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| Title | Special Report: Judicial Co-Operation in the European Union: Insolvency and Rescue |
| Authors | Lynch Fannon, Irene;Gant, Jennifer L. L.;Finnerty, Aoife |
| Publication date | 2020 |
| Original Citation | Lynch Fannon, I., Gant, J. L. L. and Finnerty, A. (2020)'Special Report: Judicial Co-Operation in the European Union: Insolvency and Rescue,' The Thomson Reuters – City Law School Insolvency Lecture, International and Commercial and Company Law Review, 31(2), pp. 65-80. |
| Type of publication | Article (non peer-reviewed);Conference item |
| Link to publisher's version | https://www.ucc.ie/en/jcoere/publications/judicial-co-operation-in-the-european-union-insolvency-and-rescue.html |
| Rights | © 2020 The Authors. International and Commercial and Company Law Review published by Sweet & Maxwell. |
| Download date | 2026-11-04 07:16:53 |
| Item downloaded from | https://hdl.handle.net/10468/10147 |

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# Special Report:

# Judicial Co-Operation in the European Union: Insolvency and Rescue

*The Thomson Reuters – City Law School Insolvency Lecture*[1]

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## A. Introducing the JCOERE Project[2]

The JCOERE project[3] is funded by the European Commission Directorate General ("DG") Justice and is part of a broader call for projects focussing on judicial co-operation in the European Union. A broad range of diverse legal issues come within this call, which prioritises judicial co-operation in civil and criminal matters; judicial training; and effective access to justice in Europe.[4] The JCOERE project focusses on judicial co-operation in insolvency law and is focussed on judicial co-operation in the context of preventive restructuring. The project hypothesises that there will be obstacles to court co-operation that are specific to preventive restructuring. These obstacles will be classified by type; at first differentiating between substantive rules and procedural rules, and within those broad categories, there will be a further categorisation by type. The starting point is the particular obligation imposed on courts and practitioners to co-operate in insolvency matters under the Recast Insolvency Regulation 848/2015.[5] Within this general obligation placed on courts to co-operate, our particular focus is on preventive restructuring frameworks. The JCOERE project has focussed on preventive restructuring because of the move signalled by the European Union in its policy document '*A New Approach to Business Failure'* (March 2014)[6] that it was anxious to introduce a restructuring process both for corporations and individual entrepreneurs. Following a range of deliberations in the intervening years there is now a fully-fledged Preventive Restructuring Directive which has been passed (Directive 2019/1023)[7] and which requires all Member States to introduce a preventive restructuring process.

Many of these projects, and JCOERE is no exception, have some applied research elements. Accordingly, it was part of the initial bid that the project would engage with members of the European Judiciary and members of the European insolvency practising professions (including turnaround and rescue specialists) to assess the validity of this hypothesis, to explore attitudes to rescue or preventive restructuring across Europe, and indeed attitudes to the concept of judicial or court to court co-operation

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[1] Lecture given at the 3rd Cross-Border Corporate Insolvency and Commercial Law [CI&CL] Research Group Conference 2019, 26th April at City Law School, London with our heartfelt thanks to Dr Eugenio Vaccari for inviting the project to feature in such a prestigious point on the programme.
[2] The JCOERE Project (No. 800807) is funded by the European Union's Justice Programme (2014-2020).
[3] The content of this article represents the views of the authors only and is their sole responsibility. The European Commission does not accept any responsibility for use that may be made of the information it contains.
[4] For more information about the calls and proposals in the Justice funds, see the following website: <https://ec.europa.eu/info/funding-tenders/opportunities/portal/screen/programmes/just>.
[5] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) OJ L 141/19 (the "EIR Recast").
[6] Com(2014) 1500 final, Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency, Brussels 12.3.2014.
[7] Directive (EU) 2019/1023 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20th 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) OJ L 172/18, 26.6.2019, p. 18–55 (the "Preventive Restructuring Directive" or "PRD").

across Europe. In that context it was also part of the project that existing guidelines relating to court co-operation would be described and judicial awareness of these guidelines together with examples of best practise would also be considered. As the project has evolved it has become apparent that issues surrounding a general awareness of rescue processes and the dynamics involved in rescue is an important matter, given the nascent character of many domestic legal frameworks in the rescue space. Accordingly, the project will certainly elucidate potential obstacles in the form of the application of substantive rules typical of rescue, together with procedural issues that may inhibit cross-border judicial co-operation in the EU.

## B. Specific goals of the JCOERE Project

This section of the paper describes the specific goals of the JCOERE project as described in the project bid to the EU. Within the constraints of this paper, the following Section C describes our progress in respect of some of these goals. Section D, the concluding section, will serve to illustrate how it is expected that the research project is likely to evolve and will indicate some conclusions, which we predict as outcomes of the research.

### *1. Collaborative and Applied Research.*

As described in the introduction, one of the specific requirements of an EU bid for funding is that the research project is collaborative and, in addition, the specific DG supporting the JCOERE project includes a requirement that funded projects have applied outcomes where the research will benefit particular cohorts or audiences.

The creation of a collaborative team across three European universities, together with an organisation such as INSOL Europe is a challenge for those who are more accustomed to the sole researcher model. However, once initial challenges were met, which often related to tasks deriving from management of compliance requirements from the EU and from home and partner universities, by mid-2019 the JCOERE project was in full swing.

The applied nature of the research also involves engaging with what are sometimes described as 'target audiences,' which in this case can be described as members of the judiciary and practising colleagues specialising in insolvency turnaround. Partnership with an organisation such as INSOL Europe is designed to support this interaction and the applied element of the project. To facilitate this kind of engagement, it was also necessary to address the ethical requirements surrounding such engagement, particularly when it is intended to solicit views from, and engage proactively with, the European judiciary to document their perception of the legal obligations to co-operate imposed on courts by the EIR Recast. In creating the Project Team, the project has been fortunate to attract judicial members to the Advisory Board and in the research team who have been most helpful in advising on how to engage effectively with the judiciary

### *2. A Consideration of the EU Legislative Framework*

The most important part of the project focuses on the obligation imposed on courts in the EIR Recast to co-operate in insolvency matters. Focussing on restructuring and rescue frameworks, the project is designed to consider obstacles, both substantive and procedural, to co-operation. Specifically, Articles 42-44 of the EIR Recast impose co-operation obligations in the context of insolvency proceedings, which are described as main, secondary, or territorial where these concern a single debtor. Articles 56-58 describe similar co-operation obligations in the context of insolvency proceedings relating to two or more members of a group of companies.

In tandem with the EIR Recast, the second part of the legal framework forming the basis of the JCOERE research is the Preventive Restructuring Directive 2019/1023 (the "PRD"). Fortunately for JCOERE

this much debated Directive was passed in June 2019, thus preventive restructuring is currently the subject of considerable focus by academics and practitioners in Europe.[8]

The JCOERE project will describe the history and enactment of the Directive. It will also engage in a comparative study of preventive restructuring frameworks in a number of EU Member States benchmarked against the provisions of the Directive. These will include legislative frameworks pre-existing the Directive, such as the Irish Examinership[9] process, the French *sauvegarde* process,[10] and the Spanish restructuring processes,[11] together with those that were enacted in anticipation of the Directive, for example the Dutch WHOA legislation,[12] which is in the process of being enacted in the Netherlands. The study will range over additional Member States including Austria and Germany, where at present there is no preventive restructuring framework, and countries such as Poland and Romania, representing former Eastern Bloc countries. The research will benchmark the UK with particular reference to the Scheme of Arrangement[13] process.

### *3. The JCOERE Research Hypothesis.*

As previously described, the JCOERE project seeks to assess the interplay between the co-operation obligations in the EIR Recast and how these will play out in the context of preventive restructuring. We hypothesise that certain elements of a typical restructuring process will be quite problematic in a cross-border context, including provisions regarding a comprehensive stay on creditor actions, the treatment of dissenting creditors, in particular the use of 'cram down' provisions and the operation of court approval of the final compromise. This might be more difficult in view of the fact that the PRD envisages approval by an 'appropriate authority,' which may not be a court in some Member States. This latter point is an example of the procedural obstacles to co-operation which the project envisaged at the outset, as the expectation that one particular court would proactively co-operate (in a manner that is envisaged by commentators) with a quasi-judicial body or administrative authority is unrealistic. Such procedural obstacles may be even more acute in the context of preventive restructuring, given the complex interplay of the need for collective procedures, the consonant protection of creditors' rights which such procedures assume, the altogether more radical interference with creditor rights involved in developed restructuring processes, and how all these matters are treated differently in different jurisdictions.

### *4. Solutions and Target Audiences.*

In keeping with the goals of a DG Justice funded project, it is also necessary to offer solutions to the problems identified. Accordingly, JCOERE will also consider existing guidelines for co-operation for judges and will also set out to increase awareness, not only of the characteristics of a preventive restructuring process, but also of how obstacles to co-operation might be overcome. The project will then engage with the judiciary to discover how these may be dealt with practically to facilitate court to court co-operation. Models or practices adopted by courts in their efforts to satisfy the obligation to cooperate will be documented.

This information will be collated and synthesised with a view to providing guidance and practical information to the European judiciary at large in how such matters could be dealt with in cross-border insolvency cases.

## C. Progress and Some Findings

[8] On 26th June 2019 the Preventive Restructuring Directive (the 'PRD') was published in the Official Journal of the European Union OJ L 172/18, 26.6.2019, with an implementation date of 17th July 2021, see PRD, Article 34 Transposition.
[9] Originally introduced by the Companies (Amendment) Act 1990, the legislation was amended in 1999 and is now included in Part 10 of the Companies Act (IRL) 2014.
[10] Regulated by Articles L620-1 to L628-10 of the Commercial Code and introduced by Law n°2005-845 of 26 July 2005 and as amended by Ordinance n°2008-1345 of 18 December 2008; Ordinance n°2014-326 of 12 March 2014; Law n°2015-990 of 6 August 2015; and Law n°2016-1547 of 18 November 2016
[11] Ley 22/2003 de 9 de julio, artículo 5 bis, 71 bis y Disposición Adicional 4ª.
[12] *Wet homologatie onderhands akkoord ter voorkoming van faillissement* (Act on the confirmation of a private restructuring plan in order to prevent bankruptcy, WHOA).
[13] UK Companies Act 2006, Part 26.

Since the time that the JCOERE Team gave the Thomson Reuters – City Law School Insolvency Lecture at the 3rd Cross-Border Corporate Insolvency and Commercial Law [CI&CL] Research Group Conference on 26th April 2019, the JCOERE Project has progressed significantly. This section will offer insights into the progress made to date. Our first Report ["JCOERE 1"] will be finalised by the beginning of January 2020.[14]The JCOERE 1 Report begins with a discussion of the context and commentary surrounding both judicial co-operation and preventive restructuring as understood in European terms. To that end a brief discussion of the obligation to cooperate under the EIR Recast will be summarised in the next section of this paper, followed by a brief summary of the progress of preventive restructuring in the EU, including evolution of the Directive through the various EU institutions. These contextual discussions help to set the scene for a limited summary of the findings subsequent to the analysis of the questionnaires mapping preventive restructuring frameworks in contributing jurisdictions, including a consideration of how these national frameworks will change following implementation of the PRD. The purpose of this section is to give an indication only of the progress so far on the project and the drafting of the JCOERE 1 Report.

*1. The EIR Recast and Obligations to Co-Operate*

The European Insolvency Regulation and its Recast have had a long and complicated history, from early treaties setting the groundwork for simplifying the formalities governing reciprocal recognition and enforcement of judgments,[15] to a lukewarm reception of several insolvency conventions, [16] to the recent EIR Recast and its enhanced obligation to cooperate. The Recitals acknowledge that 'as a result of widely differing substantive laws, it is not practical to introduce insolvency proceedings with universal scope in the entire Community' and that '[t]o protect legitimate expectations and the certainty of transactions in [other] Member States…provisions should be made for a number of exceptions to the general rule.'[17] The Regulation itself therefore provides for a number of ways for Member States to assert their sovereignty, despite its aim to coordinate proceedings throughout the EU. Among the changes included in the EIR Recast that are relevant to our Report is the extension of the EIR to also cover pre-insolvency procedures,[18] hence its likely application to procedures developed in the implementation of the incoming PRD.[19]

Co-operation between judges and courts has developed over time to help resolve the differences that exist between universal and territorial approaches.[20] The EIR has generally been viewed as constituting an important step toward judicial co-operation within the EU.[21] The EIR Recast has extended the rules on co-operation and communication and now addresses this between IPs, courts, and between courts and IPs.[22]

Prior to the passing of the EIR Recast, a number of Member States had also developed supplementary legislation or rules that required national courts to cooperate with foreign insolvency courts where main proceedings had been opened.[23] Codes and best practice guidelines were also developed in the time

[14] This date is part of the commitment in terms of 'deliverables' to the EU at bid stage.
[15] Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters of 25 September 1968 OJ 1990 C189/2, replaced by Council Regulation (EC) No 44/2001 of 22 December 2000, OJ 2001 L12/1.
[16] E Comm Doc 3.327/1/XIV/70-F (Preliminary Draft Convention); European Convention on Certain International Aspects of Bankruptcy (Istanbul Convention) ETS No 136 and Convtion on Insolvency Proceedings, *OJ L00000;* Miguel Virgos and Etienne Schmit, 'Report on the Convention on Insolvency Proceedings' (Council of the European Union 1996).
[17] EIR Recitals 11 and 24 as cited in Gerard McCormack, 'Universalism in Insolvency Proceedings and the Common Law' (2012) 32(2) Oxford Journal of Legal Studies 325, 340.
[18] G McCormack, 'Reforming the European Insolvency Regulation: A Legal and Policy Perspective' (2014) 10(1) J Private Int'l L 41, 45.
[19] Indeed, the Irish Examinership procedure; the French *Sauvegarde*; *Sauvegarde accélérée* and *Sauvegarde financière accélérée* procedures; and the Spanish *Procedimiento de homologación de acuerdos de refinanciación, the Procedimiento de acuerdos extrajudiciales de pago, and the Procedimiento de negociación pública para la consecución de acuerdos de refinanciación colectivos, acuerdos de refinanciación homologados y propuestas anticipadas de convenio* are all included in Annex A as existing insolvency processes incorporating a preventive restructuring element, broadly speaking which are covered by the Regulation.
[20] Paul J Omar, 'Genesis of the European Initiative in Insolvency Law' (2000) (12(3) IIR 147, 151.
[21] Reinhard Bork and Renato Mangano, *European Cross-Border Insolvency Law* (OUP 2016) 16.
[22] EIR Recast Articles 41-44; Renato Mangano, 'From "Prisoner's Dilemma" to Reluctance to Use Judicial Discretion: The Enemies of Co-operation in European Cross-Border Cases' (2017) 26 IIR 314; Bob Wessels, 'Themes of the Future: Rescue Businesses and Cross-Border Co-operation' (2014) 27(1) Insolv Int 4, 7.
[23] Bork and Mangano (n 21) 199.

between the passing of the original EIR and its Recast[24] and the EIR Recast refers to these specifically in Recital 20.[25] It was, however, determined that the EIR Recast should also contain a prescriptive and extended obligation for courts to cooperate and communicate.[26] As such, it introduced Arts 41-44 into the EIR Recast.

Article 42(1) states that:

> "In order to facilitate the coordination of main, territorial and secondary insolvency proceedings concerning the same debtor, a court before which a request to open insolvency proceedings is pending, or which has opened such proceedings, shall cooperate with any other court before which a request to open insolvency proceedings is pending, or which has opened such proceedings…"

The first part of this article clearly sets an obligation of co-operation that is not contingent on the opening of both proceedings. This prescription is aimed at preventing fraudulent manipulation or erroneous determination of the COMI,[27] leading to the filing of a secondary proceeding where the main proceedings should actually have been supported by the second court.[28] This obligation is mitigated by including a common prescription of international law that refers to the laws by which a national court is bound, obliging them to co-operate 'to the extent that such co-operation is not incompatible with the rules applicable to each of the proceedings'. This prescription gives an out for courts where co-operation would be an interference with national law.[29] In the context of preventive restructuring, domestic rules that give added or stronger protection to national creditors may well lead to a lack of co-operation under this provision.

Article 42(2) sets out the parameters of one of the best forms of co-ordinating insolvency proceedings - communication:

> "In implementing the co-operation … the courts, or any appointed person or body acting on their behalf … may communicate directly with, or request information or assistance directly from, each other provided that such communication respects the procedural rights of the parties to the proceedings and the confidentiality of information."

This article also gives an out to the courts in the event that communication contravenes procedural rights or confidentiality of the parties, giving courts the opportunity to interpret this obligation further in light of its obligations to domestic creditors and parties. Where procedural aspects do not align, co-ordination and communication may well be impeded in a cross-border insolvency, despite the obligation placed on courts to co-operate. The discussion of the entry threshold below illustrates additional procedural issues that inhibit co-operation.

Article 42(3) sets out a menu of the forms that co-operation might take, including:

> "(a) co-ordination in the appointment of the insolvency practitioners; (b) communication of information by any means considered appropriate by the court; (c) co-ordination of the administration and supervision of the debtor's assets and affairs; (d) co-ordination of the conduct of hearings; and (e) co-ordination in the approval of protocols, where necessary."[30]

[24] See for example the European Communication and Co-operation Guidelines for Cross-Border Insolvency of 2007 (CoCo Guidelines); the EU Cross-Border Insolvency Court-to-Court Co-operation Principles and Guidelines of 2014 (Judge Co Guidelines); and The III/ALI Global Principles for Co-operation in International Insolvency Cases.
[25] Bob Wessels, 'Themes of the Future: Rescue Businesses and Cross-Border Co-operation' (2014) 27(1) Insolv Int 4, 8.
[26] Renato Mangano, 'From "Prisoner's Dilemma" to Reluctance to Use Judicial Discretion: the Enemies of Co-operation in European Cross-Border Cases' (2017) 26(3) IIR 314, 314-315.
[27] Centre of Main Interests.
[28] Bork and Mangano (n 21) 200-201.
[29] *idem,* 202-203.
[30] EIR Recast Art 42(3)(a-e).

While the EIR Recast does not specify which courts should communicate or when they should do so, the principle of mutual trust and sincere co-operation set out in the TEU Art 4[31] would appear to insist that a court communicates every item of information that could lead to an efficient proceeding.[32] The existence of an obligation, however, does not guarantee co-operation, particularly given the discretion present both in the EIR Recast and accepted in a number of cases where co-operation was challenged.

*2. Preventive Restructuring and the New Directive*

The PRD is modelled on what could be considered a radical restructuring process exemplified by Chapter 11 of the US Bankruptcy Code. Interestingly, Ireland has a similar process, which was introduced in 1990 and was specifically modelled on Chapter 11 (it would seem as part of Ireland's Foreign Direct Investment (FDI) strategy, designed to attract US multinationals to locate their European operations in Ireland). In terms of having a process that has an official entry threshold, includes a universal stay, includes cram down provisions, both intra- and cross-class, and provision for court approval of a compromise or scheme, Ireland's Examinership process is unusual in a European context. In reality, radical preventive restructuring is not that well developed across the EU, and, from the responses to the JCOERE questionnaires, some aspects of which will be discussed below, not necessarily welcomed universally across the EU. The Directive therefore does cut a new path.

As previously described, the JCOERE Project aims to categorise rules that might become problematic by type, at first distinguishing between substantive and procedural rules. Categorisation of substantive rules reflects the restructuring mechanisms described in several Directive provisions, including rules concerning a stay or moratorium and rules relating to 'cram-down' provisions. The question of whether it is reasonable for a court in the second state to decline jurisdiction becomes more immediate in such circumstances as Member States have the scope to implement these provisions with surprisingly extensive flexibility, which could lead to significantly different treatment of creditors spread throughout those Member States included in a cross-border restructuring. In such cases, a court may decline to defer jurisdiction in order to protect domestic creditors that may be subject to more onerous rules than in their home jurisdiction. Additionally, rules relating to the protection of rescue financing; and rights *in rem* will also likely be problematic. Additional issues that seem to have emerged as being important during the discussions on the Directive are rights accorded particularly to employees and court or judicial approval processes.

At this point in time in the JCOERE project, the responses to a questionnaire aimed to map preventive restructuring frameworks and focussing on specific provisions in several EU Member States have been collected and are being analysed for the JCOERE 1 Report. Firstly, it includes those partnered on the JCOERE Project: Ireland (University College Cork), Italy (Università degli Studi di Firenze), and Romania (Universitatea Titu Maiorescu). Secondly, contributors from several other Member States have taken part: Germany, Austria, Poland, Denmark, The Netherlands, Spain, France, and the United Kingdom (for comparative purposes).

The questionnaire was in three parts. In Part 1 questions concerning existing legislative restructuring provisions in those jurisdictions were posed. Part II focussed on substantive provisions in the Directive and asked whether these were mirrored in existing legislation or if not, what format was expected legislation going to take. In Part III, procedural questions were asked.[33]

*3. Exposition of the Directive: Identifying the Development of Important Concepts.*

The Articles of the PRD connected to the hypotheses of the JCOERE Project are Articles 6, 9, 10, 11, 13, and 17. These Articles address the stay of individual enforcement actions; the protection of new

[31] "Pursuant to the principle of sincere co-operation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties."
[32] Bork and Mangano (n 21) 203.
[33] We would like to express our heartfelt thanks to our Partners at Università degli Studi di Firenze in Italy and Universitatea Titu Maiorescu in Romania along with our individual country report contributors, Dr Emilie Ghio and Dr Paul Omar (France), Gert-Jan Boon (The Netherlands), Professor Stephan Madaus (Germany), Susanne Frustdorfer (Austria), Sylwester Żydowicz (Poland), Dr Line Langkjaer (Denmark), and Dr Antonio Sotillo Marti (Spain).

finance; decreased court formality; workers; and the cross-class cram-down. The stay and the protection of new financing are clearly now enshrined in Articles 6 and 17 respectively. The cross-class cram-down and the connected principles concerning the adoption and confirmation of restructuring plans are set out in articles 9-11, while article 11 contains the mechanics of the provision as well as some of its most controversial characteristics. Article 13 covers the protection of workers. Finally, decreased court formality is described in Article 4, but really is present as a concept in all of the aforementioned Articles.

As described in the introduction, the journey to the Directive really began in earnest when the EU Commission drafted a Recommendation dated 3rd March 2014 and entitled 'A New Approach to Business Failure' and an accompanying Impact Assessment.[34] It was the view of the Commission at that time that the EU was still facing the single largest economic crisis in its history and that consequently, improving the efficiency of insolvency laws was critical to supporting economic recovery, given the record numbers of bankruptcies across Member States.[35] Even though colloquially there is a good deal of emphasis on the idea of offering a different approach to business failure for corporates and individuals, which is usefully summarised in the phrase 'a second chance for entrepreneurs,' a more sober analysis reveals that studies had shown that in fact rescue processes were also more beneficial to lenders than traditional insolvency processes. So, in fact, the requirements of capital and capital markets[36] also gave the new approach an impetus, which was more removed from the 'second chance' idea than may have been originally intended.[37]

Part III of the Recommendation set out the Commission's position on preventive restructuring frameworks, which covered a number of areas. Section 6 lists common principles or elements that should be part of all national insolvency frameworks::

(i) the availability of early restructuring for debtors likely to become insolvent;

(ii) the debtor retaining control over the day-to-day business operations;

(iii) the availability of a stay of individual enforcement action;

(iv) cram-down; and

(v) protection for new financing.

Of these, and in terms of the progression of the JCOERE project, the provision of the stay of individual enforcement actions has generated considerable debate in addition to the question of how to protect the interests of dissenting creditors or, put another way, how to operate a cram-down provision. A third issue that seems to be more problematic than one would have expected is the actual threshold of entry for those seeking to avail of the preventive restructuring process- the issue described at i) above. Finally, the priority that must be given to new financing is obviously an important practical issue for any rescue process. It should be emphasised at this point that the JCOERE project focusses on corporate rescue only and is not concerned with insolvency or rescue of individual debtors ('second chance entrepreneurialism').

The JCOERE 1 Report describes the debates over these issues in detail and has also mapped how these matters are dealt with in domestic processes to date. The rules that were identified as being particularly problematic in terms of co-operation are largely and happily reflective of the debates surrounding the passage of the PRD. There are other subjects that are adumbrated in the Commission's Recommendation, which were and will continue to be problematic in the sense that these issues attracted a variety of views throughout the legislative history of the PRD. All of these are approached differently, even in countries which already have preventive restructuring processes, and all gave rise to considerable debate in for a from the Commission Recommendations to the Committee of Experts, to Parliamentary committees consulted at national level to European Parliamentary Committee stages.

[34] See Recommendation 2014 (n 6).
[35] Executive Summary of the Impact Assessment SWD(2014)62 – p 1.
[36] See Communication from the Commission to the European Parliament, The Council, and the European Economic and Social Committee and the Committee of the Regions Action Plan on Building a Capital Markets Union, COM(2015) 468 final.
[37] Salla Saastomionen speech to the *Arge Insolvenzgerecht*, Brussels, June 2019.

This part of the project has identified several issues of relevance, but this paper will focus on two of these: the threshold of entry into the process and the imposition of a stay.

i. Entry Threshold

In terms of the progression of a rescue process the first issue that became problematic in debates was the threshold of entry for a debtor to avail of a preventive restructuring process. There continues to be a debate as to the availability of preventive restructuring to businesses that are technically insolvent as in some European countries this eventuality gives rise to obligations on directors and others, for example an obligation to proactively commence a liquidation process. However, the Directive in Article 4 states that the threshold of entry is where there is a 'likelihood of insolvency'.

Article 4(1) provides that:

> "Member States shall ensure that, where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework that enables them to restructure, with a view to preventing insolvency and ensuring their viability, without prejudice to other solutions for avoiding insolvency, thereby protecting jobs and maintaining business activity."

However, the Directive does not preclude the Member States from allowing preventive restructuring even where the particular company or business is insolvent.[38]

ii. The Stay

Once the debtor is permitted to avail of the preventive restructuring process, the next question that was debated during the legislative history of the PRD was the issue of the stay, both in terms of its length and its nature. Thus, from the Commission Recommendations onwards through debates at the Committee of Experts[39] and following consultation with various parliamentary committees, both domestic and from the European Parliament, the issue of the characteristics of the stay continued. Debates focussed on whether a blanket stay was justified or whether Member States could provide for partial stays in relation to particular creditors only. The length and duration of the stay was also an issue. The Committee of Experts were concerned by the apparent link between the "moral hazard problem" and the length of the (extension of the) stay and advocated for the duration of the stay to be of a limited period of 2 months and that any extension would be "granted under stricter conditions". Their conservatism was not met by the PRD, which gives a choice to Member States to provide for an initial stay of 4 months (which arguably more accurately reflects the reality of the time needed to put together a compromise) rather than two and for the possibility of extensions to be granted (again within the terms of the legislative framework) for a maximum of 12 months. These provisions prevailed despite objections of European Parliament Committees who also took exception to the universal nature of the stay. Ultimately, the PRD provides opportunities for compromise between the more conservative views on what the nature of the stay should be, i.e. specific or universal allowing for Member States to choose a framework that allows for a selective or universal stay but the PRD does not compromise on the minimum length of 4 months, perhaps supporting the view that a rescue cannot practically be arranged in a shorter period.

Differing approaches gave rise to the final draft allowing for some considerable leeway in terms of implementation of the PRD for Member States. These issues are also reflected in the responses received from the JCOERE questionnaire. It is already clear that differences will emerge in how Member States choose to implement the PRD.

What is interesting though is that in relation to some of the debate occurring throughout the legislative process and now at implementation stage, more can be learnt from states that have well-developed preventive restructuring processes. Ireland is one of those. In terms of the two issues chosen as examples here, the Examinership has a well-defined entry threshold which does not preclude an insolvent

[38] Irish examinership process allows a debtor to apply for protection of the court where the company is or is likely to be insolvent.

[39] The Commission established the Expert Group on Restructuring and Insolvency Law – which met a number of times 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 Commission Recommendation may be amended, thereby making it more effective across the EU and leading to more legal certainty. Interestingly, despite the fact that Ireland had over 30 years of experience of a Chapter 11 type restructuring process there was no Irish member of this group.

company from applying[40] and in addition to some particular requirements[41] allows the court to exercise discretion to allow the restructuring process to proceed based on whether there is a reasonable prospect of the survival of the company.[42] This last requirement has generated considerable jurisprudence over a thirty-year period,

As for the stay, again the Irish Examinership process provides that once the petition is presented, ie usually initiated by the debtor a stay is granted and then confirmed. This stay runs for 70 stays and can be extended on application to the court. It is a universal protection period described in detail in the legislation. [43]

As stated the UK Scheme of Arrangement is also referred to as a benchmarked process. The entry threshold for schemes is simply generated by the acceptance of jurisdiction by the court and as long as no formal insolvency process is commenced the creation of a scheme is available to the debtor company. The stay is entirely at the discretion of the court.[44]

### *4. Implementing the Directive: Obstacles to Judicial Co-operation in Preventive Restructuring*

This section will continue to extrapolate on the opening hypothesis and amplify the debate with reference to the questionnaire responses that have been most interesting and potentially important in the analysis of the obstacles to judicial co-operation arising from preventive restructuring frameworks so far. The threshold of insolvency is controversial in a small number of jurisdictions, while the stay or moratorium is viewed as being difficult in a broader range of jurisdictions, and finally different tests for assessing the fair treatment of dissenting classes of creditors has also received analysis.

#### i. <u>The Threshold of Insolvency</u>

The threshold of insolvency did not feature in the original questionnaire but was included in a set of follow up question following the realisation in the analysis of the responses that this question is not only of academic interest, but may well demonstrate issues of failed harmonisation where some jurisdictions require a company to essentially be insolvent to even use preventive restructuring procedures while others may allow a "pre-insolvency" approach. The differences between these approaches potentially interfere with some of the fundamental principles of insolvency law, such as the introduction of a collective enforcement approach only when a company has reached that insolvency threshold, whereas pre-insolvency does not have the same requirement that strict rules of distribution or traditional principles of insolvency should apply. The ongoing question is to what extent should the

[40] 509. (1) Subject to subsection (2), where it appears to the court that (a) a company is, or is likely to be, unable to pay its debts, (b) no resolution subsists for the winding up of the company, and (c) no order has been made for the winding up of the company

[41] 512 (4) The court shall not give a hearing to a petition if a receiver stands appointed to the whole or any part of the property or undertaking of the company the subject of the petition and such receiver has stood so appointed for a continuous period of at least 3 days prior to the date of the presentation of the petition.

[42] 509 (2) The court shall not make an order under this section unless it is satisfied that there is a reasonable prospect of the survival of the company and the whole or any part of its undertaking as a going concern.

[43] 520 (4) For so long as a company is under the protection of the court in a case under this Part, the following provisions shall have effect: (a) no proceedings for the winding up of the company may be commenced or resolution for winding up passed in relation to the company and any resolution so passed shall have no effect; (b) no receiver over any part of the property or undertaking of the company shall be appointed, or, if so appointed before the presentation of a petition shall, subject to section 522, be able to act; (c) no attachment, sequestration, distress or execution shall be put into force against the property or effects of the company, except with the consent of the examiner; (d) where any claim against the company is secured by a mortgage, charge, lien or other encumbrance or a pledge of, on or affecting the whole or any part of the
property, effects or income of the company, no action may be taken to realise the whole or any part of that security, except with the consent of the examiner; (e) no steps may be taken to repossess goods in the company's possession under any hire-purchase agreement (within the meaning of section 530), except with the consent of the examiner; (f) where, under any enactment, rule of law or otherwise, any person other than the company is liable to pay all or any part of the debts of the company (i) no attachment, sequestration, distress or execution shall be put into force against the property or effects of such person in respect of the debts of the company; and (ii) no proceedings of any sort may be commenced against such person in respect of the debts of the company; (g) no order for relief shall be made under section 212 against the company in respect of complaints as to the conduct of the affairs of the company or the exercise of the powers of the directors prior to the presentation of the petition.

[44] See generally J Payne, *Schemes of Arrangement: Theory, Structure and Operation* (OUP 2014).

purposes or aims of traditional insolvency law influence the aims and functions of preventive restructuring. The former purposes or aims have been described as including the following ideals:[45]

- To provide an equal fair and orderly procedure in handling the affairs of insolvent companies, ensuring that creditors receive an equal and equitable distribution of assets, normally reliant on the principle of *pari passu* distributions following a specified order of priority;
- To provide procedures that ensure debts are satisfied with as little delay and expense as possible;
- To ensure that insolvency regimes are conducted in an honest, independent and competent manner;
- To provide mechanisms allowing for the treatment of the debtor's affairs before their position is hopeless, hence the emphasis on rescue and rehabilitation, of which preventive restructuring forms a part;
- To provide procedures that enable both creditors and debtors to be involved in the resolution of the insolvency and prevent conflicts;
- To attempt to diminish as far as possible the deleterious effects of insolvency on the interests of the public;
- To provide a flexible but respectable system.

The flexibility in the PRD as passed is likely to allow the Member States to maintain their fundamental positions on this continuum, which along with conflicts within the set of underlying principles, procedural differences, and court discretion, may cause obstacles to co-operation where issues are treated differently and creditors and other stakeholders are treated less favourably in a jurisdiction to which a court is being asked to defer.

*1. The Stay*

The stay of enforcement actions has been a focus of the Commission's efforts to improve restructuring and insolvency law since the Recommendation of 2014.[46] This focus has followed through into the various iterations of the Proposed Directive and is enshrined in Article 6 of the PRD. Agreeing to the nature of the stay in the PRD, however, was challenging due to the extreme differences in views of the Member States on the appropriate balance between benefits to the debtor and disadvantages to the creditors, which is apparent mainly in the debate surrounding the duration of the stay that would be provided by the PRD. The longer a stay is in place, the more money creditors will lose in terms of opportunity costs, such as the interest they could gain by investing it differently or the value of using that money sooner to support a supplier's ongoing business. If a creditor is 'out-of-the-money', there is no loss to them, hence an adverse impact that is balanced against 'in-the-money' creditors.[47]

What is important to note in relation to the findings subsequent to the questionnaire responses is that several Member States have a maximum term of the moratorium that is less than 12 months. However, the wording of the PRD indicates that the 12-month extended term is a maximum limit, which means that Member States with shorter terms can retain these. As a result, in a cross-border insolvency in which one jurisdiction has adopted the maximum extended term in contrast with a jurisdiction adhering to a shorter term, creditors in the jurisdiction that has a shorter term will notionally be disadvantaged by the longer term applied by the other jurisdiction, should it be deferred to by the domestic jurisdiction. A judge may choose not to do this on public policy grounds if the court hearing the case places greater value on protecting domestic creditors who might be treated more favourably in a domestic process over the benefit of a coordinated proceeding with a longer moratorium period in the jurisdiction of the principle proceedings.

[45] Andrew Keay and Peter Walton, *Insolvency Law Corporate and Personal* (4th edn, LexisNexis 2017) 22 – only those purposes that relate to corporate insolvency and preventive procedures have been listed.
[46] Recommendation 2014 (n 6).
[47] Nicolaes Tollenaar, *Pre-Insolvency Proceedings: A Normative Foundation and Framework* (OUP 2019) 147-151.

## D. Conclusion

The PRD was conceived with great intentions of achieving a minimum level of harmonisation and the development of a more cohesive and effective preventive restructuring framework coordination throughout the EU. During the inter-institutional negotiations, influence of the Trilogue, and Member State parliaments the minimum harmonisation possibilities have been severely weakened. There are so many derogations that many Member States will be able to introduce new or reformed procedures that utilise their preferred mechanisms, which may continue to differ significantly from other jurisdictions, thus to a large extent, defeating the purpose of the PRD of minimum substantive harmonisation. Without some reasonable level of harmonisation in the way that creditors are treated, it will be difficult to avoid conflicts in co-operation where a court feels obliged to address the interests of has its domestic creditors.

The research itself presents its own challenges, as in the analysis of the responses to the questionnaire, it has become clear, not that it was ever doubted, that individual jurisdictions use different terminologies that, even when translated, defy connection. Although space does not permit a full discussion of each and every issue, an emergent issue in the academic commentary, which is bound to affect implementation by Member States and which exemplifies this type of problem is the debate on the merits of what are called Absolute Priority and Relative Priority Rules.[48] This debate emerged during the institutional negotiations, Trilogue discussions, and debates among the experts' groups[49] and revealed a stark dividing line between those who adhere to a strict Absolute Priority Rule and those who tend to take a more flexible approach to the treatment of dissenting classes of creditors in a cross-class cram-down: Those who favour what has been called, not without some substantial confusion due to differences in how the concept is perceived, a Relative Priority Rule. While this article does not have the scope for an in-depth discussion of the variety of arguments in favour and against each of these rules, the PRD has allowed for derogations among three rule choices. Firstly, it appears to favour the Relative Priority Rule. However, in reality this Rule cannot be easily defined as it seems to be simply anything that departs from absolute priority and interferes with the priority ranking of claims as they would be treated in a liquidation. It is inherently flexible and, it could be argued, promotes company/business rescue because of this flexibility. In contrast a strict adherence to absolute priority does not seem conducive to a flexible restructuring framework. That said, there are well-intentioned arguments of abuse of such flexibility – the ability of junior creditors to overcome the objections of senior creditors (some would say 'to hold senior creditors' hostage) in order to get a plan across the voting thresholds. It has been argued that this creates a moral hazard in the potential for abuse it presents to more powerful junior creditors.

There is a stark difference in the principles in different jurisdictions in adopting versions of these rules. Similarly to the moratorium discussion, should different jurisdictions choose different rules to assess fairness of treatment of dissenting classes, then judges may refuse to defer where a relative priority rule will see funds diverted from senior creditors in favour of more powerful, but junior creditors, who may otherwise hold up the process by refusing to agree to a plan. In addition, a second derogation to "unfair prejudice" is available, which is quite familiar to the Irish jurisdiction. An unfair prejudice test tends to leave the assessment of a plan and its treatment of dissenting creditors fully in the hands of the judiciary, allowing for an interpretative approach rather than adherence to any definable rule. Similar decisions have been made in the UK under the Scheme of Arrangement process. This is of course easier in a Common Law jurisdiction, such as Ireland, and England and Wales, but with the general preference of Civil Law jurisdictions for the application of rules, this could again cause difficulties for co-operation where judges are less inclined to defer where they perceive that domestic creditors would be less favourably treated in a foreign jurisdiction than in their own.

Comparative law is always a challenge, but in preventive restructuring, a newish concept that has apparently defied a globally agreed definition, it is even more troubling. Fundamental concepts seem to be outside the scope of agreement. The JCOERE Project is not only exploring the conflicts presented

[48] A brief discussion on this matter will be included to illustrate the challenges involved with a full discussion presented in a later publication.
[49] While the Trilogue negotiations are not publicly available, other documents that are relevant to the negotiations include the following: Reports by Member States on the drafts of the Directive; Minutes of Experts' Group Meetings; European Parliament Committee Reports by the Committee on Legal Affairs, the Committee on Employment and Social Affairs, Committee on Economic and Monetary Affairs, and the Committee of the Regions; and Reports by the Council of the European Union, among others.

by preventive restructuring to judicial co-operation but may well reveal new challenges to the comparative law methodology that only a project with new concepts can reveal. It is fascinating. It is useful. And it will hopefully result in a new approach to assisting the judiciary in its obligation to co-operate that goes beyond guidelines and rules. Watch this space![50]

[50] Follow our progress on our website, here < https://www.ucc.ie/en/jcoere/>, on LinkedIn < https://www.linkedin.com/company/15853586/>, and on Twitter @JCOEREProject.