CLIFFORD CHANCE

Briefing note

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A second chance for the European Insolvency Regulation: All change?

On 5 February 580 out of 668 MEPs in Strasbourg voted in favour of updating the European Regulation on Insolvency Proceedings. The Regulation provides the current legislative framework governing cross border insolvency cases in Europe. It is generally accepted that changes are required to ensure that the Regulation keeps apace with the economic times and the amendments are seen as opportunity to take on board lessons learnt since its original enactment in May 2002. The proposals have been billed as giving viable businesses a second chance.

The main changes relate to extending the scope of the Regulation so that they encompass more pre-insolvency and rehabilitation style proceedings and introduce an EU wide system of web based insolvency registers. These changes are to be welcomed. Before the vote, the Parliament received a report produced by the European Parliament's Committee on Legal Affairs (the Report) and whilst many of the proposed changes embrace the EU rescue and recovery culture, some of the changes set out in the Report differ quite radically from the European Commission's own proposals. Some of those proposals have the potential to undermine the certainty and efficient working of the Regulation and will not necessarily be a good thing for all stakeholders.

Next steps

There are still various EU legislative stages to go through before the amendments become law; most importantly the precise text of the amendments needs to be agreed between the European Parliament, the Commission and the Council.

The European Commission hopes agreement on the text will be reached by June this year. The implementation of an amended Regulation is then still likely to be a couple of years off.

We consider in this briefing some of the main issues of concern in relation to the current status of the amendments as set out in the Report and their potential impact on stakeholders.

In terms of the current position, the Report, from an English law perspective, raised concern in three main areas, namely: (1) the exclusion of out of court procedures from the Regulation; (2) the introduction of a minimum 3 month period for establishing a debtor's centre of main interests (COMI); and (3) the introduction of group coordination proceedings to enable a non-binding group coordination plan to be pursued.

Exclusion of out of court procedures?

Perhaps the most controversial of the changes included in the Report from an English law perspective was the exclusion of out of court procedures from the scope of the Regulation. This would have resulted in out of court administrations, creditors' voluntary liquidations, and company voluntary arrangements all falling outside the Regulation, thereby depriving such procedures from the benefit of automatic recognition across Member States. The original proposal from the Commission was much more inclusive and, indeed, was limited to clarifying the meaning of "court" so that it would, in fact, encompass such proceedings. We understand that this aspect of the Report did not get favourable

Key issues

- Will, out of court procedures, be excluded?
- Is a 3 month minimum period for COMI realistic?
- Are group coordination proceedings workable?

treatment at the EU Parliament on Wednesday, and as such the proposed amendments in this regard are, we believe, not to be pursued. This is to be seen as a very positive step, especially in the English corporate insolvency sphere where the lack of availability and recognition of out of court processes under the Regulation could have had an adverse impact on the financial outcome for stakeholders - in particular creditors.

Minimum period for COMI

Another significant departure from the Commission's original proposals is the introduction of a minimum 3 month look-back period for establishing a debtor's COMI. The Commission's original proposals had focussed on explaining the meaning of COMI and reflecting how this should be interpreted in line with the developing case law. The original proposals were widely welcomed. In this latest Report, the introduction of a new minimum period is aimed at preventing forum shopping by obliging the debtor to conduct the administration of his interests on a regular basis in the insolvency jurisdiction for at least 3 months prior to the opening of insolvency proceedings or provisional proceedings. This was considered necessary, in particular in the context of bankruptcy tourism cases. In a corporate context, whilst the introduction of a minimum period may not create too many difficulties in practice, this period would nonetheless need to be factored into the structuring of complex restructuring cases. In addition, by introducing an arbitrary period for establishing COMI, in cases where there has been a genuine shift in COMI, stakeholders may suffer when circumstances do not permit a 3 month period to have elapsed before formal proceedings become necessary; likewise for companies that simply fail in their infancy. Furthermore, it should be noted that, even if the 3 month period is satisfied, it will not prevent challenges relating to jurisdiction being initiated as the proposed amendments also include an express provision to allow creditors in other Member States to initiate such a challenge.

Group coordination proceedings

The most radical proposal (described in the Report itself as "ambitious") is the potential introduction of group coordination proceedings. This proposal provides that, in addition to individual proceedings for each company in the group taking place in individual Member States, a group process led by an independent coordinator would also take effect. The coordinator would have the role of identifying and outlining procedural and substantive recommendations for the coordination of the insolvency proceedings, mediating disputes between group members and presenting a plan that recommends a comprehensive set of measures to resolve the group member's insolvencies. In particular, the plan may recommend measures to re-establish the economic and financial soundness of the group or part of it, settle disputes, and facilitate agreements between group members. It also appears that the group coordination plan can get court approval without any direct creditor involvement, and even comments from the insolvency representatives from individual group companies may not be reflected in the plan. In reality, notwithstanding Court approval, it appears to offer no more than a protocol for coordination, which can already be pursued under the current Regulation. Whilst it has been generally acknowledged that a solution for groups of companies presents one of the biggest challenges in cross border insolvency cases, the Commission had sought to address this by proposing amendments that encouraged cooperation but left the mechanisms to facilitate cooperation flexible. In the Report, however, the introduction and operation of formal coordination proceedings which would co-exist with individual proceedings is much more prescriptive - although any group coordination plan proposed by the independent coordinator would not be binding on the individual insolvency representatives of each individual group company; and whilst individual insolvency representatives have a duty to consider the recommendations, they can deviate from the group coordination plan provided that they explain why to their creditor body. In practice, we consider that such coordination proceedings would add another layer of cost (to be shared by each group member) and complexity and, with no binding effect, will serve little purpose. Nothing under the current Regulation would prevent a coordinated approach should it be considered feasible. Consequently, there appears to be little to be gained in this proposal and instead leaves open the potential for further distraction and mischief as individual group members seek to initiate coordination proceedings first so as to gain some influence over the process or at least have a process taking place in a jurisdiction that is familiar to them. New definitions are included in the amendments for group companies which may mitigate these risks. For example, "crucial functions within the group" which is the keystone for determining the jurisdiction of group coordination proceedings means "the ability .... to take and enforce decisions of strategic relevance for the group or parts of it", or "the economic significances .... which shall be presumed if the group members contribute at least 10 per cent to the consolidated balance sheet and turnover". However, it is not entirely clear as to how this will be interpreted in practice. In addition, we doubt that the role of coordinator would prove to be an attractive option, not least because of potential liabilities for breaches of duty (the nature and scope of which remain unclear in the current draft amendments which are included in the Report).

Whilst the amendments in general are to be welcomed, in particular where they seek to extend the scope of the proceedings covered by the Regulation and clarify the aspects of the Regulation which have been wanting, further work is needed on the detail. In particular, some aspects, such as the introduction of group coordination proceedings need to be revisited as there is a danger that at best they will be of little use, but may also prove to be exploited in ways that are certainly not envisaged under the current proposals. There is likely to be a future discussion between the European Parliament, the Commission and the Council on the precise amendments and, on the assumption that the differences can be compromised to result in an agreed text, it is hoped that as the Regulation itself gets a makeover, it will also provide an important tool to facilitate a second chance for viable businesses to continue.

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