

Main and Secondary Proceedings in the recast of the European Insolvency Regulation

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The only good secondary proceeding is a synthetic secondary proceeding

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Introduction

The recast of Council Regulation (EC) No 1346/2000 on insolvency proceedings is fast approaching. After a long and arduous legislative process², an adoption of the amending regulation in its current form (excluding further minor, linguistic alterations) during the course of 2015 now seems likely.³ The new Regulation's entry into force can be reasonably expected two years thereafter.

Beyond a widened scope of application, changes to the framework enveloping the concept of COMI and the introduction of long awaited, publicly accessible insolvency registers, it is the relationship between main and secondary proceedings that is about to receive a considerable overhaul. It is this overhaul and the underlying relationship between two major principles of international insolvency law – the principle of unity and that of universality - that shall be the focus of the following paper.

Through the use of academic sources, case law and empirical data it is the author's goal to convey that (a) the handling of secondary proceedings within the framework of the current Regulation is woefully inadequate, (b) the recast, while aiming to alleviate some of the shortcomings, cannot change the intrinsically detrimental consequences of parallel proceedings, (c) the greatest achievement of the recast is therefore the introduction of synthetic proceedings as a way to avoid the opening of secondary proceedings and (d) the legislative implementation of the synthetic proceedings is unfortunately not beyond reproach and ought to – if the proposal is accepted in its current form – be the cause of many a referred question.

1. The origins of secondary proceedings

The road towards a coherent and comprehensive framework for European insolvency law began in 1963 with the establishment of an expert committee and consequently the first proposal for a convention on insolvency proceedings in 1970. While this first proposal envisioned a remarkably strict adherence to the principle of unity (i.e. concentrating cross border insolvencies within a single proceeding), the principle of universality (i.e. the universal application of the *lex fori concursus*) was neglected by the proposed split of the estate into a multitude of smaller parts, each comprised of the assets situated in one Member State and subject to the insolvency regime of that state.

The second proposal (1980) followed the general approach of its predecessor, retaining the ideas of (a) a single insolvency proceeding, (b) a split of the estate according to where the assets are situated and (c) the resulting plurality of applicable domestic insolvency regime.

The failure of these proposals lead to the “European Convention on Certain International Aspects of Bankruptcy”, signed by the European Council in 1990.⁴ It was here that the concept of secondary proceedings

² The reform process started in 2012 – in accordance with Article 46 EIR – with a report on the application of the Regulation, conducted by *Hess/Oberhammer/Pfeiffer*. This report has since been published as the “Heidelberg-Luxembourg-Vienna Report” in 2014. Based on the report the European Commission presented a first draft of a “Proposal for a Regulation of European Parliament and of the Council amending Council Regulation (EC) 1346/2000 on insolvency proceedings” on December 12, 2012. The European Parliament revised this draft further and presented its own proposal on December 20, 2013. Taking into account the changes proposed by the Parliament, the Council of the European Union consolidated the changes into a new proposal on November 20, 2014, and subsequently (after language revision) released the latest version of the proposal on February 26, 2015.

³ The latest draft (February 2015) can be found here (accessed March 30, 2015): <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%2016636%202014%20INIT>

⁴ The “European Convention on Certain International Aspects of Bankruptcy” (also known as the *Istanbul Treaty*) from June 5, 1990.

("secondary bankruptcies") was first established in European Law, by providing the "liquidator in the main bankruptcy" or "any other person or body granted to right to request the opening of a bankruptcy (...)" the option to request a secondary bankruptcy (Article 18), "governed by the bankruptcy law of the Party where that bankruptcy is opened" (Article 19). By allowing any state to "declare that it will not apply" the provisions on secondary bankruptcies (Article 40), this introduction of secondary proceedings was timid at best, which might have led to the Convention only being ratified by Cyprus.

It did however pave the way for the Convention on insolvency proceedings, which was signed by twelve Member States in 1995 – a mere three years after a first draft had been published. The convention ultimately failed due to political reasons that lay beyond insolvency law,⁵ but its groundbreaking impact becomes evident, considering that the European Insolvency Regulation – which entered into force in 2002 – is based mostly verbatim on the "failed" Convention.

The Convention (and accordingly the Regulation) reversed the respective emphases on the principles of unity and universality of former proposals by abandoning the idea of a "split up estate" with a multitude of applicable insolvency regimes – thus strengthening the principle of universality – while at the same time making secondary proceedings an established element of European insolvency law – thus weakening the principle of unity.

2. Secondary proceedings within the framework of the current Regulation

A secondary proceeding is – in short – a separate insolvency proceeding that can be opened in a Member State after⁶ a main proceeding has already commenced in another Member State. It requires the debtor to run an "establishment"⁷ within the territory of that other Member State and may only be aimed at the liquidation of the debtor's assets, Article 3 EIR.

The debtor's insolvency is to be assumed in these proceedings;⁸ their estate is limited to the assets within the territory of the respective Member State (Article 27 EIR) and the applicable insolvency law follows the domestic insolvency regime of said Member State (Article 28 EIR).

To ensure a minimum amount of coherence in the execution of these parallel proceedings a duty to "communicate and cooperate" is imposed upon the administrators of both main and any secondary proceeding (Article 31 EIR) and a limited number of participation rights are granted to administrators in any parallel proceeding (Article 32 EIR).

The extensive consultation of practitioners during the external evaluation of the Insolvency Regulation⁹ "demonstrate[d] the necessity of a reassessment of secondary proceedings".¹⁰ The study conducted in 2012 provides a

⁵ The convention was signed by 14 of the 15 Member States – the UK refused to sign due to tensions with the European Community over the looming ban on British beef (caused by the outbreak of BSE). The ensuing quarrel between the UK and Spain over the sovereignty over Gibraltar further complicated the situation and ultimately led to the expiration of the deadline for the signature of the Convention. Further reading: *Wessels*, Current Topics of International Insolvency Law, 2004, Deventer.

⁶ Or exceptionally: before (Articles 36, 3 (2), (4) EIR).

⁷ Defined in Article 2 lit (h) as: "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods."

⁸ For it has (presumably) already been established in the previously opened main proceeding.

⁹ As mentioned above this evaluation was based on Article 46 EIR, which required a report on the application of the Insolvency Regulation ten years after its entry into force.

¹⁰ Heidelberg-Luxembourg-Vienna Report, Executive Summary, para 55.

unique set of empirical data on the experiences that insolvency administrators, judges and academics in the Member States had with the Insolvency Regulation and serves as an useful starting point for an assessment of the shortcomings.

In the course of the study, 26 national reporters were provided with questionnaires to be disseminated across “their” Member States, thus gathering large amounts of information on all aspects of the application of Regulation 1346/2000, including ten questions on secondary proceedings.¹¹ When assessing the answers to these questions, several shortfalls of the current framework become apparent.

a) “Winding-up” as the only objective of secondary proceedings

The insistence of Article 3 (3) EIR that secondary proceedings “*must be winding-up proceedings*” has received almost universal repudiation with regard to its impact on the likelihood of success of restructuring efforts within the main proceeding.¹²

Not only does the constraint unnecessarily limit the options of insolvency administrators (in both main and secondary proceedings) in executing their duties in a way that might be most beneficial to the debtor’s creditors. Taking into account that Article 27 EIR does not permit the court opening secondary proceedings

¹¹ The full questionnaire as well as each and every answer provided by the various national reporters can be found here (accessed March 30, 2015): http://ec.europa.eu/justice/civil/document/index_en.htm. The following six questions proved to be the most informative:

1. System of Secondary Proceedings

Q29 Could you give examples of cases where the opening of secondary proceedings was considered as a useful tool to protect the interests of local creditors or to facilitate the administration of the main proceedings and instances in which it has not?

Are you aware of cases in which secondary proceedings have been opened abusively?

Q30 Does the fact that secondary proceedings are restricted to winding up proceedings create difficulties in conducting a cross-border rescue of a company with establishments in different Member States? If so, has it been possible to overcome these difficulties?

2. Coordination of Main and Secondary Proceedings

Q34 Does the duty to cooperate and to communicate information between liquidators (insolvency practitioners) in your experience work efficiently and effectively?

Yes. If so, could you exemplify?

No. If so, how could cooperation be improved?

Q35 Have the provisions of Article 31 (3), Article 32 (3), Article 33 and Article 34 been used in practice and, if so, was the outcome satisfactory? If so, please exemplify?

Q36 Should the Insolvency Regulation include additional instruments empowering the main insolvency practitioner to influence the course of secondary proceedings? If so, which instruments?

3. Estate

Q38 Are you aware of any cases in which it has been proven problematic to assign specific powers (avoidance claims, right to disclaim, etc.) to either the insolvency practitioner appointed in the main proceedings or the insolvency practitioner appointed in the secondary proceedings?

In case the main insolvency practitioner has entered into obligations on behalf of the estate prior to the opening of the secondary proceedings, are you aware of cases in which it has been difficult to assign such debts to the estate of either the main or the secondary proceedings?

¹² At the same time this detrimental impact was considered – at least by several practitioners from the UK (*Bevick/Perkins*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 30, S. 643) – as a “*useful deterrent for the commencement of secondary proceedings*”, which – though it might be a beneficial side effect – can hardly be assumed to be legislative impetus of the restriction.

to examine the debtor's insolvency,¹³ this might also lead to the forceful liquidation of solvent subsidiaries of the debtor, even though these subsidiaries could provide a substantially higher contribution to the estate if kept in business as part of the restructuring efforts.¹⁴

Against the backdrop of recital 20, which acknowledges that “[m]ain insolvency proceedings and secondary proceedings can, however, contribute to the effective realisation of the total assets only if all the concurrent proceedings pending are coordinated”, the static objective of secondary proceedings and the disruptive effect this fixation on winding-up can have on the effective execution of many of the restructuring instruments provided by national insolvency laws, lead to the EIR being nothing less than a considerable, legislative obstacle to the coordination of cross border insolvencies in this regard.

The national reporters from Poland summarized these issues articulately: “*Even the mere fact of the opening of secondary proceedings as winding-up proceedings would cause a major disruption into the activity of the subsidiary in question, causing adverse legal and economic effects, including far-reaching changes into contractual relationships of the company as well as a crisis of confidence of customers and business partners and ‘stigmatisation’ effects related to winding-up bankruptcy. The continuation of secondary proceedings as winding-up bankruptcy would render any restructuring practically impossible.*”¹⁵

On a more general note: The plethora of different types of proceedings within the national insolvency regimes makes a clear-cut distinction between winding-up and restructuring proceedings impossible,¹⁶ as – for instance – winding-up proceedings might well be aimed at the sale of the debtor's business as a whole.¹⁷ Lastly the Regulation itself is not particularly consistent when it comes to the “winding-up” restriction of secondary proceedings.¹⁸

¹³ Potentially even after the main proceeding is considered “closed” according to the insolvency statute of the main proceeding.

¹⁴ A practical example of the aforementioned shortcomings can be found in the *Christianapol* case: In 2008 the Meaux Commercial Court opened *sauvegarde* proceedings against Christianapol on the ground that the debtor was not in a situation calling for the cessation of payments, but that it would be in that situation if financial restructuring was not undertaken quickly. In 2009 *Bank Handlowy* filed for the opening of secondary proceedings against Christianapol under Article 27 EIR, shortly before the Meaux Commercial Court approved a rescue plan, which included the assets situated in Poland and prohibited the transfer of parts of those assets, thus arguably closing the main proceeding. The case reached the ECJ who – by answering the three referred questions – held in November 2012 that:

1. When determining whether or not an insolvency proceeding is to be considered “closed”, Article 4 (2)(j) EIR solely refers to the insolvency statute of the State of the opening of proceedings to decide at which moment the closure of those insolvency proceedings occurs.

2. Article 27 EIR does not allow for the examination of the debtors insolvency by the court asked to open secondary proceedings, even if the main proceedings have a protective purpose and do not require the debtors' material insolvency.

3. The fact that a main proceeding has been aimed at restructuring and to that end considerable assets located in another Member State have been included in the restructuring efforts does not impede on the possibility to open secondary proceedings in the latter state according to Article 27 EIR.

Considering the unequivocal wording of Articles 4 (2) and 27 EIR these rulings are less surprising than they corroborate anticipated concerns.

¹⁵ *Rachwał/Porzycki*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 30, S. 637.

¹⁶ *Oberhammer*, Heidelberg-Luxembourg-Vienna Report, Coordination of Proceedings, S. 251, para 932-935.

¹⁷ As is – for example – the case in Germany, where the selling of companies by the instrument called “übertragende Sanierung” is considered a winding-up proceeding. This instrument is currently more common in German law than the restructuring by means of creditor agreements. Further reading: *Uhlenbruck* in *Uhlenbruck*, *Insolvenzordnung*, München, 2010, § 159 para 47.

¹⁸ Further information: *Paulus*, *EuInsVO*, Frankfurt a.M., 2013, Article 3 para 50 et seq. (German).

b) Coordination of parallel proceedings

Similar consensus can be observed concerning the further coordination of parallel proceedings, where a variety of problems were identified. This being said, the criticism when it comes to specific problems experienced or recognized differentiates just as widely as do the proposed amendment and solutions to these issues.

aa) Right to request secondary proceedings

According to Article 29 EIR¹⁹ the right to request the opening of secondary proceedings belongs (a) to the liquidator in the main proceeding and (b) to any other person or authority empowered to request the opening under the law of the Member State within the territory of which the opening is requested. This means – for most if not all Member States – that both debtor as well as any creditor may request the opening of secondary proceedings at any time.²⁰

This appears to be in line with recital 19 EIR, wherein examples of the supposedly beneficial results of secondary proceedings are given. While the “*protection of local interests*” is mentioned, the motives of the administrator in the main proceeding are also addressed – specifically the presumed interest to open secondary proceedings in cases “*where differences in the legal systems concerned are so great that difficulties may arise from the extension of effects deriving from the law of the State of the opening to the other States where the assets are located*”.

While similar thoughts have been mentioned by some of the national reporters of the external evaluation,²¹ the underlying sentiment does not hold up to close scrutiny.

Examining the instances in which a secondary proceeding has been opened, one quickly notes that the idea that insolvency administrators of main proceedings ask for the opening on the grounds of complex estates flies in the face of reality.

Not only are secondary proceedings requested by the administrator in the main insolvency proceedings²² a rarity, but moreover are the few instances where it is indeed the main administrator who desires the opening of these proceedings evidently not motivated by the wish to share the burden of a complex estate, but rather to make use of preferential insolvency regimes in other Member States for the sake of advancing his/her own efforts.²³

¹⁹ And recital 18 EIR for that matter.

²⁰ Further applicants depend on the national insolvency regime of the Member State in question and may include public authorities, prosecutors, etc.

²¹ The national reporter for Belgium, *Lievens*, mentions a “*general academic consensus that secondary proceedings can also work beneficially. If the debtor’s estate is too complex to manage from one Member State alone, it could be in the interest of the main insolvency practitioner to open secondary proceedings in Member States where the debtor has establishments.*” *Lievens*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 32, S. 652.

²² Subsequently abbreviated as “main administrator”.

²³ The *Aklor* case helps to illustrate this point: The German provisional administrator (“schwacher vorläufiger Verwalter”) requested the opening of secondary proceedings in France. The Alkor Venilia-GmbH boasted a considerable number of establishments in other Member States (France, the UK, Italy, Belgium and Austria) and a yearly revenue of about 150 million Euros (in 2009). Nonetheless it was by no means the complexity or size of the estate that motivated the administrator to request the opening of secondary proceedings – though this was claimed by the latter to be the prime reason. The true reason why the opening of secondary proceedings was beneficial lay rather within French insolvency law; specifically in the different mechanism to ensure the salaries of employees of an insolvent company (“Association pour la gestion du régime de Garantie des créances Salariales”). Under French law such aid can only be granted in case of winding-up proceedings (“liquidation judiciaire”) and not in restructuring proceedings (i.e. “procédure de sauvegarde”). Thus the administrator – unable to pay the salaries due to the

Conversely there is an abundance of examples where creditors requested the opening of secondary proceedings not primarily to protect their interests, but for other, questionable reasons. These reasons might be as arbitrary as the fact that creditors “*were not happy*” with the main administrator,²⁴ as opposed to the principle of mutual trust as the tendency to open secondary proceedings to challenge territorially unjustified main proceedings,²⁵ or – arguably even worse – remain completely opaque in cases where “*the tactical opening of secondary proceedings caused significant value destruction*”²⁶.

Two solutions to address this undesirable state of affairs come to mind: Either by limiting the right to request secondary proceedings (to the main administrator and possibly certain, secured creditors), which would lead to – in the words of one practitioner “*the consequence that practically no such proceedings would take place any longer*”,²⁷ or (the less radical approach) by granting Member States’ courts the right to reject the opening in cases where secondary proceedings are considered detrimental towards the estate while simultaneously ensuring that the main administrator is given ample chance to convince said court that a secondary proceeding would be needless and wasteful.²⁸

bb) The coordination of parallel proceedings

If and once secondary proceedings are opened, the continuous cooperation between the respective administrators becomes essential. Considering that Article 32 (1) EIR grants any creditor the right to lodge his claim in either main, secondary, or both proceedings and Article 32 (2) EIR specifically tasks the administrators to lodge claims which have been lodged in the proceedings for which they were appointed in any parallel proceedings, it becomes apparent that a persistent and assiduous working relationship is at least highly desirable if not outright necessary.²⁹

shortage of the estate – sought to open secondary proceedings mainly to rid himself (and the estate of the main proceeding) of the obligation to pay these salaries. This none withstanding the Commercial Court of Nanterre opened secondary proceedings.

From a German perspective the significance of this case is further enhanced by the fact that the right of a provisional administrator – a common instrument in German insolvency law to preserve the estate before the opening of proceedings – to open secondary proceedings was by no means a given.

A similar case was mentioned by the Portuguese national reporter: *Nordmeier*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 29, S. 630.

²⁴ *Schellmann/Slonina*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 32, S. 652.

²⁵ This usage of secondary proceedings as “counter-measures” is – according to *Schellmann/Slonina* – quite widespread in Austria. For example it is noted that “*Austrian courts often interpreted requests to open main insolvency proceedings in Austria as a request for main and in eventum secondary proceedings*”. This practice lead “*nearly automatically*” to the opening of secondary proceedings in cases where there was an establishment in Austria. Further information: *Schellmann/Slonina*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 29, S. 620-621.

²⁶ *Richter*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 32, S. 653.

²⁷ *Oberhammer*, Heidelberg-Luxembourg-Vienna Report, Coordination of Proceedings, S. 238, para 898.

²⁸ This second approach is what the recast of Regulation (EC) 1346/2000 aims to implement. See below: 4. a) *Synthetic proceedings*.

²⁹ Article 32 (3) EIR furthermore grants the administrators the right to “*participate in other proceedings on the same basis as a creditor*”. While still potentially useful, this right is limited to attendance without granting any participatory powers and ultimately hardly more than a courtesy. It has been opined that Article 32 (3) EIR – specifically the term “*on the same basis as a creditor*”- is to be understood as meaning that the administrators are not just allowed attendance of creditor meetings, but rather that they might also represent the creditors of “their” parallel proceeding. Considering that any number of parallel proceedings still serve the benefit of the *same* creditors – who are at liberty to lodge their claims in any number of parallel proceedings – this cannot be the case however: Creditors of secondary proceedings can be (and oftentimes are) at

The Regulation aims to ensure this cooperation via Article 31 (1) EIR, which holds the liquidators of main and secondary proceedings “*duty bound to communicate information to each other*”. What information exactly this entails remains purposefully vague – instead of an exhaustive list Article 31 (1) EIR speaks of “*any information which may be relevant to the other proceedings*”.³⁰ Article 31 (2) EIR adds the duty to “*cooperate*”³¹ and Article 31 (3) EIR provides the – ultimately inconsequential – right to the main administrator to submit “*proposals on the liquidation or use of the assets in the secondary proceedings*”.

Asked whether they thought this duty to cooperate and to communicate information worked efficiently and effectively³² and which means are being relied upon to improve the coordination of main and secondary proceedings³³ the practitioners’ replies reveal three major themes:

1. Cooperation and communication between administrators is generally held to be a “*vital tool towards ensuring the coordination of proceedings*”³⁴ and the correlating duty established by Article 31 (1) EIR is deemed “*certainly beneficial*”³⁵.

2. Replies critical to the framework of the EIR argue primarily for the need for guidelines or best practices to facilitate coordination³⁶ and/or a strengthening of the role of the main administrator³⁷.

3. The multinational nature of parallel proceedings in and of itself unfortunately oftentimes leads to lingual and cultural differences that can impede on a close cooperation.³⁸ The sheer geographical distance between administrators is considered a further hindrance, as is “*some uncertainty, or distrust, relating to the foreign insolvency proceedings*”.³⁹

In line with these considerations, many issues regarding the coordination of proceedings lie not within the principal approach of the Regulation (i.e. the establishment of a duty to cooperate and communicate) but are a result of the unspecific wording of Article 31 EIR and the lack of practical tools to assist the administrators in their duties.⁴⁰

While Article 31 EIR only obligates the administrators, it has long been argued that the responsible courts should be similarly obliged to communicate and cooperate with each other as well as with the administrators

the same time creditors of the main proceeding, making a representation not only useless, but might also impede on the rights of the – involuntarily – represented.

³⁰ Specifically mentioned are only – the first in deference to the aforementioned Article 32 EIR and the second to Articles 34 and 35 EIR – “*the progress made in lodging and verifying claims and all measures aimed at terminating the proceedings*”.

³¹ Without giving any indication as to how this cooperation is to be conducted.

³² Heidelberg-Luxembourg-Vienna Report, Annex A, Question 34, S. 662 et seq.

³³ Heidelberg-Luxembourg-Vienna Report, Annex A, Question 33, S. 658 et seq.

³⁴ *Klamaris*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 34, S. 663.

³⁵ *Bonnici/Bencini/Ciantar*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 34, S. 666.

³⁶ *Vuimsalu/Varul*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 34, S. 664; *ibid. Klarmaris*, S. 665; *ibid. Bonnici/Bencini/Ciantar*, S. 666; *ibid. Galic/Orebek*, S. 669.

³⁷ *Hess/Pfeiffer/Piekenbrock/Seagon/Laukemann/Magnus*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 34, S. 664; *ibid. Vuimsalu/Varul*, S. 664; *ibid. Cauder*, S. 669; *Garcimartin Alferez/Heredia Cervantes/Torralba*, S. 669; *ibid. Bylander*, S. 670.

³⁸ *Richter*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 34, S. 663.

³⁹ *Schellmann/Slonina*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 29, S. 619.

⁴⁰ Be it by providing standardized forms to overcome the language barriers, by promoting the issuance of protocols or by encouraging unwilling administrators through potential liability.

of parallel proceedings.⁴¹ Whether such a duty can be read into Article 31 EIR seems doubtful – considering the clear wording of the Article a legislative affirmation might well be considered necessary and would certainly be advisable.⁴²

cc) Hierarchical concessions

Secondary insolvency proceedings are not “lesser” main proceedings. Though several restrictions are imposed on them (i.e.: the insistence of them being winding-up proceedings, Article 3 (3) EIR; the limitation of the estate to the assets in the Member State of the opening court, Article 3 (2) EIR) they are still to be regarded as complete, separate proceedings.⁴³

Governed by the insolvency regime of the opening Member State (Article 28 EIR) and administered by a (necessarily) different liquidator, secondary proceedings are conceived as conceptually equal to main proceedings.⁴⁴ Certain hierarchical concessions have been implemented nonetheless, mainly providing the necessary procedural link between the parallel proceedings:

(1) Article 33 EIR – Stay of liquidation

After the opening of secondary proceedings the main administrator loses his/her right to dispose of assets situated in the Member State in which the secondary proceeding has been opened, Articles 18 (1), 27 EIR.⁴⁵

He/She (and only him or her) may however request the court which opened secondary proceedings to stay the liquidation in whole or in part up to a maximum of three months at a time⁴⁶, Article 33 (1) EIR. This is his only way to delay the otherwise inevitable wind-up of part of the estate to salvage – for instance – a previously commenced restructuring effort.

The stay of liquidation may be ended at any time, following a request by the main administrator, the administrator of the secondary insolvency proceeding⁴⁷ or any creditor as well as of the courts own volition, Article 33 (2) EIR. In cases where the request did not originate from the main administrator, the court shall

⁴¹ For instance this has been argued by the Vienna Higher Regional Court: “*Although the wording of Art. 31 of the EU Insolvency Regulation only obliges the trustees in bankruptcy to cooperate, this also applies to the court according to the prevailing opinion and under the UNCITRAL model law.*” OLG Wien, *Beschluß* vom 9. 11. 2004 - 28 R 225/04w (*nicht rechtskräftig*).

⁴² Further information and arguing for – at least – a communication duty between courts: *Paulus*, EuInsVO, Article 31 para 6b (German); *Commandeur* in Nerlich/Römermann, InsO, Article 31 para 30 (German).

⁴³ *Beck* in NZI, 2006, S. 609 et seq. [610] (German).

⁴⁴ Further information on the hierarchical relationship between main and secondary proceedings: *Paulus*, EuInsVO, Article 17 para 4 et seq. (German).

⁴⁵ Note that the main administrator may freely remove assets from other Member States before secondary proceedings are opened in said states. This right is specifically mentioned in Article 18 (1) EIR, though this is merely a further confirmation of a general principle – in cases where no secondary proceeding is ever opened, the main administrator is naturally free to move any of the debtors assets (irrespective of their location) as he sees fit. Article 38 EIR further extends this right to temporary administrators, who may request “*any measures to secure and preserve any of the debtor’s assets situated in another Member State, provided for under the law of that State*” – this should not be misunderstood as meaning that the temporary main administrator might not access these assets according to the rights granted to him/her by the *lex fori concursus* of the main proceeding. It rather grants him/her additional possibilities to use instruments provided for by the law of a (potential) future secondary proceeding.

⁴⁶ With the possibility of subsequent extensions of this timeframe.

⁴⁷ Abbreviated subsequently as “secondary administrator”.

only terminate the stay “if that measure no longer appears justified, in particular, by the interests of creditors in the main proceedings or in the secondary proceedings”, Article 33 (2) EIR. It has been rightfully noted, that the interests of the creditors in the secondary proceedings should already be considered when determining the order to stay the proceeding, in order to avoid a gratuitous back and forth.⁴⁸

Even though the stay may only be rejected “if it is manifestly of no interest to the creditors in the main proceedings” – an assumption the court(s) responsible for the secondary proceeding(s) can hardly substantiate reliably⁴⁹ – the questioning of practitioners revealed that the instrument of Article 33 EIR is nonetheless of limited practical importance.⁵⁰ This is most likely due to the fact that the main administrator can only hope to make good use of his limited reprieve if he/she already has a potential buyer lined up and just needs a few additional weeks to finalize negotiations – a situation that does present itself rather sporadic.⁵¹

(2) Rights influencing the distribution of assets *in* (Article 31 (3) EIR) and the ending *of* secondary proceedings (Article 34 EIR)

The main administrator has no direct way of influencing the way in which the secondary proceeding is conducted. In particular the EIR does not grant him/her the authority to give orders or directives to the secondary administrator(s). To partially compensate for that, Article 31 (3) EIR orders the secondary administrator(s) to “give the liquidator in the main proceedings an early opportunity of submitting proposals on the liquidation or use of the assets in the secondary proceedings”. There is little evidence that these proposals are of great importance or even commonly used⁵² – which might be due to the fact that the secondary administrator is free to ignore them if he/she so chooses – but in principle (and assuming both administrators are willing to consider cooperation) Article 31 (3) EIR does provide for an expedient way to ensure a modicum of cooperation.

Article 34 EIR provides an important procedural link between main and secondary proceeding: Article 34 (1) subpara. 1 EIR ensures that the main administrator may propose to close the secondary proceeding “without liquidation by a rescue plan, a composition or a comparable measure” assuming such a measure is provided for by the domestic insolvency regime of the secondary proceeding. Conversely Article 34 (1) subpara. 2 EIR states that any of the aforementioned measures can only become final if either the main administrator

⁴⁸ Otherwise the court might be inclined to stay proceedings on one day only to terminate the stay the very next, if he deems the interests of the creditors in the secondary proceeding to be the only factor arguing against the stay; *Paulus*, EuInsVO, Article 33 para 9 et seq. (German).

⁴⁹ *Paulus*, EuInsVO, Article 33 para 8 (German).

⁵⁰ Heidelberg-Luxembourg-Vienna Report, Annex A, Question 35, S. 670-674, in particular the reports from Belgium, Bulgaria, Cyprus, Finland Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and the UK.

⁵¹ Nonetheless these situations – if they do in fact present themselves – do potentially benefit substantially from Article 33 EIR: In *Collins & Aikman* the English main administrator requested both the stay of the secondary proceeding in Austria as a whole and (alternatively) the stay of the liquidation of assets. The main administrator reasoned that he was in the process of acquiring a buyer who would be willing to purchase the debtors assets in its entirety and while the Austrian court (*LG Loeben*) did not consider this to meet the requirements of Article 33 EIR the appeal court (*OLG Graz*) subsequently granted the stay of liquidation in regards to the assets. (It did however not stay the secondary proceeding itself, arguing that Article 33 (1) EIR does only encompass the liquidation of assets, not validly opened secondary proceedings as a whole.) While the main administrators negotiations ultimately proved fruitless and the LG Loeben accordingly ordered the termination of the stay (Article 33 (2) EIR) in order to allow the secondary administrator to sell the assets of “his” estate, the case highlights that – in different circumstances – the stay could have resulted in the preferable outcome of a sale of the debtor’s assets as a whole.

⁵² Heidelberg-Luxembourg-Vienna Report, Annex A, Question 35, S. 670-674.

consents or “*if the financial interests of the creditors in the main proceeding are not affected*”.⁵³ In cases where a stay of liquidation has been ordered according to Article 33 (1) EIR, the right to propose such a “closing measure” is furthermore granted solely to the main administrator and the debtor, Article 34 (3) EIR.

The main feature of Article 34 EIR is the – albeit exceptional – possibility to infringe on the “winding-up proceedings only rule” of Article 3 (3) EIR by *sensibly*⁵⁴ granting the main administrator the means to achieve a reorganization of the estate of the secondary proceeding.

As with Article 31 EIR, the relevance of Article 34 EIR remains modest due to its limited practical applications and applicability. Nonetheless, to quote the Swedish national reporter (Bylander): “[T]hose measures [that of Article 34 EIR] are of importance not only if used, but also just because of their existence in the Regulation. The existence of such a competence for the liquidator in the main proceeding puts pressure on the secondary liquidator to cooperate, and perhaps this prevents abusive measures in the secondary proceeding”.⁵⁵

d) Systematic conclusions

The EIR in its current form does not provide a framework that facilitates the efficient and effective execution of parallel proceedings.

While it tries to alleviate the disruptive split of estates that is the essence of secondary proceedings and many of its instruments towards this aim (the stay of proceedings, Article 33 EIR; proposal-rights granted to the main administrator, Articles 31 (3), 34 (1) EIR; communication and cooperation duties, Article 31 (1), (2) EIR) have been deemed principally commendable, they are evidently not sufficient to address the wide-spread aversion that administrators and academics time and time again laid bare in no uncertain terms against the general concept of secondary proceedings (i.e.: regardless of any framework which might or might not be ideally suited to the efficient and effective handling of parallel proceedings).⁵⁶

Several ideas to change the interplay between parallel proceedings have been brought forth to address some of the specific shortfalls of the procedural framework: The aforementioned notion of generally strengthening the role of the main administrator vis-à-vis the administrators of secondary proceedings; the limitation of the right to request secondary proceedings either to include only the main administrator or – at the very least – to exclude creditors whose claims would not benefit from the special protection granted by secondary proceedings anyway; or a reliable method to prevent the opening of secondary proceedings altogether.

Before addressing the amendments envisioned by the “new” Insolvency Regulation and assessing whether or not they are likely to dissipate some of the concerns, it is however necessary to examine the considerable reluctance towards secondary proceedings in general; a reluctance that demands acknowledgement and consideration beyond the placating reference to political inevitability.⁵⁷

⁵³ The protection of the creditors in the main proceeding is further ensured by Article 34 (2) EIR, which holds that “[a]ny restriction of creditors’ rights arising from a measure referred to in paragraph 1” may only affect them if they consent.

⁵⁴ Paulus, EuInsVO, Article 33 para 1 (German).

⁵⁵ Bylander, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 35, S. 674.

⁵⁶ See below: 3. *The case against secondary proceedings*.

⁵⁷ This is by no means to say that e.g. Oberhammer (Heidelberg-Luxembourg-Vienna Report, Coordination of Proceedings, S. 234, para 898 et seq.) is wrong in summing up as follows: “National systems of insolvency law would never think of providing for parallel proceedings against one debtor within the respective territory – generally the opening of insolvency proceedings within one jurisdiction has universal effects, i.e. there must be no parallel proceedings and (...) there is only one liquidator taking care of all the debtor’s

3. The case against secondary proceedings

The following quote by Oberhammer serves as an ideal starting point: “In a “perfect world” the proceedings opened at the debtor’s COMI would affect all assets in all Member States in the interest of all creditors involved and there would be no space for parallel proceedings.”⁵⁸

While rarely beneficial to the efforts of the main administrator and equally rarely in the economic interest of the creditors in the main proceeding,⁵⁹ it seems this unequivocal criticism towards secondary proceedings neglects the positive effect these proceedings might have on the prospects of the “protection of local creditors”, recital 19 EIR.⁶⁰

This protection stems from (a) the applicability of the national insolvency regime of the Member State in which secondary proceedings are opened in combination with (b) the vast difference between domestic insolvency laws that equates to large discrepancies as to the preferential status of certain creditor groups.⁶¹ Taking into account that the sole purpose of Articles 5 et seq. of the Regulation is to ensure certain claims and rights are protected by excluding them from the *lexi fori concursus*,⁶² only those local creditors can hope to benefit from the opening of secondary proceedings, whose claims and rights are not already protected by the aforementioned Articles.⁶³

It is this potential protection of privileges via the opening of secondary proceedings⁶⁴ that serves as the only possible justification for the disruption of the principles of universality and unity, which would otherwise be nothing but a baseless concession to territorialism.

However – and now we come back to the “perfect world” without secondary proceedings – one cannot regard this instrument aimed at the special protection of local creditors as an isolated issue. Rather it has to be weighed against the impact it has on the overarching goal of the Regulation: The efficient and effective operation of cross border insolvency proceedings to facilitate the proper functioning of the internal market.⁶⁵

assets within such a jurisdiction. After all, insolvency proceedings are collective proceedings resulting in an attachment of the entirety of the debtor’s assets. Within the national systems, one would therefore normally not think of, e.g., appointing different liquidators for different assets and/or different groups of creditors, as this would obviously be detrimental to the efficiency of such collective proceedings.”

⁵⁸ Oberhammer, Heidelberg-Luxembourg-Vienna Report, Coordination of Proceedings, S. 234, para 888.

⁵⁹ See above: 2. c) aa) Right to request secondary proceedings.

⁶⁰ Whether or not such a special treatment is deemed to be appropriate is another question altogether. The framework of the EIR – and specifically recital 19 – makes it clear that such a treatment is intended and must therefore be accepted.

⁶¹ The special privileges granted to employees are a common example and lay at the heart of e.g.: *MG Rover* (High Court of Justice Birmingham, 30.03.2006, No. 2377/2006).

⁶² Whether or not certain assets do not even fall within the estate at all will not be discussed here. Further information on that issue can be found at *Omar*, European Insolvency Law, Farnham, 2004, S. 151 et seq.; *Reinhart*, MüKo – InsO, Munich, 2013, Article 5 para 13 et seq. (German).

⁶³ This – at first glance – seems to support the notion that such additional protection via secondary proceedings is unwarranted, since the European lawmaker has definitively listed those interests in Articles 5 et seq. who he deems to warrant special protection. However this argument falls short, given that the numerous privileges awarded by national insolvency regimes might simply have convinced the legislature that secondary proceedings are needed as a failsafe, in case specific rights are not sufficiently addressed by Articles 5 et seq. Considering the sheer number of these differences (and the fact that the special protection would hinge on the *lex fori concursus* of the main proceeding as well, since the question of preferential treatment is oftentimes a relative one) this interpretation is certainly worth considering.

⁶⁴ And accordingly the application of a different national insolvency regime.

⁶⁵ Recital 2 EIR.

When establishing this impact one has to take into account both the *ideal* cases of secondary proceedings (cases in which the opening of secondary proceedings had little or no impact on the amount of ultimately distributed assets) and the *worst* case scenarios (cases in which either the detrimental impact was extensive⁶⁶ or the motivation to open secondary proceedings was arbitrary or irrational⁶⁷).

For several reasons this balancing act does not come out in favor of secondary proceedings: The most apparent detrimental effect the opening of secondary proceedings has on the estate, is the obvious increase in costs that goes along with the necessity of appointing a second administrator and the involvement of a second court. The amount of these costs largely depends on the individual Member State and is subject to individual circumstances:

A paper provided by the World Bank gives some estimation – albeit without distinguishing between cross-border proceedings and purely domestic insolvencies –⁶⁸ and shows that the procedural costs are quite substantial. In 2010 the cost of insolvency proceedings was about 6 percent of the estate in the United Kingdom, 8 percent of the estate in Germany, 9 percent in France and Sweden and as much as 15 percent in Spain and 22 percent in Italy.⁶⁹

While these costs might be somewhat smaller in the case of secondary proceedings, they are both a direct burden to all creditors of main and secondary proceedings alike (with the possible exception of those privileged creditors for whose benefit the secondary proceeding was opened) and – even more important – avoidable by nature. Even the ideal execution of a secondary proceeding therefore leads to an (economically unnecessary) dwindling of the estates – hardly the effective and efficient operation of cross-border insolvencies that recital 2 EIR envisions.

The preferential treatment granted by the opening of secondary proceedings to those creditors who benefit from the applicability of an insolvency regime other than that of the main proceeding, is neither warranted nor conducive to the harmonization of insolvency law intended by the Regulation nor a boon to the underlying principles of judicial recognition and mutual trust between the Member States.

First off, the preferential treatment is not *warranted*: The main argument for the necessity of special protection for local creditors is that of predictability. Local creditors, it is argued, must be able to trust in their domestic insolvency regime, in order to accurately anticipate the consequences of the debtors' bankruptcy and the effects this will have on their claims. There are several issues with this line of argumentation:

As mentioned the Articles 5 et seq. EIR were designed specifically to ensure the durability of certain rights and claims, meaning that those either (a) are not affected by the opening of insolvency proceedings in another Member State *at all* (e.g. Article 5, 6, 7 EIR), (b) are not governed by the *lex fori concursus* but the insolvency regime of the Member State where they are located (e.g. Articles 8, 9, 10, 12, 14, 15 EIR) or (c) are being detracted from the applicability of the *lex fori concursus* if certain requirements are met (e.g. Article 13 EIR).⁷⁰ By including these provisions within the Regulation, the European lawmaker has acknowledged that

⁶⁶ *Richter*, Heidelberg-Luxembourg-Vienna Report, Annex A, Question 32, S. 653.

⁶⁷ As in the case recounted by *Schellmann/Slonina* (Heidelberg-Luxembourg-Vienna Report, Annex A, Question 32, S. 652), where secondary proceedings were applied for because the creditors “were not happy” with the main administrator.

⁶⁸ It seems a fair assumption that these numbers should be considered a conservative estimate, since there is no obvious reason why cross-border proceedings could potentially be more cost-efficient than domestic ones. The opposite seems far more likely.

⁶⁹ The World Bank, *Doing Business*, Washington, 2010, S. 77 et seq.

⁷⁰ Further information on this controversial issue: *Omar*, *European Insolvency Law*, Farnham, 2004, S. 151 et seq.; *Reinbart*, *MüKo – InsO*, Munich, 2013, Article 5 para 13 et seq. (German).

certain rights merit special protection and simultaneously provided a framework to implement said protection.⁷¹ If such a structure for the protection of rights – which are deemed worthy of protection – already is in place, the opening of secondary proceedings naturally can only serve the interest of local creditors whose claims and rights fall outside the scope of Articles 5 et seq. EIR. It is only these creditors who can raise the argument of predictability.

The question then becomes the following: Can the disruption⁷² of main – due to the opening of secondary – proceedings be justified by the interests of local creditors, even though their rights are not protected by Articles 5 et seq. EIR; justified specifically by the trust they put into the application of “their” domestic insolvency law?

Are creditors always aware that their debtor might have his COMI in another Member State and insolvency proceedings might therefore be opened under an unknown insolvency regime? Certainly not, though banks, public entities and other major creditors might be aware. Conversely most small creditors might be unaware that they are conducting business with an “establishment”⁷³, but it appears equally doubtful that they are endowed with considerable knowledge regarding their own domestic insolvency law and the special rights it might grant.

With regards to the question of “predictability” one must further keep in mind the prevailing definition of the debtors’ COMI: Supported by recital 13 EIR – which refers to the ascertainability of the COMI by third parties – the determination of the place where main proceedings are to be opened has been objectified more and more.⁷⁴ If, accordingly, the COMI is located in accordance with objective indications, the reasoning that local creditors are not aware of the potential applicability of a foreign insolvency regime loses persuasiveness.

Granted – this does not bear great weight when it comes to categories of creditors whose claim to special protection does primarily stem from socio-political considerations; employees being amongst the most prevalent of these creditor groups.⁷⁵ While rarely not aware that the COMI of their employer is located abroad and equally rarely familiar with the details of insolvency law within their Member State, one can assume that they generally know about the domestic protection methods granted to the employees of a bankrupt employer.⁷⁶

⁷¹ Article 5 EIR for example, aims to address that : “Rights in rem have a very important function with regard to credit and the mobilization of wealth. They insulate their holders against the risk of insolvency of the debtor and the interference of third parties. They allow credit to be obtained under conditions that would not be possible without this type of guarantee. Rights in rem can only properly fulfil their function insofar as they are not more affected by the opening of insolvency proceedings in other Contracting States than they would be by the opening of national insolvency proceedings”. Virgós/Schmidt, Report on the convention on insolvency proceedings, para 97.

⁷² And the detrimental economical effect this will cause for the estates.

⁷³ I.e.: „any place of operations where the debtor carries out a non-transitory economic activity with human means and goods“, Article 2 (h) EIR.

⁷⁴ Most noteworthy by the *Eurofood* decision: “the centre of main interests must be identified by reference to criteria that are both objective and ascertainable by third parties. That objectivity and that possibility of ascertainment by third parties are necessary in order to ensure legal certainty and foreseeability concerning the determination of the court with jurisdiction to open main insolvency proceedings. That legal certainty and that foreseeability are all the more important in that, in accordance with Article 4(1) of the Regulation, determination of the court with jurisdiction entails determination of the law which is to apply.” ECJ, May 2, 2006, C-341/04, para 33.

⁷⁵ See below: 4. a) aa) Background.

⁷⁶ In Germany this special protection is the “Insolvenzgeld”.

Even though it are in fact oftentimes those special privileges of employees that lead to the opening of secondary proceedings,⁷⁷ the underlying argument does not ring true when examined closer: Directive 2002/74/EC on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer holds in Article 8a: “*When an undertaking with activities in the territories of at least two Member States is in a state of insolvency within the meaning of Article 2(l), the institution responsible for meeting employees' outstanding claims shall be that in the Member State in whose territory they work or habitually work.*”⁷⁸

Summing up, the Regulation itself provides for the protection of many common special interests in case of insolvency. Claiming that foreign proceeding cannot be anticipated by local creditors contradicts the notable trend to locate the COMI of a business based on its “ascertainability by third parties”. Local creditors whose rights might not be sufficiently guaranteed by Articles 5 et seq. EIR and whose protection is deemed importance for socio-economic reasons are often protected by other legal acts.⁷⁹

The opening of secondary proceedings to protect those interests, which are already adequately guaranteed by either the EIR or other instruments, results in an unjustified diminution of the insolvency estate.

If and when local privileges have not been included in the framework of the EIR and are not protected by other means, the opening of secondary proceedings might be economically beneficial for the local creditors, it is however still not the most effective or efficient way to achieve the desired protection from a legislative perspective. Why, if the secondary proceedings are mainly initiated to preserve special privileges of local creditors, are those privileges not simply excluded from either the *lex fori concursus* or the insolvency proceeding as a whole?⁸⁰ It may not prove feasible or practical to list all of these privileges within Articles 5 et seq. EIR, but this cannot automatically mean that the decay of the insolvency estate, that is an inevitable consequence of the opening of secondary proceedings, is the only appropriate remedy.⁸¹

If the principle of universality of the *lex fori concursus* has to be restricted for the sake of privileged rights, it seems rational to – at least – preserve the principle of unity with regards to the main insolvency proceeding as much as one can. While the reality of “mutual trust” might not always include the legal orders of all Member States⁸², it demands – in a cross-border insolvency context – the acceptance of a singular proceeding and cannot be conciliated with the opening of secondary proceedings in their current form.

4. The proposed amendments

As has been shown, many of the problems and issues encountered when dealing with secondary proceedings stem from the mere fact of their existence alone. They are but a political concession to localism

⁷⁷ In fact, it can even be the motivation for the main administrator in those rare cases where he is the one requesting the opening of secondary proceedings (e.g. the *Alkor* case). This has been discussed above: 2. c) aa) *Right to request secondary proceedings*.

⁷⁸ In Germany this directive was adopted in § 165 (1) SGB III, which states unequivocally that domestic employees are granted the German “*Insolvenzgeld*” even if their employer is located in another Member State.

⁷⁹ E.g.: Directive 2008/94/EC of the European Parliament and of the Council of 22 October 2008 on the protection of employees in the event of the insolvency of their employer.

⁸⁰ Comparable to how Articles 5 et seq. protect special privileges.

⁸¹ Even a – carefully worded – universal rule that covers a wide array of possible privileges and precludes them from the *lex fori concursus* would be conceivable and certainly constitute an economically better alternative.

⁸² Consider the common „public policy-exception” by which courts can reject the recognition of foreign decisions, Article 26 EIR.

and owe their implementation to the unjustified believe that local creditors *deserve* the inaccurately presumed superior protection granted by their own domestic insolvency regime.

Considering this innate flaw of secondary proceedings, the proposed amendments to the EIR and its adherence to the possibility of secondary proceedings is necessarily underwhelming. That being said, this does of course not mean that the proposed changes might not help to lessen the detrimental effects of secondary proceedings.

a) Synthetic proceedings

The inclusion of what is commonly being referred to as “synthetic proceedings” deserves close attention, as it is directly in line with the foregoing grading of secondary proceedings as harmful distractions and causes of economic calamities.

aa) Background

The disrupting effect of secondary proceedings became empirically most prevalent within the context of group of company insolvencies.⁸³ Not only did the necessity for any opened secondary proceeding to be aimed towards liquidation prevent the reorganization (or wholesome sale) of solvent parts of corporation, it also became apparent that the complex structures of large groups of companies require the well-coordinated efforts of the involved insolvency administrators to achieve a more substantial realization of assets and – conversely – that unilateral acts and uncoordinated splits of the estate can prove detrimental for the entirety of creditors.

The concept of “synthetic proceedings” as an answer to these issues was introduced by British courts in the mid-2000s:

The High Court of Justice Birmingham ruled in 2005 that the (British) joint administrators of the MG Rover Group “*may make payments to the [foreign] employees of the company, such that they receive the same monies as the employees would receive if secondary proceedings were commenced (...) provided that the administrators think of the making of such payments is likely to assist achievement of the purpose of administration*”. While the court could not expect to outright prevent the potential opening of secondary proceedings, it hoped at least to “*that by this means courts in other member states may come to appreciate that the principal objective of the administration is to rescue the relevant national sales company as a going concern, and if that is not reasonably practicable (or would not achieve the best result for the company's creditors as a whole) then to achieve a better result for that national sales company's creditors as a whole than would be achieved by an immediate winding up.*”⁸⁴

One year later the High Court of London confirmed in *Collins & Aikman* that administrators may – under English law – give oral assurances to creditors that “*if there were no secondary proceedings in the relevant*

⁸³ This might be surprising at first glance. Groups of companies – being comprised of several legal entities – require the opening of several main proceedings, one for each legally independent company. If secondary proceedings are opened subsequently, they may thus only interfere with one of the main proceedings. Considering that the individual companies within a group are often closely connected and can only function as a part of the whole, the opening of secondary proceedings for only one of the establishments of only one the parts might nonetheless still carry great risk to the overall restructuring or liquidation efforts.

⁸⁴ *MG Rover* (High Court of Justice Birmingham, 30.03.2006, No. 2377/2006).

jurisdiction then their respective financial positions as creditors under the relevant local law would as far as possible be respected in the English administration”.⁸⁵

Finally in *Nortel* the High Court of Justice Chancery Division agreed to the “*sending of appropriate letters*” to the courts of Member States in which secondary proceedings might be opened “*with a view to obtaining assistance from the courts of various Member States in the form of prior notification to the Joint Administrators of any request or application for the opening of secondary insolvency proceedings in those jurisdictions and the giving to the Joint Administrators of an opportunity to be heard on any such application. This is intended to enable them to explain to the relevant court why such proceedings would not be in the interests of the creditors.*”⁸⁶

bb) Implementation

The EU lawmaker followed the example of the English courts and the advice offered by academia⁸⁷ and implemented the instrument of synthetic proceedings in the amendment of the Insolvency Regulation.⁸⁸ This measure results in one of “*two specific situations*⁸⁹ in which the court seized of a request to open secondary insolvency proceedings should be able, at the request of the insolvency practitioner in the main insolvency proceedings, to postpone or refuse the opening of such proceedings” to address that “[s]econdary insolvency proceedings may also hamper the efficient administration of the insolvency estate”, recital 41 EIR-P.

Compared to the improvised nature of the synthetic proceedings as implemented by the English courts, Article 36 EIR-P provides a “proper” procedural framework for what it calls “an undertaking”, while leaving no doubt that the principal aim of the instrument remains unchanged: the avoidance of secondary insolvency proceedings.

The undertaking may be given unilaterally by the main administrator and corresponds approximately to the guarantee that “*when distributing those assets [located in the Member State in which secondary insolvency proceedings could be opened] or the proceeds received as a result of their realization, he will comply with the distribution and priority rights under national law that creditors would have if secondary insolvency proceedings were opened in that Member State*”, Article 36 (1) EIR-P. It is important to note that the provision *prima facie*⁹⁰ does *not* restrict the distribution of the assets for the benefit of “local creditors” only.⁹¹ Rather the wording of Article 36 (1) EIR-P refers to the “*distribution and priority rights (...) that creditors would have*”.⁹²

⁸⁵ *Collins & Aikman* (High Court of Justice Chancery Division Companies Court, 15.07.2005, No. 4717-4725/2005)

⁸⁶ *Nortel* (High Court of Justice London, 11.02.2009, (2009) EWHC 206 (Ch)).

⁸⁷ *Oberhammer*, Heidelberg-Luxembourg-Vienna Report, Coordination of Proceedings, S. 243-244, para 914.

⁸⁸ Articles 36, 38 (2) EIR-P.

⁸⁹ The temporary stay of secondary proceedings being the other one, recital 45 EIR-P.

⁹⁰ See below: 4. cc) *Open questions concerning synthetic proceedings*.

⁹¹ “Local creditor” being defined in Article 2 (11) EIR-P as: “*a creditor whose claims against a debtor arose from or in connection with the operation of an establishment situated in a Member State other than the Member State in which the centre of the debtor’s main interests is located*”. This definition shows that it is not necessary for a “local creditor” to be local. It is rather the claim of the creditor that – having arisen from or in connection with the establishment – determines the status of a “local creditor”. Further information: *Thole* in ZEuP 2014, S. 39 et seq. (S. 64) (German).

⁹² The same is true for both the French version: “*(...) lors de la répartition de ces actifs ou des produits provenant de leur réalisation, il respectera les droits de répartition et de priorité prévus par le droit national, qui auraient été conférés aux créanciers si une procédure d’insolvabilité secondaire avait été ouverte dans cet État member.*” and the German version of the Proposal: “*(...) dass er bei der Verteilung dieses Vermögens oder des bei seiner Verwertung erzielten Erlöses die Verteilungs- und Vorzugsrechte nach nationalem Recht wahr, die Gläubiger hätten, wenn ein Sekundärinsolvenzverfahren in diesem Mitgliedstaat eröffnet worden wäre.*“

(Known) local creditors have to approve the undertaking after being informed by the main administrator “of the undertaking, of the rules and procedures for its approval, and [after the vote has been held] of the approval or rejection of the undertaking”, Article 36 (5) EIR-P. Additionally, the creditors of the main proceeding have to approve of the undertaking in accordance with any form or approval requirements as to distributions of the State of the opening of the main proceedings, assuming such requirements do exist, Article 36 (4) EIR-P.

If the undertaking has been approved, its main effect is that the “*law applicable to distribution of proceeds from the realization of assets [those assets which are located in the Member State where secondary proceedings would be opened], to the ranking of creditors’ claims, and to the rights of creditors in relation to the assets*” is no longer be the *lex fori concursus*, but rather the domestic insolvency regime of the aforementioned Member State.⁹³

The given and approved undertaking “*shall be binding on the estate*”, Article 36 (6) EIR-P and non-compliance on the side of the main administrator renders him/her liable for any damage caused to local creditors, Article 36 (10) EIR-P.⁹⁴

While the undertaking does not prevent the opening of secondary proceedings outright, it does set up considerable obstacles in their way:

- Once it is binding, secondary proceedings may only be lodged within 30 days of having received notice of the approval of the undertaking, Article 37 (2) EIR-P.
- When the opening of a secondary proceeding is requested, the court “*shall, at the request of the insolvency practitioner, not open secondary insolvency proceedings if it is satisfied that the undertaking adequately protects the general interests of local creditors*”, Article 38 (2) EIR-P.

Whether or not these obstacles – specifically the granting of judicial discretion when determining if the undertaking “*adequately protects the general interests of local creditors*” – prove themselves to be a sufficient hindrance to the opening of secondary proceedings remains to be seen. Assuming the courts keep their focus on the *economic* interests of creditors (both local and non-local) there is much reason to expect an undertaking given in good faith to successfully stave off secondary proceedings.

Reiterating the fundamentally detrimental nature of secondary proceedings, the implementation of synthetic proceedings is to be welcomed. It provides an instrument which makes allowance for special, domestic privileges while maintaining the procedural integrity of the main proceeding, thus preserving the principle of unity.⁹⁵

cc) Open questions concerning synthetic proceedings

The EU lawmaker tried to provide a set of comprehensive, procedural rules to smoothen the transformation from synthetic proceedings as a makeshift solution based on English case law to a streamlined instrument with clear rules and requirements.

⁹³ It is of note that for any other purpose, it is still the *lex fori concursus* that is solely applicable.

⁹⁴ Additionally local creditors have to be informed about an impending distribution and may challenge such distribution before the courts of the main insolvency proceedings, Article 36 (7) EIR-P.

⁹⁵ Admittedly at the cost of the principle of universality, though the indefinite applicability of domestic insolvency regimes of other Member States (i.e.: other than that of the main proceeding) when secondary proceedings are opened might be viewed as a considerably greater price to pay.

While this necessarily results in a decrease in flexibility,⁹⁶ ideally this decrease would be more than compensated for by the legal certainty that is the result of a cohesive framework. Unfortunately the wording and systematic of the new provisions governing synthetic proceedings leaves much to be desired and struggles to answer more questions than it poses.

The undertaking enables the main administrator to fictionally split the estate in order to avoid a real fragmentation. This split-off fragment is comprised exclusively of assets located in that Member State in which secondary proceedings would have been opened, Article 36 (1) EIR-P. It remains but fictional, since its contents are still subject the *lex fori concursus* – only the “*distribution of proceeds from [their] realization*“, “*the ranking of creditors’ claims*“ and the “*rights of creditors in relation to [these] assets*“ allow the *lex fori secundarii* to supersede the principle of universality (and accordingly the *lex fori concursus*) partially. This construction might lead to trouble when assessing where *exactly* the border between *lex fori concursus*, *lex fori concursus secundarii* and autonomous EU-insolvency law runs, how the new synthetic proceedings work with later secondary proceedings:

- Does – for instance – the right to give an undertaking (Article 36 EIR-P) allow the main administrator to overstep the authority granted to him/her by Article 21 (1) EIR-P, according to which he/she “*may exercise all the power conferred to him[/her], by the law of the state of the opening of proceedings, in another Member State*“?⁹⁷
- Is the „estate“⁹⁸ of the synthetic proceeding in any way reserved for the privileged access of local creditors? Article 36 (1) EIR-P states that the undertaking consists of the main administrators guarantee that he/she will “*comply with the distribution and priority rights under national law that creditors would have if secondary insolvency proceedings were opened in that Member State*“. Considering that: „if secondary insolvency proceedings were opened“ all creditors (local and foreign alike)⁹⁹ could – for better or worse – lodge their claims in the secondary proceeding as well as in the main proceeding (Article 45 (1) EIR-P) and thus gain access to the distribution order of the *lex fori concursus secundarii*, it seems plausible that in case an undertaking is given, any „non-local“ creditor can expect his claim be subject to the same distribution order with regards to the split-off assets.¹⁰⁰ If, conversely, the lawmaker wanted to grant access to the assets of the synthetic proceeding exclusively to „local creditors“ –

⁹⁶ By providing a strict set of rules in which the main administrator has to operate as compared to the “anarchic” way in which English courts (in *Nortel, Collins & Aikman, MG Rover*) paved the way for synthetic proceedings by expanding on the powers of the main administrator under English law.

⁹⁷ This point has been previously raised by *Thole* in ZEuP 2014, S. 39 et seq. (S. 65) (German). He is right in arguing that this added authority should have been clearer laid out by Article 36 EIR-P. There is every reason to assume that this additional powers are indeed intended and do not have to align with the *lex fori concursus* – otherwise synthetic proceedings would lose much of their applicability as most domestic insolvency laws neither contain nor allow instruments that equate to synthetic proceedings.

⁹⁸ Rather: The fragment of the main estate which is governed by the *lex fori concursus secundarii* with regards to distribution, creditor ranks and creditor rights in relation to these assets.

⁹⁹ As mentioned before, „local creditor“ does not equate to „domestic creditor“ but rather only requires the creditors claim to have arisen from or in connection with the operation of an establishment situated in a Member State other than the Member State in which the centre of the debtor’s main interest is located, Article 2 (11) EIR-P.

¹⁰⁰ Assuming the foreign creditors claim can boast the same „privileged nature“ under the *lex fori concursus secundarii*, this would mean his claim will also get the preferential treatment provided by the synthetic proceeding.

which would certainly go a long way in ensuring that the latter would approve the undertaking – this would require clearer indication.¹⁰¹

- Is Article 36 (4) EIR-P to be read as meaning that all non-local creditors need to approve the undertaking? Is it conversely really meant to state that non-local creditors need to approve the undertaking only in case the lex fori concursus stipulates “*approval requirements as to distribution, if any*“ but not in those Member States which don’t provide such requirements?¹⁰²
- While Article 36 (6) EIR-P states that an undertaking “*given and approved in accordance with this Article shall be binding on the estate*“, there is no clear indication as to what this „binding“ nature of the undertaking signifies. Does the binding effect really apply directly to the estate rather than to the main administrator?¹⁰³ Would it allow creditors to bring actions against the estate? If so, before which court are these claims to be raised? If so, wouldn’t Article 36 (7) (8) EIR-P become obsolete, since the right to challenge the planned distribution of assets which does not comply with the terms of the undertaking (Article 36 (7) EIR-P) and the right to request the court of the main proceeding to order “*any suitably measure necessary to ensure compliance with the terms of the undertaking*“ (Article 36 (8) EIR-P) needn’t have been introduced individually considering the undertaking itself provides a „binding“ effect?
- More questions arise with regards to the cross-border movement of assets by the main administrators. As a general rule the administrator may “*remove the debtor’s assets from the territory of the Member State in which they are situated*“, Article 21 (1) EIR-P. If secondary proceedings are opened thereafter, the secondary administrator may claim (through the courts or out of court) that the removed assets were part of the estate of the secondary proceeding and thus retrieve them, Article 21 (2) EIR-P.¹⁰⁴ If an undertaking is given, the administrator can therefore in principal remove assets from any Member State as he/she sees fit and only after the undertaking has proven incapable of avoiding the opening of secondary proceedings “*shall [the main administrator] transfer any assets which it removed from the territory of that Member State after the undertaking was given or (...) their proceeds, to the insolvency practitioner in the secondary insolvency proceedings*“, Article 36 (6) EIR-P. The wording of this second sentence of Article 36 (6) EIR-P is unfortunate, as it’s reference to the timeframe „after the undertaking was given“ might lead to the assumption that assets removed *before* the undertaking was given, do not have to be returned to the Member State where secondary proceedings are opened afterwards. It seems more likely that those assets can be claimed by the secondary administrators according to the general rule of Article 21 (2) EIR-P and that the second sentence of Article 36 (6) EIR-P is rather redundant than exceptional.¹⁰⁵

¹⁰¹ It would also require considerable explanation, as it would create a new division between creditors foreign to the original structure of the Regulation.

¹⁰² If so, this would be hard to justify. The domestic distribution of an estate is something fundamentally different to secondary proceedings. Denying non-local creditors the right to approve the undertaking simply because their domestic insolvency regime does not provide rules for an entirely different situation seems excessive. While it can be argued that non-local creditors should not have the right to approve synthetic proceedings since they would not get a say in whether or not secondary proceedings are opened as well. A coherent rule would be preferable in any case.

¹⁰³ This might lead to problems in insolvency regimes in which the insolvency estate is not considered an independent legal entity.

¹⁰⁴ The Regulation remains unchanged in this regard, Article 18 (1), (2) EIR.

¹⁰⁵ For the second sentence of Article 36 (6) S. 2 EIR-P to have any scope of application beyond the general rule of Article 21 (1), (2) EIR-P it would have to be interpreted as an exception. Following the wording this exception could conceivably – though admittedly far-fetchedly – be the aforementioned right of the main administrator to retain the removed assets.

- Local creditors are granted a specific liability claim in Article 36 (10) EIR-P, covering “*any damage caused to local creditors as a result of its non-compliance with the obligations and requirements set out in this Article*“. Unfortunately there is neither an indication as to *who* shall be the applicant of this claim (individual local creditors?, the „estate“ of the synthetic proceeding?, the estate of a subsequent secondary proceeding?), nor *where* it needs to be raised (courts of the Member State of main or secondary proceeding?), nor *where* it is to be considered to come into existence (Member State of main or secondary proceeding?, administrator’s place of business?).
- Lastly there are some concerns regarding the interplay between Article 38 (3) EIR-P and Article 38 (1) EIR-P. If the main administrator should enter into negotiations with the creditors (with the likely aim of achieving an acceptable undertaking) and a temporary stay of individual enforcement proceedings has been granted to that end, the court where the opening of secondary proceedings has been requested may stay said opening “*for a period not exceeding three months, provided that suitable measures are in place to protect the interests of local creditors*”, Article 38 (3) (subs. 1) EIR-P.¹⁰⁶ While the intention to grant the main administrator a temporary respite to negotiate an undertaking is laudable, it remains unclear why the court retains the discretion to deny the stay of the opening of secondary proceedings, especially in cases where further protective measures for the benefit of the local creditors have been implemented. It appears advisable to change the wording of Article 38 (3) EIR-P so that the court “shall” stay the opening if the provision’s requirements are met – if only to allow the main administrator to invoke Article 39 EIR-P in case the stay is not granted and challenge the opening of secondary proceedings “*before the courts of the Member State in which secondary insolvency proceedings have been opened on the ground that the court did not comply with the conditions and requirements of Article 38.*”

b) Amendments to secondary proceedings

Considerable changes to the handling of secondary proceedings accompany the implementation of synthetic proceedings.

The highly criticized¹⁰⁷ insistence for secondary proceedings to be necessarily aimed at the winding-up of the debtors’ estate has been dropped from Article 3 (3) EIR-P, which now allows for secondary proceedings to seek reorganization as well as liquidation. This change by itself should have significant impact on the devastating effect secondary proceedings nowadays oftentimes exert on a coordinated restructuring effort.

Another novelty is the inclusion of a judicial review of the decision to open secondary proceedings, Article 39 EIR-P. The main administrators will be able to challenge said decision before the courts of the Member States in which secondary proceedings have been opened on the ground that it does not comply with Article 38 EIR-P (i.e.: it was opened even though an undertaking was given, approved and deemed to adequately protect the interests of local creditors, Article 38 (2) EIR-P).

¹⁰⁶ Article 38 (3) EIR-P provides an example for this “suitable protection” in subsection 2: “*The court (...) may order protective measures to protect the interests of local creditors by requiring the insolvency practitioner or the debtor in possession not to remove or dispose of any assets which are located in the Member State where its establishment is located unless this is done in the ordinary course of business*”. Furthermore the provision also provides a general rule as to which a court “*may also order other measures to protect the interests of local creditors during a stay, unless this is incompatible with the national rules on civil procedure*”.

¹⁰⁷ See above: 2. b) “*Winding-up*” as the only objective of secondary proceedings.

The Regulation remains quiet on what the implications of a successful challenge are – it stands to reason however that the challenge must result in a retraction of the opening decision¹⁰⁸ and a restoration of the main administrators’ right to dispose of the assets – located in the Member State in question – as he sees fit, Article 21 EIR-P.

The coordination of parallel proceedings received a lot of legislative attention:

- The amendment now provides three separate provisions for the coordination between administrators (Article 41 EIR-P), between courts (Article 42 EIR-P) and between administrators and courts (Article 43 EIR-P).¹⁰⁹
- The much bemoaned¹¹⁰ lack of any indication as to *how* the legislator envisioned the cooperation between administrators has been resolved. While Article 41 (1) EIR-P explicitly allows the cooperation in “any form”, it also mentions the conclusion of agreements or protocols, thus giving administrators at least an idea as to how they might proceed. Additionally, the norm further substantiates the precise content of the cooperation: Article 41 (2)(a) EIR-P expands on the communication of information “*which may be relevant to the other proceedings*” by including “*all measures aimed at rescuing or restructuring the debtor*”.¹¹¹ The compatibility of secondary proceedings and restructuring/rescue endeavors is further increased by Article 41 (2)(b) EIR-P, which encourages the administrators to actively “*explore the possibility of restructuring the debtor and (...) coordinate the elaboration and implementation of a restructuring plan*”. While the main administrator’s right to submit (early) proposals on the realization of the secondary insolvency proceedings’ assets remains unchanged, the proposal adds in Article 42 (2)(c) EIR-P the general duty to “*coordinate the administration of the realization or use of the debtor’s assets and affairs*”.
- The importance of court to court coordination finds its validation in Article 42 EIR-P. A general obligation for a “*court, before which a request to open insolvency proceedings is pending, or which has opened such proceedings*” to cooperate “*with any other court before which a request to open insolvency proceedings is pending, or which has opened such proceedings*” can be found in Article 42 (1) EIR-P.¹¹² The proposal intends to keep the court to court coordination flexible and free from bureaucratic red tape by allowing direct communication and a free flow of information between the involved courts.¹¹³ The list of issues that specifically require cooperation provided for in Article 42 (3) EIR-P includes most notably the appointment of administrators, (3)(a) and the supervision of both the administrators efforts and of “*the debtor’s assets and affairs*”, (3)(c).
- Closely resembling Article 42 EIR-P is Article 43 EIR-P, according to which the cooperation between administrators (main, secondary and territorial) and any involved court (main, secondary and

¹⁰⁸ A decision that itself will then be subject to automatic, EU-wide recognition, Article 19 (1) EIR-P.

¹⁰⁹ Thereby providing a framework for the cooperation and communication amongst the latter two.

¹¹⁰ See above: 2. c) bb) *The coordination of parallel proceedings*.

¹¹¹ Furthermore a concession has been made to data protection: The administrator is duty bound to provide information only, if “*appropriate arrangements are made to protect confidential information*”, Article 41 (2)(a) EIR-P. How this *appropriateness* is to be judged (and by whom) remains unclear and judicial interpretation can be expected.

¹¹² The norm further allows for the appointment of an „independent person or body” for the purpose of said cooperation, Article 42 (1) EIR-P.

¹¹³ “[P]rovided that such communication respects the procedural rights of the parties to the proceedings and the confidentiality of information”, Article 42 (2) EIR-P.

territorial) is to be implemented “*by any appropriate means, such as those set out in Article 42 (3) [EIR-P]*”, Article 43 (2) EIR-P.

c) Concluding remarks

The changes to the rules on coordination (cooperation and communication) should not be underestimated. By providing examples of instruments that might be used by courts and administrators alike, the European lawmaker has answered one of the most pressing clamors for reform. Considering how many cases were plagued by lack of communication, diverging interests or sheer ignorance,¹¹⁴ there is every reason to assume that the risk of secondary proceedings irreconcilably sidelining prospective restructuring efforts will be considerably reduced.

While the judicial review of decisions by which secondary proceedings have been opened and the abolition of the “winding-up-only” restriction for secondary proceedings are sensible and noteworthy improvements, they can’t but pale when compared to the introduction of the “quite revolutionary”¹¹⁵ synthetic proceedings to the framework of the EIR:

The main strength of synthetic proceedings is the – deceptively trivial – fact that they are not secondary proceedings. By focusing on the real reason that make secondary proceedings so attractive for local creditors (i.e.: their interest in obtaining the special protection which their claims are subject to under the *lex fori concursus secundarii*) and creating a recourse which allows these creditors to secure their privileged treatment through an instrument that does not rip apart the insolvency estate beyond repair, the “New Insolvency Regulation” succeeds in – while not abolishing secondary proceedings altogether – doing the next best and politically the only viable thing.

Leaving aside the many conceptual advantages of synthetic proceedings, their legislative implementation unfortunately leaves a lot to be desired.¹¹⁶ Further amendments could fix many of the described shortcomings which would allow synthetic proceedings to prove their superiority over secondary proceedings and might eventually lead to a paradigm shift and the abolition of secondary proceedings. Considering that the latter have no economic value for insolvency proceedings and are rather firmly rooted in political narrow-mindedness and ill-conceived territorialism, one can only hope that the synthetic proceedings are but the first nail in their well-deserved coffin.

¹¹⁴ See above: 3. *The case against secondary proceedings.*

¹¹⁵ *Thole* in ZEuP 2014, S. 38 et seq. (S. 64) (German).

¹¹⁶ See above: 4. a) cc) Open questions concerning synthetic proceedings.