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The recast European Insolvency Regulation: impact on distressed debt investors

What's happening?

In 2002, the European Insolvency Regulation (EIR) introduced a regime governing the administration of insolvent corporates or individuals which operate in more than one member state of the European Union (EU). A "recast EIR" will apply to insolvency proceedings commenced on or after 26 June 2017.

Why are the EIRs important?

The EIRs ensure recognition, without further formality, of insolvency proceedings throughout the EU (except Denmark) and determine the law applicable to such proceedings. They apply only where the debtor's centre of main interests (COMI) is situated in a member state (other than Denmark) and do not apply to insolvency proceedings on foot in other jurisdictions. The EIRs are only binding on participating member states and so will be of limited practical use where assets are situated outside the EU. The EIRs envisage there being one set of main insolvency proceedings, with the possibility of multiple territorial (or secondary) insolvency proceedings.

Consultation of stakeholders and legal and empirical studies had identified various shortcomings with the EIR. The recast EIR was designed to address these shortcomings and includes many helpful changes. In particular:

- The recast EIR places a greater emphasis on rescue and rehabilitation, and is extended to proceedings which provide for restructuring of a debtor at a stage

where there is only a likelihood of insolvency, proceedings which leave the debtor fully or partially in control of its assets and affairs, and proceedings providing for a debt discharge or a debt adjustment.

- The recast EIR includes new rules providing for coordination and cooperation between courts and insolvency practitioners, and the new possibility of synthetic (or virtual) secondary insolvency proceedings. A requirement in the EIR whereby territorial / secondary insolvency proceedings had to be liquidation proceedings has been removed.
- In the recast EIR the presumption that a debtor's COMI is in the place of its registered office will not apply if the registered office has shifted in the preceding three months – a measure designed to curb abusive forum shopping.

It is hoped that the recast EIR will encourage greater investment (including distressed investment) in Europe, due to its greater emphasis on rescue and rehabilitation, by imposing mandatory obligations of cooperation and coordination between office-holders and courts and by facilitating group insolvency processes. The creation of interconnected insolvency registers in 2018-19 will ensure all stakeholders have access to reliable information about ongoing insolvency proceedings in the EU.

Uncertainties introduced by Brexit

The exit model and the legislative changes that will result from "Brexit" remain wholly unclear. The formalities for the UK to leave the EU are unlikely to be completed before 2019 at the earliest. In the event of a "hard Brexit", the recast EIR (being an EU "regulation") would cease to apply automatically between the UK and the remaining EU (rEU) member states.

It is hoped, given the success of the EIR, that there will be a collective desire, both in the UK and in the rEU member states, to retain the effects of the recast EIR regime as far as possible, whether as part of a withdrawal treaty or via a series of bilateral agreements between the UK and multiple rEU member states. Bilateral arrangements could, however, result in inconsistent and unpredictable outcomes for pan European insolvencies. A less attractive outcome still is that the UK is forced to rely on the vagaries of private international law in each rEU member state. Any such 'halfway' solutions to the gap left by the EIRs would increase the risk of competing insolvency proceedings between the UK and individual rEU member states, due to the removal of the rule requiring automatic recognition of insolvency proceedings. There could also be increased uncertainty for UK insolvency practitioners seeking the assistance of rEU courts (and vice versa).

What distressed debt investors need to know about the recast EIR

Many investor claims in the context of distressed debt investing may either fall outside the scope of the recast EIR or fall to be determined by a law other than the law of the main insolvency proceedings. This is because distressed claims will take many forms, and the correct categorisation of the claim will determine whether the recast EIR is relevant. The authors have written a chapter summarising key considerations for investors arising from the recast EIR, discussing the impact on distressed investing in Europe. This can be found in Investing in Distressed Debt in Europe: The TMA Handbook for Practitioners (ISBN: 9781911078104), and a copy is appended to this legal briefing.

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The recast EU Insolvency Regulation and its impact on distressed investing

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1. Key concepts

In this chapter, 'EIR' (or '2000 EIR') refers to Council Regulation (EC) 1346/2000 of May 29 2000 on insolvency proceedings. The term 'recast EIR' refers to Regulation (EU) 2015/848 of May 20 2015 on insolvency proceedings (recast). At the time of writing, the EIR is due to be replaced by the recast EIR (as further detailed under headings 3 and 4 below). As both regulations contain similar terms, the 'EIRs' is a reference to both the 2000 EIR and the recast EIR.

The 2000 EIR introduced a regime governing the administration of insolvent corporates or individuals which operate in more than one member state of the European Union. The EIRs ensure recognition, without further formality, of insolvency proceedings throughout the European Union (except Denmark) and determine the law applicable to such proceedings. They apply only where the debtor's centre of main interests is situated in a member state (other than Denmark)[1] and do not apply to insolvency proceedings on foot in other jurisdictions. The EIRs are only binding on participating member states and so will be of limited practical use where assets are situated outside the European Union.[2] The EIRs envisage there being one set of main insolvency proceedings, with the possibility of multiple territorial (or secondary) insolvency proceedings. Currently (under the 2000 EIR), secondary insolvency proceedings must be winding-up proceedings (as listed in Annex B to the EIR). Broadly speaking (and with certain exceptions), the EIRs follow the general principle that the applicable law shall be that of the member state in which the proceedings (main, territorial or secondary) have been opened. This law determines, in particular, the ranking of claims and the procedural rights of creditors.[3] Under the 2000 EIR there is no process for the coordination of (or

1 In the interests of brevity, the term 'member states' is used throughout this chapter to refer to participating member states for the purposes of the EIRs. Note however that Denmark is not bound by the EIRs and the EIRs do not apply to debtors in Denmark or to establishments in Denmark of debtors from elsewhere in the European Union. Similarly, given the direct effect of the EIRs, if a current participating member state were to leave the European Union, the EIRs would cease to apply following that departure.

2 For instance, if an insolvent Italian company has granted security over assets in New York, the New York court will not be required by the EIRs to recognise insolvency proceedings opened in Italy. It might be necessary to take steps to open separate US proceedings or to apply to the New York court to recognise the Italian proceedings based on US rules for recognition of foreign insolvency proceedings.

3 See EIR, Article 4; recast EIR, Article 7.

cooperation between) different insolvency proceedings affecting a group of companies.

2. Relevance of the insolvency regulations to distressed-debt investing

It is important to highlight at the outset that many investor claims in the context of distressed-debt investing may either fall outside the scope of the EIRs or fall to be determined by a law other than the law of the main insolvency proceedings. Such matters include rights *in rem* (security), set-off and claims in respect of securities held in a settlement system (see under headings 7 and 8 below). Insurance undertakings, banks and other credit institutions, and collective and other investment undertakings are excluded from the scope of the EIRs (see under heading 9 below). Furthermore, despite recent enlargement in the scope of proceedings covered by the recast EIR, some tools commonly used for the solvent restructuring of a debtor will continue to fall outside the scope of the EIRs. These include the English law scheme of arrangement procedure (a commonly used option for the restructuring in the United Kingdom of overseas companies, as explained under heading 12 below), discussed in detail in a separate chapter.[4]

Distressed claims will take many forms, and the correct categorisation of the claim will determine whether the EIRs are relevant. For instance, the treatment of debt claims acquired under syndicated loans could amount to a claim against the borrower (for instance, if a loan is acquired through a transfer or assignment) and the EIRs would apply to the insolvency proceedings of that borrower. Alternatively, where the investor has entered into a risk participation with an existing lender, while the investor will clearly be interested to receive timely and accurate information regarding any insolvency proceedings relating to the borrower, it may have no direct claim in the borrower's insolvency; rather, a separate contract with the lender of record. Investments may be made through capital market instruments, which are frequently held in a settlement system where the investor's direct counterparty is not the issuer. If the issuer becomes insolvent, the EIRs will not be relevant to determine the claim of the investor against its immediate counterparty. Investors will often take synthetic positions in debt through contracts for difference (or they may participate in hedging documentation in relation to a company's debt obligations to third parties), in which case the EIRs will have no bearing on the investor's claim against its counterparty. In cases where the investor is exposed to the credit risk of a credit institution, note that the eventual insolvency of that counterparty would also be outside the scope of the EIRs (see under heading 9 below). Claims against a debtor purchased by an investor which itself owes money to that debtor (ie, an attempt to use set-off) also fall outside the scope of the EIRs (see under heading 8 below).

Distressed-debt investors will commonly adopt a multi-strategy approach, investing in instruments at different levels of the capital structure (potentially including direct or synthetic equity stakes, for instance). As a result, an investor may be faced with multiple exposures, some being within the scope of the EIRs and some outside their scope. It should be noted that the EIRs do not, of themselves, regulate

4 See "Schemes of arrangement" chapter.

mergers and acquisitions processes for the acquisition of equity, or conversion of debt into equity; these are matters for local law procedures. However, to the extent that such local law process is an 'Annex A' procedure (further explained under heading 6 below), the recognition of the procedure, and of any moratorium which accompanies it, may provide more stability and certainty of outcome for a loan-to-own investor.

3. A brief history of the 2000 EIR and recast EIR

After 40 years of successive aborted projects for pan-European conventions on insolvency proceedings led by various committees of the European Economic Community, the Council of Europe and the European Council of Ministers, the EIR came into force as a regulation on May 31 2002. It sets out insolvency recognition and conflict of law rules for the European Union, except Denmark. As a regulation, the EIR has direct effect in participating member states and its interpretation is a matter of European Union law. The EIR's objectives (set out in Recitals 2 and 4) were:

- that cross-border insolvency proceedings should operate efficiently and effectively so as to encourage the proper functioning of the internal market; and
- to avoid incentives for the parties to transfer assets or judicial proceedings from one member state to another, seeking to obtain a more favourable legal position, commonly referred to as 'forum shopping'.

The EIR is generally regarded as a success. Case law of the Court of Justice of the European Union has clarified interpretation on a number of points, leading to more uniform application across participating member states. However, the financial crisis of 2008 and ensuing Eurozone crisis put growth firmly back on the Commission's agenda, and it was concluded that revision of the EIR would link in with the European Union's political priorities to promote economic recovery and sustainable growth, to encourage investment and to promote the survival of businesses. Consultation of stakeholders and legal and empirical studies commissioned by the Commission identified five main shortcomings with the 2000 EIR:[5]

- The EIR does not cover national procedures which provide for a restructuring of the company at a pre-insolvency stage or proceedings which leave the existing management in place.
- There can be difficulties in determining which member state is competent to open insolvency proceedings.
- The opening of secondary insolvency proceedings can hamper the efficient administration of the company's estate.
- It is difficult to obtain reliable information on proceedings in other jurisdictions, in the absence of effective rules on publicity of insolvency proceedings and the lodging of claims.
- The EIR does not contain specific rules dealing with the insolvency of a multinational enterprise group, despite a large number of cross-border insolvencies involving groups of companies.

5 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) (2012/0360 (COD)).

Negotiations between the European Parliament, the Council and the Commission culminated with the regulation recasting the EIR being adopted on May 20 2015. The stated objectives of the recast EIR are to improve efficiency of the European framework for resolving cross-border insolvency cases, to ensure a smooth functioning of the internal market and its resilience in economic crisis. This objective, the Commission[6] says, links in with the European Union's current political priorities to promote economic recovery and sustainable growth, a higher investment rate and preservation of employment as set out in the 'Europe 2020' strategy.

4. Implementation timetable for the recast EIR

The recast EIR will apply to insolvency proceedings commenced on or after June 26 2017 (Articles 84(1) and 92).[7] The 2000 EIR will continue to apply to any proceedings opened before that date (Article 84(2)). Note however that the obligation for member states to establish national registers (discussed under heading 15 below) will apply from June 26 2018, and the interconnection of national insolvency registers will apply from June 26 2019. The recast EIR effects various fundamental changes to the scope and operation of the 2000 EIR.

In view of the imminent implementation of the recast EIR, the remainder of this chapter focuses on the rules as amended by the recast EIR.

5. Brexit

This chapter was, for the most part, written before the outcome of the referendum on the United Kingdom's membership of the European Union became known on June 24 2016. At the time of publication, the exit model and the legislative changes that will result from Brexit (assuming that the procedure under Article 50 of the Treaty on European Union is invoked) remain wholly unclear. The formalities for the United Kingdom to leave the European Union are unlikely to be completed before 2019 at the earliest. At that point the recast EIR (being an EU regulation) will cease to apply automatically between the United Kingdom and the remaining EU member states (rEU). It is the authors' hope, given the success of the EIRs, that there will be a collective desire, both in the United Kingdom and in the rEU, to retain the effects of the recast EIR regime as far as possible. This could be achieved as part of a withdrawal treaty between the United Kingdom and the rEU. Alternatively, it could be achieved through a series of bilateral agreements between the United Kingdom and as many of the rEU member states as possible to achieve broadly the same effect; though potentially resulting in inconsistent and unpredictable outcomes for pan-European insolvencies. A less attractive outcome still is that the United Kingdom is forced to rely on the vagaries of private international law in each rEU member state.

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6 Commission staff working document – Impact assessment – Accompanying the document Revision of Regulation (EC) No 1346/2000 on insolvency proceedings (SWD (2012) 416 final).

7 Article 84 is (oddly) silent as to how to treat proceedings opened on June 26 2017! *Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings* (3rd edition 2016, at 8.808) suggests the recast EIR should apply to proceedings opened on June 26 2017 because Article 92 (entry into force) states that the recast EIR applies from June 26 2017.

From the United Kingdom's perspective, any such halfway solutions to the gap left by the EIRs would increase the risk of competing insolvency proceedings between the United Kingdom and the rEU, due to the removal of the rule requiring automatic recognition of insolvency proceedings. There could also be increased uncertainty for UK insolvency practitioners seeking the assistance of the rEU courts (and vice versa).

6. Main, territorial and secondary proceedings

The recast EIR places a greater emphasis on rescue and rehabilitation, and is extended to proceedings which provide for restructuring of a debtor at a stage where there is only a likelihood of insolvency, proceedings which leave the debtor fully or partially in control of its assets and affairs, and proceedings providing for a debt discharge or a debt adjustment. Consistent with this approach, the term "liquidator" has been replaced with the term "insolvency practitioner" throughout. Annex A sets out, for each member state, an exhaustive list of proceedings which are within the regulation's scope. In the case of the United Kingdom, for instance, this includes a court-supervised winding-up, a creditors' voluntary winding-up (with confirmation by the court), administration, voluntary arrangements under insolvency legislation (such as company and individual voluntary arrangements) and bankruptcy or sequestration. However, none of the types of receivership available under English law fall within the scope of the EIRs. Receiverships are not collective regimes and do not have an equivalent in most other member states. Although it is no longer a procedure of wide application, note that this includes administrative receivership, which can apply where a floating charge has been granted by specific entities defined by statute (including project finance and utility companies). An administrative receiver has wide powers to take custody of the charged assets, run a company's business and dispose of its assets, either piecemeal or as part of the sale of the business as a going concern, to satisfy the secured debt.

The concept of a debtor's centre of main interests ('COMI') is an essential element of the recast EIR. The debtor's COMI is defined as "the place where the debtor conducts the administration of its interests on a regular basis and is ascertainable by third parties" (Article 3(1)). It has been common for debtors to move (or purport to move) their COMI in order to utilise insolvency proceedings available in other member states and the recast EIR attempts to curb this trend (see under heading 13 below).

If a debtor's COMI is within the European Union (with the exception of Denmark) then the courts of the member state where the debtor's COMI is situated have the jurisdiction to open "main insolvency proceedings" (recast EIR, Article 3(1)). There can only be one set of main insolvency proceedings in respect of a debtor. If a debtor's COMI is within a member state, but the debtor has an establishment in another member state, the courts of the member state where that debtor has an establishment have jurisdiction to open territorial insolvency proceedings (Article 3(2)). Territorial insolvency proceedings are restricted to the assets in the relevant member state (Article 3(2)). For rules determining where assets are situated for these purposes, see under heading 10 below. Once main insolvency proceedings are opened, any territorial insolvency proceedings already in progress or

opened subsequently will be classed as secondary insolvency proceedings (Article 3(3) and (4)). There can be multiple territorial/secondary insolvency proceedings.

A welcome change effected in the recast EIR is that secondary insolvency proceedings are no longer required to be winding-up proceedings (as were listed in Annex B of the 2000 EIR). The former position had been widely criticised as frustrating efforts to rescue group companies or divisions in other member states.

The recast EIR has an enlarged scope. Article 1 states that it will apply to public collective proceedings, including interim proceedings, which are based on a law relating to insolvency and in which, for the purpose of rescue, adjustment of debt, reorganisation or liquidation:

- the debtor is totally or partially divested of his assets and an insolvency practitioner is appointed;
- the assets and affairs of the debtor are subject to control or supervision by a court (this is to include a situation where the court only intervenes on appeal by a creditor; see Recital 10); or
- a temporary stay of individual enforcement proceedings is granted by a court or by operation of law to allow for negotiations between the debtor and creditors, provided sufficient safeguards are in place for creditors during this time (which includes *sauvegarde financière accélérée* in France; *procedimiento de homologación de acuerdos de refinanciación* in Spain; and *accordi di ristrutturazione* in Italy).

The recast EIR will not apply to confidential procedures. A new Recital 12 explains that while confidential proceedings may play an important role in some member states, their confidential nature makes it impossible for a creditor or a court located in a different member state to know that such proceedings have been opened, thereby making it difficult to provide for recognition on an EU-wide level. French mandataire ad hoc and conciliation proceedings will therefore remain outside the scope of the recast EIR.

In order to avoid the delay and expense of opening secondary insolvency proceedings, Article 36 allows the insolvency practitioner in the main insolvency proceedings to give a unilateral undertaking, in respect of assets located in any member state in which secondary insolvency proceedings could be opened, to the effect that when distributing those assets or the proceeds received as a result of their realisation, it will comply with the distribution and priority rights that creditors would have under national law if secondary insolvency proceedings were opened in that member state. These are colloquially referred to as 'synthetic' (or 'virtual') proceedings. Secondary insolvency proceedings, it is broadly accepted, can frustrate entirely or disrupt a rescue or better realisation of a group's assets, and lead to duplicated and/or wasted costs. Article 36 follows the template established in *Collins & Aikman* [2007] 1 BCLC 182 and *Nortel* [2009] BCC 343; cases where an administrator in United Kingdom insolvency proceedings undertook to respect local priorities of distribution in order to avoid a plethora of secondary insolvency proceedings being opened.

7. Cross-border recognition of insolvency proceedings – scope

The recast EIR provides that any judgment opening insolvency proceedings shall be recognised in all other member states (Article 19). Article 7 lists all the matters to be determined by the law applicable to such proceedings. The aim is to achieve certainty of outcome by replacing the various national conflict of laws rules which might otherwise apply in relation to insolvency proceedings. There are several exceptions to the general rule that the law applicable to insolvency proceedings is that of the state where proceedings are commenced. These are contained in Article 8 (third parties' rights *in rem*), Article 9 (set-off), Article 10 (reservation of title), Article 11 (contracts relating to immovable property), Article 12 (payment systems and financial markets), Article 13 (contracts of employment), Article 14 (effects on rights subject to registration), Article 15 (European patents with unitary effect and Community trademarks), Article 16 (detrimental acts), Article 17 (protection of third-party purchasers) and Article 18 (effects of insolvency proceedings on pending lawsuits or arbitral proceedings). We will now examine the exceptions of most relevance to distressed-debt investors.

8. Exceptions to the basic choice of law rule – rights *in rem*, set-off and securities held in a payment or settlement system

Investors with the benefit of security for the debt or obligation of a distressed debtor will be keen to ensure that they have direct recourse to the relevant collateral in the event of default by the debtor, regardless of the onset of the debtor's insolvency. A prerequisite for this result (as stated in Recital 68, which highlights that "such rights are of considerable importance for the granting of credit") is that the laws of every relevant jurisdiction should respect the continued validity and enforceability of such rights *in rem* despite the debtor's insolvency. Otherwise, where the collateral is situated in a different member state from that in which the main insolvency proceedings are opened, a secured creditor could be vulnerable to variations between national laws relating to the impact of insolvency on security arrangements, the resulting uncertainty impacting negatively on the value of secured debt.

Article 8[8] protects secured creditors and states:

> *The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets, both specific assets and collections of indefinite assets as a whole which change from time to time, belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings.*

This means that, to the extent that the law where the assets are situated protects the rights of a secured creditor and permits enforcement (notwithstanding the debtor's insolvency), these rights will trump any contrary provisions in the law of the main insolvency proceedings. While the use of "such a negative and vague phrase"[9] as "shall not affect" could lead to various interpretations, it is generally accepted to

8 See also Recitals 22, 39 and 68.
9 McCormack, "Security rights and the European Insolvency Regulation: a legal quagmire" (2016) 4 JIBFL 224.

be more than simply a choice of law rule, and to mean that a creditor may seek to enforce its security interest in the member state where the charged assets are situated despite the opening of insolvency proceedings. Investors may also take comfort from the wide drafting of Article 8, which covers future assets, monetary claims and other receivables. The reference in Article 8(1) to "collections of indefinite assets as a whole which change from time to time" gives comfort that a floating charge (a key concept in the United Kingdom and Ireland, but with no equivalent in most civil law jurisdictions) falls within the scope of the exemption.

Nevertheless the Article 8 exemption will not always be available. For instance, if assets are not situated in a member state, Article 8 will not apply and so the law of the main insolvency proceedings will determine the extent to which local law is to be followed. In this context the revised and improved *situs* rules contained in the recast EIR (considered under heading 10 below) are relevant. Note also the importance of the distinction between the local assets and the rights *in rem* over them; any surplus remaining after the exercise of such rights are subject to the law of the main insolvency proceedings. Furthermore the exemption in Article 8 is not applicable to security granted after the opening of the main insolvency proceedings; such rights will be subject to the law of the main insolvency proceedings. This is significant in view of the expansion, under the recast EIR, of proceedings which fall within its scope (some of which are early stage or interim proceedings). Fresh security granted in the context of such proceedings would not therefore benefit from the Article 8 exemption.

Despite the importance of the rights *in rem* exemption, some significant concerns remain about its scope.[10] Article 8 states that insolvency proceedings "shall not affect" secured creditors. However it is unclear how this principle sits alongside either the possibility of an insolvency practitioner making a payment to a secured creditor to extinguish its security right (especially in situations where the creditor is under-secured), or an obligation on a secured creditor to contribute to the general costs of the insolvency proceedings (eg, to pay the expenses of an administrator). An investor in secured debt might also be concerned as to the potential application of moratoria on enforcement, which could reduce the value of the collateral. This is particularly relevant as the recast EIR includes several provisions for a court to order a stay of opening proceedings or of enforcement proceedings. Although a new Recital 69 states that "any such stay should not affect the rights in rem of creditors," recitals are not binding, and so it is unclear how this principle might be respected alongside the overriding objective of business rescue (often facilitated by moratoria on security enforcement).

Article 9[11] provides that:

The opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of a debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim.

10 For further analysis of the uncertainties surrounding the application of the rights *in rem* exemption, see McCormack, "Security rights and the European Insolvency Regulation: a legal quagmire" (2016) 4 JIBFL 224.

11 See also Recital 70.

As a consequence, set-off rights potentially remain available to an investor, whether or not the law of the relevant insolvency proceedings permits set-off in the circumstances. Set-off receives very different treatment from one jurisdiction to another. For instance, most civil law systems apply a restrictive approach to insolvency set-off. When read together, Article 7 (applicable law) and Article 9 (set-off) potentially allow an investor to elect to take advantage of set-off rights where this is permitted under either the law of the contract (assuming the investor's claim derives from a contract incorporating an express and valid choice of law), or the law where proceedings are opened. There is some debate as to whether the 'law applicable' (for the purposes of Article 9) is restricted to the law of a member state (which is not an express requirement of Article 9, despite being an express requirement of other articles containing exemptions) and also whether 'law' for these purposes means the generally applicable civil or common law, or whether it could also encompass that member state's insolvency law. In some scenarios this may be a crucial question because set-off is commonly applied differently in insolvency. In the United Kingdom for instance, set-off is treated as a mandatory process which applies (as a matter of public policy) where requirements of mutuality are satisfied. Investors may be able to indulge in forum shopping in the application of available set-off rights, something which the recast EIR has attempted to restrict in other areas (for instance in its restrictions on COMI-shifting).[12] The wording of the Article 9 exemption also means that creditors likely to benefit from set-off will be best advised to ensure that the debtor's claim against them is expressly governed by a law which allows the broadest possible set-off rights.

Distressed investing will often relate to securities held in a payment or settlement system. The impact of counterparty insolvency on contracts between parties operating in such systems is therefore of significant commercial importance, crucial for the market to retain confidence in the binding nature of such transactions. Article 12 provides that:

> *… the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Member State applicable to that system or market.*

This rule is bolstered by Article 12(2), which states that actions for voidness, voidability or unenforceability of payments or transactions carried out under the relevant system (potentially detrimental to creditors) will be subject to the law applicable to the relevant system. A special proviso in Article 12(1) subjects the protection of rights *in rem* over assets belonging to the debtor to the law of the *situs* (as envisaged by Article 8, discussed above). As highlighted by Recital 71, Article 9 potentially overlaps with Directive 98/26/EC on settlement finality in payments and securities settlement systems (the 'Finality Directive'). Since the recast EIR does not include any express provisions on formal netting arrangements (beyond the comment in Recital 71 as to the "need for special protection in the case of … netting agreements to be found in such systems"), there is some uncertainty as to whether

12 Recital 29 to the recast EIR states: "This Regulation should contain a number of safeguards aimed at preventing fraudulent or abusive forum shopping."

the recast EIR may have a wider scope than the Finality Directive with regard to netting, and also whether netting arrangements are covered by Article 9 (set-off) or by Article 12 (payment systems and financial markets).

9. Debtors outside the scope of the recast EIR

A 'debtor' for the purposes of the recast EIR includes companies, legal persons and individuals. Recital 25 states that the recast EIR "applies only to proceedings in respect of a debtor whose centre of main interests is located in the Union". This potentially includes a debtor which is registered outside the European Union but which is found to have its COMI within it. The correct ascertainment of the debtor's COMI (as further discussed under heading 13 below) is therefore critical to determine whether a debtor is subject to the recast EIR. Debtors that do not have their COMI in a member state are out of the EIRs' scope. This is significant because even if a debtor has substantial connections with the European Union and assets located in member states, the EIRs will be of no assistance in achieving certainty of outcome for creditors. Where the EIRs do not apply, the pre-existing laws of each member state will apply to determine the conduct of proceedings and matters of cross-border recognition. Applicable rules will vary significantly depending on the location of relevant assets or counterparties. English courts, for instance, might instead have to apply the rules contained in the common law, the Cross-Border Insolvency Regulations 2006 (SI 2006/1030), Section 426 of the Insolvency Act 1986 or bilateral treaties with other non-EU states.

Article 1(2) of the recast EIR expressly excludes proceedings that concern specified entity types. Of particular reference to distressed-debt investing (depending on the nature of the investor's counterparty on any given trade), note that insolvency proceedings relating to credit institutions are outside the scope and reference should instead be made to the Credit Institutions Directive,[13] Bank Recovery and Resolution Directive (2014/59/EU) and implementing legislation such as (in the United Kingdom) the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (SI 2004/1045). Article 1(2) also excludes insolvency proceedings relating to insurance undertakings, investment undertakings and collective investment undertakings.

10. Where are distressed assets situated for the purposes of the recast EIR?

Article 2(9) contains rules determining where assets are situated for the purposes of the recast EIR. These rules are significantly more detailed than corresponding provisions in the 2000 EIR, reducing the scope for uncertainty. For example, registered shares in companies (unless they are held via an intermediary and constitute 'book entry securities') are deemed to be situated in the member state where the company that issued the shares has its registered office. Financial instruments, the title to which is evidenced by entries in a register or account maintained on behalf of an intermediary ('book entry securities') are deemed to be

13 Directive of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (2001/24/EC).

situated in the member state in which the register or account in which the entries are made is maintained. For instance, this includes bonds held through a clearing house such as Euroclear or Clearstream. Cash held in a bank account is deemed to be situated in the member state indicated on the account's international bank account number (IBAN). Clarification is also included as to the *situs* of other assets, such as intellectual property.

11. Related actions and recognition of judgments – which rules to apply?

Article 6 provides that the courts of the member state where insolvency proceedings have been opened will have jurisdiction for any action deriving directly from the insolvency proceedings and closely linked with them, such as avoidance actions. Recital 35 explains the purpose of Article 6 and states that:

> *Such actions should include avoidance actions against defendants in other Member States and actions concerning obligations that arise in the course of the insolvency proceedings, such as advance payment for costs of the proceedings. In contrast, actions for the performance of the obligations under a contract concluded by the debtor prior to the opening of proceedings do not derive directly from the proceedings. Where such an action is related to another action based on general civil and commercial law, the insolvency practitioner should be able to bring both actions in the courts of the defendant's domicile if he considers it more efficient to bring the action in that forum. This could, for example, be the case where the insolvency practitioner wishes to combine an action for director's liability on the basis of insolvency law with an action based on company law or general tort law.*

The EIRs and the recast Brussels Regulation[14] (the 'Judgments Regulation') are intended to be mutually exclusive and to "dovetail almost completely with each other".[15] However, confusion has often arisen as to how the two regimes should interact, and as to which proceedings, judgments and other actions derived therefrom fall within their scope.[16] Article 6 of the recast EIR is intended to codify existing principles governing the relationship between the Judgments Regulation and the EIRs.

Article 32 (recognition and enforceability of other judgments) provides for automatic recognition, without further formalities, of judgments given by competent courts concerning "the course and closure of insolvency proceedings, and compositions approved by the court". This rule applies to judgments deriving directly from the insolvency proceedings and closely linked with them, even if they were handed down by another court, and also to judgments relating to preservation measures taken after the request for the opening of insolvency proceedings or in connection with it. Article 32(2) provides that the recognition and enforcement of judgments that do not fall within the scope of the recast EIR will be governed by the Judgments Regulation.

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14 Council Regulation (EU) 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

15 Schlosser Report on the Brussels Convention [1979] OJ C59/91, [53]. See also *Re Rodenstock GMBH* [2011] BUS LR 1245 [47].

16 See, for example, C-295/13 *H (Liquidator of GT GmbH v HK* and C-111/08 *SCT Industri v Alpenblume; Polymer Vision R&D Ltd v Van Dooren* [2012] ILPr 14 and *Fondazione Enasarco v Lehman Brothers Finance SA* [2014] EWHC 34 (Ch).

12. Schemes of arrangement

Schemes of arrangement under Part 26 of the UK Companies Act 2006 allow a company to reach an arrangement or compromise with its members and/or creditors. With particular regard to distressed investing, it should be noted that the scheme of arrangement procedure is not included in Annex A (as it is not a "voluntary arrangement under insolvency legislation") and so falls outside the scope of the recast EIR. The English courts have, for many years, asserted a jurisdiction to sanction (ie, approve) schemes of arrangement in respect of foreign companies, including those domiciled in other member states and further afield. As a result English law schemes of arrangement have become an attractive option for the solvent restructuring of overseas companies. Recent case law has made it easier for an overseas company to establish a sufficiently close connection with England for the court to sanction a scheme of arrangement (for instance, on the basis of the company simply being party to finance documents governed by English law). Insolvency is not a prerequisite and the scheme of arrangement is a powerful restructuring tool: it will bind each class of members and/or creditors irrespective of whether they voted in favour of the scheme of arrangement, provided the requisite majority of that class of members or creditors approves the scheme of arrangement and it is sanctioned by the court. A scheme of arrangement is the only procedure available under English law that enables secured creditor claims to be compromised without their consent (ie, a cram down) if such approval and sanction are obtained. The English courts' extensive jurisdiction to sanction schemes of arrangement in respect of overseas companies would have been significantly restricted if schemes of arrangement had been included in Annex A. The impact of schemes of arrangement on distressed investing are covered in more detail in the "Schemes of arrangement" chapter of this book.

In *Re Rodenstock GmbH* [2011] EWHC 1104, Briggs J (as he then was) concluded that a scheme of arrangement, at least in respect of a solvent company, is a proceeding within the ordinary scope of the Judgments Regulation and should therefore be recognised in each other member state. Briggs J did, however, leave open the question of whether a scheme of arrangement in respect of an insolvent company could be said to be within the scope of the Judgments Regulation. The Judgments Regulation expressly states that it does not apply to "proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings."[17] In *In re Magyar Telecom BV* [2014] BCC 448, Richards J referred to *Rodenstock*, and suggested that a scheme of arrangement between an insolvent company and its creditors would fall within the Judgments Regulation, at least unless the company was subject to any insolvency proceeding failing within the EIR.

A foreign company proposing a scheme of arrangement and wishing to ensure that the English court is willing to assume jurisdiction under the Judgments Regulation might be well advised to ensure that at least one (preferably more, both in terms of number and in value) of its scheme creditors is domiciled in England

17 Judgments Regulation, Article 1(2)(b).

prior to launching the process. Article 8(1) of the Judgments Regulation provides that a person domiciled in a member state may be sued:

> *… where he is one of a number of defendants, in the courts for the place where any one of them is domiciled, provided that the claims are so closely connected that it is expedient to hear and determine them together.*

In *Rodenstock*, Briggs J suggested that if the Judgments Regulation applied, schemes could fall within the scope of this article, as scheme creditors, being entitled to appear and oppose the scheme, could be regarded as 'defendants' for this purpose. In *Re Van Gansewinkel Groep BV and others* [2015] EWHC 2151 (Ch) Snowdon J, and in *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch) Newey J, reached the same conclusion.

If the Judgments Regulation ceases to apply to the United Kingdom following its exit from the European Union this could affect the recognition of schemes of arrangement in the rEU. Those seeking to promulgate schemes in the United Kingdom would be required to establish recognition in the rEU via the application of rules of private international law, which could produce uneven results across rEU member states.

If the Judgments Regulation does not apply to a scheme of arrangement for an insolvent company, Article 32 of the recast EIR should ensure recognition of the scheme if it is proposed as part of a compromise through a main insolvency proceeding. However if the recast EIR is no longer applicable to the United Kingdom post-Brexit, this could result in continued uncertainty (see under heading 5 above).

13. Restrictions on moving a debtor's COMI to achieve a favourable outcome

The recast EIR contains various new provisions which are designed to curb abusive COMI-shifting. Companies commonly engineer an artificial shift in their COMI in order to make use of proceedings not available in their home jurisdiction, often to the disadvantage of unsecured creditors. English courts, for instance, have jurisdiction to appoint an administrator to a foreign company if it can be shown that the insolvent company's COMI is in the United Kingdom. This has led to overseas companies becoming subject to 'pre-packaged administrations' in the United Kingdom – an expedited sale process whereby an 'administrator in waiting', having concluded that the purposes of the administration are best served by selling some or all of the business and assets of a distressed company, negotiates with potential buyers and agrees a sale prior to the company going into administration. Once the company goes into administration, the sale assets are purchased by the buyer immediately thereafter. Pre-packs avoid an administrator having to deal with unsecured creditors, and the practice has received criticism for a perceived lack of transparency and accountability; see for example the case of *Re Damovo Group SA* (unreported, April 25 2007) and *Re Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (Ch).

One of the core objectives of the recast EIR is "preventing fraudulent or abusive forum shopping". Recital 28 states:

> *When determining whether the centre of the debtor's main interests is ascertainable by third parties, special consideration should be given to creditors and to their perception*

as to where a debtor conducts the administration of its interests. This may require, in the event of a shift of centre of main interests, informing creditors of the new location from which the debtor is carrying out its activities in due course.

Article 3(1) provides that, in the absence of evidence to the contrary, the COMI of a company is presumed to be the place of its registered office, and the COMI of an individual exercising an independent business or business activity, is presumed to be his principal place of business, while that of an individual not exercising an independent business or business activity, is presumed to be the place of his habitual residence.

Recital 30 of the recast EIR identifies the circumstances in which this presumption may be rebutted. These are, in relation to a company:

… where the company's central administration is located in a Member State other than that of its registered office, and where a comprehensive assessment of all the relevant factors establishes, in a manner that is ascertainable by third parties, that the company's actual centre of management and supervision and of the management of its interests is located in that other Member State.

A common hallmark of abusive forum shopping over the years has been an artificial COMI shift achieved shortly before entry into insolvency proceedings. Article 3(1) establishes a new look-back test, whereby the registered office presumption will only apply if the registered office has not been moved to another member state within the three-month period prior to the request for the opening of insolvency proceedings. Although this mechanism will make it harder to demonstrate an effective COMI migration (and is intended to prevent abuses), it will not necessarily frustrate a COMI shift required to complete an expedited debt restructuring using the EU procedure likely to achieve the most favourable outcome for creditors. A similar three-month look-back test applies to the definition of 'establishment', relevant to the facility to open territorial (or secondary) proceedings. This rule aims to prevent a debtor from impeding territorial proceedings by closing an establishment shortly before the onset of insolvency.

The Commission is keen to prevent abuses and the recast EIR requires it to submit a study on abusive forum shopping by June 27 2020.[18] The effectiveness of the new rules on COMI-shifting is promoted by additional safeguards designed to ensure that insolvency proceedings are opened in the appropriate jurisdiction. Under (new) Article 4, a court seised of a request to open insolvency proceedings (or, where insolvency proceedings are opened in accordance with national law without a decision of the court, the insolvency practitioner appointed in such proceedings) must of its own motion examine whether it has jurisdiction under Article 3, specifying the grounds on which jurisdiction is based. Under (new) Article 5, the debtor or any creditor may challenge the decision opening main insolvency proceedings. These new articles are intended to address the suspicion that the courts of some member states were not examining their jurisdiction with sufficient rigour. It will be interesting to see how the courts apply the COMI test where a migration occurs during the look-back period; for instance when faced with a challenge by a debtor or creditor under Article 5.

18 Recast EIR, Article 90.

14. Groups of companies

Groups of companies are addressed in a new Chapter V (insolvency proceedings of members of a group of companies) of the recast EIR, introducing procedural rules on the coordination of the insolvency proceedings of members of a group of companies. These include rules providing for coordination and cooperation between courts and insolvency practitioners, and the new possibility of synthetic (or virtual) secondary insolvency proceedings. The requirement in the EIR whereby territorial insolvency proceedings and secondary insolvency proceedings had to be liquidation proceedings has been removed. Where one company controls (directly or indirectly) another company, there will be a group of companies for the purposes of the recast EIR.

The recast EIR imposes duties on insolvency office-holders and courts seised of insolvency proceedings to cooperate ("to facilitate the effective administration of proceedings") and communicate with one another in respect of insolvency proceedings of group companies. Article 56 requires an insolvency practitioner, in implementing the required cooperation, to consider whether possibilities exist for coordinating the administration and supervision of the affairs of group members, and for restructuring group members, and if so to coordinate the proposal and negotiation of a coordinated restructuring plan. Article 60 confers various rights on an insolvency practitioner in respect of a group of companies, being:

- a right to be heard in any of the proceedings opened in respect of any other member of the same group;
- a right to request a stay of the realisation of assets in insolvency proceedings relating to any other member of the same group; and
- a right to apply for the opening of group coordination proceedings.

Of these, the right to apply for the opening of group coordination proceedings is perhaps the most significant. Such proceedings will involve the appointment of a 'group coordinator' to oversee the various insolvency proceedings and/or the restructuring of the group to facilitate a group coordination plan. Any court having jurisdiction over the insolvency proceedings of any member of the group may consider a request to open group coordination proceedings. Any insolvency practitioner appointed in respect of any member of the group may object to the inclusion of that member of the group in group coordination proceedings, but flexibility is given to that insolvency practitioner to opt back in later. Under Article 70, insolvency practitioners must "consider the recommendations of the coordinator and the content of the group coordination plan". The procedures for coordination of groups of companies are elaborate and it remains to be seen whether extensive collaboration between insolvency practitioners in different jurisdictions will prove to be workable in practice.[19]

19 See for instance Fletcher, "The European Insolvency Regulation Recast: the main features of the new law" 2015 (28) *Insolvency Intelligence* 97. Ian Fletcher QC expresses the view that the coordination procedures are so complex that it "cause[s] one to doubt whether this elaborate compromise will prove to be workable in practice."

15. Improved access to information for creditor and more user-friendly procedures for submitting claims

The recast EIR sets out a requirement for member states to establish national registers of insolvency proceedings by June 26 2018.[20] These are to display core information about the proceedings (listed in Article 24(2)) which will include practical details to inform creditors and enable them to file claims. Registers must be updated as soon as possible after the opening of any relevant proceedings. A second phase (applicable from June 26 2019) will entail the creation of a system for the interconnection of national registers. Core information on insolvency proceedings must be made available free of charge, but member states will be permitted to charge a reasonable fee for access to underlying documentation. Recital 76 states that the aim is to improve the provision of information to relevant creditors and courts and to prevent the opening of parallel insolvency proceedings.

The recast EIR includes provisions for the Commission to adopt further legislation to introduce standardised forms both for the notification of known foreign creditors when proceedings are opened and for the subsequent filing of claims by creditors. Article 53 (right to lodge claims) states that legal representation is not necessary for a creditor to lodge a claim, and that a foreign creditor may lodge claims "by any means of communication, which are accepted by the law of the State of the opening of proceedings". Article 54 (duty to inform creditors) potentially allows notices to "known foreign creditors" to be transmitted in another language, "if it can be assumed that that language is easier to understand for the foreign creditors". Article 55 (procedure to lodge claims) allows a creditor to lodge a claim in any official language of the European Union (although the creditor may still be required to provide an official translation). These changes should make communication easier for distressed investors, but it remains to be seen to what extent they will facilitate the prompt and cost-effective exchange of information and filing of claims across the European Union.

16. Conclusion

It is the authors' hope that the recast EIR will encourage greater investment (including distressed investment) in Europe, due to its greater emphasis on rescue and rehabilitation, by imposing mandatory obligations of cooperation and coordination between office-holders and courts, by facilitating group insolvency processes, and by creating interconnected insolvency registers to share information. Investors, it is submitted, want information, legal certainty, predictability of outcome and the ability and opportunity to participate in a rescue and/or restructuring which will recover value. The recast EIR should, at least in some part, help investors to meet those objectives. However some commentators have expressed concern that the new group coordination procedures are complex and may prove difficult to put into practice.[21]

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20 Recast EIR, Article 24.

21 See, for instance, Lane & Madsen, "Procedural law implications in the European Union under the Insolvency Regulation" in Olivares-Caminal (ed), *Expedited Corporate Debt Restructuring* (OUP, 2015): "Arguably, group coordination proceedings could increase restructuring costs in circumstances where little benefit is returned, and cross-border coordination is already separately provided for in the revised ECIR."

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