

Global Restructuring & Insolvency Guide

European Union

Overview and Introduction

The term “European insolvency law” may either refer to the sum of the insolvency laws of the EU’s member states (as adopted by the respective national legislative bodies, and including such laws to implement European insolvency law directives) or refer to the insolvency laws adopted by the EU itself being directly effective in the member states without any implementation. European insolvency law in the latter sense will be dealt with in this chapter.

European insolvency law determines conflict-of-law issues, such as international jurisdiction, recognition and applicable law, and modifies applicable local law in cross-border cases. Therefore, although European insolvency law provides neither for a comprehensive insolvency regime (in the sense of harmonising all member state laws) for insolvencies of European groups of companies, nor for European cross-border insolvencies in general, it must inevitably be taken into account when dealing with insolvencies in Europe.

Applicable Legislation

At the beginning of the European unification process, cross-border insolvencies were governed by the international insolvency laws of the member states – as modified by bilateral treaties – only. It soon became clear that there was a need to establish common rules governing cross-border insolvencies. However, it took several decades to agree on such rules.

On 29 May 2000, the Council of the European Union adopted the Regulation on Insolvency Proceedings (Council Regulation (EC) No 1346/2000 – the “**EU Insolvency Regulation**” or the “**Regulation**”). The European Insolvency Regulation was followed by directives on the Reorganization and winding-up of insurance undertakings (Directive 2001/17/EC of 19 March 2001 – the “**EU Insurance Undertakings Directive**”) and credit institutions (Directive 2001/24/EC of 4 April 2001 – the “**EU Credit Institutions Directive**”), both adopted by the European Parliament and the European Council. A further directive on the recovery and resolution of banks is in the final stages of approval (the “**Bank Recovery and Resolution Directive**”). The final vote on this text is due to take place in April 2014 with the anticipated date for implementation by member states being December 2014.

The EU Insolvency Regulation entered into force on 31 May 2002. As a regulation, it does not need to be implemented by the member states but has to be directly applied by national courts. Both the EU Insurance Undertakings Directive and the EU Credit Institutions Directive had to be implemented by the member states, and all member states covered by this Guide have implemented both directives and amended their national laws accordingly. Note, however, that the Regulation does not apply in Denmark.

There have been a number of amendments to the annexes of the Regulation to address the addition of new member states and update references to national insolvency law. The consolidated text of the amended annexes can be found in Council Regulation (EC) No 583/2011 of 9 June 2011.

At the time of writing a European proposal to update the Regulation is being considered. The changes proposed are relatively substantial in nature and include:

- Broadening the scope of the Regulation to catch arrangements designed to avoid entering formal insolvency proceedings;
- Moving the definition of “center of main interests” to the body of the legislation from the recitals;
- Allowing secondary proceedings to take the form of whichever national insolvency proceeding is most appropriate; and

- Adding new provisions for the co-ordination of insolvency proceedings relating to groups of companies.

The current draft anticipates a two-year delay between publication of the amended Regulation in the Official Journal and the new provisions taking effect.

Scope of Applicability

The EU Insolvency Regulation applies to collective insolvency proceedings involving the (partial or total) divestment of a debtor and the appointment of an insolvency office-holder whose function is to manage the debtor's estate for the benefit of all creditors in collective proceedings. The proceedings to which the regulation applies are conclusively listed in annexes to the Regulation. The Regulation does not apply to insolvency proceedings concerning insurance undertakings, credit institutions and certain investment undertakings.

The EU Insolvency Regulation applies in all member states (except Denmark), provided that the centre of the debtor's main interests is situated in the territory of a member state and the insolvency proceedings are of a cross-border nature. The latter is true, for example, if: assets of the insolvency estate are situated in several member states; the debtor has entered into contracts with contractual partners domiciled in other member states; or creditors of the debtor are domiciled in other member states. Whether the cross-border nature may also be established by a relation to non-member states is still disputed. So far, UK courts in particular tend to take the position that this is sufficient; the European Court of Justice has not yet decided on this matter.

Note that if a debtor's place of incorporation is outside of the territory of the member states but its centre of main interests is determined to be within such territory, the Regulation will apply to that insolvency, for example, for the purposes of determining jurisdiction to open proceedings and the recognition of its insolvency office-holders within the EU.

International Jurisdiction and Recognition

The courts of that member state within the territory of which the centre of a debtor's main interests is situated have jurisdiction to open insolvency proceedings. The competent court within the courts of a member state so having jurisdiction is determined according to national law.

Centre of Main Interests

Under the European Insolvency Regulation, the location of the centre of the debtor's main interests ("COMI") is the decisive criterion for determining international jurisdiction and applicable insolvency law. Any debtor has one COMI only.

In the case of companies or entities, the place of the registered office is presumed to be the COMI in the absence of a proof to the contrary. In cases of doubt, the insolvency court has to investigate independently whether this legal presumption is rebutted.

Given the importance of the COMI for the entire insolvency proceedings on the one hand, and the abstract description of the COMI on the other hand, it is unsurprising that a substantial case law on COMI issues has developed. Initially, some courts decided that the COMI was at the place of the debtor's head office functions or strategic management (mind of management theory); other courts determined the COMI as the place of the debtor's main business activity (business activity theory).

On 2 May 2006, the European Court of Justice rendered a landmark decision (Case C-341/04, *Eurofood IFSC Ltd*) and decided that the presumption of the COMI can be rebutted only based on factors which are both objective and ascertainable by third parties. That could be so in particular in the case of a company not carrying out any business in the territory of the member state in which its registered office is situated. By contrast, where a company carried on its business in the territory of the member state where its registered office is situated, the mere fact that its economic choices were controlled by a parent company in another member state was not enough to rebut the presumption.

The principles of the *Eurofood* case were upheld by the European Court of Justice and further guidance was given on the factors national courts should consider when applying the *Eurofood* principles in *Interedil Srl (in liquidation) v Fallimento Interedil Srl & another* [2011] EUECJ C-396/09.

The *Eurofood* decision is considered a strong affirmation of the business activity theory. However, at the same time, the decision does not mean the final end of the mind of management theory; its criteria (place of head office functions or strategic management) may still apply supportively. In practice, important factors to determine the COMI are:

- Location of the debtor's business premises, production sites and warehouses;
- Place of work of the debtor's employees;
- Location of the debtor's bank accounts used for payments to creditors;
- Choice of law in contracts with creditors.

In most cases, determining a debtor's COMI is not difficult. However, in cases of doubt, particularly if the COMI is used as a migration tool for forum shopping (see below), the correct determination of the COMI may be more difficult and – at the same time – a crucial issue for the entire insolvency proceedings and restructuring efforts.

European insolvency law does not provide for a proper insolvency regime for groups of companies, and this has been the cause of much criticism of the Regulation: the insolvency of each group company is determined on an individual basis, i.e. regardless of such company forming part of an overall insolvent group. Moreover, the COMI of each group company is determined separately. As a consequence, group insolvencies may trigger numerous insolvency proceedings in numerous jurisdictions. Prior to the *Eurofood* decision of the European Court of Justice, several European courts decided in favor of a common COMI for insolvent groups of companies, arguing – based on the mind of management theory – that the group's head office functions and strategic management were concentrated at one place. After the *Eurofood* decision such argument no longer prevails. Nevertheless, practice shows that attempts to establish a common COMI in group insolvency scenarios can be successful where this is desirable to preserve value for creditors. Useful tools are, for example, concentrating all important group functions at the desired COMI, handling the entire group's communication from that desired COMI, and establishing a restructuring board at the desired COMI which plans, negotiates and implements restructuring measures for and on behalf of the entire group (cf.: Tribunal de commerce Paris, 2 August 2006, 2006047554, Dalloz 2006, 2329 – “Eurotunnel”; Local Court of Cologne, 19 February 2008, 73 IE 1/08 – “PIN-Holding”).

The COMI of self-employed business people, merchants, manufacturers, tradesmen, etc. is usually at their offices or manufacturing sites; the COMI of consumers is usually at their residences.

Using the COMI as a Migration Tool

Since the COMI is the decisive criterion for determining international jurisdiction and applicable insolvency law, it is sometimes worth considering a shift of the COMI prior to filing for insolvency to take advantage of the most beneficial insolvency regime or to better coordinate group restructurings (“**forum shopping**”). Conversely, creditors might wish to seek contractual protection against a COMI shift of their debtors. In any case, one should not forget that a COMI shift is time-consuming, costly and burdensome and needs to be planned well in advance. The pros and cons of a shift have to be weighed up carefully, and the insolvency laws involved need to be analysed thoroughly, before taking a decision.

Recognition of Insolvency Proceedings

With respect to one and the same insolvent debtor, European insolvency law permits the opening of main insolvency proceedings only once (for additional territorial proceedings, see below). Any judgment by a court of a member state ordering opening of insolvency proceedings has to be recognised in all the other member states, even if the opening court erroneously assumed jurisdiction, unless recognition would be manifestly contrary to a member state's public policy. In principle (for

exceptions, see “Applicable Law” and “Territorial Proceedings” below), as a consequence of such recognition:

- The judgment opening the proceedings produces, with no further formalities, the same effects in any other member state as under the law of the state of the opening of proceedings and applies to all assets of the debtor in all member states;
- The liquidator appointed by the court may exercise in all other member states all the powers conferred on him by the law of the state of the opening of proceedings;
- Judgments rendered by the court concerning the course and closure of the proceedings, compositions approved by that court, and judgments deriving directly from, and closely linked with, the insolvency proceedings are recognized with no further formalities; and
- The jurisdiction of the opening court may be challenged only as provided for under national procedural law.

Applicable Law

Basic Principle

As a basic principle (for exceptions, see “Exceptions” and “Parallel Proceedings” below), the law applicable to the insolvency proceedings and their effects is that of the member state within the territory of which the proceedings are opened (state of the opening of proceedings). That law determines the conditions for the opening of the proceedings, their conduct and their closure, including, *inter alia*:

- Against which debtors insolvency proceedings may be brought;
- The assets which form part of the insolvent estate;
- The powers of the liquidator and restrictions imposed on the powers of the debtor;
- The conditions under which set-offs may be invoked;
- The effects of the insolvency proceedings on pending contracts to which the debtor is party;
- The effects of the insolvency proceedings on proceedings brought by individual creditors (with the exception of pending lawsuits);
- The rules governing the lodging, verification and admission of claims;
- The rules governing the distribution of proceeds from the realization of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off;
- The conditions for, and the effects of, closure of insolvency proceedings, in particular by composition;
- Creditors’ rights after the closure of insolvency proceedings;
- Allocation of the costs and expenses incurred in the insolvency proceedings; and
- The rules relating to the invalidity, voidability or unenforceability of legal acts detrimental to the community of creditors.

Exceptions

However, the basic principle described above is subject to numerous important exceptions to protect legitimate expectations and the certainty of transactions in member states other than the state of the opening of proceedings:

- The opening of insolvency proceedings does not affect the rights in rem of creditors or third parties in respect to assets belonging to the debtor which are situated within the territory of another member state at the time of the opening of proceedings. The term “assets” includes all kind of tangible, intangible, moveable or immovable assets, and both specific assets and collections of indefinite assets as a whole which change from time to time as, for example, in case of a floating charge under UK law. Though such rights in rem may not be affected by the opening of the proceedings, they may well be affected later in the course of the proceedings, for example, by a rescue plan or a composition;
- Creditors may still demand the set-off of their claims against the claims of the debtor, provided that such a set-off is permitted by the law applicable to the debtor’s claim;
- Insolvency proceedings against the purchaser of an asset do not affect the seller’s rights based on a reservation of title, and, vice versa, insolvency proceedings against the seller of an asset, after delivery of the asset, do not constitute grounds for rescinding or terminating the sale and do not prevent the purchaser from acquiring title, provided that, in each case, the asset is situated within the territory of another member state at the time of the opening of proceedings;
- The effects of insolvency proceedings on contracts conferring the right to acquire or make use of immovable property are governed solely by the insolvency law of the member state within the territory of which the immovable property is situated;
- The effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market are governed solely by the insolvency law of the member state applicable to that system or market;
- The effects of insolvency proceedings on employment contracts and relationships are governed solely by the insolvency law of the member state applicable to the employment contract;
- The effects of insolvency proceedings on the debtor’s rights in immovable property, a ship or an aircraft registered in a public register are determined by the law of the member state under the authority of which the register is kept;
- Persons benefitting from an act detrimental to all the creditors may defend themselves against a challenge to the relevant act by proving that the act in question is subject to the law of a member state other than that of the state of the opening of proceedings (e.g. due to a contractual choice of law) and that under the applicable law the act is valid and cannot be challenged or avoided in any way; to a certain extent, this exception may help to protect transactions against potential clawback actions triggered by an insolvency where clawback regimes allow for different defences to a claim;
- If – after the opening of insolvency proceedings – the debtor disposes, for consideration, of: immovable assets; ships or aircrafts registered in public registers; or securities whose existence presupposes registration in a register, the validity of that disposal is governed by the insolvency law of the member state within the territory of which the immovable asset is situated or under the authority of which the register is kept;
- The effects of insolvency proceedings on a pending lawsuit concerning an asset or right of which the debtor has been divested are governed solely by the law of the member state in which that lawsuit is pending.

Parallel Proceedings

Overview

In addition to the insolvency proceedings that may be opened by the courts of the member state within the territory of which the debtor's COMI is situated ("**main proceedings**"), the EU Insolvency Regulation provides for two types of parallel proceedings:

- Secondary proceedings, i.e., winding-up proceedings opened by the courts of a member state after main proceedings have been opened by the courts of another member state; and
- Territorial insolvency proceedings opened by the courts of a member state prior to the opening of main proceedings by the courts of another member state.

Parallel proceedings may be opened only by courts of a member state within the territory of which the debtor possesses an establishment, i.e., has a place of operations where the debtor carries out a non-transitory economic activity with human means and goods. The mere fact that some of the debtor's assets are situated in a member state does not constitute an establishment in that member state.

Parallel proceedings are governed by the insolvency laws of the member state in which the parallel proceedings are opened. These laws apply to the same extent (and with the same exceptions) they would apply if main proceedings were opened in that member state (see above). The effects of parallel proceedings in a member state are restricted to the assets of the debtor situated in that member state at the time at which the judgment opening proceedings becomes effective.

Secondary Proceedings

Secondary proceedings, i.e. parallel proceedings opened by the courts of a member state after main proceedings have been opened by the courts of another member state, are always winding-up proceedings. Secondary proceedings may be opened upon request by:

- The liquidator in the main proceedings; or
- Any other person or authority empowered to request the opening of insolvency proceedings under the law of the member state of the secondary proceedings.

The courts opening the secondary proceedings do not examine whether the debtor – under the insolvency law applicable to the secondary proceedings – would be insolvent; the mere opening of the main proceedings justifies the opening of the secondary proceedings.

The liquidator in the main proceedings and the liquidators in all secondary proceedings are obliged to properly inform each other about the proceedings and cooperate with each other. The liquidators shall lodge in other proceedings claims which have already been lodged in proceedings for which they were appointed, provided that the interests of the creditors in the latter proceedings are served thereby, subject to the right of creditors to oppose the lodgment or to withdraw the lodgment of their claims where the applicable law so provides. Moreover, the liquidators are empowered to participate in the other proceedings as if they were a creditor, in particular by attending creditors' meetings. They are also entitled to inspect the files of the respective insolvency courts; however – though still subject to confirmation by the courts – they do not have any voting rights.

In addition, the liquidator in the main insolvency proceedings may:

- Submit proposals to liquidators in the secondary proceedings on the liquidation or use of the assets in the secondary proceedings;
- Request the court that opened the secondary proceedings to stay the process of liquidation in secondary proceedings, provided that in that event the court may require the liquidator in the main proceedings to guarantee the interests of the creditors in the secondary proceedings;
- Propose that the secondary proceedings be closed, without liquidation, by a rescue plan, composition or comparable measure where the law applicable to the secondary proceedings

allows for such closure, or object to such measure, unless the financial interests of the creditors in the main proceedings are not affected by the proposed measure.

If by the liquidation of assets in the secondary proceedings all claims allowed under those proceedings have been satisfied, the liquidator in the secondary proceedings has to transfer any assets remaining to the liquidator in the main proceedings.

Territorial Proceedings

Territorial proceedings, i.e. parallel proceedings opened by the courts of a member state prior to the opening of main proceedings by the courts of another member state, may be opened only:

- Where main proceedings cannot be opened because of the conditions of the law of the member state where the debtor's COMI is situated; or
- Upon request by a creditor who has his domicile, habitual residence or registered office in the member state in which the debtor's establishment is situated, or whose claim arises from the operation of that establishment.

To open territorial proceedings the opening court has to examine whether the debtor – under the insolvency law applicable to the territorial proceedings – is in fact insolvent. Territorial proceedings may be opened either as winding-up proceedings or as proceedings aiming at the restructuring of the debtor.

If after the opening of territorial proceedings main proceedings are opened in the member state in which the debtor's COMI is situated, the territorial proceedings turn into secondary proceedings and the associated principles (see "Secondary Proceedings" above) apply insofar as the progress of the territorial proceedings permits. In such case, the liquidator in the main proceedings may request that territorial proceedings which have been opened as restructuring proceedings be converted into winding-up proceedings if this proves to be in the interests of the creditors in the main proceedings.

Provision of Information and Lodgment of Claims

With regard to the provision of information and the lodgment of claims, the EU Insolvency Regulation differentiates between creditors residing in member states other than the state of the opening of proceedings (EC creditors) and creditors residing in the state of the opening of proceedings (local creditors) or third countries (third country creditors):

- As soon as main or parallel proceedings are opened in a member state, the competent court or the liquidator appointed by it has to immediately inform known EC creditors by individual written notice;
- EC creditors have to lodge their claims in the main proceedings and in all territorial proceedings in writing, but are entitled to use their local language. Any lodgment must include copies of supporting documents, if any, and indicate the nature of the claim, the date on which it arose and its amount, as well as whether the creditor claims preference, security in rem or a reservation of title in respect of the claim and what assets are covered by the guarantee he is invoking. Further details of the lodging (lodging periods, consequences of missing them, costs, verification, admission and ranking of lodged claims, etc.) are governed by the national insolvency law applicable;
- Local creditors and third country creditors have to be informed and may lodge their claims in accordance with the national insolvency law applicable.

In addition, liquidators lodge claims which have already been lodged in proceedings for which they were appointed (see "Secondary Proceedings" above). It is not yet clear, however, whether the liquidators are legally obligated to lodge such claims and may be held liable if they fail to do so.

Dividend Distribution and Creditor Strategy

The insolvency of a debtor may trigger several insolvency proceedings (main proceedings in one member state and parallel proceedings in other member states). Dividends may be distributed both in the main proceedings and in the parallel proceedings, in each case in compliance with the respective applicable national insolvency law. Creditors do not necessarily participate in all of the proceedings and dividends distributed may vary. Nevertheless, one basic principle of the EU Insolvency Regulation is equal treatment of creditors (*par condition creditorum*). The Regulation seeks to achieve such equal treatment by way of dividend imputation.

Distribution Rules

Dividends are distributed in accordance with the following rules:

- No creditor is entitled to receive distributions of an amount exceeding the amount of his claim;
- Any creditor is entitled to lodge the entire amount of his claim in the main proceedings and in all parallel proceedings, irrespective of any dividends already obtained. If, for example, a creditor has a claim of EUR 100,000 and the liquidator of parallel proceedings has distributed to that creditor a dividend of EUR 10,000, the creditor may still lodge a claim of EUR 100,000 in the main proceedings. Whether the same is true if a creditor has not obtained a dividend but a partial satisfaction of his claim by way of security enforcement depends on the applicable national insolvency law;
- The ranking of claims is solely governed by the national insolvency law applicable to the respective (main or parallel) proceedings;
- A creditor who has, in the course of insolvency proceedings, obtained a dividend on his claim shares in distributions made in other proceedings only where creditors of the same ranking have, in those other proceedings, obtained an equivalent dividend (imputation). Dividends lawfully obtained do not need to be repaid.

It should be noted that these rules do not apply to the claims of creditors resident in non-member states. The treatment of those claims is solely governed by the applicable national insolvency law (i.e. by such national law's international insolvency provisions as modified by bilateral treaties).

Example

A (simplified) example may illustrate these rules:

The debtor has its COMI in Spain and an establishment in Germany. Main proceedings have been opened in Spain; secondary proceedings in Germany. The debtor has two creditors only: Creditor A and Creditor B. Both have unsecured, equally ranking claims of EUR 100,000. Creditor A has lodged his claims in both proceedings. Creditor B has lodged his claims in the main proceedings only.

- (a) The distributable funds amount to EUR 90,000 (main proceedings in Spain) and EUR 50,000 (secondary proceedings in Germany). In such case, dividends are distributed as follows:
- Secondary proceedings in Germany: as sole creditor having lodged claims, Creditor A obtains a dividend of EUR 50,000 (equalling 50% of Creditor A's claims). Creditor B has not lodged his claims in Germany and does not obtain any dividend.
 - Main proceedings in Spain: Creditor B is entitled to a pre-dividend equivalent to the dividend obtained by Creditor A in the secondary proceedings in Germany (50%, i.e. EUR 50,000). The remainder of the distributable funds (EUR 40,000) is distributed to the creditors proportionally (in accordance with the nominal amounts of the lodged claims). Hence, Creditor B obtains an overall dividend of EUR 70,000 (equalling 70% of Creditor B's claims), and Creditor A obtains a dividend of EUR 20,000 (equalling 20%, and, together with the dividend obtained by Creditor A in Germany, 70% of Creditor A's claims).

This example demonstrates the equal treatment of the creditors. In the end, both creditors obtain dividends equalling 70% of their lodged claims. However, this is not always the case.

(b) If, in the above example, the distributable funds amount to EUR 50,000 (main proceedings in Spain) and EUR 90,000 (secondary proceedings in Germany), dividends are distributed as follows:

- Secondary proceedings in Germany: As sole creditor having lodged claims, Creditor A obtains a dividend of EUR 90,000 (equalling 90% of Creditor A's claims). Creditor B has not lodged his claims in Germany and does not obtain any dividend.
- Main proceedings in Spain: Creditor B is entitled to a pre-dividend equivalent to the dividend obtained by Creditor A in the secondary proceedings in Germany (90%, i.e. EUR 90,000). Since the funds distributable in the main proceedings amount to EUR 50,000 only, the entire funds (equalling 50% of Creditor B's claims) are distributed to Creditor B. Though Creditor A has lodged his claims, he does not obtain any dividends.

This variation of the example demonstrates that the creditors may not always be treated equally. Though Creditor A's claims have been satisfied by 90% and Creditor B's claims by 50% only, Creditor A is not obligated to repay any of the funds lawfully received as dividend in the secondary proceedings in Germany.

Creditor Strategy

Such unequal treatment may occur if creditors (and the liquidators) do not lodge their claims in that proceedings in which the highest dividends may be obtained. Similarly, creditors may be treated unequally if creditors (and the liquidators) fail to initiate, or lodge their claims in, proceedings in which their claims would have obtained a preferred ranking.

It is not yet clear whether: the liquidators are legally obligated to lodge in all other proceedings claims which were lodged in their own proceedings, and the liquidators may be held liable if they fail to do so (see "Secondary Proceedings" above). As a consequence:

- Creditors should not rely on a lodgment by the liquidators. Instead, they should always make sure to lodge their claims in the main proceedings and all parallel proceedings in which substantial dividend distributions may be expected; and
- Creditors should always check whether they may successfully apply for the opening of secondary proceedings in jurisdictions in which their claims would obtain a preferred ranking.

Conclusions and Additional Observations

Though the EU has common rules governing European cross-border insolvencies, a substantive common insolvency law does not yet exist. Nevertheless, European insolvency law deals with important conflict-of-law issues such as international jurisdiction, recognition and applicable law. Therefore, it has always to be taken into account both by debtors and creditors in cross-border insolvencies or restructurings if European member states are involved.