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TWENTY SUGGESTIONS FOR A MAKEOVER OF THE EU INSOLVENCY REGULATION

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The EU Insolvency Regulation has been in force for over four years now. The balance appears to be positive however the handling of cross-border insolvencies within the Community could certainly be improved. A list of 20 recommendations follows below. The list is by no means exhaustive. The recommendations are presented with the intention of providing food for thought for the evaluation process pursuant to Article 46 InsReg.

The balance is, of course, measured by assessing the EU Insolvency Regulation's initial aims, centred around: (a) the proper functioning of the internal market (recital 2), (b) preventing the supply of incentives to seek more favourable legal positions (forum shopping, recital 4), (c) improvement of efficiency and effectiveness in cross-border insolvencies, and (d) harmonized conflict of law rules (Virgós/Schmit Report (1996), nr. 8). Compared to the fragmented and uncertain state of affairs of some ten years ago, an enormous step forward has been made in providing a recognizable framework for cross-border insolvency, especially with regard to international jurisdiction, recognition of judgments, choice of law provisions, position of creditors and powers of office holders. Cross-border insolvencies in the EU have become much more predictable and a step in the right direction has been made by the moderate choice for a model of coordinated universality. The significance and influence of the Regulation in terms of the search for solutions to problems arising in cross-border insolvencies cannot be overestimated. Insolvency specialists and advisers in the field of financial relationships will have to be more than aware of the Regulation's existence and the way in which courts in several jurisdictions have interpreted its provisions.

Shortcomings. Having said this, now the shortcomings. They have been limited to two or three per related topic, without detailed re-examination.¹ For a list of suggestions for improvements, see too the comments of Moss and Paulus² and of Omar.³

Insolvency Regulation

With regard to the Regulation itself: it is seldom appreciated in literature or practice that the Regulation is the result of forty years of negotiation between representatives of a group of countries that, over the years, increased from six to fifteen. The result is a compromise between the different underlying policies of insolvency law systems of the various Member States. The final outcome in the

¹ This article is published in September 2006 on www.bobwessels.nl, see weblog: 2006-09-doc4. What follows is extensively discussed in Bob Wessels, *International Insolvency Law*, Deventer: Kluwer, 2006, Chapter IV.

² Gabriel Moss and Christoph Paulus, *The European Insolvency Regulation – The Case for Urgent Reform*, in: *Insolvency Intelligence*, October 2005.

³ Paul J. Omar, *Addressing the Reform of the European Insolvency Regulation: Wishlist or Fancies?*, in: *Insolvency Intelligence* (forthcoming). See also Paul J. Omar, *Confronting the Challenge of Diverse Priority Rules through the European Insolvency Regulation*, in: *International Case-Law Alert No. 10* (June 2006), at www.eir-database.com.

mid-1990's was reached at a time when several of the Member States were considering or introducing certain types of reorganisation proceedings alongside the winding-up proceedings that had been in operation for several decades (or longer) in most European states. In addition, special rules relating to the insolvency of natural persons were in the making in several countries.

(i) *Inflexible tool.* The Regulation, binding in its entirety and directly applicable in the Member States, is the EC's most forceful measure relating to the individual jurisdiction of a Member State. Changes over time in all Member States (based on economic changes or shifts in policy priorities) can only find their way into the Regulation under the method laid down in Article 45 of amending the Annexes. In April 2005 and in April 2006 the Annexes A, B and C were amended. The amendment of for example the April 2005 changes followed a proposal from the Commission resulting from the fact that 'Belgium, Spain, Italy, Latvia, Lithuania, Malta, Hungary, Austria, Poland, Portugal and the United Kingdom notified the Commission, pursuant to Article 45 of Regulation (EC) No 1346/2000, of amendments to the lists set out in Annexes A, B and C to that Regulation.' The reasons behind the notifications could shed light on related questions but such reasons are unknown. It would be interesting to discover whether other countries also requested amendments to the Annexes which were rejected by the Commission.

The Regulation only allows the Annexes to be amended. Article 46 provides that no later than 1 June 2012, and every five years thereafter, the Commission shall present to the European Parliament, the Council and the Economic and Social Committee a report on the application of the Regulation, which shall be accompanied if need be by a proposal for adaptation of the Regulation. In the dynamic and developing legal environment of international insolvency this process can be viewed as slow and reactive. A pro-active process e.g. by a Committee of experts (as in the EU banking industry) would be more appropriate. If the process were pro-active, the Council or the European Parliament could make recommendations, on the request of the Commission, or the Committee of experts could do so on its own initiative. It should be noted at this juncture that a European insolvency industry hardly exists, most practitioners work in their own jurisdiction, a European Insolvency Institute comprising academics and practitioners from the majority of States involved is still lacking, let alone the availability of structured education on a European basis and a 'European' licensing system for practitioners;

(ii) *Rescue culture.* Given this history one may wonder whether the Regulation sufficiently promotes a rescue culture, for example, rescue plans in secondary proceedings are only permitted when the domestic insolvency law allows for them (Article 34);

(iii) *Procedural framework.* The procedural framework of the Regulation can be considered to be unsatisfactory. This may be explained by the connection between the origins of the Regulation and what is (now) the Brussels Regulation 2002. The Insolvency Regulation may have closed a gap in the system of international jurisdiction and recognition of judgments relating to civil, commercial and insolvency matters, but alignment with other areas of EU law, particularly EU corporate law is lacking, e.g. alignment with the (future) EC directives relating to transfers of corporate seats and cross-border mergers and the characterisation of certain rules as falling under the domain of insolvency law or corporate law.⁴ In addition, the Regulation's compatibility with domestic legal systems of Member States leave much to the activity of Member States, where some guidance from the Regulation would have been welcome, e.g. Articles 31-37 and the lack of any procedural rules;

⁴ See Bob Wessels, *The EC Insolvency Regulation: Three Years in Force*, in: *European Company Law*, June 2005, Issue 2, 50ff, and Paul Omar, *The Convergence of Company and Insolvency Initiatives within the European Union*, in: *European Company Law*, June 2005, Issue 2, 59ff.

(iv) *Method of interpretation.* The basis of the Regulation in Title IV EC Treaty (the progressive establishment of ‘an area of freedom, security and justice’) assigns to the Regulation a method of interpretation (Article 234 EC Treaty) that is unproductive given the nature of insolvency proceedings (urgency of final decisions, ‘no time to loose’ character of insolvency). In addition, the status of the Virgós/Schmit Report (1996) is somewhat uncertain and the various languages of the Regulation that were examined for the purposes of this publication (Dutch, English, German and French - four of the twenty authentic languages) give rise to several differences in interpretation. The application of the InsReg in relatively small cases seem costly; any delay will have an influence on the possibility of continuing the debtor’s business;

(v) *Uncertain terms and expressions.* Finally, the Regulation uses several uncertain terms, other than the obvious ones (‘centre of main interest’; ‘establishment’; ‘public policy’). Examples of important but ambiguous or incomplete terms are ‘the time of opening of proceedings’ (Article 2(f)), the localisation rules (Article 2(g) for contracts or for shares, and ‘claims’ of tax or social security authorities (Article 39) which may be filed in all proceedings (do such claims also cover interest and fines?)

Jurisdiction

The following remarks may be made in relation to jurisdiction:

(vi) *COMI.* As demonstrated in various cases the general description for ‘centre of main interest’ is not sufficient to encompass all types of debtors, e.g. natural persons as private persons, natural persons as professionals, smaller companies and larger (groups of) companies with segregated ‘management and control’ (‘head office functions’) and factual operations.⁵

(vii) *Compressed decision.* The ‘COMI’ decision seems to be too ‘compressed’ as the courts decision on the opening of insolvency proceeding also comprises the decision concerning the applicable law, the extension of this law and the powers of the liquidator throughout Europe.⁶

(viii) *Information.* There is no guarantee that the information the court receives is complete, an uncontested decision can be made by a party who has an interest;

(ix) *Proof.* Moreover, in general it is uncertain what will amount to sufficient proof on behalf of a debtor which has its COMI in a certain State (is it sufficient that the courts are satisfied or should proof be beyond a certain degree of doubt?). Courts follow different approaches with regard to the strength of the presumption that a debtors’ registered office is the location of his COMI (a strong presumption of just one of the circumstances to be taken into account);

(x) *COMI shopping.* In addition, following analysis of several court cases, it appears that the COMI operates as a movable object, which may be moved (manipulated) by certain debtors in a manner that is equivalent to forum shopping;

(xi) *Establishment.* Although the local effect of secondary insolvency proceedings seems to function well, its legal form and strict nature (domestic liquidation proceedings) may be open for debate. Any

⁵ The decision of the European Court of Justice 2 May 2006 only provides a first step in clarifying the interpretation of COMI, see Bob Wessels, *The place of the registered office of a company: a cornerstone in the application of the EC Insolvency Regulation*, in: 3 European Company Law, August 2006, 183ff.

⁶ See Samuel L. Bufford, *International Insolvency Case Venue in the European Union: The Parmalat and Daisytek Controversies*, in: 12 Columbia Journal of European Law, Spring 2006, 429ff.

alternative should have a stronger supportive function for the main proceedings, including wider powers for the main liquidator to shape the organisation of this function. To conclude on the subject of jurisdiction, some courts have ruled that an ‘establishment’ can also function as the registered office of a subsidiary whose insolvency has been opened in another Member State (where ‘head office functions’ of the parent are centralised). Although the history of the Regulation does not seem to provide support for such decisions, the consequence is that uncertainty remains concerning how the decision, which includes the applicability of a foreign *lex concursus* and the powers of the liquidators appointed, relates to the domestic corporate or insolvency law duties of the management of the subsidiary.

Choice of law rules

The conflict of law rules in Articles 5-15 provide a harmonized miniature code of unprecedented value. Nevertheless, it is submitted that the elaboration gives rise to uncertainty in relation to several central terms and ambiguity which results from unclear formulations:

(xii) *Vague terms*. Vague terms include ‘Opening of insolvency proceedings’ and ‘shall not affect’ in Articles 5-7, ‘law’ in Articles 6 and 14, ‘State’ in Articles 8, 10, 11, 13 and 14, and ‘solely’, which appears in Articles 8, 9, 10 and 15. Related questions also arise from the differences in the Dutch, English, French and German texts of Articles 5-15. In certain cases such differences may give rise to the view that the current formulation of certain choice of law provisions should be amended;

(xiii) *Policy choices*. The conflict of law rules reflect the policy choices of a large majority of Member States at a certain moment in time. Such policies may have changed in recent years, e.g. the choice for Article 5 as a ‘hard and fast rule,’ which results in the over-protection of secured creditors. The protection offered in relation to contracts concerning immovable property (Article 8) seems ready for reconsideration as certain other contractual positions, e.g. with regard to consumers, may in current times lead to an exception to the applicability of the *lex concursus*. Several changes in respect of these choices might be on the wish list of those Member States which joined the EU in 2004.

It may be premature to assess whether the Regulation has been sufficiently successful in avoiding forum shopping. In practice doubts are expressed, in short: (1) in ‘a race to the court’ the first COMI wins, (2) the set of choice of law rules may promote financial engineering in the choice of jurisdiction (to limit risks) and optimize set-off, and, in general, (3) will the whole PIL insolvency framework be sufficiently coherent?

Recognition

The Chapter on recognition of insolvency proceedings also comprises rules on publication.

(xiv) *European publications*. It is undisputed that in the mid 1990s there was no thought of a *European Insolvency Register* in the minds of the drafters. However, nowadays, it seems a natural course of action to establish a European web-based register. This is compatible with the aim of improving judicial cooperation. The web-based register could consist of judgements opening insolvency proceedings to avoid courts in other Member States opening main insolvency proceedings where such proceedings have already been opened against the same debtor. Furthermore the liquidator’s appointment (Article 19) and any supplemental Orders given by a court may be listed on such a register. The relationship between domestic registrations is an item for further discussion;

(xv) *Recognition of related judgments*. Another shortcoming is the unnecessary complexity of the system established for the recognition of insolvency-related judgments (Article 25);

Communication and cooperation

The mutual duties with regard to communication and cooperation (Article 31) are unsatisfactory in two ways:

(xvi) *Content*. There is inadequate detail with regard to the duties of liquidators, who therefore may be insufficiently aware of their mutual duties on a European level, in respect of working towards a common goal and the ultimate unity of the process of administering the debtor's estate as an economic unit. The mutual interwovenness of the proceedings (originating from procedural rights of the main liquidator) and of the claims of creditors (lodging; comparing; distribution) assume the adequate and unconditional realisation of mutual duties with regard to information and cooperation. Secondly:

(xvii) *Communication and cooperation between courts*. 'Court-to-court communication and cooperation' is not required or provided for under the Regulation. This can be considered somewhat peculiar as within the field of international insolvency as 'communication and cooperation' in cross-border cases has become a guiding practice in large parts of the world and has recently found its way to countries which have adopted Articles 25 – 27 UNCITRAL Model Law. Court-to-court communication and cooperation is largely based on Title IV EC Treaty and its foundation in Article 10 EC Treaty, speaking out for Member States' (judicial) cooperation.

What is not offered under the Regulation

Three other topics deserve to be mentioned in the category of what is not offered under the Insolvency Regulation:

(xviii) *No harmonisation*. As recital 11 indirectly indicates, the Insolvency Regulation is based on the idea, generally accepted over the last few decades, that harmonisation of domestic rules relating to insolvency was impossible given the differences in substantive laws, including preferential rights. See my earlier publication⁷ with reference to, for example, differences in the way in which businesses are financed, protection policies of certain interest groups and different cultures in relation to the social phenomenon of 'insolvency'. It should nevertheless be mentioned that several provisions of the Regulation are characterized as substantive rules and are therefore now accepted throughout Europe as unified rules concerning the topics to which they relate, see for example Articles 7(2), 20, 29-35, 39 and 40;

(xix) *No group provisions*. I have always been reluctant to criticize the Regulation for its lack of provisions relating to the insolvency of one or more companies, which, along with other companies, form a group of corporations. In my view critics have paid too little attention to the history of the Regulation and its basis in the EC Treaty as a measure concerning 'procedural law', not related to 'corporate law' or the idea of free establishment. Nevertheless, several court cases demonstrate the need for the Regulation to provide a solid set of rules, not just those related to 'international jurisdiction' of a court. Changes could also be considered with regard to the nature of secondary proceedings, to the powers of the main liquidator, the establishment of a committee of creditors which duly represents the involved corporate debtors (parent company and subsidiaries), certain forms of consolidation and the treatment of inter-company loans;

(xx) *No relationships with non-EU Member States*. To a great extent the Regulation only applies within the territory of the Community (except for Denmark). The consequences for debtors or

⁷ Bob Wessels, *Insolvency Law*, in: Jan M. Smits (ed.), *Encyclopaedia of Comparative Law*, Edgar Elgar, London, 2006, pp. 294-311.

creditors outside of the Community are small.⁸ The reason for the limitation can be understood in a historical and political context, but is clearly at odds with growing patterns of business and financial relationships. Commonly, in trading or financial relationships with e.g. Denmark, Norway, Switzerland, Turkey or Japan and the USA the COMI is located outside the Community, thus, a debtor will remain untouched by the Insolvency Regulation.

⁸ Vanessa Marquette and Candice Barbé, *Council Regulation (EC) No. 1346/2000. Insolvency Proceedings In Europe and Third Countries. Status and Prospects*, in: A. Nuyts & N. Watté (eds.), *International Civil Litigation in Europe and Relations with Third States*, Bruxelles: Bruylant, 2005, 419ff.