jurisdiction to open insolvency proceedings. We also know which law applies to such proceedings. The next topic is whether these proceedings, opened in one Member States, will be recognised in another Member States and, subsequently have legal effects in the latter Member State. The issues relating to recognition are covered in Chapter II of the EIR Recast. Article 19 contains a general principle, under which any judgment opening insolvency proceedings by a court of a Member State which has jurisdiction pursuant to Article 3 (that is, both main and secondary proceedings) shall be recognised in all other

[60] Virgós-Schmit Report, para 120.
[61] See Dutch Bankruptcy Act, Art 57 and Italian Bankruptcy Law, Art 51.

Member States from the moment that it becomes effective in the state of the opening of proceedings. The same approach applies to insolvency related judgments, deriving directly from insolvency proceedings and closely connected to them (see paragraph 5.3.4. on related actions above).

7.1 Immediate and automatic recognition

The EIR Recast, in line with the EIR 2000, provides for the immediate recognition of judgments concerning the opening, conduct and closure of insolvency proceedings which fall within its scope (Recital 65 of the EIR Recast). Judgments handed down in the course of proceedings not listed in Annex A (for example, UK schemes of arrangement) fall outside the scope of the EIR Recast and do not enjoy the benefits of the automatic recognition. The same approach is adopted to the recognition of judgments handed down in direct connection with such insolvency proceedings. This system of automatic and immediate recognition is based on the principle of mutual trust between Member States, underpinning the EIR Recast system as a whole. Based on this mutual trust, the decision of the first court to open proceedings should be recognised in other Member States without those Member States or their courts having the power to scrutinise that first court's decision on either procedural or substantive grounds. The only exception to this rule – violation of public policy – will be discussed below.

The EIR Recast's approach to recognition, built on the principles of mutual trust and *favor recognitionis* (facilitation of recognition), is in stark contrast to the one adopted by the UNCITRAL Model Law. Recognition of a foreign proceeding under the latter instrument is based on an application for recognition (Article 15 of the Model Law). It does not work automatically. For example, the US, having incorporated the Model Law via Chapter 15 of the Bankruptcy Code, requires the filing of a petition for recognition of a foreign proceeding.[62] Besides, courts in the United States of America (United States or US) will always scrutinise the jurisdiction of a foreign court. In *In re Creative Finance Ltd (In Liquidation)*,[63] the US court dismissed a case filed under Chapter 15 due to the fact that it could not conclude that the debtor had either COMI or an establishment in the jurisdiction of the initial filing (BVI in this case). No such review would be allowed pursuant to Article 19 of the EIR Recast.

Article 19(2) of the EIR Recast adds that the recognition of main proceedings (Article 3(1)) shall not preclude the opening of secondary proceedings (Article 3(2)) by a court in another Member State. This is logical as the EIR Recast adheres to the framework of modified universalism with one main insolvency proceeding and the plurality of secondary proceedings across the EU (with the exception of Denmark).

7.2 Recognition of insolvency-related judgments

Article 32 of the EIR Recast deals with the recognition of insolvency-related judgments. It explicitly mentions judgments concerning the course and closure of insolvency proceedings and compositions approved by the court. Judgments made in the course of insolvency

[62] 11 US Code, § 1504.
[63] 543 B.R. 498 (Bankr SDNY 2016).

proceedings may also include dismissal of an insolvency practitioner and rulings related to the insolvency process. Such judgments are recognised without further formalities from the time they become effective in the originating forum.

Article 32 equally applies to judgments that derive directly from insolvency proceedings and which are closely linked with them, even if they have been handed down by a different court from the court that opened the insolvency proceedings. Judgments rendered as a result of actions falling under Article 6 of the EIR Recast (entitled "Related actions") will naturally come within the scope of Article 32. Examples may include an action to set aside acts detrimental to the general body of creditors, an action on the personal liability of one or more directors based on insolvency law, or an action relating to the admission or the ranking of a claim.[64]

In addition to judgments made in the course of insolvency proceedings, Article 32 extends to preservation measures taken after the request for the opening of insolvency proceedings or in connection with it. This ensures the effectiveness of the forthcoming insolvency proceedings. For example, a preservation measure can constitute a provisional injunction prohibiting the disposal of assets by the debtor. The issuance of preservation measures and their practical effects are not limited to main insolvency proceedings and could be vital in protecting local creditors while the application to open secondary insolvency proceedings is pending (*see* Recital 46 of the EIR Recast).

7.3 Effects of recognition

Article 20 of the EIR Recast sets out the effects of recognition. The judgment opening main insolvency proceedings, with no further formalities, produces the same effects in any other Member State as under the law of the state of the opening of proceedings.[65] The effects of the judgment opening main insolvency proceedings must be recognised and effected *ipso jure*, with no need to resort to any additional approval process or procedure, such as *exequatur*. This is in line with the universal character of main insolvency proceedings.

In essence, the EIR Recast extends the effects dictated by the applicable *lex concursus* of the main insolvency proceedings to the territory of all other Member States ("extension model"). In other words, the *lex concursus*, with its procedural and substantive effects (Article 7 of the EIR Recast), is exported and imposed on other Member States. The *lex concursus* and not the laws of those affected Member States determine the effects of the opening of the main insolvency proceedings. The Virgós-Schmit Report non-exhaustively lists some of such (possible) effects:[66] prohibition of individual executions (enforcement moratorium), inclusion of the debtor's assets

[64] Virgós-Schmit Report, para 196.

[65] In this respect the EIR Recast is starkly different from the Model Law. Article 20 of the Model Law defines a selected number of effects arising from the recognition of foreign main insolvency proceedings, such as a stay of individual actions against the debtor and a stay of execution against the debtor's assets. However, the actual administration and distribution of the insolvency estate and any other relief available are subject to the law of the recognising state and not the *lex concursus*. This stems from the fact that the Model Law does not contain explicit rules on choice of law.

[66] Virgós-Schmit Report, para 154.

in the insolvency estate regardless of their territorial location and the obligation to return what has been obtained by individual creditors after the opening of insolvency proceedings.

The limitations of the extension model may arise from the EIR Recast itself, or result from the opening of secondary proceedings. As discussed above, there are numerous exceptions to the application of the *lex concursus* (Articles 8 to 18 of the EIR Recast). Besides, main proceedings cannot produce effects on assets within the jurisdiction of secondary proceedings. The *lex concursus* ends where the *lex concursus secundarii* begins. The effects of the opening of secondary proceedings are determined by the *lex concursus secundarii* and restricted by the geographical borders of the state of the secondary proceedings. As a result, the extension model does not apply to secondary proceedings, the effects of which can only be challenged in courts of the jurisdiction of the secondary proceedings (Article 20(2) of the EIR Recast).

7.4 Enforcement of insolvency and related judgments

In contrast with recognition, enforcement requires the exercise of the state's coercive power to ensure compliance. Due to the principles of national sovereignty, direct application of coercive powers can be performed only by the state where assets or persons to which action relates are situated.[67]

Article 32(1) of the EIR Recast establishes that the judgments covered by it (for example, insolvency-related judgments) must be enforced in accordance with Articles 39 to 44 and 47 to 57 of the Brussels I Recast. According to Article 39 of the Brussels I Recast, a judgment given in a Member State which is enforceable in that Member State shall be enforceable in the other Member States without any declaration of enforceability being required. Therefore, no form of approval or *exequatur* is necessary. This was not the case under the EIR 2000, which referred to Article 31 of the Brussels Convention (later replaced by the Regulation (EC) Number 44/2001), mandating the declaration of enforceability from the court in a state where enforcement was sought.

The very procedure for the enforcement of judgments is governed by the law of the Member State in which enforcement is sought. This law will determine, *inter alia*, the competent enforcement authorities, the enforcement process and the rights and obligations of parties to the enforcement process.

7.5 Public policy exception

Since 2002, the principle of mutual trust and the general presumption of the legitimacy and validity of foreign insolvency judgments (*favor recognitionis*) have been fundamental to the EIR 2000. They remain fully applicable, fifteen years later, in the framework of the EIR Recast. As shown above, insolvency and insolvency-related judgments must be recognised automatically and immediately. There is one exception, however. Any Member State may refuse to recognise insolvency proceedings opened in another Member State, or to enforce a judgment handed

[67] *Idem*, para 190.

down in the context of such proceedings, where the effects of such recognition or enforcement would be manifestly contrary to that state's public policy (Article 33 of the EIR Recast).

Under the EIR Recast, the public policy exception has two angles. Firstly, a foreign insolvency judgment must not be scrutinised in regard to its merits (known as the absence of *révision au fond*). All questions regarding the substance of the judgment must be discussed before the courts of the state that opened insolvency proceedings. In the state where recognition or enforcement is requested (requested state), the court is only permitted to consider whether the foreign judgment will have *effects* contrary to that state's public policy. Secondly, the EIR Recast precludes verification by the recognising court of the international insolvency jurisdiction accepted by the court of the Member State in which proceedings have been opened pursuant to Article 3 of the EIR Recast. The fact that the court that opened insolvency proceedings erred in accepting its jurisdiction, must not trigger non-recognition in other Member States.

The term "public policy" appears to be a somewhat open, abstract norm. This legal norm should be derived from the national law of the requested state and therefore the concept does not necessarily have an EU-wide uniform meaning. Public policy is based on the fundamental principles of the law of the requested state and involves, in particular, constitutionally protected rights and freedoms and fundamental policies of the requested state (Article 33 of the EIR Recast). In *Eurofood IFSC Ltd*, the CJEU stressed that a Member State may refuse to recognise insolvency proceedings where the decision to open the proceedings was taken in *flagrant* breach of the fundamental right to be heard. In the context of insolvency proceedings, the right of creditors or their representatives to participate in accordance with the equality of arms principle is of particular importance.

Grounds for non-recognition should be reduced to the minimum necessary (Recital 65 of the EIR Recast). Such grounds could stem from grave breaches of either the procedural or substantive principles of the public order of a requested state. The most important procedural rights include, *inter alia*, the right to be heard and to have a real opportunity to present evidence and contest arguments of the opposing party (equality of arms).[68] However, as the application of public policy is always fact-specific, one can imagine situations that require urgent reaction and measures from the court or insolvency practitioners. For example, the exigence of preservation measures may justify departure from a strict application of the right to be heard, provided that sufficient safeguards are in place (for example, that the affected party has an opportunity to challenge the measure adopted in short order). The public policy exception may also be triggered by the lack of independence and impartiality by the court, as well as corruption or fraud involved in the course of insolvency proceedings. Among substantive rights, a major role is played by the right to property and private ownership. For example, in one case the

[68] Improper notification of a creditor in insolvency proceedings regarding a hearing on the distribution of the estate was seen to violate the right to a fair trial (*Zavodnik v Slovenia*, no 53723/13, ECtHR 2015). Despite the fact that the ECtHR is not a part of the EU institutional system, all Member States are contracting parties to the European Convention on Human Rights (ECHR) and are bound by its interpretation by the ECtHR. The fundamental character of rights guaranteed by the ECHR makes it particularly relevant for determining the substance and scope of public policy.

ECtHR found a violation of the right to property on account of the way the insolvency proceedings were handled.[69]

8. CREDITORS' RIGHTS AND THEIR PROTECTION UNDER THE EUROPEAN INSOLVENCY REGULATION

Equality of creditors, effective administration of the insolvency estate and maximisation of the return to creditors are the core principles that underlie the operation of the EIR Recast. To achieve these goals, the EIR Recast establishes detailed rules related to the lodgement of creditors' claims, the provision of information to creditors and the balancing of creditors' rights in a situation of multiple insolvency proceedings. In this section of the guidance text we will describe some of the most important creditors' rights guaranteed by the EIR Recast and explain how they fit within the framework of the EIR Recast.

8.1 Right to lodge claims

Article 45(1) of the EIR Recast provides that any creditor may lodge its claim in the main insolvency proceedings and in any secondary insolvency proceedings. This follows from the autonomous nature of secondary proceedings. The lodging and admission of claims in main insolvency proceedings does not lead to their *ipso facto* admission in secondary proceedings, and *vice versa*. The rules governing the lodging, verification and admission of claims differ from one jurisdiction to another (Article 7(2)(h) of the EIR Recast). However, any provisions of national law limiting the right to lodge claims, for example to local creditors only, will contradict Article 45 and should not be enforceable on the basis of violating the principle of *paritas creditorum*.[70]

Despite the fact that filing claims in multiple proceedings can increase the chances of getting paid, lodging claims in each insolvency proceeding may prove to be costly, particularly for micro and small enterprises. To protect their interests, Article 45(2) empowers insolvency practitioners in main and secondary insolvency proceedings to lodge the claims they have received in other insolvency proceedings. More accurately, the insolvency practitioners *must* lodge such claims, provided that the interests of creditors in proceedings for which they have been appointed are served by doing so and subject to the right of creditors to oppose such lodgment or to withdraw the lodgment of their claims where the applicable law so provides. This provision is of a substantive character and aims at protecting creditors who might have no means or awareness to file in other proceedings themselves. As regards the need to consider the interests of creditors, it is commonly accepted that the insolvency practitioner must only decide whether the filing in other proceedings is in the general interest of creditors in his proceedings.

It is true that a multiplicity of submissions in parallel insolvency proceedings do not receive well-co-ordinated actions from the insolvency practitioners appointed in each of the separate proceedings, and may therefore lead to a double distribution. For this reason, insolvency

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[69] *OAO Neftyanaya Kompaniya Yukos v Russia*, no 14902/04, ECtHR 2011.

[70] "*Par est condicio omnium creditorum*" literally means: "the condition of all creditors is equal". This maxim is widely employed to express the principle of equality of treatment and status to be accorded to all creditors generally. It is a principle which admits of numerous exceptions, which vary according to the provisions contained in the laws of the various countries.

practitioners need to effectively communicate with each other, particularly on any progress made in lodging or verifying claims, pursuant to Article 41(2) of the EIR Recast. Article 45(3) adds that the insolvency practitioner in the main or secondary insolvency proceedings is entitled to participate in other proceedings on the same basis as a creditor, in particular by attending creditors' meetings. This, however, does not create a power of representation. The insolvency practitioner attends creditor's meetings in his own capacity and, as a general rule, cannot vote on behalf of creditors.

Article 53 of the EIR Recast states that any *foreign* creditor may lodge claims in insolvency proceedings by any means of communication accepted by the law of the state of the opening of these proceedings. For the sole purpose of lodging a claim, representation by a lawyer or another legal professional is not mandatory. The rights of a non-foreign creditor[71] must be determined by the *lex concursus*. Recital 63 of the EIR Recast clarifies that a creditor does not always have to lodge a claim personally; instead it can be done by the insolvency practitioner acting on behalf of certain groups of creditors, for example employees, where the national law so provides.

In order to create a level playing field and to ensure equal treatment of local and foreign creditors, the EIR Recast adds some important rules that override national legislation. For example, according to Article 55(1) of the EIR Recast, any foreign creditor may lodge its claim using the standard claims form established in accordance with Article 88 of the EIR Recast.[72] The form must bear the heading "*lodgement of claims*" in all the official languages of the institutions of the EU. The unification of forms for filing claims in insolvency should simplify access of foreign creditors to insolvency proceedings opened in other Member States and to their insolvency registers. In particular, this concerns micro- and small-sized businesses and natural persons, which are often unable to file their claims abroad due to the high costs involved, both in getting information and in receiving appropriate legal, translation and administrative support. The standard claim form should include information on the creditor, the amount of the claim and its nature and preferential status (if any). The standard claim form must be accompanied by copies of any supporting documents (Article 55(2) of the EIR Recast). National authorities cannot ask for additional (new) information from a foreign creditor or require notarisation of the respective form. Nonetheless, they can ask for additional evidence, related to what has been stated in the form.

Claims must be lodged within the period stipulated by the law of the Member State of the opening of proceedings (*lex concursus*). In practice, foreign creditors might be disadvantaged, if for the reason of language, time or territorial barrier, they learn about the opening of insolvency proceedings too late to timely submit their claims. To solve this problem, Article 55(6)

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71 The definition of a "foreign creditor" is given in Art 2(12) of the EIR Recast, which characterises it as a creditor who has its habitual residence, domicile or registered office in a Member State other than the State of the opening of proceedings, including the tax authorities and social security authorities of Member States. Thus, a creditor which has its habitual residence, domicile or registered office in the insolvency forum or outside the EU, does not fall under the definition. Tax and social security authorities have been mentioned for the avoidance of any doubt as to their rights compared to those creditors who do not act in the public interest.

72 Standard forms, including the standard claims form, have been adopted by the Commission Implementing Regulation (EU) 2017/1105 of 12 June 2017 (Implementing Regulation).

stipulates that in the case of a foreign creditor, the filing period shall not be less than 30 days following the publication of the opening of insolvency proceedings in the insolvency register of the Member State of the opening of proceedings. This requires creditors to closely monitor the local registers (which will in future be done through the interconnected interface via the e-Justice Portal) to see if insolvency proceedings have been initiated against the debtor. The description of the rules on insolvency registers follows below in paragraph 8.3.2. of the guidance text.

8.2 Return and imputation

To better understand the rules of the EIR Recast concerning return and imputation (Article 23), one should be reminded of the principle of equal treatment of creditors in insolvency proceedings which underpins the system of the EIR Recast. This principle highlights that, unless special rules apply (for example, regarding rights *in rem*) all similarly situated creditors should equally participate in the distribution of insolvency proceeds. However, in practice there can be situations when a creditor obtains more than other creditors, thus raising equality and fairness concerns. The EIR Recast tries to avoid these situations.

Article 23 of the EIR Recast contains two distinct rules, describing two different situations, but protecting the same principle of *paritas creditorum*. Article 23(1) of the EIR Recast deals with the situation in which a creditor obtains total or partial satisfaction of its claim on the assets belonging to the debtor situated within a territory of a Member State other than the state of the main insolvency proceedings. If such satisfaction is received *after* the opening of main insolvency proceedings, the creditor must return what has been obtained back to the insolvency practitioner. As explained in the Virgós-Schmit Report,[73] this rule is the consequence of the universality of the main proceedings, which encompass all the debtor's assets, wherever situated in the EU, and affects all the creditors. Otherwise, if each creditor can individually enforce its claim in various Member States, the principles of collective satisfaction and equality of creditors will inevitably be breached.

For Article 23(1) of the EIR Recast to apply, several conditions should be satisfied. Firstly, the creditor needs to get partial or total satisfaction of the claim. Secondly, such satisfaction should come from the debtor's assets. Thirdly, the expropriated assets shall be located in a Member State, different from the state of the insolvency forum. Non-Member States are therefore excluded. If the creditor receives satisfaction from the debtor's assets located in a non-Member State, it is the *lex concursus* that determines the effects of such satisfaction, not the EIR Recast. Fourthly, satisfaction must happen after the opening of main insolvency proceedings. The time of the opening of proceedings is linked to the time at which the judgment opening insolvency proceedings becomes effective, regardless of whether the judgment is final or not (Article 2(8) of the EIR Recast). Fifthly, the obligation to return what has been acquired is subject to exceptions arising from Article 8 (entitled "third parties rights *in rem*") and Article 10 (entitled "reservation of title"). Realisation of a right *in rem* under the applicable *lex situs* is not seen as a violation of the collective enforcement principle,[74] while the reservation of title carves out the

[73] Virgós-Schmit Report, para 172.
[74] *Idem*, para 173.

relevant asset from the insolvency estate and, hence, cannot violate the principle of equal treatment of creditors. However, a creditor who validly exercised its security right must return to the insolvency estate whatever amount has been obtained in excess of the secured claim.

The EIR Recast permits the opening of several insolvency proceedings against the same debtor. Secondary (territorial) proceedings can be opened at the place of the debtor's establishment (Article 3(2) of the EIR Recast). As explained above, creditors are free to lodge their claims in the main insolvency proceedings and in any secondary insolvency proceedings as they wish (Article 45 of the EIR Recast). Thus, a creditor may satisfy its claim in insolvency proceedings opened in one Member State before other creditors in another Member State without violating the EIR Recast. Under Article 23(2) of the EIR Recast, such a creditor can keep what has been received as part of the distribution in the insolvency proceeding. However, in order to ensure the equal treatment of creditors, the "enriched" creditor can share in distributions made in other proceedings only when creditors of the same ranking or category have, in those other proceedings, obtained an equivalent dividend. This rule has been named the "hotchpot rule". It essentially aims at rebalancing creditors' returns in a situation of plurality of insolvency proceedings.

Imagine that a general unsecured creditor, creditor A, has filed its claim for USD 10,000 in two separate insolvency proceedings: proceeding 1 (main insolvency proceeding), proceeding 2 (secondary insolvency proceeding). In proceeding 1 creditor A managed to get a partial satisfaction of its claim in the amount of USD 5,000 or 50% of the total amount. Meanwhile, other similarly ranked creditors in proceeding 2 did not participate in proceeding 1 and can receive only 30% of their claims in proceeding 2. In this scenario creditor A will not be able to seek anything more, as he has his claim satisfied to a greater extent (proportion) compared to other creditors. However, if creditors in proceeding 2 could get 70% of their claims satisfied, creditor A would be authorised to claim the remaining 20% or USD 2,000.

Two complications may, however, arise. Member States differ in their approaches to the ranking of creditors and no harmonisation in this regard is achievable in the near future. Since different insolvency laws apply to different proceedings, each governed by its own *lex concursus* or *lex concursus secundarii*, the ranking of the same claim may differ depending on the respective jurisdiction. Keeping this in mind, the only ranking that matters is that given to the claim by the law governing proceedings in which distribution is to be effected.[75] In the above example, if creditor A ranks higher in proceeding 2 than the remaining creditors, it would be able to increase its satisfaction rate. However, special consideration may be prescribed by the *lex concursus secundarii*. This is also the case with the rights of creditors who have obtained partial satisfaction by virtue of a right *in rem* or through a set-off. The EIR Recast does not regulate whether the amount of the original claim or the remaining claim shall be taken into account in further distributions. This question should be resolved by the applicable *lex concursus (lex concursus secundarii)* (Article 7(2)(i) of the EIR Recast).

[75] *Idem*, para 175.

8.3 Notification of creditors and insolvency registers

The exercise of the right to file claims is dependent on the creditors' knowledge about the opening of insolvency proceedings. To make the right to file claims and participate in insolvency proceedings meaningful, the EIR Recast contains mandatory rules on creditor notification and the establishment of insolvency registers. These rules constitute major progress when compared to the provisions of the EIR 2000.

8.3.1 Duty to inform creditors

Notwithstanding the importance of publicity for the smooth handling of cross-border insolvencies, the EIR 2000 left it to the discretion of the liquidator to publish information on the opening of the insolvency proceedings in other Member States (Article 21 of the EIR 2000). In contrast, Article 28(1) of the EIR Recast obliges the insolvency practitioners or debtors in possession to request publication of the notice on the opening of insolvency proceedings, whether main or secondary, at the place of the debtor's establishment in accordance with the publication procedures provided for in that Member State. This obligation arises from the presumption that the debtor's establishment coincides with the location of (a number of) its creditors. The publication must specify, where appropriate, the name of the insolvency practitioner appointed and whether the opened proceeding is main or secondary. Article 28(2) of the EIR Recast states that the insolvency practitioner or the debtor in possession *may* also request the publication in any other Member State, if they consider it necessary or beneficial for the proper administration of the insolvency estate, for example when the debtor has a substantial number of assets or creditors in that Member State.

Article 28 of the EIR Recast co-exists with other articles, aimed at ensuring the publicity of insolvency proceedings for the benefit of the debtor's creditors. Article 54 of the EIR Recast compels the court of the opening of insolvency proceedings, or the insolvency practitioner appointed by such court, to immediately inform the known foreign creditors as soon as insolvency proceedings are opened.[76] The need to separately inform foreign creditors is related to particular difficulties and barriers (for example, language, procedure, information) such creditors face in obtaining information about foreign insolvencies. While defining the term "foreign creditor", the EIR Recast does not clarify who "known" foreign creditors are. Such creditors would certainly include those mentioned in the debtor's books, contracts, or separately listed in the information attached to the debtor's insolvency filing.

The information in the creditors' notice must in particular include time limits for the lodging of claims, the penalties laid down in regard to those time limits, the body or authority empowered

[76] The EIR Recast does not mention *local* creditors. The procedure and extent of informing such creditors is therefore left for the applicable *lex concursus* to determine. Another controversial issue arises with respect to creditors located outside the EU or in Denmark. While EIR 2000, Art 40 imposed an obligation to inform "creditors who have their habitual residences, domiciles or registered offices in the other *Member States*", the EIR Recast refers to all known foreign creditors, whether in or outside the EU. Therefore, it can be defended that all creditors located outside the state of the opening of insolvency proceedings must be informed pursuant to Art 54 of the EIR Recast. Note that Art 54 adds a European layer onto the existing domestic rules, which may at national level mandate informing creditors all over the world.

to accept the lodgement of claims and any other measures. Such notice must also indicate whether creditors whose claims are preferential or secured *in rem* need to lodge their claims. The notice must include a copy of the standard form for the lodging of claims referred to in Article 55 of the EIR Recast, or information on where that form is available.

As regards the procedure for informing creditors, Article 54(2) of the EIR Recast mentions the use of individual notices, while Article 54(3) of the EIR Recast lays down that the information must be provided using the standard notice form that must be published in the European e-Justice Portal. The connection between the two means of notification is not entirely clear. It may be argued that publication in the insolvency register is insufficient to comply with the duty to inform creditors. In addition, Article 54(1) presupposes an action on its own initiative, where it provides that the insolvency practitioner shall inform known foreign creditors "immediately". We believe, however, that with the fully operational interconnection of insolvency registers, the need for individual notices will be diminished. Before the full operational capacity of the European e-Justice Portal is established, the procedure for publicising relevant information is left to the applicable national law and will most probably result in individual letters (including e-mails) sent to each creditor. At the same time, as mentioned above, the standard notice form was adopted in mid-2017 by the Implementing Regulation. The standard notice form to be used to inform known foreign creditors of the opening of insolvency proceedings, as referred to in Article 54(3) of the EIR Recast, is set out in Annex I to the Implementing Regulation.

Importantly, while prescribing the duty to inform creditors, the EIR Recast does not set out the consequences of its violation. These consequences must be determined by the *lex concursus*. Member States have adopted different approaches in dealing with improper notices and the resultant late filings. While some courts (for example, in Slovenia and the Czech Republic) hold that the argument of the expiry of the claim-bar date cannot be invoked against unnotified creditors, others (for example, in France and Finland) do not prescribe such consequences. In any case, the failure to notify creditors does not limit the effects of the debtor's insolvency. These effects are linked purely to the fact of the opening of proceedings in the jurisdiction of the debtor's COMI (main proceedings) or establishment (secondary proceedings).

8.3.2 Insolvency registers

The efficient functioning of cross-border insolvency proceedings relies on the exchange of information between insolvency practitioners, courts and creditors. In particular, a court opening insolvency proceedings needs to know whether the debtor is already subject to insolvency proceedings in another Member State. Under the EIR 2000, every Member State had its own insolvency registration system (which did not always work adequately) and the inter-connectedness of these registers was not ensured. The EIR Recast has made considerable progress in this regard. According to Article 24 of the EIR Recast, Member States must establish and maintain in their territory one or several registers in which information concerning insolvency proceedings is published (insolvency registers). That information must be published as soon as possible after the opening of such proceedings. The EIR Recast determines the minimum amount of information to be published in the insolvency registers. It includes the date of the opening of insolvency proceedings, the court that opened insolvency proceedings, the type of insolvency proceeding (main, secondary or territorial), the debtor's name, reregistration

number, registered office, the name, postal address or email of the insolvency practitioner, etcetera.

The publicity of information regarding the opening of insolvency proceedings is crucial for creditors, both local and foreign, as they might be required by the *lex concursus* to file their claims within a prescribed period of time. Late filing may affect their ranking, or otherwise negatively influence their position in the insolvency proceeding. To improve the publicity of insolvency proceedings, Article 25 of the EIR Recast prescribes the creation of a decentralised system for the interconnection of insolvency registers. That system must be composed of the national insolvency registers and the European e-Justice Portal, which will serve as a central public electronic access point (search engine) to information in the system.[77] Thus, when the decentralised system is established (expected in mid-2019), it will be possible to search for information on insolvency proceedings opened in any of the EU Member States by using a single search platform, instead of the scores of national insolvency registers.

8.3.3 Honouring of an obligation to a debtor

The EIR Recast provides for the immediate effect of the judgment opening insolvency proceedings across the EU (Denmark excluded). These effects apply regardless of the publication of such a judgment in the originating Member State. This may cause situations where the insolvent debtor's counterparties are not aware of the opening of insolvency proceedings. Such counterparties might end up rendering performance to the debtor as opposed to the insolvency practitioner, as the *lex concursus* may require. If this is the case, these parties run the risk that their obligations will not be discharged and they will be required to perform again, this time to the insolvency practitioner. Article 31 of the EIR Recast protects the performing party in such cases. If such a party was not aware of the opening of insolvency proceedings while performing its obligations for the benefit of the debtor instead of the insolvency practitioner, appointed in the proceedings in another Member State, the obligation will be properly discharged. This is not a conflict of laws rule used to determine international jurisdiction or applicable law, rather it is a provision of substantive law that applies in each Member State independently of the *lex concursus*.

The question that arises, is how one determines whether a person is aware or unaware of the opening of insolvency proceedings? The EIR Recast introduces a presumption in this regard. This has already been discussed under Article 28, where the insolvency practitioner is required to publicise the judgment opening insolvency proceedings in any other Member State where the debtor has an establishment. He may also decide to request such publication in other Member States if it is deemed necessary (Article 28(2) of the EIR Recast). Article 31(2) prescribes that if the obligation is honoured before the publication provided for in Article 28 has occurred in the state concerned (for example, the state in which the person honouring the obligation is

[77] Since the summer of 2014, the EC has already maintained an interconnection search interface, a functionality of the European e-Justice Portal at https://e-justice.europa.eu/content_insolvency_registers-110-en.do, which allows interested parties to search for insolvent entities, either natural or legal persons, within the EU. As of December 2018, it includes seven participating states, namely Germany, the Netherlands, Slovenia, Estonia, Austria, Italy and Romania. By entering the debtor's name, one can search for the insolvency case throughout all seven jurisdictions.

established or the state in which the obligation is honoured, as the case may be), there is a presumption of ignorance (lack of knowledge). If the obligation is honoured after the publication has taken place, there is a presumption of awareness. These two presumptions are rebuttable, but under each of them the burden of proof shifts from one party to the other. For instance, once publication has taken place, it is for the debtor honouring the obligation in question to provide evidence rebutting the presumption.[78] It is not clear how this system of presumptions will operate when the interconnection of insolvency registers becomes effective. In our opinion, the availability of information on the opening of insolvency proceedings through the interface of the European e-Justice Portal pursuant to Article 25 of the EIR Recast should lead to the presumption of awareness, by analogy with publication under Article 28 of the EIR Recast.

Article 31(1) of the EIR Recast applies to an obligation which has been honoured in a Member State for the benefit of a debtor who is subject to insolvency proceedings opened in another Member State. When performance occurs in the same Member State as the Member State of the opening of insolvency proceedings, Article 31 does not apply and the effects of such performance are determined by the *lex concursus*. The same approach is taken whenever performance takes place in a non-Member State.

Article 31 of the EIR Recast quite logically extends to the obligation of a third party (counterparty) who is a debtor of the insolvent debtor. Does it also apply to a payment made at the behest of a debtor, who is subject to insolvency proceedings, to one of the latter's creditors? This question was answered in the negative by the CJEU in *Christian Van Buggenhout v Banque Internationale à Luxembourg SA*.[79] This case concerned the insolvency of Grontimmo (debtor), a property development company with its registered office in Antwerp (Belgium). A few days after the debtor's insolvency, its bank, Banque Internationale à Luxembourg (Luxembourg), effected a number of payments on the debtor's behalf to one of its creditors. The judgment opening the proceedings against Grontimmo was published in the jurisdiction of the main insolvency proceedings (Belgium), but not at the bank's seat (Luxembourg). Grontimmo's insolvency practitioners demanded the bank to repay the sums transferred to the creditor allegedly in contravention of the divestment of the insolvent company's assets. The bank refused, arguing that it had been unaware of the opening of insolvency proceedings in Belgium. It tried to rely on Article 24 of the EIR 2000 (now Article 31 of the EIR Recast). The CJEU was not persuaded and noted that the provision in question protects the debtors of the insolvent debtor, who honour their obligations for the benefit of the latter in good faith. In this case it was not the debtor benefiting, but its creditor who received money from the debtor's bank. Any different interpretation would allow the debtor, via third parties who are unaware of the opening of insolvency proceedings, to transfer the assets to its creditors seeking to obtain a more favourable legal position.

[78] Virgós-Schmit Report, para 187.
[79] Case C-251/12, ECLI:EU:C:2013:566 (Sep 19, 2013).

Self-Assessment Exercise 5

One of the major underlying principles of the EIR is the principle of *paritas creditorum* (equality of creditors). How is this principle ensured in practice? Support your answer with references to the applicable provisions of the EIR Recast.

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

9. COMMUNICATION AND CO-OPERATION IN EUROPEAN INSOLVENCY CASES

The system of the EIR Recast allows for the opening of several parallel insolvency proceedings against the same debtor. In this context, Recital 48 rightly points out that the efficient administration of the insolvency estate and the effective realisation of the total assets require proper co-operation between the actors involved in all the concurrent proceedings. Proper co-operation implies the various insolvency practitioners and the courts involved co-operating closely, in particular by exchanging relevant information. Co-operation and communication within the EIR Recast framework stems from the general idea of mutual trust and sincere co-operation, which is indispensable for the functioning of the EU.[80] In addition, it certainly makes sense that when there are several proceedings against one debtor (which can have only one estate and the same group of creditors), such proceedings should be co-ordinated.

It must be noted that the EIR 2000 contained only one article mandating insolvency practitioners in main and secondary proceedings to communicate information to each other (Article 31 of the EIR 2000). In contrast, the EIR Recast introduces a comprehensive framework for co-operation and communication between insolvency practitioners (Article 41 of the EIR Recast), between courts (Article 42 of the EIR Recast), and between insolvency practitioners and courts (Article 43 of the EIR Recast). Such a framework should enable the efficient and effective deployment of the debtor's assets and protection of creditors' rights. These articles have their match in Articles 56 to 59 of the EIR Recast in matters of co-operation and communication in insolvency proceedings relating to two or more members of a group of companies.

It is important to note that that the EU legislator, although providing a general framework for ways and forms of cross-border co-operation, also relies on best practices that have been developed in (international) insolvency practice. Recital 48 provides that "[w]hen cooperating, insolvency practitioners and courts should take into account best practices for cooperation in cross-border insolvency cases, as set out in principles and guidelines on communication and cooperation adopted by European and international organisations active in the area of insolvency law …". In this statement, the EU legislator acknowledges the value of these best practices and relies on the professionality and integrity of the organisations that have drafted or have adopted them. Among such guidelines are European Communication and Cooperation Guidelines for Cross-Border Insolvency (CoCo Guidelines, October 2007; a revision is due in

[80] Treaty on European Union, Art 4; and Treaty on the Functioning of the European Union, Art 81.

2019), the EU Cross-Border Insolvency Court-to-Court Communications Principles and Guidelines (EU JudgeCo Principles and Guidelines, December 2014) and the UNCITRAL Practical Guide on Cross-Border Insolvency Cooperation (2009). These authoritative (not legally binding) texts laid down the groundwork for the EIR Recast provisions on communication and co-operation.

9.1 Co-operation and communication between insolvency practitioners

According to Article 41(1) of the EIR Recast, the insolvency practitioner in main insolvency proceedings and insolvency practitioner(s) in secondary proceedings concerning the same debtor shall co-operate with each other, as long as it is compatible with the rules applicable to the respective proceedings. Similar wording can be found in Article 31(2) of the EIR 2000. However, Article 41 of the EIR Recast adds that such co-operation may take any form, including the conclusion of agreements or protocols.

The practice of entering into protocols dates back long before the adoption of the original insolvency regulation at the end of the last decade of the last century. One notable example is the *Maxwell* case.[81] Maxwell Communication Corporation plc (Maxwell) was a UK-based media holding company with a large US presence. Unable to perform its obligations under the UK credit facilities, it filed a pre-emptive Chapter 11 petition in the US on 16 December 1991. The very next day, Maxwell's directors also petitioned for an administration order in the UK. Unco-ordinated handling of two simultaneous proceedings could have disturbed efficient administration of the insolvency estate. Instead, a protocol was negotiated. Under the protocol, the UK joint administrators and the US-appointed examiner undertook to co-ordinate insolvency proceedings, for example by requiring the consent of the examiner for certain actions performed by the administrators. A similar practical approach was taken in the insolvency of Lehman Brothers Group, the largest bankruptcy in history with over USD 600 billion in liabilities, over 75 separate proceedings and more than 16 official representatives. According to the court documents, "[t]he chaos that ensued was unprecedented and presented the potential for highly fractious proceedings permeated by years of extended, complex and expensive litigation among competing interests and entities".[82] In order to co-ordinate multiple insolvency proceedings opened against Lehman Brothers Holdings Inc and its affiliated debtors worldwide, the protocol was signed by most of the official representatives of the companies belonging to Lehman Brothers Group. This protocol served the purpose of ensuring proper notification, communication and data sharing between insolvency practitioners appointed in insolvency proceedings of the Lehman Brothers Group.

Insolvency practitioners must as soon as possible communicate to each other any information which may be relevant to other proceedings. In particular, it should address any progress made in lodging and verifying claims and all measures aimed at rescuing or restructuring the debtor, or at terminating the proceedings (Article 41(2)(a) of the EIR Recast). Without constant communication, Article 23 of the EIR Recast (entitled "Return and imputation"), guaranteeing

[81] *Maxwell Communications Corp.*, [1992] B.C.L.C. 465; 170 B.R. 800 (Bankr SDNY 1994); Aff'd B.R. 807 (Bankr SDNY 1995); 593 F.3rd 1036 (2nd Cir, 1996).

[82] Debtors' Amended Response to Objections to Approval of Proposed Disclosure Statement, *In re Lehman Bros. Holdings*, No 08-13555 (Bankr SDNY Aug 23, 2011), para 1.

the balance of creditors' rights across several insolvency proceedings, will be inoperative. The predecessor of Article 41 of the EIR Recast, Article 31 of the EIR 2000, did not mention the need to communicate information on measures related to the debtor's rescue and restructuring. Reference to such measures in the EIR Recast indicates its widened scope and policy preferences towards saving economically viable but distressed businesses. In order to explore the possibility of business rescue, insolvency practitioners must co-ordinate the elaboration and implementation of a restructuring plan. The third situation in which communication and co-ordination between IPs is vital, concerns the administration or the realisation or use of the debtor's assets and affairs. In this respect Article 41(2)(c) of the EIR Recast mandates insolvency practitioners in secondary proceedings to provide the main insolvency practitioner with an early opportunity to submit proposals on the realisation or use of assets in secondary insolvency proceedings.[83]

9.2 Co-operation and communication between courts

The EIR 2000 did not contain specific provisions prescribing co-operation and communication between courts in insolvency proceedings, that is, it only referred to insolvency practitioners (using the term "liquidators"). Nevertheless, the need for co-operation between courts was evident. In the case of *Bank Handlowy*,[84] involving main insolvency proceedings in France (*sauvegarde*) and secondary winding-up proceedings in Poland, the CJEU noted that "[t]he principle of sincere cooperation laid down in Article 4(3) [TEU] requires the court having jurisdiction to open secondary proceedings, […] to have regard to the objectives of the main proceedings and to take account of the scheme of the Regulation, which […] aims to ensure efficient and effective cross-border insolvency proceedings through mandatory coordination of the main and secondary proceedings guaranteeing the priority of the main proceedings".

The EIR Recast codified some existing best practices in the area of co-operation and communication but went further by obliging the court before which a request to open insolvency proceedings is pending, or which has opened such proceedings, to co-operate with any other court faced with the issue of opening insolvency proceedings or which has already opened such proceedings (Article 42(1) of the EIR Recast).[85] Thus, co-operation extends in time before the insolvency proceedings are opened. This is done to ensure better co-ordination and to preclude abusive forum shopping. The co-operation covers all sorts of proceedings, including territorial (independent) proceedings and is in principles limited only to the extent that such co-operation is incompatible with the rules applicable to each of the proceedings involved.

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[83] The CoCo Guidelines elaborate on this point, noting that the sale of (large parts of) assets is the most common method used in a liquidation. A co-ordinated and aligned approach across national borders is likely to produce greater value. Piecemeal sale of the debtor's assets or a "crown jewel" asset crucial for continuation of its business can hinder restructuring attempts in the main insolvency proceedings and diminish the total value available to creditors.

[84] Case C-116/11, *Bank Handlowy w Warszawie SA v Christianapol sp. z o.o.*, ECLI:EU:C:2012:739 (Nov 22, 2012).

[85] Despite a positive obligation to co-operate and communicate information, courts in the EU do not always easily comply with this obligation, or follow it in different ways and to different degrees. The reasons for such divergence may come from different national (legal) traditions. For instance, the Irish constitutional principle that justice must be administered in public can make it considerably more difficult to engage in direct (without prior open court hearing involving affected parties) communication with courts in other Member States.

Court-to-court co-operation can take various forms and may be implemented by any means that the court considers appropriate. For instance, it can result in co-ordination related to the appointment of insolvency practitioners. In that context, courts may appoint a single insolvency practitioner for several insolvency proceedings concerning the same debtor, provided that this is compatible with the rules applicable to each of the proceedings, in particular with any requirements concerning the qualification and licensing of the insolvency practitioner (Recital 50 of the EIR Recast). In practice this is hardly achievable, since the rules on qualification and licensing of IPs vary considerably among Member States. Language constitutes another barrier. The courts are empowered to co-ordinate the administration and supervision of the debtor's assets and affairs, synchronise the conduct of hearings and the approval of protocols, where necessary (Article 42(3) of the EIR Recast). Under the EU JudgeCo Guidelines, courts may consider conducting joint hearings (Guideline 10) and utilising various means of electronic communication (Guideline 8).

9.3 Co-operation and communication between insolvency practitioners and courts

In addition to court-to-court (Article 42 of the EIR Recast) and insolvency practitioner-to-insolvency practitioner (Article 41 of the EIR Recast) co-operation and communication obligations, the EIR Recast introduces court-to-insolvency practitioner obligations (Article 43 of the EIR Recast). It describes three situations in which such duties arise, namely an insolvency practitioner in:

(a) main insolvency proceedings must co-operate and communicate with any court before which a request to open secondary insolvency proceedings is pending, or which has opened such proceedings;

(b) territorial or secondary insolvency proceedings must co-operate and communicate with the court before which a request to open main insolvency proceedings is pending, or which has opened such proceedings; and

(c) territorial or secondary insolvency proceedings must co-operate and communicate with the court before which a request to open other territorial or secondary insolvency proceedings is pending, or which has opened such proceedings.

Thus, communication and co-operation extend to both vertical (main ↕ territorial / secondary proceedings) and horizontal relations (territorial/secondary ↔ territorial / secondary proceedings). Consider the following example: the secondary insolvency proceedings entail the realisation of assets belonging to such proceedings separately (independently) of main proceedings. In all likelihood, this will lead to a piecemeal liquidation and suboptimal returns to creditors. To avoid this situation, Article 46(1) of the EIR Recast commits the court in the secondary proceedings to stay the process of asset realisation in whole or in part on receipt of the request from the main insolvency practitioner. Such a request can be rejected only if it is manifestly of no interest to the creditors in the main insolvency proceedings. Without timely communication between insolvency practitioners and courts, the ideal of co-ordinated asset management (including asset sales) will be unattainable. The same goes for the goal of business restructuring that becomes more achievable with the power of an insolvency practitioner in the

main insolvency proceedings to propose a restructuring plan, a composition or a comparable measure in secondary proceedings (Article 47(1) of the EIR Recast).

Self-Assessment Exercise 6

Recent years have seen an increase in both the complexity of international insolvencies and in the rise of various soft law instruments (for example, guidelines and recommendations), addressing the issue of court-to-court communication and co-operation in insolvency cases. You are required to write a brief essay explaining why such communication and co-operation is essential for the achievement of the best results for creditors and other stakeholders.

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

10. PREVENTION OF SECONDARY PROCEEDINGS

The EIR Recast's starting point is the universality of the main insolvency proceeding. Secondary proceedings understandably complicate the operation of an insolvent debtor, result in additional costs for insolvency practitioners and courts, lengthen the proceedings either to the detriment of creditors and / or may disrupt the debtor's efficient restructuring or streamlined liquidation. Because the opening of secondary proceedings leads to the fragmentation of the insolvency estate into main and secondary insolvency estates, increases transaction costs and facilitates turning to the courts, the EIR Recast contains a number of options to avoid the opening of secondary insolvency proceedings.

10.1 Right to give an undertaking ("synthetic" secondary proceedings)

According to Article 38(2) of the EIR Recast, where the insolvency practitioner in the main insolvency proceedings has given an undertaking in accordance with Article 36, the court asked to open secondary proceedings should not, at the request of the insolvency practitioner, open them if it is satisfied that the undertaking adequately protects the general interests of local creditors.[86] So what is an undertaking and how does it help avoid the opening of secondary insolvency proceedings?

Before we describe the reasoning and operation of Article 36 of the EIR Recast (entitled "Right to give an undertaking in order to avoid secondary insolvency proceedings"), it is important to note that this rule has originated from judicial innovation. Absent in the EIR 2000, instruments similar to undertakings were used in court practice. The background to Article 36 lies in two English cases where the insolvency practitioners involved convinced territorial creditors that

[86] The latter requirement is somewhat similar to the "best interest of creditors" test used in confirmation proceedings under Chapter 11 of the US Bankruptcy Code. In its application to the undertaking, it means that the court should be persuaded that local creditors will receive at least as much as they would in case the secondary proceedings were to be opened.

avoiding the opening of secondary proceedings was in their best interests. In *MG Rover Belux SA/NV*,[87] no secondary proceedings were opened (which would have been in the form of winding-up proceedings given the restricted approach of the EIR 2000 at the time) and therefore would have interfered with the strategy of the main proceedings). The rescue case (administration under UK law) was successful and realisations exceeded the initial estimates, which led to higher returns to unsecured creditors.

In the case of *Collins & Aikman Europe SA*,[88] the High Court of Justice authorised the English-appointed joint administrators of a group of companies to implement the assurances given earlier to creditors in the relevant European jurisdictions and hence to *pro tanto* depart from the application of the ordinary provisions of English law, the law of the main proceedings. The case concerned the Collins & Aikman Group, which was a leading supplier of automotive components, typically plastic and soft-trim products used in the interiors of motor vehicles. In Europe the Group operated through 24 legal entities spread over 10 jurisdictions. In 2005 these entities applied for the UK court to open insolvency proceedings. Subsequently, insolvency proceedings were opened in the UK against all 24 companies, including those registered on the continent (for example, in Spain, Sweden, Germany, Belgium, Italy and the Netherlands).

The appointed joint administrators immediately recognised that although the European companies were incorporated in several different European jurisdictions, they formed a closely-linked group, many of the functions of which were organised on a Europe-wide rather than a national basis. The strategy developed by the administrators was based on this understanding and included the adoption of a co-ordinated approach to the continuation of the businesses. Administrators were, however, very aware that, whilst the main proceedings were in England, creditors remained entitled to seek the opening of secondary proceedings in any of the other countries where a relevant company had an "establishment". To avoid such secondary proceedings, oral assurances were given by or on behalf of the joint administrators to local creditors that their claims would be dealt with in accordance with the relevant (foreign) insolvency law and the respective ranking of creditors. As a result, creditors were to receive the benefits of the secondary proceedings (such as preferential payments), while such proceedings did not formally exist. Thus, the terms "synthetic" or "virtual" secondary proceedings were proposed. Ultimately, the English court supported this very practical and commercially-driven solution and empowered the administrators to implement any assurances that they had earlier given.

The concepts of party autonomy and centralisation of the insolvency forum underpin Article 36 of the EIR Recast. According to this article, in order to avoid the opening of secondary insolvency proceedings, the insolvency practitioner in the *main insolvency proceedings* may give a unilateral undertaking (the "undertaking") in respect of the assets located in the Member State in which secondary insolvency proceedings could be opened, that when distributing those assets or the proceeds received as a result of their realisation, he will comply with the distribution and priority rights under national law that creditors would have if secondary

[87] Re MG Rover Belux SA/NV (In Administration) [2006] EWHC 1296 (Ch); [2006] EIRCR(A) 277.
[88] *Re Collins & Aikman Europe SA and other companies* [2006] EWHC 1343 (Ch).

insolvency proceedings were opened in that Member State.[89] Thus, the judicial innovation of *Collins & Aikman Europe SA* has now been institutionalised. This approach kills two birds with one stone. Firstly, it allows for the centralisation of control over the major decisions affecting the debtor and the insolvency estate, such as the development of a cohesive restructuring plan, in one jurisdiction. Secondly, it safeguards the rights and legitimate expectations of local and preferential creditors by ensuring compliance with the priority rights guaranteed under the relevant local insolvency laws.

Just like the concepts of COMI and establishment, an "undertaking" reflects an autonomous substantial norm, that is, it has an autonomous meaning and must be interpreted independently of national legislation. It constitutes a unilateral (one-sided) promise (undertaking) given by the main insolvency practitioner to local creditors in order to avoid the opening of secondary insolvency proceedings. Such an undertaking covers the assets located in the Member State where secondary proceedings may be requested (secondary asset pool) and guarantees treatment "as if" secondary proceedings have been opened. In practice, this means that the distribution of the "secondary asset pool" will comply with the distribution and priority rights under the national law that creditors would have had if secondary insolvency proceedings had been opened in that Member State.

Some substantive and procedural requirements for the undertaking cover its content, language and form. First of all, the undertaking must specify the factual assumptions on which it is based. In particular, such assumptions should relate to the value of the assets located in the Member State concerned, as well as the options available to realise such assets (Article 36(1) of the EIR Recast). Generic undertakings to treat local assets as if secondary proceedings are in place, will not suffice. Secondly, pursuant to Article 36(3), the undertaking must be made in the official language (one of the official languages) of the Member State where secondary proceedings could have been opened. Thirdly, it must be in writing and in compliance with any other pre-requisites relating the form and approval requirements as to distributions, if any, dictated by the *lex concursus* of the main insolvency proceedings (Article 36(4) of the EIR Recast). Additionally, Article 36(5) of the EIR Recast prescribes that an undertaking must be approved by "known local creditors". Such an approval needs to follow the rules on qualified majority and voting that apply to the adoption of restructuring plans in the Member State of the avoided (synthetic) secondary proceedings.

If an undertaking is given in full compliance with Article 36 of the EIR Recast and if it adequately protects the general interests of local creditors, the court seized of a request to open secondary insolvency proceedings must not open such proceedings (Article 38(2) of the EIR Recast). In other words, the discretion of the court is very limited. In the case of a failure to avoid the

[89] It must be noted that an undertaking, as prescribed by Art 36 of the EIR Recast, is always one-sided and only works in vertical relations, that is, main insolvency practitioner → local creditors. It cannot be applied to avoid the opening of main insolvency proceedings, eg, by a request from the insolvency practitioner appointed in territorial proceedings. This is a serious restriction, particularly for insolvencies of groups of companies, which may require concentration of insolvency proceedings at the location of both the COMIs and establishments of group members. Interestingly, the avoidance of main insolvency proceedings (reversed synthetic proceedings) has been used in practice in *Re Videology Ltd* [2018] EWHC 2186 (Ch). The case concerned the secondary insolvency proceedings in progress in the US and avoided main insolvency proceedings in the UK. No such practical approach is, however, available under the EIR Recast.

opening of secondary insolvency proceedings, the insolvency practitioner in the main insolvency proceedings must return any assets which have been removed from the territory of the Member State of attempted (synthetic) secondary proceedings back to the secondary asset pool (Article 36(6) of the EIR Recast).

10.2 Stay of the opening of secondary insolvency proceedings

It is frequently the case that a stay of individual enforcement measures follows the opening of main insolvency proceedings. In addition to assuring the integrity of the insolvency estate, the stay provides a breathing space for the debtor to negotiate a restructuring deal with its creditors. In this context, the opening of secondary proceedings may frustrate the process of negotiations and undermine business rescue. To prevent this from happening, the EIR Recast provides for the possibility for the court to temporarily stay the opening of secondary insolvency proceedings, when a temporary stay of individual enforcement proceedings has been granted in the main insolvency proceedings. The stay of the opening of secondary proceedings therefore preserves the efficiency of the stay granted in the main insolvency proceedings (Recital 45 of the EIR Recast).

The stay of the opening of secondary insolvency proceedings does not take place automatically (*ex officio*). It requires a request from the insolvency practitioner or the debtor in possession (Article 38(3) of the EIR Recast). The stay may be imposed for a period not exceeding three months and on condition that suitable measures are in place to protect the interests of local creditors. To guard these interests the court may decide to order protective measures, for example, by requiring the main insolvency practitioner not to remove or dispose of any assets situated at the place of the debtor's establishment, unless this is done in the ordinary course of business. This is despite the fact that under otherwise applicable rules (see Article 21(1) of the EIR Recast), the main insolvency practitioner would be able to remove the debtor's assets. The court may also order other measures to protect the interest of local creditors during a stay, unless this is incompatible with the national rules on civil procedure.

A stay can be lifted in three circumstances. Firstly, if the negotiations between the debtor and its creditors result in an agreement (restructuring plan), the court *must* lift the stay. Secondly, if the continuation of a stay is detrimental to creditors' rights, in particular if the negotiations have been disrupted or it has become evident that they are unlikely to be concluded. Thirdly, if the insolvency practitioner or the debtor in possession has infringed on the prohibition on disposal of the debtor's assets or on removal of them from the territory of the Member State where a stay was given. In the last two cases, the court has a discretion to lift or retain the stay.

Compared to the provision of an undertaking, the tool of a stay is a weaker form of protection of the "integrity" of the main insolvency proceeding against the opening of secondary proceedings. Unlike the case with an undertaking, the court requested to issue a stay under Article 38(3) of the EIR Recast does not have to refrain from the opening of secondary proceedings ("the court … *may* stay"). In other words, it is within the court's discretion to do so. Besides, even if granted, a stay cannot exceed three months. The undertaking is not confined to any rigid time frames. Therefore, if the conditions laid down in Article 36 of the EIR Recast are satisfied and the general interests of local creditors are safeguarded, an undertaking can

provide a shield against the opening of secondary proceedings for a period exceeding three months. At the same time, the procedure for securing a stay is much simpler and more straightforward when compared to the use of an undertaking, which requires the approval by local creditors and needs to be recognised by the court concerned.

11. INSOLVENCY OF GROUPS OF COMPANIES

It has become part of modern economic reality that businesses increasingly operate across national borders through a network of interconnected companies. Economically speaking, such entities frequently operate as a single unit, accomplishing a common goal of profit-making. However, legally speaking, an enterprise group comprises of separate legal persons with separate estates. This mismatch is particularly obvious in a situation of insolvency, where the legal separateness of members of a group of companies does not reflect economic reality. In insolvency, the commonly used approach, sometimes referred to as the "principle of the five ones", results in one insolvent debtor, one insolvency estate, one insolvency proceeding, with one court and one insolvency office holder dealing with the insolvency. This outcome is determined by the concept of entity shielding, which may lead to the procedural and substantive separateness (fragmentation) of insolvency proceedings, opened against members of the corporate group.

As succinctly stated by Professor Irit Mevorach, "[t]he key dilemma with groups is whether to give effect to the economic reality of integrated business operating through separate entities thus referring to the group as a whole, or to strictly adhere to the corporate form and address each group member separately".[90] For legislation to be drafted, a policy choice between economic reality (hardly disturbing the integrated business) or the protection of creditors, especially where different group members may have very different levels of assets to distribute, has to be made.

The need to ensure the fair and efficient administration of cross-border insolvencies concerning enterprise group members and to guarantee protection and maximisation of the overall combined value of the operations and assets of the enterprise group, has gradually drawn the attention of the World Bank, International Insolvency Institute, INSOL International, UNCITRAL and other standard-setting organisations. In 2010, UNCITRAL issued Part III of the Legislative Guide on Insolvency Law (entitled "Treatment of enterprise groups in insolvency"), highlighting the lack of guidance "on how the insolvency of enterprise groups should be addressed more comprehensively and, in particular, whether and in what circumstances enterprise groups should be treated differently from a single corporate entity". UNCITRAL Working Group V (Insolvency Law) is now considering the development of draft legislative provisions aimed at providing countries' legislatures with such guidance and facilitating fair and efficient administration of cross-border insolvencies of enterprise group members. The draft text was pending in December 2018.

[90] I Mevorach, *The Future of Cross-Border Insolvency: Overcoming Biases and Closing Gaps*, Oxford University Press, 2018, p 227.

As opposed to the EIR 2000 and the Model Law, which do not touch upon the issues pertinent to the insolvency of different group members, the EIR Recast contains a whole chapter (Chapter V) dedicated to group insolvencies, with over twenty articles. It provides two sets of tools. Articles 56 to 60 of the EIR Recast prescribe co-operation and communication duties for courts and insolvency practitioners involved in insolvency proceedings opened against members of an enterprise group. Articles 61 to 77 of the EIR Recast introduce a distinct mechanism of the so-called group co-ordination proceeding, including the figure of a group co-ordinator. In this section of the guidance text we will first look at the foundations for treating corporate groups members in insolvency as promulgated in the CJEU case law. We will then review the new EIR Recast rules on co-operation and communication in a group setting. Finally, co-ordination proceedings under the EIR Recast will be scrutinised.

11.1 *Eurofood IFSC Ltd* and entity-by-entity approach

We have already mentioned the case of *Eurofood IFSC Ltd* and its importance in clarifying the concept of COMI. This case is no less significant for laying down the guiding principles for the treatment of corporate groups in insolvency. The case concerned Eurofood with its registered office in Ireland. It was a wholly owned subsidiary of Parmalat SpA, a company incorporated in Italy and the main operating entity of the Parmalat group. On 27 January 2004, the largest creditor of Eurofood, the Bank of America, filed a winding-up petition to the High Court of Dublin, which on the same day appointed a provisional liquidator. Meanwhile, on 9 February 2004, the Italian government purported to place Eurofood under extraordinary administration with Dr Enrico Bondi tasked to complete its restructuring. On 20 February 2004, the Tribunal of Parma declared Eurofood insolvent. The resulting jurisdictional battle between the Italian and Irish courts led to the referral to the CJEU, which delivered its authoritative decision on 2 May 2006.

Before considering this decision, we should briefly describe the business of Eurofood. Eurofood's principal objective was the provision of financing facilities for companies in the Parmalat group, mainly its subsidiaries in Venezuela and Brazil. It was a special purpose vehicle formed for the purpose of raising funds for the group and its constituent members. In other words, Eurofood did not play an independent business (production) function, but instead served the interests of other Parmalat group members, primarily through attracting financing and on-lending within the group.

The main question related to Eurofood's COMI, as the latter was crucial for determining the court competent to open the main insolvency proceedings. First of all, the CJEU stressed that the mere control (for example, by way of shareholding or otherwise) of a subsidiary by its parent company was not sufficient to rebut the presumption laid down by the EIR 2000 that the place of the registered office is presumed to be the COMI. Instead, COMI must be identified by reference to criteria that are both objective and ascertainable by third parties, primarily by the debtor's creditors. Certainly, a parent company's control is not always visible for third parties. What seems remarkable, however, is that the court allocated very little attention to studying the nature of the business operations performed by Eurofood and its place and role in the Parmalat group, as perceived by third parties. The CJEU only mentioned once (in the section titled "Background and questions referred for a preliminary ruling") that Eurofood's principal

objective was the provision of financing facilities for companies in the Parmalat group. The court formulated the approach, according to which,

> "where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different Member States, the presumption […] can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect."

The court then interpreted the words "factors which are both objective and ascertainable by third parties":

> "That could be so in particular in the case of a company not carrying out any business in the territory of the Member State in which its registered office is situated. By contrast, where a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by that Regulation."

The court relied on the principle of effectiveness but considered such effectiveness in a narrow sense (single-entity-effectiveness), largely overlooking the context of a complex multinational enterprise, experiencing financial difficulties in multiple jurisdictions and at the same time trying to pursue a restructuring in a single "point of entry". However, the Irish legislation did not give any basis to take into account the wider context of the Parmalat group. The entity-by-entity approach embraced by the CJEU could be partially explained by the liquidation-oriented nature of the EIR 2000, highlighted above. However, even if the company is destined to be liquidated, the highest possible realisation of its value may depend on whether a co-ordinated group-wide solution (for example, a going concern sale involving several legal entities) is available. The CJEU was generally criticized for its failure to provide some further guidance. The fact that *Eurofood IFSC Ltd* was one of the first CJEU decisions on the EIR 2000 might have contributed to the CJEU's reluctant or constrained adjudication.

Nevertheless, the entity-by-entity approach developed by the CJEU in *Eurofood IFSC Ltd* has become deeply ingrained in the European insolvency law and has not changed with the adoption of the EIR Recast. The latter does not introduce the concept of "group (enterprise) COMI". Neither does it sanction substantive (pooling of assets and liabilities) or procedural (single insolvency proceeding) consolidation of insolvency proceedings opened against members of a group of companies.[91]

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[91] It should be noted that some European jurisdictions allow for the pooling of assets and liabilities of some or all members of a corporate group, so that a creditor of one member becomes, in essence, a creditor of all members. For instance, art L. 621-2 of the French Commercial Code provides for a consolidation of insolvency proceedings against companies whose property is intermixed or where the corporate body is a sham. However, due to entity shielding and legal separability, substantive consolidation remains extremely rare in Europe. In Case C-191/10, *Rastelli Davide e C. Snc v Jean-Charles Hidoux*, Case C-191/10, ECLI:EU:C:2011:838 (Dec 15, 2011), the CJEU had to decide whether the court, having opened the main insolvency proceedings in one Member State (France),

11.2 Insolvency of corporate groups under the EIR Recast

The lack of provisions dealing with insolvency of multinational enterprise groups in the EIR 2000 was seen as a considerable weakness.[92] A large number of cross-border insolvencies in the EU involves groups of related companies. But the prevailing entity-by-entity approach is generally regarded as diminishing the prospects of a successful restructuring of the group as a whole and leads to its break-up into constituent parts. In other words, the regulatory framework is not conducive to achieving the principles of (modified) universalism, procedural efficiency, equal treatment of creditors and value maximisation.

As a response, the newly adopted EIR Recast introduced a whole chapter (Chapter V) dedicated to group insolvencies, with over twenty articles. Besides, it added a new important Recital 53, addressing the possibility of jurisdictional consolidation. Even through COMIs of members of a corporate group still have to be determined separately for each group member, the EIR Recast reserves the possibility for a court to open insolvency proceedings for several companies belonging to the same group in a single jurisdiction if that court finds that COMIs of those companies are located in a single Member State (Recital 53 of the EIR Recast). In such a case, the court should also be able to appoint, if appropriate, the same insolvency practitioner in all the proceedings concerned, provided that this is not incompatible with the rules applicable to them. Bringing members of a corporate group into a single jurisdiction, even with the applicable restrictions (entity-by-entity COMI determination), can significantly reduce transaction costs arising from multiple insolvency proceedings and enhance the chances for a successful restructuring (rescue) of a group as a whole. The solution offered in Recital 53 is both practical and flexible, and has been used in the past.[93]

As indicated in Recital 51, the EIR Recast aims at achieving the efficient administration of insolvency proceedings relating to different companies forming part of a group of companies. It recognises the specificity of the economic, financial, strategic and organisational reality of complex business structures. The EIR Recast offers a definition for a "group of companies". According to Article 2(13), group of companies means a parent undertaking and all its subsidiary undertakings. The parent undertaking should control, either directly or indirectly, one or more subsidiary undertakings. An undertaking which prepares consolidated financial statements pursuant to Directive 2013/34/EU on the annual and consolidated financial statements, shall be deemed to be a parent undertaking (Article 2(14) of the EIR Recast). Thus, the definition of a group of companies is sufficiently broad to cover various types of company groups involving varying degrees of control and unity (vertical and horizontal integration). It is

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could join to those proceedings a second company whose registered office was in another Member State (Italy) solely on the basis that the property of the two companies had been intermixed. The court noted that the legal personality of the two debtors should be respected and that each debtor constituting a distinct legal entity was subject to its own court jurisdiction.

92 See Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings, COM(2012) 744 final.

93 A good example is the Nortel Network Group, a multinational telecommunications and data networking equipment manufacturer headquartered in Ontario, Canada. On 14 Jan 2009, the High Court of Justice of England and Wales, Chancery Division opened main insolvency proceedings under English law in respect of all the companies in the Nortel Group established in separate Member States of the EU. Thus, the COMI of 18 Nortel Group member companies in Europe were found to be in the UK.

predicated on the broad definition of "control", which includes both equity and non-equity-based control (agreement or operational (management) related).

11.2.1 Co-operation and communication in group insolvencies

The legal framework for co-operation and communication in the context of group insolvencies closely resembles the rules for co-operation and communication between main and secondary proceedings (Articles 41 to 43). Recital 52 of the EIR Recast explicitly states that the various insolvency practitioners and the courts involved in group insolvencies should be under a similar obligation to co-operate and communicate with each other as those involved in main and secondary insolvency proceedings relating to the same debtor. In our opinion, such duties should not be limited to intra-EU group insolvencies, but extend to co-operation and communication with courts and insolvency practitioners in non-Member States.

The duties of co-operation and communication in the context of group insolvencies apply in three major scenarios:

(a) between insolvency practitioners (Article 56 of the EIR Recast);

(b) between courts (Article 57); and

(c) between insolvency practitioners and courts (Article 58).

Insolvency practitioners appointed in insolvency proceedings, opened against members of the same corporate group, must co-operate to the extent that such co-operation is appropriate to facilitate the effective administration of those proceedings and so far as it is compatible with the rules applicable to them and does not entail any conflict of interest (Article 56 of the EIR Recast). When compared to similar rules for insolvency practitioners in main and secondary proceedings (Article 41), Article 56 of the EIR Recast appears less prescriptive. Since there is no main (dominant) proceeding (at least not in a legal sense), and each proceeding remains separate, the EIR Recast does not mandate co-operation if such co-operation does not make commercial sense, that is, it is not necessary for the effective administration of each insolvency proceeding. The imperative to avoid any conflict of interest may also become a significant deterrent to effective communication and co-operation in cases of corporate groups. Being an open norm with unclear subject matter, it creates risks of loose interpretation and ample grounds to refuse co-operation.

In any case, insolvency practitioners must (i) as soon as possible communicate to each other any information which may be relevant to the other proceedings (Article 56(2)(a) of the EIR Recast), (ii) consider whether possibilities exist for co-ordinating the administration and supervision of the affairs of the group members and, if so, co-ordinate such administration and supervision (Article 56(2)(b)), and (iii) consider whether possibilities exist for restructuring group members and, if so, co-ordinate with regard to the proposal and negotiation of a co-ordinated restructuring plan (Article 56(2)(c)). To improve co-operation in the absence of one dominant insolvency proceeding, the EIR Recast allows insolvency practitioners to agree to grant additional powers to an insolvency practitioner appointed in one of the proceedings, provided

that such an agreement is permitted by the rules applicable to each of the proceedings involved. They may also divide certain tasks among them, for example, by way of an agreement or protocol. However, in practice, without a developed regulatory framework, purely voluntary co-operation may be stalled by high transaction costs and collective action problems. Therefore, a new group co-ordination proceeding has been approved at EU level. We will turn to this instrument in the next section of this guidance text.

As regards the courts, they should also co-operate to the extent such co-operation facilitates the effective administration of the proceedings. Article 57(3) of the EIR Recast lists cases in which the co-operation may be desirable: (a) co-ordination in the appointment of insolvency practitioners, (b) communication of information by any means considered appropriate by the court, (c) co-ordination of the administration and supervision of the assets and affairs of the members of the group, (d) co-ordination of the conduct of hearings, and (e) co-ordination in the approval of protocols, where necessary. For the purpose of improving court-to-court communication, courts may appoint an independent person or body (intermediary) to act on their instructions (Article 57(1)). This is in line with Principle 17 of the EU JudgeCo Principles and Principle 23 of ALI-III Global Principles, which envisage the appointment of an independent intermediary. In doing so, the court is advised to give due regard to the views of insolvency practitioners in pending insolvency cases before appointing an intermediary. The role of the intermediary may be set out in a protocol or an order of the court.

Co-operation and communication are generally limited by matters of practicality (that is, they should facilitate the efficient administration of insolvency proceedings), rules and limitations imposed by the *lex concursus* of the jurisdictions concerned and obligations to avoid conflicts of interest (Articles 56(1), 57(1) and 58 of the EIR Recast). Specific to court-to-court communication, is the requirement to respect the procedural rights of the parties to the proceedings (Article 57(2) of the EIR Recast).

In order to ensure efficient co-operation within corporate groups, the above limitations should be interpreted narrowly. The principles of the most complete and uninhibited exchange of information and sincere co-operation (Article 4(3) of the TEU) come from the trust underpinning the operation of the EU. The notion of trust between jurisdictional systems of the EU member states extends to all cross-border matters, whether applied in a single-entity scenario or in the case of insolvency of a corporate group.

11.2.2 Group co-ordination proceedings

With a view to improving the co-ordination of insolvency proceedings of members of a group of companies and to allow for co-ordinated restructuring of the group, the EIR Recast introduces procedural rules on the co-ordination of the insolvency proceedings of members of an enterprise group. Such rules strive to ensure the efficiency of the co-ordination, whilst at the same time respecting each group member's separate legal personality (Recital 54 of the EIR Recast). This latter requirement, as we will show below, has led to a rather modest result.

As noted above, the EIR Recast does not sanction substantive, procedural or even jurisdictional consolidation. Instead, it offers a co-ordination mechanism called the "group co-ordination

proceeding". Therefore, nothing structural for groups themselves. It is important to note that group co-ordination proceedings are voluntary in nature (for the member of the group to be included in group co-ordinating proceedings). In addition, these proceedings lead to non-binding actions (recommendations) of a group co-ordinator. For these reasons, the new set of rules on group insolvency have had a mixed reception in legal literature, with the majority of authors expressing doubts as to their effectiveness and practical value, as well as to the high costs the group co-ordinating proceedings may bring with them and their complex character.[94] Additional problems may arise if the corporate group has members located in non-Member States, meaning that the EIR Recast will not bind courts and insolvency practitioners in such non-Member State proceedings and that the latter cannot form part of the group co-ordination proceedings. This, however, should not prevent the possibility of entering into cross-border agreements or protocols.

The opening of a group co-ordination proceeding can be requested by an IP appointed in insolvency proceedings opened in relation to *any* group member, and before *any* court presiding over insolvency proceedings of a group member (Recital 55, Article 61 of the EIR Recast). Two conclusions can be drawn. First, only insolvency practitioners appointed in proceedings against a group member can request the opening of group proceedings. Creditors, including public authorities, are not empowered to do so. Second, group co-ordination proceedings can be initiated in any court presiding over insolvency proceedings (whether main or secondary) against any group member. The EIR Recast does not introduce a concept of a group (or enterprise) COMI and does not otherwise indicate the main court, which is decisive in performing the tasks of co-ordination.

The request for the co-ordination proceeding must be accompanied by a proposal as to the person to be nominated as the group co-ordinator and an outline of the proposed group co-ordination, as well as reasons for such request (Article 61(3) of the EIR Recast). This information should convince the requested court and insolvency practitioners that the opening of group co-ordination proceedings is feasible, reasonable and justified. The outline of the proposed group co-ordination can be considered as a forerunner for a detailed group co-ordination plan, which has to be produced by the co-ordinator upon the opening of group co-ordination proceedings (Article 72(1)(b) of the EIR Recast). Following the receipt of the request to open group co-ordination proceedings, the requested court must consider whether the opening of such proceedings is appropriate to facilitate the effective administration of the insolvency proceedings relating to the different group members. It must also make sure that no 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 (Article 63(1) of the EIR Recast). In other words, the opening of the group co-ordination proceedings has to be Pareto efficient (Pareto optimal). This means that at least some creditors should be made better off without making any other creditors worse off.

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[94] *See* C Thole and M Dueñas, "Some Observations on the New Group Coordination Procedure of the Reformed European Insolvency Regulation", *International Insolvency Review*, Vol 24, Iss 3, 2015, pp 214-227; M Weiss, "Bridge over Troubled Water: The Revised Insolvency Regulation", *International Insolvency Review*, Vol 24, Issue 3, 2015, pp 192-213; B Hess, P Oberhammer, S Bariatti *et al* (eds), *The Implementation of the New Insolvency Regulation: Improving Cooperation and Mutual Trust* (Nomos / Hart, 2018), p 220.

One of the weakest points in the EIR Recast group co-ordination regime is the right of every insolvency practitioner concerned to object against the inclusion within group co-ordination proceedings of the insolvency proceedings in respect of which he or she has been appointed (Article 64(1) of the EIR Recast). It is noticeable that Article 64 of the EIR Recast does not explicitly require insolvency practitioners to give reasons for their objection. However, it is our view that the objecting insolvency practitioner is well-advised to provide a substantiated statement of the reasons for his objection.[95] Where an insolvency practitioner has objected to the inclusion of the affected proceeding into group co-ordination proceedings, this proceeding will not be a part of the group co-ordination proceedings (Article 65(1) of the EIR Recast) and the co-ordinator shall have no rights with regards to the "excluded" Member State. If no objection is filed within the prescribed period (30 days), the "silent" (non-objecting) insolvency proceeding automatically falls under the group co-ordination proceeding. Thus, the scheme proposed by the EIR Recast is essentially an "opt-out" scheme.[96]

After the noted period for objections has elapsed, the court seized with jurisdiction may open the group co-ordination proceedings. To do so, it is necessary for the court to be convinced that the opening of such proceedings would facilitate the effective administration of the affected insolvency proceedings and that the creditors in any participating group member will not be financially disadvantaged by the contemplated inclusion in the group proceedings (Article 63(1) of the EIR Recast). In its decision to open the group co-ordination proceedings, the court must appoint a co-ordinator, decide on the outline of the co-ordination and estimate costs and the share to be paid by the group members (Article 68(1) of the EIR Recast). Such a decision must be brought to the notice of the participating insolvency practitioners and of the co-ordinator.

Before the decision to open group co-ordination proceedings is made, insolvency practitioners have the power to change and relocate the co-ordinating court. According to Article 66(1), where at least two-thirds of all insolvency practitioners appointed in insolvency proceedings of the members of the group have agreed that a court of another Member State is the most appropriate court for the opening of group co-ordination proceedings, that court shall have exclusive jurisdiction. In this scenario, the court first seized of jurisdiction must decline its jurisdiction in favour of the chosen court. The possibility of insolvency practitioners choosing the co-ordination jurisdiction by agreement is remarkable, and highlights the private element in

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[95] An insolvency practitioner considering the lodging of an objection, should not only make a legal calculation (complexities, costs, loss of time) but also take account of an external perspective of how the general group of creditors or the market will react to the refusal to join group proceedings and therefore exclude itself from a co-ordinated effort to get the maximum value for the group as a whole.

[96] This does not mean that if an insolvency practitioner has opted-out from participating in the group co-ordination proceedings there is no option to opt back in. On the contrary, the initial "objector" (Art 69(1)(a)) or an insolvency practitioner of the newly opened insolvency proceedings against a new group member (Art 69(1)(b)) are able to subsequently request to participate in group co-ordination proceedings. In such a case the co-ordinator decides whether or not to allow this. The fact is that a subsequent opt-in of another group member may have significant repercussions for the entire co-ordination "fabric". For this reason, the subsequent opt-in requires the co-ordinator to consult the insolvency practitioners involved and accede to the opt-in request, subject to certain conditions being met (EIR Recast, Art 69(2)). In particular, the co-ordinator must either be satisfied that the inclusion of a new member will facilitate the effective administration of all other insolvency proceedings and that no creditor will be worse off financially (Pareto efficiency test), or he must secure an agreement from all other insolvency practitioners involved.

group co-ordinations and underscores the expansion of the use of private law mechanisms (such as in rescue plans) in a traditionally court-driven insolvency and restructuring environment.

11.2.3 Group co-ordinator

Group co-ordination proceedings are realised by and with the help of a person, called the (group) co-ordinator. According to Article 71(1) of the EIR Recast, the co-ordinator must be a person eligible under the law of a Member State to act as an insolvency practitioner. The *lex concursus* of the Member State where the appointment of the co-ordinator is sought should be decisive in this regard. Additionally, Article 71(2) prescribes that the co-ordinator must not be one of the insolvency practitioners appointed to act in respect of any of the group members. This is necessary to ensure independence and impartiality of the group co-ordinator, who must have no conflict of interest in respect of the group members, their creditors and the insolvency practitioners appointed in respect of any of the group members. The system for dealing with the insolvency proceedings of members of a group of companies, and to allow for co-ordinated restructuring of the group, is built on a clear distinction between the insolvency aspect (of the individual members running individual proceedings) and the co-ordination aspect (to co-ordinate these proceedings by an independent other person).

The co-ordinator must always perform his duties impartially and with due care. Whenever the co-ordinator acts to the detriment of the creditors of a participating group member, or fails to comply with his or her obligations under Chapter V of the EIR Recast, the court must revoke the appointment of the co-ordinator either on its own motion or at the request of the insolvency practitioner of a participating group member (Article 75 of the EIR Recast).

Among the most important duties (obligations) of the co-ordinator is the duty to:

(a) act impartially and with due care (Article 72(5));

(b) identify and outline recommendations and propose a group co-ordination plan (Article 72(1)); and

(c) co-operate with insolvency practitioners (Article 74).

Article 72 of the EIR Recast forms the heart of Chapter V of the EIR Recast. This article sets out the tasks, rights and duties of the co-ordinator. The co-ordinator must:

(a) identify and outline recommendations for the co-ordinated conduct of the insolvency proceedings; and

(b) propose a group co-ordination plan.

In identifying and outlining recommendations for the co-ordinated conduct of the insolvency proceedings, the co-ordinator "should always strive to facilitate the effective administration of the insolvency proceedings of the group members, and to have a generally positive impact for the creditors" (Recital 57 of the EIR Recast). This means that the recommendations may

contain all types of measures that enable commercially sensible solutions and have a generally positive impact on the creditors.

The group co-ordination plan may contain measures to re-establish the economic performance and the financial soundness of the group or any part of it, such as the increase of equity capital, simplification of the financial structure of the group, and the elimination of deficiencies in the intra-group cash pooling system. Measures might also aim to improve business performance, including through the reorganisation of the group structure, the realignment and refocusing of business activities, replacement of management, and personnel reduction. Plans may include solutions to settle intra-group disputes and avoidance actions related to, for instance, intra-group sales on the basis of transfer pricing, performance of services by one group member for another below market price, and the gratuitous allocation of means of production and licenses. Other plans could see agreements between insolvency practitioners of the insolvent group members, for example, to settle intra-group disputes, to implement a group co-ordination plan in the insolvency plans of the individual group members, to reconsider the treatment of intra-group contracts or to provide security. Notably, the group co-ordination plan cannot include recommendations as to any consolidation of proceedings or insolvency estates (Article 72(3) of the EIR Recast).

In order to be able to effectively co-ordinate parallel insolvency proceedings, the co-ordinator is vested with various rights. He may participate in any of the proceedings opened in respect of any member of the group. The co-ordinator may also mediate or suggest mediation of any dispute arising between two or more insolvency practitioners of group members, and present and explain the co-ordination plan to the relevant persons or bodies within insolvency proceedings to which the group members participating in the group co-ordination are subject (Article 72(2)(c)). This is important as the co-ordinator can inform the participants of any pros and cons of the plan and what its implementation will entail for the future of the group and its individual members. Finally, the group co-ordinator may request a stay for a period of up to six months of the proceedings opened in respect of any member of the group, if it is necessary to ensure the proper implementation of the plan and would be to the benefit of the creditors in the proceedings for which the stay is requested. The request must be made to the court that opened the proceedings for which the stay has been requested (Article 72(2)(e)). The stay appears to be the most powerful tool in the hands of the co-ordinator, as it relates to the whole of the group member's insolvency proceedings (and not only to, for example, asset realisation). Furthermore, it has a direct effect on the course of the individual insolvency proceedings. It is particularly in contrast to the fact that, as a general rule, actions by the co-ordinator are recommendatory in nature and insolvency practitioners are not obliged to follow recommendations that emanate from the co-ordinator (Article 70 of the EIR Recast).

Self-Assessment Exercise 7

Question 1

"The very structure of a modern corporate group can make it the engine of injustice and fraud […]. The result may be that a corporate form is ignored for most of the life of a corporate group until, at the moment of insolvency, the corporate form arises from its desuetude to control the legal rights of all concerned […]. There are many implications of all this, but one of them is that executives can find themselves captains of a legal armada of limited liability vehicles, each of which may have billions of dollars in assets or nearly none." Jay Lawrence Westbrook, 2018[97]

Write a short essay, *inter alia*, mentioning the following:

1. Do you agree with the author (and why)?
2. What is / are the problem(s) raised by the author? Provide examples where such problem(s) can arise in practice.
3. What is / are the solution(s) available to the problem(s) discussed in 2 above (for example, in some of the national laws) and which of these do you support (and why)?
4. Is / are the described problem(s) addressed under the EIR Recast? If yes, how are the problems addressed?

Question 2

Study the framework of group co-ordination proceedings introduced by the EIR Recast. Do you believe that such a framework is efficient and effective for dealing with the insolvency of corporate groups? Present and explain at least three arguments, justifying your position. For the answer to this question, you are not required to write an essay.

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

12. THE EUROPEAN INSOLVENCY REGULATION 2015 AND THE EU DIRECTIVE ON PREVENTIVE RESTRUCTURING FRAMEWORKS 2019

Alongside the modernisation of private international law rules dealing with cross-border insolvency law in the EU, and as the EU was grappling with the devastating effects of the global financial crisis of the late 2000s, the European Commission kicked off a new policy initiative focused on supporting a more business-friendly environment for debtors in financial distress through the rescue of viable companies and the improvement of insolvency recovery rates. The Committee on Legal Affairs of the European Parliament issued a series of recommendations on insolvency proceedings in the EU to the EU Commission in a 2011 report. The Committee

[97] J L Westbrook, "Transparency in Corporate Groups", *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol 13, 2018.

included several important policy points supporting the proposal, discussing a variety of issues surrounding the discrepancies between national insolvency law frameworks and the challenges these posed to EU cross-border insolvency. Of note, the Legal Affairs Report supported the harmonisation of the ability of companies to initiate insolvency proceedings themselves, the timely initiation of proceedings in order to allow for the rescue of companies, and the availability of pre-insolvency proceedings.[98] The need for an increased harmonised approach to these issues was central to the Committee's reasoning.

The Commission responded to the European Parliament in the form of a Communication entitled "A New Approach to Business Failure and Insolvency", which was published in 2012.[99] The Commission identified key areas where national differences in relation to the rescue of companies could create "legal uncertainty and an 'unfriendly' business environment".[100] In 2014 and following this Communication, the Commission published the similarly titled Recommendation on a "New Approach to Business Failure and Insolvency". The Impact Assessment drafted before the passing of the Recommendation listed four policy options to achieve the harmonisation objectives: (1) preserve the status quo, (2) draft a recommendation on minimum standards relating to preventive restructuring procedures, (3) draft a directive on the same topic as the recommendation, or (4) set up a fully harmonised procedure, common to all Member States of the EU.[101] The recommendation was adopted as it was considered to achieve the policy objectives of the initiative while avoiding the lengthy negotiations that would accompany the drafting of a binding instrument such as a directive.[102]

The objective of the Commission's Recommendation was to "ensure that viable enterprises in financial difficulties […] have access to national insolvency frameworks, which enable them to restructure at an early stage with a view to preventing their insolvency".[103] It was argued that preventing insolvency would maximise the value to the economy as a whole, benefit those connected with businesses at risk of insolvency, such as creditors, employees and owners, and contribute to saving jobs.[104] Achieving greater coherence between national insolvency frameworks would also maximise return to creditors and investors, thereby encouraging cross-border investment.[105] The Commission generally stated that "the creation of a level playing field in these areas would lead to greater confidence in the systems of other Member States for companies, entrepreneurs and private individuals, and improve access to credit and encourage investment".[106]

In the 2014 Recommendation, the Commission highlighted the following substantive elements that were considered desirable for a harmonised approach: (i) to introduce flexibility in national

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98 European Parliament Committee on Legal Affairs, "Report with recommendations to the Commission on insolvency proceedings in the context of EU company law" (2011) A7-0355/2011, Motion for a European Parliament Resolution, para 1.1.
99 COM(2012) 742 final.
100 *Idem*, p 5.
101 SWD(2014) 61 final, p 27.
102 *Idem*, pp 41 *et seq*.
103 Recommendation 2014, Recital 1.
104 *Idem*, Recitals 1 and 12.
105 *Idem*, Recital 11.
106 *Idem*, Recital 8.

preventive restructuring procedures by limiting the need for court formalities to where they are necessary and proportionate, (ii) to provide for a stay of individual enforcement actions, (iii) to protect the interests of dissenting creditors, namely that the court should reject any restructuring plan that would likely reduce the rights of dissenting creditors below what they could reasonably expect to receive, were the debtor's business is not restructured, (iv) to ensure that the preventive restructuring process be on a debtor-in-possession model, (v) to include the possibility of cross-class cram-down provisions and, (vi) to protect new and interim financing.

Due to a limited take-up of the Recommendation and even cherry picking by Member States, calls for further harmonisation were made by the EU, supported by a report from the Association for Financial Markets in Europe (AFME) which revealed that that improving the recovery rate by 10 percentage points in Europe would reduce corporate bond spreads by 18 to 37 basis points. Applied across the economy, this lower risk premium could add between EUR 41 and EUR 78 billion to the EU gross domestic product (GDP) over the long-term. The biggest gains would accrue in large economies such as Italy and Spain, yet smaller Member States such as Bulgaria, Croatia and Greece, for example, would gain the most in relative terms, adding as much as 2% to long-term GDP if they were to align their insolvency regimes to the European average. While national reforms were underway in several Member States as discussed above, these reforms were not co-ordinated. The AFME considered them "piecemeal advances rather than a big step forward for the Single Market". In this regard, it noted that what "is needed is limited and carefully targeted harmonisation of insolvency laws at EU level. Fresh impetus should come from a new legislative proposal which the Commission will publish by December".[107] The Commission established an Expert Group on Restructuring and Insolvency Law, which met throughout 2016. It was comprised of over 20 leading academics and practitioners from 12 EU countries and its function was to discuss various aspects of insolvency law and, more specifically, to focus on how the 2014 Recommendation could be amended. In November 2016, the European Commission issued its Proposal for an Insolvency Directive,[108] which came into existence in June 2019.

The Directive was part of the Juncker Plan – the Investment Plan for Europe – set out by the former European Commission President Jean-Claude Juncker in 2014 and the Capital Markets Union (CMU) project. Commentators have also spoken of the Directive as "Europe's response to the United States Code 11 (the Bankruptcy Code)".[109] The Commission determined that a "higher degree of harmonisation in insolvency law is […] essential for a well-functioning single market and for a true Capital Markets Union [as] increased convergence of insolvency and restructuring procedures would facilitate greater legal certainty for cross-border investors and encourage the timely restructuring of viable companies in financial distress".[110] The policy rationale behind the proposal suggested that "[b]oosting jobs and growth in Europe requires a stronger rescue culture which helps viable businesses to restructure and continue operating

[107] AFME, "Potential economic gains from reforming insolvency law in Europe" (February 2016).
[108] COM(2016) 723 final.
[109] G McCormack, "The European Restructuring Directive – A General Analysis" (2020) 33 *Insolvency Intelligence* 11, 12; AFME, "Potential economic gains from reforming insolvency law in Europe" (February 2016), p 2.
[110] COM(2016) 723 final, p 2.

while channelling enterprises with no chance of survival towards swift liquidation […]. This proposal is an important step towards such a change of culture".[111]

In June 2019, the EU adopted the Directive and the text was the result of long and complex negotiations since the proposal was presented in 2016. In short, debtors will have access to early warning tools that enable them to detect the deterioration of the business, leading, in turn, to engaging in restructuring processes at an early stage. The overarching objective is to promote the development of a new culture of preventive restructuring with viable companies experiencing financial difficulties being offered early access to restructuring procedures, irrespective of their location in the European Union. The main building blocks of the Directive and its policy options mirror the Recommendation on a New Approach to Business Failure and Insolvency and include, *inter alia*, early warning systems and access to information; preventive restructuring, with (i) easy access to preventive restructuring procedures allowing debtors to restructure their debts at an early stage, (ii) the possibility for debtors accessing the preventive restructuring procedure to remain in control of their assets and day-to-day operation of the business through a debtor-in-possession model, (iii) a stay on creditor actions to encourage good-faith debtors to apply for restructuring at an early stage, (iv) the possibility to cross-class cram-down dissenting creditors, (v) the "best interests of creditors" test and the absolute priority rule, which aim at protecting creditors, and (vi) the protection of new and interim financing, which is a key attribute to any successful restructuring plan.

Overall, the Directive is aimed at creating harmonised restructuring frameworks throughout the Member States, including key commonalities with the processes from these jurisdictions. It did so by introducing a number of concepts and provisions associated with robust and successful existing restructuring frameworks, such as Chapter 11 of the US Bankruptcy Code, the Irish Examinership, the UK Scheme of Arrangement and the French *sauvegarde* process. It is the first instrument that substantively harmonises insolvency law across the EU, albeit only a narrow aspect of it, that is, preventive restructuring, and as a result it represents a milestone in the development of European insolvency law. Interestingly, however, in its final form, the Directive's harmonisation method is minimum standards for preventive restructuring mechanisms. Therefore, while the Directive on Preventive Restructuring is a welcome first step in the harmonisation of EU insolvency frameworks by addressing a number of important topics relating to restructuring, the Directive will not lead to the harmonisation envisioned in the 2014 Recommendation. First, the Directive does not harmonise core aspects of substantive insolvency law, such as a common definition of insolvency, the conditions for opening insolvency proceedings, the ranking of claims, avoidance actions and the identification and tracing of assets belonging to the insolvency estate.

[111] COM(2015) 468 final, p 6. See also the objective of the Directive, as stated in Recital 1 ("The objective […] is to contribute to the proper functioning of the internal market and remove obstacles to the exercise of fundamental freedoms, such as the free movement of capital and freedom of establishment, which result from differences between national laws and procedures on preventive restructuring [and] insolvency […] [T]his Directive aims to remove such obstacles by ensuring that: viable enterprises […] that are in financial difficulties have access to effective national preventive restructuring frameworks which enable them to continue operating […] and that the effectiveness of restructuring, insolvency and discharge procedures is improved, in particular with a view to shortening their length").

Rather, it acknowledged that: "the current diversity in Member States" legal systems over insolvency proceedings seems too large to bridge given the numerous links between insolvency law and connected areas of national law, such as tax, employment and social security law".[112]

Second, the Directive:

> "sets common objectives, in the form of principles or, where necessary, targeted rules. While aiming to achieve the needed coherence of frameworks across the EU, the [Directive] gives Member States the flexibility to achieve the objectives by applying the principles and targeted rules in a way that is suitable in their national contexts. This is particularly important since some Member States already have elements of well-functioning frameworks in place."[113]

This is due to the fact that the final text of the Directive ultimately reflects considerable compromise. The negotiation, both in the Council and in the European Parliament, resulted in numerous modifications to the legal text, especially in relation to some of the more controversial provisions that are key to a successful preventive restructuring. Issues such as governance of restructuring proceedings and how creditors are treated in terms of the priority of their claims under a plan, for example, vary significantly across the Member States, reflecting diverse regulatory traditions. Most of the changes introduced in the negotiation process watered down the harmonisation effect of the Directive, mainly by introducing a greater scope for derogation than might be expected of a full harmonising instrument. The end result has been characterised as a "puzzling variety of diverging options".[114]

As a result, it is anticipated that the harmonising effect of the Directive will be limited. Policy and technical choices of Member States in the implementation of the Directive will likely result in different restructuring models, which will result in the availability of systems that are located at different points of the spectrum. The introduction of minimum standards means that the scope of the Directive caters to a jurisdiction's *status quo*, permitting in some respects only minor or incremental adjustments to the procedures already present in a legal system, rather than the introduction of something entirely new that align with the frameworks introduced in other Member States. Differences can already be observed in early implementation efforts, particularly in the Netherlands and in Germany.

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[112] COM(2016) 723 final, p 6.

[113] *Idem*, p 7.

[114] V Rotaru, "The Restructuring Directive: A Functional Law and Economics Analysis from a French Law Perspective" (*Droit et Croissance*, 2019), p 1.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

Name the main legal documents addressing insolvency issues at European level that preceded the adoption of the EIR 2000.

Question 2

What were the major differences in the approaches taken by each of these legal documents towards "unity" and "universality" of insolvency proceedings?

Commentary and feedback on Self-assessment Exercise 1

Question 1

EEC Preliminary Draft Convention on bankruptcy, winding-up, arrangements, compositions, and similar proceedings (1970) (1970 Convention); Draft Convention on bankruptcy, winding-up, arrangements, compositions and similar proceedings (1980) (1980 Convention); European Convention on Certain International Aspects of Bankruptcy, Istanbul, 5.VI.1990 (Istanbul Convention); and European Union Convention on Insolvency Proceedings, 23 November 1995 (EU Convention).

Question 2

As early as the 1950s, there was an understanding of the need to introduce uniformity in the regulation of insolvency proceedings at EEC level. A situation in which each Member State had absolute freedom to decide when to accept international insolvency jurisdiction, which law to apply and how to treat foreign insolvencies, no longer satisfied the interests of the growingly integrated market. The questions, however, remained as to the scope, character and underlying principles of such regulation.

The early EEC Conventions (1970 and 1980 Conventions) were ambitious and offered a solution based on the principles of unity and universality. The principle of unity entails the opening of one single and unified insolvency process against a debtor. The principle of universality suggests that insolvency proceeding produce a worldwide effect, that is, they cover the totality of the debtor's assets, wherever situated. Under the pure universalist vision of insolvency, the insolvency proceedings would be decided by one court (that is, at the place of the debtor's "centre of administration"), applying one set of procedural and substantive rules. From the very beginning, this highly centralised and optimistic approach proved to be unrealistic, as the national insolvency law remained divergent on matters such as ranking and the priority of claims, transaction avoidance and directors' liability. The preoccupation with the protection of local interests led to both Conventions adopting a position under which the rights of preferential creditors remained to be regulated by local preference (ranking) rules. This led to the break-up of insolvency estates into national "sub-estates" and effectively killed off the unity and universalism of insolvency proceedings.

In contrast to the EEC Conventions, the Istanbul Convention of 1990 took a polar opposite stance and offered a plurality model, entailing several proceedings against the same debtor. Under the pressure of varying interests of the Council of Europe member states, the Istanbul Convention also provided for the possibility of opt-outs from some of its most important provisions concerning exercise of powers of the liquidator and secondary bankruptcies. This led to different rules being applied in different states, which could have evidently resulted in a substantial hindrance to its effective and harmonised application.

The EU Convention took a middle ground approach between unity / universality of the early EEC Conventions and plurality of the Istanbul Convention. Like the Istanbul Convention, the EU Convention permitted the opening of several insolvency proceedings against the same debtor – one main and one or more secondary proceedings. However, compared to the Istanbul Convention, the scheme of main / secondary proceedings prescribed in the EU Convention was much more structured, predictable and efficient. Main insolvency proceedings enjoyed universal scope, covering the totality of the debtor's assets. The prevalence of main proceedings with extensive extraterritorial powers of the main IP brought it closer to the universalist model. This compromise between universality and plurality (territoriality) received the name of modified or limited universalism.

Self-Assessment Exercise 2

Question 1

What is the scope of the EIR Recast? Draft a step-by-step plan (guide) for checking whether the EIR Recast applies.

Question 2

Please read the facts of the hypothetical case below and answer whether the EIR Recast applies to the opened insolvency proceedings. Use your step-by-step plan and record each step taken in deciding on the application of the EIR Recast.

Creative Tech BV is a company, registered in Rotterdam (the Netherlands) with the centre of main interests (COMI) in the Netherlands. It was founded in 2016 for the purposes of developing new technology solutions for the agricultural industry, involving artificial intelligence (AI) and the blockchain technology. It managed to attract over EUR 1 million from a venture capital fund in Germany and over EUR 1.5 million in loans from a Dutch bank.

Despite initial swift progress, Creative Tech GmbH failed to produce any marketable product and faced financial crisis in early 2017. This situation became even worse, when its main competitor from Germany entered the Dutch market in February 2017. Having failed to secure additional funds necessary for continued operations, on 30 June 2017, the director of Creative Tech GmbH filed an insolvency application with the court in Rotterdam, which opened the suspension of payments proceedings (*De surséance van betaling*) on 7 July 2017 and appointed the administrator (*De bewindvoerder in de surséance van betaling*).

Commentary and feedback on Self-assessment Exercise 2

Question 1

Determination of the EIR Recast's scope requires answering the following questions: when does it apply in time (temporal scope), to whom does it apply (personal scope), which proceedings are covered by it (material scope) and what are its geographical limitations (geographical scope).

A step-by-step plan can be schematically drawn as follows:

1. The debtor has COMI in a Member State of the EU, except Denmark → YES
2. The debtor is not a bank, insurance company or another "excluded" undertaking → YES
3. The proceeding opened against the debtor is listed in Annex A to the EIR Recast → YES
4. The proceeding is opened after 26 June 2017 → YES.

If all four steps have led to a "YES," the EIR Recast should be applicable to the opened insolvency proceeding.

Question 2

Firstly, it is necessary to look for the "centre of the debtor's main interest" (Article 1(1) of the EIR Recast), ie the debtor's COMI. The EIR Recast applies only when the debtor's COMI is located within the EU (excluding Denmark). In the hypothetical case, it is directly stated that COMI of Creative Tech BV is in the Netherlands, which is an EU Member State. Thus, the requirement of the geographical scope is satisfied.

Secondly, one needs to check whether the personal scope of the EIR Recast is complied with. As Creative Tech BV is neither a bank, nor any other excluded" entity, it falls within the personal scope of the EIR Recast.

Thirdly, in order to fall within the scope of the EIR Recast, an insolvency proceeding has to be listed in Annex A (material scope). The proceeding of *De surséance van betaling* opened against Creative Tech BV is mentioned in Annex A. Therefore, it falls within the material scope of the EIR Recast.

Fourthly, temporal scope must be checked. This scope requires that the insolvency proceeding is opened after 26 June 2017 (the entry of the EIR Recast into force). The facts of the case indicate that the insolvency proceeding in question was opened on 7 July 2017, that is within the temporal scope of the EIR Recast.

Having studied the facts of the case against the background of the EIR Recast, we can conclude that the EIR Recast is applicable to the insolvency proceeding opened against Creative Tech BV.

Self-Assessment Exercise 3

Question 1

What is the difference between main and secondary proceedings under the EIR Recast?

Question 2

Study the basic aspects dealt with under the previous heading and write a brief essay providing arguments in favour and against the system of main and secondary proceedings, as established by the EIR Recast.

Commentary and feedback on Self-assessment Exercise 3

Question 1

The EIR Recast enables main insolvency proceedings to be opened in the Member State where the debtor has the centre of its main interests (COMI). COMI has an autonomous meaning and corresponds with the "place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties" (Article 3(1) EIR Recast). Main insolvency proceedings have universal scope and are aimed at encompassing all the debtor's assets (Recital 23 of the EIR Recast). They play a dominant role in resolving debtor's insolvency. In order to ensure this role, the IP in such proceedings acquires several possibilities for intervening in secondary insolvency proceedings which are pending at the same time. For instance, the main IP can propose a restructuring plan or composition, or apply for a suspension of the realisation of the assets in secondary insolvency proceedings (Recital 48 of the EIR Recast).[115]

The universal ambition of the main insolvency procedure is limited by the "territorialistic" nature of secondary proceedings, which can be opened to run in parallel with main insolvency proceedings. The territorial nature of secondary insolvency proceedings means that their effects are limited to the assets located in the Member State of secondary proceedings. Secondary proceedings can be opened in a Member State where the debtor has an establishment, which is defined as the "place of operations where a debtor carries out or has carried out a non-transitory economic activity with human means and assets" (Article 2(10) of the EIR Recast). The opening of territorial proceedings disturbs the otherwise coherent insolvency estate by creating a separate insolvency (sub)estate carved out from the main insolvency proceeding and its *lex concursus*.

Question 2

The EIR Recast adheres to the complex (multi-layered) system allowing for the opening of several insolvency proceedings against the same debtor in different Member States. The multiplicity of insolvency proceedings creates additional costs (for example, court fees, salaries of IPs, communication and translation costs, time costs) and complicates the efficient administration of the insolvency estate (Recital 41 of the EIR Recast). The single insolvency estate is effectively partitioned along jurisdictional lines. Moreover, problems may arise when the nature of main and secondary proceedings differs, for example, main proceedings are rehabilitative, while secondary proceedings aim at the company's liquidation. The rules on communication and co-operation in the EIR Recast, as well as other tools to control the opening and the course of secondary proceedings, should mitigate against such risks.

[115] The dominance of main insolvency proceedings also follows from Case C-212/15, *ENEFI Energiahatékonysági Nyrt*, ECLI:EU:C:2016:841 (Nov 9, 2016), in which the CJEU ruled that foreign creditors who have not participated in main insolvency proceedings could forfeit their right to pursue claims in secondary proceedings, if the forfeiture follows from the law of the main proceedings (*lex concursus*).

As regards the reasoning behind the introduction of secondary insolvency proceedings, the EIR Recast cites protection of local interests and the need to ensure effective handling of complex insolvency estates, which are too difficult to administer as a unit (Recital 40 of the EIR Recast). Thus, secondary insolvency proceedings perform a dual function: protecting local interests (defensive function) and improving the administration of the insolvency estate (auxiliary function). Initiation of secondary insolvency proceedings safeguards the expectations of (local) creditors as to the applicable insolvency law, including their position in creditors' ranking. Another argument in favour of secondary proceedings is that they facilitate the participation by micro and small creditors, which may otherwise choose not to participate in foreign insolvency proceedings (for example, due to additional legal, translation, travel and other costs).

Self-Assessment Exercise 4

Question 1

The EIR Recast provides for a number of exceptions to the general rule on the application of the law of the insolvency forum (*lex concursus*). Give two examples of such exceptions and explain the rationale behind them.

Question 2

Solar Panels Srl (debtor) is a company registered in Bari (Italy). Its main line of business consists of manufacturing solar panels (mainly in Italy) and their distribution in other parts of Europe. In June 2017, it had to cease operations due to a lack of raw material availability. As a result, the company suffered a liquidity shortage and had to file for insolvency. By judgment of 15 July 2017, the *Tribunale di Bari* opened insolvency (*fallimento*) proceedings against Solar Panels Srl.

Among the assets owned by the debtor is a plot of land of 500 m² located near Amsterdam (the Netherlands). This land plot was mortgaged in favour of DutchBank (creditor), which financed operations of Solar Panels. Since the debtor entered into default on its obligations in August 2017, DutchBank decided to foreclose on the mortgaged asset in the Netherlands. Can DutchBank do so? When answering the question, please refer to the relevant provisions of the EIR Recast and relevant national law (if necessary).[116]

[116] See Dutch Bankruptcy Act, Art 57 and Italian Bankruptcy Law, Art 51

Commentary and feedback on Self-assessment Exercise 4

Question 1

The exceptions to the application of the *lex concursus* are provided in Articles 8 to 18 of the EIR Recast. They cover different scenarios and pursue well-defined economic and social goals. For example, Article 8 of the EIR Recast insulates rights *in rem* (for example, pledge or mortgage) of creditors or third parties in respect of assets owned by the debtor. This exemption from the *lex concursus* serves to ensure legal and economic stability, in particular in respect of the credit market, since holders of rights *in rem* are insulated against the risk of insolvency (and its respective legal effects) and the interference of third parties. This adds legal certainty and minimises insolvency-related risks for secured creditors, allowing them to charge lower interest rates and provide liquidity (inexpensive credit) to the market.

Article 13 of the EIR Recast derogates from the general application of the *lex concursus* and makes the effects of the proceedings on employment contracts and on labour relations subject to the law of the Member State applicable to the contract of employment, including its law on insolvency. This special approach aims to protect employees and labour relations from the application of a foreign law, different from that which governs the contractual relations between employers and employees. As opposed to Article 8 of the EIR Recast, which protects credit relations, Article 13 safeguards rights and expectations of employees. This ensures protection of a weaker party (employee) and promotes social cohesion throughout the EU.

Question 2

Based on the facts of the case, we can conclude that the EIR Recast is applicable. To answer the question of whether DutchBank can lawfully foreclose on the mortgaged asset located in the Netherlands (ignoring the opening of insolvency proceedings in Italy), we need to refer to the applicable provisions of the EIR Recast.

Article 7 of the EIR Recast lays down the general rule, under which the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened. This law (*lex concursus*) determines, *inter alia*, the effects of insolvency proceedings on proceedings brought by individual creditors and the rules governing the distribution of proceeds from the realisation of assets. Since the main insolvency proceedings were opened in Italy, Italian law should be considered to be the *lex concursus*. Under Italian law, mortgages over real estate are enforced through a court-administered enforcement procedure. Besides, as a general rule, secured creditors cannot bring individual enforcement actions in relation to assets included in the bankruptcy estate once the insolvency has been declared (Article 51 of the Italian Bankruptcy Law). Based on Italian law, out-of-court individual enforcement of the bank's claim is impossible.

However, Article 8 of the EIR Recast states that the opening of insolvency proceedings **shall not** affect the rights *in rem* of creditors in respect of immovable assets, belonging to the debtor and situated within a Member State, other than the state of the opening of insolvency proceedings. In our case, the mortgage was established prior to insolvency and over the asset (ie, the plot of land) located in the Netherlands (not in Italy). Therefore, Article 8 of the EIR Recast applies and insulates the right in question from the effects of Italian law. According to article 57 of the Dutch Bankruptcy Act, mortgagees may exercise their (preferential recovery) rights as if there was no bankruptcy liquidation proceeding. Thus, DutchBank may independently exercise its security rights (for example, by means of a public sale with no court intervention) regardless of the debtor being subject to insolvency proceedings in Italy.

Self-Assessment Exercise 5

One of the major underlying principles of the EIR is the principle of *paritas creditorum* (equality of creditors). How is this principle ensured in practice? Support your answer with references to the applicable provisions of the EIR Recast.

Commentary and feedback on Self-assessment Exercise 5

Philip R. Wood, writing on the bankruptcy ladder of priorities, concluded that "[e]ven the most cursory examination of bankruptcy internationally shows that the *pari passu* rule is nowhere honoured. The dewy utopia of equality is pure sentimental fiction".[117] This assertion holds true for the EU, where substantive harmonisation of insolvency laws, including ranking and priority of creditors, is still in its infancy. Nevertheless, the EIR Recast, without encroaching on the sovereign powers of the Member States, introduces a few procedural and substantive rules ensuring *paritas creditorum*. One such rule can be found in Article 23(1) of the EIR Recast, which mandates the return to the debtor's insolvency estate what has been taken from it by the creditor following the opening of main insolvency proceedings (assuming no territorial proceedings have been opened). Article 23(2) of the EIR Recast encompasses another rule, addressing a situation of multiple insolvency proceedings opened against the same debtor across the EU. Since under the EIR Recast creditors are free to file their claims in as many proceedings as they wish (Article 45 of the EIR Recast), a situation may arise in which a creditor obtains more favourable treatment than the other creditors of the same class by receiving payment on the same claim in insolvency proceedings in different jurisdictions. To safeguard the equal treatment of creditors, Article 23(2) of the EIR Recast prescribes that a creditor claiming in more than one proceeding should not receive more than the proportion of payment that is obtained by other creditors of the same ranking or category. This rule, also called "hotchpot rule", is replicated in Article 32 of the Model Law.

[117] P R Wood, *Principles of International Insolvency* 237 (2nd ed, 2007).

The equality of creditors is further supported by the rules related to notifications and insolvency registers. For example, Article 28(1) of the EIR Recast obliges the insolvency practitioners to request the publication of the notice on the opening of insolvency proceedings, whether main or secondary, in the place of the debtor's establishment. Additionally, Article 54 of the EIR Recast compels the court, which has opened insolvency proceedings, or the insolvency practitioner appointed by such court, to immediately inform the known foreign creditors as soon as insolvency proceedings are opened. The timely notification and visibility of insolvency proceedings is equally facilitated by the creation of national insolvency registers (Article 24 of the EIR Recast) and the EU-wide decentralised system for the interconnection of insolvency registers to be launched via the e-Justice Portal (Article 25 of the EIR Recast). This visibility should counter creditor passivity and encourage active actions by creditors, both in terms of claim filings and the exercise of other insolvency-related rights, such as challenging a debtor's pre-insolvency transactions or bringing the debtor's (former) directors to liability, as the case may be.

Self-Assessment Exercise 6

Recent years have seen an increase in both the complexity of international insolvencies and in the rise of various soft law instruments (for example, guidelines and recommendations), addressing the issue of court-to-court communication and co-operation in insolvency cases. You are required to write a brief essay explaining why such communication and co-operation is essential for the achievement of the best results for creditors and other stakeholders.

Commentary and feedback on Self-assessment Exercise 6

Co-operation and communication between courts in insolvency proceedings is a global trend. There are, at present, three principal sets of guidelines for court-to-court communication. These are the American Law Institute / International Insolvency Institute Guidelines (ALI-III Guidelines) Applicable to Court-to-Court Communications in Cross-Border Cases (updated version from 2012), the already mentioned EU JudgeCo Principles and Guidelines (2015) and the Judicial Insolvency Network (JIN) Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters (2016). The United States Bankruptcy Court for the District of Delaware and the Supreme Court of Singapore were the first to adopt the JIN Guidelines in February 2017. The United States Bankruptcy Court for the Southern District of New York and the Supreme Court of Bermuda followed suit on 17 February and 9 March 2017 respectively. England and Wales adopted the JIN Guidelines in May 2017, as did the British Virgin Islands. In September 2017 New South Wales (Australia) joined the team, followed by the United States Bankruptcy Court for the Southern District of Florida in February 2018, making Florida the third US state to sign up to them. Evidently, the JIN Guidelines mainly apply in the circle of "common law" jurisdictions.

The reasons for the adoption of and adherence to these best practices are manifold, all equally conducive for the achievement of the best results for debtors, their creditors and other stakeholders involved. Lack of communication and co-operation between courts may result in inconsistent judgments, unequal distributions for creditors (that is, made in violation of the *paritas creditorum* principle) and diminishment of the remaining value of the enterprise. The effective realisation of the debtor's estate to extract the maximum value for its creditors, for example, through the sale of the international business as a going concern, is inconceivable without communication and proper planning. Justice Kannan Ramesh of the Supreme Court of Singapore highlighted that "achieving effective restructuring outcomes in cross-border restructuring must be assessed against the reality that substantial aspects of practice in this realm are still not governed by any hard law […] and will conceivably remain so at the very least in the short-to-medium term".[118] In this respect, court-to-court communication guided by best practices, is one of the very few available instruments to facilitate rescue of financially distressed but economically viable enterprises.

Within the EIR Recast framework, the principles of efficient court-to-court communication and co-operation have resulted in Articles 42 and 57 (for cases of groups of companies), which mandate such communication and co-operation.

Self-Assessment Exercise 7

Question 1

"The very structure of a modern corporate group can make it the engine of injustice and fraud […]. The result may be that a corporate form is ignored for most of the life of a corporate group until, at the moment of insolvency, the corporate form arises from its desuetude to control the legal rights of all concerned […]. There are many implications of all this, but one of them is that executives can find themselves captains of a legal armada of limited liability vehicles, each of which may have billions of dollars in assets or nearly none." Jay Lawrence Westbrook, 2018[119]

Write a short essay, *inter alia*, mentioning the following:

1. Do you agree with the author (and why)?
2. What is / are the problem(s) raised by the author? Provide examples where such problem(s) can arise in practice.
3. What is / are the solution(s) available to the problem(s) discussed in 2 above (for example, in some of the national laws) and which of these do you support (and why)?
4. Is / are the described problem(s) addressed under the EIR Recast? If yes, how are the problems addressed?

[118] K Ramesh, Singapore Insolvency Conference 2018 – Keynote address, 23 July 2018, p 10.
[119] J L Westbrook, "Transparency in Corporate Groups", *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol 13, 2018.

Question 2

Study the framework of group co-ordination proceedings introduced by the EIR Recast. Do you believe that such a framework is efficient and effective for dealing with the insolvency of corporate groups? Present and explain at least three arguments, justifying your position. For the answer to this question, you are not required to write an essay.

Commentary and feedback on Self-assessment Exercise 7

Question 1

We should agree with Professor Westbrook that very often company and insolvency law rules create a disconnect between business (economic) and legal reality. While being solvent, group members act like a single enterprise, creating synergies and reinvesting profits within the group. From the outside, for the general public and, very likely, external creditors, group members may act under the same corporate brand, thus creating the impression of one company with one strong corporate identity and one pool of assets. Towards third parties, the integrated businesses can be regarded as a unity of enterprises. Internally, this interconnectedness is further facilitated by some widespread forms of mutually dependent intra-group finance, such as cross-guarantees and intra-group loans.

However, upon insolvency, these economic ties and business relationships are usually broken apart and each legal entity within the group is subject to a separate insolvency proceeding with a separate insolvency practitioner and a separate insolvency estate. This result emanates from the company law principles of legal separateness (entity shielding; the "principle of the five one's") and limited liability. In other words, the group "lives" as a whole. However, when the crisis strikes, the group members "die" on their own. This can lead to suboptimal results, detrimental to both the creditors and the debtors. For example, unco-ordinated negotiation efforts in establishing restructuring plans by only a few of the group members, or the realisation of assets in parallel insolvency proceedings opened in different states, may not only undermine any prospects for a successful group rescue, but will probably lead to a value-destructive piecemeal liquidation.

The diversity of corporate groups makes it difficult (and perhaps even impossible) to come up with a single recipe for resolving group crises. In literature and practice, different solutions have been proposed, ranging from simple communication, co-ordination and the appointment of the same insolvency practitioner to more advanced procedural consolidation (one court and / or restructuring plan) and substantive consolidation (single procedure with one unified estate). Whereas in most Member States procedural consolidation is unavailable under the law, concentration of all or the majority of proceedings in one court or appointment of the same insolvency practitioner for different companies within a company group occurs in practice (for example, in the Netherlands, Germany, Italy and the UK). Substantive consolidation is much rarer and is permitted in very specific exceptional circumstances – usually, in a situation of intermingled assets and liabilities.[120]

The EIR Recast does not sanction procedural or substantive consolidation. However, it mentions the possibility of appointing the same insolvency practitioner in all proceedings concerned, provided that this is compatible with the rules applicable to them (Recital 53 EIR Recast). Besides, the EIR Recast mandates co-operation and communication between insolvency practitioners appointed in separate insolvency proceedings (Article 56), as well as the co-ordination of parallel insolvency proceedings opened against group members (Chapter V, Section 2).

Question 2

Having studied the framework of the EIR Recast, we believe that the regulation of group co-ordination proceedings (Chapter V, Section 2) will probably miss the desired goal of securing the efficient administration of group insolvency proceedings, including co-ordinated restructuring of the group. Four arguments can be advanced.

First, the voluntary nature of group co-ordination proceedings (Recital 56 of the EIR Recast) and the possibility of an easy opt-out without explanation or good cause (Article 64 of the EIR Recast) make group co-ordination proceedings a toothless instrument. Moreover, even if such proceedings have been instituted, the insolvency practitioners are not obliged to follow the co-ordinator's recommendations or the group co-ordination plan in whole or in part (Article 70 of the EIR Recast). The system is non-committal.

[120] For more information, see B Wessels and S Madaus, *Instrument of the European Law Institute - Rescue of Business in Insolvency Law*, 2017, p 348.

Second, the fact that the creditors of the group members are not necessarily consulted about the opening of (or joining), or opting-out, from the group co-ordination proceedings could make such proceedings artificial, without genuine creditor involvement and support.[121] For instance, Article 63 of the EIR Recast obliges the court seized with the request to open the group co-ordination proceedings to give the insolvency practitioners involved the opportunity to be heard. No similar right is given to the affected creditors.

Third, practically speaking the initiation of an additional proceeding (group co-ordination proceedings) adds a layer of complexity, resulting in time consuming actions and increased costs. Unclear prospects, ambiguous rules (for example, on conflict of interest), the non-binding nature and the incurrence of potentially large costs (translation, travel, fees of a group co-ordinator and his assistants) may exceed the potential benefits. This cost-benefit analysis can explain why, almost a year and a half since the EIR Recast has entered into force, to our knowledge there have been no group proceedings opened.

Fourth, additional problems may arise if the corporate group has members located in non-Member States, meaning that the EIR Recast will not bind courts and insolvency practitioners in such non-Member State proceedings, and that the latter will not form part of the group co-ordination proceedings. Usually, large corporate groups are not confined to the territory of the EU and have subsidiaries all over the world. Their exclusion from the group proceeding may significantly limit the effectiveness and usability of the group provisions in the EIR Recast.

[121] Note that prior to taking the decision to participate or not to participate in the co-ordination, an insolvency practitioner may be required to obtain any necessary approval. This could include approval by relevant creditors under the applicable *lex concursus*. Thus, involve/ment of creditors in the group co-ordination proceedings is largely a matter of national law and not of the EIR Recast.

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