The power of the collective: EIR in focus

Catherine Burton provides an update on the Recast European Insolvency Regulation before many of its provisions apply at the end of June 2017.

As reported in *RECOVERY* Winter 2015 (Technical Update – Europe, is there more to come?) the recast Insolvency Regulation (Regulation (EU) No. 2015/848) (the recast regulation or EIR) was adopted by the European Parliament and Council on 20 May 2015. This article is a reminder of the key changes commencing on or after 26 June 2017. The current EC Regulation on Insolvency Proceedings no. 1346/2000 (ECR) will continue to apply to any proceedings within its scope, commenced before that date.

Those parts of the recast EIR that will not apply on 26 June 2017 comprise member states' obligation to establish and maintain national registers of insolvency proceedings (which will apply from 26 June 2018)[1] and the adoption of legislation to establish a decentralised system to connect each member state's insolvency registers and the European e-Justice Portal (with a deadline of 26 June 2019)[2].

Scope

The recast EIR continues to apply to all European member states other than Denmark and has been extended in scope to new categories of proceedings, including rehabilitation proceedings, which are set out in annex A. The emphasis remains on collective proceedings and, consequently, the UK's receivership and administrative receivership regimes remain outside the scope of the recast regulation.

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Similarly, the UK's scheme of arrangement, falling under the Companies Act 2006 rather than insolvency legislation remains outside the scope of the EIR. This will enable the English courts to continue to apply the flexible 'sufficient connection test' when considering whether to accept jurisdiction over a scheme. The recast EIR excludes confidential proceedings, making it clear in the recitals that, while they play an important role in some member states, their confidentiality militates against two important aspects of the recast EIR: publication in registers and recognition in other member states[3].

The recast EIR's recitals also explain, in wide terms, how 'collective' should be interpreted: the proceedings should include all, or a significant part, of the creditors to whom the debtor owes a substantial proportion of its outstanding debts, but the claims of creditors not involved in the proceedings must remain unaffected. Such proceedings should be aimed at rehabilitating the debtor. Those that result in the cessation of the debtor's activities or liquidation should include all of its creditors.[4] Interim proceedings that meet all other criteria of the recast EIR fall

within its scope. The recast EIR continues only to apply to those debtors whose centre of main interests is located within the European Union (thus would include, for example, a company registered in Malaysia but with its centre of main interests (COMI) in France.

Key changes – COMI and forum shopping

Recital 5 of the recast EIR includes an implied but important acknowledgment of the different types of forum shopping: those where the relevant forum is chosen to make a better return for creditors compared with those where, usually natural persons, seek a regime that they consider to be more favourable for their interests, often to the detriment of their creditors.

COMI-shifting and other devices seeking to maximise returns to creditors will be permitted – within the constraints of new COMI limitations.

COMI is now expressly defined

Article 3 provides that, for both companies and individuals, the COMI shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. For companies, the registered office presumption remains, but will not apply if the registered office has been moved to another member state within three months prior to the opening of insolvency proceedings. The majority of COMI shifts that have taken place to facilitate better returns for creditors since the introduction of the ECR rely on factual circumstances displacing the registered office presumption. Consequently this provision alone is unlikely to restrict such beneficial forum shopping.

> In line with the intention for the recast EIR to embrace rescue and rehabilitation proceedings, it is no longer necessary for secondary proceedings to be liquidation proceedings.

For individuals engaged in business or professional activity, COMI will be presumed to be their principal place of business unless that has been moved to another member state in the three months before applying to open insolvency proceedings.

For all other individuals, their COMI is presumed, in the absence of proof to the contrary, to be the place of their habitual residence. Here, however, the presumption will not apply if that has been moved to another member state within six months of the request to open insolvency proceedings.

New standard form

There is to be a standard notice (to be published on the European e-Justice Portal, headed 'notice of insolvency proceedings') that will be issued to foreign creditors by the court or relevant insolvency practitioner as soon as insolvency proceedings are opened in a member state. The notice to creditors must inform them of any time limits for claiming, the body(ies) authorised to accept and adjudicate claims and whether secured or preferential creditors need to lodge a claim. The notice will be accompanied by a standard claim form headed 'lodgement of claims'[5].

Stays and synthetic secondary proceedings

In line with the intention for the recast EIR to embrace rescue and rehabilitation proceedings, it is no longer necessary for secondary proceedings to be liquidation proceedings. Recital 41 expressly recognises that secondary insolvency proceedings can hamper the efficient administration of an insolvent estate. The regulation therefore sets out two specific situations in which a court seised of a request to open secondary proceedings should be able, at the request of the insolvency practitioner in the main proceedings, to postpone or refuse to open such proceedings.

Extending the stay

The opening of secondary proceedings may be stayed for a period of up to three months when such a stay has been granted in the main proceedings, provided the court ordering the stay of secondary proceedings is satisfied that suitable measures are in place to protect the interests of local creditors.[6]

Synthetic secondary proceedings

To avoid the opening of secondary proceedings the insolvency practitioner may give an undertaking that he will distribute assets in accordance with local distribution and priority rules in the jurisdiction where those proceedings could be issued. Under the recast EIR, the insolvency practitioner must specify the factual assumptions on which it is based, including the value of assets located in that member state and the options available to realise those assets. The undertaking must be made in writing in one of the official languages of the secondary member state and must be approved by local known creditors. The approval process for creditors within the secondary member state will replicate the qualified majority, and voting that applies in that state for the adoption of a restructuring plan under its laws. For example, if England were to be the relevant secondary member state, mirroring a CVA, a 75 per cent majority would be required to approve a proposed CVA. The procedure to approve the proffered undertaking therefore takes place largely outside court. There are a number of safeguards to ensure that the insolvency practitioner complies with his undertaking and provision for him to be liable in damages if he fails to do so.

> Perhaps the most significant change introduced by the recast EIR is a selection of measures to facilitate the coordination of insolvency proceedings affecting members of a group of companies.

This convoluted procedure could take several weeks to complete, whereas the timescale for synthetic secondary proceedings via an application to court along the lines previously seen in England, can be much faster. The wording of Article 36 'right to give an undertaking in order to avoid secondary insolvency proceedings' is permissive – 'the insolvency practitioner *may* give a unilateral undertaking', but the recitals that are secondary to the articles of the regulation and used to help to »

interpret them suggest, by use of 'two specific situations… in which the court… should be able… to postpone or refuse the opening of such proceedings', create scope for some courts to interpret the undertaking requirements to be mandatory. It remains to be seen, therefore, whether member state courts consider that they have jurisdiction to make orders of the kind formerly seen.

Location of assets

As with the ECR, the recast EIR provides for the law of the state of the opening of proceedings to determine the conditions for the opening of proceedings, their conduct and closure, but also provides a series of 11 exceptions[7] including rights *in rem*, set off, contracts of employment, pending lawsuits and contracts relating to immovable property. Several of the exceptions depend on the location of the asset in question, for example, rights *in rem* are excepted where the relevant charged asset is situated within the territory of another member state[8]. The recast EIR's definitions article[9] seeks to clarify the location of various assets so that, for example, in the case of security over shares, the registered shares in companies are deemed to be situated in the same member state where the company that issued the shares has its registered office.

Coordination of group insolvencies

As previously discussed in *RECOVERY*[10], perhaps the most significant change introduced by the recast EIR is a selection of measures to facilitate the coordination of insolvency proceedings affecting members of a group of companies[11]. Article 2 defines 'group of companies' as a parent undertaking and all its subsidiary undertakings. Section 1 of chapter V to the recast EIR imposes a duty on insolvency practitioners appointed in respect of different members of a group of companies, and the courts that open the insolvency proceedings in respect of those members, to cooperate with each other 'to the extent that such cooperation is appropriate to facilitate the effective administration of those proceedings, is not incompatible with the rules applicable to such proceedings, and does not entail any conflict of interest.'[12] It is expressly anticipated that cooperation may take any form but might include the use of agreements or protocols.

The adventurous part comes with the introduction of 'group coordination proceedings'. An insolvency practitioner appointed in relation to a member of a group of companies has a right to be heard in any proceedings opened in respect of any other member of the group. He is also entitled to request the opening of group coordination proceedings before any court which has jurisdiction over the insolvency proceedings of any member of the group[13]. His request to open group proceedings must be accompanied by a proposal for the person who will be nominated to act as 'group coordinator'[14]. That person must be eligible under the law of at least one member state to act as an insolvency practitioner but not already be acting as an insolvency practitioner of any of the members of the group and must not have any conflicts of interest in respect of members of the group, their creditors or other insolvency practitioners appointed[15].

The group coordinator's role will be to make recommendations for the coordinated conduct of the insolvency proceedings and to propose a 'group coordination plan' that will ideally set out measures to be taken to restore the financial health of members of the group.

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The court seised of the application to open group coordination proceedings will not do so nor notify all insolvency practitioners appointed in respect of each member unless it is satisfied, *inter alia*, that the opening of group proceedings is appropriate to facilitate the effective administration of the insolvency proceedings relating to different members of the group and that no creditor or any group member expected to participate in the group proceedings is likely to be financially disadvantaged by its inclusion in the proceedings. Insolvency practitioners notified of the proposed group proceedings affecting the group member to which they have been appointed, have 30 days from receipt of the notice requesting the opening of the group proceedings to object to the inclusion of their company in the group coordination proceedings or to object to the person proposed as coordinator. When a member of a group has objected to being included, they will not be responsible for any part of the costs of the coordination proceedings (which will be divided between the remaining members of the group). However it is possible for a group member who has objected to the proceedings or one whose own insolvency proceedings commenced after the commencement of the group coordination proceedings to decide to opt into the coordination proceedings at any time.

The division among members of the group of the coordinator's costs is to be proposed by the coordinator. Insolvency practitioners have 30 days to object, failing which the costs will be deemed to have been agreed. Any objections must be made to the court that opened the coordination proceedings. Its decision is challengeable in accordance with the procedures set out under the laws of the member state in which that court is located.

Where a restructuring plan is proposed for some or all of the members of the group, an insolvency practitioner appointed to one or more group members can be heard in any proceedings affecting other group members, without seeking the formal opening of group coordination proceedings. The practitioner may request a stay, initially for three months, extendable to a maximum of six months, of 'any measure related to the realisation of the assets' of other group members. Their request can only be made, and the stay ordered, if the court is satisfied that:

- a restructuring plan has been proposed and presents a reasonable chance of success;
- the stay is necessary to ensure the proper implementation of the plan; and
- the plan would benefit creditors in the proceedings in which the stay is requested.

The court hearing the application for a stay may require the insolvency practitioner to take any suitable measure available under national law to guarantee the interests of creditors in the proceedings.

Conclusion

The recast EIR seeks to address many of the perceived shortcomings of the original ECR. Some of its provisions are adventurous and it will be particularly interesting to see the extent to which the new measures for synthetic secondary proceedings and group coordination proceedings are embraced. ◻

1 Article 24
2 Article 25
3 Recitals 12 and 13 thus excluding, for example, French mandataire ad hoc and conciliation proceedings
4 Recital 14
5 Article 53
6 Recital 45 and Article 38
7 Articles 8–18
8 Article 8
9 Article 10
10 *RECOVERY* Summer 2016 Perfect Harmony.
11 Chapter V
12 Article 56 and similar wording appears in Articles 57 and 58
13 Article 60
14 Article 61
15 Article 71

CATHERINE BURTON is head of restructuring knowledge management at DLA Piper LLP.