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JCOERE's Perspective on European Integration and the Scope of Mutual Trust and Cooperation between Courts: Testing Fairness, by Irene LYNCH FANNON and Jennifer L. L. GANT

[December 4, 2020](#)[October 30, 2020](#)

Since the beginning of 2019, a team of researchers based principally at the School of Law, University College Cork in Ireland with partners at the Università degli Studi di Firenze in Italy, the Universitea Titu Maiorescu, and INSOL Europe has been working on a project enquiring into judicial cooperation as it supports economic recovery in Europe (JCOERE). We have investigated whether the enhanced obligations imposed by the [European Insolvency Regulation Recast](#) (EIR Recast) on courts and practitioners to co-operate will be difficult for cross-border restructuring cases following the introduction of robust preventive restructuring mechanisms derived from the new [Preventive Restructuring Directive](#) (PRD).

The JCOERE Project has utilised a comparative approach during both of the substantive phases of our research. The first phase, culminating in JCOERE Report 1, distributed a questionnaire to insolvency law specialists in 11 different Member States to investigate the [substantive difference between European jurisdictions' approach to restructuring, preventive or otherwise](#). JCOERE Report 2 then turned to [procedural differences as well as legal and cultural differences that could present obstacles to cooperation by stymying the facilitation of mutual trust](#). A survey was disseminated among the European judiciary resulting in responses from 50 judges among 11 different Member States. The Survey queried the experience judges have had with cross-border co-operation, along with their awareness of cooperation guidelines and judicial training requirements. This survey in connection with the examination of common legal and judicial cultural characteristics that differentiate the Member States has helped to establish essential differences among the Member States. Both reports are available on our website (click [here](#)).

European institutions have acknowledged that the question of cooperation is inextricably linked to the need for [mutual trust](#) among jurisdictions and courts and have further emphasised that it is also closely connected to the [effectiveness](#) (or not) of European integration generally. Although JCOERE has focused on what appears to be a narrow area of law in the cross over between the PRD and the EIR Recast in terms of court-to-court cooperation, it interfaces with some of the fundamental principles necessary to the success of the European project. As a result, we have recognised that our findings have not only illuminated the situation of court-to-court cooperation in the context of restructuring and insolvency, but have also added to the [big picture conversation about the effectiveness of European integration generally](#).

The PRD has introduced a number of concepts that are new and untested throughout much of the EU. While the concepts themselves are not unfamiliar, many of the new provisions have created a field of controversy and debate among academics, practitioners, and policy makers as legislators begin to work toward implementation of the Directive. The PRD has created fertile ground for these debates because there are so many [alternatives available within the legislative framework](#), which the comparative research on this project has categorised. Consequently, implementing legislation may generate different [variations](#) on the approach to corporate rescue and is not expected to yield a harmonised European approach to preventive restructuring. These differences may also create [obstacles, both substantive and procedural in nature, to the coordination of cross-border preventive restructuring procedures](#) among Member State courts. It is in this issue of court-to-court cooperation (enhanced under the EIR Recast), which has been the focus of the JCOERE Project. Among the many issues that arise in the context of restructuring, the assessment of restructuring plan fairness has been a key area of conflict.

Testing Fairness

Due to the location and jurisdictional expertise comprising the JCOERE team and its leadership base in Ireland, we were able to [benchmark](#) extant restructuring procedures throughout the EU, those provisioned by the PRD, and the ideas coming out of jurisdictions for implementation of the PRD against the standard of a 'robust restructuring procedure' exemplifying most of the key substantive characteristics of restructuring that has existed in Ireland for 30 years: the Examinership Procedure currently described in Part 10 of the Companies Act 2014, originally introduced under the Companies (Amendment) Act 1990. This benchmarking process was done through the aforementioned questionnaire distributed among insolvency law specialists from 11 Member States to assess current restructuring frameworks to measure against the provisions of the incoming PRD in order to establish likely approaches within the rather broad scope of the Directive.

Ireland has benefited from years of case law including the exercise of [judicial discretion around issues of the fairness of a negotiated plan to affected but dissenting creditors](#), which gives it a unique perspective on the arguments around this notion about the fairness tests provisioned in Article 11 of the PRD. It is our view that the Absolute/Relative Priority debate is a bit overwrought and unnecessarily controversial as well as terminologically confusing. [The US position is clearly different from the European version of absolute priority](#) so it often seems that the arguments against diverting from it are based on what seems to be a misunderstood original premise. Almost all jurisdictions will begin from a position of the original pre-entitlement priorities, but deviation from these becomes part and parcel of, and indeed a necessity for a successful restructuring. The APR is merely 'the shadow under which the compromise is made' as observed by Professor Francisco Garcimartín during a roundtable at the INSOL Europe Annual Congress in Copenhagen in 2019. The respect for relative priority is inherent in the process with deviations that are assessed to ensure fairness to all affected creditors, particularly those who dissent against the plan. In our view, this is one of the many reasons why a competent court assessment and confirmation is absolutely vital to ensure successful plan executions that are fair to all of those affected by it.

Ireland has adopted a [more nuanced approach](#), but one that is also provided for in the PRD. Article 11(2) subparagraph 2 provides for the assessment of the fairness of a plan through the application of an 'unfair prejudice test' as an additional derogation from the seemingly preferred 'relative priority rule' in article 11(1)(c) where dissenting classes are treated 'at least

as favourably as any other class of the same rank and more favourably than any junior class...'. The unfair prejudice derogation allows for provisions to be introduced that are necessary to achieve the aims of a restructuring plan as long as the plan does not 'unfairly prejudice the rights or interests of any affected parties.'

The unfair prejudice test has long been a fixture of the Irish court's fairness interpretations in relation to examinership rescue plans, which requires that before the approval of a plan with a cross-class cram-down that there must be consent from at least one class of impaired creditors. The court must also be satisfied that the compromise is equitable as regards any class of members or creditors that have not accepted the proposals; and that the scheme does not unfairly prejudice any creditor interests, per the Companies Act 2014 section 541. In the Supreme Court's judgment in *McInerney Homes Ltd* [2011] IESC 31, the court's discretion in this area was made quite clear as it did *not* approve a plan, finding in para 12 that '*it would require exceptional circumstances before a court could approve a scheme of arrangement where secured creditors could be shown to be worse off under the scheme than under the alternative methods by which the value of the secured creditors' security could be realised.*'

The Supreme Court's decision in *McInerney Homes* clearly takes into account the relative priority that secured creditors' interests will have as compared to junior creditors in procedures such as a receivership or liquidation, observing further that if a proposal required a class of creditors to receive something less than they would in the aforementioned alternative procedures, '*then that would by itself be a reason to conclude that there was unfair prejudice...unless the disparity was justified by strong reasons.*' The presence of unfair prejudice will not be found if there are simply objections from affected or dissenting parties, as occurred in *Re SIAC Construction Ltd* [2014] IESC 25. The court will also consider the prejudice caused to other stakeholders if the plan is not approved and balance such considerations as to whether a plan should be confirmed. While there may indeed be prejudice, it must be unfair for the plan to subsequently be rejected by the court, as noted by Lynch Fannon and Murphy 2012 (para 13.43).

What can be drawn from these examples is that while an effective rescue process might begin from an absolute priority position, **deviations are both common and necessary to ensure successful restructuring plans**. The tests available and applied by the courts help to prevent creditors from being treated unfairly, and are considered against the backdrop of priority rules. It could be said that the Irish system reflects the fact that in approving restructuring, judges are able to look at the circumstances on a case-by-case basis and determine, based on argument, case based evidence and precedent whether or not a restructuring plan is appropriate under the circumstances, allowing for ultimate flexibility in negotiation and, arguably, a greater likelihood of efficient restructuring success.

The **common law (Irish)** approach differs from **most civil law** approaches due to the different role played by **judicial interpretation** and the relative power of **judicial precedent**. **Tests of fairness in civil law jurisdictions tend to be laid down by legislation whereas tests, such as the unfair prejudice test, was developed within the courts of Ireland**. Civil lawyers are often sceptical about the central role played by common law courts as **gatekeepers** to entry into robust restructuring processes, in particular doubt surrounds the ability for a court to decide whether a plan has a reasonable prospect of success. In addition, there is doubt about the ability of courts to adjudicate **questions of complicated fact**, which often requires the application of fairness tests derived from case law precedent. Thus the greatest value of the common law courts as viewed by common lawyers can cause doubt in civil law courts dealing with cross-border insolvency and restructuring procedures. While certainly differences and doubts extend beyond the common law civil law divide, and indeed the JCOERE Project has explored in much greater depth than this, for the purpose of this post focusing on rules of priority, it is sufficient to note that from a comparative perspective, **the common and civil law judicial differences can seem like oil and water**.

Conclusion

There remains a significant amount of debate in this area, which has caused and is likely to continue to cause uncertainty and confusion in the implementation and then application of preventive restructuring frameworks. The PRD has provided a broad scope for implementation, which given the diversity of opinions and approaches, will likely lead to a number of implementation styles, some of which may sit outside of the EIR Recast entirely as that option is also available. **Diversity and uncertainty are the enemies of mutual trust**, which is the key underlying principle that must be present to achieve effective cooperation between courts and jurisdictions. It is likely that rather than harmonising the restructuring landscape in Europe, the PRD will introduce **additional divergences** that could lead to strategic regulatory placement to invite **forum shopping** between restructuring jurisdictions. There is some way to go yet before restructuring can be positive influence of the furtherance of the European integration project.

Comparative research such as has been engaged by the JCOERE Project is a step toward expanding the understanding among

all jurisdictions of [how to interact with each other and increase mutual trust by increasing certainty and foreseeability of outcomes](#). The JCOERE Project has observed from our interaction with the European judiciary at various events and through our judicial survey that what is needed most is [information](#) and [understanding](#) of the procedures of different jurisdictions that judges are asked to assess under the European Insolvency Regulation (recast) 848/2015. A comparative approach at an EU level to judicial training in both insolvency and co-operation would help to achieve this goal.

Posted by Professor Irene LYNCH FANNON and Dr Jennifer L. L. GANT (University College Cork)

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Addendum:

For additional discussion in this overall area, please see Irene Lynch Fannon, '[Guest Editorial](#)' (2019) 28(3) *International Insolvency Review* 299

Disclaimer:

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