**KEY POINTS**

- In March 2014, the European Commission published its recommendation on "a new approach to business failure and insolvency", which set out minimum standards for a restructuring framework in each Member State.
- The Commission will consider this year whether, and what form, any further measures for harmonisation should take.
- A European Directive aimed at harmonising European insolvency law remains a possibility, given the Commission's focus on removing barriers to a pan-European capital markets union.
- This could have a significant impact on English restructuring law which, despite the success of the English scheme of arrangement and pre-pack administration, arguably falls short of the minimum standards proposed.

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# What's next for insolvency law reform in Europe: a pan-European insolvency law?

The reforms to the Council Regulation (EC) 1346/2000 on insolvency proceedings (ECIR) and their impact on cross-border insolvency have been well documented. By contrast, the European Commission's recommendation of March 2014 on "a new approach to business failure and insolvency" (the Recommendation) has gone relatively unnoticed. However, if the Recommendation were elevated to the status of a European directive, it would have significantly wider ramifications for insolvency and restructuring proceedings in Europe.

## BACKGROUND TO THE RECOMMENDATION

The Recommendation was issued in response to a resolution from the European Parliament in November 2011. The resolution identified that disparity between national insolvency laws creates competitive advantages and disadvantages and can impede the successful restructuring of insolvent companies. The European Parliament requested that the Commission submit proposals relating to an EU corporate insolvency framework "in order to ensure a level playing field". The Recommendation sets out those proposals.

The objective of the Recommendation is to encourage Member States to put in place a framework for a rescue culture that enables the efficient restructuring of viable enterprises in financial difficulty and gives honest entrepreneurs a second chance. The Recommendation sets out minimum standards for how this could be achieved. It asks Member States to:

- 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;
- allow debtors to restructure their business without needing to formally open court proceedings;
- 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;
- facilitate the process for adopting a restructuring plan, keeping in mind the interest of both debtors and creditors, with a view to increasing the chances of rescuing viable businesses; and
- 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.

The Recommendation asked Member States to put in place appropriate measures by March 2015. The Commission stated that they would "assess the state of play, based on the yearly reports of the Member States, to evaluate whether further measures to strengthen the horizontal approach on insolvency are needed".

One year on, no update has been published by the Commission as to the success or failure of the Recommendation. However, the Commission's focus on harmonising European insolvency law has clearly not diminished. If anything, harmonisation is now viewed as pivotal to the development of a pan-European capital markets union, as evidenced in the Commission's Green Paper "Building a Capital Markets Union". The Green Paper states that removing the divergences in national insolvency law "could contribute to the emergence of pan-European equity and debt markets, by reducing uncertainty for investors needing to assess the risks in several Member States".

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## AFME RESPONSE

Recognising the importance of the Recommendation to cross-border investment, the Association for Financial Markets in Europe (AFME), an industry body promoting fair and efficient European capital markets, has been

quick to engage with the Commission. In its brief letter to the Commission in March 2015, AFME set out the negative effects of disparities amongst European insolvency regimes and restructuring laws, and suggested reforms which would help increase confidence and efficiency in the European capital markets. The letter draws on the experiences of AFME and its insolvency committee members, including those of the Authors.

In its letter to the Commission, AFME advocated the following:

- **stay:** a properly defined stay on enforcement action;
- **valuation:** a consistent method or platform for resolving stakeholder disputes as to the basis of valuation of a distressed company;
- **cram-down:** a court-approved cram-down of out-of the money creditors and shareholders;
- **role of creditors:** the ability for creditors to propose restructuring plans; and
- **post-petition financing:** automatic priority status and no regulatory restrictions on the provision of interim funding to a company undergoing a court-supervised restructuring.

The letter highlighted that any certainty or efficiency gained through Europe-wide initiatives such as the Capital Markets Union, or the European Commission's attempts to create a "single rulebook", are undermined if investors and stakeholders remain subject to 28 different European insolvency regimes.

The letter also appended a comprehensive guide to the insolvency and restructuring regime in seven of the key jurisdictions in which AFME's high-yield members operate. The guide, which was co-ordinated by the Authors, highlights the strength and weaknesses of the restructuring regimes in these jurisdictions and gives recent examples of forum shopping that has taken place as a result of the deficiencies.

## MARKET RESPONSE IN THE UK

The reaction to the Recommendation in the UK, particularly as to the level of EU involvement in insolvency law reform, has been mixed. Perhaps this is unsurprising given the success of English restructuring tools to restructure failing European businesses.

The English scheme of arrangement has, in recent years, been established as a viable, and often cheaper and more flexible, alternative to US Chapter 11 for restructuring European debtors who have been able to establish a "sufficient connection" with the UK.

Historically, debtors undertook a COMI shift to the UK to establish a sufficient connection (for example, European Directories). Since 2011, the exercise of the jurisdiction of the English courts to sanction schemes of foreign companies has expanded significantly. Notably, a change of governing law to English law, merely to gain access to the scheme as a restructuring tool, has been accepted by the English courts (eg *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch) and *DTEK Finance B.V., Re* [2015] EWHC 1164 (Ch) although, it should be noted that, in both cases, there were other links to England).

Similarly, the English pre-pack administration has proved a popular tool for the restructuring of distressed European debtors (eg WIND Hellas). Typically, debtors have undertaken a COMI shift to the UK in order to avail themselves of this restructuring procedure. However, the recent "flip-up" pre-pack of the German automotive group, ATU, is another example of the flexibility of English restructuring law as a viable option to restructure European companies (*Re Christophorus 3 Limited* [2014] EWHC 1162 (Ch)).

Despite the fact that many view this as "good forum shopping", the elimination of forum shopping is at the top of the European Commission's agenda. By equipping each Member State with an insolvency law that enables a distressed debtor to restructure in its home jurisdiction at an early stage, debtors could rely on their own jurisdiction's restructuring procedures, rather than those of its European neighbours, thereby increasing certainty and market efficiency.

> ... UK insolvency and restructuring law arguably falls short on a number of minimum standards set out in the Commission's Recommendation.

## DOES THE UK RESTRUCTURING REGIME MEASURE UP TO THE RECOMMENDATION'S MINIMUM STANDARDS?

Despite the fact that UK insolvency and restructuring procedures are generally considered to rescue businesses faster and at a lower cost than many other European regimes (as noted in the Word Bank's "Doing Business Survey", 2015), UK insolvency and restructuring law arguably falls short on a number of minimum standards set out in the Commission's Recommendation.

Neither the scheme of arrangement nor a CVA (other than for small companies) triggers a stay on individual creditor enforcement action. However, it should be noted that in the context of a scheme, it may be possible to apply to the court on a case by case basis to seek protection from enforcement (as in *Bluecrest Mercantile BV v Vietnam Shipbuilding Industry Group & others* [2013] EWHC 1146). The implementation of a lengthy stay would, therefore, represent a move away from the existing regime.

More crucially, an English scheme does not provide for a court-approved cram down of creditors across creditor

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classes (as US Chapter 11 does). The implementation of a cross-class cram-down would represent a fundamental divergence from existing practice.

Given the potential implications for UK restructuring law, the UK Insolvency Service issued a call for evidence on the Recommendation in February 2015. In the Loan Market Association's (LMA) response, the LMA noted that the introduction of a cram-down mechanism across classes of creditors would not necessarily improve the UK regime. It also noted that the introduction of a stay on enforcement action by creditors, rather than achieving the Commission's objective of promoting cross-border investment may, in fact, deter creditors from investing in the first place.

By contrast, in the City of London Law Society's response to the call for evidence, the Law Society noted the importance of legislative reform to UK insolvency law to ensure that it retains its competitive advantage in terms of efficiency and effectiveness. In particular, the Law Society noted the "root and branch" review of the US Chapter 11 bankruptcy regime conducted by the American Bankruptcy Institute in 2014 and the Dutch draft Bill on Continuity of Companies II, which is expected to come into force as early as 2016.

Implementation of the ABI's recommendations in relation to Chapter 11 are likely to be far from imminent given the controversial nature of several of the recommendations.

The scope of the review was also more limited than the review into restructuring law which is being, or has been, conducted across many European Member States. The Dutch Bill, for example, proposes an entirely new restructuring procedure based largely on the English scheme of arrangement, but which cherry-picks elements of the US Chapter 11 procedure that are not available under English law. The proposed Dutch scheme would, for example, implement a cross-class cram-down if the scheme is not approved by all classes, but is nevertheless declared by the court to be universally binding on the basis that the non-consenting parties could not reasonably have voted against the scheme.

The Netherlands is far from alone in Europe in terms of reform to insolvency law in recent years. To name but a few, there have been significant reforms in France, Germany, Italy, Spain and, most recently, Poland, which adopted a new restructuring law in April 2015. The International Monetary Fund programme of assistance has also been instrumental to European insolvency law reform, including in Cyprus, Ireland and Portugal, where reforms to insolvency and restructuring law were required as part of the IMF programme of assistance.

> … we envisage that the dominance of English proceedings to restructure European debtors may start to subside with the emergence of viable European alternatives.

It may take some time for the judiciary in each Member State to iron out any wrinkles with the new restructuring laws and to apply them in a sufficiently consistent manner for them to be the restructuring tool of choice for a local debtor. However, we envisage that the dominance of English proceedings to restructure European debtors may start to subside with the emergence of viable European alternatives.

## INTERPLAY WITH THE ECIR

The UK Government has successfully fought to keep the scheme of arrangement outside the scope of the reformed ECIR, principally to ensure the survival of the English court's ability to accept jurisdiction for schemes involving foreign companies. However, for a number of Member States, their restructuring law falls within the scope of the revised ECIR, for example the French *Sauveguarde* and new *Accelerated Financial Sauveguard and Accelerated Sauvegaurde* procedures (see Annex A to the ECIR).

The ECIR rules govern jurisdiction to open proceedings and the effect of proceedings once open. It will be interesting to see how the dynamic between the Recommendation and the ECIR plays out.

## CONCLUSION

With the EU's focus on all things "pan-European", is there now truly a pan-European insolvency law on the horizon?

In the preamble to the revised ECIR, the Regulation acknowledges the fact that "as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope throughout the Union". However, that does not mean that the Commission could not (or would not) give the minimum standards set out in the Regulation the force of law.

It is clear that the perception that the European capital markets would benefit from harmonisation of European insolvency law is gaining momentum and once wheels are set in motion at a European level (albeit at a glacial pace), it can be difficult to stop them. ■

*Further Reading*

- Insolvency law harmonisation on a European level: an achievable aim? [2011] 1 JIBFL 30.
- Commission recommendation for a new European approach to business failure and insolvency [2014] 3 CRI 114.
- LexisNexis RANDI blog: The challenges of harmonising insolvencies and restructurings.