A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond

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Abstract

This paper critically reviews the EU Commission's proposals for a reform of the European Insolvency Regulation (EIR). The focus of the paper is on the Regulation's use as a tool for business restructuring in Europe. The paper argues that the Commission's proposals are not based on sound regulatory objectives. Contrary to the Commission's opinion, preserving businesses is not an end in itself. Further, the Commission is too cautious regarding the harmonisation of substantive insolvency laws of the Member States. The scope of the EIR should be restricted to (fully) collective proceedings. The 'Centre of Main Interests' concept should be substituted by the registered office of a company. Universalism remains on the reform agenda in the long run. Finally, procedural consolidation is more efficient than procedural coordination in a group setting.

Keywords: European Insolvency Regulation, Business Restructuring, Harmonisation of Insolvency Laws, Scope of the European Insolvency Regulation, Forum Shopping, Centre of Main Interests, Multiplicity of Proceedings, Coordination of Proceedings, Corporate Groups

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A NEW FRAMEWORK FOR BUSINESS RESTRUCTURING IN EUROPE: THE EU COMMISSION'S PROPOSALS FOR A REFORM OF THE EUROPEAN INSOLVENCY REGULATION AND BEYOND[*]

HORST EIDENMÜLLER[**]

ABSTRACT

This paper critically reviews the EU Commission's proposals for a reform of the European Insolvency Regulation (EIR). The focus of the paper is on the Regulation's use as a tool for business restructuring in Europe. The paper argues that the Commission's proposals are not based on sound regulatory objectives. Contrary to the Commission's opinion, preserving businesses is not an end in itself. Further, the Commission is too cautious regarding the harmonisation of substantive insolvency laws of the Member States. The scope of the EIR should be restricted to (fully) collective proceedings. The 'Centre of Main Interests' concept should be substituted by the registered office of a company. Universalism remains on the reform agenda in the long run. Finally, procedural consolidation is more efficient than procedural coordination in a group setting.

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§1. INTRODUCTION

It is now more than 10 years since the European Insolvency Regulation (EIR) entered into force. The EIR provided, for the first time, a governance framework for cross-border insolvencies in Europe.[1] Its guiding principle can be termed 'modified universalism': main insolvency proceedings are administered in the Member State (MS) in which the debtor's Centre of Main Interests (COMI) is located; territorial proceedings – independent and secondary – can take place in all MS in which the debtor has an establishment. Insolvency proceedings are subject to the principle of *lex fori concursus*; yet, there are important exceptions to this principle. Finally, the opening of insolvency proceedings and other decisions taken in the course of such proceedings are automatically recognised in all other MS.

According to Article 46 of the EIR, the EU Commission is charged with presenting a report on the EIR's application no later than 1 June 2012 and every five years thereafter. The report shall be accompanied, if need be, by a proposal for adaptation of the Regulation. The Commission presented its report on 12 December 2012.[2] On the same date, it proposed a regulation amending the EIR.[3] The Commission's amendment proposal must be seen against the backdrop of its views

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1 Scholarly debate has focused on the question over whether the EIR only regulates intra-community cross-border insolvency issues, or whether it also governs the relationship of European Member States to non-European states. The Virgos/Schmit report on the multinational insolvency treaty that preceded the EIR – the treaty never entered into force – clearly states that non-European states do not fall within the scope of the treaty. See Virgos/Schmit, 'Erläuternder Bericht zu dem EU-Übereinkommen über Insolvenzverfahren', in Stoll (ed.), Vorschläge und Gutachten zur Umsetzung des EU-Übereinkommens über Insolvenzverfahren im deutschen Recht (Mohr Siebeck, Tübingen, 1997), 32, 38. See also Eidenmüller, 'Europäische Verordnung über Insolvenzverfahren und zukünftiges deutsches internationales Insolvenzrecht', 21 (2001) *Praxis des Internationalen Privat- und Verfahrensrechts (IPRax)*, 2, 4 with further references.

2 Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the application of Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings, COM(2012) 743 final.

3 Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings, COM(2012) 744 final. See also Commission Staff Working Document, Impact Assessment, Accompanying the document Revision of Regulation (EC) No 1346/2000 on insolvency proceedings, SWD(2012) 416 final; Commission Staff Working Document, Executive Summary of the Impact Assessment, Accompanying the document Revision of Regulation (EC) No 1346/2000 on insolvency proceedings, SWD(2012) 417 final.

on how to approach future business failures and insolvencies in Europe.[4] The Commission's views on this issue, in turn, are part of its Entrepreneurship 2020 Action Plan, which was published on 9 January 2013.[5]

The Commission's amendment proposal is a carefully drafted and well reasoned document. As such, it compares favourably with the Commission's slim Company Law Action Plan that was also published on 12 December 2012.[6] Based on sound research and public consultations, and assisted by the advice of an expert group, the report on the EIR's application starts out by stating that '... the Regulation is generally regarded as a successful instrument for the coordination of cross-border insolvency proceedings in the Union.'[7] Most observers probably would agree with this assessment. The governance framework established by the EIR for cross-border insolvencies represented a positive step forward compared to the *status quo ante*, and, in practice, it has worked reasonably well. Legal uncertainty associated with the COMI concept enshrined in Article 3(1) EIR has been reduced, if not resolved completely, by a series of important judgments rendered by the European Court of Justice (ECJ).[8] Restructuring practice has crafted some remarkably innovative tools to assist global restructurings. An example is a 'synthetic secondary proceeding', which avoids the formal opening of such a proceeding by promising local creditors that they will not fare worse than if a 'real secondary proceeding' had been opened.[9] Courts across Europe have accumulated expertise in handling a regulatory framework that, when it entered into force in

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4 See Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: A new European approach to business failure and insolvency, COM(2012) 742 final. This document also dates from 12 December 2012.

5 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Entrepreneurship 2020 Action Plan – Reigniting the entrepreneurial spirit in Europe, COM(2012) 795 final.

6 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, COM(2012) 740/2. In fairness to the Commission, it must be said that the Company Law Action Plan is a political document and not a specific legislative proposal. Specific and well-reasoned proposals will hopefully follow.

7 COM(2012) 743 final, 4.

8 Case C-341/04, *Eurofood IFSC Ltd,* [2006] ECR I-3813; Case C-396/09, *Interedil*, 14 (2011) *Neue Zeitschrift für das Recht der Insolvenz und Sanierung* (*NZI*), 990; Case C-191/10, *Rastelli Davide*, 15 (2012) *NZI*, 147.

9 High Court of England and Wales (Ch), *Collins & Aikman*, (2006) EWHC 1343; Amtsgericht Köln (Court of first instance Cologne), 8 (2005) *NZI*, 564.

2002, required courts to apply rules and concepts novel to the jurisprudence and insolvency practices in many MS.

However, the assessment that the EIR is generally regarded to be a successful instrument does not lead the Commission to conclude that nothing could or should be changed. There is always room for improvement. In its amendment proposal, the Commission identifies, in particular, the following areas, which, in its view, require change:[10] (1) First, the Commission is of the view that the scope of the EIR should be extended. It is suggested that such an extended scope would include, *inter alia*, pre-insolvency and what the Commission calls 'hybrid' proceedings (revised Article 1 EIR). (2) Second, the Commission believes that the COMI concept has worked reasonably well. However, it suggests that the jurisdiction rules of the EIR should be clarified and the procedural framework for determining jurisdiction improved. Hence, the Commission suggests revisisions to the EIR in order that the COMI concept be detailed on the basis of the existing ECJ jurisprudence (revised Article 2 (1) EIR). Further, MS' courts ceased of a request to open insolvency proceedings shall be put under a duty to examine *ex officio* whether they have jurisdiction (new Article 3b (1) EIR). (3) Third, the Commission believes that the negative effect of secondary proceedings on the efficient administration of insolvency proceedings should be mitigated. In particular, the Commission suggests that courts be permitted to refuse the opening of secondary proceedings if this is not necessary to protect the interests of local creditors ('synthetic secondary proceedings', revised Article 18 (1) and new Article 29a (2) EIR); also, the cooperation requirements are extended to the courts involved (new Articles 31a and 31b EIR). (4) Fourth, the Commission is of the opinion that the publicity of proceedings should be enhanced and the procedure for the lodging of claims improved. Hence, it is suggested that MS be required to publish the relevant court decisions in cross-border insolvency cases in a publicly accessible electronic register that is interconnected with the registers of other MS (new Articles 20a, 20b, 20c and 20d and revised Articles 21 and 22 EIR). In addition, the Commission suggests that standard forms for the lodging of claims be introduced (revised Article 41 EIR). (5) Fifth and finally, the EIR currently does not include rules on multiple insolvency proceedings relating to different members of the same group of companies. The Commission proposes to enhance the coordination of such proceedings by proposing, *inter alia*, that the liquidators and

[10] COM(2012) 744 final, 5 et seq.

courts involved in the different main proceedings must cooperate and communicate with each other (new Articles 42a, 42b and 42c EIR). Further, the Commission proposes to give the liquidators involved in such proceedings the procedural tools to request a stay of the other respective proceedings and to propose a rescue plan for the members of the group that are subject to insolvency proceedings (new Article 42d EIR).

In the following sections, I will critically review the Commission's proposals. My focus will be on *corporate insolvencies* because these are central to the Commission's proposals and its broader policy agenda of enhancing entrepreneurship in the EU. In §2 I will examine the regulatory objectives pursued by the Commission, and in §3 the regulatory roadmap that it proposes. §4 will address the envisaged reform of the scope of the EIR. §5 will examine forum shopping and the COMI concept, and §6 the multiplicity of – main and secondary – proceedings and their coordination. In a final section, I will analyse the insolvency treatment proposed by the Commission for corporate groups (§7). §8 will summarise the main findings of this essay.

§2. REGULATORY OBJECTIVES

A business in financial distress should be kept alive only if it is economically viable. A business is in financial distress if it is insolvent on a balance sheet or cash flow basis. It is economically viable if its going concern value exceeds its liquidation value. These statements all are received wisdom in bankruptcy scholarship.[11] Based on these criteria, the overwhelming majority of businesses in financial distress should be liquidated. This is also true in a cross-border context. To be sure, businesses who engage in cross-border activities tend to be larger, and it might be suggested that larger businesses in financial distress exhibit a higher likelihood of their going concern value exceeding their liquidation value. However, we do not have empirical evidence to support this proposition. Moreover, the evidence we do have suggests that, also in the cross-border context, the overwhelming majority (~

[11] See, for example, Eidenmüller, 'Trading in Times of Crisis', 7 (2006) *European Business Organization Law Review* (*EBOR*) 239, 241.

90%) of businesses in financial distress should be liquidated and not saved and restructured.[12]

The EU Commission clearly is of a different opinion, however. For example, the Staff Working Document accompanying the reform proposals presents the advantages of business rescue in an unconditional and unqualified way as if these advantages could be realised in each and every business bankruptcy: 'The benefits of business rescue can be summarized as follows: Maximisation of asset value ... Better recovery rates for creditors ...'.[13]

The lack of proper reflection regarding the regulatory objectives pursued shows also at a different angle of the Commission's proposals. The Commission's communication on 'A new European approach to business failure and insolvency' suggests that national insolvency laws should be approximated, for example, with respect to the rules providing a second chance to entrepreneurs. However, this second chance, according to the Commission, should be reserved for entrepreneurs 'in honest bankruptcies'.[14] Distinguishing between 'honest' and 'dishonest' bankruptcies surely would involve a difficult, fact sensitive inquiry in practice. But my concern here is of a different character. The Commission's proposed distinction is aimed at deciding who should get a second chance as a business person, and who might get state support for such a chance. With respect to this issue, the proposed distinction arguably is a meaningful one. However, portions of the Commission's communication suggest that it contemplates a much broader application of the proposed distinction: 'Action could be taken to differentiate more between honest and dishonest bankruptcies.'[15] This could be interpreted to suggest that, in the Commission's view, the rescue/liquidation decision also should depend on whether the bankruptcy is 'honest' or 'dishonest'. However, for that decision, the suggested distinction is completely irrelevant. The rescue/liquidation decision should be taken solely on the basis of the relationship between the going concern value of a business and its liquidation value.

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[12] See, for example, the data on insolvencies and liquidations provided by the Amadeus database: https://amadeus.bvdinfo.com/version-2013228/home.serv?product=amadeusneo (last visited 5 March 2013), as well as (for Germany) the most recent data provided by 16 (2013) *Zeitschrift für das gesamte Insolvenzrecht* (*ZInsO*), Issues No 4-9, Beihefter Insolvenzreport.

[13] SWD(2012) 416 final, 11.

[14] COM(2012) 742 final, 5.

[15] COM(2012) 742 final, 5.

In conclusion, it appears that the Commission's proposals are not based on sound regulatory objectives. The Commission appears to lack a precise and economically well-founded view as to when a business in financial distress should be kept alive and restructured. Moreover, the Commission suffers from a misguided 'restructuring euphoria' that is not supported by the data on business failure. This data suggests that the overwhelming majority of businesses in financial distress should be liquidated instead of being kept alive and restructured.

§3. REGULATORY ROAD MAP

The Commission's focus clearly is to update the existing EIR framework. In the previously mentioned communication on 'A new European approach to business failure and insolvency', the Commission considers various areas in which, in its view, some harmonisation of the substantive insolvency laws of the MS could produce benefits.[16] These areas consist of the second chance for entrepreneurs in 'honest' bankruptcies (just discussed), shorter discharge periods that encourage a second chance, a harmonisation of the rules on the opening of (insolvency) proceedings, rights of creditors to initiate insolvency proceedings, the procedures in place to file and verify claims, and the promotion of restructuring plans. The Commission expresses a certain sympathy for pursuing the path of harmonisation as advocated by the European Parliament.[17] Ultimately, however, the Commission believes that the time is not ripe for such a step. In its view, more comparative analysis is needed in order to prepare the ground for harmonising substantive insolvency laws of the MS: 'The approximation of national insolvency laws and procedures would ... require an in-depth comparative-law analysis of national insolvency laws and procedures which would enable the Commission to identify the precise areas in which procedural harmonisation would be necessary and feasible, and not too intrusive to the national legislations and insolvency systems.'[18]

Clearly, the more that sound comparative analysis could inspire harmonisation efforts, the better. However, it seems that the Commission overstates the lack of existing scholarship that can be used to guide sensible harmonisation measures. In

[16] See COM(2012) 742 final, 5 et seq.
[17] Resolution of the European Parliament, 15/11/2011, Document 2001/2006(INI).
[18] SWD(2012) 416 final, 44.

fact, much progress has been made in this respect during the last decade.[19] It appears that it is instead the anticipated political difficulties in getting the MS to negotiate on crucial harmonisation measures that has contributed to the Commission's reluctance to pursue harmonisation now, rather than a real lack of relevant scholarship. This is all the more unfortunate because there are certain issues where harmonisation measures of the EU are clearly necessary for the efficient administration of cross-border insolvencies. To mention just two such issues:

First, rescue or restructuring efforts should be undertaken as early as possible in order to save the greatest possible going concern value.[20] The Commission rightly points out that as between MS there currently are significant differences regarding the deadlines a debtor must meet when the opening of insolvency proceedings is mandatory.[21] However, the issue of a timely triggering of rescue or restructuring efforts is one that arises much earlier than the filing duties of which the Commission speaks. In order to get a corporation's management to undertake rescue or restructuring efforts early on, proper incentives must be in place. Such incentives can come in the form of liability rules. An example would be the wrongful trading remedy enshrined in Section 214 of the UK Insolvency Act 1986. A good case can be made for harmonising MS' national insolvency laws along these lines. The current diversity regarding liability rules in the various European jurisdictions provides strong incentives for the management of distressed companies to forum shop for a bankruptcy venue that would allow them to duck personal liability.[22] The Commission should be reminded of the 2003 Company Law Action Plan in which a harmonised European wrongful trading remedy was already contemplated.[23]

Second, an issue of paramount importance for the financing of businesses and restructuring efforts is the body of rules on security interests in moveable property. The Commission's considerations have completely neglected to account for this

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[19] See, for example, Eidenmüller and Kieninger (eds.) *The Future of Secured Credit in Europe* (De Gruyter, Berlin, 2008); Wood, *Maps of World Financial Law* (6th ed., Sweet & Maxwell, London, 2008); Wood, *Principles of International Insolvency* (2nd ed., Sweet & Maxwell, London, 2007); Westbrook et. al., *A Global View of Business Insolvency Systems* (World Bank, 2010); McBryde et al. (eds.), *Principles of European Insolvency Law* (Kluwer, London, 2005); Goode, *Principles of Corporate Insolvency Law* (4th ed., Sweet & Maxwell, London, 2011); Brouwer, 'Reorganization in US and European Bankruptcy Law', 22 (2006) *European Journal of Law and Economics* 5.

[20] Eidenmüller, 'Trading in Times of Crisis', 7 (2006) *EBOR* 239, 241, 244 et seq.

[21] COM(2012) 742 final, 6.

[22] See Eidenmüller, 'Trading in Times of Crisis', 7 (2006) *EBOR* 239, 244 et seq.

[23] COM(2003) 284 final, 16.

critical issue. The existence of such an interest should not depend on where the property is located. However, this is precisely the consequence of the *situs rule* that determines the applicable substantive law with respect to security interests under the private international rule systems of practically all MS. To reduce the cost of credit, uniform rules on a European security interest in moveable property are clearly needed.[24]

According to their own terms, the reform proposals of the Commission for the procedural framework established by the EIR would apply only two years after the reform regulation has entered into force. This date is many years from now. Viewed in this light, the call for greater comparative analysis to ground any harmonisation efforts regarding the substantive insolvency laws of the MS should be seen as what it is: We cannot expect such reforms to come in the decade. This is regrettable. The Commission is far too cautious regarding the harmonisation of substantive insolvency laws of the MS given the urgent need for such reforms in certain areas. Two such issues have been mentioned.

§4. SCOPE OF THE EIR

In the last five years, the scope of the EIR has moved to the center stage of reform discussions, along with the issue of forum shopping (addressed in a later section). The reform debate concerns, first, the application of Article 1 EIR and Annex A as they stand. More specifically, the relationship between the criteria enshrined in Article 1 and a listing in Annex A must be considered unresolved.[25] Second, the insolvency laws of the MS' and restructuring practice have given certain proceedings much more weight than they had at the time when the EIR was originally negotiated and finalised: This is the case especially with respect to proceedings that do *not* lead to the appointment of a liquidator (cf. Article 1 (1) EIR) and are purely debtor-in-possession (DIP) proceedings. In addition, currently outside the scope of

[24] See Eidenmüller, 'Secured Creditors in Insolvency Proceedings', in Eidenmüller and Kieninger (eds.), *The Future of Secured Credit in Europe* (De Gruyter, Berlin, 2008), 273, 281 et seq.

[25] See Hess et al., *External Evaluation of Regulation (EC) No 1346/2000 on Insolvency Proceedings*, http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf, 36 et seq. The ECJ seems to take the position that a listing in Annex A conclusively establishes that a proceeding falls within the scope of the EIR, see Case C-116/11, *Handlowy*, 32 (2012) *Zeitschrift für Wirtschaftsrecht* (*ZIP*), 2403, 2404.

the EIR are pre-insolvency proceedings that attempt to resolve financial difficulties of a debtor (long) before financial distress becomes acute on the basis of a debtor's cash flow or balance sheet. A good example of a pre-insolvency DIP proceeding is the UK Scheme of Arrangement, which is regulated by Sections 895 – 901 of the Companies Act 2006. Much scholarly controversy currently focuses on the question concerning the circumstances under which English courts have jurisdiction to sanction a scheme affecting a debtor company that has its registered office outside the UK. A related question concerns the circumstances under which other MS may (or must) recognise the effects of such a scheme.[26] It has been argued that, under the Brussels I-Regulation,[27] English courts have jurisdiction to administer a scheme over the assets of a company having its registered office in another MS only with respect to claims that contain a choice of jurisdiction clause pointing to the UK.[28] Further, it has been argued that only claims that are governed by English law may be subject to a scheme.[29]

Against this background, the Commission proposes a significant expansion of the scope of the EIR (revised Article 1 EIR). More specifically, the Commission proposes that pre-insolvency and so-called 'hybrid proceedings' (a term used by the Commission for DIP proceedings) should be included within the scope of the EIR. The Commission's main justification for this move is that only with such a framework could a universal recognition of the effects of such proceedings throughout the EU be achieved and the hold-out problem mitigated.[30] The latter problem refers to the strategic incentive of creditors in restructurings to hold back cooperation, i.e., insist on full payment or hold-out, relying on all the others to make

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[26] High Court of England and Wales (Ch), *Rodenstock*, (2011) EWHC 1104; High Court of England and Wales (Ch), *Tele Columbus*, (2010) EWHC 1944; Bundesgerichtshof (Federal Supreme Court of Germany), *Equitable Life*, 15 (2012) *NZI*, 425; Eidenmüller/Frobenius, 'Die internationale Reichweite eines englischen Scheme of Arrangement', 65 (2011) *Wertpapiermitteilungen* (*WM*), 1210; Mankowski, 'Anerkennung englischer Solvent Schemes of Arrangement in Deutschland', 66 (2012) *WM*, 1201; Paulus, 'Das englische Scheme of Arrangement – ein neues Angebot auf dem europäischen Markt für außergerichtliche Restrukturierungen', 31 (2011) *Zeitschrift für Wirtschaftsrecht* (*ZIP*), 1077.

[27] Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, O.J. L12, 16/01/2001, 1-23.

[28] Eidenmüller and Frobenius, 'Die internationale Reichweite eines englischen Scheme of Arrangement', 65 (2011) *WM*, 1210, 1213 et seq.

[29] Eidenmüller and Frobenius, 'Die internationale Reichweite eines englischen Scheme of Arrangement', 65 (2011) *WM*, 1210, 1213.

[30] COM(2012) 743 final, 6.

the necessary concessions.[31] The Commission also seeks to clarify the relationship between Article 1 EIR and its Annex A. It rightly considers it unfortunate that there currently are conceivable situations (that have even become realities) in which proceedings listed in Annex A do not satisfy the material criteria provided in Article 1 (1) EIR.[32] To solve this problem, the Commission suggests a new wording for Article 1 (1) EIR that would clearly indicate that a listing in Annex A would be sufficient to bring a proceeding within the scope of the EIR. At the same time, the Commission wishes to ensure that only those proceedings that fulfil the material criteria enshrined in Article 1 (1) EIR should make it into Annex A. To this end, the Commission proposes a revised Article 45 (2) EIR that reads as follows: 'In order to trigger an amendment of Annex A, Member States shall notify the Commission of their national rules on insolvency proceedings which they want to have included in Annex A, accompanied by a short description. The Commission shall examine whether the notified rules comply with the condition set out in Article 1 and, where this is the case, shall amend Annex A by way of delegated act.'

The Commission's plan to extend the scope of the EIR is problematic for various reasons. First, as a purely practical matter, the Commission probably has overlooked the fact that by giving a MS the initiative to include a particular proceeding in Annex A under the revised Article 45 (2), MS might refrain from pursuing this option if the status quo appears to hold more benefits for them. This might especially be the case with respect to the proceeding of greatest controversy: the UK Scheme of Arrangement. After all, if this proceeding were included in Annex A, forum shoppers could get access to it only if they manufactured a (new) COMI in the UK, and doing this can be very costly. We have empirical evidence that strongly suggests that high costs are a significant factor limiting bankruptcy forum shopping in the EU.[33] Hence, even though a particular pre-insolvency or 'hybrid' proceeding may satisfy the material criteria enshrined in Article 1 (1) revised EIR, it might not fall within its scope because a MS may simply refrain from making an application for such a proceeding to be included in Annex A.

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[31] Eidenmüller, *Unternehmenssanierung zwischen Markt und Gesetz* (Otto Schmidt, Cologne, 1999), 21.

[32] COM(2012) 743 final, 6-7.

[33] Eidenmüller et al., 'Regulierungswettbewerb im Unternehmensinsolvenzrecht', 13 (2010) *NZI*, 545, 547 et seq.

Second, as a matter of legal terminology, 'hybrid' is an odd word for characterizing DIP proceedings. The US Chapter 11, for example, is a paradigmatic DIP proceeding, and no US bankruptcy lawyer would characterise this proceeding other than a bankruptcy proceeding. It surely would surprise an American bankruptcy scholar to learn that Chapter 11 is a 'hybrid' proceeding.

Third, and most importantly, the Commission does not have a concept covering when universal recognition of a proceeding is *justified*, and which proceedings should properly be included within the scope of the EIR. The proposal put forward on 12 December 2012 and the accompanying documents contain many statements displaying the confusion of the Commission as to what justifies including a proceeding within the scope of the EIR. To give just two examples: The Commission alludes to the criterion of confidentiality as one that distinguishes those proceedings that should fall outside the scope of the EIR from those insolvency proceedings that should be covered by it. But private, contractual proceedings are supposed to fall within that scope '... as from the moment [they] become[s] public.'[34] If this were to be taken literally, the test would appear to be nearly impossible to apply in practice. Further, the proposed revised Article 1 EIR retains the criterion of 'collectivity' as an important factor for a proceeding to be included within the scope of the EIR. However, at the same time, the Commission characterizes pre-insolvency proceedings as 'semi-collective' proceedings, and these proceedings, as we already have seen, are suggested to fall within the scope of the EIR.[35] Hence, the relevance of the criterion of 'collectivity' remains ambiguous.

A convincing reform of Article 1 EIR would indeed make the criterion of 'collectivity' the one and only criterion for including a proceeding within the scope of the Regulation. The distinctive feature of insolvency proceedings is that they address a multi-party prisoners' dilemma associated with financial distress: there are not enough assets available to satisfy all creditors' claims, and each creditor has a dominant strategy to seek full payment of his or her claim; this is despite the fact that some cooperative action, for example, a debt rescheduling or a stay on enforcement efforts, would be in the interest of the creditors as a whole.[36] Insolvency

[34] SWD(2012) 416 final, 6.
[35] SWD(2012) 416 final, 48.
[36] Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, Cambridge MA, 1986), 10 et seq.; Eidenmüller, *Unternehmenssanierung zwischen Markt und Gesetz* (Otto Schmidt, Cologne, 1999), 17 et seq.

proceedings impose a 'collective contract' on the creditors that replicates a hypothetical bargain. Given high transaction costs and the strategic incentives for the parties in financial distress, this bargain is usually something that creditors are in no position to conclude ad hoc. Hence, only 'fully' collective proceedings should be considered to be insolvency proceedings within the meaning of Article 1 EIR, and the regulation should be reformed accordingly. Only proceedings that bind *all* creditors of a debtor should justify universal recognition of their effects, which is the consequence of Article 16 EIR. The upshot of this is that proceedings like the UK Scheme of Arrangement would not even be a potential candidate for a proceeding covered by the EIR – regardless of whether the UK initiates its inclusion in Annex A or not.

§5. FORUM SHOPPING / COMI CONCEPT

The topic that has probably received the greatest attention in the first 10 years of the EIR's existence is its rules on international jurisdiction with respect to main insolvency proceedings. According to Article 3 (1) EIR, '[t]he courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or a legal person, the place of the registered office shall be presumed the centre of its main interests in the absence of proof to the contrary.' The COMI concept establishes a fact sensitive test that is difficult to apply in practice. In the early years of the EIR, English courts, in particular, tended to give the COMI concept a fairly broad reading especially in group settings. This broad reading posited that the COMI of a subsidiary could easily be found at the place of the registered office of the holding company.[37] The ECJ, in its jurisprudence on Article 3 (1) EIR,[38] attempted to narrow the scope of Article 3 (1) EIR by focusing on more objective factors discernible by the parties, especially a company's creditors. In doing so, the ECJ could rely on recital 4 of the EIR, which explicitly stipulates as a goal the curtailing

[37] See, for example, High Court of England and Wales (Ch), *Re BRAC Rent-A-Car International Inc,* (2003) 2 All ER 201; High Court of England and Wales (Ch), *Re Daisytek-ISA Ltd and others,* (2004) BPIR 30; High Court of England and Wales (Ch)*, Enron Directo SA* (unreported).

[38] Case C-341/04, *Eurofood IFSC Ltd,* [2006] ECR I-3813; Case C-396/09, *Interedil*, 14 (2011) *NZI*, 990; Case C-191/10, *Rastelli Davide*, 15 (2012) *NZI*, 147.

of incentives for parties to engage in forum shopping. In addition, recital 13 of the EIR establishes an interpretative guideline for the COMI concept, whereby COMI '... should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.'

Despite these judicial attempts to curtail forum shopping, such forum shopping is a ubiquitous phenomenon in European restructuring practice.[39] Scholars continue to debate whether all kinds of forum shopping should be condemned, and whether, and under what conditions, European law should recognize a doctrine of 'abuse of law' that could be applied to disallow (certain) attempts to manufacture a new COMI for the purposes of forum shopping.[40] It has also been suggested that the COMI concept be replaced by a concept that makes the place of a company's registered office the single decisive criterion.[41] Alternatively, it has been suggested that the presumption in favour of the registered office enshrined in Article 3 (1) EIR should be taken more seriously.[42] Such moves would significantly reduce the legal uncertainty currently stemming from the application of the COMI concept. Moreover, if a company's registered office were the single decisive criterion, this would also ensure that main insolvency proceedings would always be tied to a jurisdiction that, under the incorporation doctrine, also provides the company law applicable to the business that finds itself in insolvency proceedings.

The European Commission is aware that forum shopping exists. However, its assessment of forum shopping is biased. Essentially, the Commission attempts to draw a distinction between businesses and individuals. In the assessment of the Commission, forum shopping with respect to businesses is (always) beneficial. The beneficiary of such restructuring forum shopping efforts is the UK. This, so the Commission believes, is because of '... the flexible regime for restructuring companies offered by English law ... [that] attracts companies from other European jurisdictions.'[43] And yet, according to the Commission, forum shopping with respect

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[39] Eidenmüller et al., 'Regulierungswettbewerb im Unternehmensinsolvenzrecht', 13 (2010) *NZI*, 545, 547 et seq.

[40] Eidenmüller, 'Abuse of Law in the Context of European Insolvency Law', *6* (2009) *European Company and Financial Law Review* (*ECFR*) 1; Reuß, 'Taking Creditors for a Ride – Insolvency Forum Shopping and the Abuse of EU Law', 53 (2012) *Seoul Law Journal* 667.

[41] Eidenmüller, 'Free Choice in International Company Insolvency Law in Europe', 6 (2005) *EBOR* 423, 447.

[42] Armour, 'Who Should Make Corporate Law? EC Legislation versus Regulatory Competition', 58 (2005) Current Legal Problems 369, 408.

[43] SWD(2012) 416 final, 21-22.

to individuals is a different matter. Here, the primary beneficiary of insolvency tourism is France. Such insolvency tourism occurs in practice because of the different discharge periods that various European jurisdictions have in their insolvency laws. Forum shopping to obtain a shorter discharge period harms an individual's creditors. According to the Commission, this is a consequence that should be avoided: 'Bankruptcy tourism is problematic ...'.[44]

This simple distinction between 'good business forum shopping' to the UK and 'bad individual forum shopping' to France is overly simplistic. What needs to be examined is not whether forum shopping actions are taken by businesses or individuals. Rather, the decisive factors are the various motives of forum shoppers and the effects of forum shopping actions on the assets available for distribution to the creditors.[45] Forum shopping undertaken to increase the available assets for distribution to creditors is beneficial and should not be sanctioned. By contrast, forum shopping motivated purely by distributive goals and undertaken to increase the asset share for the forum shopper has no value-enhancing effects and is detrimental. Most likely, individual forum shopping, based on these criteria, almost always is undertaken for merely distributive motives. For this reason, it is problematic. Business forum shopping, however, cannot be categorised as 'always beneficial', contrary to what the Commission wants observers to believe. Indeed, there are cases of business forum shopping that are motivated by increasing restructuring value. However, there are also cases where such forum shopping is undertaken not for efficiency reasons but rather to exploit non-adjusting creditors or other third parties. A notable example is the *Brochier* case, which led to a veritable jurisdiction battle between the English and German courts a couple of years ago.[46] In addition, the German Federal Supreme Court has already dealt with a case in which a German limited liability company forum shopped to Spain in order to 'bury' the company there and defraud its creditors.[47] Hence, a better approach to the problem of forum shopping would be to differentiate between different forms of

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[44] SWD(2012) 417 final, 5.

[45] Eidenmüller, 'Abuse of Law in the Context of European Insolvency Law', 6 (2009) *ECFR* 1,10.

[46] High Court of England and Wales (Ch), *Hans Brochier Holdings Ltd v Exner,* (2007) BCC 127 = (2006) EWHC 2594; Amtsgericht Nürnberg (Court of first instance Nuremberg), *Hans Brochier Holdings,* 10 (2007) *NZI*, 185; Amtsgericht Nürnberg, *Hans Brochier Holdings,* 10 (2007) *NZI*, 186.

[47] Bundesgerichtshof (Federal Supreme Court of Germany), 81 (2007) *Die deutsche Rechtsprechung auf dem Gebiete des Internationalen Privatrechts* (*IPRspr*), 722.

forum shopping and, more specifically, between forum shopping undertaken for efficiency purposes and forum shopping undertaken for distributive reasons.

One way of accomplishing this would be to apply an 'abuse of law' doctrine, as previously noted. COMI shifts undertaken for purely distributive reasons could be considered abusive and hence irrelevant for the purposes of establishing international jurisdiction for main insolvency proceedings. An even better approach to address abusive forum shopping would be to replace the COMI concept with the registered office as the single decisive criterion for determining international jurisdiction with respect to main insolvency proceedings, as noted above as well.[48] This solution would not only bring near-absolute certainty to the determination of international jurisdiction. It would also ensure that the company law rules applicable to a specific business and the applicable insolvency rules would always belong to the same jurisdiction. This would considerably ease the handling of insolvency proceedings and avoid unnecessary frictions associated with conflicting insolvency and company law provisions. Finally, the proposed solution would likely eliminate abusive COMI shifts because a change in a company's registered office can, under the existing European legal framework, only be undertaken on the basis of the rules adopted by the MS to implement the 10th company law directive on cross-border mergers.[49] This directive contains important safeguards with respect to the interests of a company's stakeholders, most notably its creditors.[50] Hence, changing the registered office of a company would be possible only by observing certain procedural safeguards that prevent abusive shifts from occurring.

Unfortunately, the Commission does not seek to pursue this route. It suggests that the EU retain the COMI concept, refine it slightly by incorporating major elements of the ECJ jurisprudence in Article 3 (1) EIR, and make the MS' courts examine *ex officio* whether they have jurisdiction pursuant to Article 3 EIR in an international insolvency case (refined Article 3b EIR).[51] For the foregoing reasons,

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[48] Clearly, the proposed solution would be assisted by a European-wide commercial (company) register. However, it also works on the basis of the current system of national registers of the MS.

[49] Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies, O.J. L310, 25/11/2005, 1-9.

[50] See Articles 6 (2) (c) and 7 (1).

[51] The Commission also suggests a new Article 3a EIR, whereby courts of the MS, within which insolvency proceedings have been opened pursuant to Article 3, shall have jurisdiction for any action that derives directly from the insolvency proceedings and is closely linked with such proceedings. This new provision would codify the so-called *vis attractiva concursus* principle. On

this must be viewed as a distinctly second-best approach. The ambiguity and uncertainty associated with the application of the COMI concept in restructuring practice will remain with us in the future. It remains to be seen whether and how the MS' courts respond to abusive COMI shifts through the application of a European doctrine of abuse of law – clearly this would not reduce the uncertainty associated with the COMI concept and may even increase it. Moreover, the Commission's position is contradictory: on the one hand, it praises the COMI concept because it allegedly assures a 'genuine' connection of an insolvency proceeding to a particular jurisdiction.[52] Yet, on the other hand, it praises business forum shopping to the UK. But you cannot have it both ways: The purpose of the COMI concept is to establish a barrier against *all* forms of forum shopping. By contrast, making the registered office the single decisive criterion for determining international jurisdiction with respect to main insolvency proceedings does allow for forum shopping, but it does so only if procedural safeguards regarding the interests of a company's stakeholders are observed.

§6. MULTIPLICITY OF PROCEEDINGS

The fundamental policy issue regarding transnational bankruptcies is the question over whether a universalist or territorialist approach should be adopted. Under universalism, there is just one proceeding over the assets of a debtor with world-wide effect, i.e., regardless of the assets' location. By contrast, territorialism implies a (potential) multiplicity of proceedings in all jurisdictions in which the debtor has assets, with the effect of each proceeding being limited to the respective jurisdictions.[53] On theoretical grounds, universalism is supported by much stronger (economic) arguments: it is associated with lower transaction costs, it facilitates restructurings, it prevents an international asset race, and it does not skew

this issue, see Prager/Keller, 'Der Vorschlag der Europäischen Kommission zur Reform der EuInsVO', 16 (2013) *NZI*, 57, 59 et seq.

[52] SWD(2012) 416 final, 19.

[53] McCormack, 'Universalism in Insolvency Proceedings and the Common Law', 32 (2012) *Oxford Journal of Legal Studies* (*OJLS*) 325, 327; Franken, 'Cross-Border Insolvency Law: A Comparative Institutional Analysis', http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2047399 (last visited 5 March 2013).

investment decisions.[54] In comparison to these advantages, the fact that universalism burdens creditors to pursue claims in a foreign form does not carry much weight, especially given the decreasing costs of cross-border filings associated with developments in modern communication technologies. Nevertheless, the world-wide regulatory trend is not towards straightforward universalism, but rather towards what can be termed 'modified' or 'mitigated' universalism. Under such a system, there is a single main insolvency proceeding with principally world-wide effect, but also the possibility of territorial proceedings with local effect. This is the approach, for example, embodied by the UNCITRAL Model Law on Cross-Border Insolvency.[55] It is also the approach of the EIR.

Despite the compelling arguments in favor of universalism, the European Commission sticks to the existing approach in principle. However, it attempts to reduce the negative effect of territorial proceedings on restructuring value. As mentioned, the Commission introduces the possibility of 'synthetic secondary proceedings' (refined Article 18 (1) and new Article 29a (2) EIR) and quashes the liquidation restriction currently embodied in Article 3 (3) EIR (refined Article 3 (3) EIR). Moreover, the Commission seeks to improve the coordination between main and secondary insolvency proceedings by extending the cooperation and communication regime to the courts involved (revised Articles 31a and 31b EIR), and by explicitly allowing agreements or protocols as legitimate forms of cooperation (revised Article 31 (1) Sentence 2, new Article 31a (3) (d) EIR).[56]

Again, this is a distinctly second-best approach for addressing the central regulatory problem in international bankruptcies. 'Synthetic secondary proceedings' are conditioned on an undertaking by the liquidator appointed in the main insolvency proceeding that guarantees local creditors a treatment replicating their position under 'real' secondary proceedings. 'Synthetic secondary proceedings' address some of the problems associated with secondary proceedings such as higher transaction costs or problems with respect to transnational restructurings. However, the condition just described retains one of the underlying flaws of territorialism,

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[54] On the investment incentive effects of territorialism, see Bebchuk and Guzman, 'An Economic Analysis of Transnational Bankruptcies', 42 (1999) *Journal of Law & Economics* 775, 793 et seq.

[55] UNCITRAL Model Law on Cross-Border Insolvency (1997), http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html (last visited 27 February 2013).

[56] Such protocols or agreements are essentially 'bankruptcy contracts', see Eidenmüller, 'Der nationale und der internationale Insolvenzverwaltungsvertrag', 114 (2001) *Zeitschrift für Zivilprozess* (*ZZP*) 3, 5.

namely, that it might skew investment decisions. Moreover, whenever the required undertaking is not given, the full machinery of a main proceeding, coupled with a potential multiplicity of secondary proceedings, may be set in motion, with all the negative economic effects, for example, high transaction costs, this imposes on transnational restructurings. Agreeing to a bankruptcy contract in a complex transnational corporate restructuring, for example, is an extremely complicated and costly task, and the costs might even sky-rocket if disputes under such a contract arise and enforcement issues surface. Conflict regarding the cooperation duty specified in the EIR is all the more likely, since the regulation nowhere specifies the precise conditions in which a cooperation duty of the involved liquidators and/or courts would arise and the exact content of such a duty. It is submitted that the correct standard would be the achievement of a Pareto-superior outcome, i.e., the possibility of enhancing the net value of the assets available for distribution in all proceedings involved.[57]

Summing up the discussion, the Commission retains the 'modified universalist' approach of the EIR even though the arguments for straightforward universalism are compelling. The Commission seeks to improve the coordination between main and secondary insolvency proceedings. But these efforts might prove counter-productive since they could potentially impose higher transaction costs.

§7. TREATMENT OF CORPORATE GROUPS

A final topic of major concern to the European Commission and its reform proposals is the treatment of corporate groups in international insolvencies. The current regulatory framework does not contain rules on this issue. Moreover, English courts' broad reading of Article 3 (1) EIR in the early years of the EIR was primarily motivated by the concern to achieve an efficient administration of multiple insolvencies in group settings. The Commission therefore rightfully believes that it is necessary to address this issue and provide rules for inclusion in the EIR with respect to the handling of 'group insolvencies'. When considering various policy options,[58] the Commission does not consider 'substantive consolidation' as a

[57] Eidenmüller, 'Verfahrenskoordination bei Konzerninsolvenzen', 169 (2005) *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* (*ZHR*) 528, 533 et seq, 535.

[58] SWD(2012) 416 final, 31 et seq.

possibility. Such consolidation is an option in the United States, where courts have allowed a pooling of assets and liabilities in group settings under certain circumstances.[59] It is unnecessary to criticize the Commission for not considering this option. Quite to the contrary: substantive consolidation has detrimental economic *ex ante* effects, as the pricing of credit risks might become (extremely) difficult. Instead, the Commission proposes a model of 'procedural coordination', whereby the communication and cooperation regime in place with respect to main and secondary insolvency proceedings regarding the same debtor would be extended to multiple main proceedings over the assets of distinct debtor companies that are all part of a corporate group (new Articles 42a, 42b, 42c, and 42d EIR).

Again, this reform proposal by the European Commission is a step forward. However, it falls short of what would be a much more effective form for enhancing the administration of group insolvencies. This more effective form is 'procedural consolidation'. Under procedural consolidation, one insolvency court would be designated in charge of the multiple (main) insolvency proceedings over the assets of multiple debtors within the group setting. Also, only one insolvency administrator would be appointed with respect to these multiple proceedings. A proposal along these lines has just recently been put forward in a discussion paper of the Federal Ministry of Justice in Germany regarding 'group insolvencies' in (purely) domestic settings.[60] It is clearly much more effective to coordinate a multiplicity of proceedings by having the same individuals or institutions in charge of these proceedings, rather than providing for complicated and costly coordination mechanisms such as bankruptcy contracts.[61] There are no convincing arguments as to why this reform cannot or should not also be undertaken on the European level with respect to transnational bankruptcies. As an aside, I should like to add that the group concept used by the Commission is also more restrictive than that used by the recent reform proposal in Germany.[62] The European proposal restricts the

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[59] See, for example, U.S. Supreme Court, *Sampsell v. Imperial Paper & Color Corp*., 313 (1941) U.S. 215; for further case law cf. Tabb, *The Law of Bankruptcy* (2nd ed., Thomson Reuters , New York, 2009), 242 et seq.

[60] See §§ 3a, 3b, 56b revised *Insolvenzordnung* based on the discussion paper of the German Ministry of Justice, http://www.rws-verlag.de/fileadmin/zbb-volltexte-3/2013-01-03_DiskE_Konzerninsolvenzrecht_-_Versendung.pdf (last visited 27 February 2013).

[61] Eidenmüller, 'Verfahrenskoordination bei Konzerninsolvenzen', 169 (2005) *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* (*ZHR*) 528, 537.

[62] Contrast Article 2 (i) and (j) revised EIR with § 3a, § 4 of the revised *Insolvenzordnung* based on the discussion paper of the German Ministry of Justice.

coordination regime to group settings involving a parent company and at least one subsidiary company. In contrast, the German proposal also covers settings in which many companies operating on the same level are united by a unitary management on the basis of a contractual agreement. Also in the latter settings, cooperation and coordination of a multiplicity of insolvency proceedings involving many debtors can be beneficial.

To conclude, the European Commission attempts to achieve progress with respect to the administration of cross-border insolvencies in group settings by extending the EIR's communication and coordination regime with respect to main and secondary insolvency proceedings also to multiple main insolvency proceedings over many debtors bound together in a corporate group. This is a step forward, but again, 'procedural consolidation' would have been comparatively more feasible and efficient than the 'procedural coordination' proposed by the Commission.

§8. SUMMARY

Based on a careful review of the EIR's application in practice during the 10 years since it entered into force, the European Commission, on 12 December 2012, published a report assessing that application and providing a proposal for the EIR's reform. It is probably fair to characterise this proposal as a modest attempt to cautiously and carefully improve upon the status quo. In many respects, the proposal, if enacted, would indeed bring progress. At the same time, in other respects, it clearly falls short of what is both feasible and necessary to significantly improve the international governance framework for transnational bankruptcies.

This essay has attempted to highlight some of the shortcomings of the Commission's proposal. The main findings of the paper can be summarised as follows:

(1) The Commission's proposals are not based on sound regulatory objectives. Preserving businesses is not an end in itself.
(2) The Commission is too cautious regarding the harmonisation of substantive insolvency laws of the MS. Especially with respect to the duties of managers of

companies in financial distress and security rights in movables, harmonisation measures of the EU are necessary now.

(3) The scope of the EIR should be restricted to (fully) collective proceedings. The collective nature of proceedings should be the one and only criterion for a proceeding to fall within the scope of the EIR.

(4) The COMI concept should be substituted by the registered office. This would significantly improve legal certainty and, at the same time, encourage only 'beneficial forum shopping' that is welcomed by all stakeholders of a company.

(5) The 'modified universalist' approach of the EIR should be given up in favour of straightforward universalism.

(6) 'Procedural consolidation' with respect to multiple insolvency proceedings regarding many debtors in a group setting is more efficient than 'procedural coordination' proposed by the Commission.

Given the overly modest and unambitious nature of the EU Commission's proposals, these proposals hopefully will not even get more diluted in the course of the legislative process at the European level. European businesses need an efficient regulatory governance structure for transnational bankruptcies that will remedy significant deficiencies in the current structure. They cannot wait another decade for progress to be made in this regard.[63] And they need such a structure not only for intra-community cross-border insolvencies but also with respect to non-European states – something that the EIR *could* provide but does not do so currently.[64]

[63] Unfortunately, the reform process is further complicated by the peculiar position of the UK with respect to Title V of Part Three of the TFEU. If the Commission's proposals are adopted, and the UK does not opt into the amending measure, it may find itself out of the EIR completely, i.e., even the existing measure would no longer be binding upon or applicable to it, see COM(2012) 744 final, 10. This would be a most undesirable consequence.

[64] On this issue, see note 1 above. Unfortunately, the EU Commission does not perceive any need to extend the scope of the EIR to cover the relationship with non-European states, see COM(2012) 743 final, 8.

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