Improving the Revision of the European Union Regulation on Insolvency

By

Hon. Samuel L. Bufford

I. Introduction

The European Commission ("the Commission") transmitted its recommendations for the revision of the European Insolvency Regulation, Regulation 1346/2000 ("the Regulation") to the European Parliament, the Council and the European Economic and Social Committee on December 12, 2012 ("the Commission recommendations"). Issuance of the revised Regulation is expected in 2014.

The proposed revisions are extensive and principally cover five areas. First, the scope of the Regulation is expanded to include debtor in possession insolvency regimes, hybrid and pre-insolvency proceedings, and insolvency proceedings for natural persons. Second, the revisions seek to clarify the jurisdiction rules and to improve the procedural framework for determining jurisdiction. Third, the revisions alter the legal regime for secondary proceedings by authorizing a court to refuse to open secondary proceedings, waiving the mandate that secondary proceedings be winding-up proceedings, and improving the cooperation between secondary proceedings and main proceedings. Fourth, the revisions require the establishment of publically accessible national registers

---

1 Copyright 2014 Samuel L. Bufford.

2 Distinguished Scholar in Residence, Dickinson School of Law, Pennsylvania State University; U.S. Bankruptcy Judge, C.D. Cal. (retired). Judge Bufford served as a U.S. bankruptcy judge for the Central District of California in Los Angeles for 25 years before joining the faculty of Pennsylvania State University.


4 See id., Recital 9a. The proposal would continue to exclude national restructuring provisions that are conducted in private without notice to the public.

5 The jurisdiction rules are improved by giving the right to any party in interest, who is located in another E.U. State, to challenge a decision opening main proceedings. See id., art. 3b(3).
for insolvency cases, which must be interconnected throughout the European Union, where all relevant court decisions must be published.\(^6\) Fifth, the revisions provide a measure of coordination for insolvency proceedings for the various members of a group of companies.\(^7\)

These changes, in my view, are all commendable and should be adopted. However, in two respects they do not go far enough.

This article addresses two issues that are not adequately addressed, in my view, in the Commission’s recommendations. First, the framework proposed to improve the coordination of transnational cases for groups of companies within the European Union and to promote communication with respect to such cases is insufficient. Recent transnational insolvency cases for groups of companies involving countries that have already adopted the expanded coordination regime (essentially the UNCITRAL Model Law on Cross-Border Insolvency (“the Model Law”))\(^8\) have already shown that more is needed to deal adequately with the transnational problems that arise in such cases. A stronger regime is required to provide an adequate framework to accommodate such insolvency cases effectively.\(^9\)

Second, the revision, like the original Regulation, lacks entirely a regime for coordinating transnational insolvency cases for the same or related entities where one or more of the insolvency cases is commenced in a State outside the European Union. Like the existing Regulation, the revised Regulation is limited to the coordination of cases pending only within the European Union. The largest and most challenging transnational cases involve insolvency proceedings in non-E.U. States, as well as within the European Union, for members of a group of companies.

II. Groups of Companies

\(^6\) See id., arts. 20a (establishing insolvency registers); 20b (requiring that they be interconnected).

\(^7\) See id., arts. 42a-42d.


The treatment (including coordination) of transnational insolvency cases for the members of groups of companies or enterprise groups is the most important unsolved problem of international insolvency law. The present regime (including both the Regulation and the Model Law) is limited to single legal entities. The proposed revisions make a substantial effort to address this issue, but do not go far enough.

A. The Commission Proposal

The Commission’s proposed revisions would adopt a regime for the coordination of insolvency cases for groups of companies that is substantially advanced from the present law. These revisions would impose obligations both (a) on the liquidators in each of the insolvency cases for the company group members and (b) on the courts where these insolvency cases are pending. These obligations fall into three categories: obligations of liquidators, obligations of courts, and obligations between liquidators and courts.

1. Obligations Between Liquidators

The proposal would impose an obligation on the liquidators of the various entities to cooperate and communicate among themselves to the extent that (a) such cooperation is appropriate to facilitate the effective administration of the proceedings, (b) that it is not incompatible with the rules applicable to their own proceedings, and (c) that it does not entail any conflict of interest. This provision is an extension of the existing provision requiring liquidators to communicate and to cooperate where they are appointed with respect to the same legal entity.

10 It is a remarkable achievement of international insolvency law that the coordination of cases for members of groups of companies remains the largest problem to be solved. Twenty years ago there was virtually no international insolvency law at all, despite efforts for many decades to develop such a regime. The entire structure that we have today is less than twenty years old. The structure put in place beginning in 1996 has been a major accomplishment with respect to coordinating international insolvency cases. It has been utilized in cases large and small, including the largest international insolvency cases in history. It now needs improvement to make it even more effective.

11 See Proposal, supra note 3, art. 31(1) (requiring the liquidator in the main proceeding and those in secondary proceedings as to the same legal entity to communicate to each other any
Notably, the proposed revision specifies that one form of cooperation between liquidators may be achieved through the use of agreements or protocols. This provision is highly important because it will authorize liquidators to utilize protocols as a method of cooperation.

Second, the proposal would impose an obligation on liquidators to communicate to each other any information that may be relevant to their respective proceedings, to explore the possibilities for restructuring the group, and to coordinate the negotiation of a coordinated restructuring plan where restructuring is possible, and to coordinate the administration and supervision of the affairs of the group members that are subject to insolvency proceedings.

2. Obligations of Courts

---

12 See Proposal, supra note 3, at 9. The language specifying that cooperation “may take the form of agreements or protocols” is misleading to a certain extent. Id. A protocol is a document that typically includes an outline of forms of cooperation and communication between liquidators by specifying manners in which such obligations may be manifested. A protocol typically involves other matters, also, such as allocation of responsibilities between the parties in interest and the courts. See generally, UNCITRAL, UNCITRAL Practice Guide on Insolvency Cross-Border Cooperation, 23-33 (2009), available at http://www.uncitral.org/pdf/english/texts/insolven/Practice_Guide_english.pdf.

13 Protocols have been widely used in common law States between liquidators and other representatives of the insolvency estate. However, none of the States involved has legislation specifically addressing protocols. Because these States have common law legal systems, the use of protocols relies on the typical common law assumption that the parties and the courts both have the power to do anything that is not prohibited by law. This provision will make such authorization explicit in every E.U. country, and especially the civil law countries where the permissibility of a protocol is in doubt.

14 The proposal would condition such communications on the adoption of appropriate arrangements to protect confidential information. See Proposal, supra note 3, art. 42a(2)(b).

15 See id., art. 42a(2). In addition, the proposal would authorize the liquidators to agree to grant “additional powers” to a liquidator appointed in one of the proceedings where permitted by the applicable rules. See id., art. 42(a)(3).
A second set of obligations imposed by the proposed revisions to the Regulation would require the relevant courts, where insolvency proceedings are opened for members of a group of companies, to communicate with each other. It is notable that such communication between the relevant courts would be mandated, not merely authorized.

3. Obligations Between Liquidators and Courts

The proposed revisions to the Regulation would impose a third set of obligations, which would apply between liquidators and courts. The proposal would impose an obligation on each administrator to cooperate and communicate with any court where an insolvency proceeding has either already been opened or where a request for the opening of such a proceeding is pending. Specifically, the proposal would authorize such a liquidator to request information from that court about the relevant proceedings in that court. In addition, the proposal would authorize such a liquidator to request assistance from that court with respect to the proceedings in the liquidator’s home State (where the liquidator has been appointed).

Importantly, each liquidator would be required to cooperate and communicate with the liquidators and the courts with respect to an insolvency case of any other group member, to the extent that such cooperation is appropriate to facilitate the coordination of the proceedings and is not incompatible with applicable rules.

4. Powers of Liquidators and Stay of Proceedings

---

16 See id., art. 42b.

17 See id. The International Insolvency Institute has co-sponsored a set of draft guidelines for carrying out court-to-court communication and cooperation. See Am. L. Inst., Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (2003). In addition, the European Union is expected to open for public comment its own set of guidelines for court-to-court communications in 2014.

18 See Proposal, supra note 3, art. 42c.

19 See id.

20 See id.

21 See id.
In addition to the foregoing obligations that the Commission proposal would impose on liquidators and courts, the proposal also would authorize additional actions by the liquidators and the courts in such related proceedings. The proposal would authorize a relevant liquidator to be heard and to participate in any proceedings for any other member of the group of companies (including attend creditors’ meetings), and to request a stay of such proceedings. In addition, a liquidator appointed for any such group member would be authorized to propose a rescue or reorganization plan for all or some of the members who are the subject of insolvency proceedings, and to introduce it in the proceedings for each of the affected entities.

Furthermore, the imposition of a stay of the insolvency proceedings for another member of the group of companies would be mandatory if it is proven (by the liquidator requesting the stay or by any other party) that it would be “to the benefit of the creditors in those proceedings.” Any such stay would be subject to the same qualifications as the Regulation now imposes for granting a stay of secondary proceedings: it may only be issued for three months at a time, and the court may require the liquidator to guarantee the interests of the creditors in that proceeding.

B. Additional Measures Needed for Groups of Companies

A more ambitious project is needed for the effective coordination of insolvency cases for groups of companies and their members, in addition to the measures proposed by the Commission (which are a good start). The commencement of individual insolvency cases for group members in a variety of States frequently results in a lack of coordination, and their liquidators often work at cross purposes, resulting in a substantial loss of value for creditors. The Lehman Brothers cases constitute a prime example of this problem.

22 See id., art. 42d(1).
23 See id.
24 See id., art. 42(d)(2).
25 See id.; cf. Regulation, art. 33(1).
26 In the United States, for example, shareholders frequently retain an interest in a chapter 11 debtor (usually quite small), even though creditors may not be paid in full, because the creditors have consented by approving a chapter 11 plan.
To resolve this problem, two more parts to the international insolvency regime are needed. First, the Regulation should provide for a single E.U. venue for the commencement of all of the insolvency cases for all the members of a group of companies. Adequate coordination is unlikely so long as the insolvency cases of different group members are commenced in different States. A single venue would greatly promote the coordination and communication that is essential to the efficient management of the cases for the entire enterprise group. It would also facilitate the appointment of common office holders, where appropriate, for the group members that are the subject of insolvency proceedings.

The Regulation should also provide for an umbrella insolvency group case for all of the group members, which would be strongly coordinated with the insolvency cases of the individual member entities. Better integration of the respective insolvency cases is needed to provide an efficient mechanism to deal with insolvencies of members of groups of companies under E.U. law. A group center of main interests (enterprise group COMI, or ECOMI) should be authorized, where an umbrella insolvency case can be

---

27 Some members of the group of companies may have sufficient financial resources and business that they do not need insolvency proceedings. They will not be included in the group insolvency proceedings.

28 In some circumstances it may be important for the ECOMI court to permit the commencement of a separate insolvency case in another State, where the COMI of a particular group member is located. For example, it may be important for regulatory purposes for the insolvency case of a group member to be commenced in its COMI State. However, the separate interests of the creditors for a particular entity can be protected by maintaining the segregation of that entity’s assets and making distributions therefrom based on the priorities provided in the law of that entity’s COMI.

29 This recommendation is similar in many respects to the INSOL Europe recommendation for a European Rescue Plan. My proposal differs in that it provides for a single venue for the filing of all of the related cases, and for a common venue for the processing of the cases from beginning to end, subject to qualifications specified infra. See infra text at notes 28-33. See, also, Jean-Luc Vallens, Reform of the European Insolvency Regulation on Cross-Border Insolvency Proceedings: A French Point of View, available at http://www.insol-europe.org/download/file_4876, ¶ 14 (suggesting that the ECOMI be determine by the location where the strategic commercial decisions are made concerning the subsidiaries).

commenced or opened to coordinate all of the insolvency cases of the member entities of the group.\textsuperscript{31}

Analogous to the COMI, the ECOMI State should be the State where the center of main interests of the enterprise group is located, as viewed by creditors and other parties in interest. The proper venue for an ECOMI insolvency case is the State where the ECOMI is located.\textsuperscript{32} This should also be the State where an insolvency case for any member of the group of companies at issue should presumptively be commenced.\textsuperscript{33}

All such cases should be assigned to a single judge in a particular court in the ECOMI State for administration and supervision. Once an ECOMI case has been commenced, the law should provide that no insolvency case for any member of the group may be commenced in any other State, except with the permission of the ECOMI court.

Such an umbrella insolvency proceeding would facilitate addressing the issues common to the various insolvency cases for the group members, would simplify procedures for addressing common issues, and would avoid the necessity of keeping separate records for each of the entities on these matters. Without a common umbrella case, for example, it would likely be necessary for the separate file for each entity to contain a duplicate record of the common issues proceedings.

Notably, procedures for coordinating insolvency cases for the members of a group of companies already exist in certain E.U. States.\textsuperscript{34} Where the COMI for each entity is located in the same State, this procedure is frequently used and is consistent with the creation of an "umbrella" court that can address the common issues for the entire group.

\textsuperscript{31} While I think that there should also be individual insolvency cases for each of the legal entities, they should be jointly administered in a single court, and perhaps with a joint liquidator for all of the insolvent members.

\textsuperscript{32} One proposal is to locate the ECOMI in the State where the ultimate parent of the group of companies is located. \textit{See e.g.}, Robert van Galen, \textsc{Corporate Rescue} 38-41 (2013)(describing and criticizing this approach).

\textsuperscript{33} It is important to provide procedures for the protection of the rights of the creditors and other parties in interest of the separate entities within the group. Thus, this procedure should not amount to the substantive consolidation or pooling of all of the entities in a single administration (which is the insolvency law equivalent of corporate merger).

with the present Regulation.\textsuperscript{35} However, a much broader procedure is needed, which permits the filing of these insolvency cases in the same State even where their COMI's are located in different States.

Much more extensive use of choice of law rules will be required for a regime providing for the commencement of insolvency cases for all of the group members, including those whose registered office is located elsewhere, in the same State. The traditional rule of \textit{lex concursus}\textsuperscript{36} for an insolvency proceeding will have to recognize many more exceptions beyond those already incorporated into the Regulation.\textsuperscript{37} A variety of issues should typically be governed by the law of the COMI for each individual entity, such as determining the validity of claims, exercising of avoidance actions, and the applying distributional priority among creditors. On the other hand, the procedural rules of the forum State should generally apply to all of the cases for the group members, including the procedures for opening a case, the administration of the insolvency estate (including the appointment of liquidators and the powers that they may exercise), the manner of proving claims (which will be facilitated by the adoption of an E.U. claim form),\textsuperscript{38} the deadline for lodging claims, and the proposing and approval of a reorganization plan (whether joint or separate) for each entity.

In some circumstances, it may be appropriate to commence a secondary proceeding for a particular member of a corporate group in the State of its own COMI. However, this should be permitted only with the authorization of the court where the ECOMI case is pending, and subject to conditions imposed by that court. The special accommodation in the present version of the Regulation, giving a right to open secondary proceedings that take priority in a particular State, is an accommodation to territorial interests that should no longer be protected in an era of an integrated international economic system.

This proposal will require additional education of judges in the insolvency law of other E.U. States. While this was difficult to image several decades ago when the structure of the Regulation was formulated, it is no longer unreasonable to expect a

\textsuperscript{35} The Commission report notes this practice and states that it does not propose to change it. \textit{See Proposal, supra} note 3, at 10.

\textsuperscript{36} \textit{See} Regulation, art. 4.

\textsuperscript{37} \textit{See id.}, arts. 5-14 (providing choice of law rules for a variety of creditors and assets).

\textsuperscript{38} \textit{See Proposal, supra} note 3, art. 40.
judge to understand and apply the insolvency law of another E.U. State in a particular case. The insolvency systems of the various E.U. States are not so obscure and complex that a judge cannot be educated to understand how the insolvency law of another E.U. State should apply in a particular circumstance. There has been a substantial approximation of the insolvency laws of the various E.U. members in recent years. In addition, all are based substantially on only three models: the French, the German and the UK insolvency laws. 39

III. Coordination with Insolvency Cases Outside the European Union – Adoption of the UNCITRAL Model Law

The Regulation is presently limited to an entity whose main proceedings 40 and secondary proceedings 41 are opened only within the geographical limits of the European Union, 42 and does not provide in any respect for main or secondary proceedings commenced elsewhere. Thus, the Regulation makes no provision for a court in an E.U. State to grant recognition or to provide cooperation, coordination or communication respecting an insolvency proceeding (whether main or secondary) pending outside the European Union, even where there are assets located in an E.U. State or there is some other connection between the non-E.U. main proceeding and a judicial proceeding in an E.U. State. In addition, there is no provision in the Regulation for insolvency

39 Indeed, throughout the entire world, all insolvency systems are based on one of these three systems or the U.S. system. With a knowledge of these four systems, understanding the insolvency laws of a particular county consists principally in learning the details of how its law differs in its details from the model on which it is based.

40 “Main proceeding” is a term introduced into the legal lexicon by the Regulation. It is defined as an insolvency proceeding commenced in the State where the debtor’s center of main interests is located. See Regulation, arts. 3(1) & 27. The term was soon adopted by the UNCITRAL Model Law. See Model Law, supra note 8, arts. 2(a) & (b) (defining “foreign proceeding” and “foreign main proceeding”).

41 “Secondary proceeding” is also a new term introduced into the legal lexicon by the Regulation. It is defined as an insolvency proceeding as to a debtor in a State other than that where the COMI is located, where the debtor maintains an “establishment.” Regulation, Arts. 3(2) & 27. An establishment is “any place of operations where the debtor carries out a non-transitory economic activity with human means and goods. Regulation, art. 2(6). The Model Law adopts essentially the same concept, but calls it a “non-main proceeding.” See Model Law, supra note 8, art. 2(c).

42 Perhaps this restriction was adopted to permit the development of experience on the coordination of domestic (to the European Union) cases before launching on the more difficult project of coordinating them with non-European Union cases.
proceedings located entirely within the European Union, if the debtor’s COMI is located outside the European Union. The proposed revisions fail to address these shortcomings.  

The Regulation should adopt the UNCITRAL Model Law for application to transnational insolvency cases that are not covered by the Regulation. The Model Law is the international standard for a structure for the coordination of insolvency cases outside of the European Union. It has been adopted in more than twenty countries and has been applied by courts in many major trading countries. Its provisions have been litigated in many courts and have given rise to substantial case law and commentary. This makes it a generally well-known structure for the coordination of international insolvency cases.

---

43 See Samuel L. Bufford, Revision of the European Union Regulation on Insolvency Proceedings -- Recommendations, 3 INT'L INSOLVENCY L. REV. 341 (2012) (recommending that the Regulation be amended to include provisions on these issues).

44 See generally Model Law, supra note 8.

45 I do not advocate that, for E.U. insolvency cases, the Model Law be adopted in place of the Regulation. The Regulation has features, not found in the Model Law, that make it more effective, such as the automatic recognition of judgments opening insolvency cases in other E.U. States and the specification of exceptions to the lex fori rule. The proposed revisions to the Regulation adopt many of the more developed provisions in the Model Law, such as greater requirements for communication and cooperation. Neither instrument yet provides for insolvency cases for groups of companies.

46 For a list of countries that have adopted the Model Law, see UNCITRAL.org/english/UNCITRAL Texts and Status/Insolvency/UNCITRAL Model Law on Cross-Border Insolvency (1997)/Status.html.

47 Several E.U. countries have adopted the Model Law on their own to provide for the coordination of international insolvency cases involving countries outside the European Union. These countries include the United Kingdom, Spain, Poland, Romania, Serbia and Montenegro. Germany has adopted its own separate provisions for international coordination of insolvency cases. See InsO (Ger.), §§ 343-358 (2012). The remaining EU countries have no law for the recognition of a non-EU insolvency case or for coordinating insolvency proceedings under their own laws with non-EU insolvency proceedings.

48 The adoption of the UNCITRAL Model Law on Cross-Border Insolvency provides only a partial solution to the problem of coordinating transnational insolvency cases involving proceedings both inside and outside the European Union. The Model Law itself is based on the same assumption as the Regulation, that the coordination is needed for insolvency proceedings for a single legal entity. A discussion of these issues is beyond the scope of this paper.

49 With the adoption of the Model Law, the Regulation would also have to provide that the Model Law does not apply with respect to matters governed by the Regulation.
IV. Conclusion.

Insolvency law deals with economic interests, which lies at the heart of European integration in the European Union. Union-wide economic integration is largely a product of the European Union itself, as it has evolved since its formation more than six decades ago. Economic interests do not differ substantially from State to State in the world economic order in which we now live. Thus the development of an E.U. order for dealing with economic distress and failure is an essential piece of the international economic order that the European Union has created. The proposals in this paper will be an important step in facilitating this integration of the systems for economic distress and failure.

This proposal will also further promote the goals of insolvency law:50 preserving economic value in the difficult circumstances that arise in this context; providing clarity and predictability in the international insolvency system; promoting equality of distribution to creditors similarly situated; providing procedural fairness to all creditors, and especially those from other Member States; protecting employment; and at the same time respecting the separateness of individual legal entities.

50 See, e.g., Bufford, supra note 9, at 692-98 (elaborating on the international goals of insolvency law); see also LEGISLATIVE GUIDE, supra note 9, 9-16. The Legislative Guide states several additional goals that apply to international insolvency law generally, and perforce to the insolvencies of enterprise groups: striking a balance between liquidation and reorganization; providing timely, efficient and impartial resolution of insolvency; preserving the insolvency estate to permit equitable distribution to creditors; and recognizing existing the rights of existing creditors and establishing clear rules for the ranking of creditors. See id. at 14. See also Irit Mevorach, Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency, 18 CARDOZO J. INT’L & COMP. L. 359, 370-73 (2010).