

# Teaching and Research in International Insolvency Law: Challenges and Opportunities

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## **Editorial Preface**

Leiden in Spring 2014 saw the INSOL Europe Academic Forum Joint Conference with NACIIL and the Leiden Law School assemble to pay tribute to Professor Bob Wessels, whose valedictory lecture was timed to coincide with the event.

Bob Wessels has had an impeccable pedigree combining aspects of practice, judicial expertise and academic excellence. He was an independent legal counsel, advisor and arbitrator with over 35 years of experience prior to being appointed as to the Chair of International Insolvency Law at the University of Leiden in 2007. Prior to this, he was also Professor of Civil and Commercial Law at the Vrije University Amsterdam, a position he occupied from 1988 to 2008. He has also been a partner of the Legal Services group (Moret) of Ernst & Young Tax Advisors and their alliance partner Holland van Gijzen Attorneys and Civil Law Notaries from 1993 until 2005, at which point he began his own practice.

Bob Wessels' particular contribution to international academia first became noted outside his home country at a conference in Brisbane hosted by Professor Rosalind Mason (Queensland University of Technology) in March 2005. He promoted the idea of greater co-operation between the delegates at the conference as well as the wider academic community working in insolvency. An immediate consequence of that meeting and the formation of the "Brisbane Initiative" was the proposal for an international insolvency diploma as an enhanced qualification for practitioners. The details of the project were elaborated at a conference in London in January 2006 at which academics and practitioners from a wide range of countries and backgrounds were represented. The project, taken up by INSOL International, saw its first cohort of 25 practitioners (now known as Fellows) begin in 2008 and is still going strong.

Bob Wessels has also been involved in a number of international projects reflecting his diverse interests. The first was the project jointly chaired with Professor Miguel Virgos (Madrid), which saw the development of the European Communication and Co-Operation Guidelines for Cross-Border Insolvency to expand on the duty contained in Article 31 of the then European Insolvency Regulation. The guidelines, which were formally adopted by INSOL Europe in Monaco in October 2007, were designed to assist courts and practitioners in determining the extent of possible co-operation in all cases with an international element. The second endeavour was the commission by the American Law Institute ("ALI") and the International Insolvency Institute ("III") of Professors Ian Fletcher and Bob Wessels as Joint Reporters of a project titled "Principles for Cooperation in International Insolvency Cases", which sought to examine the existence of an international consensus for harmonised rules for a co-operation framework. This project resulted in the adoption of the ALI-III Guidelines and Principles by those organisations at a meeting in New York in March 2012.

Building on the above initiatives, Bob was also instrumental in a successful joint funding bid in 2012 to the European Commission by the Leiden and Nottingham Law Schools, which developed principles and guidelines specifically aimed at judges called the “*EU Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines*”, subsequently also offering judicial training across Europe to judges on their intended operation. The guidelines are intended to support the workings of the European Insolvency Regulation (revised in 2015) to ensure that the text works efficiently and effectively to deal with debtors’ estates on a cross-border basis. This very much fits the current international environment for cross-border matters based on models reflecting cooperation and communication between courts and practitioners with which Bob has been very familiar and which also led him to set up NACIIL, joint hosts of this conference.

Bob also served as the Chair of the INSOL Europe Academic Forum from 2007 to 2010. During this period, a particular contribution of his to the future of the profession was the Young Academics’ Network (“YAN”) initiative, launched in 2009 and which groups together doctoral students and early career researchers across Europe, providing them with a support framework and the opportunity to engage in collaborative research on topics of common interest. Since 2010, YAN members have had a dedicated session within the Academic Forum conference schedule, where many have presented the fruits of their research and have also gone on to take up roles in the organisation. Bob continues to mentor doctoral students within the Leiden Law School and will do for some time to come.

It is in tribute to all of Bob’s many achievements that this modest offering is presented as a memento of the conference. In summary, we would like to express our appreciation to all those who have assisted in making the project a success, not least the contributors themselves. If not otherwise noted by the contributors, the law is stated as at 15 August 2015.

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## A Note on the Academic Forum

The INSOL Europe Academic Forum, founded in 2004, is a constituent body of INSOL Europe, a Europe-wide association of practitioners in insolvency. The Academic Forum's primary mission is to engage in the representation of members interested in insolvency law and research, to encourage and assist in the development of research initiatives in the insolvency field and to participate in the activities organised by INSOL Europe. The membership of the Academic Forum includes insolvency academics, insolvency practitioners with recognised academic credentials as well as those engaged in the research and study of insolvency. The Academic Forum meets annually in conjunction with the main conference of INSOL Europe and also arranges half-yearly conferences around suitable themes of interest to the practice and academic communities. Previous meetings have taken place in Prague (2004), Amsterdam (2005), Monaco (2007), Leiden and Barcelona (2008), Brighton and Stockholm (2009), Leiden and Vienna (2010), Milan, Venice and Jersey (2011), Nottingham and Brussels (2012), Trier and Paris (2013), Leiden and Istanbul (2014) as well as Trier and Nottingham (2015).

At the Paris 2013 conference, Professor Christoph Paulus, of the Humboldt University Berlin, where he is the Chair of Civil, Civil Procedural, Insolvency and Roman Laws, was elected Chair of the Management Board for a three-year term. Paul Omar (Nottingham Trent University, the United Kingdom) serves as Secretary to the Board, while Florian Bruder (Max Planck Institute, Germany), Jessica Schmidt (University of Bayreuth, Germany), Rolef de Weijs (Chair of the Young Academics' Network), Emmanuelle Inacio and Myriam Maily (INSOL Europe Technical Officers) as well as Professor Michael Veder (Radboud University Nijmegen, the Netherlands) are ordinary members of the Board. Professor Rebecca Parry (Nottingham Trent University, the United Kingdom) is the Editor of the Conference Proceedings series and *ex officio* a member of the board. A Supervisory Committee has also been established as a consultative board for Academic Forum projects whose membership includes senior insolvency academics and practitioners.

The Academic Forum is sponsored by SGH Martineau, who took over sponsorship from Edwin Coe LLP in 2014. With the sponsorship received, the Academic Forum offers travel grants to enable up to 5 young scholars to attend and deliver papers at each conference, in some cases speaking to an international audience for the very first time. The funding has also permitted the inauguration of a series of lectures given by judges, practitioners and academics of international repute and eminence. Previous speakers have included Professor Jay Westbrook (University of Texas, the United States), Gabriel Moss QC (3/4 South Square, Gray's Inn, the United Kingdom), The Hon Mr Justice Ian



Kawaley (Supreme Court of Bermuda), Professor Dr. Karsten Schmidt (President of the Bucerius Law School, Germany), Professor Bob Wessels (Leiden Law School, the Netherlands), Professor Ian Fletcher (University College London, United Kingdom) and Professor Rosalind Mason (Queensland University of Technology, Australia).

A series of publications arising from Academic Forum conferences was inaugurated in 2009 by reports from the 2008 Leiden and Barcelona events. These have now been joined by conference proceedings booklets from most of the conferences listed above with others yet to come. In early 2015, the Academic Forum reached a milestone with the publication of the 21st volume in the series titled “International Insolvency Law: Future Developments”. Overall, the publications are intended to form a comprehensive report of the conferences and contain accounts of recent research in the insolvency field useful for academics and practitioners alike. The series inaugurated by the Academic Forum has also served to stimulate debate and discussion in the academic arena and are a useful indicator of current themes and future developments in the subject area.

The Academic Forum’s next event will be its annual meeting on 30 September-1 October 2015 in conjunction with the INSOL Europe conference in Berlin. Further conferences are being planned for 2016 and beyond. Details of academic conferences will be posted at the Academic Forum website at: [www.insol-europe.org/academic/](http://www.insol-europe.org/academic/) as and when available. Further information about the work of the Academic Forum can also be obtained via the website as well as a dedicated Facebook page.

## A Note on NACIIL

In August 2011, the *Netherlands Association for Comparative and International Insolvency Law (NACIIL)* (in Dutch: *Nederlandse Vereniging voor Rechtsvergelijkend en Internationaal Insolventierecht*; or *NVRII*) was established. Its goal is to promote an interest in and knowledge of comparative and international insolvency law. To this end, the association holds conferences and organises lectures or courses, initiates student initiatives and the publication and distribution of articles and reports. As many of the initiatives are in English, the association also reaches out to professionals, scholars and students (with their COMI) outside the Netherlands in an aim to further jointly the development of comparative and international insolvency law. At present, the Association has over 160 members.

The board of the *Netherlands Association for Comparative and International Insolvency Law* is composed of:

Professor Bob Wessels, Professor of International insolvency law, University Leiden (chair);

Professor Michael Veder, Professor of Civil Law, Radboud University Nijmegen and Advisor to Resor N.V., Amsterdam (vice-chair);

Anthon Verweij, LL.M, PhD-Fellow, Centre for Business Administration, Faculty of Law, University Leiden (secretary/treasurer).

The other members of the board are:

Dr. André Berends, Ministry of Finance, The Hague;

Jasper Berkenbosch, Partner at DLA Piper;

Hon. Justice Mincke Melissen, Vice-President, District Court of Amsterdam;

Robert van Galen Esq., Partner at Nauta Dutilh N.V, Amsterdam;

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Website in Dutch: [www.nvrii.org](http://www.nvrii.org); website in English: [www.naciil.org](http://www.naciil.org)

To become a member of NACIIL (financial contribution EUR 35 per year, which includes the reports of the annual meeting) or a sponsor of any of the conferences, please contact: [a.m.verweij@law.leidenuniv.nl](mailto:a.m.verweij@law.leidenuniv.nl)

**PART I**  
**RESEARCH AND YOUNG**  
**ACADEMICS' NETWORK**



# Chapter 1

## In Pursuit of a Middle Way for China's Regional Cross-Border Insolvency

Xinyi Gong\*

### **I Introduction: Why is a Regional Arrangement Needed: A Reply of Supreme People's Court<sup>1</sup>**

In 2011, upon a request for recognition of the winding-up proceeding concerning *Norstar Automotive*, the Beijing High Court referred a question to the Supreme People's Court in order to make clear whether or not the winding-up order rendered by the Hong Kong High Court can be recognized in the Mainland. The Supreme People's Court replied:

“In accordance with the Article 1 of Arrangement of the Supreme People's Court between the Mainland and the HKSAR on Reciprocal Recognition and Enforcement of the Decisions of Civil and Commercial Cases Pursuant to Choice of Court Agreements between Parties Concerned, the winding-up order in dispute does not fall within the ambit of the enforceable final judgment under the Arrangement and thus the Arrangement is irrelevant to this case. The Article 265 of the Civil Procedure Law and the Article 5 of the Enterprise Bankruptcy Law, which provide rules on recognition and enforcement of *foreign* judgments (bold and italics added by the author) cannot be applied to this case, either. The decision of your court that in accordance with the aforementioned legislation, recognition of the winding-up order in dispute can be granted is groundless.

In conclusion, it is lack of legal basis that the Mainland court could recognize the winding-up order rendered by the Hong Kong High

\* The author would like to express the greatest debt of gratitude to her supervisor, Professor Bob Wessels, for his inspiration and instruction. If there are any errors or omissions, the responsibilities are solely the author's.

1 The conference paper was a summarized version of my article with the title “A Middle Way --- Tailoring the Model Law and the Regulation into China's Context”, which is created on the basis of one of the chapters in my PhD dissertation, partly published on <http://www.iiiglobal.org/iii-prize-in-insolvency.html> and at present has the working title “In Pursuit of a Middle Way for China's Regional Cross-border Insolvency”.

Court. The court shall refuse to recognize the winding-up order in dispute.”<sup>2</sup> (translated by the author)

The reply of the Supreme People’s Court reveals the impact of China’s complex political composition on its legal systems. After the People’s Republic of China resumed its sovereignty over Hong Kong and Macao respectively in 1997 and 1999, China becomes a country composed of peculiar political compounds, which include the Mainland China,<sup>3</sup> Hong Kong SAR, and Macao SAR. In accordance with the Basic Law, Hong Kong and Macao, as Special Administrative Regions (SAR), enjoy the high degree of executive, legislative autonomy and *independent* judicial power (emphasis added by the author), including that of final adjudication of SAR.<sup>4</sup> From then on, Hong Kong and Macao can no longer be treated as “foreign” jurisdictions. Due to the new identity of the two SARs, the regional legal cooperation arrangements have to be stipulated to fill in the gap.<sup>5</sup> Otherwise, without the appropriate legal basis, as stated in the reply of the Supreme People’s Court, the judgments rendered by the SAR courts cannot be recognized. As for Taiwan, there is still political uncertainty. Nevertheless, the cross-strait relationship is undergoing changes due to closer economic cooperation.<sup>6</sup> The cross-strait legal cooperation was initiated since 2009 when the Mainland and Taiwan entered into the Agreement between Both Sides of the Taiwan Strait on Jointly Fighting against Crimes and Mutual Judicial Assistance. Nevertheless, insolvency has not been included into the regional legal cooperation arrangements among the four regions yet.

2 [2011] Supreme People’s Court Civil Order No. 19 (in Chinese).

3 In this chapter, the Mainland China purely serves as a geographic term to describe the geopolitical area under the jurisdiction of the People’s Republic of China (PRC), generally excluding the PRC Special Administrative Regions of Hong Kong and Macao.

4 Articles 16, 17 and 19, Basic Law of HKSAR; Articles 16, 17 and 19, Basic Law of Macao SAR.

5 The arrangements concerning recognition and enforcement of civil and judicial judgments: Hong Kong SAR and the Mainland:

- 2006 Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned;

Macao SAR and the Mainland:

- 2006 Arrangement Between the Mainland and the Macao Special Administrative Region on the Mutual Recognition and Enforcement of Civil and Commercial Judgments.

6 In 2010, the signing of the Cross-strait Economic Cooperation Framework Agreement (ECFA) embarked on a new era of the economic interaction between the two sides. This agreement is a preferential trade agreement between the governments of the Mainland China and Taiwan that aims to reduce tariffs and commercial barriers between the two sides. As for the cross-strait relationship, the visible development is that See A. Ramzy, *China and Taiwan Hold First Direct Talks Since ‘49* (New York Times, 11 February 2014), available at: [http://www.nytimes.com/2014/02/12/world/asia/china-and-taiwan-hold-first-official-talks-since-civil-war.html?\\_r=0](http://www.nytimes.com/2014/02/12/world/asia/china-and-taiwan-hold-first-official-talks-since-civil-war.html?_r=0) (last viewed 15 July 2014).

There are two regimes that both successfully contribute to the international development of the cross-border insolvency, which are the UNCITRAL Model Law on Cross-border Insolvency 1997 (the “Model Law”) and the European Insolvency Regulation (Council Regulation (EC) 1346/2000) (the “EIR”). Although there have been a few multilateral initiatives in dealing with issues arising from cross-border insolvency, either on the international level or on the regional level, most of them failed to gain wide and active acceptance.<sup>7</sup> Hence, it is of significance to conduct comparative research on the two regimes to discover their respective merits as well as their differences, which will help to find a better solution to China’s cross-border insolvency issues. Meanwhile, it is also important to figure out how China’s “group” characteristics will influence the way of adopting those two regimes.

## II A Model Law or A Regional Arrangement: China in a Group Context

In the course of international cooperation, the consequence of the political reality is that it might involve “four Chinas”. For instance, in the WTO Agreement, the People’s Republic of China, “Hong Kong, China”, “Macao, China” as well as “Chinese Taipei”<sup>8</sup> all enjoy full membership of WTO.<sup>9</sup> Therefore, to adopt the Model Law in China, it means to adopt the Model Law in four independent jurisdictions. The Model Law is not designed for regional cooperation but aims at

- 7 For instance, some has been replaced by the EIR. For instance, the Nordic Bankruptcy Convention of 1933. Some refer to the EIR and share the similarities, such as the Uniform Insolvency Act of OHADA in Africa, which has proven the status of the EIR as benchmark for other regional initiatives. See B. Wessels, *International Insolvency Law* (Volume X) (3rd ed) (2012, Kluwer, Deventer), at paragraph 10077. As for the Southern African Development Community, some have adopted the Model Law route, like South Africa: *Ibid.*, at paragraph 10080. In Latin America, some relevant efforts have been made, for example, through Treaty of Montevideo 1940. However, with limited provisions it was not that successful. See P. Wood, *Principles of International Insolvency* (2nd ed) (2007, Sweet & Maxwell, London), at paragraph 29-081; see also I. Fletcher, *Insolvency in Private International Law. National and International Approaches* (2nd ed) (2005, Oxford University Press, Oxford); T. Araya and J. Donaldson, Latest Events on Cross-border Insolvency in Latin America (February 2006), copy available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=874627](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=874627) (last viewed 15 July 2014).
- 8 On 1 January 2002, Taiwan acceded to WTO under the title of “Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu”, abbreviated as “Chinese Taipei”. As stated in the literatures of Taiwanese scholars, the fact that Taiwan did not use the “Republic of China” as its official title to join the WTO shows its reluctant compromise with political reality. In addition, due to PRC’s insistence, Taiwan joined the WTO 1 day after PRC’s accession. See P. Hsieh, “Facing China: Taiwan’s Status as a Separate Customs Territory in the World Trade Organization” (2005) 39(6) *Journal of World Trade* 1195; See also C-H. Wu, “A New Landscape in the WTO: Economic Integration Among China, Taiwan, Hong Kong and Macao” (2012) 3 *European Yearbook of International Economic Law* 241, at 241-242.
- 9 Prior to PRC and Taiwan becoming members of the WTO, Hong Kong had become a contracting party to GATT from 23 April 1986 and Macao on 11 January 1991 under the arrangements of UK and Portugal. After PRC resumed the exercise of sovereignty over Hong Kong and Macao as from 1997 and 1999, the two SARs will, on their own, continue to be WTO Members, using the name of “Hong Kong, China” and “Macao, China”. See the WTO documents: [http://www.wto.org/english/thewto\\_e/acc\\_e/chinabknot\\_feb01.doc](http://www.wto.org/english/thewto_e/acc_e/chinabknot_feb01.doc) (last viewed 15 July 2014) As for the legal basis, please refer to Article 152, Basic Law of HKSAR; Article 137, Basic Law of Macao SAR.

promoting the efficiency of dealing with the cases of the cross-border insolvency on a global level. Considering the diversity of national legislations, the drafters placed text in italics between square brackets to “instruct” the national legislators to complete the text in their own way.<sup>10</sup> Although the spirit of a Model Law and the intention of its drafters, is that a State should stay as close as possible to the text of the Model Law to ensure a degree of certainty and predictability, the degree of certainty achieved in relation to harmonization is likely to be lower than that resulting from a convention<sup>11</sup> since the character of the Model Law, as a soft law instrument, is a recommendation in essence.

Nevertheless on a regional level, it is easier to achieve uniformity than on a global level, for instance, the EIR. However, a regional regime cannot simply be copied and pasted. Even under the circumstances that the conventions can be implemented in both the Mainland and the two SARs, it is still necessary to make some regional arrangements since those conventions are only applicable to the “States”, which is deemed as inappropriate to deal with the relevant domestic issues. Furthermore, more considerate arrangements are made exclusively for the regional cooperation. The New York Convention is such an example. Although both the Mainland and the two SARs are contracting “States” to the New York Convention, mutual arrangements are signed in dealing with the enforcement of arbitral awards among the three regions.<sup>12</sup> Nevertheless, it is noteworthy that one of the most important provisions, Article V of the New York Convention, is almost copied and pasted in each of the three arrangements.<sup>13</sup> Therefore, to some extent, it seems that the New York Convention serves as the “model law” *de facto* for the relevant regional cooperation in China.

### III In Pursuit of a Middle Way

#### *The Coordinated Approach*

From pure universalism to modified universality, from ancillary proceedings with extra-territorial jurisdiction to parallel proceedings with main and non-main

10 A. Berends, “The UNCITRAL Model Law on Cross-border Insolvency: A Comprehensive Overview” (1998) 6 *Tulane Journal of International and Comparative Law* 309, at 320, 323.

11 Wessels, above note 7, at paragraph 10195; See also UNCITRAL Guide to Enactment and Interpretation, at paragraph 22.

12 Hong Kong SAR and the Mainland China: Arrangement Concerning Mutual Enforcement of Arbitral Awards (1999); Macao SAR and the Mainland China: Arrangement Concerning Mutual Recognition and Enforcement of Arbitral Awards between the Mainland and the Macao Special Administrative Region (2007); Hong Kong SAR and Macao SAR: Arrangement Concerning Reciprocal Recognition and Enforcement of Arbitral Awards Between the Hong Kong Special Administrative Region and the Macao Special Administrative Region (2013).

13 Article 7, Hong Kong SAR and the Mainland Arrangement; Article 7, Macao SAR and the Mainland Arrangement; Article 7, Hong Kong SAR and Macao SAR Arrangement.



jurisdiction, the way to approach universalism is undergoing changes. To identify whether or not it is main or non-main is just one way to approach universalism as close as possible. However, it does not mean it equals to universalism. There are variations of modified universality and territoriality.<sup>14</sup> The EIR, which “seeks to reconcile the advantages of the principle of universality and the necessary protection of local interests”,<sup>15</sup> according to Wessels, is based on the model of “coordinated universalism”.<sup>16</sup> How to coordinate the main and secondary proceedings? It is Article 31 of the EIR that gives the answer, which provides cooperation and communication between liquidators. From the experience of the Model Law, regardless of universalism or territorialism, UNCITRAL introduced the provisions concerning cooperation and communication between the courts and representatives of the parallel proceedings.<sup>17</sup>

Moreover, both the EIR and the Model Law are designed merely for individual debtors. They do not provide treatment for enterprise groups, which are multiple proceedings involving more than one debtor of the same group. However, it is an era that investment flows global. In accordance with the World Investment Report 2014 issued by United Nations Conference on Trade and Development (“UNCTAD”), 39% of global FDI flows to developed countries, while those to developing economies reached 54 per cent of the total and the rest went to transition economies. Meanwhile:

“transnational corporations (TNCs) from developing economies are increasingly acquiring foreign affiliates from developed countries located in their regions. Developing and transition economies together invested 39 per cent of global FDI outflows, compared with only 12 per cent at the beginning of the 2000s.”<sup>18</sup>

Will the host forum solution, i.e. a single center through one court and subject to a single governing law, which currently represents the principle of universality in

14 For example, “strengthening universality”: H. Buxbaum, “Rethinking International Insolvency: The Neglected Choice-of-Law Rules and Theory” (2000) 36 *Stanford Journal of International Law* 23; “contractualism”: R. Rasmussen, “A New Approach to Transnational Insolvencies” (1999) 19 *Michigan Journal of International Law* 1; “virtual territoriality”: E. Janger, “Virtual Territoriality” (2010) 48 *Columbia Journal of Transnational Law* 401; “cooperative territorialism”: L. LoPucki, “The Case of Cooperative Territoriality in International Bankruptcy” (2000) 98 *Michigan Law Review* 2216.

15 Virgós-Schmit Report, no.13.

16 Wessels described the basic principle as coordinated universality. See Wessels, above note 7, at paragraph 10456. While some scholars also considered the basic principle as modified universality, for which see M. Virgós and F. Garcimartín, *The European Insolvency Regulation: Law and Practice* (2004, Kluwer Law International, Deventer), at no. 17.

17 Chapter IV, Model Law.

18 UNCTAD, World Investment Report 2014, at ix.

dealing with a single debtor, still work in a group context? It will meet challenges in practice, in particular the complicated internal structure and arrangement of groups, which might be undetectable to the third parties. According to UNCTAD:

“TNCs frequently make use of special purpose entities (SPEs) to channel their investments, resulting in large amounts of capital in transit. For example, an investment by a TNC from country A to create a foreign affiliate in country B might be channeled through an SPE in country C. In the capital account of the balance of payments of investor home and host countries, transactions or positions with SPEs are included in either assets or liabilities of direct investors (parent firms) or direct investment enterprises (foreign affiliates) indistinguishable from other FDI transactions or positions.”<sup>19</sup>

Neither EU nor UNCITRAL opted for a group center approach. In EU, as aforementioned, the EIR is undergoing reform. Both the European Commission and the Parliament did not try to accommodate main proceedings for the enterprises group but attach value to cooperation and communication, in particular between courts.<sup>20</sup> According to Moss, it is too complicated to define a COMI of a group and might trigger forum-shopping problems by making arrangement of the ultimate parent company in advance.<sup>21</sup> In regard to whether or not to adopt COMI to enterprise groups, UNCITRAL indicated the difficulty, partly related to “the very nature” of multinational enterprise groups, including a proper definition of group, relevant determinative factors and jurisdiction over members etc., partly owing to the challenge of reaching widely accepted global consensus on these issues.<sup>22</sup> Instead, it is indicated in the new Part Three of the UNCITRAL Legislative Guide on Insolvency Law (Treatment of Enterprise Groups in Insolvency (2010)) (“Legislative Guide on Enterprise Groups”) that enterprise groups usually relates to more than one debtor and thus the link between parallel proceedings of all members of the same group might not be well connected.<sup>23</sup> That is why cooperation and communication between a court and a foreign court or foreign representatives becomes so important that it builds up bridges between all those

19 Ibid., Chapter I, at 3.

20 European Parliament legislative resolution of 5 February 2014 on the proposal for a regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (COM(2012)0744 – C7-0413/2012 – 2012/0360(COD)), Recital 20a.

21 G. Moss, “A Very Decent Proposal: The European Commission’s Proposals for Reforming the EC Regulation on Insolvency Proceedings 1346/2000” (2013) 26(4) *Insolvency Intelligence* 56.

22 Legislative Guide on Enterprise Groups, at Chapter III, at paragraphs 5-6.

23 Ibid. at paragraph 9.

separate proceedings concerning one group, which helps to reinforce commercial predictability and promote fair and efficient administration of proceedings.<sup>24</sup>

In addition to EU and UNCITRAL, a more recent model is *Global Principles for Cooperation in International Insolvency Cases* (“Global Principles”)<sup>25</sup> contributed by Fletcher and Wessels, who were appointed by the American Law Institute (“ALI”) and the International Insolvency Institute (“III”) to prepare a Report in which the Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (“Court-to-Court Guidelines”) is also included. These Guidelines in their original form were included in Appendix B of the ALI-NAFTA Principles and represent procedural suggestions for increasing communications between courts and between insolvency administrators in cross-border insolvency cases. These ALI-NAFTA Guidelines have already been used in many cross-border cases, recently in such cases as *Lehman Brothers* involving some 70 insolvency proceedings in 17 countries all over the world.<sup>26</sup>

The ultimate goal of a cross-border insolvency regime is to find a way coordinating all those competing proceedings. Since business nowadays goes global, which has been proved via the data collected by UNCTAD, it is getting more and more difficult to identify a “home” for debtors, especially in the case of enterprise groups. Thus both EU and UNCITRAL have adopted cooperation and communication, parallel to the COMI approach, based on respect for independence and authority of sovereign courts as neutral and efficient mechanism, which coordinates multiple insolvency proceedings of enterprise groups across different jurisdictions. Even the key supporter of territorialism, LoPucki, also advocates in his theory of “cooperative territorialism” that every state can administrate the bankruptcy asset located within its jurisdiction and meanwhile courts and representatives should cooperate and communicate.<sup>27</sup> If universalism is regarded as the “golden thread”,<sup>28</sup> it seems that cooperation and communication can properly serve as golden bridge across the boundary set up by universalism and territorialism. In particular, with respect to enterprise groups, it will be more efficient to facilitate cooperation and

24 Ibid. at paragraph 7.

25 The Report is based on a global research and survey and aims at a worldwide acceptance of the ALI-NAFTA Principles.

26 American Law Institute and International Insolvency Institute, “Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases: Report to the ALI” (2012, American Law Institute, Philadelphia PA) (no page number is provided in the online version), available at: <http://www.iiiglobal.org/component/jdownloads/finish/557/5932.htm> (last viewed 15 July 2014).

27 L. LoPucki, “Cooperation in International Bankruptcy: A Post-Universalist Approach” (1999) 84 *Cornell Law Review* 750.

28 *McGrath and Others v Riddell* [2008] UKHL 21, at paragraph 30.

communication between courts on an equal basis as well as between courts and insolvency practitioners.

### *Balance between Mutual Trust and Reciprocity*

To achieve cooperation in that regard, there are different options available. One is the principle of mutual trust under the EIR. In retrospect to EU's integration experience, from the Treaty of Paris to the Treaty of Lisbon, it is clear that mutual trust can simply not be established overnight.<sup>29</sup> Moreover, the relationship between China and the two SARs cannot be deemed as a Union, a supranational organization and member states but a Central People's Government and local administrative regions, which shall enjoy a high degree of autonomy and come directly under the Central People's Government.<sup>30</sup> In pursuit of resumption of sovereignty, the Central Government, based on the "one country, two systems" policy, restrains its power and promises to keep the way of life as it is in both regions within 50 years in accordance with the Basic Law.<sup>31</sup> However, in a country with two systems, conflicts are something inevitable. For instance, after reunification, there are several occasions, which incurred the interpretation of the Basic Law. Each of them might challenge the smooth implementation of the Basic Law. In 1999 there was dispute involving the right of mainland-born children to stay in HKSAR and resulted in a series of related cases.<sup>32</sup> The second one related to the constitutional development of Hong Kong, specifically the provisions in the Basic Law on the method for the selection of the Chief Executive and the method for the formation of the Legislative Council after 2007.<sup>33</sup> The third occasion related to the length of office of the Chief Executive of Hong Kong.<sup>34</sup> In addition, in a case between an American company against the Democratic Republic of the Congo (DR Congo), it raised the problem related to the application of the doctrine of state immunity.<sup>35</sup>

29 D. Chalmers, G. Davies and G. Monti, *European Union Law* (2nd ed) (2010, Cambridge University Press, Cambridge), at 1-48.

30 Article 12, Basic Law of HKSAR; Article 12, Basic Law of Macao SAR.

31 Article 5, Basic Law of HKSAR (Chapter I General Principles); Article 5, Basic Law of Macao SAR (Chapter I General Principles).

32 *Ng Ka Ling & Others v Director of Immigration* (1999) 2 HKCFAR 4 and *Chan Kam Nga & Others v Director of Immigration* (1999) 2 HKCFAR 82.

33 The Basic Law does not have clear provisions spelling out the procedures for amending the relevant provisions. See Basic Law - the Source of Hong Kong's Progress and Development, Chapter 2 in M. Tam (ed), *The Basic Law and Hong Kong - The 15th Anniversary of Reunification with the Motherland* (2012, HK Government, Hong Kong), at 86-87, available at: [http://www.basiclaw.gov.hk/en/publications/book/15anniversary\\_reunification\\_ch2\\_3.pdf](http://www.basiclaw.gov.hk/en/publications/book/15anniversary_reunification_ch2_3.pdf) (last viewed 15 July 2014).

34 In March 2005, the State Council accepted the resignation of the second-term Chief Executive in the middle of his five-year term. A question arose as to whether the term of office of his successor should be a full five-year term, or the remainder of the original five-year term (i.e. two years): *Ibid.*, at 87.

35 On 26 August 2011, the SCNPC confirmed, inter alia, that Hong Kong should grant absolute state immunity to DR Congo: *Ibid.*, at 87-88.

It seems that mutual trust is still under construction in China, which might still be too high to be reached at this moment.

The principle of reciprocity is applied right now in the Mainland. It is provided under Article 5 of the Enterprise Bankruptcy Law (“EBL”) that in addition to international treaties, the principle of reciprocity serves as one of the conditions to grant recognition to foreign insolvency proceedings. In Taiwan, the latest draft of Taiwan Bankruptcy Act, it is stated that the Taiwan court shall dismiss the application of recognition if the foreign court that opened the insolvency proceeding does not recognize the Taiwan insolvency proceedings,<sup>36</sup> which has been summarized by Westbrook as negative reciprocity.<sup>37</sup> Nevertheless, it might not be appropriate to apply the same approach to each other within a region where the integration is undergoing as those applied to the foreign insolvency proceedings. The principle of reciprocity could result in a stalemate or retaliatory action concerning recognition and thus goes against the purposes of closer cooperation. In fact, comity is also the approach currently adopted by the Hong Kong court. In the case of *Hong Kong Institute of Education v. Aoki Corporation* [2004] 2 HKLRD 760, the court held that:

“The attitude of comity in relation to foreign insolvency (or similar) proceedings is one which English and Hong Kong Courts have espoused.”<sup>38</sup>

Moreover, it has been said that in the absence of reciprocity, only international agreements may achieve cooperation.<sup>39</sup> As aforementioned, on the regional level, there are already mutual arrangements in matters of recognition of civil or commercial judgments between the Mainland China and the other three regions.<sup>40</sup> If the principle of reciprocity is adopted to deal with regional legal cooperation in China, it can be deemed as a step backward in that regard. In a region where the socio-economic cooperation is getting closer, people, products and problems gradually move freely cross the border and out of reach of their own jurisdiction.

36 Article 299, Taiwan Debt Clearance Act (latest draft), published online by the Judicial Yuan on 14 February 2014.

37 J. Westbrook, “Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum” (1991) 65 *American Bankruptcy Law Journal* 457, at 468.

38 *Hong Kong Institute of Education v. Aoki Corporation* [2004] 2 HKLRD 760, at paragraph 125.

39 P. Omar, “The Landscape of International Insolvency Law” (2002) *International Insolvency Review* 173, at 184.

40 2006 Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned; 2006 Arrangement Between the Mainland and the Macao Special Administrative Region on the Mutual Recognition and Enforcement of Civil and Commercial Judgments; 2009 Agreement between Both Sides of the Taiwan Strait on Jointly Fighting against Crimes and Mutual Judicial Assistance.

To achieve the expectation that the local interests can be protected once located in some other neighboring jurisdiction, every region has to often rely on each other in the way of cooperation. Thus, comity, which is a principle, softer than mutual trust but stronger than reciprocity, can serve as the proper legal basis that encourages the local courts to act all times to increase regional legal ties in order to advance the comprehensive and enhanced legal cooperation among the four regions in China.

### *Functional Jurisdiction Solution*

From *Eurofood* to *Interedil* and *Rastelli*, the CJEU clearly set up the central administration as the criterion for jurisdiction. It has also streamlined the key conditions to the rebuttal of the presumption. The influence of its contribution has been adopted into the proposal with respect to the amendment to the EIR prepared by the EU Commission as well as the EU Parliament.<sup>41</sup> The key-points, such as “central administration”, “objective and ascertainable by the third party” and “a comprehensive assessment of all the relevant factors”, which directly derived from the judgment rendered by the CJEU, clearly left its track on both legislative proposals. Once adopted, they will influence the interpretation of COMI in a more direct way.

In fact, the authoritative interpretation on COMI rendered by the CJEU also has its impact on the Model Law. In 2013, recognizing that some uncertainty with respect to the interpretation of certain provisions of the Model Law has emerged in the jurisprudence arising from its application in practice, Working Group V of UNCITRAL issued additional guidance through revision of the Guide to Enactment of the Model Law on Cross-Border Insolvency with respect to the interpretation and application of selected aspects of the Model Law to facilitate uniform interpretation,<sup>42</sup> in which it has been repeatedly stressed that:

“Notwithstanding the different purpose of center of main interests under the two instruments, the jurisprudence with respect to interpretation of that concept in the EC Regulation may be relevant to its interpretation in the Model Law.”<sup>43</sup>

With respect to the decisive factors, which should be taken into consideration in determining COMI, it is stated under the Guide and Interpretation that:

41 Amendment 6, European Parliament legislative resolution of 5 February 2014 on the proposal for a regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (COM(2012)0744 – C7-0413/2012 – 2012/0360(COD)).

42 Document Number A/RES/68/107 A-B.

43 UNCITRAL Guide to Enactment and Interpretation, at paragraphs 82, 141.

“In most cases, the following principal factors, considered as a whole, will tend to indicate whether the location in which the foreign proceeding has commenced is the debtor’s center of main interests. The factors are the location: (a) where the central administration of the debtor takes place, and (b) which is readily ascertainable by creditors.<sup>44</sup>

... In all cases, however, the endeavour is an *holistic* one, designed to determine that the location of the foreign proceeding in fact corresponds to the actual location of the debtor’s centre of main interests, as readily *ascertainable by creditors*.<sup>45</sup> (bold and italics added by the author)

Why do the identical terms serving different purposes under different regimes end up with the identical interpretation? It is partly because of the nature of the Model Law, which is merely a recommendation and countries are free to enact it as they wish.<sup>46</sup> It will be left to the enacting States to decide whether or not to adopt it. The other reason is that the EIR is established on a viable government structure that can supervise and unify the interpretation of the EU legislation. The Model Law is not. Without the equivalent institutional arrangement like the CJEU, it seems to be unlikely that the interpretation of COMI under the Model Law can achieve the same degree of uniformity as that under the EIR.

It has been acknowledged that at this moment it is unlikely to establish a permanent court with a purely legal competence in China, which is equivalent to the CJEU. So far, instead of direct judicial contact between the courts, the judicial cooperation between the Mainland and the two SARs, which is provided under the Basic Law,<sup>47</sup> is maintained in a judicial and administrative mixed character.<sup>48</sup> The cross-border insolvency is a matter, which should be left to the courts to decide and interference from the government, though more or less inevitable, should be reduced as much as possible. Hence, to solve the cross-border insolvency disputes between a supreme court and the governments cannot be deemed as appropriate. To tackle the

44 Ibid., at paragraph 145.

45 Ibid., at paragraph 146.

46 Berends, above note 10, at 319.

47 The Mainland and the SARs are allowed to maintain juridical relations with the judicial organs of each other and may render assistance to each other through consultations: Article 95, Basic Law of HKSAR, Article 93, Basic Law of Macao SAR.

48 With respect to legal cooperation, the Supreme People’s Court from the Mainland side, the Department of Justice (DoJ) of HKSAR and the Secretariat for Administration and Justice of Macao SAR are the competent authorities who enter into the aforementioned regional legal cooperation arrangements.

cooperation deadlock and to take one step further in the regional legal cooperation context, a single cross-jurisdictional cooperation instrument is needed.

Meanwhile, arbitration is not a preferred form of dispute settlement mechanism in the Mainland China. First of all, in accordance with Article 20 of the Arbitration Law of the PRC, a party can challenge the validity of the arbitration agreement either before the arbitration commission or before the people's court for a ruling. Moreover, if one party requests the arbitration commission to make a decision and the other party applies to the people's court for a ruling, the priority was given to the ruling rendered by the people's court. In 2005, the Supreme People's Court issued judicial interpretation with respect to this provision.<sup>49</sup> If the application is submitted to the court before the arbitration institution makes a decision, the court can accept the application and decide whether or not the arbitration agreement is effective. Secondly, in accordance with Article 16 of the Arbitration Law, a designated arbitration commission should be included into arbitration clauses. It is stipulated under Article 18 that if an arbitration agreement contains no such provisions concerning the arbitration commission, the arbitration agreement shall be deemed as null and void. Therefore, only institutional arbitration is accepted in China and ad hoc arbitration is excluded from China's arbitration law. Therefore, if the arbitration approach was accepted, a specialized arbitration tribunal in dealing with the cross-border insolvency disputes would have to be established. It does not fit in China's court-control tradition or the reality that in accordance with the EBL, in which the courts are the sole authority vested with a broad set of powers, both procedurally and substantively, in dealing with insolvency cases.<sup>50</sup>

By taking into consideration into all those aforementioned factors, I propose to convene a special meeting in dealing with the jurisdiction disputes. The participants of the meeting shall be the judges of the highest-level court from the three regions upon the request of the lower courts. The special meeting aims at providing a single cross-jurisdictional platform, which promotes the direct judicial communication between the judges from the three regions and enables integrated negotiation on the specific issues referred to them. The special meeting shall be attended by the judges of the highest-level court from the three regions. A close list of those judges shall be discussed in advance in order to guarantee the quality and impartiality of the candidates and the member of the JSC from each region

49 Interpretation No. 7 [2006] of the Supreme People's Court, Article 13: Where, after an arbitration institution makes a decision on the effectiveness of an agreement for arbitration, a party concerned applies to the people's court for confirming the agreement for arbitration as effective or applies for revoking the arbitration institution's decision, the application shall not be accepted by the people's court.

50 S. Li and Z. Wang, "The Function of China's Court in Enterprise Bankruptcy and the Future Trend – Observations from the Four Year Implementation of China's Existing Bankruptcy Law" (2012) *INSOL International Journal* 8-13.



can choose one candidate from its own region. To take a step further, the way of resolving the disputes arising from the regional cross-border insolvency, is not negotiation. After discussion, the special meeting will give consultant opinions upon the request of a court once there are questions of jurisdiction in the cross-border insolvency based on a comprehensive assessment of relevant factors. Without interfering with the independent judicial power granted to the SARs by the Basic Law,<sup>51</sup> the consultant opinions of the special meeting is not binding but serve as the proper interpretation on the specific jurisdictional issues, which deserves the due respect of the courts concerned.

### *Court-to-Court Cooperation and Communication*

Can a court make a decision wholly independent of the future actions of the other court in matters of cross-border insolvency especially with respect to enterprise groups? A joint hearing of Nortel Networks between U.S. and Canada, which was held on 12 May 2014, said no.<sup>52</sup> After the failure of mediation,<sup>53</sup> the two court decided to hold a combined trial to discuss how to divide over USD 7 billion of assets in escrow.<sup>54</sup> As aforementioned, cooperation and communication between courts has been adopted by EU and UNCITRAL in coordinating cross-border insolvency proceedings involving enterprise groups since it is difficult to prevent members of the same group from opening of parallel proceedings. In addition, considering the prominent role of courts in insolvency proceedings in China,<sup>55</sup> cooperation and communication between courts may be the more efficient way to promote the reorganization and rescue plan and reduce the risk of piecemeal insolvency proceedings that have the potential to destroy going-concern value.

51 Article 2, Basic Law of HKSAR: The National People's Congress authorizes the Hong Kong Special Administrative Region to exercise a high degree of autonomy and enjoy executive, legislative and independent judicial power, including that of final adjudication, in accordance with the provisions of this Law. Article 2, the Basic Law of Macao SAR: The National People's Congress authorizes the Macao Special Administrative Region to exercise a high degree of autonomy and enjoy executive, legislative and *independent judicial power*, including that of final adjudication, in accordance with the provisions of this Law (bold and italics added by the author).

52 B. Wessels, "Nortel Network Joint hearing as a test case for EU JudgeCo Principle 10?" (13 May 2014), available at: <http://bobwessels.nl/2014/05/2014-05-doc8-nortel-network-joint-hearing-as-a-test-case-for-eu-judgeco-principle-10/> (last viewed 15 July 2014).

53 T. Hals, "After Mediation Fails, Court Fight over Nortel Begins" (Reuter, 7 March 2013), available at: <http://uk.reuters.com/article/2013/03/07/us-nortel-bankruptcy-idUSBRE92607C20130307> (last viewed 15 July 2014).

54 Information available from the website of Koskie Minsky LLP, who represents the Canadian Creditors Committee, available at: <http://www.kmlaw.ca/Case-Central/Overview/Page/?rid=107&cpid=34> (last viewed 15 July 2014).

55 PRC: Articles 3 and 5, Enterprise Bankruptcy Law; See also Li and Wang, above note 50; HKSAR: section 176, Cap 32; Macao SAR: Article 20, Civil Procedure Code of Macao.

Although the current regional recognition and enforcement in civil and commercial matters is mainly carried out in a mixed judicial and administrative way,<sup>56</sup> there are also some examples of court-to-court cooperation and communication among the Mainland and the two SARs. Special arrangement has been made to enable service of documents and taking evidence to be conducted in a court-to-court way. The Mainland and Hong Kong Courts may entrust to each other the service of judicial documents in civil and commercial proceedings.<sup>57</sup> Requests for service of judicial documents shall be made through the various Higher People's Courts in the Mainland and the High Court of the HKSAR.<sup>58</sup> With respect to the Mainland and Macao, court-to-court cooperation extends to taking evidence. The various Higher People's Courts in the Mainland and the Court of Final Appeal of Macao SAR can entrust each other with the service of judicial documents and taking evidence in civil and commercial matters directly.<sup>59</sup> It is also stipulated under both arrangements that any problems occur in the course of implementing the arrangement shall be settled through negotiations between the courts, i.e. the Supreme People's Court and the High Court of the HKSAR or the Court of Final Appeal of Macao SAR.<sup>60</sup> Therefore, though conducted in some limited area, direct court-to-court cooperation is allowed to operate in China on the regional level.

The forms of cooperation and communication that China can adopt are mainly protocols and joint hearings. Protocols are the most common means that facilitates cross-border cooperation and communication of multiple insolvency proceedings in different States. Protocols evolved from the practice of cross-border insolvency in common law countries.<sup>61</sup> The court-to-court protocols have been gradually standardized in the common law practice, particularly the *Loewen* case in 1999.<sup>62</sup> Instead of being ambitious, the success of the *Loewen* protocol has been summarized

56 As stated above note 48, the current bilateral legal cooperation arrangements are signed between the Supreme People's Court from the Mainland side, the Department of Justice (DoJ) of HKSAR and the Secretariat for Administration and Justice of Macao SAR.

57 Article 1, Arrangement for Mutual Service of Judicial Documents in Civil and Commercial Proceedings between the Mainland and Hong Kong Courts.

58 *Ibid.*, Article 2.

59 Articles 1 and 2, Arrangement for Mutual Service of Judicial Documents in Civil and Commercial Proceedings between the Mainland and Macao Courts.

60 *Ibid.*, Article 2; Article 10, Arrangement for Mutual Service of Judicial Documents in Civil and Commercial Proceedings between the Mainland and Hong Kong Courts.

61 *In re Maxwell Comm. Corp.*, 170 BR 800 (Bankr. SDNY 1994) and [1992] BCLC 465; *Re Olympia & York Developments Ltd. v. Royal Trust Co.*, (1993), 20 CBR (3d) 165; *In Re Nakash*, 190 BR 763 (Bankr. SDNY 1996); *In re Commodore Int'l Ltd.*, 231 BR 175 (Bankr. SDNY 1997). Affirmed 253 BR 336 (SDNY 2000), affirmed 262 F. 3d96 (2<sup>nd</sup> Cir. 2001).

62 *In re Loewen Group Inc.*, Case No. 99-1244 (Bankr. D. Del. 30 June 1999); the protocol can be downloaded from <http://www.iiiglobal.org/component/jdownloads/finish/573/1753.html> (last viewed 30 June 2014).

as “it says so little”.<sup>63</sup> In addition to court-to-court communication provisions,<sup>64</sup> the *Loewen* protocol focused on joint recognition of the stay of proceedings and actions as stipulated under the foreign law<sup>65</sup> and dispute settlement procedure relating to the application of the protocol, including opening of a joint hearing of both courts.<sup>66</sup> The concentrated content of the *Loewen* protocol maintained its neutral position on cross-border cooperation and coordination. In EU, it has been observed by Maltese that protocols do not play a role as active as they do in the common law countries. There are only a few examples of protocols applied also in civil law jurisdictions, such as *Daisytek*,<sup>67</sup> *SENDO*<sup>68</sup> and *Swissair*.<sup>69</sup> The intra-EU Protocols do not address any matters related to jurisdiction or recognition, which is governed by the EIR.<sup>70</sup> Moreover, Article 31 of the EIR merely establishes the duty of liquidators to cooperate and communicate information but it does not provide legal basis of cooperation and communication between courts. It seems that regardless of different legal systems, protocols will be more acceptable if they focus more on process and procedure or providing a framework for communication and cooperation. Besides, it will be easier for civil law jurisdiction to utilize protocols if there is appropriate statutory basis.

Joint hearing is also a form of cooperation and communication. The merits of joint hearing is to promote the efficiency of current proceedings, by enabling the courts to solve the complex problems of different insolvency proceedings directly and in a timely manner and bringing relevant parties in interest together at the same time for direct contact and the opportunity to share information and discuss and resolve outstanding issues or potential conflicts in other jurisdiction.<sup>71</sup> However, traditionally not all the courts may at their discretion allow direct cross-border judicial cooperation, especially the courts in the civil law jurisdiction. That’s why appropriate statutory authorization for the approval of direct cooperation is needed, including approval of a protocol between the courts, in which a provision

63 B. Wessels, B. Markell and J. Kilborn, *International Cooperation in Bankruptcy and Insolvency Matters* (2009, Oxford University Press, Oxford), at 43.

64 *In re Loewen Group Inc.*, Case No. 99-1244 (Bankr. D. Del. 30 June 1999), at paragraphs 10–12.

65 *Ibid.*, at paragraphs 22–24.

66 *Ibid.*, at paragraph 27.

67 UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (hereinafter Practice Guide on Cooperation), Annex I, at 14.

68 K. Pannen (ed), *European Insolvency Regulation* (2007, De Gruyter Recht, Berlin), at 660-666.

69 Practice Guide on Cooperation, Annex I, at 41.

70 M. Maltese, “Court-to Court Protocols in Cross-border Bankruptcy Proceedings: Differing Approaches between Civil Law and Common Law Legal Systems” (2013), at 39, available at: [http://iiglobal.org/images/pdfs/maltese\\_michele%20submission.pdf](http://iiglobal.org/images/pdfs/maltese_michele%20submission.pdf) (last viewed 15 July 2014).

71 UNCITRAL Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency (2010), at paragraph 38; Practice Guide on Cooperation, at 154.

of joint hearing was enclosed. Hence, the UNCITRAL Model Law provides such a statutory basis in Article 27, which is:

“one means of facilitating coordination of multiple proceedings is to hold joint or coordinated hearings or conferences, where appropriate, to resolve issues that have arisen”.<sup>72</sup>

This is particularly useful for some courts that lack such “general equitable or inherent powers”.<sup>73</sup>

### *Role of Intermediaries*

The legal cooperation between the Mainland and the two SARs is based on the constitutional arrangement, i.e. the Basic Law.<sup>74</sup> Such a legal basis does not exist between the Mainland and Taiwan. In 2009, the two sides signed the only mutual agreement in matters of legal cooperation, which is the 2009 Agreement between Both Sides of the Taiwan Strait on Jointly Fighting against Crimes and Mutual Judicial Assistance (the 2009 Agreement). On 6 April 2014, due to the outbreak of the protest against President Ma,<sup>75</sup> who was accused of pushing an agreement on opening up services trade with the Mainland China, the drafts of the Regulations on Treatment and Supervision of the Agreements Reached between the Taiwan Area and the Mainland Area the Cross-strait Trade in Service Agreement were submitted to the Parliament for review and would probably serve as the legal basis for the future cross-strait cooperation. If that is the case, the possible influence on the validity of all the cross-strait agreements, including the 2009 Agreement will still need to be observed.

72 Practice Guide on Cooperation, at III-154.

73 Ibid., at III-20.

74 Article 95, Basic Law of HKSAR: The Hong Kong Special Administrative Region may, through consultations and in accordance with law, maintain juridical relations with the judicial organs of other parts of the country, and they may render assistance to each other.

Article 93, Basic Law of Macao SAR: The Macao Special Administrative Region may, through consultations and in accordance with law, maintain juridical relations with the judicial organs of other parts of the country, and they may render assistance to each other.

75 It is reported that since 18 March 2014, dozens of activists, mostly students broke in the debating chamber of the Legislative Yuan, Taiwan’s parliament, in Taipei. They resisted attempts by the police to evict them overnight and continued to occupy the chamber until their demand was met. In particular, they wanted Mr. Ma to come to the chamber himself to apologize for the way in which his party pushed an agreement on opening up services trade with China without going through due proceeding and should pass the agreement to the parliament in order to scrutinize the services agreement item by item. The occupation lasted till 10 April. See Banyan, “Students in the House” (The Economist, 20 March 2014), available at: <http://www.economist.com/blogs/banyan/2014/03/politics-taiwan>. See also <http://www.voanews.com/content/taiwan-protesters-occupy-legislature-demand-end-to-china-trade-pact/1874277.html> (last viewed 15 July 2014).

In addition, both the cross-strait economic arrangement (e.g. ECFA) and legal arrangement<sup>76</sup> were signed via the intermediaries, which are the Association for Relations across the Taiwan Straits (“ARATS”) from the Mainland side and the Straits Exchange Foundation (“SEF”) from the Taiwan side. Both of them are private institutes but in fact deal with public affairs and undertake some of the government functions. Against the current economic, political and social background, direct cooperation between the courts is not yet possible in the cross-strait context. Indirect cooperation and communication can be achieved through liquidators or through any person or body appointed to act at the direction of the courts.<sup>77</sup> Moreover, in 2012, the ALI/III Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases (the Global Principles) were reported by Professors Wessels and Fletcher. The Global Principle 23 introduces an independent intermediary, a new professional function to overcome any hurdles in global communication.<sup>78</sup> Considering the semi-governmental cooperative manner between the Mainland and Taiwan and lack of the binding legal basis, the cross-strait insolvency cooperation is suggested to be conducted via the intermediaries.

## Summary

China’s complex political composition has impacts on its regional legal systems. Four independent jurisdictions coexist in China, where legal cooperation in matters of cross-border insolvency is still missing. The UNCITRAL Model Law and the EIR both successfully contribute to the international development of the cross-border insolvency. On the basis of comparative research of the two regimes, efforts have been made to find a better solution to China’s cross-border insolvency issues, which better fit into China’s “group” characteristics. The Model Law is not designed for regional cooperation but endeavors to achieve efficiency and cooperation of the cross-border insolvency cases on a global level. As a soft law instrument, the Model Law is a recommendation in essence, whereas on a regional level, it is easier to achieve uniformity than on a global level, such as the EIR. Nevertheless a regional regime cannot simply be copied and pasted. A middle way is attempted to be sought by referring to the merits of both regimes.

76 The legal cooperation arrangement, the Agreement, were signed by the SEF and the ARATS, including the 1993 Agreement on Verification of Application of the Notarized Certificates, in which it states that the two organizations sent copy of notarized certificate involving inheritance, adoption, marriage, birth, death, trust, education, settlement, custody and property rights etc. directly to each other or via local notary as well as the 2009 Agreement between Both Sides of the Taiwan Strait on Jointly Fighting against Crimes and Mutual Judicial Assistance.

77 Article 25(1), Model Law.

78 See above note 26, Guideline 10.

Regardless of the boundary set up by universalism and territorialism, China's regional cross-border cooperation regime is to be established upon the cooperative approach. As for recognition, the principle of mutual trust as adopted by the EIR cannot apply to China's situation. In a country where the progress of reunification is less than 20 years, conflicts are something inevitable and it still takes time for each region to get used to each other and thus fosters the growth of mutual trust. The principle of reciprocity, which is applied right now in the Mainland China could result in a stalemate or retaliatory action concerning recognition and thus goes against the purposes of closer cooperation. The principle of comity, which is a principle, softer than mutual trust but stronger than reciprocity, can serve as the proper legal basis concerning recognition in China. With respect to jurisdiction, the authoritative interpretation on COMI rendered by the CJEU clearly set up the central administration as the criterion for jurisdiction in the cases of *Eurofood*, *Interedil* and *Rastelli*, which also has influence on the Model Law. The instrument arrangement of EU contributes to high degree of uniformity in interpreting the important indicator of the cross-border insolvency jurisdiction. At this moment it is unlikely to establish a permanent court with a purely legal competence in China, which is equivalent to the CJEU. Neither can it be solved through arbitration since it is not a preferred form of dispute settlement mechanism in the Mainland China. I propose to convene a special meeting in dealing with the jurisdiction disputes. The special meeting aims at providing a single cross-jurisdictional platform, which promotes the direct judicial communication between the judges from the three regions and enables integrated negotiation on the specific issues referred to them. Without interfering with the independent judicial power granted to the SARs by the Basic Law, the consultant opinions of the special meeting is not binding but serve as the proper interpretation on the specific jurisdictional issues, which deserves the due respect of the courts concerned.

Parallel to the traditional main and non-main jurisdictional approach, cooperation and communication can properly serve as golden bridge across the boundary set up by universalism and territorialism. In particular, with respect to enterprise groups, it will be more efficient to facilitate cooperation and communication between courts on an equal basis as well as between courts and insolvency practitioners. Particularly in tackling cross-border insolvency issues with respect to enterprise groups, it has been proved in practice that courts could not do their jobs properly absent cooperation with other national courts. In China, though in some limited area, regional court-to-court cooperation and communication is possible. For both protocols and joint hearings, proper statutory basis for such forms of cooperation and communication is needed since most of them are civil law jurisdictions that are lack of general equitable or inherent powers to adopt such measures. In

terms of cross-strait insolvency cooperation, it is suggested to cooperate via the intermediaries because of the semi-governmental cooperative manner between the Mainland and Taiwan and lack of the binding legal basis, the cross-strait insolvency cooperation.





## Chapter 2

# The Delegation of Powers to the European Supervisory Authorities and the Single Resolution Mechanism

Stella Kaltsouni

### I - Introduction

The current economic and financial crisis has shattered the premises of the post-war European and international financial system; it challenged established theories and institutions and found them unable to provide a credible response to the challenges it brought.<sup>1</sup> The global financial crisis revealed significant gaps in the EU regulation of the financial system and shortcomings in its practical implementation; it highlighted deficiencies in the structures for cross-border resolution and weaknesses in the supervisory cooperation and coordination between Member States.<sup>2</sup>

1 G. Zavvos, “Towards a European Banking Union: Legal and Policy Implications” (18 April 2013), at 1, available at: [http://www.levyinstitute.org/conferences/minsky2013/Zavvos\\_speech.pdf](http://www.levyinstitute.org/conferences/minsky2013/Zavvos_speech.pdf).

2 F. Demarigny, J. McMahon and N. Robert, “Review of the New European System of Financial Supervision (ESFS) – Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA and ESMA) – The ESFS’s Micro-Prudential Pillar”, Study for the European Parliament (October 2013), at 18.

In response to the global financial crisis the EU established in 2010 a number of agencies in the financial services sector.<sup>3</sup> As the financial crisis continued to progress, in 2012 the EU political leaders recognized the need to move towards the establishment of the European Banking Union (“EBU”)<sup>4</sup> comprising three pillars:

- the Single Supervisory Mechanism (“SSM”), including a single rule-book (e.g. the Capital Requirements Regulation<sup>5</sup> (“CRR”), the Capital Requirements Directive IV<sup>6</sup> (“CRD IV”) and the Bank Recovery and Resolution Directive<sup>7</sup>);
- the Single Resolution Mechanism (“SRM”), comprising the Single Resolution Board (“SRB”), established as an EU agency, and a Single Resolution Fund (“SRF”); and
- the Common Deposit Guarantee System.

3 On the basis of the recommendations of the 2009 de Larosière Report, the EU replaced the EU’s former supervisory committees with a new European system of financial supervision (“EFSF”). The new system comprises the three European Supervisory Authorities (“ESAs”), established as EU agencies, i.e. the European Banking Authority (Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, at 12–47); the European Securities and Markets Authority (Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, at 84–119); and the European Insurance and Occupational Pensions Authority (Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331, 15.12.2010, at 48–83). The European Systemic Risk Board (“ESRB”, Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24/11/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010, at 1–11; Council Regulation (EU) No. 1096/2010 of 17/11/2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, OJ L 331, 15.12.2010, at 162–164) is responsible for macro-prudential supervision; the three ESAs with the ESRB form the Joint Committee of the European Supervisory Authorities. The three ESAs, the ESRB and the national supervisory authorities form the EFSF.

4 European Council Conclusions 28/29 June 2012, EUCO 76/12; European Council Conclusions of 18 October 2012 on completing the EMU.

5 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012, OJ L 176, 27/06/2013, at 1–337.

6 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27/06/2013, at 338–436.

7 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council Text with EEA relevance, OJ L 173, 12.6.2014, at 190–348.

The decision of the Court of Justice of the EU (“CJEU”) in case C-270/12<sup>8</sup> (*Short Selling* case), delivered on 22 January 2014, concerning the delegation of powers to EU agencies has critical implications for the functioning both of the agencies established in the financial services sector in 2010 and of the SRM, and in particular of the SRB, since it relates to the justification and scope of the powers that may be conferred to it.

This paper briefly examines the rationale for the establishment of agencies in the EU; it then reviews the landmark CJEU *Meroni* judgment,<sup>9</sup> which constitutes the guiding principle for the conferral of powers to EU agencies. Subsequently, it examines how the CJEU has applied the *Meroni* doctrine in other cases, and most importantly in the *Short Selling* case, regarding the conferral of powers to the European Securities and Markets Authority (“ESMA”) to ban short selling in specific circumstances. Finally, it attempts at assessing the impact of the *Short Selling* case on the conferral of powers to the SRB to adopt crucial decisions for the resolution process, such as the adoption of decisions triggering the resolution of a bank.

## II - Rationale for the Establishment of EU Agencies

Over the last 20 years, the EU legislator has granted executive functions to specific offices, bodies and agencies in an increasing number of policy areas.<sup>10</sup> During the 1990s there was a growing consensus that a number of scientific and technical tasks should be allocated to specialized agencies to allow the Commission to cope with the increasing demands of the ever integrating internal market.<sup>11</sup> In the new millennium, the Commission established new agencies in diverse sectors, including food safety, maritime safety, aviation safety, information security, railways, as well as in the financial services sector, including the European Supervisory Authorities (“ESAs”) and the proposed SRB.

The powers agencies are entrusted with are enshrined into their constitutive instruments. As will be explained below, EU agencies cannot be provided with wide discretionary powers in accordance with the *Meroni* doctrine. Subject to this limitation, the Commission distinguishes between executive and regulatory agencies. “Executive agencies” have purely managerial tasks, assisting the

8 Case C-270/12 *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union (Short Selling case)* [2014] (not yet reported).

9 Case 9/56 *Meroni v High Authority* [1957–1958] ECR 133.

10 K. Lenaerts and P. Van Nuffel, *European Union Law* (2011, Sweet & Maxwell, London), at 707.

11 T. Tridimas, “Community Agencies, Competition Law, and ECSB Initiatives on Securities, Clearing and Settlement” (2009) 28(1) *Yearbook of European Law* 232.

Commission in the implementation of its financial support programs and are subject to its strict supervision.<sup>12</sup> “Regulatory agencies” are actively involved in the executive function by enacting instruments that contribute to regulating a specific sector;<sup>13</sup> the ESAs and the SRB fall within this category. Nonetheless, the use of regulatory agencies must respect the *balance of powers between the institutions* and preserve the unity and integrity of the executive function at European level; this naturally affects the scope of the responsibilities and powers that can be delegated to them.<sup>14</sup>

It is often argued that the creation of agencies at the EU level aimed at offsetting the administrative deficit, which became particularly acute as the former European Community acquired new powers, the fulfillment of which required highly technical knowledge.<sup>15</sup> The establishment of agencies was further encouraged by the criticism over the Commission’s managerial capacities<sup>16</sup> and the need to lighten its workload.<sup>17</sup> In addition, European agencies responded to the need to institutionalize cooperation and integration of Member States’ administrations and between the latter and the Commission; similarly, they addressed the need to decentralize the decision-making process by entrusting powers to a body that is external to the Commission, but subject to its influence.<sup>18</sup> Moreover, it was submitted that political authorities, due to their short-term political mandate, cannot provide long-term commitments and policy credibility, elements which are essential for the good functioning of the markets.<sup>19</sup>

The economic crisis rendered necessary the creation of agencies in order to reinforce the cooperation of national supervisors at the EU level and streamline the adoption of supervisory standards (rule book). These agencies provide a mechanism where

12 Commission Communication, “The Operating Framework for European Regulatory Agencies”, COM(2002) 718, at 3.

13 *Ibid.*, at 4. See, however, P. Craig, *EU Administrative Law* (2012, Oxford University Press, Oxford), at 150 ff. for a different classification of agencies to: a) decision-making agencies, which have the power to make individual decisions binding upon third parties; b) quasi-regulatory agencies, with strong recommendatory powers; c) information and coordination agencies.

14 Commission Communication, above note 12, at 5–6.

15 J. Mendes, *Participation in EU Rule-Making: A Rights –Based Approach* (2011, Oxford University Press, Oxford), at 103.

16 R. Dehousse, “Misfits: EU Law and the Transformation of European Governance”, Jean Monnet Working Paper 2/02, at 9.

17 See, e.g. Recital 4, Council Regulation (EC) No. 58/2003 of 19 December 2002 laying down the statute for executive agencies to be entrusted with certain tasks in the management of Community programmes, OJ L 11, 16.1.2003, at 1–8.

18 E. Chiti, “An important part of the EU’s institutional machinery: Features, problems and perspectives of European agencies” (2009) 46 *Common Market Law Review* 1398.

19 Y. Meny, “De la démocratie en Europe: Old Concepts and New Challenges” (2002) 41(1) *Journal of Common Market Studies* 6.

the interests of national supervisory authorities can be interlocked.<sup>20</sup> Furthermore, as agencies reach decisions by majority voting, national interests of individual Member States are nuanced.<sup>21</sup> Finally, they can help address two of the perceived causes of the crisis, i.e. lack of cooperation amongst national regulators and lax enforcement.<sup>22</sup>

### *Observations on the Establishment of EU Agencies*

This does not mean, however, that the establishment of agencies by the EU is not faced with criticism. In the financial services sector, the establishment of agencies contributed to the improved cooperation between national supervisors and to the development of a single rule-book for financial services in the EU; nonetheless, supervision (and resolution) of banks remained to a large extent within national boundaries, which is contrary to the notion of integrated banking markets.<sup>23</sup> More generally, it is often argued that agencies lead to additional bureaucracy at the EU level, make the decision-making process less transparent and render more difficult the determination of who is actually accountable.<sup>24</sup> Agencies are not democratically elected and are not subject to the strict requirements for independence that the judiciary is. They also challenge the principle of separation of powers since they can often take both legislative and individual decisions, manage and judge.<sup>25</sup> Finally, since Member States retain control and influence over the EU agencies through their over-representation in the administrative boards to the detriment of the Commission,<sup>26</sup> concerns are raised over their independence and ability to serve the Union interest.

The CJEU has provided some insights as to how the concerns over the accountability and legitimacy of EU agencies can be addressed. In case C-518/07<sup>27</sup> the Court held that the principle of democracy does not preclude the existence of public authorities outside the classic hierarchical administration which are, in varying degrees, independent from the government. However, “the absence of any parliamentary influence over those authorities is inconceivable”; this could be remedied if the

20 T. Tridimas, “Financial Supervision and Agency Power: Reflections on ESMA”, in N. Shuibhne and L. Gormley (eds), *From Single Market to Economic Union: Essays in Memory of John A. Usher* (2012, Oxford University Press, Oxford), at 64.

21 *Idem*.

22 *Idem*.

23 Proposal for a Council regulation conferring specific tasks on the European Central bank concerning policies relating to the prudential supervision of credit institutions, COM (2012) 511, at 1.

24 Tridimas, above note 11, at 232.

25 *Idem*.

26 S. Andoura and P. Timmerman, “Governance of the EU: The Reform Debate on European Agencies Reignited”, European Policy Institutes Network, Working Paper No. 10 (October 2008), at 17.

27 Case C-518/07 *European Commission v Federal Republic of Germany* [2010] ECR I-01885.

management of the authorities in question was appointed by the Parliament or the government and if they were required to regularly report their activities to the Parliament.<sup>28</sup> Even though this judgment refers to agencies established by Member States, it shows that, according to the CJEU, legitimacy (and accountability) can be ensured via democratic oversight over the agencies' activities.<sup>29</sup>

Today the accountability arrangements to which EU agencies are subject to can be classified in the following categories:

- managerial accountability (i.e. managerial accountability towards management boards);
- political accountability vis-à-vis the European Parliament and the Council;
- financial accountability of the agency vis-à-vis the various financial forums (e.g. the Court of Auditors); and
- judicial accountability to the CJEU,<sup>30</sup> which, after the adoption of the Lisbon Treaty, has been enshrined into the TFEU (Article 263).

### **III - Legal limitations on agencies' regulatory powers arising from the *Meroni* doctrine**

The *Meroni* case, decided in 1958, concerned a challenge against the delegation of powers to two private law entities (the “Brussels agencies”, with distinct legal personalities) to administer the financial arrangements for the ferrous scrap scheme, a measure introduced to stabilize Community prices. The Court concluded that the delegation of powers to the Brussels agencies was unlawful. It is a landmark case in the EU institutional framework since the Court elaborated on the constraints of Community institutions to delegate their powers to other EU bodies as follows:

- 1) *The delegating authority cannot confer to another body powers different from those that the delegating authority received itself from the Treaty*.<sup>31</sup> In the absence of this rule, the delegating authority would be able to extend its powers or avoid legal constraints by conferring its powers to a delegate.<sup>32</sup>

28 Ibid., at paragraphs 42–46.

29 H. Hofmann and A. Morini, “The Pluralisation of EU Executive – Constitutional Aspects of “Agentification” (2012) 12(4) *European Law Review* 435.

30 M. Busuioc, *European Agencies: Law and Practices of Accountability* (2013, Oxford University Press, Oxford), at 56.

31 Case 9/56 *Meroni v High Authority* [1957 – 1958] ECR 133 (“*Meroni*”), at 150.

32 Tridimas, above note 11, at 242.

- 2) *Agencies (i.e. the delegate) must exercise their powers under the same rules to which the delegating authority would be subject to if it was exercising them directly*.<sup>33</sup> In *Meroni*, even though the High Authority<sup>34</sup> was subject to the Treaty rules to give reasons, publish data, etc., the decision delegating powers to the Brussels authorities failed to introduce similar constraints. This meant that those agencies were given more extensive (and unaccountable) powers than the ones the High Authority held under the Treaty.<sup>35</sup>
- 3) *The delegation of powers to an agency must be expressly provided in the delegating act*.<sup>36</sup>
- 4) *The powers conferred upon agencies must not involve a wide margin of discretion; the conferral must refer to clearly defined executive powers, the use of which must be entirely subject to the supervision of the delegating authority*.<sup>37</sup> This restriction derives from the principle of balance of powers (or “institutional balance”,<sup>38</sup> currently explicitly recognized under Article 13(2) of the TEU) under which each institution must act within the limits prescribed by the Treaties.<sup>39</sup> Delegation of such power “to bodies other than those which the Treaty has established to effect and supervise the exercise of such power each within the limits of its own authority, would render that guarantee ineffective”.<sup>40</sup> The Court concluded that in the present case the Brussels agencies were not bound by objective criteria and that the exercise of their powers involved a wide margin of discretion which was, thus, not compatible with the requirements of the Treaty.<sup>41</sup>

33 *Meroni*, at 149-150.

34 The independent collegiate executive of the Treaty Establishing the European Coal and Steel Community (ESCS Treaty) endowed the task of achieving the objectives laid down by the Treaty and acting in the general interest of the Community (Articles 8–9 of the ESCS Treaty).

35 *Meroni*, at 149-150.

36 *Ibid.*, at 151. This is also reiterated in case T-311/06, *FMC Chemical SPRL v EFSA* [2008] ECR II-88, at paragraph 66.

37 *Ibid.*, at 151.

38 It is worth noting, however, that according to M. Chamon the concepts “balance of power” and “interinstitutional balance” are not the same. He argues that the principle of “balance of power” was originally conceived as a substitute for the principle of separation of powers and aimed at protecting individuals against abuse of power. Therefore, he concludes, when referring to the “balance of power” in *Meroni* the Court did not express a concern on the effect any delegation of powers would have on interinstitutional relations but a concern on the impact on the Treaty’s system of judicial protection: M. Chamon, “EU Agencies between *Meroni* and *Romano* or the Devil and the Deep Blue Sea” (2011) 48 *Common Market Law Review* 1058.

39 B. Smulders and K. Eisele, “Reflections on the Institutional Balance, the Community Method and the Interplay between jurisdictions after Lisbon”, College of Europe Research Paper in Law 04/2012, at 4, available at [http://aei.pitt.edu/39285/1/researchpaper\\_4\\_2012\\_smulderseisele\\_final.pdf](http://aei.pitt.edu/39285/1/researchpaper_4_2012_smulderseisele_final.pdf).

40 *Meroni*, at 152.

41 *Ibid.*, at 154.

#### IV - Applicability of the *Meroni* Doctrine in the Subsequent CJEU Case-Law

In literature, Chamon has stated that a number of arguments have been made against applying the *Meroni* doctrine in the current institutional framework; indeed, *Meroni* was decided more than 50 years ago, under completely different factual and institutional contexts. The Brussels agencies were bodies established under private law, whereas today's EU agencies operate under EU law.<sup>42</sup> While the Brussels agencies had been endowed with powers by the High Authority, EU agencies today are established and receive their powers by the EU legislator, on the basis of secondary legislation.<sup>43</sup> In addition, Chamon submits that *Meroni* was decided under the ECSC Treaty, whereas today EU agencies operate under the considerably different legal framework of the EU treaties.<sup>44</sup> He also argues that the rigidity of the *Meroni* doctrine is incomprehensible in fairly complex areas where the legislators can be confident that they share the same policy goals as the regulators.<sup>45</sup> Yataganas observed that, as implementation powers lie in principle with the national supervisors, conferral of these powers to an EU agency does not amount to a delegation of powers by an EU institution to an EU agency but rather "an extraction of powers from the national administrations".<sup>46</sup> The Commission's reliance on the *Meroni* doctrine has been perceived by some as an effort to preserve its prerogatives, against the pressure of the Member States to expand their control in the policy making.

42 Chamon, above note 38, at 1059.

43 *Idem*.

44 *Idem*. The significance of agencies in the current EU institutional legal order is highlighted by the changes introduced with the Treaty of Lisbon. Even though the Treaties still do not include a provision regulating the conferral of powers to EU institutions/bodies, Articles 263, 265 and 267, TFEU implicitly authorize establishment of agencies by requiring submission of the acts of these bodies to judicial review, as required in *Meroni*. The system for financial control and audit is also applicable to agencies (Articles 287 and 325, TFEU) as well as the obligation to ensure good administration (Article 9, TEU and Articles 15, 16 and 228, TFEU). The Charter of Fundamental Rights also specifically refers to agencies (Articles 41, 42, 43 and 51).

45 X. Yataganas, "Delegation of regulatory authority in the European Union", Jean Monnet Working Paper 3/01, 2001, at 30.

46 D. Geradin, "The Development of European Regulatory Agencies: What the EU should learn from American Experience" (2005) 11 *Columbia Journal of European Law* 10.



Nonetheless, most legal scholars and the European Commission still treat the *Meroni* doctrine as “good law”.<sup>47</sup> Unlike some fields where there is a general agreement of the “public good” to be attained (air safety), in others (e.g. securities regulation, and, in general, financial stability), Member States can have very different views on the pursued objectives or, even if they agree on an objective, they may still disagree on how to achieve it.<sup>48</sup> Thus, delegation of wide discretionary/regulatory powers to EU agencies in these fields might mean that they would not be exercising executive powers but making policy choices, which should be made by the EU institutions.

The EU courts have also continued to review instances of delegation of powers within the framework of the *Meroni* ruling.<sup>49</sup> In *Tralli*, the Court ruled that the rules on the delegation of powers regarding staff issues within the ECB and the exercise of those powers by the ECB bodies were in compliance with the *Meroni* doctrine.<sup>50</sup> In that case, it appears that the Court somewhat relaxed the doctrine with respect to the delegation of powers pertaining to the internal organization and management of EU institutions, according to Tridimas.<sup>51</sup> In *Alliance for Natural Health*, the Court held that any delegation of power must be clearly defined and that the exercise of the power must be subject to strict review in the light of objective criteria, which, however, may be contained in recitals.<sup>52</sup> In *DIR International Film*, the delegation of powers by the Commission to a private body (“EFDO”) to decide on funding was upheld as complying with the *Meroni* doctrine since the agreement

47 Chiti, above note 18, at 1421-2. See also the Impact Assessment accompanying the proposal for Regulation (EU) No. 513/2011 amending Regulation (EC) 1060/2009 on credit rating agencies the Commission noted that “according to the “*Meroni*” case law established by the ECJ, agencies/authorities may not be delegated the power to take decisions which require difficult choices in reconciling various objectives laid down in the Treaty amounting to the execution of actual economic policy. On the other hand, clearly defined executive powers can be delegated to an agency including powers, that involve the need to interpret Community law provisions to determine their application and which leave the authority a certain margin of appreciation in applying these rules”, and went on to review the compatibility of the identified policy options with this principle (SEC(2010) 678, 2 June 2010, at 13 and 30-31) Previously, the Impact Assessment Board had required further clarifications concerning the compatibility of the proposed Regulation with the *Meroni* ruling (European Commission Impact Assessment Board, Opinion “DG MARKT: Impact assessment on: Proposal for Amending Regulation 1060/2009 on credit rating agencies”, 26 February 2010, Ref. Ares(2010) 108790 – 02/03/2010).

48 P. Schammo, “The European Securities and Markets Authority: Lifting the Veil on the Allocation of Powers” (2011) 48 *Common Market Law Review* 1894.

49 Craig, above note 13, at 155.

50 C-301/02, *Carmine Salvatore Tralli v European Central Bank* [2005] ECR I-4071, at paragraphs 42–52.

51 Tridimas, above note 20, at 62.

52 Joined Cases C-154/04 and C-155/04, *The Queen, on the application of Alliance for Natural Health and Others v Secretary of State for Health and National Assembly for Wales* (reference for a preliminary ruling) [2005] ECR I-6451, at 90-92.

between the EFDO and the Commission made EFDO's decision subject to the Commission's prior agreement.<sup>53</sup>

Some authors argue that certain agencies have been entrusted with powers which are indeed stretching the *Meroni* doctrine to its limits as they seem to have been granted with an important margin of discretion.<sup>54</sup> This is the case not only where agencies have been empowered to adopt binding decisions<sup>55</sup> but also where they play an essential part in the decision-making process.<sup>56</sup> The Court also seems to have relaxed the *Meroni* constraints in Case T-187/06 by holding that the more limited judicial review applicable to the Commission when it makes complex technical assessments can be applied in other scientific domains too, like botany or genetics.<sup>57</sup> It is worth noting that in that case the Court did not explicitly recognize that it was dealing with the decision of an agency and not of the Commission,<sup>58</sup> thus implying that the same regime applies to both. Even though the ruling does not explicitly refer to the *Meroni* case-law, it is of significance since it provides that an agency can be empowered to adopt administrative decisions entailing a margin of appreciation; this seems to stretch the notion of "clearly defined executive power" that agencies, according to the *Meroni* doctrine, should be entrusted with. Furthermore, the finding that agency decisions can be subject to a more limited judicial review, similarly to Commission decisions, seems to contradict the *Meroni* ruling, according to which agency action is subject to strict supervision.<sup>59</sup> This could raise constitutional questions on agencies' democratic legitimacy since the Commission, an EU institution, cannot be considered of equivalent constitutional value and legitimization with an agency.

53 Joined cases T-369/84 and T-85/95, *DIR International Film Srl and others v Commission of the European Communities* [1998] ECR II-357, at 52-53.

54 H. Hoffmann, G. Rowe and A. Turk, *Administrative Law and Policy of the European Union* (2011, Oxford University Press, Oxford), at 243.

55 See, e.g. Council Regulation (EC) 2100/94 of 27 July 1994 on Community plant variety rights, OJ 1994 L 227/1; Council Regulation (EC) 207/2009 of 26 February 2009 on the Community trade mark (codified version), OJ 2009 L 78/1.

56 E.g. under Regulation 726/2004 where the EMEA issues scientific opinions on applications for the authorization of pharmaceutical products with the Commission adopting the final decision in accordance with the comitology procedure.

57 Hoffmann *et al.*, above note 54, at 243. T – 187/06 *Ralf Schröder v Community Plant Variety Office (CPVO)*, [2008] ECR II-03151, at paragraphs 59–67.

58 M. Chamon, "EU agencies: does the Meroni Doctrine make sense?" (2010) 17 *Maastricht Journal of European & Comparative Law* 281, at paragraph 19.

59 Hoffmann *et al.*, above note 54, at 243.

## V - The *Meroni* Doctrine and Case C-270/12 (“*Short Selling*”)

ESMA was established in 2010, succeeding the Committee of European Securities Regulators (“CESR”), against the background of the shortcomings in financial supervision stemming mainly from the fact that supervision remained national whereas financial institutions operate on a cross-border basis.<sup>60</sup> The ESMA Regulation aimed at restoring a reliable and stable financial system, thereby re-establishing trust in the financial markets. Additionally, the EU legislators concluded that “a mechanism to ensure that national supervisors arrive at the best possible supervisory decisions for cross-border financial market participants” was necessary in order to achieve these objectives.<sup>61</sup>

ESMA was granted a series of tasks related to the supervision of financial markets (contribution to common standards and practices and to consumer protection; adoption of guidelines and recommendations; participation to colleges of competent authorities; coordination of competent authorities). Moreover, Article 9(5) of the ESMA Regulation stipulated that:

*“the Authority may temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union in the cases specified and under the conditions laid down in the legislative acts referred to in Article 1(2) or if so required in the case of an emergency situation in accordance with and under the conditions laid down in Article 18”*

In 2012, against the continuation of the financial crisis and the short selling crisis in the EU, the EU legislators adopted Regulation (EU) 236/2012 on short selling and certain aspects of credit default swaps, a regulation aimed at harmonizing short selling (“Short Selling Regulation”).<sup>62</sup> Short selling is a practice consisting in the sale of securities not owned by the vendor at the time of the sale with a view to benefiting from a fall in the price of securities. In the event of disturbance on the financial markets, the Regulation seeks, inter alia, to prevent an uncontrolled fall in the price of financial instruments as a result of the effect of short selling (e.g.

60 Recitals 1, 3 and 7, Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, at 84–119 (“ESMA Regulation”).

61 Recital 8, ESMA Regulation.

62 Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, OJ L 86, 24.3.2012, 1–24.

as in the case where, on 19 May 2010, Bafin unilaterally banned short selling on certain instruments, which triggered a sell-off).<sup>63</sup>

The Regulation was adopted on the basis of Article 114 of the TFEU, which permits the adoption of harmonization measures for the establishment and functioning of the internal market. Article 28 of the Regulation vests ESMA with certain powers of intervention. Accordingly, ESMA may adopt measures that are legally binding on the EU Member States' financial markets in exceptional circumstances, i.e. where there is a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the EU; in all other instances, the relevant power remains with the national authorities.

In May 2012, the United Kingdom brought an action before the CJEU seeking annulment of Article 28 of the Short Selling Regulation.<sup>64</sup> The United Kingdom contended, *inter alia*, that ESMA has been given a very large measure of discretion of a political nature which is at odds with the EU principles relating to the delegation of powers laid down in *Meroni v High Authority*.<sup>65</sup>

#### *The First Plea on the Compatibility of the Powers delegated to ESMA under Article 28 of the Short Selling Regulation with the Meroni doctrine*

The *Short Selling* case, decided by the CJEU on 22 January 2014, is a landmark case of the CJEU, not only because of the implications it has on the exact entity it relates to, i.e. the ESMA and its powers to ban short selling at the European level,

63 M. Gargantini, "The ESMA decision: Implications for the governance of the ESAs", Presentation at the Conference held by the University of Luxembourg on "The Landmark 2014 ESMA decision of the European Court of Justice - Perspectives for EU financial services regulation and supervision" on 27 March 2014, at 8–9.

64 Case C-270/12 *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union* [2014] (not yet reported) ("*Short Selling*").

65 More specifically, the UK argued that (paragraphs 27-34):

- a) ESMA's determination as to whether the criteria set out in Article 28(2) of the Short Selling Regulation entails a very large measure of discretion; this is so as the determination of whether there is a threat to the orderly functioning and integrity of financial markets is a highly subjective judgment;
- b) ESMA is provided with a wide range of choices as to which measures to impose and as to any exceptions, decisions which have very significant economic and financial policy considerations;
- c) The factors which must guide ESMA's decision encompass tests which are highly subjective and ESMA enjoys a wide margin of discretion when considering the criteria set out in that provision;
- d) ESMA's measures, even though temporary in nature, can have significant, long-term consequences.
- e) ESMA enjoys a broad discretion as to the application of the policy in question.

The UK further argued: that the Short Selling Regulation breached the principle established in *Romano*, preventing agencies from adopting quasi-legislative measures; that as Articles 290-291, TFEU circumscribe the circumstances in which certain powers may be given to the Commission, the Council has no authority under the Treaties to delegate powers such as those provided for in Article 28 of Regulation No. 236/2012 to an EU agency; that, if, Article 28, Regulation No. 236/2012 is to be regarded as authorizing ESMA to direct decisions at natural or legal persons, that provision is *ultra vires* Article 114, TFEU. Especially with regards to the last plea it is worth noting that this was supported by the Advocate General but eventually rejected by the Court; however, this analysis does not fall within the scope of this study, which focuses only on the Court's ruling with respect to the first plea, alleging violation of the *Meroni* doctrine.

but most importantly due to the implications it has, and could have had, on the building of the EBU and in particular of the SRM. Had the Court ruled that the conferral of powers on the ESMA was in violation of the EU legal and institutional framework, the negotiations for the establishment of the SRM, where the proposal also stipulates the delegation of significant powers to the SRB, would have been dangerously jeopardized (see below in Section VI).

Concerning the delegation of powers to agencies and the *Meroni* doctrine, the *Short Selling* case raises two “institutional issues”:

- (i) whether the *Meroni* doctrine should still be applicable within the current institutional framework, despite its significant differences with the institutional framework of 1958; and
- (ii) whether the *Meroni* doctrine should apply invariably to private entities (set outside the EU framework and thus, by definition, politically unaccountable) and public law entities (set by the EU legislator).

Indeed, today the Lisbon Treaty explicitly enshrined agencies in the EU legal order (e.g. Article 263 of the TFEU). Nonetheless, despite this updated reading, the CJEU did not question at all the applicability of the *Meroni* doctrine; on the contrary, it confirmed its validity as it actually reviewed the delegation of powers to ESMA under the principles contained therein. Thus, even though the Court did not recently discuss the establishment of EU agencies and the conferral of powers to them through the lenses of the *Meroni* doctrine (*ENISA* case,<sup>66</sup> *Smoke Flavourings* case,<sup>67</sup> *Schröder* case<sup>68</sup>), with the *Short Selling* judgment the CJEU confirms that the principles of the *Meroni* ruling must be observed when determining the powers to be conferred to an agency, especially as regards the restrictions to the delegation of powers which entail a large margin of discretion.

Following the *Meroni* judgment regarding the nature of the powers which can be delegated to agencies, the Court in the *Short Selling* case tried to determine whether the delegation of powers in Article 28 of the Short Selling Regulation concerns clearly defined executive powers the exercise of which can, therefore, be subject to strict review in the light of objective criteria determined by the delegating authority, or whether it involves a discretionary power implying a wide

66 Case C-217/04 *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union* [2006] ECR I-3771.

67 Case C-66/04 *United Kingdom v. European Parliament and Council* [2005] ECR I-10553.

68 Case T-186/06 *Ralf Schröder v Community Plant Variety Office (CPVO)* and C-38/09 *Ralf Schröder v Community Plant Variety Office (CPVO)* [2010] ECR I-03209.

margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy.<sup>69</sup>

It is worth noting that the Court did not provide any further criteria to clarify the borderline of what constitutes a “wide margin of discretion” and what the factual/technical assessment which can be undertaken by an agency; nonetheless, it concludes that ESMA’s discretion is sufficiently circumscribed by various conditions and criteria. First, the Court notes that before taking any decision, ESMA must examine the conditions and factors contained in Articles 28(2) and (3) of the Short Selling Regulation, which are cumulative.<sup>70</sup> Furthermore, ESMA’s discretion is circumscribed by both the requirement to consult with the ESRB and the temporary nature of the measures adopted.<sup>71</sup> According to the Court, the factual technical assessment conducted by ESMA is further emphasized by the provisions of Commission Delegated Regulation No. 236/12.<sup>72</sup> Thus, the Court concludes that the powers granted to ESMA under Article 28 of Regulation No. 236/2012 are precisely delineated and amenable to judicial review in the light of the objectives established by the delegating authority.<sup>73</sup>

When examining the extent of the discretion ESMA is entrusted with, the Advocate General in his Opinion stresses that ESMA has no discretion on whether to act if the conditions contained in the Short Selling Regulation and the relevant Commission Delegated Regulation No. 918/2012 are met.<sup>74</sup> Furthermore, according to the Advocate General, ESMA was established precisely in order to proceed to complex assessment of facts.<sup>75</sup> The fact that experts’ opinions may conflict does not necessarily imply the existence of “subjective judgments or untrammelled discretion”. According to the Advocate General:

“objectivity is in fact dependent on procedural guarantees ensuring that decision makers base their assessments on a broad factual basis and sound methodology, after having consulted the relevant actors...”

69 *Short Selling*, at paragraph 41.

70 *Ibid.*, at paragraphs 46–48.

71 *Ibid.*, at paragraph 50.

72 *Ibid.*, at paragraph 52.

73 *Ibid.*, at paragraph 53.

74 *Short Selling* (Opinion of Advocate General Jääskinen), at paragraph 98.

75 *Ibid.*, at paragraph 99.

These are requirements that are reflected in Article 28 of Regulation No. 236/2012.<sup>76</sup> Thus, he also concludes that ESMA is not provided with wide discretionary powers.<sup>77</sup>

### *Observations on the Court's Reasoning concerning the First Plea*

The assessment of the Court and the Advocate General concerning ESMA's margin of discretion still raises some questions. First, even though ESMA's power to act is circumscribed by various conditions, which on their face seem stringent and precisely delineated, they can still be open to significantly differing interpretations. It could be argued that the assessment of whether there is a *threat to the orderly functioning and integrity of the financial system*, whether the measures adopted by the national competent authorities *adequately* address such threats and whether the measures ESMA adopts *affect the efficiency* of the financial markets, are somewhat vague and discretionary since they require the consideration of various factors, in different economic circumstances and, possibly, the balancing of competing policy interests. Indeed, the Commission Delegated Regulation No. 918/2012 has attempted to frame more precisely the instances that constitute a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the Union.<sup>78</sup> However, the definition contained therein arguably does not provide clear guidance as to which are the conditions that need to be fulfilled in order for the threat of financial, monetary or budgetary instability to be considered as *serious* or for the default by a Member State or supranational issuer to be *possible*. It could thus be claimed that these criteria are not specific enough to ensure that ESMA will not encroach upon the exclusive power of EU institutions to determine the policy of the Union in this field.

<sup>76</sup> *Ibid.*, at paragraph 100.

<sup>77</sup> *Ibid.*, at paragraph 101. It should be noted however that Advocate General Jääskinen in his Opinion held that Article 28, Short Selling Regulation could not be established under Article 114, TFEU (at paragraphs 48–53).

<sup>78</sup> Article 24(3), Commission Delegated Regulation No. 918/2012 stipulates:

For the purposes of Article 28(2)(a), a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the Union shall mean:

- (a) any threat of serious financial, monetary or budgetary instability concerning a Member State or the financial system within a Member State when this may seriously threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union;
- (b) the possibility of a default by any Member State or national note issuer;
- (c) any serious damage to the physical structures of important financial issuers, market infrastructures, clearing and settlement systems, and supervisors which may seriously affect cross-border markets in particular where such damage results from a natural disaster or terrorist attack when this may seriously threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union;
- (d) any serious disruption in any payment system or settlement process, in particular when it is related to interbank operations, that causes or may cause significant payments or settlement failures or delays within the Union cross-border payment systems, especially when these may lead to the propagation of financial or economic stress in the whole or part of the financial system in the Union.



Furthermore, the requirement imposed on ESMA to consult with the ESRB<sup>79</sup> and inform the relevant national competent authorities arguably does not affect the discretionary nature of its powers since ESMA is not obliged to comply with the ESRB recommendations. Even though the Advocate General claims that the existence of different opinions does not amount to the exercise of “subjective judgments or untrammelled discretion”, the fact that there could be a disagreement between the ESRB and ESMA means that the same factual situation could be subsumed differently to the same rules and, thus, the exact course of action is at ESMA’s discretion and could even amount to making policy choices. Finally the temporary nature of the measures ESMA can adopt, which according to the Court circumscribes ESMA’s discretion,<sup>80</sup> is not restrictive of the extent of powers conferred on ESMA.<sup>81</sup> The Court’s reference to the temporary nature of the measures adopted by ESMA seems mostly related to the fact that only exceptionally can ESMA override the decision of national authorities which, as a rule, exercise supervision over short selling activities.

## **VI - Impact of the *Meroni* and *Short Selling* Judgments on the Single Resolution Board**

In my view, the *Short Selling* judgment is of critical importance for the SRM, and in particular regarding the powers delegated to the SRB, which shall be established as an EU agency. Even though the *Short Selling* judgment does not provide us with absolute legal certainty as to which are the powers which involve a “wide margin of discretion” in crucial areas of Union policy and thus cannot be conferred on an agency such as the SRB, the Court’s analysis indicates that the final assessment will depend on how the SRB’s powers are circumscribed in the final text of the Regulation and in the Commission delegated acts which will be issued on the basis of the authorization contained therein.

According to the initial Commission proposal, the SRB would be granted several types of powers during the so-called preventive phase, the resolution phase and the use of the SRF; the SRB would also have the power to impose sanctions. However, some of the powers awarded to the SRB may/could raise questions as to their compatibility with the *Meroni* doctrine. For example, under the Commission’s original proposal the SRB should conduct an assessment of resolvability when

79 Above note 3.

80 *Short Selling*, at paragraph 50.

81 H. Hofmann, “Case C-270/12 UK v EP and Council (ESMA – Short Selling) of 22 January 2014”, presentation at the conference mentioned above note 63.



drafting resolution plans.<sup>82</sup> Since the assessment of resolvability is an essential component of effective resolution,<sup>83</sup> the criteria for the SRB to carry out its assessment should be specific so as not to leave a wide margin of discretion. In the original Commission proposal the determination of whether a company is resolvable was based on undetermined legal concepts, e.g. according to Article 8(2):

“an entity shall be resolvable if it is feasible and credible for the resolution authority to either liquidate it under normal insolvency proceedings or to resolve it by applying to it the different resolution tools and powers without giving rise to *significant adverse consequences* for the financial systems, including circumstances of *broader financial instability* or system wide events...” (emphasis added)<sup>84</sup>

In order to address these concerns, the SRM Regulation tries to define the concepts of “significant adverse consequences” and “negative impact on financial stability”; furthermore, it provides that, when determining the significant adverse consequences, the SRB must take into account the relevant warnings and recommendations of the ESRB and the relevant criteria developed by the EBA.<sup>85</sup>

The compromise achieved between the EP and the Council also brought significant changes to the original Commission proposal concerning the decision-making procedure for triggering the resolution process. Thus, the ECB, as the European Supervisor, has the primary responsibility for triggering the whole process; however, the SRB may ask the ECB to take such a decision and if the ECB declines to do so, the SRB may decide on its own.<sup>86</sup> This significantly deviates from the original Commission proposal where only the Commission could place a bank under resolution, upon the recommendation of the SRB.<sup>87</sup> Nonetheless, in order to ensure compliance with the *Meroni* doctrine, the EU legislator requires the Board’s decision to place a bank under resolution to be endorsed by the Commission; the Commission can object to the resolution scheme if it disagrees with the discretionary aspects of the Board’s decision.<sup>88</sup> This ensures that the Board, as

82 Article 10, Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010 of the European Parliament and of the Council (SRM Regulation, not yet published in the Official Journal of the EU).

83 Ibid., Recital 46.

84 Council of the European Union, Opinion of the Legal Service, 7 October 2013, 14547/12, at paragraphs 21–23, available at: [https://archive.org/stream/802602-clis-banking-union/802602-clis-banking-union\\_djvu.txt](https://archive.org/stream/802602-clis-banking-union/802602-clis-banking-union_djvu.txt).

85 Article 8(5), SRM Regulation.

86 Ibid., Article 18(1).

87 Article 16(5) of the original Commission proposal.

88 Article 18(6), SRM Regulation.

an agency, does not take decisions that amount to policy choices or that require the balancing of competing policy objectives. At the same time, it implies that the Commission cannot disagree with the Board's technical assessment. Furthermore, if the Commission considers that the placement of a bank under resolution does not serve the public interest or if it wishes to materially modify the amount of the Fund to be used, the final decision must be taken by the Council.<sup>89</sup> The Council, as an EU institution, is competent to take such a decision; however, certain concerns over possible conflicts of (national) interests and the over-politicisation of the process are raised, especially as regards the use of the Fund. Furthermore, it is interesting that non-participating Member States' representatives will participate in the voting at the Council (even though they do not fall within the scope of the SRM Regulation) while non-Euro area participating Member States are not capable of participating in the adoption of decisions at the ECB Governing Council, in its role as the Single European Supervisor.

## VII - Conclusions

With its decision in the *Short Selling* case, the Court reconfirmed that the delegation of powers to EU agencies must be strictly framed, that agencies should be accountable to the EU institutions and that their acts must be subject to judicial review. The *Short Selling* judgment has a stabilization effect not only for ESMA but also, and most importantly, for the establishment and functioning of the SRB, where the issue of which powers can be delegated to the Board has been at the center stage of the tortuous negotiations. However, it should not be overseen that the *Short Selling* ruling relates to a very specific case where ESMA is granted the power to ban short selling only in exceptional circumstances, as in all other instances the relevant power remains with the national authorities. Therefore, it should be carefully extrapolated to other instances where the power to act is with the EU institutions which are the ones deciding to sub-delegate it to EU agencies. Thus, it is more likely that in the future the Court will review on a case-by-case basis whether the delegation of powers to agencies complies with the *Meroni* doctrine. It remains to be seen whether in the years to come the scope of the powers to be delegated to the SRB will be challenged before the CJEU and whether it will be considered to be in compliance with the *Meroni* doctrine. In fact, the powers delegated to the SRB concerning the resolution of banks are of critical importance

<sup>89</sup> Ibid., Article 18(7).

not only due to their economic impact but also due to their impacts on fundamental rights (e.g. the right to property) protected by the CJEU.<sup>90</sup>

90 On the effects of the new corpus of EU fundamental rights on the EU institutions see C. Ladenburger, “FIDE 2012 – Session on “Protection of Fundamental Rights post-Lisbon – The interaction between the Charter of Fundamental Rights, the European Convention of Human Rights and National Constitutions – Institutional Report”, at 7–14, available at: [http://www.fide2012.eu/index.php?doc\\_id=88](http://www.fide2012.eu/index.php?doc_id=88).



## Chapter 3

# Comparative Corporate Law Theory and Harmonisation of EU Insolvency Law: Understanding the Impact of Path Dependency

Irene Lynch Fannon

### Introduction

Comparative corporate law scholarship is divided on whether corporate governance and corporate law systems are converging or whether, in contrast, corporate governance systems across the globe, display significant differences which will persist over time. Such difference and resistance to convergence can be explained by reference to path dependency theory. Since the 1990s, the debate between convergence theorists and divergence or path dependency scholars has raised interesting questions regarding the future development of corporate law and corporate governance.

To be clear, this chapter considers corporate insolvency law as a part of corporate law. Acknowledging that this is not always how corporate insolvency law is considered in modern law schools, it is argued here that there are insufficient bright line boundaries between the two areas of enquiry to separate corporate insolvency law from corporate law generally. This is particularly true in relation to one particular area of insolvency law referred to in this chapter as an example of substantive law, namely rules on corporate rescue and restructuring. The categorisation hypothesis is admittedly less true in relation to the second area of substantive insolvency law which is referred to, namely the treatment of tax debts as preferential creditors.

This chapter will proceed as follows. Part I will outline the corporate governance/corporate law debate around convergence versus path dependency. Part II will then explore the significance of path dependency in relation to the development of domestic EU insolvency systems. Differences which have emerged in the last fifteen years or so between Irish and UK systems will be referred to as examples which illustrate that significant divergence is possible even between systems, which, up until that time, were so similar as to be almost identical. Two particular areas of law will be considered to illustrate this phenomenon; the first regarding corporate

restructuring systems, a matter of particular interest to current EU harmonisation plans; and the second regarding the treatment of state tax debts as preferential creditors. This section will briefly outline the sources and apparent causes of this divergence. In addition the Irish and UK comparison will also illustrate a counter-intuitive proposition that divergence is increasing rather than decreasing despite EU harmonisation projects. Part III will consider the phenomenon of path dependency in contradistinction to EU drives towards deeper harmonisation of insolvency law systems. Particular reference will be made to recent Commission plans for further harmonisation of corporate rescue and restructuring systems and questions will be raised as to the likelihood of success.

## **I - Convergence versus Path Dependency**

Writing in 2001, Hansmann and Kraakman, two pre-eminent US corporate governance scholars made the following (some would say audacious)<sup>1</sup> claim regarding corporate governance, corporate law systems and convergence:

“The triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured...the standard model earned its position as the dominant model of the large corporation the hard way, by out competing during the post-World War-II period the three alternative models of corporate governance: the managerialist model, the labor-oriented model, and the state-oriented model.”<sup>2</sup>

This statement singled out Anglo American corporate governance structures and corporate law systems as being centrally focussed on issues concerning the shareholder- management relationship. This system was developed in contrast to other models which they described as the “labor-oriented model”, the “state-oriented model” and the “managerialist-oriented model”. European models present in member states of the European Union, in countries such as Germany and the Netherlands, were identified as representing versions of the “labor-oriented model” and the “state-oriented model” and were in both cases described as models which had been less successful than the Anglo-American model. Particular criticism was directed at the presence in a number of European corporate governance systems of rules regarding “co-determination”, namely the presence of worker representatives on boards of directors of European companies. Not only was the Anglo-American

- 1 See M. Welsh, P. Spender, I. Lynch Fannon and K. Hall, “The End of the End of History for Corporate Law” (2014) 29 *Australian Journal of Corporate Law* 147 (Special Edition from the Corporate Law Teachers of Australia Conference 2014).
- 2 H. Hansmann and R. Kraakman, “The End of History for Corporate Law” (2001) 89 *Georgetown Law Journal* 439, at 461.

model identified as being triumphant in relation to these other models, a more assertive claim was made to the effect that there was real evidence that other systems were converging towards this model. Even though the scholarship of the authors was and is generally highly respected, at the time other corporate governance/ corporate law scholars were sceptical of this claim.<sup>3</sup>

Over time, the views of Hansmann and Kraakman seem to have moved on the particular issues of convergence, but not necessarily on the issue of superiority of the Anglo American system:

“Likewise, we take no strong stand here in the current debates on the extent to which corporate law is or should be ‘converging,’ much less on what it might converge to. That is a subject on which reasonable minds can differ. Indeed, it is a subject on which the reasonable minds that have written this book sometimes differ.”<sup>4</sup>

More significantly, a school of thought, developed on the basis of a theoretical concept in economics known as path dependency, identified the same phenomenon of path dependency in development of legal systems. Specifically claims regarding a chronologically linear convergence of corporate governance systems were challenged and divergent rules and practices were identified as being path dependent. Path dependency theory also explains why differences in legal rules persist and why convergence may be more an aspiration than a reality.

- 3 M. Roe, “Some Differences in Company Structure in Germany, Japan, and the United States” (1993) 102 *Yale Law Journal* 1927; R. Gilson and M. Roe, “Understanding the Japanese Keiretsu: Overlaps Between Company Governance and Industrial Organization” (1993) 102 *Yale Law Journal* 871; B. Black and J. Coffee, “Hail Britannia? Institutional Investor Behavior Under Limited Regulation” (1994) 92 *Michigan Law Review* 1997. These anti convergence scholars are referred to by Hansmann and Kraakman in their article. See also I. Lynch Fannon, *Working Within Two Kinds of Capitalism Corporate Governance and Employee Stakeholding, US and EC Perspectives* (2003, Hart Publications, Oxford); I. Lynch Fannon, “The European Social Model of Corporate Governance: Prospects for Success in an Enlarged Europe”, in P. Ali and G. Gregoriou (eds), *International Corporate Governance after Sarbanes-Oxley* (2006, John Wiley & Sons, New Jersey) (423-443); I. Lynch Fannon, “From Workers to Global Politics: How the Way we Work Provides Answers to Corporate Governance Questions”, in J. O’Brien (ed), *Governing the Corporation, Regulation and Corporate Governance in an Age of Scandal and Global Markets* (2005, Wiley Publications, London) (101-121); L. Bebchuk and M. Roe, “A Theory of Path Dependence in Corporate Ownership and Governance” (1999) 52 *Stanford Law Review* 127; O. Hathaway, “Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System” (2001) 86 *Iowa Law Review* 601; R. Posner, “Path Dependency, Pragmatism and a Critique of History in Adjudication and Legal Scholarship” (2000) 67 *University of Chicago Law Review* 573.
- 4 See further H. Hansmann and R. Kraakman, “What is Corporate Law?”, in H. Kraakman and P. Davies *et al.* (eds), *The Anatomy of Corporate Law* (2009, OUP, Oxford) (1-33), at 5; W. Allen, “Contracts and Communities” (1993) 50 *Washington and Lee Law Review* 1, who describes the philosophical theories underpinning these different views.

In their seminal work on path dependency, Bebchuk and Roe<sup>5</sup> make two arguments. First, that *corporate governance structures* are path dependent (an argument that need not detain us here) and second, that *corporate rules* are also path dependent. In this case rules refer to all rules affecting corporate structures and outcomes including corporate law, but also insolvency and securities law.<sup>6</sup> According to Bebchuk and Roe, there are a number of factors which might determine both the choice of legal rules and the persistence of particular rules, even where in both cases the choice of rule is neither optimal or efficient. Such factors include:

- preceding conditions in the economy;
- interest group politics;
- combinations of institutional structures which can include *inter alia* procedural rules, judicial practices and enforcement capabilities; and
- finally, the authors argue that path dependent rules may be historically determined where rules persist because institutions and structures have been developed which address the needs and problems arising under these rules.<sup>7</sup>

## II - Path Dependency and Insolvency Law: Ireland and the UK as a Case Study

For many years Irish (Republic of Ireland) and UK insolvency law systems developed on extremely similar, if not identical lines.<sup>8</sup> In the two areas of law which I propose to identify as examples of divergence, namely corporate restructuring and the treatment of preferential creditors, very similar rules prevailed up until 1990. However, in a surprising development in the last decade a divergence emerged between the two jurisdictions. In the UK, this was driven by the Enterprise Act 2002 which represents a significant point of divergence in the two systems and a significant change of policy and theoretical approach in the UK from the system which had existed beforehand.

5 Bebchuk and Roe, above note 3; C. Paulus, "Global Insolvency Law and the Role of Multinational Institutions?" (2007) 32 *Brooklyn Journal of International Law* 755.

6 *Ibid.*, at 1.

7 Bebchuk and Roe, above note 3, at 154. See further Hathaway, above note 3, at 102.

8 In both jurisdictions, the Cork Committee Report was considered to be a seminal road map for the future development of insolvency law over the following decades from its publication in 1985. Passed in 1986, the Insolvency Act (UK) was the first development. In 1987, a significant Bill on Company Law was published in Ireland and this was enacted as the Companies Act 1990 and the Companies (Amendment) Act 1990. The Irish Companies Act 1963 is in the process of being consolidated with other subsequent pieces of legislation, presently in the form of the Companies Bill 2012. In the UK, the Companies Act 2006 represents as similar overhaul. However, the Enterprise Act 2002 (UK) is significant as a point of divergence between both systems.



## *Path Dependency and Corporate Restructuring*

Broadly speaking, corporate restructuring, if it occurred at all during the last recession in both jurisdictions (as distinct from voluntary or compulsory liquidation), occurred through receivership or through the statutorily established version of administrative receivership under the UK Insolvency Act 1986. The Cork Committee Report<sup>9</sup> was considered in both jurisdictions to set out a clear direction in relation to corporate rescue. The report stated that it was important that an insolvency legal framework was designed:

“.....to provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country...”

These recommendations led indirectly to the introduction of examinership in Ireland under the Companies (Amendment) Act 1990,<sup>10</sup> while, in the UK, the administration procedure introduced under the Insolvency Act 1986 offered a similar rescue framework. However, at the time of its introduction, the Irish system was much more radical in relation to the ability of the corporation to be rescued at the expense of some creditors and the provision of “cram-down” procedures.<sup>11</sup> Therefore between 1990 and 2002, the Irish system displayed more rescue friendly characteristics. However, the administration procedure was radically revamped under the UK Enterprise Act 2002.<sup>12</sup> Now, as things stand, the over-hauled administration procedure is central to the UK system following significant changes made to this process under the Enterprise Act 2002.

9 Insolvency Law and Practice, Report of the Cork Review Committee (Cmnd. 8558, 1982) (“Cork Committee Report”), at paragraph 198, stated the following:

“...the aims of a good modern insolvency law are....to recognise that the effects of insolvency are not limited to the private interests of the insolvent and his creditors, but that other interests of society or other groups in society are vitally affected by the insolvency and its outcome, and to ensure that these public interests are recognised and safeguarded; to provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country...”

10 Companies (Amendment) Act 1990.

11 The Irish examinership process includes provisions for the ‘cram-down’ of creditors who might not agree to the restructuring and compromise of their debts. Thus the court can approve a scheme of restructuring even where a creditor objects. Creditors may argue that they are being ‘unfairly prejudiced’ by the restructuring but this is a matter for the court. See further sections 24-25, Companies (Amendment) Act 1990, discussed in I. Lynch Fannon and G. Murphy, *Corporate Insolvency and Rescue* (2012, Bloomsbury Professional, Dublin), Chapters 12 and 13. For a recent Supreme Court decision on the issue of “unfair prejudice”, see *Re SIAC Construction Ltd.* [2014] IESC 25.

12 “Company rescue is at the heart of the revised administration procedure. We want to make sure that viable companies do not go to the wall unnecessarily. That is why we are restricting administrative receivership and revising administration to focus on rescue and to make it more accessible to companies as well as their creditors. That is not just good for the companies themselves; it is also good for their suppliers, customers and employees.”: *per* Lord McIntosh (Hansard, H.L. Deb. Col. 766) (29 July 2002).

In addition, in the current recessionary period, the adoption of schemes of arrangement provided for in the UK Companies Act 2006 has become a “cutting edge” solution to corporate restructuring.<sup>13</sup> Similar provisions regarding schemes of arrangement exist in the Irish Companies Act 1963,<sup>14</sup> but at present practitioners in Ireland greatly favour the examinership process. The effect of the European Insolvency Regulation<sup>15</sup> on cross border insolvencies is significant in this context and to some extent has had unintended consequences on the provision of restructuring services, particularly in the UK. Currently, the EIR covers examinerships and administrations as corporate insolvency processes. Accordingly, a centre of main interests (“COMI”) must be identified to establish jurisdiction. In contrast, neither schemes of arrangement (in both jurisdictions), nor receiverships are covered by the EIR and so COMI need not be established to allow courts to take jurisdiction. This has become particularly relevant to the growth in popularity of English schemes of arrangement.<sup>16</sup> The “cutting edge” nature of the Scheme of Arrangement process and the fact that it is not covered by the EIR has contributed to significant divergence in practice in the EU. It presents particular challenges for EU harmonisation plans also and raises issues concerning forum shopping.

#### *Path Dependency and State tax debts as Preferential Creditors*

Whilst EU initiatives have focussed on either jurisdictional harmonisation or broad brush attempts at substantive harmonisation, significant detailed differences will also continue to persist. EU policy documents, in particular the later documents which will be described below describe the challenges presented by such divergence. There is concern over the effects which such divergence has on individual firms and broader macro-economic issues. Rescue of viable businesses is a case in point. However, another important issue which is raised here as an example is not only extremely detailed in its application but also is of macro-economic significance.

13 Sections 895-899, Companies Act 2006 (UK); J. Payne, “Cross Border Schemes of Arrangement and Forum Shopping” (2013) 14 *European Business Organisation Law Review* 563.

14 Irish company law is undergoing a major consolidation and reform project as contained in the Companies Bill 2012. Chapter 9, Part I re-enacts the provisions on schemes of arrangements.

15 Council Regulation 1346/2000 on Insolvency Proceedings (“EIR”).

16 There have been over 80 restructurings through schemes of arrangement before the English courts, including the following cases involving European companies: *Re Rodenstock GmbH* [2011] EWHC 1104; *Primacom Holdings GmbH* [2012] EWHC 164; *Re Metrovascesa*, Ch (29 March 2011) (unreported); *SA Re NEF Telecom Co BV*, [2012] EWHC 2944; *Re Cortefiel SA* [2012] EWHC 2998; *Re Seat Pagine Gialle SpA* [2012] EWHC 3686. See further Payne, above note 13; G. McCormack, “Jurisdictional Competition and Forum Shopping in Insolvency Proceedings” (2009) 68 *Cambridge Law Journal* 169; G. Moss, “Group Insolvency-Choice of Forum and Law: The European Experience under the Influence of English Pragmatism” (2007) 32 *Brooklyn Journal of International Law* 1005.

In Ireland and the UK, a significant variation has emerged in relation to the position of state tax debts. Preferential status for a range of creditors, but most spectacularly for the state's tax debts, was abolished in the UK Enterprise Act. Preferential status for revenue debts remains a key feature of Irish insolvency law. Under section 285 of the Irish Companies Act 1963, state tax debts are accorded preferential status on insolvency. In contrast the preferential status which had been accorded to such debts under English and UK insolvency law has been totally abolished under the Enterprise Act 2002. The consequences of this divergence have not fully played out in relation to cross border insolvencies. However, it can be hypothesised that as state tax collection is particularly important in relation to the recovery of sovereign debt stability, the macro-economic context is important in relation to this issue. This might be particularly relevant as the Irish National Asset Management Agency continues to dispose of assets which are based in the UK.<sup>17</sup>

As it stands there are now significant consequences regarding the distribution of assets to creditors under English law. The position of the floating chargeholder is changed significantly, as it is now not subject to priority claims of a significant preferential creditor such as the state tax authority. Furthermore the floating chargeholder is liable to a top slice of up to 10% of funds for distribution to unsecured creditors, representing a public policy choice favouring private trade creditors over public/state tax debts.<sup>18</sup> Finally the decision of the House of Lords in *Re Spectrum Plus Ltd.*,<sup>19</sup> which significantly changes the possibility of creating a fixed charge over book debts can all be regarded through the prism of path dependency as being inter-related developments, none of which have really been changed in the neighbouring Irish jurisdiction.<sup>20</sup>

These practical examples of divergent developments in Irish and English insolvency law illustrate some aspects of path dependency theory. These examples also elucidate the nature of the challenges faced by EU harmonisation projects.

17 National Assets Management Agency Act 2012.

18 Enterprise Act 2002.

19 *Re Spectrum Plus Ltd.* [2005] 2 AC 680.

20 The significance of the overruling of *Re Siebe Gorman Ltd.* [1979] 2 Lloyd's Reports 142 in the above case, in particular because *Siebe Gorman* set out the possibilities of creating fixed charges over book debts and is followed in Irish commercial practice, has yet to play out in the Irish courts.

### III - Path Dependency and EU Harmonisation of Insolvency Laws

#### *Path Dependency and Restructuring Processes*

The divergence between restructuring processes in the UK and Ireland is part of a wider and arguably much more acute problem in the broader European context. In the documents accompanying the Commission proposals of March 2014<sup>21</sup> restructuring processes across the EU are classified into three groups, illustrating existing differences (although some argument may be made from an Irish perspective in relation to the classification of systems available under Irish law). The UK system which allows for both a relatively formal and informal company voluntary arrangement (“CVA”) is used as a benchmark.

The practical significance of the level of divergence across the EU is described in the following terms:

“Many European restructuring frameworks are still inflexible, costly, and value destructive. Insolvency systems in some Member States often channel viable businesses towards liquidation. An effective insolvency law should be able to liquidate speedily and efficiently unviable firms and restructure viable ones in order to enable such firms to continue operating and to maximise the value received by creditors, shareholders, employees, tax authorities, and other parties concerned. At present it is safe to conclude that receiverships and schemes of arrangements are outliers in the corporate restructuring framework.”<sup>22</sup>

In terms of path dependency theory, it is to be expected that the Bebchuk and Roe analysis indicates problems arising for further harmonisation. The radical nature of the Irish restructuring process was prompted by *preceding conditions* in the domestic economy, particularly regarding the imperative of rescuing the Irish beef industry at the time of its introduction. A continued emphasis on saving jobs has informed its development.<sup>23</sup> Following initial enactment in 1990, pressure from

21 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Commission proposal for a Regulation of the European Parliament and the Council for the reform of the Council Regulation on Insolvency COM(2012) 744 final; Commission Staff Working Document Impact Assessment Accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency Brussels, 12.3.2014 SWD(2014) 61 final. For an executive summary of this document, see also Commission Staff Working Document Impact Assessment 12.3.2014 SWD (2014) 62 final.

22 Idem; see also Staff Working Document SWD (2014) 61/final, at 1.

23 I. Lynch, J. Marshall *et. al.*, Chapter 10 in *Corporate Insolvency and Rescue* (1996, Butterworths, Dublin).

banking interests in following years led to a re-balancing of more provisions in an amendment in 1999, but nevertheless these are still present in the legislation.<sup>24</sup>

Conditions such as these will vary across European jurisdictions. Applying the concepts of path dependency to the restructuring processes already in existence, it is clear that a harmonised EU system of restructuring will have to accommodate the *interest group politics* which have been addressed effectively in existing processes. So, for example, if schemes of arrangement are currently favoured because they tend to favour shareholders (new owners or equity investors in companies), new domestic rescue scheme will have to address this issue. This may not be in keeping with the view of others that existing creditors such as secured lenders should be favoured over new equity investors. In this particular case both the path dependency of rules and the path dependency of ownership structures are significant.<sup>25</sup>

In relation to English schemes of arrangement in particular, it is also clear that because of the interface between this process and the current terms of the EIR, a significant interest group likely to resist harmonisation are the legal profession and insolvency practitioners who believe that schemes of arrangement offer a unique opportunity for restructuring. This may be a belief borne out by the level of successful restructurings achieved under this process. Furthermore, procedural rules, and in particular judicial practises in relation to jurisdiction matters in England have supported this approach.

#### *Path Dependency and Preferential Status for Tax Debts*

The abolition of preferential status for state tax debts and the consequent development of an entirely different approach to priorities of creditors represented a change in political choice in the UK. In its entirety the Enterprise Act 2002 represented a significant shift towards a more market driven approach to insolvency. Again path dependency theory allows us to explain and describe the potential resistance to similar changes in other jurisdictions. In the case of Ireland, abolishing preferential status for tax debts is most unlikely in light of an incomparability of what path dependency theorists refer to as ‘enforcement capabilities’ for the Irish tax authorities. Similarly, political choice analysis would

24 Companies Act 1999. See further Lynch Fannon and Murphy, above note 11, in Chapter 13. Interestingly, the Staff Working Document accompanying the Commission’s recent proposals classify the UK and Ireland into two different groups with Ireland described as having early restructuring processes but classified with other countries with “effectiveness” issues. The example given is that schemes cannot be binding with a majority vote. In Ireland this is not the case.

25 See further B. Wessels, “Themes of the Future: Rescue Businesses and Cross-Border Co-Operation” (2014) 27(1) *Insolvency Intelligence* 4.

indicate resistance to such a change in light of the significance of tax collection in the current Irish macro-economic context.

In addition the issues which have been raised by the House of Lords decision in *Re Spectrum Plus Ltd.*<sup>26</sup> are not as yet entirely resolved in the UK, let alone in Ireland. In both jurisdictions reliance was placed on the authority of the decision in *Re Siebe Gorman Ltd.*<sup>27</sup> to encourage lenders to use fixed charges on book debts as security for loans. However, the House of Lords made it clear that the overruling of the decision in *Siebe Gorman* had retrospective effect, thus casting a long shadow over lending agreements which had existed at that time. A path dependent analysis leads us to predict that because of historically determined rules regarding priorities, we might not see as much change in coming years in other jurisdictions. The premise that rules are historically determined allows us to understand that where there has been a significant development of institutions and structures which address needs and problems arising under a particular set of rules, it will be more difficult to dismantle these structures to allow for new rules. This describes the Irish position, but could equally apply to other EU jurisdictions. A further principle emanating from path dependent scholars might mitigate against further dramatic change without a strongly signalled piece of legislation, namely the principle that legal rules should accommodate rather than interfere with existing business practices.<sup>28</sup> This is certainly an argument against any further judicially driven refinement of priority rules and practices.

#### *Path Dependency and EU Harmonisation of Insolvency Law*

Following a series of important initiatives, the latest document emanating from the Commission in 2014 and the accompanying working documents considers these

<sup>26</sup> Above note 19.

<sup>27</sup> Above note 20.

<sup>28</sup> J. Hay *et. al.*, "Toward a Theory of Legal Reform" (1996) 40 *European Economic Review* 559.

challenges in detail.<sup>29</sup> Renewed drives towards harmonisation of insolvency laws<sup>30</sup> in the European Union have focussed on the importance of corporate restructuring and the rehabilitation of bankrupt entrepreneurs. This article will not consider the second issue in any detail but will focus on the current initiatives in the context of restructuring. These initiatives are challenged by current significant divergence amongst domestic systems of which the Irish and UK divergence is simply the “tip of the iceberg” as it were.

The project of harmonising EU insolvency laws has become particularly important in the macro-economic context. Working documents accompanying the Commission’s proposals for a new approach to business failure and insolvency point to Hungary to illustrate the point that absent specific kinds of restructuring methods in Hungary approximately 4,300 viable firms were lost. Over 200,000 firms across the EU failed every year in the last few years and the consequences for jobs and entrepreneurship are significant. Consequently, harmonisation or at least approximation of rules on restructuring processes has now come to the top of the European agenda as exemplified in the recent Communication issued in March 2014:

“This proposal aims at improving conditions and incentives for effective preventive restructuring of firms (i.e. to change the composition, conditions and/or structure of assets and liabilities of debtors in financial difficulty with the objective of avoiding insolvency) and on giving a second chance to honest entrepreneurs who once failed. It links in with the EU’s current political priorities to promote economic recovery and sustainable growth, a higher

29 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Commission proposal for a Regulation of the European Parliament and the Council for the reform of the Council Regulation on Insolvency COM(2012) 744 final; 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. Strasbourg, 12.12.2012 COM(2012) 742 final. See also Commission Recommendation on a new approach to Business Failure and Insolvency (Brussels 12.3.2014-C(2014) 1500/final OJ L74/65). See further Commission Staff Working Document Impact Assessment Accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency Brussels, 12.3.2014 SWD(2014) 61 final. See also Commission Staff Working Document Impact Assessment 12.3.2014 SWD (2014) 62 final for an executive summary of this document. See further INSOL Report to the European Parliament: Harmonisation of Insolvency Law at EU Level, DG Internal Policies, 2010. See further Leiden International Insolvency and Rescue Research Newsletter discussion of the European Law Institute Business Rescue Project, available at [www.europeanlawinstitute.eu](http://www.europeanlawinstitute.eu) (last viewed 10 June 2014).

30 See further P. Omar, “The European Insolvency Regulation 2000: A Paradigm of International Insolvency Cooperation.” (2003) *Bond Law Review* 190; G. McCormack, “Restructuring European Insolvency Law: Putting in Place a New Paradigm” (2010) 30 *Legal Studies* 126.

investment rate and the preservation of employment, as set out in the Europe 2020 strategy for jobs and growth.”<sup>31</sup>

The Staff Working Document (“SWD”) accompanying the Commission Recommendations on a new approach to Business Failure and Insolvency<sup>32</sup> canvases a number of options regarding further harmonisation of restructuring processes. In summary these options range from maintaining the status quo to complete harmonisation. The recommendation adopts what is described as Option 2 in the SWD. Accordingly and in vindication of the path dependency theorists, at this point in time it seems that further drives towards harmonisation at EU level, will for the moment, take place through “soft law” options. As of March of this year (2014) the European Commission has issued a recommendation that member states will enact further insolvency law procedures to facilitate the restructuring of businesses. The language is significant: Member States are “invited” to enact particular reforms:

“On 9 January 2013 the Commission adopted the Entrepreneurship 2020 Action Plan where the Member States are invited, among others, to reduce when possible, the discharge time and debt settlement for an honest entrepreneur after bankruptcy to a maximum of three years by 2013 and to offer support services to businesses for early restructuring, advice to prevent bankruptcies and support for SMEs to restructure and re-launch.”<sup>33</sup>

It is interesting to note that the broader macro-economic policy drivers are clearly articulated:

“An approximation of the Member States’ bankruptcy systems has also been recommended, with a view to removing the barriers to the flow of capital in the European Union, by the Organisation for Economic Cooperation and Development in its 2014 Economic Review for the European Union, by a High Level Expert Group on SME and Infrastructure Financing<sup>10</sup> as well as by the Association for Financial Markets in Europe.”<sup>34</sup>

31 SWD 2014 final/61, at 2.

32 Commission Recommendation on a new approach to Business Failure and Insolvency (Brussels 12.3.2014-C(2014) 1500/final OJ L74/65).

33 *Ibid.*, at 3.

34 *Idem.*



It is envisaged that these new procedures would include the following characteristics:

- (i) Facilitate the restructuring of businesses in financial difficulties at an early stage, before starting formal insolvency proceedings, and without lengthy or costly procedures to help limit recourse to liquidation;
- (ii) Allow debtors to restructure their business without needing to formally open court proceedings;
- (iii) Give businesses in financial difficulties the possibility to request a temporary stay of up to four months (renewable up to a maximum of 12 months) to adopt a restructuring plan before creditors can launch enforcement proceedings against them;
- (iv) Facilitate the process for adopting a restructuring plan, keeping in mind the interests of both debtors and creditors, with a view to increasing the chances of rescuing viable businesses;
- (v) Reduce the negative effects of a bankruptcy on entrepreneurs' future chances of launching a business, in particular by discharging their debts within a maximum of three years.<sup>35</sup>

Finally, the Commission recommendation provides for a monitoring and evaluation period in relation to this soft law approach. Initially member states will be given a 12 month period in which to make changes. After that as the report notes “soft law” recommendations come:

“inevitably with the risk of low up-take by the Member States and of a considerable proportion of the discrepancies currently affecting the smooth working of the internal market still remaining in place.”

The document continues:

“Thus, 18 months after its adoption, the Commission will conduct an evaluation of the extent to which the Recommendation is being implemented in the Member States. The Commission will also assess, most likely on the basis of an external study, the effectiveness of the actions that Member States will be taking in terms of achieving the [policy] objectives set out” in section 5 [of the document]...”

<sup>35</sup> Press Release issued by the European Commission 12.3.2014, available at: [http://ec.europa.eu/justice/civil/files/c\\_2014\\_1500\\_en.pdf](http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf) (last viewed 10 June 2014). See also the main document, above note 29, at 47-48.

## Conclusion

Two concluding comments are offered. The first is that this recommendation seems to concede that detailed harmonisation of restructuring processes is not viable at this time. Different approaches to harmonisation are articulated in the SWD accompanying the proposals:<sup>36</sup>

“The European Insolvency Regulation (EIR)<sup>37</sup> proposal and the current initiative are complementary. “The EIR and its reform deal with the problems of jurisdiction, applicable law, recognition and enforcement of insolvency decisions, as well as coordination of cross-border insolvency proceedings. It “works with” the insolvency procedures that exist in the Member States and ensures that their results are recognised throughout the EU. The revision of the Regulation will extend the scope of the Regulation to preventive/pre-insolvency procedures and certain personal insolvency procedures which are currently not covered by the Insolvency Regulation. However, the EIR proposal will not oblige Member States to introduce specific types of procedures or to ensure that their procedures are effective in promoting rescue and second chance. The current initiative would therefore be complementary to the Insolvency Regulation by requiring Member States to ensure that their national insolvency procedures comply with certain minimum standards.”

Nevertheless the Commission recommendation does not impose a mandatory set of standards and is itself not a harmonising document.

Second, sounding a cautionary note, the insights provided to us from path dependency scholarship, allow us to recognise that it is possible that the importation of one system to another may not be as viable as would first appear. The core aspects of path dependency theory as outlined above will be equally valid in understanding difficulties which might be presented even in a watered down

<sup>36</sup> Above note 31, at 5.

<sup>37</sup> For a current description of the law arising from the European Insolvency Regulation see further D. Milman, “EC Regulation on Insolvency Proceedings 1346/2000: A Review of the Current Law and Practice” (2012) 326 *Company Law Newsletter* 1.

attempt at ‘cross-fertilisation’ of different systems.<sup>38</sup> The previous section has illustrated significant differences in both the legal framework for restructuring and restructuring practice during the current recession in Ireland and the UK. Similarly changes in preferential status for state tax debts enacted in the Enterprise Act 2002 represented significant divergence in approaches to this issue. This statute provided a context for further path dependent development with a significant judicially driven change in *Re Spectrum Plus Ltd*. In considering and extrapolating from significant divergence between UK and Irish insolvency law, the only two common law countries in the European Union, which have had similar legal histories and, until recently, almost identical insolvency law systems, we are faced with serious questions regarding the possible success of an EU Harmonisation plan.

The divergence between Irish and English insolvency rules is offered as a case study illustrating the challenges faced by renewed harmonisation projects at EU level. Path dependency theory provides a theoretical framework in which such divergence can be understood. Furthermore path dependency theory will provide analytical tools which will elucidate the causes and nature of such divergence, even where systems have been so similar for significant periods of time. In doing so this theory, and its further development may also provide a means to define the parameters of a harmonisation project which will succeed:

“Disparities between national insolvency laws can create obstacles, competitive advantages and/or disadvantages and difficulties for companies with cross-border activities or ownership within the EU. The study found that harmonising insolvency processes would increase the efficiency restructuring process and increase returns to creditors. The study concluded that ‘there are certain areas of insolvency law where harmonisation is worthwhile and achievable’...”<sup>39</sup>

38 As a final word of caution, a discussion of basic principles of insolvency law, for which see R. Goode, *Principles of Insolvency Law* (2011, Sweet and Maxwell, London), stating that in many jurisdictions, these encompass the following principles: (i) transparency; (ii) equitable distribution of assets; (iii) fairness or equity of treatment as between classes of creditors and shareholders, the *pari passu* principle; and (iv) efficiency and final discharge where no fault is implied, might lead one to conclude that schemes of arrangement as currently applied in the UK infringe principles (i)-(iii) in some cases. If the recommendations from the Commission are modelled on schemes of arrangement, there is a clear danger that these proposals will not be acceptable in some jurisdictions.

39 Above note 31, at 1. Note the document refers to the following supporting documentation:

- Study on a New Approach to Business Failure and Insolvency – Comparative Legal Analysis of the Member States’ Relevant Provisions and Practices (INSOL Europe) (Annex 1 to this report);
- Fostering a rescue culture in the EU: preventive corporate restructuring procedures and second chance for entrepreneurs (DG ECFIN, Annex 2 to this report);
- A Second Chance for Entrepreneurs, Final Report of an Expert Group, DG ENTR (referring to the INSOL study commissioned by the European Parliament study on this issue. INSOL Europe, Harmonisation of Insolvency Law at EU level, 2010, PE 419.633).



**PART II**  
**ROUNDTABLE AND WORKSHOPS**



## Chapter 4

# Judicial Cross-Border Cooperation on Insolvency Matters Today and Tomorrow: Roundtable Report

Anna Bandina

### **Introduction**

In the course of the conference on teaching and research in international insolvency law held in April 2014 in Leiden, the Netherlands, one of the most heated discussions was that on Cross-Border Judicial Cooperation. The discussion was chaired by Professor Paul Omar and the participants included Former President of the Supreme Court of Belgium Judge Ivan Verougstraete, Justice of High Court of London Sir David Richards, Professor of the Cologne University (Germany) Heinz Vallender and Mincke Melissen from the District Court of Amsterdam.

Professor Paul Omar raised the most actual matters faced by academics, judges and practitioners while discussing judicial cooperation on cross-border insolvency:

- Is such cooperation a right or rather an obligation of judges?
- What are the means to be applied by judges while communicating with judges from other countries?
- Should the law command judges' obligation to cooperate with foreign procedures?
- What are the key obstacles faced by judges striving to set up cooperation?

### **Language Barrier and Closeness for Cooperation**

Ivan Verougstraete drew the attention of the participants to the fact that one of the practical difficulties is a language barrier. There are not too many judges involved in cross-border insolvency who are fluent in either of the commonly used international languages. We are talking here not merely of one's ability to communicate a message in a foreign language, either orally or in writing. One must possess knowledge of specific linguistic connotations, legal terms and other professional jargon. It should be noted that involving professional interpreters for

cooperation is not always a best mean to set up a sense of partnership among judges, as a lot depends on personal communication skills, an ability to find common tongues while discussing nuances and technicalities of foreign court procedures. Mincke Melissen pointed out that in her opinion cooperation processes prove to be far more effective if started not via official requests but rather via personal communication – telephone or e-mail. Such direct communication helps create an atmosphere of trust which will further on turn out very handy when solving complex procedural matters and contradictions, if any.

Another obstacle for cross-border cooperation is a judge's personal opinion on involving or being involved in cooperation on matters of cross-border insolvency. Taking into account that laws of most jurisdictions do not provide for direct obligation of a judge to cooperate, and the matter lies largely in a judge's discretion. Heinz Vallender mentioned that certain Swedish judges openly declared that they will never cooperate with foreign jurisdictions. Given such an opinion, all approached from foreign judges to set up a cooperation cannot but fail.

### **The Role of the Court in Cross-Border Cooperation**

The participants of the discussion also voiced another softer position on the necessity to cooperate on cross-border insolvency. Sir David Richards pointed out that his experience in insolvency burdened by a foreign element showed that in reality very few matters bring about the necessity for actual judicial cooperation. The key role in his opinion should be allocated to liquidators and practitioners. One of the most important matters that implies cooperation is a debtor's assets, their valuation and distribution to be cared for by liquidators and practitioners. It should be noted that all participants unanimously agree that practitioners should be nominated by court in all proceedings on cross-border insolvency. Practitioners should be the ones in charge of cooperation with practitioners nominated by foreign courts in parallel court proceedings involving insolvency.

Judge Richards also mentioned that the maximum involvement of liquidators and practitioners bears a great role in judicial systems in which judges do not have the broad authority traditionally enjoyed by English courts and thus do not possess the authority to cooperate with foreign judges without a direct reference in the law. Judge Richards state further that another complication becomes clear when an increasing number of parties are involved in cross-border insolvency court proceedings: the list of legal counsellors supporting insolvency of multinational companies, as well as practitioners nominated by a court tends to get narrower while



the number of cross-border insolvencies continues to grow, which inevitably leads to a conflict of interests for liquidators and practitioners nominated in proceedings.

### **The Duty to Cooperate vs. The Willingness to Communicate**

The discussion also touched upon a matter of making it a legal duty for judges hearing cross-border insolvency cases to cooperate with foreign jurisdictions. While not denying the advantages of judicial cooperation, it was noted that the matter of a judge's right to refrain from cooperation has been largely unexplored. In most cases, such refusal to cooperate is explained by the absence of a legally binding international cooperation regime. In this case, when international acts or national law prescribe that courts must cooperate, there must be an equal approach provided stating that refusal for such cooperation should be considered legal and well-based. As of today, such approach has not been duly documented, but now already many scientists and practitioners support the position implying that such refusal must be made in writing and be well motivated and at the same time beyond dispute. Hence, it will not be considered sufficient for a judge to state that cooperation with an international jurisdiction might result in limiting the rights of national creditors; he or she would rather have to list in detail which preferences might be unduly obtained by foreign creditors thanks to various foreign jurisdictions being addressed.

It was noted that, taking into account the lack of possibility for most Roman-German judges to conduct any actual cooperation, the very first necessary step should be not an obligation to cooperate but rather documenting a judge's right to cooperate. Relevant obligations and responsibility for their violation might be further introduced in case the will of a legislator is not used for the application of the law. This position was severely criticized: the history of coordinating administrators evidently demonstrates that not all judges support the necessity to legally prescribe an obligation to cooperate with a foreign jurisdiction. Judge Richards mentioned that there may be cases when one should respect a judge's refusal to cooperate with a foreign colleague and such refusal can be construed on reasons to be respected. Thus in cases when secondary proceedings were opened for a mere cause to obtain access to assets due to a creditor's better position as dictated by a foreign national law, in case a judge determined an abuse of rights to exist, such refusal to cooperate may be explained by his or her strivings to protect interests of national creditors and debtor.

## **Secret Policy**

Mincke Melissen pointed another important matter: judicial cooperation should not in any case be held in secret. The judicial party and other parties involved in the process shall get accustomed to such cooperation and evidence their advantages first hand; this should be supported by information openness in judicial proceedings. It should be noted here that not every detail must be mandatorily disclosed – the judges must possess a dispositive right to rule on matters of publicity. Here official cooperation procedures are not mandatorily required – contacts in the form of minor personal notes might be applied indicating readiness to cooperate.

## **EU Cross-Border Insolvency Court-to-Court Cooperation Principles**

Academics actively continue to lay the basis for forming soft law provisions targeted at further judicial cooperation expansion and perfection. In order to further develop the INSOL Europe Principles for Communication and Cooperation developed by members of the Academic Forum, EU Cross-Border Insolvency Court-to-Court Cooperation Principles have been developed. These principles are of a recommendatory nature and are mostly targeted at providing for methodical guidelines for judges to use in their day-to-day activities. A first draft of the JudgeCo Principles was presented at the conference in Leiden, this draft to be amended and finalized by the end of 2014. Led by Professor Bob Wessels, the scientific society have accomplished a great load of work on cross-border insolvency judicial cooperation in terms of systematizing the practical experience accumulated during the last decade.

# Chapter 5

## Principles and Best Practices for Insolvency Office-Holders in Europe

Bernard Santen

### Introduction

Within a global society that throughout recent history has shown increased reliance on the concept of credit for all kinds of purposes, it is of no surprise to see that the importance attached to adequate and efficient insolvency law has increased alongside. Numerous countries have updated their insolvency regimes to that end. However, due to the growing European integration and globalization in general, European insolvency office holders (“IOHs”)<sup>1</sup> are more and more confronted with international issues e.g. foreign investors, foreign subsidiaries and foreign trade creditors. National law by its nature is not able to cover all these issues and the need for international initiatives on coordination and harmonization in insolvency proceedings became more and more urgent. Developments as the UNCITRAL Model Law and the European Insolvency Regulation (“EIR”),<sup>2</sup> applicable in the EU since May 2002, can be seen as a clear drive towards harmonization of cross-border matters, such as the recognition of insolvency judgments and insolvency related judgments, rules applicable to cross-border cases and the duty for liquidators in cross-border cases to cooperate with each other.

Nevertheless, in 2011, the European Parliament (“EP”) came to realize that there are certain areas of insolvency law where harmonization is worthwhile and is likely to be achieved more easily.<sup>3</sup> In a motion, the EP recommends legislative action “on

1 Following the EBRD Insolvency Office Holder Principles of June 2007 and other recent publications, e.g. Statement of Insolvency Practice (UK) 9; M. Vanmeenen, “The Insolvency Office Holder in Belgium”, in P. Omar and B. Wessels (eds), *Crossing (Dutch) Borders in Insolvency* (2009, INSOL Europe, Nottingham) (19-30), this report applies the neutral term Insolvency Office Holder (“IOH”) as the overarching term for the various national designations. The definition of IOH is aligned with that of a liquidator as referred to in Article 2(b) of the EIR: “any person or body whose function is to administer or liquidate assets of which the debtor has been divested or to supervise the administration of his affairs.”

2 Council Regulation (EC) No 1346/2000.

3 2011/2006(INI) procedure file, titled: “Draft report from the European Parliament, with recommendations to the Commission on insolvency proceedings in the context of EU company law”.

the harmonization of general aspects of the requirements for the qualification and work of liquidators”. The motion further states that:

“the liquidator must be competent and qualified to assess the situation of the debtor’s entity and to take over management duties of the company.”

Moreover, in December 2012,<sup>4</sup> the European Commission (EC) submitted a report on the application of the EIR, as required by Article 46 of the EIR, to the EP, the Council and the Economic and Social Committee. In accordance with Article 46, this report was accompanied by a proposal to adapt the Regulation. The focus of the EC Proposal<sup>5</sup> is on:

- (a) enhanced restructuring possibilities; and
- (b) intensification of communication and cooperation between liquidators, between courts, and between each other.

On the intensification of communication and cooperation, the last line of Recital 20 of the Proposed EIR reads:

“In their cooperation, liquidators and courts should take into account best practices for cooperation in cross-border insolvency cases as set out in principles and guidelines on communication and cooperation adopted by European and international associations active in the area of insolvency law.”

We could also refer to the newly proposed Recital 20a and to proposed changes in Articles 31 and 31b of the EIR, all aimed at improving and facilitating communication and cooperation in cross-border cases amongst liquidators and courts, and between liquidators and courts.

## **The Assignment**

The call for “principles and guidelines on communication and cooperation adopted by European and international associations active in the area of insolvency law” as quoted in Recital 20 of the Proposal challenged INSOL Europe to have such principles and Guidelines for IOHs drafted. In early 2013, INSOL Europe gave Leiden Law School the assignment:

4 Proposal for a regulation of the European Parliament and of the Council amending Council Regulation (EC) No 346/2000 on insolvency proceedings (SWD(2012) 416 final, {SWD(2012) 417 final).

5 Available at: [http://ec.europa.eu/justice/civil/commercial/insolvency/index\\_en.htm](http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm).

“To design a set of Principles and Best Practices for Insolvency Office Holders (IOHs) in Europe.”

The idea is that by designing this set of Principles and Best Practices, mutual trust between IOHs as well as the trust in the IOHs’ work by the general public would be enhanced. Consequently, IOHs would be able to work more efficiently, which once again would enhance the trust in the IOH profession in the market.

INSOL Europe and Leiden Law School decided to divide the work into three phases, resulting in three reports. In order to gather sufficient support by IOHs for such a set of Principles and Best Practices, they cannot be designed without sufficient regard to and analysis of existing sets of rules on the subject. It was decided to focus in Report I on the existing international rules and to address the following research questions:

- Would it be possible to develop a framework for the uniform analysis of the existing rules for IOHs?
- Would the results of the analysis of existing international rules be supportive to the design of Principles and Best Practices for IOHs?

Report II analyses the sets of rules applicable to IOHs in 11 European countries. Here the main questions read:

- Would the results of the analysis of existing national rules in 11 European countries be supportive to the design of Principles and Best Practices for IOHs?
- Which topics in IOH related rules would be served by creating Principles and/or Best Practices?

Report III delivers the Principles and Best Practices for IOHs in Europe. This chapter summarizes some of the findings of Report I and Report II thus far, and provides a preview of Report III.<sup>6</sup>

## **Framework**

Since a framework for the analysis of rules for IOHs did not exist, our first task was to create a uniform framework for the analysis. From a tentative analysis of a few sets of international rules, we deduced four main categories of subjects:

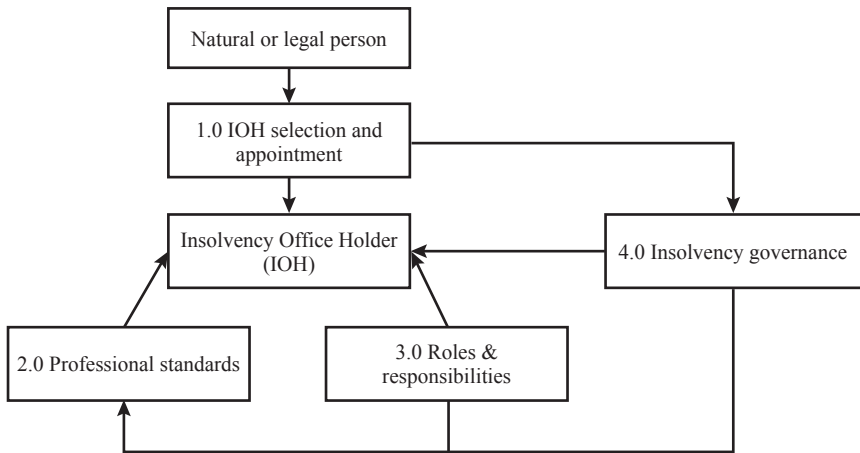
1.0 IOH selection and appointment: answers the question how to become an IOH;

<sup>6</sup> At the time of writing, Report I is final, Report II is in the public draft phase and Report III is in an internal draft phase.

- 2.0 Professional standards: focuses on the professional and ethical standards for the IOH;
- 3.0 Roles & responsibilities: relates to what an IOH should do once appointed;
- 4.0 Insolvency governance: discusses the various monitoring functions on the IOH's work.

These categories form the framework on which the analysis is based. Figure 1 depicts this framework. Anyone willing to become an IOH should normally pass a selection procedure and should subsequently be appointed (Category 1.0 of the framework). Once an IOH, the IOH should adhere to professional and ethical standards (Category 2.0) and should act according to certain roles and responsibilities (Category 3.0). Finally, a governance system (Category 4.0) is necessary in order to ascertain a minimum quality of work and to avoid carelessness or abuse.

**Figure 1: A Framework to Compare Rules for IOHs**



Based on the elementary framework of Figure 1, we started the analysis of the international sets of rules. Gradually, the framework developed during the analysis into a sufficiently detailed model. The expansion and refinement with 15 Level II provisions (“Subcategories”) and refined to 34 Level III provisions (“Topics”) enabled us to categorize all relevant provisions into the framework. “Subcategories” divide the categories into specific areas of attention. “Topics” are the operational issues in those areas of attention. Figure 2 presents this expanded and refined framework for the detailed analysis of rules for IOHs to which we will now refer as the “Model”.

**Figure 2: Model for the Analysis of a Set of Rules for IOHs**

<i>Level I Categories</i>	<i>Level II Subcategories</i>	<i>Level III Topics</i>
<i>1.0 IOH selection and appointment</i>	<i>1.1 License and registration</i>	<i>1.1.1 Requirements &amp; contra indicators</i>
		<i>1.1.2 Licensing procedures</i>
	<i>1.2 Establishment of authority</i>	<i>1.2.1 Basis of authority</i>
		<i>1.2.2 Mandate</i>
		<i>1.2.3 (Inter)national recognition</i>
	<i>1.3 Corporate groups</i>	<i>1.3.1 Appointment of a single IOH</i>
<i>1.3.2 Administration as one estate</i>		
<i>2.0 Professional standards</i>	<i>2.1 Education</i>	<i>2.1.1 Recurring training</i>
	<i>2.2 Professional skills</i>	<i>2.2.1 Experience</i>
		<i>2.2.2 Other qualities</i>
	<i>2.3 Professional ethics</i>	<i>2.3.1 Ethical standards</i>
<i>2.4 Insurance</i>	<i>2.4.1 Liability insurance</i>	
<i>3.0 Roles &amp; responsibilities</i>	<i>3.1 Administration</i>	<i>3.1.1 Managing the estate</i>
		<i>3.1.2 Reversal of legal acts</i>
		<i>3.1.3 Agreements</i>
		<i>3.1.4 Creditor ranking</i>
		<i>3.1.5 Liquidation</i>
		<i>3.1.6 Reorganization</i>
	<i>3.2 Liability &amp; litigation</i>	<i>3.2.1 Establishing liability</i>
		<i>3.2.2 Initiation of litigation</i>
	<i>3.3 Communication</i>	<i>3.3.1 Communication with creditors, courts and other stakeholders</i>
		<i>3.3.2 Communication protocol</i>
		<i>3.3.3 Reporting standards</i>
	<i>3.4 Coordination and cooperation</i>	<i>3.4.1 Coordination and cooperation among IOHs (in corporate groups)</i>
<i>3.4.2 Coordination &amp; cooperation among foreign representatives (in cross-border insolvency)</i>		
<i>3.4.3 Coordination &amp; cooperation with foreign courts (in cross-border insolvency)</i>		
<i>4.0 Insolvency governance</i>	<i>4.1 Accountability</i>	<i>4.1.1 Disclosures</i>
		<i>4.1.2 Mandatory audit</i>
		<i>4.1.3 Liability insurance</i>
	<i>4.2 Remuneration</i>	<i>4.2.1 Fees</i>
		<i>4.2.2 Costs &amp; expenses</i>
	<i>4.3 Supervision</i>	<i>4.3.1 Competent authority</i>
		<i>4.4.1 Investigation</i>
	<i>4.4 Disciplinary action</i>	<i>4.4.2 Disciplinary proceedings</i>

## Findings

Report I shows that the international sets of rules we analysed, 13 in all, neatly fitted into the model. Report II tests whether national rules would fit in as well. It appears that the model does not need any changes and is capable of analyzing national sets of rules for IOHs. Our detailed analysis of these rules shows that whilst in some areas e.g. administration or remuneration, identical solutions are found in several countries, in others the countries do not have any similar rules or lack rules at all. Where a level playing field for IOHs was lacking, we decided that the Principles and Best Practices were to create one.

When to use a Principle, and when a Best Practice? We chose for a Principle when aiming to contribute to a level playing field for standards of conduct and for a Best Practice when aiming at a level playing field for the IOHs' specific performance. In company law,<sup>7</sup> this divergence is known as that between standards and rules. Compliance to standards is in the end decided upon by courts, since they are of an abstract nature, whilst compliance with rules is easier to establish since these contain specific provisions i.e. to do or to leave an act.

We deduced from the country analysis, that levelling the playing field requires 7 Principles and 21 Best Practices to be divided over the various categories of IOH related rules as given in Table 1.

**Table 1: Summary Findings on Room for Principles and Best Practices**

Categories	Principles	Best Practices
IOH selection & appointment	1	5
Professional Standards	2	4
Roles & Responsibilities	3	8
Insolvency governance	1	4
Total	7	21

Is a “Best Practice” really where we are looking for? Literature relates “Best Practices” to “benchmarking” and, by implication, Best Practices may well be understood as urging for the best solutions attainable. Since our intention is not to strive for the highest attainable level of practices but for a workable solution for all IOHs over Europe and by so doing to contribute to a level playing field of IOHs in cross-border insolvencies, we still deliberate whether “Guidelines” might be the better word. During the presentation, we will show some of the draft Principles and Best Practices and discuss their feasibility using cases.

<sup>7</sup> P. Davies, *Introduction to Company Law* (2010, OUP, Oxford).



# Chapter 6

## Principles and Best Practices for Insolvency Office-Holders in Europe: Workshop Report

Renée Van Hoof

### Introduction

European insolvency office holders (“IOHs”) are increasingly confronted with cross-border cases which necessitates cooperation and communication with other IOHs from different countries. This may cause numerous challenges. For example: how is the other IOH qualified and how is the other IOH appointed? Is that IOH independent? How can trust, cooperation and communication between IOHs, courts and each other be facilitated? At the European level, these challenges are also acknowledged. In 2011, the European Parliament recommended in a motion legislative action on:

“the harmonization of general aspects of the requirements for the qualification and work of liquidators.”<sup>1</sup>

### About the Project

In December 2012, the European Commission stated in the proposal<sup>2</sup> to modify the European Insolvency Regulation that there should be enhanced restructuring possibilities and intensification of communication and cooperation between liquidators, between courts, and between each other. With this in mind INSOL Europe asked Leiden University to design principles and best practices for insolvency office holders. The goal of these principles and best practices: to enhance mutual trust between IOHs as well as the trust in the IOH’s work by the general public. The principles and best practices are divided into four categories:

- First, in “the selection and appointment of an IOH”, which provides answers to the question how to become an IOH.

1 European Parliament A-series, Commission Report, 7th Parliamentary Term, No. 355 of 2011.

2 Recital 20, Commission Document 744 of 2012, final.

- Second, in “professional standards”, which focuses on professional and ethical standards for an IOH.
- The third category, in “roles and responsibility”, describes what an IOH should do once he or she is appointed.
- Finally and fourth, in “insolvency governance”, discusses the various monitoring mechanisms on the IOH’s work.

At the IEAF-NACIIL Joint Conference on 14-15 April 2014, these principles and best practices were discussed in a workshop conducted by Patricia Godfrey (Nabarro LLP London), Jasper Berkenbosch (DLA Piper Amsterdam) and Bernard Santen (Leiden University).

### **Terminology**

The first question that was raised was how these principles and best practices can be defined? Principles are of a more abstract nature and aimed to direct the behaviour of the IOH. These principles are to be judged *ex post*. Best practices are used for more specific situations and are judged *ex ante*. However, terminology can cause some confusion. For example, should one use the term “guidelines” instead of “best practices”? Guidelines may have, as participants suggested, more legal meaning and parties using the guidelines can relatively easily deviate from the guidelines. Best practices may imply that one is aiming for the highest standard possible. Deviating is in that case not that easy. Moreover, it is not the aim of the project team to implement the highest standards in other countries. With the principles and best practices one is looking for an internationally acceptable practice that serves as a minimum standard. The term guidelines, the workshop participants felt, may be preferred over best practices.

### **Applicability**

Besides the question of which terminology should be used, one should decide to whom these principles and best practices should apply. One aims in the first place to apply these principles and best practices on an international level for liquidators in cross-border cases. Applying the principles and best practices on this international level has the effect that IOHs can expect from each other that they have a certain level of education, training and ethical standards. Because of the consequent creation and enhancement of mutual trust and therewith cooperation, cross-border cases will be solved more effectively. Furthermore, the question was raised as to whether these principles and best practices could also be used

as a national minimum standard. For example, INSOL Europe members could commit themselves to match those standards in their own country in addition to the national legislation and regulation by professional bodies in their country. This option may even be most effective and is the interesting dimension behind the assignment from INSOL Europe.

Having principles and best practices that apply on a national level can create even more mutual trust and most of all create an opportunity for IOHs to put pressure on each other to fulfil the requirements of the principles and best practices. However, since one is aiming for an international acceptable level, this minimum level may not be enough on a national level in some countries. On the other hand, one cannot ask IOHs to apply the highest standards possible. To give a solution to this problem, the principles and best practices encourage professional bodies, such as the Dutch INSOLAD or German VAD, to draft higher standards for their members.

But, what will happen if members of the professional body do not comply with the principles and best practices on a national level? In that case, the professional body can take disciplinary actions against the IOH. This will not only maintain a certain level of quality of IOHs in a country, but will also relieve courts from monitoring IOHs in a specific country. Another dimension to the national application of the principles and best practices is that they can apply to courts and to the general public as well. Courts will feel much more at ease to appoint IOHs because they know that there is a minimum standard that IOHs have to comply with, whether they are a member of a professional body or not. For the general public and creditors, the principles and best practices can enhance the trustworthiness of an appointed IOH; the creditor can thus trust the honesty and integrity of the IOH.

## **The Case**

With the principles and best practices in place, cross-border cases can be solved more effectively. But, how will these principles and best practices be applied? To show the applicability of the principles and best practices, the audience was asked during the workshop what they would do in the following (imaginary) conflict of interest case:

“IOH A has been the lawyer of creditor C of firm Z. In this capacity, she has negotiated a debt restructuring involving re-scheduling of debt repayments to C over 12 months. Five months afterwards, firm Z goes bankrupt without the involvement of A or C. The Z bankruptcy is the main proceedings, subsidiary ZF’s proceedings in country F are secondary. IOH F is the IOH of ZF.”

The question to the audience was if IOH A would be free to accept an appointment as an IOH. In general, the audience agreed that not just any relation or connection of an insolvent debtor with an IOH should have the consequence that an IOH should decline an appointment. Too strict an application would cause an unworkable situation, especially in small countries.

Besides the professional material involvement of a liquidator, one may want to look to see if there is a substantial conflict of interest. There may be a difference between a conflict of interest with a secured creditor or an ordinary creditor. The answer to the question “would IOH be free to accept an appointment as an IOH if a partner of her big lawyers office had negotiated the deal without any involvement of A)?” was generally that an IOH in that case should decline an appointment as well, because of a professional and material involvement.

And the last question regarding the case: What would/should IOH F do if IOH A accepted the appointment? Would one go to a judge or to a professional body for disciplinary action? The general opinion regarding this question was that an IOH should do something. Whether a court or a professional body should decide on the matter remains an open question.

Even though it is an imaginary case, this does not mean it is not realistic. For these conflict of interest situations, there is also a best practice drafted:

“An IOH resigns immediately when his or her family members, those of his (former) spouse or comparable, a personal relation, or a professional relation of him/her or an office member over the past 12 months, appear as the insolvent debtor.

An IOH considers to resign immediately when his or her family members, those of his or her (former) spouse or comparable, a personal relation, or a professional relation of him/her or an office member over the past 12 months, appear as a creditor.”<sup>3</sup>

Some interesting questions were raised regarding the draft best practices. For example, would it make a difference if there is a conflict of interest with a major creditor or a minor creditor? Should the material impact of the conflict of interest play a role? And is 12 months a realistic and sufficient time span to look back on

3 Best Practice 3.1, INSOL Europe Statement of Principles and Best Practices for Insolvency Office Holders in Europe, (third public draft, June 2014), available at: <http://www.tri-leiden.eu/news/news-overview/third-public-draft/> (last viewed 11 July 2014).

the activity of the IOH? All of these questions regarding the topic of conflict of interest will definitely contribute to the further development of this best practice.

## **Conclusion**

The European Parliament, as well as the European Commission both recognize that there is room to enhance cooperation, communication and mutual trust between IOHs, courts and each other. Unfortunately, this cooperation does not come naturally. Cross-border cases involve different IOHs, different backgrounds and different standards. How can an IOH from country A trust that another IOH from country B lives up to a certain level of ethical standards and a certain professional quality? There are differences in education, training and professional standards. Even in the same country and within the same professional body, opinions may differ on several topics, such as conflict of interests in insolvency cases.

IOHs need to level the playing field to ensure mutual trust between themselves, courts, each other and the general public. Besides, this level playing field will enhance the efficiency of solving cross-border cases. The principles and best practices can provide this international level playing field, were the standards are set on an international acceptable level. The principles and best practices can also be used for the application on a national level. For some countries this level may not be sufficient, but professional bodies are at any time entitled to draft higher standards than the principles and best practices.



# Chapter 7

## Corporate Rescue in Belgium

Melissa Vanmeenen

### Introduction

The European Commission has recently set out a series of common principles for national insolvency procedures for businesses in financial difficulties.<sup>1</sup> The objective of this Recommendation is:

“to shift the focus away from liquidation towards encouraging viable businesses to restructure at an early stage in order to prevent insolvency.”<sup>2</sup>

Promotion of rescue and reorganisation tools has been on the European agenda for quite some years now<sup>3</sup> and is also an important feature of the revision of the European Insolvency Regulation.<sup>45</sup>

In this contribution, Belgian corporate rescue mechanisms will be briefly explained and reviewed against the backdrop of some of the Commission’s recent recommendations concerning corporate rescue. The Member States are

- 1 Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, 2014/135/EU, (*OJ* 14 March 2014, 74/65) (“EC Recommendation”). For some comments, see NACIIL, Workshop on the Commission’s Recommendation on a New Approach to Business Failure and Insolvency (4 June 2014, Amsterdam), presentations available at: <http://www.nacilil.org/activiteiten/nacilil-workshop-ec-recommendation-on-a-new-approach-to-business-failure-and-insolvency/>.
- 2 Consideration (1), EC Recommendation.
- 3 See e.g. European Parliament Resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law, nr. 2001/2006(INI), (*OJ* C 153E 31 May 2013, 1-9); 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 12 December 2012, COM(2012) 742 final. See also the recent study commissioned by the European Commission, “Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States’ relevant provisions and practices” (May 2014) by INSOL Europe, available at: [http://ec.europa.eu/justice/civil/document/index\\_en.htm](http://ec.europa.eu/justice/civil/document/index_en.htm).
- 4 Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings *OJ* L 160, 30 June 2000, 1-18.
- 5 See the Commission Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (SWD(2012) 416 final, SWD(2012) 417 final); European Parliament legislative resolution of 5 February 2014 on the proposal for a regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (COM(2012)0744–C7-0413/2012–2012/0360(COD)) and Council of the EU, Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings - General approach, 5 June 2014. ST 10284 2014 ADD 1 COR 1.

invited by the Commission to implement the minimum standards set out in its Recommendation by 14 March 2015. This bottom-up approach illustrates the main goal of the Commission: all EU Member States should have in place efficient reorganisation procedures based on the same common features.<sup>6</sup> Harmonising national reorganisation procedures may be beneficial for cross-border insolvency procedures. However, a more fundamental question is whether a national law that meets the European recommendations also effectively adds value in terms of reorganisation.

In this chapter, this fundamental question will be illustrated with two examples stemming from Belgian law. The first theme discusses the question how far a legislator should go to “prevent” traditional insolvency (Part II). In a second example, the question of access conditions to a formal reorganisation procedure is discussed (Part III). However, before we can examine these questions, a general introduction to Belgian reorganisation procedures is required (Part I).

## I - Corporate Rescue in Belgium

### *Some History*

A first attempt to introduce a proactive corporate rescue scheme dates from 1 January 1998,<sup>7</sup> with the entry into force of the Judicial Reorganisation Act of 17 July 1997 (“*Concordat Judiciaire*”).<sup>8</sup> This new legislation focused on prevention of financial distress and assisting undertakings in reorganising and overcoming their difficulties. In summary the judicial reorganisation consisted of a moratorium period during which the debtor proposed a plan to his creditors. This reorganisation plan was adopted if approved by a majority of creditors and homologated by the court. Simultaneously with the introduction of the Judicial Reorganisation Act, a new Bankruptcy Act<sup>9</sup> was adopted. At the time, rescue was considered the highest goal and liquidation (by way of a bankruptcy) the ultimate remedy when there was no hope whatsoever for an enterprise’s recovery.

6 See also L. Kortmann, Commentary on the Commission’s Recommendation on a New Approach to Business Failure and Insolvency (4 June 2014, Amsterdam), presentation available at the website mentioned, above note 1.

7 See on the (former) Belgian system, E. Dirix and I. Verougstraete, “National Report for Belgium”, in W. McBryde *et al.* (eds), *Principles of European Insolvency Law* (2003, Kluwer Legal Publishers, Deventer) (93-146).

8 The Judicial Reorganisation Act of 17 July 1997 (Loi relative au concordat judiciaire - Wet betreffende het gerechtelijk akkoord), *Belgian State Gazette* (28 October 1997), entered into force on 1 January 1997. All official texts of this and other laws noted below are available in Dutch, French and German at: <http://www.ejustice.just.fgov.be/wet/wet.htm>.

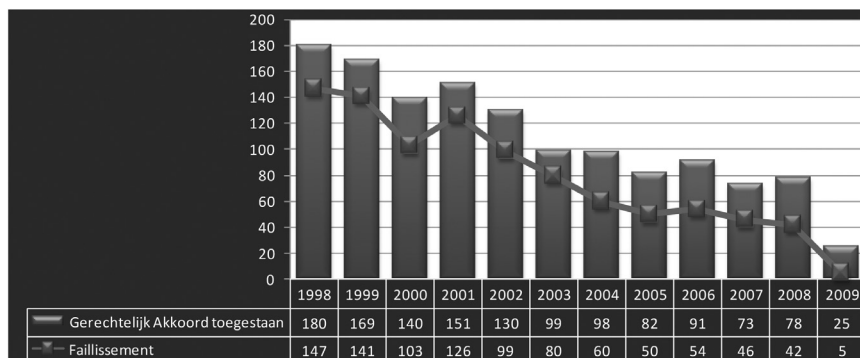
9 The Bankruptcy Act of 8 August 1997 (Loi sur faillites – Faillissementwet), *Belgian State Gazette* (28 October 1997), entered into force on 1 January 1997. Please note that bankruptcy proceedings in Belgium are only available for debtors with a commercial activity (companies and individuals).



The Belgian legislator hoped the new legislation would increase the number of judicial reorganisations and proportionately reduce the number of liquidations. Unfortunately these hopes turned out vain: since the implementation of the new legislation, the number of liquidations has steadily increased, while the number of applications for judicial reorganisation has decreased year after year. The chart below provides an overview of the number of procedures that were opened in the period from 1 January 1998 to 31 March 2009.

**Table 1: Judicial Reorganisation Procedures in the Period 1 January 1998 to 31 March 2009**

Source: Graydon Belgium NV



The chart illustrates a gradual decrease of the number of procedures. Moreover, the yearly amount of reorganisation procedures opened is peanuts compared to yearly bankruptcy figures of 7,000- 8,000 in the same decade. Furthermore, about 70% of the judicial reorganisation procedures ended up in bankruptcy anyway (the number is demonstrated by the descending line in the chart).<sup>10</sup>

The generally accepted failure of the Judicial Reorganisation Act was attributed to several factors: the procedure was too expensive by the compulsory appointment of an administrator, the creditors (in particular public authorities) were not willing to participate in the rescue plan, the maximum term to come to recovery was not sufficient, courts were too severe in their judgement on the chances of recovery, the legal provisions lacked clarity and led to fierce doctrinal discussions etc. In short, there was a lot of uncertainty. These problems prevented enterprises and their advisors starting a procedure in due time. A procedure of judicial reorganisation

<sup>10</sup> For more information and statistics on the judicial reorganisation procedure, see data at: [www.graydon.be](http://www.graydon.be) (in Dutch and French). For a general overview, see the study “Het bedrijf in moeilijkheden voorbij” (March 2008, Graydon), at 23-25.

was considered as the last resort, in many cases leading inevitably to bankruptcy.<sup>11</sup> This, in turn, fed the perception that judicial reorganisation was not a reliable rescue process, but only a precursor to bankruptcy. The judicial reorganisation procedure thus became stuck in a vicious circle.

### *The Business Continuity Act: A New Solution?*

In search of a better approach to rescue, the Belgian legislator introduced the Business Continuity Act of 31 January 2009 (“BCA”).<sup>12</sup> The main objective remains unchanged: to sustain the continuity of businesses as much as economically possible. One can distinguish two different tracks of reorganisation within the BCA: informal reorganisation and formal reorganisation.<sup>13</sup> Both ways of reorganisation are handled exclusively by the Commercial Courts. As the title of the Act indicates, these tools are only accessible for commercial undertakings (legal or natural persons).

The informal reorganisation under the BCA is supported by a rather unique “technique”:<sup>14</sup> the “*Enquête commerciale - Handelonderzoek*”, which could be translated as “Commercial Investigation Procedure”. This mechanism seeks to prevent undertakings from becoming insolvent by monitoring their financial position and encouraging company reform at early signs of trouble.

The formal reorganisation under the BCA is started at the request of the debtor.<sup>15</sup> In accordance with the EC Recommendation,<sup>16</sup> the formal judicial reorganisation entails a moratorium period granted by the court to protect the debtor from his creditors by suspending their rights.<sup>17</sup> The moratorium is granted for a maximum

11 See the number of judicial reorganisation procedures ending up in bankruptcy indicated by the red line in the chart above.

12 The Business Continuity Act of 31 January 2009 (Loi relative à la continuité des entreprises/Wet betreffende de continuïteit van de ondernemingen), *Belgian State Gazette* (9 February 2009), entered into force on 1 April 2009 (“BCA”).

13 Please note that both tracks already existed in the Judicial Reorganisation Act.

14 This technique was introduced by court clerks in the 1960s. The Judicial Reorganisation Act has officially confirmed the technique by incorporating it in a legal act. For more details on the *Enquête commerciale – Handelonderzoek*, please see M. Vanmeenen, *De juridische efficiëntie van het handelonderzoek: toetsing van de rechtspraktijk aan de preventiedoelstelling van de wetgeving en de vereisten van de economische en maatschappelijke realiteit* (2006 dissertation at K.U.Leuven), available at: <https://lirias.kuleuven.be/.../Melissa+Vanmeenen+doctoraat+-+final.pdf>.

15 Exceptionally the procedure can be introduced by a creditor or the public prosecutor (see Article 59, BCA).

16 See Recommendations 6(c) and 10, EC Recommendation.

17 See Articles 30-34, BCA. The stay of individual enforcement actions is also binding upon secured and preferential creditors (see Recommendation 10, EC Recommendation).

initial period of 6 months,<sup>18</sup> with unlimited possibilities for renewal up to 12 months.<sup>19</sup> In exceptional circumstances the moratorium can be extended up to 18 or 24 months.<sup>20</sup> These terms deviate from the EC Recommendation proposing an initial period of 4 months, with a possibility of renewal up to maximum 12 months.<sup>21</sup>

The procedure does not bring about strict court control: as a rule, the debtor remains in possession and is trusted to conduct his business as usual without any court intervention. Exceptionally, in fraudulent cases, the debtor or its directors can be divested and replaced by an administrator.<sup>22</sup> This debtor-in-possession regime fits the EC Recommendation perfectly.<sup>23</sup> The opening of the reorganisation procedure is published in the *Belgian State Gazette* and creditors should be informed personally of the opening by the debtor.

During the moratorium period the debtor will start a reorganisation exercise. The reorganisation procedure offers three restructuring options: an amicable settlement, a collective agreement or a transfer of business under court supervision. The collective agreement option fully corresponds to the framework proposed by the EC Recommendation based on a restructuring plan adopted by the majority of creditors and confirmed by a court.<sup>24</sup> On the contrary the amicable agreement and the transfer of business are not addressed in the EC Recommendation. The following paragraphs will briefly summarize the essential features of each option.

An amicable agreement consists of a settlement between the debtor and at least two or more creditors (Article 43 of the BCA).<sup>25</sup> This option requires that creditors voluntarily agree to restructuring measures proposed by the debtor, e.g. deferral of payments, debt reductions etc. The debtor is free to choose which measures he considers to be appropriate and to whom he will propose them. However, a creditor will only be bound by these measures, if he accepts them explicitly. Exceptionally the court can impose a payment deferral without the consent of the creditor. Once

18 Ibid., Article 24. Please note that the moratorium granted by the court may vary from case to case. For an overview of the average period granted, see the study "Wetswijziging WCO werpt eerste vruchten af - Een analyse voor- en na de wetswijziging van 1 augustus 2013" (28 March 2014, Graydon), at 10, available in Dutch and French at: <https://graydon.be/blog/article/2014/03/28/wetswijziging-wco-werpt-eerste-vruchten-af>.

19 See Article 38, BCA.

20 Ibid., Articles 38 and 60 for the conditions of this exceptional moratorium period.

21 See Consideration (18) and Recommendation 13, EC Recommendation.

22 See Article 28, BCA.

23 See Consideration (17) and Recommendation 6(b), EC Recommendation.

24 Ibid., Consideration (19) and Recommendations 6(d) and 15-26.

25 Please note that the BCA provides for two very similar types of amicable settlements: an informal settlement, without moratorium (Article 15, BCA) and a formal settlement with moratorium (Article 43, BCA).

agreed upon, the amicable settlement will be presented to and acknowledged by the court and the procedure will end.

Judicial reorganisation by way of amicable settlement offers two advantages compared to an ordinary settlement with creditors. First there is the moratorium, which guarantees that the debtor can negotiate a tailored solution, without being threatened by possible enforcement measures by (other) creditors or even bankruptcy proceedings. Secondly the amicable settlement is protected against certain effects of the suspect period, meaning that the settlement cannot be reversed in case of a subsequent bankruptcy.<sup>26</sup>

A large majority of debtors opt for a collective agreement under the judicial reorganisation procedure (Articles 44-58 of the BCA). This reorganisation scheme involves a reorganisation plan elaborated by the debtor and submitted to a vote by all the creditors involved in the plan.<sup>27</sup> The BCA provides for mandatory rules concerning the content of the reorganisation plan.<sup>28,29</sup> Strict rules regarding mandatory information aim to inform the creditors in a correct and proper manner of the current state and the prospects of the debtor. The reorganisation plan can propose restructuring measures such as instalment periods, debt reductions (principal claim and interest), debt-equity conversion, a restricted right to set off claims, transfer of business etc. The time limit of all proposed measures is set at five years maximum. As a rule all creditors should recover at least 15% of their claim.<sup>30</sup>

Once the debtor files his reorganisation plan, all creditors touched by the plan are invited to take note of this plan, to comment on the plan and to take part in the vote.<sup>31</sup> The reorganisation plan is accepted, when it is approved by more than half of the creditors present at the vote, together representing more than half of the principal amount of the claims involved.<sup>32</sup> The BCA requires a double majority to

26 Please note that the protection is limited to payments conducted in the course of the amicable settlement. Moreover fraudulent settlements can also be reversed, if a fraudulent intention is proved by the liquidator.

27 Please note that this option is quite similar to the “concordat” mechanism in the previous Judicial Reorganisation Act.

28 See Articles 47-52, BCA. Recently these rules were amended to prevent abuses by the debtor, especially to protect claims of public authorities like taxes and social security.

29 Compare with the requirements in Recommendation 16, EC Recommendation.

30 See Article 49/1, BCA. The minimum recovery rate of 15% was only recently introduced by the Act of 27 May 2013, which aims to reduce abuses by debtors. Compare to Consideration (19) and Recommendation 22(c), EC Recommendation. Please note that the debtor may deviate from this rule, if he explicitly motivates this proposal taking into account the necessities to successfully rescue his business.

31 See also Recommendation 24, EC Recommendation.

32 See Article 54, BCA. Please note that claims of creditors which are not present or represented at the vote, are not taken into account for the calculation of the majority.

limit abuses. Contrary to the EC Recommendation, the BCA does not provide for any classes of creditors in view of the voting of the plan.<sup>33</sup>

When a reorganisation plan is approved by the required double majority of creditors, the court (still) needs to ratify the reorganisation plan. The court can only reject a reorganisation plan if the debtor did not respect the formal requirements of the BCA or if the plan violates rules of public order.<sup>34</sup> Except for the rule on new financing, the BCA complies with the minimum conditions under which a reorganisation plan can be confirmed by the court as stated in Recommendation 22. However, contrary to the EC Recommendation,<sup>35</sup> the BCA does not provide for a possibility for the court to reject a reorganisation plan which clearly does not have any prospect of preventing the insolvency of the debtor and ensuring the viability of the business. This is a conscious choice of the Belgian legislator when adopting the BCA.<sup>36</sup> It was argued that creditors are better placed than the courts to decide on the content and the success of the reorganisation plan. Courts should not appreciate the economic feasibility of the reorganisation plan. This view was confirmed in a leading case by the Belgian Constitutional Court.<sup>37</sup>

In accordance with the EC Recommendation,<sup>38</sup> the plan will be binding upon all creditors involved. Once the reorganisation plan is approved by the judge. The plan will be binding irrespective of the fact that such a creditor voted against the plan, was not present at the vote or even was not informed of the procedure.

A third reorganisation tool is the so-called “transfer of business under court supervision” (Articles 59-70/1 of the BCA). This mechanism basically comes down to a transfer of the business activity or any viable part of it by a court representative. Such a transfer may be initiated on a voluntary basis at the request of the debtor, but can also be forced upon this debtor in specific circumstances. Once the court decides to initiate the transfer, the debtor is no longer in charge of the reorganisation process. The transfer is prepared and effectuated by the court representative, who will search the relevant market for the best offers. If

33 See Recommendations 17-18, EC Recommendation.

34 See Article 55, BCA.

35 Recommendation 23, EC Recommendation.

36 See considerations in “Wetsvoorstel betreffende de continuïteit van de ondernemingen”, Kamer 2007-08, nr. 0160/002, 70, available in Dutch and French at: <http://www.dekamer.be/kvvcr/showpage.cfm?section=/flwb&language=nl&cfm=ListDocument.cfm>.

37 See Constitutional Court (Case 8/2012) (18 January 2012), consideration B.11, case available in Dutch and French at: <http://www.const-court.be/>. For comments on this case, please see A. Van Hoe and I. Verougstraete, (2012) 5 *Tijdschrift voor Belgisch Handelsrecht - Revue de Droit Commercial Belge* 435; M-F. Rigaux, (2012) 6467 *Journal des Tribunaux* 125; P. Hannes, (2012) 263 *Nieuw Juridisch Weekblad* 379.

38 See Recommendations 25-26, EC Recommendation.

comparable offers are being made, priority must be given to the preservation of employment. All relevant offers will be presented to the court by the court representative. The final decision to transfer (part of) the business is taken by the court taking into account the rights of creditors and employees.

The proceeds of the sale(s) are distributed by the court representative among the creditors taking into account any existing security interests. This distribution process is very similar to a distribution in a bankruptcy. The transfer of business under the BCA is therefore perceived as an alternative to bankruptcy. In the end, the debtor remains with some or no assets at all, and the creditors should receive at least as much as if the company was bankrupt.<sup>39</sup> Preserving (going concern) value and employment are considered to be the main (expected) benefits of the transfer procedure vis-à-vis a traditional bankruptcy procedure.

To conclude, one can safely say that in general the Belgian BCA fits the recent Recommendation of the European Commission quite well. But what does this mean in terms of successful rescue results? This question is not easy to answer.

Although the first results of the BCA were promising, the Belgian legislator decided to amend the BCA in 2013.<sup>40</sup> The main intentions were to optimize the existing rules and to reduce abuses.<sup>41</sup> In the following chapters, an example of both intentions will be illustrated. Firstly the Belgian legislator wanted to optimize out-of-court prevention by introducing additional warning signals. Secondly it was deemed necessary to restrict access to the formal reorganisation procedure, because the procedure was abused by debtors.

## **II - Focus on Out-of-Court Reorganisation: To prevent or not to prevent? How far should we go?**

The informal reorganisation track in the BCA consists of different elements: a detection and warning mechanism (“Commercial Investigation Procedure”) and a possibility to negotiate an informal amicable agreement, with or without the assistance of a court-appointed mediator. Although the Commercial Courts are involved in each stage of the informal reorganisation, this phase is considered as an out-of-court reorganisation.

39 This minimum requirement is also pursued in the EC Recommendation for a reorganisation plan dividend, see Recommendation 22(c), EC Recommendation.

40 The Act of 27 May 2013, *Belgian State Gazette* (22 July 2013), entered into force on 1 August 2013.

41 See considerations in “Wetsontwerp tot wijziging van verschillende wetgevingen inzake de continuïteit van de ondernemingen”, Kamer 2012-13, nr. 2692/001, available in Dutch and French at: <http://www.dekamer.be/kvcr/showpage.cfm?section=flwb&language=nl&cfm=ListDocument.cfm>. Avoiding abuses is also reflected in the concern in Consideration (16), EC Recommendation.

Informal reorganisation is also firmly promoted in the EC Recommendation.<sup>42</sup> However Belgian informal reorganisation mechanisms differ substantially from the options considered in the EC Recommendation. In the following paragraphs, the Belgian mechanisms will be briefly summarized.

The goal of Commercial Investigation is twofold: early warning and timely intervention (Articles 8-12 of the BCA). The Commercial Court establishes a Chamber of Commercial Investigation, composed of standing judges and businesspeople (lay judges), to monitor the financial situation of troubled business entities and request them to appear in court if their difficulties appear to be heading toward corporate insolvency. The Chamber of Commercial Investigation aims at making the management of the undertaking aware of its problems by warning against potential insolvency risks and encouraging the management to seek proper advice and apply remedial measures.

Commercial Investigation targets undertakings moving in the “twilight zone”. These are undertakings that are threatened by insolvency, but can still be rescued with the proper assistance and timely application of restructuring measures. Experience learns that many managers of ailing undertakings tend to deny warning signals and often refuse to admit that their business is in trouble. Even managers who know what has to be done to effect a turnaround may be under pressure to maintain the *status quo*. The presence of an authoritative and independent outsider can benefit these managers by serving as an external source insisting on often painful, yet necessary measures that would otherwise be attributed to the management. The Chamber of Commercial Investigation is well placed to both confront managers with problems they are ignoring, as well as shielding managers from blame for unpopular decisions.

The judges of the Chamber of Commercial Investigation will insist on the importance of reorganisation measures to the benefit of the company, its stakeholders and the economy in general. However these judges are not allowed to advise or assist the business manager in any way regarding which specific reorganisation measures must be taken, such assistance being considered to be incompatible with the impartiality of the judicial function.

At the request of the debtor the Chamber of Commercial Investigation may appoint a business mediator, who will assist the debtor with negotiations to be conducted with his creditors (Article 13 of the BCA).<sup>43</sup> To stimulate informal reorganisation

42 See Consideration (17) and Recommendations 7-8, EC Recommendation.

43 Compare with Recommendation 9, EC Recommendation.

arrangements the BCA also provides for protective measures in respect of informal amicable settlements concluded between debtor and a least two creditors (Article 15 of the BCA). When such an amicable settlement is (confidentially) registered with the Commercial Court, payments to creditors executing this settlement cannot be annulled by a liquidator if the undertaking is declared bankrupt afterwards.

In the event that an enterprise is insolvent beyond repair, the Commercial Investigation Procedure serves to accelerate the winding up of the undertaking, so-called “corporate cleansing”. Article 12 §5 of the BCA provides that the Chamber of Commercial Investigation can send the files of all virtually insolvent undertakings to the public prosecutor, who can then file for bankruptcy. This requirement is designed to stop undertakings from continuing activities that harm creditors and other stakeholders.

The Commercial Investigation Procedure has been running for about 20 years, but, for several reasons, it is difficult to evaluate its success according to the benchmark of rescuing undertakings in financial distress. First there is no reliable statistical data on the extent to which the intervention of the Chamber of Commercial Investigation produces successful rescues. There is also no hard evidence that undertakings that emerge intact from rescue initiatives are able to sustain a meaningful economic presence beyond the short-term. Second, the Commercial Investigation Procedure is a “voluntary procedure”, which means that undertakings are not bound to cooperate in any way or to attend the hearings. Unfortunately many managers ignore the invitations of the Commercial Court and stay out of reach. This means that the Commercial Investigation never attains its maximum capacity.

Monitoring all undertakings in Belgium is a time consuming activity for the Commercial Courts. As far as we know, the actual costs entailed by the Commercial Investigation have never been examined and it is unclear to what extent undertakings really benefit from it. However, despite the absence of empirical proof, the key actors assert that Commercial Investigation has a positive impact on Belgian business. It is said that due to the intervention of the Commercial Court, managers are more aware of the need to anticipate and to manage insolvency risks. Moreover managers realize that timely professional help can make the difference between a viable business keeping afloat and going under.

Building upon this experience, the Belgian legislator recently introduced a new “warning tool” pursuing the same goal as the Commercial Investigation Procedure. The Act of 27 May 2013<sup>44</sup> introduced a legal obligation for external accountants,

44 See above note 40.



auditors, tax advisors, etc. to warn the management for serious and corresponding facts which may affect the debtor's business continuity.<sup>45</sup> If the debtor does not take the necessary measures to ensure the continuity of the business within one month from such notification, the external accountant, auditor or tax advisor may inform the President of the Commercial Court. The first communication to the debtor is mandatory, the latter communication to the President of the Commercial Court, however, is only a possibility. One may expect that a professional advisor will only turn to the court in a worse case scenario. For now, it is unclear what the impact of these new rules will be. The BCA does not provide for any sanction if the professional advisor does not comply with the rules. In any case, non-compliance with the first obligation may lead to a liability claim versus the professional advisor.

The informal reorganisation framework illustrates the determination of the Belgian legislator to focus on awareness raising among undertakings in financial distress. But how far can or should a legislator go in trying to prevent insolvency of its undertakings? The best laid schemes of mice and men, it is clear that having a legal framework is never sufficient to prevent insolvency, only the business management has the key to success.

### **Focus on Formal Reorganisation under Court Supervision: Easy Access or Strict Conditions to benefit from a Moratorium**

When investigating reorganisation possibilities, one has to start by answering the question whether the business is worth saving in the first place. For many small businesses, liquidation is (still) the best solution. Thus, the Commission's Recommendation rightly focuses on *viable undertakings*. The question remains what a viable undertaking might be? Consideration (16) of the EC Recommendation states that:

“a restructuring framework should enable debtors to address their financial difficulties at an early stage, when their insolvency could be prevented and the continuation of their business assured. However, in order to avoid any potential risks of the procedure being misused, the financial difficulties of the debtor must be likely to lead to its insolvency and the restructuring plan must be capable of preventing the insolvency of the debtor and ensuring the viability of the business.”

This assumption is also reflected in Recommendations 1, 6(a) and 11(b), where the viability of the enterprise, the intervention as soon as it is apparent that there is a

<sup>45</sup> See Article 10, BCA.

likelihood of insolvency and the prevention of insolvency is stressed. Determining the scope of the formal reorganisation procedures has always been a difficult issue in Belgium. Under the previous Judicial Reorganisation Act, the procedure could only be granted if the debtor convinced the court that recovery was reasonably possible. This profitability needed to be demonstrated by the debtor,<sup>46</sup> which explains why so little procedures were opened under the previous legislation (see Table 1 above).

The Belgian legislator opted for a completely different approach in the BCA. According to Article 23 of the BCA, a procedure is granted when the continuity of the undertaking *seems to be* threatened immediately or in the future.<sup>47</sup> As soon as the debtor requests the opening of the procedure and alleges he faces a continuity problem, the court is bound to open the procedure. The debtor needs to document his request with evidence. However these financial data were considered less important, as judges can no longer consider the viability of the business when deciding on the opening. Moreover Article 23 of the BCA expressly states that the fact that the debtor is insolvent is no longer an obstacle to grant the procedure. This easy access is one of the fundamental features of the BCA. It was argued that it was too difficult for judges to decide upfront whether or not an undertaking could be saved. The assessment of the viability is postponed to a later stage in the proceedings, meanwhile offering the debtor protection from his creditors. This approach was called the “open doors” approach (“*open portal*” *benadering*) allowing any distressed undertaking to benefit from the procedure.<sup>48</sup> It was hoped that the more undertakings would start a reorganisation procedure, the more of them would be saved.

Due to the “open doors” approach, the formal procedure of judicial reorganisation gained popularity, leading to a substantial increase of procedures (see Table 2 below). The easy access was seconded by the low initial procedural cost<sup>49</sup> and the fact that no legal or financial assistance was required to file a request. Furthermore as from the moment of filing, a debtor is temporarily protected against its creditors till the court decides on the opening.<sup>50</sup> Obviously a lot of undertakings without any serious prospect or even intent to reorganise their business, took advantage

46 See Article 9 §2, Judicial Reorganisation Act.

47 Compare with Recommendation 6(a), EC Recommendation: “as soon as it is apparent that there is a likelihood of insolvency.”

48 See on this “open doors” approach, M. Tison, “De Wet Continuïteit Ondernemingen: het portaal naar een nieuw insolventierecht?” in A. Bossuyt *et al.* (eds), *Liber Spei et Amicitiae Ivan Verougstraete* (2011, Larcier, Gent) (379-388); E. Dirix, “Het insolventierecht op nieuwe wegen” (2011-12) 6 *Rechtskundig Weekblad* 77.

49 Filing a petition for a judicial reorganisation only costs EUR 60.

50 See Article 22, BCA.

of this rather cheap opportunity. It may not come as a surprise that the “open doors” approach was criticized,<sup>51</sup> since it allowed undertakings to be protected against their creditors without any warranty for a reasonable attempt to resolve their problems.

Taking into account these abuses,<sup>52</sup> the Belgian legislator amended the BCA in 2013<sup>53</sup> to ensure that only serious candidates can benefit from the protection offered by the BCA. It is important to stress that the “open doors” approach remained unchanged, forcing judges to open the procedure as soon as there appears to be a continuity threat. The amendments focused on tightening certain procedural aspects, making it far more difficult for an undertaking to file for a reorganisation procedure. According to the amended Article 17 of the BCA any petition to open a reorganisation procedure should be supported by compulsory financial information.

A debtor needs to submit *inter alia* recent financial statements, a budget with an estimate of the revenues and expenses during the moratorium period and a firm proposal clarifying the proposed restructuring measures to turn around the problems. The financial data need to be prepared with the assistance of an external accountant or auditor to ensure that the data provided are reliable. These new requirements increase the costs and the time needed to prepare a petition to open the procedure significantly. Moreover the Belgian legislator decided to increase the initial filing fee to EUR 1,000<sup>54</sup> (instead of EUR 60). At first sight such an increase of costs is contrary to the EC Recommendation, which expressly states that the restructuring procedure should not be costly (Recommendation 7). However, what

51 See for an overview with references, M. Vanmeenen, “Drie jaar Wet Continuïteit Ondernemingen – Over kleine en grote knelpunten en misverstanden” in CBR (ed), *CBR Jaarboek 2011-12* (2012 Intersentia, Antwerp), at 412-414.

52 See “Wetsontwerp tot wijziging van verschillende wetgevingen inzake de continuïteit van de ondernemingen, Kamer 2012-13, nr. 2692/001, 5, no. 4, available in Dutch and French at: <http://www.dekamer.be/kvvcr/showpage.cfm?section=/flwb&language=nl&cfm=ListDocument.cfm>. For a critical analysis of abuses in the BCA, see C. Verbruggen and S. Van Ommeslaghe, “Abus de droit et loi sur la continuité des entreprises”, in A. Zenner and M. Dal (eds), *Actualité de la continuité, continuité de l’actualité* (2012, Larcier, Brussels) (99-140).

53 See above note 40. For an overview and commentary of all amendments, see M-C. Ernotte and B. Inghels, “La loi du 27 mai 2013 modifiant diverses législations en matière de continuité des entreprises: ajustement ou rétrécissement?” (2013) *Journal des Tribunaux* 637; L. De Keyser *et al.*, “Wijzigingen aan de wet betreffende de continuïteit van de ondernemingen” (2013) *Tijdschrift voor rechtspersoon en vennootschap* 740; D. Pasteger, “Actualités du droit des entreprises en difficulté”, in N. Thirion (ed), *Chronique d’actualités en droit commercial* (2013, Larcier, Brussels) (181-239); A. Zenner and C. Alter, *La loi sur la continuité des entreprises revisitée par la loi du 27 mai 2013*, (2013, Larcier, Brussels); T. Lysens, *De gewijzigde wet continuïteit van ondernemingen: een eerste commentaar*, (2013, Kluwer, Mechelen); A. Van Hoe, “Continuïteit voor de Wet Continuïteit Ondernemingen” (2013) 77/31 *Rechtskundig Weekblad* 1202.

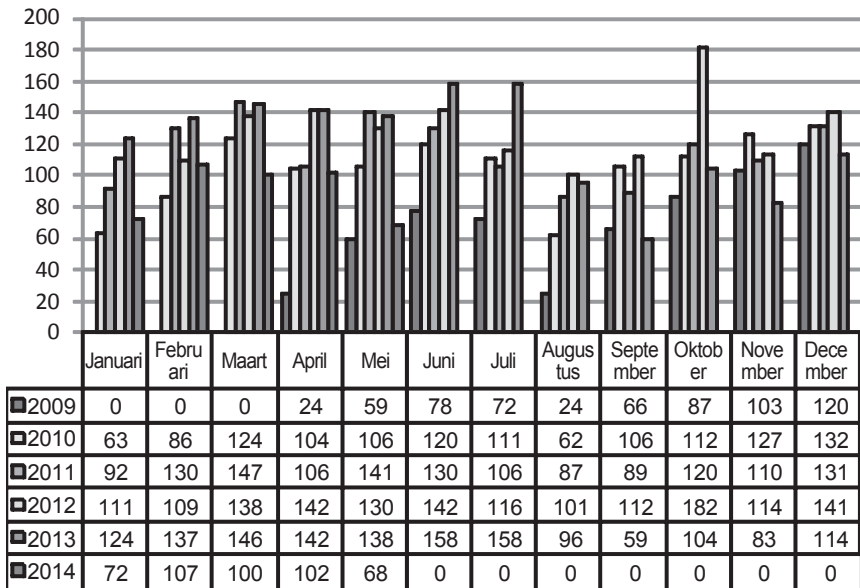
54 See Article 269/4, Tax Code on registration, mortgage and court fees (*Wetboek der registratie-, hypotheek- en griffierechten*). Please note that the increase of the filing costs to EUR 1,000 is not applicable at present. A future Royal Decree will determine the date of entry into force, which may be no later than 31 December 2014.

is a fair and reasonable cost of a reorganisation procedure anyway? Might the price of a procedure be a valid criterion to select undertakings worth saving?

The amendments to the BCA entered into force on 1 August 2013 and had a significant impact on the number of procedures opened. Table 2 below shows the number of judicial reorganisation procedures opened since the introduction of the BCA<sup>55</sup> on a monthly basis. Since August 2013, the number of initiated judicial reorganisation procedures decreased by nearly one third.

**Table 2: Judicial Reorganisation Procedures introduced since the BCA Amendments**

Source: Graydon Belgium NV



When comparing these figures with the chart concerning the situation under the previous Judicial Reorganisation Act, we see a major increase of procedures. However it is important to supplement this BCA chart with the fact that after a five year period, 75 to 80% of these BCA-undertakings end up in bankruptcy anyway.<sup>56</sup> This leads to the conclusion that, at least for now, there is no significant change in terms of preventing bankruptcy under the BCA compared to the Judicial Reorganisation Act.

<sup>55</sup> 1 April 2009.

<sup>56</sup> For a detailed analysis, see the study mentioned, above note 18.

The question remains whether the amendments of the BCA will have any impact on the “prevention” results. Could it be that fewer (procedures) means more (prevention)? By imposing stricter conditions and requiring better preparation of the file by the debtor, the Belgian legislator hopes to improve the overall quality and success rate of the reorganisation procedure. While the BCA formally still adheres to the “open doors” approach, the new filing requirements resulted in a cutback of one third of undertakings, who were either not willing or not able to meet the new standards. The question is whether these new rules adequately filter out the bad files (undertakings abusing the procedure) from the good files.



# Chapter 8

## The Uneasy Case for Bankruptcy Legislation and Business Rescue

Jan Adriaanse

### Introduction

This chapter<sup>1</sup> proposes that the attempt to strengthen insolvency legislation, in terms of:

“...promoting the ability to reorganize and rescue a company in distress”

through adaptations to European bankruptcy laws, is insufficient to save companies from bankruptcy. Moreover, new legislation in the current “corporate rescue culture” may actually have the opposite effect. The real issue in a rescue attempt is rebuilding trust amongst all parties involved. Legislation and financial restructuring are only to be considered means to reach this goal.

### The Trend towards Corporate Rescue

Currently a “corporate rescue trend” can be spotted worldwide where each country would ideally have effective legislation in place, focused on “reorganization and rehabilitation of the debtor”.<sup>2</sup> By adopting rehabilitation paragraphs in insolvency legislation, the aim is to reduce the amount of viable businesses that fall prey to liquidation (bankruptcy). In that line of thought, insolvency legislation ought to encourage companies to look for protection against creditors at an early stage in order to create a “stable environment” in which the company can get “back on its feet”, with the appointed administrator playing a central role.

1 This article is an updated and revised version of J. Adriaanse *et al.*, “Faillissementswetgeving redt bedrijven niet” (2007) *Tijdschrift voor Insolventierecht* 149.

2 See, for example, a considerable number of current IMF, World Bank, UNCITRAL, Asian Development Bank and European Union e-publications on the subject. For an overview of more historic developments regarding the subject, see, *inter alia*, J. Adriaanse, *Restructuring in the Shadow of the Law. Informal Reorganisation in the Netherlands* (Leiden University Dissertation) (2005, Kluwer, Deventer).

## The Problem

Although I am not in principle against the aims of bankruptcy legislation reform, I cannot fail to observe a fundamental problem. Empirical evidence shows that companies in financial difficulties can only be saved when a process of active *turnaround and stakeholder management* is initiated. In this, altering bankruptcy legislation is, in the best case scenario, a positive contribution, no more than that.

The potential downside is, however, that new judicial debtor-friendly instruments (or one could say: creditor-unfriendly instruments) to be put in place will (further) isolate important lenders (banks, suppliers/creditors etc.). Furthermore, placing a great(er) emphasis on “forced” deals within and outside of insolvency, for example thinking about debt-discharge voting-mechanisms (“haircuts”), will further complicate reorganizations rather than provide solutions. Bankruptcy legislation, at least the reorganization paragraph thereof, ought to be viewed as an “*option of last resort*”,<sup>3</sup> which should be treated with caution or, at least, not freely and opportunistically “applied” in case of financial difficulty by entrepreneurs and their advisors.

Below, these arguments are strengthened by use of several findings from a research project conducted by Leiden University between 2003-2005. Currently, researchers in Leiden are working on new projects which are partially aimed at mapping causes for financial difficulties in practice. The first results seem to underline these earlier findings.

The earlier research has been conducted at the so-called *Intensive Care Divisions* of four Dutch banks: ABN-Amro, Rabobank, ING and (now the former bank) Fortis, as well as by a number of consultancy firms. The size of the enterprise was made irrelevant; an average of the Dutch businesses being researched in the project. In total, 35 attempts to save companies from bankruptcy were examined, by use of intensive case-study research as well as 23 interviews and over 465 surveys being conducted (among insolvency office holders, SME-accountants, credit managers and turnaround consultants).<sup>4</sup> The results have also been, for the purpose of this article, tested against a number of standard works within the turnaround literature.<sup>5</sup>

3 See also V. Finch, “The Recasting of Insolvency Law” (2005) 68 *Modern Law Review* 713.

4 For more information about the problem definition, research plan and results, see Adriaanse, above note 2.

5 These include, but are not limited to: J. Argenti, *Corporate Collapse: The Causes and Symptoms*, (1976, McGraw-Hill, London); D. Bibeault, *Corporate Turnaround. How Managers turn Losers into Winners* (1982, McGraw-Hill, New York NY) (reprinted 1998); and S. Slatter and D. Lovett, *Corporate Turnaround, Managing Companies in Distress* (1999, Penguin Books, London).



## Difficulties in a Rescue Mission

The current “rescue rush” by legislators seems mainly driven by the phenomenon that many formal (court-led) reorganizations in practice actually fail. From that perspective, it is vital to address the many bottlenecks and fail factors in practice. Clearly, revised legislation should be aimed at eliminating difficulties which practice (so far) has not been able to eliminate. Based on the research conducted, the following summary of difficulties can be formulated (written down in the form of a *worst practice overview*).

Firstly, there is often an underestimation by management concerning the necessity for quick, comprehensive and adequate reorganization of the business activities from an integral new vision and strategy. When underlying causes of financial difficulties are examined, the three most prominent categories that have been identified are:

- lack of strategic entrepreneurship;
- insufficient financial insight; and
- too high variable and fixed (overhead) costs.

In virtually any case of a (near-) bankrupt company, be it a local convenience store or a multinational enterprise, one can detect questions that have been insufficiently posed, such as:

- “In which markets is the company active?”;
- “In which one should it be active?”; as well as
- “In which way should it be active?”

This also applies to questions like:

- “What are the true ‘needs’ of the company’s customers?”;
- “Who are the major (and true) competitors?”; and
- “What is truly the competitive advantage (*unique selling point*) of the company?”

More often than not, a discrepancy can be detected (an *assumption gap*) between the necessary market behavior and the actual behavior of the company in practice. Apart from a faulty strategy, distressed companies also appear to be insufficiently driven by parameters (*key performance indicators*) such as profit, cash-flow,

solvency and liquidity.<sup>6</sup> There is often a weak administrative organization and insufficient cash planning, which can cause expenses to get out of hand without management noticing. In short, there are invisible inefficiencies in the primary process of the company which explains why so often action is taken (too) late.

The final factor to be addressed here, the use of an (iterative) business plan as a *management tool*, is utilized relatively rarely, even though there is an (empirically proven) positive correlation between plan-driven entrepreneurship, where a combination of acting strategically based on financial insights takes a central role, and the diminishing likelihood of bankruptcy.<sup>7</sup> Actually, 71% of the respondents in our survey among insolvency office holders confirmed that in court-led reorganizations a sound business turnaround plan is most of the time missing.<sup>8</sup> On top of that, managers are often insufficiently aware of the severity of the crisis situation in which they find themselves and are also frequently hesitant, particularly in SME-related situations, to involve specialized turnaround advisers.

Another recurring theme is that important financiers such as banks and large suppliers are often consciously left out of the reorganization-process. Management does not allow much or any say in the turnaround process and/or is scared of informing (read: “scaring off”) these parties of their financial loss-making situation. Additionally, junior creditors are often confronted at too late a stage with (often harsh) proposals for discharge of debts.

On top of that, management is frequently insufficiently transparent towards involved parties concerning the reorganization process and the development of the financial situation. In this manner, parties involved do not have sufficient information to estimate the ever-changing risks involved. Finally, through a worsened situation (read: financial losses), solvency and liquidity has often greatly deteriorated. In a large number of failed rescue operations, the possibilities of addressing private equity and/or looking for take-over attempts appear to have been insufficiently researched, this in combination with the aforementioned difficulties.

## **Restoration of Trust**

The research conclusively underlines that the factors that cause failure are often a result of lack of communication between involved parties, as well as their

6 Regarding solvency and liquidity ratios, see, for example, B. Ganguin and J. Bilardello, *Fundamentals of Corporate Credit Analysis* (2005, McGraw-Hill, New York NY), at 80-107.

7 See, for example, S. Perry, “The Relation between Written Business Plans and the Failure of Small Businesses in the U.S.” (2001) 39 *Journal of Small Business Management* 201.

8 See Adriaanse, above note 2, at 337.

respective levels of risk perception. In fact, one could say that the potential for a successful rescue operation is mostly dependent on the question whether or not the management team can adequately *convince* its most important financiers of the viability of their struggling business. In other words, the main issue is whether management is sufficiently able to create *trust*, i.e. restore trust in light of (potential) future viability of the company, as well as in its own entrepreneurial (i.e. managerial) capabilities to guide the distressed firm to that desired future state. In other words, the core question is whether those in charge of the company are able to manage creditors' perceptions such that they feel that:

“...their interests will be met, for they are in good hands”.

This is of vital importance, for when financiers (once more) support the company, room has been created for a solution because of the renewed availability of time – a basic condition – as well as credit (the latter both literally and figuratively). In other words, through engaging with creditors and providing them with ample insight into the financial situation and ultimately a sound turnaround plan, a solid basis for success is created. Also, pro-actively communicating during the reorganization about the progress, as well as embodying a clear intention not to transfer entrepreneurial risk to creditors (unless no others options are left), the chance of conflicts and unwillingness of creditors to cooperate will likely decrease tremendously, and with it the chance of bankruptcy.

Conversely, conflicts (with potential disastrous consequences) are significantly increased when the factors discussed above are ignored. The restoration of damaged relationships is therefore an essential part of any business rescue attempt; this being completely contradictory to judicial means that have been designed to keep creditors at bay and/or force them to discharge debts. In that case a company does not create “natural viability”; in other words, involved financiers and suppliers have to be intrinsically motivated to support the survival of the company, they should not be “blackmailed by insolvency law”.

In this light, it is evident that by judicially forcing a company to abandon its contractual rights, what most rehabilitation procedures in fact imply, it is impossible to achieve needed trust. So, based on the points mentioned above, attempts to do so should be minimized as much as possible in order to increase success rates of business rescue. In other words, combatting the aforementioned bottlenecks with new insolvency legislation is simply fruitless, also because suppliers and financiers will probably *ex-ante* sharpen their *credit* and *risk management* systems in turn,

simply in order to restore the natural balance i.e. the desired cooperation model between companies, banks and other creditors.<sup>9</sup>

As such, they will take precautionary measures at a much earlier stage than currently is the case: perfectly fair since they are the providers of *risk-averse* capital. For instance, by asking for direct upfront payments and/or denouncing (trade-) credit agreements sooner. Apart from this, one should not forget that in case of approaching insolvency, economically speaking, creditors already become part-owners. Indeed, the company is at this point mostly comprised of debt and finds itself in a situation where its future existence is for the most part in the hands of creditors. The call for rights of say, supervision and insight are in this situation very well explicable and these instruments ought not to be discarded without proper consideration. On top of that, external stakeholders often have substantial market knowledge and in particular banks have in-depth knowledge concerning dealing with turnaround and restructuring challenges.

In that light, the involvement of creditors should most certainly be viewed as *positive*; research from, for example, Couwenberg and De Jong confirms this view, particularly concerning the role of banks.<sup>10</sup> Furthermore, none of the involved stakeholders will be primarily interested in forcing bankruptcy (liquidation). This “last resort” will only be addressed when the viability of the company, or at least the *perceived* viability thereof has proven to be completely lost; this, after careful consideration amongst stakeholders and often only after an extensive period of *monitoring*: could a newly appointed administrator truly make a difference in case of perceived viability lost? The answer is most likely to be negative.

### **Ability to Reorganize**

In the process of value restoration and new to-be-found viability,<sup>11</sup> the (turnaround) vision and strategy ought to be utilized in an integrated fashion in order to tackle problems. Indeed, *durante causa durat effectus*: if the fundamental causes of decline are not eliminated, the (negative) results will continue to appear. Financial restructuring, for example, in the form of an informal or judicially forced debt-agreement with remission, as well as cutting costs, are always merely means *during* the search for renewed trust, the search for new customers, and with that the search

9 See, in the same sense, Finch, above note 3, at 713ff; D. Baird and R. Rasmussen, “The End of Bankruptcy” (2002-2003) 55 *Stanford Law Review* 751.

10 See O. Couwenberg and A. de Jong, “It takes Two to Tango: An Empirical Tale of Distressed Firms and Assisting Banks” (2006) 26 *International Review of Law and Economics* 429.

11 See, in the same sense, N. Pandit, “Some Recommendations for Improved Research on Corporate Turnaround” (2000) 3(2) *M@n@gement* 31.

for viability of the company in the long term. No more, no less. A reorganization of debt as such does not in any shape or form contribute to the renewed viability of the company; it merely functions as an (undesirable) “emergency brake” when there is insufficient time to address liquidity influxes.

Thus, a company does not revive (“phoenix-esque”) unless the involved parties: shareholders, management, suppliers, banks/creditors, customers, employees, explicitly or implicitly feel that their cooperation (“*nexus of contracts*”)<sup>12</sup> ought to stay intact. However, they will only agree with this sentiment in cases where it is in their best interest. A company can therefore survive solely in cases where value is created for all stakeholders involved. As long as this is the case, the tendency will be to maintain cooperation.

By not breaking up the (current and potential) nexus of contracts, in effect by filing for bankruptcy liquidation, the stakeholders show the perceived (going concern) value of their cooperation. In turn, when bankruptcy is indeed filed, the deciders: for instance, the company’s main bank that terminates its credit, employees that file for bankruptcy, simultaneously or not with (a group of) competing junior creditors/suppliers, do not perceive the added value and with that the viability of the company: cooperation has been terminated and the end is near. Parties that want to prevent such a scenario: for instance, management and/or shareholders, thus ought not to blindly trust in a judicial reorganization procedure, and they should (remain to) show the potential economic value of the now distressed company.

The only way to achieve this is to, on the one hand, utilize a structured and methodical process of value recovery, by use of a turnaround vision and strategy which translates into a detailed yet pragmatic turnaround management process, and, on the other hand, by actively managing perceptions of all stakeholders involved. By use of this methodology, the chance augments that the company will once more be able to independently prosper and with that prove its (long-term) viability. The “ability to reorganize” can therefore be viewed as the equivalent of the ability to create value and the restoration of trust as such.

## Conclusion

It is therefore a necessity that discussions regarding “insolvency rehabilitation legislation” focus more on above mentioned aspects. Otherwise, the imminent

12 See, *inter alia*, M. Jensen and W. Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” (1976) 3 *Journal of Financial Economics* 305; R. Kraakman *et al.*, *The Anatomy of Corporate Law, A Comparative and Functional Approach* (2004, Oxford University Press, Oxford), at 6-8.

danger is that the emphasis will lie too much on, for example, more “debtor-friendly” voting quorums for compulsory settlements, as well as other ways to distance creditors, which will in fact emphasize the factors that in practice have proven to lead to failure, therefore possibly leading to the reverse of the desired result.

# Chapter 9

## Corporate Rescue: Workshop Report

Gert-Jan Boon

### Introduction

There has been increased attention on corporate rescue over the past few years in Europe and elsewhere around the world. The workshop provided insights on this topic from both legal and business perspectives. Efforts made in Belgium to introduce and improve legal tools for corporate rescue and research on turnaround management were discussed. The workshop started with an introduction by Professor Bariatti,<sup>1</sup> chair of the workshop, on the Commission's Recommendation on a new approach to business failure and insolvency ("Recommendation").<sup>2</sup>

### Recommendation of the European Commission

Professor Bariatti acted as one of the Reporters for the INSOL Europe Study<sup>3</sup> that was commissioned by the European Commission. The results of this Study were used in preparing the Recommendation. She discussed some background details of the Recommendation, in particular the initial idea of the Commission to draft a directive. This should provide for a uniform pre-insolvency proceeding to be adopted next to the currently existing proceedings under national law. Several Member States were already in the process of reforming their insolvency laws, also, Member States were not keen at transferring powers on this topic to the EU. Presenting a Directive would therefore not be realistic. Still the Recommendation will bring novelties to some countries, whereas others might take its contents into account during their process of drafting.

Three pressing challenges regarding the Recommendation were discerned by Professor Bariatti. First of all, there is a fondness in the Recommendation for pre-insolvency proceedings to rescue viable companies and maximise value for

1 Professor of Private International Law, University of Milan.

2 Commission Recommendation 12.03.2014 on a New Approach to Business Failure and Insolvency, COM(2014) 1500 final.

3 INSOL Europe, "Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices" (2014), available at [http://ec.europa.eu/justice/civil/files/insol\\_europe\\_report\\_2014\\_en.pdf](http://ec.europa.eu/justice/civil/files/insol_europe_report_2014_en.pdf) (last viewed at 15 June 2014).

creditors. The real problem however, as was experienced by national experts of the INSOL Europe Study, is that entrepreneurs start insolvency proceedings usually too late to be effective. By then, companies are often not viable anymore, which makes it much more difficult to take effective measures. Secondly, there are no clear and reliable statistics on the outcome of pre-insolvency proceedings. The choice for such proceedings is not supported by empirical data. Thirdly, there are issues relating the coordination of the Recommendation with the European Insolvency Regulation (“EIR”). Pre-insolvency proceedings are considered in the proposal of the Commission for amending the EIR, but there are still a number of issues that need to be solved.

### **Corporate Rescue in Belgium**

A lot of effort has been put in designing effective corporate rescue proceedings in Belgium over the past years. Professor Vanmeenen<sup>4</sup> explained the developments that have taken place since 1998. In that year, the *Concordat Judiciaire* was introduced, specifically designed for the rehabilitation of distressed companies. It is a simple scheme of arrangement where the debtor remains in possession. A reorganisation plan would be drawn up by the debtor, the creditors could vote on it, and a court would need to approve it. It did not work well. Statistics show that, over a period from 2002 till 2009, the number of these proceedings went down from 180 (out of 6000 bankruptcies) to 25 cases. Out of these cases, only 20% did not end up in a bankruptcy.

As of 1 April 2009, the Belgian Continuation Act (“BCA”, *Wet betreffende de continuïteit van de ondernemingen*) came into force. The BCA, aimed at commercial undertakings only, allows for informal and formal proceedings. It was considered too debtor friendly. The BCA was amended in the summer of 2013 to better protect creditors and reduce the misuse made of it. As of 200, the number of proceedings under the BCA has risen from 633 in 2009 to 1459 in 2013, but it seems to have decreased again since the amendment in 2013.

#### *Commercial Investigation Procedure*

The commercial court overlooks all companies in its district, they have access to financial information on them. A Commercial Investigation can be started when the court expects a company to face financial problems. It aims to ensure early warning and corporate cleansing. The commercial court can call up the management to inquire after their plans to address the situation. In 2013, the

4 Professor of Insolvency Law and Commercial Law, University of Antwerp.



Commercial Investigation Procedure was amended as management did not often show up at hearings. Now the accountant and auditor have a legal obligation to warn the company of threats to continuity. If the company takes no subsequent action, they need to inform the commercial court.

The court can only question the management about their plans, in order to stay impartial they cannot give any advice. However, they can appoint a business mediator to assist the management. Professor Vanmeenen questions if this framework is sufficient to prevent insolvency, as there are no figures available on its success.

### *Access to Formal Reorganisation Proceedings*

The entry requirements for formal reorganisation proceedings have changed over time. Under the BCA, a formal reorganisation procedure (a collective agreement, amicable agreement or transfer of business) provides the company with an initial stay of six months, and a maximum of twelve months. From 1998 until 2009, the judge would decide who would be let in. On the contrary, the BCA of 2009 allows any company in when its continuity seems to be threatened, either immediately or in the future. The judge cannot take the viability of the company into consideration. This led to many filings without a rescue purpose. The amendments in 2013 imposed more requirements on applications for a formal reorganisation proceeding. Companies need to pay EUR 1000 (previously EUR 60) and provide financial statements and a budget for the stay, to be prepared with the support of an external accountant or auditor. The question remains whether better prepared applications will lead to a higher success ratio. Currently 70-80% of the reorganisation proceedings result into a bankruptcy. However, the BCA requires companies to stick to a rescue plan for five years. In 2014, five years after its introduction in 2009, the first results of the BCA should therefore become available.

### **Turnaround of Companies in Distress**

Professor Adriaanse<sup>5</sup> took another perspective, as he tries to bridge the world of business and insolvency law. Research can help to better understand the reasons for failure and success of companies. Often a lack of marketing and strategic thinking causes the problem, but frequently management also starts reorganising too late. Some research has shown that after having experienced a reorganisation, management would like to have started on average 16 months earlier.

5 Professor of Turnaround Management, Leiden Law School.

The crisis experienced by management evolves over time. 17% of the companies only start reorganising when cash is almost up (liquidity crisis). 54% of the companies act at an earlier stage when the company starts making losses. The right moment for reorganising lies prior to this earnings crisis, it is when the company is in a strategic/assumption crisis. This is the moment when the company needs to redefine who it is, what it does, and what it is that makes the product and the brand a success. 29% of the companies reorganise the company already when such a crisis takes place. The difficulty is that a company is still profitable and both internal and external stakeholders may be reluctant to do a reorganisation. However, stakeholders will have more trust and confidence in reorganising the company at an early stage, than when the company is already in a liquidity crisis.

### *Successful and Unsuccessful Turnarounds*

Professor Adriaanse discussed that in order to accomplish a successful turnaround the company needs to take a holistic approach. This requires:

- stabilisation of the company (for example cash management and cost cutting);
- analysing the situation (including writing a reorganisation plan);
- repositioning; and
- reinforcing the company.

Turnarounds often fail as companies lose trust from their stakeholders. Also, there is not enough attention on communication with the stakeholders, as well as improving the operational and strategic performance of the company. Research has shown that successful companies show an active attitude towards the shareholders. They take adequate turnaround measures, going beyond pure financial issues. They are transparent towards their stakeholders, financiers are involved in the turnaround process and the company is seeking risk bearing capital.

Professor Adriaanse characterises insolvency law as being often creditor unfriendly (and at the same time debtor friendly). He questions how this relates to success and failure factors found in turnaround research. Does insolvency law and discourse on law reforms support the company management to do a more holistic turnaround planning? Also, does teaching on insolvency law pay enough attention to turnaround management?

## **Discussion**

There were three main issues during the discussion. Professor Paulus stated that, irrespective of the available legal tools, the eternal question remains what can be

achieved if the decisive factor is always the human factor. Although it is in no way a counter argument for great legislation on corporate rescue as in Belgium, the human factor is necessary to put things in reality. In this way lousy legislation may turn out very well with excellent insolvency office holders. Professor Paulus also emphasized the importance of already small numbers of reorganisations. Rescue proceedings in France and the United Kingdom do not serve large numbers of companies successfully too, nevertheless, when a rescue is successful it can still be very meaningful. Professor Vanmeenen added that with both easy and more restricted access to reorganisation proceedings the success rate remained low in Belgium. It may also be obvious as companies in such proceedings have a relatively high chance on bankruptcy. Still, in Belgium they are curious if the BCA will bring better results.

Participants in the workshop were very interested in the insights of turnaround management. It enables a broader perspective to better address the challenges of distressed companies. In particular principles of turnaround management would be useful, for example in teaching insolvency law.

Dr. De Weijs responded to Professor Adriaanse's remarks to take a holistic approach and give more attention to strategy and acquiring risk bearing equity. He considered that it may be difficult for a lawyer to come up with a new business strategy. He also noticed that there is a tendency to overlook the role of shareholders, discussions on corporate rescue tend to be focused on the creditors. They often have to accept a haircut, but could also be given a part of the company when they are not being paid in full.

This led to some discussion. Some stated that creditors would prefer money, instead of owning a part of the company, others mentioned that trade creditors would even consider the continuation of the business relation to be more valuable than payment of the debts at all. Dr. De Weijs replied that creditors would rather have a part of the company than having a haircut while the shareholders are left in place. When the creditors own part of the company they will also benefit from the upside potential. Of course, creditors may prefer a payment in full rather than getting risk bearing equity, but they can still decide to sell their shares.

Professor Bariatti concluded the workshop after a lively discussion. The workshop highlighted pressing issues in dealing with corporate rescue. Professor Vanmeenen discussed how the Belgian BCA deals with those challenges, and Professor Adriaanse showed what the insights of turnaround management can add to support successful corporate rescue.



# Chapter 10

## European Bank Resolution Rules and National Insolvency Law

Matthias Haentjens

### Introduction

Since the subprime mortgage crisis that started in the US in 2007 and subsequently hit the EU, tremendous amounts of tax payer money have been used to preserve financial institutions so as to guarantee continuation of their critical services and minimize disruptions to financial stability.<sup>1</sup> As a direct consequence of the financial crisis, it has therefore been generally argued that rules of normal insolvency law have proven to be ineffective and that specific rules for bank resolution should be introduced. In short, both financial institutions and normal insolvency law failed.

Traditionally, insolvency law serves two purposes:

- liquidation of the debtor's estate so as to satisfy the debtor's creditors with the proceeds; or
- restructuring the debtor's estate so as to satisfy the debtor's creditors through continuation of the debtor's business.<sup>2</sup>

On the basis of this dichotomy, insolvency law teaching and research in law schools is usually organized, whereby liquidation is commonly given most attention. By contrast, bank resolution rules should not be directed at satisfying creditors, but at the preservation of crucial functions, at the preservation of financial stability, at the minimization of (the need for utilization of) tax payer money and at the protection

- 1 Between October 2008 and October 2010 only, the European Commission has approved EUR 3.6 trillion of State aid measures to financial institutions. See Impact Assessment Accompanying the Document Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM(2012) 280 final, 6 June 2012, SWD(2012) 166 final ("BRRD Impact Assessment"), at 10.
- 2 Cf. B. Wessels, *Faillietverklaring* (3rd ed) (2012, Wolters Kluwer, Deventer), at paragraphs 1005 and 1017; B. Wessels, *Bestuur en beheer na faillietverklaring* (3rd ed) (2010, Wolters Kluwer, Deventer), at paragraph 4092.

of, in short, retail clients.<sup>3</sup> While a variety of new bank resolution rules has been proposed and enacted both in the US and in the EU, they have in common that they aim to facilitate expeditious measures, and that these measures are therefore taken in an administrative process rather than in a judicial one.<sup>4</sup>

This dramatic shift in purpose of insolvency law rules just discussed – and I will say more about this shift in a minute – puts pressure on the relationship between the specific rules that apply to a bank insolvency (hereinafter, for ease of contrast: “bank resolution rules”) and the rules of “normal” insolvency law that apply to businesses other than banks.<sup>5</sup> Consequently, I believe that the way normal insolvency law has been taught and researched will change because of these new bank resolution rules.

### **Governance Structure**

The pressure on the relationship between bank resolution rules and normal insolvency law is exacerbated by the origins of both bodies of law. Normal insolvency law has always remained the prerogative of national legislatures, while bank resolution rules have recently been developed and adopted by international organizations both at the global, and the regional level.<sup>6</sup>

Elsewhere, I have talked about the global level. I would like to focus today on the European level. On this level, the legislature has initiated an ambitious project commonly referred to as the Banking Union in response to the financial crisis. Under the first leg of this banking union, prudential supervision of banks in all Member States whose currency is the Euro is centralised with the European Central Bank. On 3 November 2013, the Regulation underpinning this “Single Supervisory Mechanism” (“SSM”) has entered into force.<sup>7</sup>

The second leg of the banking union involves a common recovery and resolution regime for banks. It consists of a draft Bank Recovery and Resolution Directive

3 See, e.g., Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions (2011); Recitals (1) and (27), Article 26(2), BRRD.

4 For the EU, see, e.g., BRRD Impact Assessment, at 8 et seq. and for the US, see, e.g., R. Bliss and G. Kaufman, U.S. Corporate and Bank Insolvency Regimes: An Economic Comparison and Evaluation, Federal Reserve Bank of Chicago, WP 2006-01, at 28-30.

5 “Normal insolvency proceedings” is the term the BRRD uses for the otherwise, i.e. applicable non-BRRD insolvency law.

6 See, more extensively, M. Haentjens, “Work of International Organisations on Bank Recovery and Resolution: an Overview”, Chapter 1 in M. Haentjens and B. Wessels (eds), *Bank Recovery and Resolution, A Conference Book* (2014, Eleven International Publishing, The Hague).

7 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287/63.

("BRRD"),<sup>8</sup> which aims to result in minimum harmonisation of bank resolution rules and will have to be implemented into the national laws of all EU Member States. On 18 December 2013, a "final compromise text" was published and this Directive now is in the last stages of the legislative process. Once adopted, this Directive will have to be implemented in the national laws of the Member States. It is likely that in many jurisdictions, bank resolution rules will be deemed a specialist area of law that is embedded in more general, normal insolvency law. Consequently, normal insolvency law will remain applicable to bank insolvency situations where specific bank resolution rules are absent. Moreover, the BRRD contains numerous references to normal insolvency law. In these instances, normal insolvency law rules may have to be interpreted for bank resolution purposes.

In addition, as a corollary of the BRRD, the Commission published a draft Single Resolution Mechanism Regulation ("SRMR"),<sup>9</sup> also on 18 December 2013. I will not say much about this Regulation as Professor Madaus will elaborate on that subject immediately after my talk. I only wish to draw your attention to the fact that the SRMR (as the SSM) will be directly applicable in all Member States whose currency is the Euro. Pursuant to this Regulation, the authority to take bank resolution measures as defined in the BRRD will be conferred to a European Resolution Board. But national authorities will have to execute such measures under national law as harmonised by the BRRD.<sup>10</sup> Thus, where implementation of the BRRD may respect specific national insolvency law idiosyncrasies, the European Resolution Board might not be so observant to national insolvency law, although their decisions must be executed under that law. Consequently, this governance structure will add to the complexity of the relationship between (harmonised) bank resolution rules and non-harmonised (national) normal insolvency law.

8 In full: proposal for a Directive of the European Parliament and the Commission establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM/2012/0280 final - 2012/0150 (COD)). Where in this chapter, reference is made to the BRRD, this 18 December 2013 "Final Compromise Text" is meant.

9 Proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (COM/2013/0520 final - 2013/0253 (COD)).

10 Articles 5 and 26, SRMR.

## Bank Resolution Objectives: A Paradigm Shift

The BRRD aims to achieve:

“continuity of critical functions, to avoid adverse effects on financial stability, to minimise reliance on extraordinary public financial support and to protect covered depositors and investors, and client funds and client assets.”<sup>11</sup>

These objectives imply a dramatic paradigm shift from normal insolvency law in several ways.

First, normal insolvency proceedings are directed at the liquidation of all a debtor’s assets so that its creditors may be satisfied to the greatest possible extent. This objective may not be reconcilable with the BRRD’s aim to preserve certain assets, so as to safeguard essential services and protect certain stakeholders. Unsurprisingly, therefore, maximising creditor value is notably absent from the BRRD’s objectives just listed.

Second, under normal insolvency law, (senior) creditors rank equally. As a fundamental principle of Dutch law, for instance, creditors rank *pari passu* and share equally, *pro rata parte*, in any net proceeds of their debtor’s assets.<sup>12</sup> This principle cannot be reconciled with the BRRD’s objective of protection of specific categories of creditors, viz. covered depositors and investors.<sup>13</sup>

Third, normal insolvency proceedings usually involve complex and lengthy negotiations with creditors. This may result in serious losses and pose a threat to financial stability when applied to a bank insolvency. Normal insolvency proceedings are therefore argued to be too lengthy for bank insolvencies. Bank recovery rules should thus be geared towards efficiency, rather than fairness to creditors, so as to satisfy the BRRD’s objective of avoiding adverse effects on financial stability.<sup>14</sup>

Finally, the difference in rationale of bank resolution rules under the BRRD and normal insolvency proceedings has serious consequences for their judicial

11 Article 26(2), BRRD.

12 Art. 3:277(1), Dutch Civil Code (*Burgerlijk Wetboek*).

13 S. Madaus, “Bank Failure and Pre-emptive Planning”, Chapter 3 in Haentjens and Wessels (eds), above note 6. See also below.

14 See above note 4; Madaus, above note 13.



review.<sup>15</sup> Normal insolvency proceedings usually take place under objective judicial supervision. This is the case under Dutch law, where both emergency proceedings (*noodregeling*) and bankruptcy (*faillissement*) can be declared by court order only, and the administration of both proceedings is under constant judicial review. In contrast, bank resolution must be effectuated expeditiously, so that resolution measures under the BRRD are taken by the resolution authority. Ex ante judicial review is allowed, but only if it be expeditious.<sup>16</sup> Notification of the exercise of any resolution instrument to creditors is only to be done ex post by publicly available means.<sup>17</sup>

All these differences notwithstanding, the BRRD also provides that:

- “a failing institution should in principle be liquidated under normal insolvency proceedings”;
- “the winding up of a failing institution through normal proceeding should always be considered”; and
- “resolution tools should [only] be applied where the institution cannot be wound up under normal insolvency proceedings.”<sup>18</sup>

How could these principles be reconciled with the paradigm shift just discussed? These principles must be interpreted in the light of the bank resolution objectives as set out by the BRRD.<sup>19</sup> By consequence, normal insolvency proceedings may only be applied if such proceedings would not result in a threat to critical functions, have adverse effects on financial stability, result in reliance on extraordinary public financial support or endanger the position of depositors and investors, client funds and client assets.<sup>20</sup> Considering the purpose of normal insolvency proceeding, viz. liquidation so as to maximise creditor value, and in view of the above, it would be extremely difficult, it is submitted, to think of a bank failure where these requirements would be met. It may therefore be safely assumed that as a matter of

15 See, e.g. A. Bornemann, “Resolution Regimes for Financial Institutions and the Rule of Law”, Chapter 5 in Haentjens and Wessels (eds), above note 6, for the compatibility of the BRRD regime with, specifically, Article 47, Charter of Fundamental Rights of the European Union, 2000/C 364/01.

16 Article 78, BRRD.

17 Ibid., Article 75.

18 Ibid., Recitals (27), (28) and (30), respectively.

19 Ibid., Recital (26): “The use of these additional tools and powers [of national law], however, should comply with the resolution principles and objectives as set out in this Directive.”

20 Cf. Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (“BRRD Proposal Text”), note 11: “If authorities assess that financial stability and taxpayers are not threatened, a bank (or parts of it) may be allowed to fail in the ordinary way.”

principle, the BRRD's bank resolution rules apply to a failing bank, and that it is only by way of exception that normal insolvency law would apply, either instead of bank resolution rules, or so as to complement the exercise of those rules.<sup>21</sup> This would mean that for practical purposes, the exact opposite of Recital (27) is true.

## **Resolution Tools**

The BRRD prescribes under which conditions authorities may exercise the Directive's resolution instruments or "tools". Under the BRRD, resolution tools may be exercised if a bank is failing or likely to fail, if alternative private sector measures or supervisory action would not prevent the failure of the bank, and if a resolution action is necessary in the public interest.<sup>22</sup> A resolution action is necessary in the public interest if winding up of the institution under normal insolvency proceedings would not meet to the same extent the resolution objectives expressed in Article 26 cited above.<sup>23</sup> Consequently, prior to exercising any resolution tool, the relevant authorities should make a theoretical exercise and calculate what the effects of common insolvency proceedings would have been. It may be safely assumed that the effects of normal insolvency proceedings would not meet the BRRD's objectives, so that again, the BRRD would require application of its bank resolution tools, rather than normal insolvency proceedings.<sup>24</sup>

Under the BRRD, resolution authorities may exercise, in short, the following resolution tools: a (forced) sale of business to a private party, a (forced) transfer of "good" assets to a government owned bridge institution, a (forced) transfer of "bad" assets into an asset management vehicle (asset separation), and bail-in, i.e. a cancellation or dilution of shares and a forced write down or conversion into equity of debt instruments.<sup>25</sup> These resolution tools illustrate that the traditional dichotomy of restructuring vs. liquidation does not work in a bank resolution scenario.

From the four resolution tools listed, the sale of business and the bridge institution tools are directed at (partial) liquidation of a failing bank. Under these tools, the bank is cut up and the proceeds of the transfer of its assets are distributed under the resolution authority, the remaining bank and former owners of shares or instruments of ownership (should their shares or instruments have been transferred).<sup>26</sup>

21 Normal insolvency law could apply, for instance, to specific parts of the bank when certain bank resolution tools have been used. See further below.

22 Article 27(a), BRRD.

23 *Ibid.*, Article 27(3).

24 See also below.

25 Article 31(2), BRRD.

26 *Ibid.*, Articles 32(4a) and 34(3a), respectively. Cf. also Article 65(a), BRRD.

Subsequently, the remaining bank from which the assets have been transferred shall be wound up under normal insolvency proceedings.<sup>27</sup> Additionally, normal insolvency law must eventually be applied to liquidate the bridge institution itself<sup>28</sup> and may eventually be used to liquidate the asset management vehicle.

The asset separation and bail-in tools, on the other hand, are aimed at restructuring and preservation of the failing bank. Under the asset separation instrument, the loss generating operations are insulated from the failing bank so that this institution may survive.<sup>29</sup> The bail-instrument results in recapitalisation of the bank (or of the bridge institution)<sup>30</sup> by reducing its liabilities.<sup>31</sup>

### *No Creditor Worse Off Principle*

Under the BRRD:

“no creditor should incur greater losses than it would have incurred if the institution had been wound up under normal insolvency proceedings in accordance with the no creditor worse off principle as specified in this Directive.”<sup>32</sup>

This “no creditor worse off principle”, has several important consequences.

First, the BRRD instructs Member States to carry out an ex post valuation whether shareholders and creditors having been subjected to a resolution instrument have received at least as much as they would have, should the institution be liquidated under normal insolvency proceedings. More specifically, this applies to shareholders and creditors who have been subjected to bail-in, but also to shareholders and creditors whose shares and claims, respectively, have not been transferred under a sale of business or bridge institution tool.<sup>33</sup> Should any shareholder or creditor have

27 Ibid., Article 31(5). Confusingly, Recital (28), BRRD seems to imply that the sale of business tool has a restructuring function: “A failing institution should be maintained through the use of resolution tools as a going concern. That may be achieved either through sale to or merger with a private sector purchaser, or after having written down the liabilities of the institution, or after having converted its debt to equity, in order to effect recapitalization.” Considering Article 31(5), BRRD, this may be true for bail-in, but not for the sale of business.

28 Ibid., Article 36(7). Cf. also Recital (42), BRRD.

29 Ibid., Article 36(4)(ii). Under Articles 36(4)(i) and (iii), BRRD, the asset separation tool may also be used to prevent market disturbance that might result from the liquidation of the assets transferred, or to maximise the liquidation proceeds of those assets.

30 Ibid., Article 36(5b), which states that a bridge institution can also be recapitalised by bail-in, while its assets may also be transferred to an asset management vehicle.

31 Ibid., Article 37(2) and Recital (28), cited above.

32 Ibid., Recital (4) and Article 65(b).

33 Ibid., Articles 65-66 and Recital (31).

received less than under normal insolvency proceedings, it is entitled to payment of the difference.<sup>34</sup>

Second, as one of the resolution tools that resolution authorities will be empowered to employ, shares may be cancelled or diluted, while debt instruments may be written down (possibly to zero) or converted to equity: the bail-in tool. Yet no shareholder or creditor should incur greater losses than they would have incurred if the institution had been wound up under normal insolvency proceedings. The authorities employing this resolution tool must therefore *ex ante* undertake an hypothetical exercise of valuating the position of shareholders and creditors should the institution be liquidated under normal insolvency proceedings, and compare that value against the value of the position of shareholders and creditors at the moment the bail-in tool is exercised.<sup>35</sup> Thus, the maximum aggregate amount by which shares and debt instruments may be cancelled, written down or converted, is to be calculated.

Moreover, resolution authorities employing the bail-in tool must respect the priority order amongst shareholders and creditors of normal insolvency proceedings.<sup>36</sup> Consequently, shareholders and creditors are treated as if they would have been involved in normal insolvency proceedings. The exercise of the bail-in instrument has therefore been dubbed a “synthetic insolvency”<sup>37</sup> and, in this respect, a bank resolution would achieve similar results to those of normal insolvency proceedings.<sup>38</sup> It follows that under the BRRD, normal, i.e. national (substantive) insolvency law continues to play an important role, most notably as regards the aggregate amount and priority order of bail-in, but also as regards the amount of possible compensation claims.

## Concluding Remarks

From the foregoing it follows that the European bank resolution regime is a specialist area of law for bank failures,<sup>39</sup> with objectives that are fundamentally

34 *Ibid.*, Article 67. See also Articles 30(4) and 30(2a), BRRD.

35 This valuation has been argued to be a virtual impossibility, as one would have to value, per group of creditors, the strength of their claims. See V. de Serière, “Bail-in: Some Fundamental Questions”, Chapter 8 in Haentjens and Wessels (eds), above note 6. De Serière also refers to the difficult valuation of collateral (for secured creditors), derivative contracts and structured finance contracts, which are highly sensitive to market prices. Considering the wide margins that have been employed to value the claims of several claimants in real bank insolvency cases, it is submitted that such a valuation would indeed be arguably impossible.

36 Article 52, BRRD.

37 F. Garcimartín, “Resolution Tools and Derivatives”, Chapter 9 in Haentjens and Wessels (eds), above note 6.

38 Cf. BRRD Proposal Text, at 5.

39 S. Gleeson, *Legal Aspects of Bank Bail-Ins*, LSE Financial Markets Group Paper Series (January 2012), at 3.

different from the objectives of normal insolvency law. Because of the dramatic paradigm shift from maximising creditor value to general public interest, bank resolution rules cannot be placed in the normal insolvency law dichotomy of liquidation vs. preservation or reorganisation. Nonetheless, normal insolvency law will remain of pivotal importance for bank resolution rules. In the above, we have seen that normal insolvency law will remain critical for the interpretation and application of the BRRD's bank resolution rules and that normal insolvency law will remain applicable to bank insolvency situations where specific bank resolution rules do not apply. The relationship between bank resolution rules and normal insolvency law will therefore remain an important, but also a very complex one, as in the eurozone, the BRRD's bank resolution rules will principally be exercised on the European level, while normal insolvency law is likely to remain a national prerogative. In any event, major developments in the area of insolvency law – as in other areas of law – will result from its interplay with banking law.



# Chapter 11

## Banks in Difficult Times: Shortcomings of the European Bank Resolution Regime

Stephan Madaus

### Introduction

It has become a common belief that banks or financial institutions are to be exempted from common insolvency law as they are “too big to fail”. Even in cases like the Cyprus Banking Crises where financial institutions were not too big to fail, they often seemed too interconnected to fail. Due to their size and/or interconnections with other banks, many financial institutions seem irreplaceable for governments and authorities.

In this workshop, I will not address the common sense response to the problem of a banking crisis that would be to prevent them from failing. The current EU financial stability framework is addressing this task by ensuring that banks are adequately capitalised and supervised. Instead, I will examine the proposed European bank resolution regime which does not aim at preventing failure, but to reduce the impact of failure. Though it may not be its main purpose, an efficient bank resolution regime contributes to the prevention of bank failure by reducing a moral hazard as this may keep a bank’s management and executives from engaging in excessive risk in cases where they can no longer trust in the government to use public funds to offset bad speculation. Under an efficient bank resolution regime, a failing bank would be subject to a resolution process, and its management and owners would have to face consequences and suffer losses for taking disproportionate risks.

### The Proposed EU Bank Resolution Mechanism

On 6 June 2012, the EU Commission published its “Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms” (Bank Recovery and Resolution Directive) (“RRD”).<sup>1</sup> The framework is intended to equip the relevant authorities with common and effective tools and powers to address banking

1 COM(2012) 280.

crises pre-emptively, safeguarding financial stability and minimising taxpayers' exposure to losses. On 10 July 2013, the EU Commission specified which authorities would handle a failing financial institution by publishing its proposal for a "Single Resolution Mechanism" ("SRM").<sup>2</sup> The proposed SRM would apply the substantive rules of the RRD in the banking union and will therefore be fully in line with the provisions of the RRD. The SRM proposal was approved with some substantial amendments by the European Council on 19 December 2013. It is supposed to be adopted by the European Parliament before the end of the Parliament's current legislature in May.

## **Key Attributes and Shortcomings of the European Bank Resolution Regime**

### *Strong Central Decision-Making (?)*

The European legislature understands that time is critical when a financial institution is failing.<sup>3</sup> In order to preserve financial stability, markets need to know quickly how an ailing bank is dealt with as impacts of such treatment on other market participants must be calculated immediately. Therefore, an efficient bank resolution regime must be able to generate a decision about how to treat a failing bank in a resolution before markets reopen (over night or the course of a weekend). SRM decision-making is set to minimize sources of uncertainty in the markets by centralising the decision regarding whether and how to resolve a bank at the European level. Unfortunately, this does not lead to a single decision-maker. Instead, the decision-making process would look like the graph in the appendix. A German member of the EP, *Sven Giegold*, accepted the challenge and visualised the proposed decision-making process in January, with *Michel Barnier* acknowledging him at least for effectively picturing it.

The fact that there is not a chance to have streamlined decision-making because all relevant bodies (EC, Council) want to be involved is a dilemma of European politics. At least the Council has limited substantial decision-making to the Resolution Board that is to be established by the SRM Regulation. In the relevant executive session the composition of the Board includes the Executive Director and four other permanent members, while the Commission and the ECB are to be permanent observers. In addition, further members are to be part of that session according to the interests of all Member States affected by a resolution. Although none of the participants in the deliberation are to have a veto as the decision is to

2 COM(2013) 520 final.

3 *Ibid.*, at 5.



be made by a simple majority vote,<sup>4</sup> no Member State could be required to provide extraordinary public support to any entity under resolution. Under a regime that is biased towards a recapitalisation of failing banks, such voting rules create quite a complex bargaining situation in times of urgent crisis.

### *Pre-Packaged Decision Content (?)*

As time is of the essence in a bank failure and a bank's assets and financial structure are quite complex, there is not much time for preparing a plan at the onset of a crisis. Instead, a pre-packaged plan seems ideal as it both provides for a ready-to-use solution if it is up to date and prepares a response (if possible) to all scenarios of possible failure. The EU proposal therefore requires all (recovery and resolution) plans to be prepared in good times and updated annually. They must also cover a range of scenarios and response options. While there is good reason for such requirements in theory, it is hard to believe that contingency plans will actually predict the exact scenario that eventually sees a bank failing. Still, reasonable efforts to plan for a SIFI's resolution seem appropriate because the very process of planning may expose risks and initiate a timely restructuring.<sup>5</sup>

### *The Bail-in Tool as a Key Instrument (?)*

The bail-in tool is intended to give resolution authorities the power to recapitalise a failing financial institution:

“to restore its ability to comply with the conditions for authorisation and to carry on the activities for which it is authorised.”<sup>6</sup>

The bail-in tool introduces a reorganisation option to the bank resolution regime as the failing entity would survive its “resolution”. It is a rather general question whether there is good reason for a reorganisation under such a regime.

In order to maintain financial stability despite a (major) bank's failure, quick and predictable solutions are required to calm the financial system. This cannot be achieved by a reorganisation as even a quick recapitalisation of a failing bank cannot ensure that a business model is sound. It takes time and is very uncertain that restructuring a bank's business model according to a business reorganisation plan would be successful and prevent another failure within a short period of time. Regarding the significant rate of unsuccessful reorganisations despite successfully confirmed reorganisation plans, financial stability cannot be guaranteed by a

4 Article 51, SRM Regulation.

5 “Plans are of little importance, but planning is essential.” (*Winston Churchill*)

6 Article 37(2)(a), RRD.

reorganisation of financial institutes – especially if a considerable number of liabilities remain intact.<sup>7</sup>

A reorganisation option that is almost guaranteed as the preferred option in a future bank failure because it is a key element of a bank's resolution plan weakens the incentive of a bank resolution regime to avoid moral hazard. If the only consequences that a financial institute has to fear are the mandatory replacement of senior management<sup>8</sup> and the dilution of shares,<sup>9</sup> any decision to enter into risky business would not mean to risk the very existence of the company. Such a bank resolution regime would seriously miss its chief political purpose.

It is a next-to-impossible task to seriously plan for a reorganisation of a financial institute by setting up a pre-packaged plan based solely on crisis scenarios. Even in a moment of crisis, it is complex and difficult to design and negotiate a rescue plan. As all the precautions in Section 5 of the RRD demonstrate, the preparation of a resolution plan with a bail-in tool would absorb a huge part of the capacity of resolutions authorities and still not guarantee a quick and successful reorganisation, especially in case of an unforeseen development.

A reorganisation option is not necessary to achieve the aims of a bank resolution regime: maintaining financial stability despite the failure of a financial institution. There are less extensive and costly tools available that ensure financial stability in every bank failure than the attempt of a reorganisation. If there is no market interest in a failing bank, the solution must be to immediately wind up its business or to transfer valuable parts to a bridge institution to be sold in a better market. In case of the latter, the bridge institution may be capitalised by a debt-to-equity swap, but this could be done under company law and would not interfere with the principal dissolution of the entity of a failing financial institution.

A reorganisation of a failing bank is to be financed by funds acquired from competing financial institutions.<sup>10</sup> In contrast to regular insolvency proceedings where the stakeholders of an insolvent company or private investors need to fund a reorganisation process by contributing loans, the funding of a bank resolution would be enabled by loans sponsored by amounts raised by ex-ante contributions from all financial institutions.<sup>11</sup> Such mandatory financial support of a competitor's rescue is hardly consistent with the principles of our economy.

7 Ibid., Article 47.

8 Ibid., Article 29(1)(c).

9 Ibid., Article 42(1)(b).

10 Ibid., Article 94.

11 Ibid., Article 92(1)(b).

## **Outlining a “Default Resolution Option”**

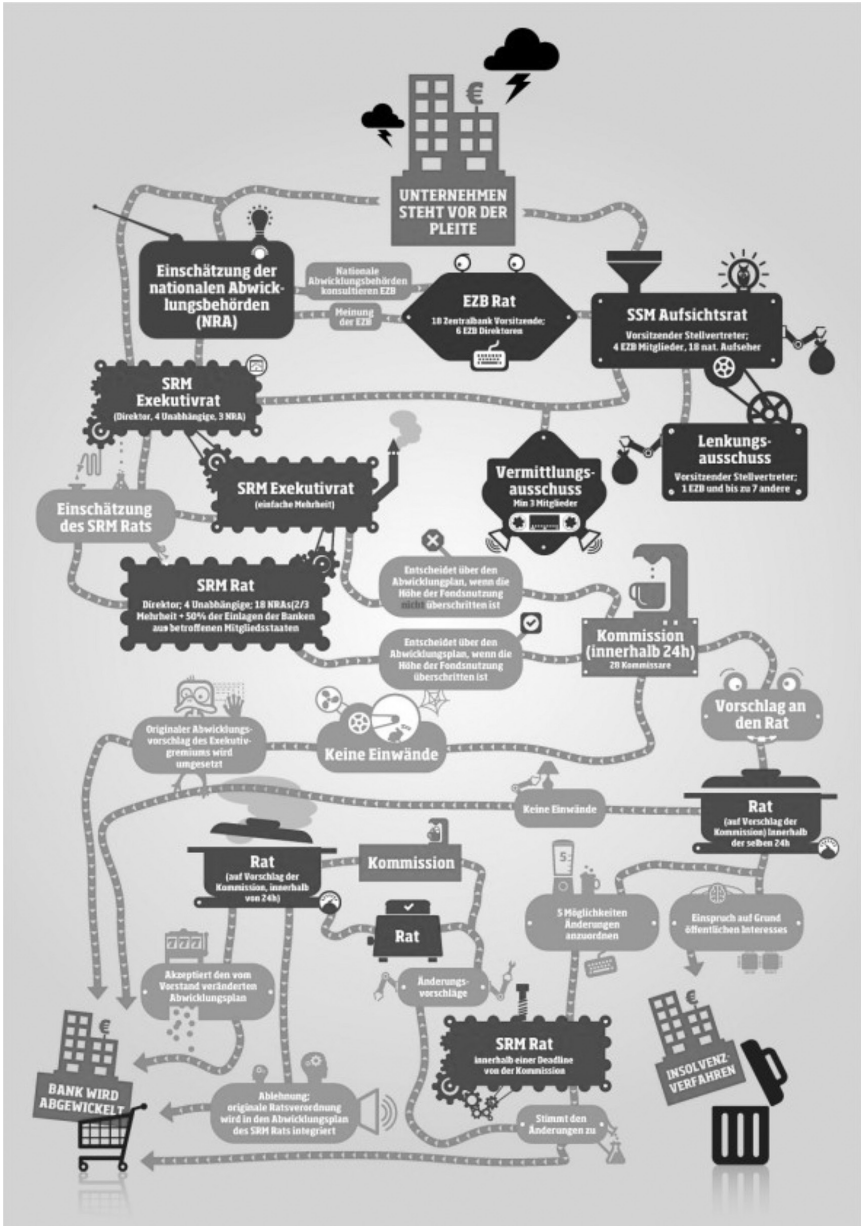
Having reflected on the results, this report concludes with the presumption that the resolution of a failing financial institution should principally consist of a quick and pre-packaged transfer of such institution’s valuable assets in addition to systemically relevant services and financial contracts (to a “good bank”), thus liquidating the failing entity. Such a quick transfer achieves all key targets of a bank resolution: maintaining the bank’s vital functions for the real economy; allocating losses with shareholders and creditors; providing markets with certainty *ex ante* as well as in a crisis. In cases where a banking group is concerned, the concept of a pre-packaged transfer falls into place with the “SPE approach” (“single point of entry”). Such a regime would consist of two stages.

### *Resolution Planning and Resolvability*

In order to enable a quick transfer in the case of failure, a marketability assessment of the core assets and services of a financial institution must be made and updated. The assessment should focus on potential investors for a bridge entity that would be established in a resolution and require fresh money. A resolution plan must also identify and document the relevant assets, service units, and types of contracts in an inventory that would be transferred. Impediments to service transfers must be addressed by resolution authorities by requiring the institution’s restructuring *ex-ante*.

### *Resolution of a Failing Financial Institution*

As soon as a financial institution fails, the respective resolution authority would arrange for the transfer of all vital assets, services and financial contracts, specified in the resolution plan, as well as all unsecured creditors’ claims and sufficient valuable assets to a bridge institution (good bank). By doing so, the failure would be resolved quickly and risks to financial stability would be contained promptly. All deposits would be part of the transfer and served by the good bank, so no impairment on their part would be incurred initially. Following this quick action, resolution authorities would assign the management of the good bank to business professionals, write down the transferred unsecured claims according to the priority set in Article 15 of the SRM Regulation and convert them to equity to be distributed among creditors with only the highest priority. Hereafter, the future of the good bank lies in the hands of its new management and owners and the resolution authorities’ focus may shift to the management of the non-vital assets and (derivative) contracts that remained with the failed entity. Of course, national law may also assign this task to other authorities or insolvency courts. Any proceeds from these proceedings would be distributed to the good bank.



# Chapter 12

## Banks in Difficult Times: Workshop Report

Lynette Janssen

### Introduction

The central theme in the workshop Banks in Difficult Times was the European bank recovery and resolution framework, established by the Bank Recovery and Resolution Directive (“BRRD”)<sup>1</sup> and the Single Resolution Mechanism (“SRM”).<sup>2</sup> The paper written by Matthias Haentjens focuses on the relationship between bank resolution rules and normal insolvency law. In his paper, Stephan Madaus examines the key attributes and shortcomings of the European bank resolution regime. During the workshop both aspects were discussed by the speakers.

### European Bank Resolution Rules and National Insolvency Law

Matthias Haentjens started his presentation with the consideration that the financial crisis that started in 2007 has shown that not only financial institutions can fail but also that normal insolvency law has failed. Traditionally, insolvency law serves two purposes: liquidation or restructuring of the debtor’s estate. The purposes of the special bank resolution rules are fundamentally different, according to Matthias Haentjens. The resolution rules are a specialist area of law for bank failures and are directed at the preservation of critical functions, the preservation of financial stability, the minimisation of the use of public funds and the protection of retail clients. These different purposes cause pressure on the relationship between normal insolvency law and bank resolution rules. This pressure is further exacerbated because of the origin of both bodies of law. On the one hand insolvency law

- 1 Proposal for a Directive of the European Parliament and the Commission establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (COM/2012/0280 final - 2012/0150 (COD)). In their contributions, Matthias Haentjens and Stephan Madaus made reference to the 18 December 2013 “Final Compromise Text” of the BRRD.
- 2 Proposal for a Regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (COM/2013/0520 final - 2013/0253 (COD)). In their contributions, Matthias Haentjens and Stephan Madaus made reference to the draft Single Resolution Mechanism Regulation published on 18 December 2013.

remains the prerogative of national legislatures. On the other hand, the bank resolution rules are recently adopted on global and on European level.

The European Banking Union consists of three parts. The first leg involves the centralisation of financial supervision in the Eurozone with the Single Supervisory Mechanism (“SSM”).<sup>3</sup> The second leg consists of a common recovery and resolution regime for banks. The BRRD is intended to equip the national authorities with common and effective tools and powers to address banking crises pre-emptively, safeguarding financial stability and minimising the use of taxpayers’ money. This BRRD aims to result in a European (minimum) harmonisation of bank resolution rules and will have to be implemented into the national laws of all Member States of the European Union. The directive is in its last stages of the legislative process. The SRM will apply the substantive rules of the BRRD, as one of the key elements of the Banking Union. It will be responsible for the resolution of all banks in the Member States participating in the SSM. A European Resolution Board decides which tools and measures have to be applied to resolve a failing bank, executed in a national context by national authorities within their own national insolvency laws.

Article 26(2) of the BRRD states that:

“[the BRRD aims to achieve] continuity of critical functions, to avoid adverse effects on financial stability, to minimise reliance on extraordinary public financial support and to protect covered depositors and investors, and client funds and client assets.”

Matthias Haentjens argued that this implies a paradigm shift from the objectives of normal insolvency law. Normal insolvency proceedings are directed at the liquidation of all assets of the debtor, at the equality of creditors, and at a fair result and take place under judicial supervision. The resolution of a bank on the other hand, aims to preserve certain assets, such as payment services, to protect certain creditors, including retail depositors, and to resolve a failing bank as quickly as possible as to minimise the risk to financial stability. The resolution takes place in an administrative procedure. National insolvency law may only be applied to a failing bank if this application would not be contrary to the purposes of the BRRD. Thus, for practical purposes, in any bank insolvency, resolution rules will (have to) be applied, rather than normal national insolvency law.

Under the BRRD, resolution authorities may apply four resolution tools: the sale of a business tool, the bridge institution tool, the assets management vehicle tool and

3 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287/63.

the bail-in tool. Matthias Haentjens explained that these tools show that the normal dichotomy of insolvency law, restructuring on the one hand and liquidation on the other hand, does not apply to and is kind of mixed in the bank resolution regime. The sale of a business tool and the bridge institution tools involve a liquidation of the remaining bank and a possible liquidation of the bridge institution, whereas the latter two tools are aimed at a restructuring and a preservation of the failing bank.

Article 65(b) of the BRRD states that:

“no creditor should incur greater losses than it would have incurred if the institution had been wound up under normal insolvency proceedings.”

This principle contains important references to normal insolvency proceedings. By means of a valuation of the position of the shareholders and creditors in case the bank should be liquidated under normal insolvency law, a hypothetical exercise, the amount must be determined *ex ante* that can be cancelled, written down or converted when applying the bail-in tool. Member States are also required to calculate *ex post*, after the application of a resolution tool, what the shareholders and creditors would have received should the bank have been resolved under normal insolvency law. If there is a difference in that valuation, the creditors and shareholders are entitled to payment of the difference. Pim Rank questioned who has to pay these claims, the bank itself or the authorities. The BRRD however does not determine this.

Roel Fransis asked if this “no creditor worse off” principle means that a threshold is established that if assets are transferred, the transferor must receive at least the amount that would be paid in a normal insolvency proceeding. Matthias Haentjens explained that this is the case and that the BRRD has very detailed rules on how to make a valuation of the bank. It will however be incredible difficult to make such a valuation in a short period of time. Pim Rank mentioned that under the current Dutch Intervention Act in case of a transfer plan the court has to make an *ex ante* evaluation and has to determine when approving on the transfer plan would be detrimental to the institution’s remaining creditors. A further discussion about the valuation of the failing bank took place. According to Robert van Galen, it is impossible for a court to make a reasonable valuation overnight. Stephan Madaus added that, under German insolvency law, the creditors committee has to agree with the sale price, so that the creditors in the end will carry the burden of the efficiency claims. In a bank resolution process however, there will generally be no time for such negotiation with the creditors. Stephan Madaus concluded that no real solution has been found for the valuation.



## **Shortcomings of the European Bank Resolution Regime**

In the second part of the workshop, Stephan Madaus highlighted some key attributes and shortcomings of the European bank resolution regime. He started his presentation by mentioning that the resolution regime was on that day being treated in parallel in the workshop and in the European Parliament, since the BRRD and the SRM were on vote in the European Parliament that afternoon.

The bank recovery and resolution framework refers to three different parts of the life circle of a bank. It provides for recovery planning, for early intervention and for resolution, which is the final step of the framework. Stephan Madaus explained that the argument to have a SRM is to have a single, strong and central decision making body in resolution. The regulation for the SRM provides therefore for a single Resolution Board with broad powers in case of bank resolution. The Board can adopt a pre-packaged resolution scheme placing a bank into resolution. The decision about the resolution is to be made by a simple majority or a two third majority vote. However, because of the involvement of the ad hoc appointed members of the Board, depending on the interests of Member States affected by the resolution of the specific bank, the involvement of the EU institutions, including the Commission and the Council, and the possible national veto in case a member state is required to provide extra-ordinary public support, there will be no single central decision maker. The decision-making process will become quite complex in times of an urgent crisis situation. Stephan Madaus argued that “there are too many cooks cooking over a weekend” and that he was “not sure that there will be a solution that will meet the taste of everyone involved.”

Also discussed by Stephan Madaus was the presumption that, to achieve all the key targets of the bank resolution rules, including maintaining the bank’s vital functions, the resolution of a suddenly failing financial institution should principally consist of a quick and pre-packaged transfer of the institution’s assets, relevant services and financial contracts and of a liquidation of the remaining bank. Since it will be difficult to determine in that situation *ex ante* and quickly what will be the minimum amount of claims that need to be written down for a recapitalisation, the bail-in tool, a restructuring tool, should be considered as an additional instrument, not as the key instrument. When certain parts of the bank are transferred to another entity, the question who deserves what can be asked afterwards.

The bail-in tool can however contribute to restructure already existing so-called “zombie” banks. When the European recovery and resolution framework will come into force these banks will petition for a resolution in order to be recapitalised and will withdraw sources of one fund, the single resolution fund. A huge problem will



exist in that scenario since the money in this fund, contributed to by the viable and healthy banks, will never be sufficient to recapitalise all banks.

Georgias Zavvos questioned the tremendous powers and the important role of the Resolution Board. He also mentioned that “the big elephants are outside the picture” since there is still a backstop needed for a credible mechanism. According to Stephan Madaus, the BRRD and the SRM focus very much on recapitalisation of the failing bank. He argued that we should let failing banks disappear. Christoph Paulus agreed on this, but was also of the opinion that you cannot always allow banks to fail because of their interrelations with the sovereign. He referred to the problems in Cyprus and Greece. Stephan Madaus believed that you cannot recapitalise all banks and that it is necessary to let some of them fail or to save only some parts that you need for your further credit supply. Irene Lynch Fannon then emphasized that the key issue still is the interconnectedness of banks, which can cause a sovereign debt problem and a national problem. Banks therefore should be supervised *ex ante*.

Rolf de Weijts pointed out that we can use the bail-in tool to restore the solvency of a bank, but that we still need the resolution fund to restore liquidity. The bank resolution rules should not be directed at a minimisation but at a stop of the use of public funds. Matthias Haentjens argued that we need to solve both short term and long term issues. The resolution fund will not contain enough money to solve the liquidity problems. If you use the bail-in tool, by writing down claims of creditors, other banks who possess bonds in the failing bank will be affected. This creates a systemic issue.

## **Conclusion**

With their presentations Matthias Haentjens and Stephan Madaus provided a clear overview of the developments and the issues relating to the European bank recovery and resolution framework. During their presentations and the lively discussions afterwards many interesting aspects and weaknesses of the framework were mentioned and it became clear that not all the questions and problems relating to the bank resolution framework are yet answered and solved.



**PART III**  
**VALEDICTORY LECTURE**



# Chapter 13

## Research in International Insolvency Law: Challenges and Opportunities

Bob Wessels

### Introduction

Mister Chancellor of the University, Mister Dean of the Faculty of Law, dear colleagues, ladies and gentlemen.<sup>1</sup> Having graduated as a lawyer forty years ago, I had already been working in legal practice for seven years when Joseph Becker wrote in the *American Journal of Comparative Law*:

“...Transnational Insolvencies are rare birds. They pass through the court in sudden flights once or twice a generation.”<sup>2</sup>

A decade later, in 1991, when I did my first teaching in New York, large insolvency cases started to pile up: Trans World Airlines (TWA) filed for Chapter 11,<sup>3</sup> Olympia & York, a major Canadian international property development firm, that build large office complexes like Canary Wharf in London and the World Financial Center in New York City, went down,<sup>4</sup> and in the same year Maxwell Communications Corporation plc, a leading British media business, listed on the stock exchanges of London and New York, entered insolvency following the unresolved death of media

1 This chapter contains a selection of my valedictory lecture, with the title “Teaching and Research in International Insolvency Law: Challenges and Opportunities”, on the occasion of my retirement as Professor of International Insolvency Law, University of Leiden, the Netherlands, during the years 2007-2014, delivered in the Academy Building at Leiden on 14 April 2014.

2 J. Becker, “Transnational Insolvency Transformed” (1981) 29 *American Journal of Comparative Law* 706ff.

3 See: <http://web.archive.org/web/20010407233345/twacargo.com/about/history.html>.

4 See: [http://en.wikipedia.org/wiki/Olympia\\_and\\_York](http://en.wikipedia.org/wiki/Olympia_and_York).

tycoon Robert Maxwell.<sup>5</sup> Many small businesses suffered from the liquidation of the Bank of Credit and Commerce International (“BCCI”), a major international bank, registered in Luxembourg with head offices in Karachi and London, which operated in over seventy countries, had over 400 branches, and had assets in excess of USD 20 billion, making it at that time the 7th largest private bank by assets in the world. BCCI came under the scrutiny of numerous financial regulators due to concerns that it was poorly regulated. Subsequent investigations revealed that it was involved in large money laundering and related financial crimes for which reasons BCCI became the target of a massive regulatory battle in 1991. On 5 July of that year customs and bank regulators in seven countries raided the bank and locked down records of its branch offices.<sup>6</sup> The rest of the BCCI case, now known as the Bank for Crooks and Criminals International, is history.<sup>7</sup> The liquidation came to an end in 2012,<sup>8</sup> and the liquidation proceedings in Luxembourg, Cayman Islands, England and United Arab Emirates were finally closed mid last year.<sup>9</sup> So it is no surprise that, in the mid-1990s, Jay Westbrook wrote for a US audience:

“Like the wail of a high speed train in the night, the field of transnational and comparative insolvency has come suddenly upon us, transformed from a distant possibility into a surrounding effect...”<sup>10</sup>

But these cases have not stopped in the 1990s. In this century global business is pushing on, and so the portion of financial distress. Now, in 2014, we know that the

- 5 See: [http://en.wikipedia.org/wiki/Robert\\_Maxwell](http://en.wikipedia.org/wiki/Robert_Maxwell). See *Maxwell Communications Corp.* [1992] BCLR 465; 170 BR 800 (Bankr. SDNY 1994); Aff’d BR 807 (Bankr. SDNY 1995); 593 F.3rd 1036 (2nd Cir., 1996). Compare E. Flashen and R. Silverman, “The Role of the Examiner as Facilitator and Harmonizer in the Maxwell Communications Corporation International Insolvency”, in J. Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (1994, Clarendon Press, Oxford), at 621; E. Flashen and R. Silverman, “Maxwell Communication Corporation plc: The Importance of Comity and Co-operation in Resolving International Insolvencies”, in B. Leonard and C. Besant (eds), *Current Issues in Cross-Border Insolvency and Reorganisations* (1994, Graham & Trotman, London), at 41; B. Göpfert, “In re Maxwell Communications – ein Beispiel einer ‘koordinierten’ Insolvenzverwaltung in parallelen Verfahren” (1996) *Zeitschrift für Zivilprozessrecht (ZZP) Int* 1 269ff; J. Westbrook, “The Lessons of Maxwell Communication” (1996) 64 *Fordham Law Review*, Issue 6, Article 3, available via: <http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=3277&context=flr>.
- 6 [http://en.wikipedia.org/wiki/Bank\\_of\\_Credit\\_and\\_Commerce\\_International](http://en.wikipedia.org/wiki/Bank_of_Credit_and_Commerce_International).
- 7 See H. Scott, “Multinational Bank Insolvencies: The United States and BCCI”, in Ziegel (ed.), above note 5, at 733ff; B. Wessels, “Protection of Small Depositors against Banks in Distress”, in B. Wessels, *Current Topics of International Insolvency Law* (2004, Kluwer, Deventer), at 329ff, with a commentary on the Directive on deposit-guarantee schemes (Directive 94/19). The European Commission has proposed to create a common European deposit guarantee scheme as the third leg of the Banking Union, but this seems – mid April 2014 – too ambitious politically, thus M. Haentjens, “Work of International Organizations on Bank Recovery and Resolution: an Overview”, in M. Haentjens and B. Wessels (eds), *Bank Recovery and Resolution. A Conference Book* (2014, Eleven International Publishing, The Hague), at 5.
- 8 See: <http://www.theguardian.com/business/2012/may/17/files-close-bcci-banking-scandal>.
- 9 See: <http://www.bcci.info/>.
- 10 J. Westbrook, “Creating International Insolvency Law” (1996) 70 *American Bankruptcy Law Journal* 563.

ten largest US bankruptcy cases (measured by asset value) only took place from 2000 onwards, for instance Enron, General Motors, Chrysler, and of course, the largest of all: Lehman Brothers.<sup>11</sup> In Europe, the firestorm of international financial distress also has had its structural influences. Cases such as Stanford Bank, the wizard of lies Bernie Madoff<sup>12</sup> and, in the Netherlands, Icesave and DSB Bank, just to name a few, have had large consequences. Since the entry into force of the European Insolvency Regulation (“EIR”) in 2002, several high profile cases could be resolved reasonably well, for instance Eurofood, Collins & Aikman and Nortel Network.<sup>13</sup> Therefore, compared with some thirty-forty years ago, the landscape of insolvency cases with international effects has changed drastically.

My lecture this afternoon is about many of these cases, it is the area of international insolvency law. But as I am saying farewell to academia, I will only deal with these cases in the context of teaching and research. First, let me say a few words on teaching. [...]

## Research and Academic Entrepreneurship

What I would like to do is to introduce you in some of the international turnaround, rescue and insolvency research Leiden Law School is involved in. The reason for choosing this topic the interest Leiden Law School colleagues and master students have shown for this research. Today is a good occasion to inform a larger audience. Let me explain.

In August last year, my colleagues of the Leiden Institute for Private Law, Professor Matthias Haentjens and Dr. Caspar van Woensel, together with some younger colleagues, organised an institute-wide retreat in *Biezenmortel*, in the Southern part of the Netherlands, on new topics in our field, such as distance learning, research into improving the effect of education, improving the assessment of students’ writings and what was called “*academisch ondernemen*”, which may be translated as “entrepreneurial spirit in academic research”. For the latter topic I was invited, together with Dr. Jean-Pierre van de Rest of the department of Business Studies.

11 The website: [www.businessinsider.com/largest-bankruptcies-in-american-history-2011-11?op=1](http://www.businessinsider.com/largest-bankruptcies-in-american-history-2011-11?op=1) lists the largest “bankruptcies” ranked by the value of each company’s assets before its bankruptcy filing: 1. Lehman Brothers (Filed Chapter 11: 2008; Value at bankruptcy: USD 691 billion), 2. Washington Mutual (2008; USD 327.9 billion), 3. WorldCom (2002; USD 103.9 billion), 4. General Motors (2009; USD 91 billion), 5. CIT Group (2009; USD 80.4 billion), 6. Enron (2001; USD 65.5 billion), 7. Consec (2002; USD 61.4 billion), 8. MF Global (2011; USD 41 billion), 9. Chrysler (2009; USD 39.3 billion), 10. Thornburg Mortgage (2009; USD 36.5 billion), 11. Pacific Gas & Electric Co (2001; USD 36.15 billion).

12 D. Henriquez, *The Wizard of Lies: Bernie Madoff and the Death of Trust* (2011, Henry Holt, New York NY).

13 For these and many other cases, see B. Wessels, *International Insolvency Law* (Wessels Insolvency Law Volume X) (3rd ed) (2012, Kluwer, Deventer).

I am not sure whether the organisers aimed to curb my enthusiasm for the subject by organising it in a former Roman Catholic convent, but, from our experience during the workshop, we learned that larger groups of Leiden Law School scholars showed a great interest in expanding their know how and skills in trying to attract (what we call) second and third party (not university related) private funding for research.

In December 2013, the Leiden Law School Turnaround, Rescue & Insolvency research team organised a public briefing about its on-going international and comparative research in these areas of rescue and insolvency of (cross-border) businesses. For Dutch lawyers, topics of research are obviously substantial in nature, but they also include the roles and responsibilities of key role players, such as insolvency administrators, courts and the legislature. Since 2012, these fields of research are sponsored by for instance the European Commission (its Action Grant Programme), the European Law Institute, INSOL Europe, the American Bankruptcy Institute, the International Insolvency Institute and the World Bank. Our research includes well-structured and substantial cooperation between researchers of the Leiden Law School (of some six people) and universities in Amsterdam (University of Amsterdam), Halle-Wittenberg, London (University College London), Nijmegen, Nottingham, Oxford and, we hope in the near future, Cologne. We as a group encounter the unique experience in doing our independent analysis, in all with over hundred non-Dutch academics, judges and insolvency practitioners from around 15 EU Member States, the USA and Canada (some of them are here, which I greatly appreciate). In addition, we learned from several Leiden master-students doing an internship for five weeks in our research projects, that they were excited about the experience and learning effect of their work.<sup>14</sup>

Allow me to explain a bit further what I see as academic entrepreneurship. I think that in the present day competitive environment of Dutch Law Schools, it must be taken as a matter of course that senior scholars should be active in promoting their School and their work. Generally, being active can be differentiated in two ways:

- (i) be generally active in your work for the law faculty, and;
- (ii) as the convent-organisers made public: Bob Wessels has much experience with attracting funds.

Evidently, the first characteristic is or should be in the genes of every scholar, being active in teaching and research, for instance by providing post-graduate

<sup>14</sup> Since February 2014, the research group has maintained a website at: [www.tri-leiden.eu](http://www.tri-leiden.eu).



training, editorships of books or law reviews, writing commentaries on court cases, membership of advisory committees, or becoming an expert advisor for new national or European legislation. I admit that these last positions are not available for all. In addition, for a law professor, the supervision of PhD dissertations is a core activity. Until now I was, what the Dutch call “promoter” of nine PhD research projects, and presently in Leiden I am supervising five PhDs. It is a pleasure to see some of my former PhD students, now doctors, or candidates present.

The suggested capability of attracting funds is less dismal or trivial as it sounds. As a matter of fact it should be seen more broadly, resulting in four groups of activities with the aim:

- (i) To create the conditions and facilities for academic training and research in a field where these were still in their infant shoes;
- (ii) To carry the banner of international insolvency law as a prime course subject within the field of company law (as in 2007, Leiden was – as far as I am aware – the first law faculty in Europe (!) with a chair specifically devoted to international insolvency law);
- (iii) To develop research and academic treatment of the subject; and
- (iv) To further professional practice.

### **An Academic “Selfie”**

Further to these goals, allow me to present a small picture of my work for the Leiden Law School over the last seven years as a Professor for International Insolvency Law, a Chair I accepted with my inaugural lecture in the *Hooglandse Kerk* on “Judicial Coordination of Cross-border Insolvency Cases”.<sup>15</sup> Together with Miguel Virgós (a Professor in Madrid) and Paul Omar (now a Professor in Nottingham), we created in 2007 the European Communication and Cooperation Guidelines for

<sup>15</sup> B. Wessels, *Judicial Coordination of Cross-border Insolvency Cases*, Inaugural Lecture, University of Leiden Law School, 6 June 2008 (2008, Kluwer, Deventer). Several texts that follow have been derived from earlier publications or draft research, discussed with others, but not published yet in its final form.

Cross-Border Insolvency (also known as the “CoCo Guidelines”).<sup>16</sup> Our work, the CoCo Guidelines, have assisted several courts and practitioners, most notably the leading administrators in the Lehman Brothers case to draft a protocol on coordination of work in nearly all jurisdictions proceedings were pending.<sup>17</sup>

Together with Bruce Markell (till last year a judge in Arizona, USA, now a Professor at Florida State University) and Jason Kilborn (now a Professor at John Marshall Law School in Chicago), I wrote the book “International Cooperation in

16 B. Wessels and M. Virgós, *European Communication and Cooperation Guidelines for Cross-Border Insolvency* (2007, INSOL Europe, Nottingham). These Guidelines are explained in e.g. B. Wessels and M. Virgós, “Accommodating Cross-border Coordination: European Communication and Cooperation Guidelines For Cross-Border Insolvency” (2007) 4(5) *International Corporate Rescue* 250ff. The CoCo Guidelines aim to provide rules to be applied by insolvency administrators within their duties to communicate and cooperate in cross-border insolvency instances to which the EU Insolvency Regulation is applicable. Their reception has been welcomed by scholars: e.g. M. Hortig, *Kooperation von Insolvenzverwaltern, Schriften zum Insolvenzrecht* (Diss. Köln, Band 25) (2008, Nomos, Baden-Baden), at 258: “...it is to be expected that the Guidelines will develop to the European standard of cooperation...” and insolvency practitioners: S. Taylor, “The Use of Protocols in Cross Border Insolvency Cases”, in K. Pannen (ed), *European Insolvency Regulation* (2007, De Gruyter Recht, Berlin), at 681: “highly laudable initiative”; L. Westpfahl *et al.*, *Grenzüberschreitende Insolvenzen* (2008, RWS Verlag, Köln), at 125: “extremely helpful”; L. Verrill, “The INSOL Europe Guidelines for Cross Border Communication”, Chapter 5 in B. Wessels and P. Omar (eds), *Crossing (Dutch) Borders in Insolvency* (2009, INSOL Europe, Nottingham), at 45: “[it is] important for the professions to be aware of and understand the need to adopt the CoCo Guidelines.” See also A. Geroldinger, *Verfahrenskoordination im Europäischen Insolvenzrecht. Die Abstimmung von haupt- und Sekundärinsolvenzverfahren nach der EuInsVO* (Veröffentlichungen des Ludwig-Boltzmann-Institutes für Rechtsvorsorge und Urkundenwesen) (2010, Manzsche Verlags- und Universitätsbuchhandlung, Wien), at 31, qualifying the CoCo Guidelines as “*Ein erster durchaus vielversprechender Versuch*” (a first and by all means very promising attempt). See also P. Zumbro, “Cross-border Insolvencies and International Protocols – an Imperfect but Effective Tool” (2010) 11 *Business Law International* (No. 2, May) 157ff, at 167: “The CoCo Guidelines reflect best practices both inside and outside Europe”; P. Mears and T. McFadden, *Court-to-Court Communications, Reform of European Regulation* (2012) (October) *ABI Journal* 33ff. For an in-depth analysis of the CoCo Guidelines, see O. Benning, *International Prinzipien für grenzüberschreitende Insolvenzverfahren* (Schriften zum Verfassungsrecht, Band 45) (2013, Peter Lang, Frankfurt), at 83, stressing another aspect, in that the CoCo Guidelines also can be used to trace European or even global principles for cross-border insolvency proceedings: “...um Europaweit oder sogar weltweit geltenden Prinzipien für grenzüberschreitende Insolvenzverfahren zu ermitteln”.

17 The CoCo Guidelines have indeed been used in the draft of February 2009 of the Cross-Border Insolvency Protocol for the Lehman Brothers Group of Companies, which governs the conduct of Lehman Brothers Holdings Inc. (“LBHI”) and its affiliated debtors worldwide. The draft refers to several other bits of soft law and to several Protocols of international cases, which are reflected in the Draft. It specifically refers to CoCo Guidelines 3 (Status), 17 (Notices) and 12.1 (“Liquidators are required to cooperate in all aspects of the case”). The annotated Draft for the Lehman Brothers Group of Companies is available at: [www.bobwessels.nl](http://www.bobwessels.nl), weblog: Archive 2006-2013, document 2009-02-doc7. The protocol which was approved by the New York Bankruptcy Court (Southern District) is available at: <http://chapter11.epiqsystems.com>. See US Bankruptcy Court for the Southern District of New York, *Case No 08-13555* (17 June 2009). The Protocol has been signed by 10 of the official representatives of (companies of) Lehman Brothers Group in Australia, the Netherlands, the Netherlands Antilles, Germany, Hong Kong, Luxembourg, Singapore, Switzerland and USA. Official representatives of Bermuda and Japan were in 2012 still considering signing the protocol, but have participated in a series of activities and meetings designed to advance the objectives of the Protocol. Only the administrators of a number of UK based companies did not sign the protocol. They argued that they were in favour of cooperation, but were required by UK law to treat each insolvent entity as a separate one. See: Bankruptcy Report number 3 (22 July 2009) and number 5 (12 March 2010), available at: [www.lehmanbrotherstreasury.com](http://www.lehmanbrotherstreasury.com) (last viewed 29 April 2014). In the case concerning Bernard L. Madoff Investment Securities LLC, several protocols have been concluded. See, for an example: <http://www.iiiglobal.org/component/jdownloads/finish/573/4344.html>.

Bankruptcy and Insolvency Matters”, published in 2009.<sup>18</sup> The book has served as the basic reading material for my Leiden students for the last five years. It has been available for free. And you know, having something without costs touches the heart of every Dutchman. In 2009, some twelve selected Leiden students were fortunate to follow special Honours Classes. With funding of some EUR 12,000 from the University of Leiden we could organise separate classes with five non-Dutch professors and judges.<sup>19</sup> It is rewarding to see some of these students, much more mature now, here this afternoon. In spreading the gospel of international insolvency law, I have been a visiting professor in e.g. Frankfurt, New York (at St. John’s) and Riga (Latvia), the last of these the Riga Graduate School of Law. In 2011, with Leiden PhD researcher Anthon Verweij, we established the Netherlands Association for Comparative and International Insolvency Law, now with over 170 members.<sup>20</sup>

To end this *selfie* of my past work, may I highlight my work with my University College London colleague Ian Fletcher, who is today celebrating its 40th wedding anniversary with his wife Letitia and therefore could not be here. After several years of work, Ian and I published in 2012 the report “Global Principles for Cooperation in International Insolvency Cases”, presented to the American Law Institute and the International Insolvency Institute (“III”).<sup>21</sup> We also wrote “Harmonization of Insolvency Law in Europe”, the 2012 report for the Dutch Association of Civil Law.<sup>22</sup> And with Professors Janis Sarra from the University of British Columbia, Vancouver, Canada, André Boraine, University of Pretoria, South Africa, Rosalind Mason, Queensland University of Technology, Brisbane, and Ray Warner, St. John’s University in New York, we introduced in 2008 a postgraduate certification programme, the INSOL International Global Insolvency Practice Course, which includes an on-line real time virtual restructuring module with courts in New York, Toronto, London and several other courts. This endgame is the great finale to this

18 B. Wessels, B. Markell and J. Kilborn, *International Cooperation in Bankruptcy and Insolvency Matters* (2009, Oxford University Press Inc., New York NY).

19 For the papers and students’ reports of discussions, see A. Verweij and B. Wessels (eds), *Comparative and International Insolvency Law. Central Themes and Thoughts* (2010, INSOL Europe, Nottingham).

20 For its activities, see: [www.nacill.org](http://www.nacill.org).

21 For the full text, see: <http://www.iiiglobal.org/component/jdownloads/finish/557/5932.htm>. Also referred to as the (June 2012) “Global Principles Report”. The Global Principles build further on the American Law Institute’s Principles of Cooperation among the member-states of the North American Free Trade Agreement (the “ALI/NAFTA Principles”). These Principles were evolved within the American Law Institute’s Transnational Insolvency Project, conducted between 1995 and 2000, for which the Reporter was Professor J. Westbrook, with the objective of providing a non-statutory basis for cooperation in international insolvency cases involving two or more of the NAFTA states, consisting of the United States, Canada and Mexico.

22 I. Fletcher and B. Wessels, *Harmonization of Insolvency Law in Europe* (Preadvies 2012 uitgebracht voor de Vereniging voor Burgerlijk Recht) (2012, Kluwer, Deventer).

learning experience, one of the Dutch INSOL Fellows, ABN Amro's Johan Jol, told me.

## **Current Research and Projects**

OK. That's the past. Turn the page. Let me make a few remarks on comparative and international research in which the Leiden Law School currently is involved. I generally explain these themes here and limit myself to three projects. One theme is for legal scholars a traditional one, it is related to substantive law. The core question is: how can we solve the conflict between principles of contract law and corporate law with evolving principles of insolvency law. It is a theme I touched upon earlier,<sup>23</sup> but this time within a research project initiated by the European Law Institute.

The other two themes, I think, are the result of a distinctively different approach to harmonisation of (substantive and procedural) laws and are looking at the organisational structure within which such laws operate. For matters of insolvency the most important actors in nearly any insolvency proceeding in Europe, more specifically the court and the insolvency office holder, have well extended roles, based on or limited to the provisions of domestic law as well as provisions in the European Insolvency Regulation. With organisational structure I mean a country's insolvency governance system in an individual case (the allocation of functions between courts and liquidators, including the legal and operational relationships between them, based on law and additional regulations) as well as a country's institutional system, merely related to the requirements to fulfil these actors' functions, including professional and ethical rules that apply to them. Where a solid contract or a smooth merger largely depends on the good work of a professional involved (a contract drafter or an M&A specialist), a successful insolvency proceeding is heavily dependent on a skilled and experienced insolvency office holder and an efficient and experienced court. Indeed, as has been submitted by Westbrook:

23 In the 5th Edwin Coe Lecture I gave in Brussels (October 2012) during the Annual Conference of the INSOL Europe Academic Forum, I submitted that with "insolvency" being one of the essential pillars upon which the internal market (in the meaning of Article 114, TFEU) rests, one presently lacks clear concepts, terms and norms as well as guiding principles. This results in the present rather fragmented and inconsistent nature of European insolvency law. The challenge is to understand and to articulate the paradigm shift in insolvency, from the sacrosanct "pay what you owe" to the balanced promotion of the continuity of businesses in distress (and reintegration of over-indebted consumers into society). Overarching and guiding principles must fit in the overall legal structure for an internal market. More specific, European insolvency law's substantial and procedural forms should be brought into alignment with norms and principles which are predominant in non-insolvency law area. See B. Wessels, "On the Future of European Insolvency Law", Chapter 11 in R. Parry (ed), *European Insolvency Law: Prospects for Reform* (2014, INSOL Europe, Nottingham).

“In the field of insolvency there are two actors whose integrity and experience are central to the functioning of the insolvency system: judges and administrators.”<sup>24</sup>

(i) *European Law Institute: Business Rescue*

First, the substantial theme. In September 2013, the European Law Institute has approved a project in the field of insolvency and company law, namely Business Rescue.<sup>25</sup> The Institute has appointed Professor Stephan Madaus (University of Halle-Wittenberg), present today, Dr. Kristin van Zwieten (from Oxford University) and myself as project reporters. The ultimate aim is to design a set of norms and requirements that will enable the further development of coherent and functional rules for business rescue in Europe. The project is to be carried out over a period of thirty months. During its first year – meaning this year 2014 – some twenty-five National Correspondents (“NCs”) will draft inventory reports on their respective national insolvency laws, based on a detailed questionnaire which has been prepared by the project reporters last month. NCs are experts from a selected group of thirteen different European countries which each represent different approaches to insolvency law. Some topics that will be covered in those reports include: the governance and supervision of in-court and out-of-court rescue, special protection for financing a rescue, treatment of executory contracts, ranking of creditors’ claims, avoidance powers, restructuring plans, special arrangements for small and medium sized enterprises (“SMEs”) and the position of turn around advisors and insolvency office holders and courts.

24 J. Westbrook *et al.*, *A Global View of Business Insolvency Systems* (2010, The World Bank, Washington DC), at 203. The view of my former Leiden Law School colleague M. Polak, now a member of the Supreme Court of the Netherlands, expressed in his valedictory lecture “*IPR-abracadabra: Internationaal privaatrecht voor tovenaars, hogepriesters en mandarijnen*” (Leiden, 2013), that the introduction of classes on International Insolvency Law, unless preceded by a thorough training in private international law, should be met with scepticism (at 11), is therefore too narrow. It is too limited also as within international insolvency “soft law” is of utmost importance, as will be explained later.

25 The European Law Institute (“ELI”) is an independent non-profit organisation established to initiate, conduct and facilitate research, make recommendations and provide practical guidance in the field of European legal development. Building on the wealth of diverse legal traditions, its mission is the quest for better law-making in Europe and the enhancement of European legal integration. By its endeavours, ELI seeks to contribute to the formation of a more vigorous European legal community, integrating the achievements of the various legal cultures, endorsing the value of comparative knowledge, and taking a genuinely pan-European perspective. As such its work covers all branches of the law: substantive and procedural; private and public. ELI is committed to the principles of comprehensiveness and collaborative working, thus striving to bridge the oft-perceived gap between the different legal cultures, between public and private law, as well as between scholarship and practice. To further that commitment it seeks to involve a diverse range of personalities, reflecting the richness of the legal traditions, legal disciplines and vocational frameworks found throughout Europe. ELI is also open to the use of different methodological approaches and to canvassing insights and perspectives from as wide an audience as possible of those who share its vision. See: [www.europeanlawinstitute.eu](http://www.europeanlawinstitute.eu).

In addition to these national reports, an inventory report on international recommendations from standard-setting organizations, such as the World Bank and UNCITRAL, will be drafted. For this work, a former Leiden Law School student, Gert-Jan Boon, has joined our team as a junior researcher. The results of the first year's work will be presented and discussed at a two day conference, which is provisionally scheduled for March 2015 in Vienna. In the later stages of the project, this output will be used by us to formulate our recommendations for harmonisation or reform, which are at this stage expected to be presented in the form of a Legislative Guide. This process will be assisted by input from a specialist Advisory Committee ("AC"), staffed by experts in relevant areas for business rescue, such as company law, labour law, securities law, competition law and accountancy.

What will be the outcome? We have just taken the first steps, so who knows. I am recalling the words of Winston Churchill, saying of politicians that they needed:

“The ability to foretell what is going to happen tomorrow, next week, next month and next year, and the ability afterwards to explain why it did not happen.”

In the beginning of my lecture, I took you back some 30-40 years. Well, compared with those times one may see the following trends:<sup>26</sup>

- business has changed; the biggest companies were manufacturers with domestic operations. Today, many of the biggest businesses are (for a large part) service companies, in the USA for instance Apple, Facebook, Google or Microsoft.<sup>27</sup> Many of the manufacturers are less dependent on hard assets, and more dependent on contracts and intellectual property as principal assets; many national legislations do not clearly provide for the treatment of such assets and affected counterparties;
- companies have changed; businesses are much more often multinational companies than thirty+ years ago, with the means of production and other operations offshore, constituting international law and choice of law

26 Compare: M. Huebner and B. Tisdell, “As the Wheel turns: New Dynamics in the Coming Restructuring Cycle” (2008/2009) *The Americas Restructuring and Insolvency Guide* 77ff; M. Gudgeon and S. Joshi, “The Restructuring and Work Out Environment in Europe”, in B. Larkin (ed), *Restructuring and Workouts: Strategies for Maximising Value* (2nd ed) (2013, Global Law Publishing London), at 7ff.; B. Wessels and R. de Weijts, “Revision of the Iconic U.S. Chapter 11: Its Global Importance and Global Feedback” (2015) *International Insolvency Law Review* 441.

27 When finalizing this text, I am reading that measured by market capitalization the largest American public companies are (in this order): Apple, Exxon Mobile, Google, Microsoft and Warren Buffett's investment conglomerate Berkshire Hathaway (The Economist, 26 April 2014), at 60.

implications. The same problems are encountered by SMEs with international markets, which in Europe may occur quite easy. Today's financial distressed debtor is likely to be a group of related, often interdependent, entities;

- the availability of capital has changed; companies had assets, which were an object of security. With the slowing down of providing credit or when credit becomes more expensive, however, debt and capital structures of most debtor companies are more complex, with multiple levels of secured and unsecured debt, often governed by equally complex inter-creditor agreements or – in Europe – with funding from private (family or crowd funded) investors;
- creditors have changed; also in Europe one sees the growth of distressed debt markets and claims trading introducing creditors with other interests in mind, such as longer term investment instead of short term liquidity; and
- finally, business environment has changed, with a growing importance of transparent rules for corporate governance, with a greater conscience for climate change, increased emphasis on human rights and desired compliance with environmental and social requirements.<sup>28</sup>

What we also see that insolvency laws have not changed, or just rather slowly.<sup>29</sup> In the USA, the original intention of Chapter 11 of the US Bankruptcy Code was the rehabilitation of businesses and the preservation of jobs and tax bases at the state, local and federal level. That intention has eroded. Presently, the emphasis is on “maximization of value” as an equal, sometimes competing or even exclusive goal, e.g. by using “fire sales” in the meaning of Section 365 of the US Bankruptcy

28 See e.g. the Equator Principles (third version, called “EPIII”), effective as at 1 January 2014. The EP form a risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects and is primarily intended to provide a minimum standard for due diligence to support responsible risk decision-making. See: [www.equator-principles.com/index.php/about-ep/about-ep](http://www.equator-principles.com/index.php/about-ep/about-ep).

29 See e.g. A. Martinez, A. Menezes and M. Uttamchandani, “Insolvency, Restructuring and Economic Development: The World Bank Group and Insolvency Systems”, in Larkin (ed.), above note 26, at 22, submitting: “Although the concept of corporate rescue as means of maximising enterprise value and preserving jobs is gaining support among industrial nations and in developing countries, many jurisdictions continue to rely on outmoded laws to address the problems of modern corporate financial distress and insolvency. ... Today's environment requires statutes that can flexibly accommodate a wide range of business solutions that make economic sense and rationalise debt to actual enterprise value. Moreover, the spreading of constituent elements on an insolvency system across numerous laws, rather than in a single code, inhibits certainty and transparency.”



Code, as was the case in Chrysler and General Motors.<sup>30</sup> Changes, however, are on the horizon.<sup>31</sup>

Europe seems more vital in re-assessing and amending its insolvency laws. Some 15 years ago, in Western Europe, when a company went bankrupt, many times the board was totally divested, meaning that all the powers were in the hands of the insolvency administrator, he or she sold all the assets and the money received was distributed to the creditors according to their rank. In 2005 Natalie Martin observed:

“Compared to U.S. bankruptcy laws, many [European] countries’ [insolvency] laws read like penal codes.”<sup>32</sup>

Professor Martin probably only analysed – with all respect – obsolete sources, as since over ten years ago, many European countries have come to understand that the existing legal framework does not meet the challenge – in the words of Professor Parry, present here today, and written one year before Martin’s article:

“...to achieve economic results that are potentially better than those that might be achieved under liquidation, by preserving and potentially improving the company’s business through rationalization.”<sup>33</sup>

In nearly all states in Europe, substantial revisions of insolvency laws have taken place or are underway. As it stands now, although even the more recent insolvency laws in several European countries continue to show substantial differences in underlying policy considerations, in structure and in content of these laws, in most of these jurisdictions there is an openness towards “corporate rescue” procedures, as an alternative to liquidation procedures, as well as a growing understanding

30 See A. Anderson and Y-Y. Ma, “Acquisitions in Bankruptcy: 363 Sales Versus Plan Sales and the Existence of Fire Sales” (2014) 22 *American Bankruptcy Institute Law Review* 1ff.

31 Since 2012, the American Bankruptcy Institute (ABI) Commission on the Reform of Chapter 11 has been studying the way Chapter 11 will be reformed. See: <http://commission.abi.org>. An international workgroup provides the Commission with reports on several topics of business financial distress in several countries, where it seems that their legislation has been inspired by “Chapter 11 as example”. Dr. Rolef de Weijts, University of Amsterdam, coordinates the work, while I chair the Committee. Countries involved in these reports are Australia, Austria, Belgium, Canada, France, Germany, Italy, Japan, Korea, the Netherlands, People’s Republic of China, Spain, England and Wales. The ABI Commission has until now (April 2014) requested comparative input on seven questions: 1. The Use of Surcharges in Sales; 2. The Treatment of IP Licenses in Insolvency; 3. Financing Options for Insolvent Companies; 4. The Role of Administrators and Monitors; 5. Plan issues: Presenting, Voting, Plans variations & Allocation Rules; 6. Creditors’ or stakeholders’ committees; 7. Claims trading. The ABI Commission is currently anticipating that the delivery of a report is in December 2014. For further information, contact Dr. Rolef de Weijts at: [chaptereleven-fdr@uva.nl](mailto:chaptereleven-fdr@uva.nl).

32 See N. Martin, “The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation” (2005) 28 *Boston College International & Comparative Law Review* 46.

33 R. Parry, “Introduction”, in K. Gromek Broc and R. Parry (eds), *Corporate Rescue. An Overview of Recent Developments from Selected Countries in Europe* (2004, Kluwer, The Hague), at 2. See also Martinez *et al.*, above note 29, at 16, submitting that specific research shows that, between 2008 and 2011, sixty reforms of insolvency systems worldwide (increasing gradually year-on-year) have/are taking place; [www.doingbusiness.org](http://www.doingbusiness.org).



to align approaches in legislation to allow for such rescues. In many of these countries the US Chapter 11 procedure has served as a model for legislators. In a recent study University of Heidelberg Professor Andreas Pieckenbrock compares the insolvency laws of England, Italy, France, Belgium, Germany and Austria. He concludes that there are five common tendencies in these rescue proceedings:

1. The board is not fully replaced by the insolvency administrator; in certain proceedings the board stays in control of the business, what we call “debtor-in-possession”;
2. Sometimes there is an earlier moment of starting a rescue process, for instance in the French *Sauvegarde*: the debtor must encounter problems that he cannot solve, which is earlier than the traditional moment that the debtor cannot pay its financial obligations when they are due;
3. In these countries, one finds a moratorium or a stay either automatic like in the *Sauvegarde* or at request (for instance the *concordato preventivo* or *réorganisation judiciaire*);
4. There are special provisions to protect fresh money available for the company while trying to work itself out of its misery; and
5. There is the possibility of a debt for equity swap, i.e. the conversion of a creditors claim into shares in the capital of the company.

Generally, as Pieckenbrock explains, such a rescue is based on the principle of a composition or an arrangement concluded between the insolvent debtor and his creditors. Such a rescue plan is binding for those creditors who voted in favour of the plan, but is also binding upon a (given percentage) of a dissenting minority of creditors (sometimes referred to as “cram-down”) or a watering down (“bail-in”) for *altgesellschafter* (existing shareholders).<sup>34</sup>

In a study of INSOL Europe on a new approach to business failure and insolvency, just published last week, the reporters (Professor Stefania Bariatti, present here today, and Robert van Galen) have studied 28 EU Member States. It is interesting to note that generally Professor Pieckenbrock’s characteristics are available in new

34 A. Pieckenbrock, “Das ESUG – fit für Europa?” *NZI* 22/2012, 906ff. By the same author, the theme has been presented in a broader context with focus on Germany, as a continuous work in progress, see A. Pieckenbrock, “Das Insolvenzrecht zu Beginn des 21. Jahrhunderts: ein Dauerbaustelle”, in W. Ebke, C. Seagon and M. Blatz (eds), *Solvvenz – Insolvenz – Resolvvenz* (2013, Nomos, Baden-Baden), at 79ff.

or renewed recovery proceedings in nearly all member states.<sup>35</sup> Several of these characteristics will challenge established theories.<sup>36</sup> Just to name a few:

- Is it necessary that a company is in “financial distress” to trigger any corporate rescue mechanism?<sup>37</sup>
- Will the Creditor’s Bargain model, which is reflected in a collective insolvency proceeding,<sup>38</sup> be substituted by a theory based on (creditors’) consensualism?<sup>39</sup>
- Can all matters be addressed by contract<sup>40</sup> or will we still need some mandatory (contract, company or insolvency) law?<sup>41</sup> Or is there another way of approaching corporate rescue by stressing the promotion of the common good, which should influence how choices should be made in the social and economic world.<sup>42</sup>
- Can “saving jobs” or “support economic growth” be a goal of insolvency law, which is rescuing a business for the benefit of creditors?<sup>43</sup>

35 For instance: debtor in possession proceedings (in certain cases supervised by an insolvency practitioner appointed by the court), a rescue plan in which creditors, sometimes even secured creditors, can be crammed down provided a certain qualified majority is reached, the ability to order a stay of the enforcement of claims, the possibility of attracting new loans, although these reporters have generally found that no super-priority was granted to new financing.

36 For an overview of issues, see e.g. S. Madaus, “Rescuing Companies involved in Insolvency Proceedings with Rescue Plans” (Report to the Netherlands Association for Comparative and International Insolvency Law 2012), available at: [www.nacil.org](http://www.nacil.org); M. Balz, “Restrukturierung in Perspective”, in W. Ebke *et al.* (eds), *Insolvenzrecht 2.020* (Deutsches, Europäisches und Vergleichendes Wirtschaftsrecht, Band 81) (2014, Nomos, Baden-Baden), at 87ff.

37 The answer starts with trying to define what “financial distress” is, see e.g. J. Wood, “Defining Corporate Failure: Addressing the ‘Financial Distress’ Concept: Part One” (2014) 27(3) *Insolvency Intelligence* 38ff.

38 See B. Wessels, “Collective insolvency proceedings: can we define what it is?”, in J. Jol *et al.*, *Herstructurering en insolventie: naar een Scheme of Arrangement?* (Zuidas Instituut voor Financieel recht en Ondernemingsrecht (ZIFO), nr. 9) (2013, Kluwer, Deventer), at 55ff.

39 See e.g. for Germany: S. Simon and C. Brünkmans, “Die Ausgliederung von sanierungswürdigen Betriebsteilen mithilfe des Insolvenzplanverfahrens nach der ESUG: Verdrängt die Glaubigerautonomie den institutionalisierten Gläubigerschutz des Umwandlungsgesetzes?” *ZIP* 2014, 657ff.

40 In this way e.g. R. Rasmussen, “Debtor’s Choice: A Menu Approach to Corporate Bankruptcy” (1992) 71 *Texas Law Review* 71ff; A. Schwartz, “A Contract Theory Approach to Business Bankruptcy” (1998) 107 *Yale Law Journal* 1807ff.

41 See e.g. R. Romano, “Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws” (1989) 89 *Columbia Law Review* 1599ff.; O. Couwenberg and S. Lubben, “Essential Corporate Bankruptcy Law” (March 2013), available at: <http://ssrn.com/abstract=2238613>.

42 For a “freaky, unorthodox and provocative” view, see A. Kammel, “Catholic Social Thought and Corporate Insolvency Law”, Chapter 1 in P. Omar (ed), *International Insolvency Law: Reforms and Challenges* (2013, Ashgate, Aldershot), 3ff.

43 For a negative answer, see T. Jackson and D. Skeel, Jr, “Bankruptcy and Economic Recovery” (Institute for Law and Economics, University of Pennsylvania Law School, Research Paper No. 13-27), available at: <http://ssrn.com/abstract=2306138>.

- How to create a transparent rescue process, with legitimate involvement of all interested parties,<sup>44</sup> including unsecured creditors and shareholders?
- If the directors of the company during a rescue process stay in control, will there be a shift in their fiduciary duties, and if so, in what way?<sup>45</sup>
- What is the ultimate justification for cram down, and therefore for a creditor-unfriendly haircut?
- Will we treat unsecured trade creditors in the same way as hedge-funds or bondholders?<sup>46</sup>
- And how to deal with so called contractual hindrance mechanisms, i.e. any sort of contractual device in the contract between the debtor and the creditor that creates a disincentive for the debtor to start a rescuing process or to file for formal insolvency?
- Will the existing shareholders be protected as if they were creditors, against dilution of their rights of shareholder?
- Will there be involvement in the process by e.g. unsecured creditors or a Workers Council?
- What is the role of the court in a pre-insolvency rescue process?

Undoubtedly, ladies and gentlemen, there will be many more of these questions, the answers to which presently up in the air. Here I am recollecting the only interesting words the unpopular US Foreign Secretary of State Rumsfeld expressed:

“As we know, there are known knowns. There are things we know we know. We also know there are known unknowns. That is to say, we know there are some things we do not know. But there are also unknown unknowns, the ones we don’t know we don’t know.”<sup>47</sup>

44 See V. Finch, “Corporate Rescue: Who is Interested?” (2012) *Journal of Business Law* 190ff.

45 A question which results from the 2012 renewal of German insolvency on business rescue, see C. Seibt and L. Westphal, “Auf dem Weg zu einem ‘Neuen Sanierungsgesellschaftsrecht’?” *ZIP* 2013, 2333ff.

46 From papers discussed in a symposium organised by the American Bankruptcy Institute in October 2013 on the theme “Hedge Funds in Bankruptcy”, it follows that hedge funds play an increasingly important and positive role in bankruptcy cases as sophisticated creditors that can work with the debtor to achieve an effective reorganization, according to the Introduction (at ii) to eight symposium papers, published in (2014) 22(1) *American Bankruptcy Institute Law Review*.

47 Department of Defense news briefing (12 February 2002). See Errol Morris’ movie “The Unknown Known”, synopsis at: [www.imdb.com/title/tt2390962/](http://www.imdb.com/title/tt2390962/).

I think the results of our work will be in the general interest of keeping “men at work” and capital or technology in a business intact. In a way corporate rescue is an art of the possible and, sometimes, the improbable. It is a unique art-form that does however not glitter and sparkle without the skill, dedication and hard work of advisors and courts involved, as well as lenders and creditors. In some five years from now, for legal matters in the vicinity of insolvency, you may however come the conclusion: he was a fine professor, but on this subject he was led by a donkey.<sup>48</sup>

(ii) *INSOL Europe: Insolvency Office Holders’ Professional Principles*

As previously said, in insolvency matters, there is in many countries a central role for the insolvency administrator. In mid-2012, we started research into the possibilities for the development of a set of principles and best practices for insolvency office holders, or insolvency administrators, what the Dutch call *faillissementscuratoren*. Not in all countries professional and ethical regulation of the role and tasks of these persons is well developed and I believe that an insolvency office holder requires certain specific qualities and skills.

In our harmonisation report of 2012, Fletcher and I adhere to a vision which was already expressed over thirty years ago in the Cork Report, the basis for England’s Insolvency Act 1986. It said:

48 On 12 March 2014, the European Commission presented a Recommendation “on a new approach to business failure and insolvency”. From the press release, it can be taken that the objective of the Recommendation is to shift the focus away from liquidation towards encouraging viable businesses to restructure at an early stage so as to prevent insolvency. With around 200,000 businesses across the EU facing insolvency and 1.7 million people losing their jobs each year as a result, the Commission wants to give viable enterprises the opportunity to restructure and stay in business. The chosen method is to reform national insolvency legislation with the aim to assist viable firms in business and safeguard jobs and at the same time improve the environment for creditors who will be able to recover a higher proportion of their investment than if the debtor had gone in formal insolvency. The Recommendation adopted on 12 March 2014 follows a public consultation last year on a European approach to insolvency. The Recommendation has 20 recitals and 36 recommendations. Within 12 months Member States are invited to implement the Recommendation’s “principles” and therefore to:

1. Facilitate the restructuring of businesses in financial difficulties at an early stage, before starting formal insolvency proceedings, and without lengthy or costly procedures to help limit recourse to liquidation;
2. Allow debtors to restructure their business without needing to formally open court proceedings;
3. Give businesses in financial difficulties the possibility to request a temporary stay of up to four months (renewable up to a maximum of 12 months) to adopt a restructuring plan before creditors can launch enforcement proceedings against them;
4. Facilitate the process for adopting a restructuring plan, keeping in mind the interests of both debtors and creditors, with a view to increasing the chances of rescuing viable businesses;
5. Reduce the negative effects of a bankruptcy on entrepreneurs’ future chances of launching a business, in particular by discharging their debts within a maximum of three years.

Eighteen months after adoption of the Recommendation the Commission will assess the state of play, based on the yearly reports of the Member States to evaluate whether further measures to strengthen the ‘horizontal approach’. See for the EC Recommendation: [http://ec.europa.eu/justice/newsroom/civil/news/140312\\_en.htm](http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm). In the planned later phase of the ELI Business rescue project, it is envisaged to take into account the Recommendation (and its findings) within the Reporters’ deliberations.

“The success of any insolvency system... is very largely dependent upon those who administer it. If they do not have the confidence and respect, not only of the courts and of the creditors and debtors, but also of the general public, then complaints will multiply and, if remedial action is not taken, the system will fall into disrepute and disuse.”<sup>49</sup>

It is, however, not only the creditors’ confidence. Ian Fletcher and I submitted in said report that it is also the trust the market puts in the insolvency office holders’ actions, which may translate in her/his ability to exercise a transparent process, for instance for unsecured creditors to be informed in a clear way about any process and to be able to influence any administration, to understand the way the profession is regulated, which would include a mechanism to maintain trust in any regulatory regime, such as a post-action review or a complaints procedure.<sup>50</sup>

The largest European insolvency practitioners association, INSOL Europe,<sup>51</sup> has commissioned a project to the Leiden Law School that envisages the design of Principles and Best Practices for Insolvency Office Holders (“IOHs”). The project is led by my colleagues Professors Jan Adriaanse and Iris Wuisman and is coordinated by Dr. Bernard Santen, all present here today. The research involved should lead to the establishment of a certain minimum level of trust for the general public, courts and other IOHs – nationally and internationally – in the way an IOH administers insolvency cases. With the outstanding assistance of Leiden master students, a framework of professional characteristics and requirements has been developed. The result has been discussed with an Academic Advisory Committee and a Project Review and Advisory Group. The related report has been presented to INSOL Europe in September 2013. In an additional report the framework is used to further analyse the existing rules for IOHs in some ten European countries, including several eastern-European countries. The analysis was ready early this year and the first draft text of the Principles and Best Practices for IOHs will be discussed with the Review & Advisory Group soon.

49 Cork Report, *Insolvency Law and Practice – Report of the Review Committee* (Chairman, Sir Kenneth Cork) (June 1982, Cmnd. 8558), at paragraph 732. This highly influential report, produced between 1976 and 1982, formed the basis for the reform of insolvency law in the UK, centred on the Insolvency Act 1986. See I. Fletcher, *The Law of Insolvency* (4th ed) (2009, OUP, Oxford) with Supplement (2011), at paragraphs 1-027ff.

50 Fletcher and Wessels, above note 22, at 82ff.

51 INSOL Europe is the European organisation of professionals who specialise in insolvency, bankruptcy and business reconstruction and recovery. It has around 1200 members. Its mission is to take and maintain a leading role in European business recovery, turnaround and insolvency issues, to facilitate the exchange of information and ideas amongst its members and to discuss business recovery, turnaround and insolvency issues with official European and other international bodies who are affected by those procedures. The association will encourage greater international co-operation and communication within Europe and also with the rest of the world. See: [www.insol-europe.org](http://www.insol-europe.org).

The IOH project organisation includes a group of some twenty professors and practitioners, mainly from Europe. They represent many legal cultures and provide scholarly input as well as insights from experienced practice. In several Member States I think that the IOH profession is ready for a big step forward towards serious improvement of its know-how and skills which should lead towards a mature professional organization. This is the more necessary where in several countries insolvency office holders are involved in pre-insolvency proceedings, such as pre-packs or what the Dutch call restart via silent administration (*doorstart via stille bewindvoering*). Both in in-court and out-of court work creditors and the public in general must be able to trust an IOH to be independent in his work, free of conflicts of interest. The principles and best practices might increase public confidence in IOHs, their work quality, and in the way they are monitored and supervised.

Personally, I find it interesting and rewarding to work to enhance the confidence in professional role players in insolvency cases and welcome the debate of the present and future rules for IOHs on a European level.<sup>52</sup>

*(iii) European Commission and International Insolvency Institute: EU Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines*

This brings me to the WhatsApp of the third and last topic, our research relating to the promotion and harmonizing of judicial cooperation, so cooperation between courts in different Member States, in cross-border insolvency cases. We call it the JudgeCo project in which we draft EU Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines. The project, jointly developed by

52 The importance of the rescue culture demand new know how and new certain skills (and a robust professional code) for insolvency practitioners, see F. Kekebus, “Thesen zur deutschen ‘Insolvenzszene 2020’”, in Ebke *et al.* (eds), above note 36, at 111ff. See also my editorial “Changing Rules: Challenges for the Profession” (2010) 2 *European Company Law* 7, from which I take: “With all these sweeping reforms, the question forces itself upon us: are insolvency professionals equipped to act and implement the rules, according to its underlying policies? A famous saying in the English Cork Report (1982) is that the success of any insolvency system is very largely dependent upon those who administer it. In Europe, insolvency practitioners can be very different animals, with a variety of cultural and professional background, and large differences in legal and disciplinary rules regarding fairness to all interests involved and accountability. They are accountants, lawyers, corporate recovery specialists and turn around professionals. What these substantial reforms ... demonstrate is that it is at least necessary to develop a much broader expertise in matters of insolvency law, company law or general contract law and also to develop know how concerning such matters as financial restructuring, accounting, tax, strategy and communication. An (insolvency) practitioner with this skill set seems the ideal candidate for the recovery of a company in the “twilight” zone. A key point in any system should be that an insolvency practitioner is receiving the confidence and respect from all stakeholders. Without that, any system is due to fail. Therefore, changes in substantial rules, including rules or practices in pre-insolvency stages are just as many challenges for any practitioner to keep pace with these developments. Turbulent times with restless rules require solid and qualified professionals.” Law Schools would be better off starting to think now how to best educate in this area of consensual out-of-court restructuring, leading to a multiparty agreement, with a good understanding what all interested parties wish to gain and to have them understand that they need to give in (stakeholder management) and to convince holding out creditors to come to unanimity (understanding “hold out” or “nuisance value”) in the absence of in-court or court-imposed binding decisions.

Leiden Law School and the Nottingham Law School, is funded by the European Commission and the International Insolvency Institute (III).<sup>53</sup> For the Commission, the research fits in the EU's project in the 'Civil Justice' Programme in order to contribute to the strengthening of the area of Freedom, Security and Justice in Europe.<sup>54</sup>

After a nine month period of study and consultation with a Review & Advisory Group, consisting of over forty academics and practitioners, including some twenty judges, we published in March 2014 the First Public Draft of the EU Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines. These principles and guidelines will be non-binding, to be applied in cross-border communication and cooperation in insolvency cases between courts within the European Union. These Principles and Guidelines will further develop court-to-court communication and coordination matters.

The need for this development within the context of the European Union is clear: presently there have been several instances of cross-border judicial cooperation, without any clear guidance on how to set up and conduct cross-border cooperation and how to take into account parties' legitimate interests. Examples are the *BenQ* case, the *PIN AG* case, a case mentioned by one of our experts (court-to-court communication between Luxembourg and Hungary) or in the matter of *Lehman Brothers*. Furthermore, the December 2012 proposal of the European Commission for an amendment of the European Insolvency Regulation is emphasising court-to-court cooperation and calls for a more concrete approach to judicial cross-border cooperation. Our project runs for two years, ending this calendar year. In the fourth quarter of this year, Professor Paul Omar and I will provide in two or three cities in Europe training for some sixty judges in working with these non-binding legal texts.<sup>55</sup>

53 The International Insolvency Institute ("III") is a non-profit, limited-membership organization (around 300 members worldwide) dedicated to advancing and promoting insolvency as a respected discipline in the international field. Its primary objectives include improving international co-operation in the insolvency area and achieving greater co-ordination among nations in multinational business reorganizations and restructurings. See: [www.iiiglobal.org](http://www.iiiglobal.org).

54 The so-called Stockholm programme. On 11 March 2014, the European Commission presented its vision for the future EU justice policy until 2020, as a logical successor to the European Council's Stockholm Programme which ends in December 2014. In its Press Release "Towards a True European Area of Justice: Strengthening Trust, Mobility and Growth", the Commission identifies three key challenges. See the Communication on the EU Justice Agenda for 2020 – Strengthening Trust, Mobility and Growth within the Union (COM [2014] 144 final of 11 March 2014; [http://ec.europa.eu/justice/effective-justice/files/com\\_2014\\_144\\_en.pdf](http://ec.europa.eu/justice/effective-justice/files/com_2014_144_en.pdf)). The Communication also sets the tone for the preferred approach to "insolvency". See my blog at: <http://bobwessels.nl/?s=justice+agenda>.

55 The Principles are 26 in number, contained in a document of (at present) some 65 pages. The Guidelines contain 18 Guidelines; in all, a document of some 25 pages. If you are interested, you can provide observations and comments on our website at: [www.tri-leiden.eu](http://www.tri-leiden.eu).

Evidently, our proposals have been greatly influenced by the responses received from the Review & Advisory group to two questionnaires, received in July and in October 2013. The questionnaires contain a selection of the (June 2012) Global Principles mentioned earlier. The chosen method to develop the *EU Cross-Border Insolvency Court-to-Court Cooperation Principles and Guidelines* has been a systematic evaluation of the possibility of adapting the June 2012 Global Principles<sup>56</sup> into an EU context, as the project's ultimate aim is to provide a standard (legally non-binding) statement of Principles and Guidelines suitable for application within the framework of the European Insolvency Regulation. This specific EU context is generally reflected in six areas:

- consistency with international norms;
- goals of the EU;
- the existence of national procedural law;
- the existing European Insolvency Regulation;
- ongoing case law; and
- developments within the EU legislature and the European Judicial Community.

#### Consistency with International Norms

Consistency with available international norms is of utmost importance, as Björn Laukemann has argued recently, referring to the 2012 Harmonisation report of Fletcher and me, submitting that consistency with international norms and EU Principles as well as a fair balance between diverging interests among creditors or between a sufficient degree of legal certainty and regulatory flexibility within an economic context doubtlessly provide significant direction for further harmonisation approaches.<sup>57</sup> During the development of the Global Principles many of the publications related to “insolvency”, by such organisations as UNCITRAL, EBRD, the World Bank and INSOL Europe have been taken into account.<sup>58</sup> It has been an integral part of the evaluation to identify core values and principles that respondents to two questionnaires (sent out during 2013) are aware of and which they feel should be considered in the evaluation of the present texts or in a proposal for a revised or a new “Principle” or “Guideline”. Such

56 For the method adopted, see the Global Principles Report, above note 21, at paragraph 1.4.2.

57 B. Laukemann, “Structural Aspects of Harmonization in European Insolvency Law”, in Collective (eds), *Le Temps et le Droit: Hommage au Professeur Closset-Marchal* (2013, Bruylant, Brussels), at 358.

58 For some ten sources, see the Global Principles Report, above note 21, at 22.



consistency should enhance certainty in European insolvency practice and stability in the furthering of the EU JudgeCo Principles and Guidelines.<sup>59</sup>

### Goals of the EU: Judicial Cooperation

Within the EU, the theme of cross-border judicial communication and cooperation has been developed within the area of “Freedom, Security and Justice”. This requires a proper functioning of the internal market on the basis that cross-border insolvency proceedings should operate efficiently and effectively resulting in the goal that the Principles and the Guidelines should be efficient and effective, whilst actively aiming at the strengthening of confidence in the functioning of the European judicial area. This is a challenge as it is acknowledged by several respondents in the JudgeCo project that in some Member States the quality of judges is mediocre, the court’s infrastructure and available means are poor, the knowledge of the European Insolvency Regulation is insufficiently developed, the experience to deal with international insolvency cases or the mastering of a second language (for instance English, German or French) is lacking,<sup>60</sup> whilst the awareness of the impact of international business is not often understood.<sup>61</sup>

### Existence of National Procedural Law

Article 81, paragraph 2, of the Treaty on the Functioning of the EU (“TFEU”) provides that in developing judicial cooperation in civil matters having cross-border implications, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt measures, particularly when necessary for the proper functioning of the internal market, aimed at ensuring:

“...(f) the elimination of obstacles to the proper functioning of civil proceedings, if necessary by promoting the compatibility of the rules on civil procedure applicable in the Member States.”

Several of the Global Principles aim to set non-binding rules related to matters regarding businesses that in many EU Member States form an integral part of national procedural law, many times in domestic legislation regarding civil

59 Ibid., at 55, where it is furthermore explained that it has benefited from the experiences gained in (non-insolvency related) cross-border activities in the area of law and the recommendations made by judges and experts in some fifty jurisdictions, as well as the materials that have led to the “Principles for Direct Judicial Communications in Specific Cases including Commonly Accepted Safeguards”, included in Direct Judicial Communications, an emerging guidance from the Hague Conference on Private International Law (2013).

60 In general on this subject: A. Sadler, “Practical Obstacles in Cross-border Litigation and Communication Between (EU) Courts” (2012) 5(3) *Erasmus Law Review* 151.

61 It should be added that several respondents have also criticized the quality of persons acting in a role as insolvency office holder, their understanding of the European Insolvency Regulation, their lack of expertise and poor quality to deal with foreign insolvency office holders and/or courts.

procedure or insolvency procedural rules. In legal literature, however, it is questioned whether Article 81(2)(f) of the TFEU may form the basis for an alignment of the civil procedural rules of the Member States irrespective of the national or international character of the litigation at hand.<sup>62</sup> Where many of these rules not only apply to businesses, but also to natural persons (consumers), the respondents to the survey have been asked to take this observation into account.

### The Existing European Insolvency Regulation

The European Insolvency Regulation is binding in its entirety and directly applicable in the Member States in accordance with the Treaty establishing the European Union (see Article 47 of the EIR). It is therefore nonsensical to test the possible application of Global Principles that would contradict the mandatory, binding rules contained in the Regulation or those matters that clearly belong to the national domain of local procedural or insolvency law of the Member States. For this reason, out of the 37 Global Guidelines, 10 have been analysed and selected that would most certainly be against the text of the EIR or domestic law. These are Global Principles 7 (Recognition), 12 (Adjustment of Distributions), 13 (International Jurisdiction), 14 (Alternative Jurisdiction), 24 (Control of Assets), 26 (Cooperation), 32 (Avoidance Actions), 33 (Information Exchange), 34 (Claims) and 35 (Limits on Priorities). These Global Principles were left out of further study and research.

### Ongoing Case Law

New case law applying the European Insolvency Regulation or judgments from national (higher) courts have also been taken into account. An example is provided by the judgment of 22 November 2012 of the Court of Justice of the European Union in the matter of *Bank Handlowy w Warszawie SA, PPHU 'ADAX'/Ryszard Adamiak, V Christianapol sp. z o.o.* (Case C-116/11). Following the approval of a rescue plan (*procédure de sauvegarde*) by the French court in Meaux, the Polish court:

“...asked the Tribunal de commerce de Meaux whether the insolvency proceedings in France, which were main proceedings for the purposes

62 For this view, see C. van Ree, “Harmonisation of Civil Procedure: An Historical and Comparative Perspective”, Chapter 3 in X. Kramer and C. van Ree (eds), *Civil Litigation in a Globalised World* (2012, TMC Asser Press, The Hague), at 39ff., submitting that business will regard these as obstacles in their decisions where to produce, market or sell their products and services. Strong support for the view that differences in national procedural rules function as trade obstacles can be found by Hon. J. Spigelman, who retired in 2010 as Chief Justice of New South Wales, Australia, in his articles: “Transaction Costs and International Litigation” (2006) 80 *Australian Law Journal* 438ff; J. Spigelman, “Cross-Border Insolvency: Co-operation or Conflict?” (2009) 83 *Australian Law Journal* 44ff.

of the Regulation, were still pending. The answer given by the French court did not provide the necessary clarification. The referring court then consulted an expert.”

The Polish court (*Sad Rejonowy Poznań-Stare Miasto w Poznaniu*) then decided to stay the proceedings pending before it and to refer questions to the Court of Justice of the EU for a preliminary ruling, which led to the judgment that Article 27 of the EIR must be interpreted as meaning that it permits the opening of secondary insolvency proceedings in the Member State in which the debtor has an establishment, where the main proceedings have a protective purpose:

“...It is for the court having jurisdiction to open secondary proceedings to have regard to the objectives of the main proceedings and to take account of the scheme of the Regulation, in keeping with the principle of sincere cooperation.”<sup>63</sup>

Therefore, the principle of sincere cooperation laid down in Article 4(3) of the EU Treaty requires the court having jurisdiction to open secondary proceedings to address the challenge:

- (i) to have regard to the objectives of the main insolvency proceedings; and
- (ii) to take account of the scheme of the Regulation, which aims to ensure efficient and effective cross-border insolvency proceedings through mandatory coordination of the main and secondary proceedings guaranteeing the priority of the main proceedings.

The introduction to the EU JudgeCo Guidelines only signals the challenge for such a court to communicate with the liquidator in the main proceedings and to ensure

63 From the Court’s arguments:

“59 As observed by the referring court, the fact remains that the opening of secondary proceedings, which, under Article 3(3) of the Regulation, must be winding-up proceedings, risks running counter to the purpose served by main proceedings, which are of a protective nature.

60 It should be noted that the Regulation provides for a certain number of mandatory rules of coordination intended to ensure, as expressed in recital 12 in the preamble thereto, the need for unity in the Community. In that system, the main proceedings have a dominant role in relation to the secondary proceedings, as stated in recital 20 in the preamble to the Regulation.

61 The liquidator in the main proceedings thus has certain prerogatives at his disposal which allow him to influence the secondary proceedings in such a way that the protective purpose of the main proceedings is not jeopardised. (...)

62 The principle of sincere cooperation laid down in Article 4(3) EU requires the court having jurisdiction to open secondary proceedings, in applying those provisions, to have regard to the objectives of the main proceedings and to take account of the scheme of the Regulation, which... aims to ensure efficient and effective cross-border insolvency proceedings through mandatory coordination of the main and secondary proceedings guaranteeing the priority of the main proceedings.”

that he will cooperate. The challenge resulting from the judgment for cross-border court-to-court cooperation is addressed in the JudgeCo Principles.<sup>64</sup>

### Developments within the EU Legislature and the European Judicial Community

On 12 December 2012, the European Commission published a Proposal for a Regulation amending the European Insolvency Regulation,<sup>65</sup> which includes a Report on the application of the EIR.<sup>66</sup> This latter Application Report summarises experiences reported by all Member States in the course of 2012, and provides:

“... The duties to cooperate and communicate information under Article 31 of the Regulation are rather vague. The Regulation does not provide for cooperation duties between courts or liquidators and courts. There are examples where courts or liquidators did not sufficiently act in a cooperative manner. These findings are confirmed by the results of the public consultation where 48% of the respondents were dissatisfied with the coordination between main and secondary proceedings.”<sup>67</sup>

In the Proposal itself, in Recital 20 to the EIR, it is expressed that main insolvency proceedings and secondary proceedings can only contribute to the effective realisation of the total assets if all the concurrent proceedings pending are coordinated. Then follows (the words underlined are new in comparison to the existing text):

“(20) ... The main condition here is that the various liquidators and the courts involved must cooperate closely, in particular by exchanging a sufficient amount of information. In order to ensure the dominant role of the main proceedings, the liquidator in such proceedings should be given several possibilities for intervening in secondary insolvency proceedings which are pending at the same time. In particular, the liquidator should be able to propose a restructuring plan or composition or apply for a suspension of the realisation of the assets in the secondary insolvency proceedings.”

64 The JudgeCo project has taken into account developments in applying Article 31, EIR in court cases, the use of the CoCo Guidelines, scholarly literature regarding ‘liquidator-to-liquidator’ communication and cooperation and initiatives to harmonise professional and ethical requirements for insolvency office holders. In the JudgeCo project, however, only those matters which have a bearing on court-to-court cooperation can be taken into account. The EU JudgeCo Guidelines relate to court-to-court cooperation; they do not address cross-border cooperation between courts and liquidators.

65 COM(2012) 744. See: [http://ec.europa.eu/justice/civil/commercial/insolvency/index\\_en.htm](http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm).

66 COM(2012) 743.

67 *Ibid.*, at 14.

The Proposal is infused by the strengthening of the paradigm of communication and cooperation in cross-border cases. Examples are an extended draft Article 31 (Cooperation and communication between liquidators),<sup>68</sup> a new Article 31a (Cooperation and communication between courts),<sup>69</sup> and a new Article 31b (Cooperation and communication between liquidators and courts).<sup>70</sup> Articles 31 and 31a explicitly provide that cross-border cooperation between liquidators may take the form of an agreement or a protocol, whilst cooperation between courts

68 Extended Article 31 - Cooperation and communication between liquidators:

- “1. The liquidator in the main proceedings and the liquidators in the secondary proceedings shall cooperate with each other to the extent such cooperation is not incompatible with the rules applicable to each of the proceedings. Such cooperation may take the form of agreements or protocols.
2. In particular, the liquidators shall:
- (a) immediately communicate to each other any information which may be relevant to the other proceedings, in particular any progress made in lodging and verifying claims and all measures aimed at rescuing or restructuring the debtor or at terminating the proceedings, provided appropriate arrangements are made to protect confidential information;
  - (b) explore the possibility of restructuring the debtor and, where such possibility exists, coordinate the elaboration and implementation of a restructuring plan;
  - (c) coordinate the administration of the realisation or use of the debtor’s assets and affairs; the liquidator in the secondary proceedings shall give the liquidator in the main proceedings an early opportunity to submit proposals on the realisation or use of the assets in the secondary proceedings.”

69 New Article 31a - Cooperation and communication between courts:

- “1. In order to facilitate the coordination of main and secondary insolvency proceedings concerning the same debtor, a court before which a request to open insolvency proceedings is pending or which has opened such proceedings shall cooperate with any other court before which insolvency proceedings are pending or which has opened such proceedings to the extent such cooperation is not incompatible with the rules applicable to each of the proceedings. For this purpose, the courts may, where appropriate, appoint a person or body acting on its instructions.
2. The courts referred to in paragraph 1 may communicate directly with, or to request information or assistance directly from each other provided that such communication is free of charge and respects the procedural rights of the parties to the proceedings and the confidentiality of information.
3. Cooperation may be implemented by any appropriate means, including
- (a) communication of information by any means considered appropriate by the court;
  - (b) coordination of the administration and supervision of the debtor’s assets and affairs;
  - (c) coordination of the conduct of hearings;
  - (d) coordination in the approval of protocols.”

70 New Article 31b - Cooperation and communication between liquidators and courts:

- “1. In order to facilitate the coordination of main and secondary insolvency proceedings opened with respect to the same debtor,
- (a) a liquidator in main proceedings shall cooperate and communicate with any court before which a request to open secondary proceedings is pending or which has opened such proceedings and
  - (b) a liquidator in secondary or territorial insolvency proceedings shall cooperate and communicate with the court before which a request to open main proceedings is pending or which has opened such proceedings,
2. The cooperation referred to in paragraph 1 shall be implemented by any appropriate means including the means set out in Article 31a (3) to the extent these are not incompatible with the rules applicable to each of the proceedings.”

could include in the approval of protocols.<sup>71</sup> Finally, in a new Recital 20a, it is stressed that the amended European Insolvency Regulation should ensure the efficient administration of insolvency proceedings relating to different companies forming part of a group of companies. Where insolvency proceedings have been opened for several companies of the same group, these proceedings should be properly coordinated and the various liquidators and courts concerned are under the same obligation to cooperate and communicate with each other as those involved in main and secondary proceedings relating to the same debtor (Article 42b of the Proposal). In the Proposal, the final sentence of Recital 20 reads as follows:

“In their cooperation, liquidators and courts should take into account best practices for cooperation in cross-border insolvency cases as set out in principles and guidelines on communication and cooperation adopted by European and international associations active in the area of insolvency law.”<sup>72</sup>

- 71 There is an upcoming tendency to use protocols, in short: agreements between appointed insolvency officeholders to communicate and coordinate parallel pending insolvency proceedings, including group insolvencies. A cross-border agreement in international insolvency cases is “... an agreement entered into, either orally or in writing, intended to facilitate the coordination of cross-border insolvency proceedings and cooperation between the courts, between the courts and insolvency representatives and between insolvency representatives, sometimes also involving other parties in interest.” The quoted description is taken from the Practice Guide on Cross-Border Insolvency Cooperation, which was adopted on 1 July 2009 by the United Nations Committee on International Trade Law (“UNCITRAL”). See Bob Wessels, “Cross-border Insolvency Agreements: What are they and are they here to stay?”, in N. Faber, J. van Hees and N. Vermunt, *Overeenkomsten en insolventie* (Serie Onderneming en Recht, deel 72) (2012, Kluwer, Deventer), at 359ff; M. Becker, *Kooperationspflichten in der Konzerninsolvenz* (2012, RWS Verlag Kommunikationsforum GmbH, Köln), at 109ff. Obvious questions for further research include: (i) Which law governs the protocol? Is Regulation no 593/2008 on the law applicable to contractual obligations (Rome I) applicable? Do parties have the freedom to choose applicable law? How does that relate to mandatory rules for instance on transparency of proceedings, protecting rights of creditors or a stay of proceedings?; (ii) What is the legal character of a protocol? Is it substantial and/or procedural; a mix of private law and public law; can it bind courts?; (iii) Protocol-parties: do all parties in an insolvency proceeding have permission to agree on a protocol? Must a court approve that an insolvency office holder will be bound by a protocol? What if this permission misses? What are the consequences of not using a protocol?; (iv) Treatment of creditors: does the protocol, agreed between insolvency office holders and approved by courts ‘bind’ creditors? Do they still have additional rights? What is the effect on third parties? What if creditors aren’t pleased with the use or the content of a protocol?; (v) Could these protocols include mediation and arbitration provisions and is not it time to start thinking about the establish a global “mediation and arbitration institute in matters of rescue and insolvency”? See e.g. A. Gropper, “The Arbitration of Cross-Border Insolvencies” (2012) 86 *American Bankruptcy Law Journal* 201ff.; E. Sussman and J. Gorski, “Capturing the Benefits of Arbitration for Cross Border Insolvency Disputes”, in A. Rovine (ed), *Contemporary Issues in International Arbitration and Mediation* (2013, Martinus Nijhoff Publishers, Leiden), at 158ff. On mediation, see Hon. J. Peck, “Settlement Talks in Chapter 11 After “WaMu”: A Plan Mediator’s Perspective” (2014) 22(1) *American Bankruptcy Institute Law Review* 65ff.
- 72 On 5 February 2014, the European Parliament (ordinary legislative procedure: first reading) adopted the ‘European Parliament legislative resolution of 5 February 2014 on the proposal for a regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (COM(2012)0744 – C7 0413/2012 – 2012/0360(COD))’. Compared to the European Commission’s December 2012 proposal, there are quite some differences. Over 60 amendments to the Commission’s proposal have been made; the European Parliament supports the suggested extension to the system of cross-border communication and cooperation.

In the light of these developments, it has been submitted that, within the EU, there is an open attitude towards “best practices” such as those under review in the JudgeCo project. Indeed, an endorsement to take into account the Global Principles follows from Commission Staff Working Document, where it is stated:

“In order to ensure the coordination of proceedings opened in several Member States, the Regulation obliges insolvency practitioners to communicate information and cooperate with each other. Several guidelines for practitioners on cooperation and communication in cross-border insolvencies have been developed by associations of practitioners [51].”<sup>73</sup>

These developments have led to the question to the respondents in the JudgeCo project to allow themselves a forward-looking vision anticipating the challenges the judiciary in general faces.

By applying the six elements as set out above, the EU JudgeCo Principles – although being a non-binding statement – are in line with the European context as set out and with international developments and other attempts at developing modes of international cooperation in the area of international insolvency. So what, you may think, this is all non-binding soft law! I respectfully disagree. A strong signal of the practical use and guidance the 2012 Global Principles provide has been given by the Supreme Court of the United Kingdom, that supported its arguments on:

“...the modern approach in the primary international and regional instruments, the EC Insolvency Regulation on Insolvency Proceedings ... and the Model Law, which is that the jurisdiction with international competence is that of the country of the centre of main interests of the debtor (an expression not without its own difficulties).”<sup>74</sup>

The court then went on to say:

“It is ultimately derived from the civil law concept of a trader’s domicile, and was adopted in substance in the draft EEC Convention of 1980 as a definition of the debtor’s centre of administration: see ... American Law Institute, *Transnational Insolvency: Global Principles*

73 Impact Assessment, SWD(2012) 416 final, at 24. Footnote [51] reads: “The most recent example are the Global Principles for Cooperation in international insolvency cases from the American Law Institute and the International Insolvency Institute, elaborated by Ian Fletcher and Bob Wessels (2012).”

74 *Conjoined Appeals in (1) Rubin & Anor v Eurofinance SA & Ors and (2) New Cap Reinsurance Corp Ltd & Anor v Grant and others*) [2012] UKSC 46, at paragraph 24.

for Co-operation in International Insolvency Cases (2012), Principle 13, pp 83 et seq.<sup>75</sup>

The Global Principles have also contributed to the development of American law. The United States Court of Appeals for the Third Circuit (in *Re ABC Learning Centres*) on 23 August 2013 has made references to Global Principle 1, and cites that it elaborates:

“the overriding objective [is to] enable courts and insolvency administrators to operate effectively and efficiently in international insolvency cases with the goals of maximizing the value of the debtor’s global assets, preserving where appropriate the debtors’ business, and furthering the just administration of the proceeding.”

Another part of the Global Principles report is cited too:

“[T]he emphasis must be on ensuring that the insolvency administrator, appointed in that proceeding, is accorded every possible assistance to take control of all assets of the debtor that are located in other jurisdictions. Id. at cmt. to Global Principle 24.”<sup>76</sup>

These court cases demonstrate the usefulness of soft law, providing not only food for thought but also guidance for courts. Unrelated to insolvency, in its method and result I regard the JudgeCo project as an instrument of choice in solving international commercial disputes in which a new concept of “judicial comity” is evolving, providing a framework of ground-rules for establishing and developing

75 Idem.

76 U.S. Court of Appeals for the Third Circuit (in *re ABC Learning Centres Ltd.*, No. 12-2808 (3rd Cir. 2013)). In the commentaries by C. LaChance, “Third Circuit Holds Chapter 15 Relief Extends to Assets Managed by Australian Receivership” *ABI Journal* (November 2013) 55ff; M. Zerjal, “ABC Learning: The ABC of Chapter 15 is to Rely on Its Plain Meaning” (2014) *International Corporate Rescue* 37ff, the unique inclusion of soft law into a judicial decision remains unnoticed. In general, soft law does not do well before courts, see J. Klabbbers, “The Undesirability of Soft Law” (1998) 67 *Nordic Journal of International Law* 381ff, although from a recent study – in competition law – it follows that the EU Court is open to “soft instruments of governance”, see O. Stefan, “Soft Law in Court: Competition Law, State Aid and the Court of Justice of the European Union: An Introduction” (2013), available at: <http://ssrn.com/abstract=2356227>.



judicial dialogue both in a general context and in relation to a specific case.<sup>77</sup> In the light of history in England & Wales, cooperation between judges and academics as we have experienced in the JudgeCo project is truly remarkable.<sup>78</sup>

Ladies and gentlemen, last Friday Sierd Schaafsma gave his inaugural lecture as a Professor of Private International Law.<sup>79</sup> Professor Schaafsma submitted that a faster and direct cross-border information exchange between judges would facilitate and improve the application of foreign law by courts.<sup>80</sup> I invite Sierd to test whether our JudgeCo principles could serve as such an enabling instrument, and, if necessary, suggest improvements to us.

## Unique Research

I will wrap up now. Again I am in a convent, the function of this Academy Building prior to 1581, this time talking about challenges and opportunities in academic research. Our research is unique in that it is distinctive in four ways: it is (in its method or application) cross-border, it is supported and reviewed by large groups of experienced experts from all over the globe, it focuses on the forefront of legal

77 As set out in the Global Principles Report, above note 21. According to Slaughter, judicial comity has four strands: (i) respect for a foreign court in its ability to apply the law honestly and competently; (ii) the entitlement, in the global task of judging foreign courts, to adjudicate those matters where local interests are closely involved; (iii) the strong judicial role in protecting individual rights; and (iv) a greater willingness to clash with other courts when necessary: “as an inherent part of engaging as equals in a common judicial enterprise”: A. Slaughter, “A Global Community of Courts” (2003) 44 *Harvard International Law Journal* 191, at 206. See also the Global Principles Report, above note 21, at 38ff. For various ways of judicial cooperation, see M. Bronkers, “The Relationship of the EC Courts with Other International Tribunals: Non-committal, Respectful or Submissive?” (2007) 44 *Common Market Law Review* 601; C. Timmermans, “Voorrang van het Unierecht door multilevel rechterlijke samenwerking” (2012-2) *Sociaal-Economische Wetgeving* 50ff; P. Koskelo, “The Need for a Common Judicial Culture in Europe – a Matter for Judges and Lawyers” (Address to the IBA Northern Europe Conference, Helsinki 3-4 September 2009), available at: [www.kko.fi/47788.htm](http://www.kko.fi/47788.htm).

78 See Lord Neuberger of Abbotsbury, “Judges and Professors – Ships Passing in the Night?” (2013) 77 *Rebels Zeitschrift für ausländisches und internationales Privatrecht* 233ff.

79 S. Schaafsma, “*IPR en EPR, Over wisselwerking, eenheid en verscheidenheid*” (Leiden 2014).

80 *Ibid.*, at 5.

developments in creating new “law”<sup>81</sup> and, last but not least, selected students are involved in its development.

The involvement of Leiden masters students in these projects will greatly enhance their knowledge and more generally will prepare them much better for legal practice. The research involves in depth analysis of specific topics, such as the position of unsecured creditors in over ten EU Member States, the influence of “insolvency” on the rights of shareholders to convene a meeting, to vote on matters unrelated to the assets, the independency of a judge, the integrity of an insolvency administrator,<sup>82</sup> the efficiency and effectiveness of legal proceedings or the concept of conflicts of interests. These latter topics are themes of utmost importance in nearly every legal job. Also a close involvement in creating non-binding rules and the importance of its effect for behaviour in insolvency cases or the adaptability of soft law by courts provide an insight how law is formed through practice. In our legal teaching, the strength is found in a combination of academy and profession. That is challenging and provides new opportunities. The result is, I think, research that is original and creative with a unique output, with added value for practitioners and judges, for the students and for the understanding and application of insolvency law at large. This type of research is no revolution, but for Leiden an innovative and attractive scenario to develop further the integration of students into research.

Non-binding rules as explained may serve as benchmarks for actors in the field of insolvency. These actors include the insolvency legislator in assessing whether

81 My personal approach to the type of projects described I developed in my work with Fletcher. In our 2012 Harmonisation Report, above note 22, we confess that we are not specialists in the area of “law-making”, but we do provide seven key indicators which may assist in identifying situations in which harmonisation of insolvency topics in Europe may be beneficial, and the working method to achieve such harmonisation. These seven criteria – not necessarily in this order and overlaps could occur – point at a direction to take in the process of developing a legislative skeleton for harmonisation of insolvency law. We named (and further explained in said report, paragraph 194ff) the following indicators:

1. Consistency with international norms: strive for consistency with international norms, so any rules will be generally applied in the same way in any member State and/or across the EU;
2. Goals for the EU: agree on the basis allowing the European legislator to act and on the goals that the European legislator set himself to achieve;
3. Take stock: map the present level of harmonisation in all areas of law related to insolvency;
4. Overriding objectives: formulate overriding objectives to take into account, such as offering any involved party a sufficient degree of legal certainty;
5. Flexible legislation: draft a legal skeleton which is sustainable, including a process which is sufficiently flexible and capable of adapting to changing circumstances in which businesses operate;
6. Need for action: examine whether there is a specific need for a certain action or legislative intervention, and if so, what would be the most suitable course of action and ensure that its result be supported by a wider group that will have to work with it;
7. Balance: any rules of such a skeleton should reflect a fair balance between the (often competing) interests of creditors and other parties concerned.

82 See (in Dutch) B. Wessels, *De onafhankelijkheid van de faillissementscurator* (preadvies Christen Juristen Vereniging (CJV)) (2013, Uitgeverij Paris, Zutphen); M. Frege, “Die Unabhängigkeit des Insolvenzverwalters”, in Ebke *et al.* (eds), above note 36, at 49ff.

present legislation meets the mark of the general non-binding European norms and consider to improve it, or, when there are no rules, use it as a start for the legislation process. In the three projects briefly explained, dialogues with stakeholders (judges, practitioners, academics) lie at the heart of our work. Further, even though the dialogues with interested groups are challenging, they are challenging in ways that have the potential to strengthen the functioning of the EU. Principles and Guidelines, in the nature of the ones which have been described may have several disadvantages. In the June 2012 Global Principles report, Fletcher and I mentioned the following:

- (i) they have an uncertain legal status;
- (ii) it may be problematic to ascertain these texts;
- (iii) they may lack quality and clarity;
- (iv) their legitimacy may be questioned;
- (v) their application or enforcement seldom is reported; and
- (vi) their effectiveness is seldom tested.<sup>83</sup>

In the context of the European Union attention should be paid to Article 288 of the TFEU (formerly Article 249 of the EC Treaty), which allows for the introduction of measures of “soft law”, as its last paragraph states: “Recommendations and opinions shall have no binding force.” It may be the case that the results of one of our research projects may be a candidate for such a measure. I am confident that the projects mentioned, including the described methodology which are or will be contained in the final reports, present results which are unbiased and of good quality. But, although I am not hesitant in saying that these reports may serve as “informal authority” for European insolvency matters.<sup>84</sup> I would be open to discuss the development of criteria or procedures to overcome the disadvantages mentioned.

Mister Vice-Chancellor, Mister Dean, Dear listeners, with this valedictory my lecturing to Leiden students has ended including marking their exams, evaluate their papers and assess their presentations during *privatissimum* and the like. I am

83 See Global Principles Report, above note 21, at 24. Compare K. Abbott and D. Snidal, “Hard and Soft Law in International Governance”, in J. Kirton and J. Madunic (eds), *Global Law* (2009, Ashgate, Aldershot), at 257ff; B. Wessels, “ALI–III Global Principles – New Strategies for Cross-Border Cooperation?”, in J. Sarra (ed), *Annual Review of Insolvency Law 2009* (2010, Carswell, Toronto), at 587ff.

84 See N. Jansen, “Informal Authorities in European Private Law” (2003) 20 *Maastricht Journal of European and Comparative Law* nr. 4.

still a supervisor for five PhD researchers, so if in future you see me in the KOG building don't be surprised! I thank the Law School sincerely for selecting in 2007 a 58 year old insolvency veteran and for their trust in appointing me in a new, undeveloped area as a professor of international insolvency law. [.....]<sup>85</sup>

Thank you for your attention.<sup>86</sup>

85 Some personal words of thanks follow.

86 According to the University of Leiden's protocol, after my lecture, speeches were given by Dean Rick Lawson, junior researcher Gert-Jan Boon, Professor Matthias Haentjens and Professor Paul Omar. I thank them all for their very friendly and sometimes moving words. As a gift, I received a *Liber Amicorum*. Interested? Go to: <http://bobwessels.nl/2014/04/2014-04-doc6-perspectives-on-international-insolvency-law-a-unique-gift/>.



