

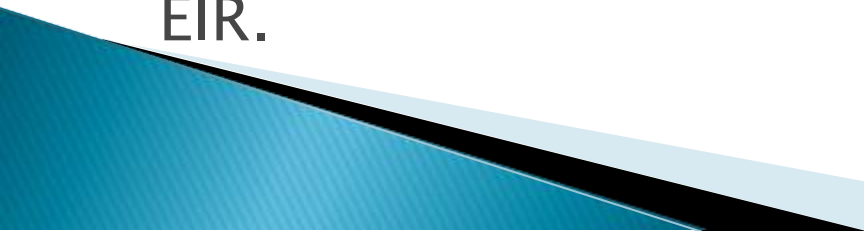
European Insolvency Regulation

7. Territorial proceedings

Dr Marek Porzycki



Territorial proceedings

- ▶ Secondary proceedings
 - ▶ take place in parallel to main proceedings in another Member State (Art. 3(3) EIR)
 - ▶ under the old EIR they had to be winding-up proceedings (Art. 3(3) and Art. 27 old EIR). This limitation had been dropped in the recast EIR.
 - ▶ Independent territorial proceedings
 - ▶ take place without main proceedings being conducted in another Member State (Art. 3(4) EIR)
 - ▶ no limitations as to the type of proceedings
- 

Aims of territorial (secondary) proceedings

- ▶ protection of local interests
- ▶ „auxilliary” proceedings:
 - cases where the estate is too complex to administer as a unit
 - need to take into account the peculiarities of local law
- ▶ see recital 19 to the old EIR, paragraphs 32–33 of the Virgos–Schmit Report, recital 40 to the recast EIR

Example

- ▶ Schuldner AG, a German company, has a production facility in Poland. German insolvency proceedings (*Insolvenzverfahren*) are opened against Schuldner AG.
- the production facility in Poland employs local staff;
- a Polish bank has granted a loan to Schuldner AG, secured by a mortgage on the real estate on which the production facility operates;
- German insolvency practitioner appointed as liquidator for Schuldner AG does not speak Polish and does not know Polish law. He has previously cooperated with a Polish restructuring advisory firm and keeps contact with it.

Jurisdiction to open territorial proceedings

- ▶ the courts of a Member State where the debtor possesses an establishment (Art. 3(2) EIR)
- ▶ definition of „establishment” – any place of operations where the debtor carries out a non-transitory economic activity with human means and assets (Art. 2(10) EIR)
- ▶ mere existence of assets in a Member State is not enough for this State’s jurisdiction (but cf. Art. 382(2) of the Polish BL for non-EU cases)
- ▶ „establishment” requires a structure consisting of a minimum level of organisation and a degree of stability necessary for the purpose of pursuing an economic activity (CJEU in Interedil)
- ▶ cases of a „race to the court” (see → Eurofood) – can COMI be requalified as establishment („second prize”)?

Examples

1. Schuldner AG, a German company, has a production facility in Poland, employing local staff. German insolvency proceedings (*Insolvenzverfahren*) are opened against Schuldner AG.
2. Schuldner AG, a German company sells wares to Polish customers. German insolvency proceedings (*Insolvenzverfahren*) are opened against Schuldner AG. At the time of the opening of proceedings, Schuldner AG has outstanding claims against 3 Polish customers and some wares in a warehouse belonging to a third-party in Poland, not yet handed over to Polish customers.
3. The same situation as under para. 2, but instead of Schuldner AG the company in question is Borçlu a.ş., a Turkish company, subject to Turkish insolvency proceedings.

Grounds to open secondary proceedings – the old EIR

- ▶ the mere fact of main proceedings pending substituted for any actual examination of insolvency for the aims of the opening of secondary proceedings (Art. 27 old EIR)
- presumption of insolvency or duty to open secondary proceedings? → duty to open if other conditions are fulfilled („automatism of opening”, *Eröffnungsautomatik*)? See Opinion of Advocate General J. Kokott of 24 May 2012 in Case C-116/11, Bank Handlowy and Adamiak. No clear answer in subsequent ECJ judgment of 22.11.2012 in this case.

Grounds to open secondary proceedings – recast EIR

- ▶ No re-examination of insolvency of the debtor for the purposes of secondary proceedings only in cases where main proceedings required that the debtor be insolvent (Art. 34 EIR)
- ▶ In other cases (pre-insolvency proceedings as main proceedings) – all requirements of the law of secondary jurisdiction need to be examined, including insolvency of the debtor as the case may be
 - if main insolvency proceedings are restructuring proceedings applicable to solvent debtor in distress, aimed at avoiding insolvency, the court examining the request to open secondary proceedings should examine insolvency of the debtor and may refuse to open secondary proceedings if conditions specified by national law are not met

Example

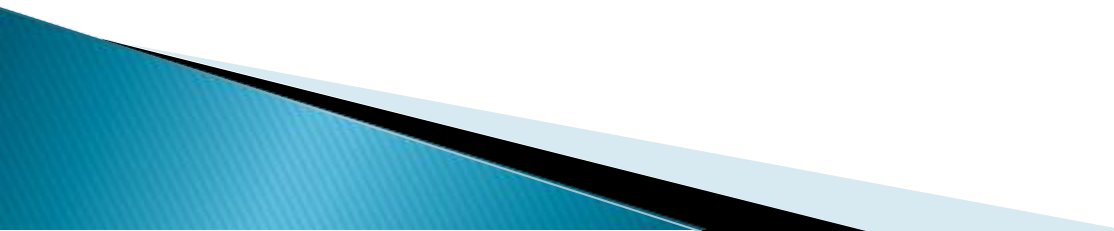
- ▶ Débiteur S.A., a French company, has a production facility in Poland, employing local staff. French pre-insolvency proceedings (*procédure de sauvegarde*) are opened against Débiteur S.A. *Procédure de sauvegarde* is applicable to debtors who are not yet insolvent but they are threatened by insolvency.
- situation under Art. 27 of the old EIR?
- situation under Art. 34 EIR?

Example

- ▶ Débiteur S.A., a French company, has a production facility in Poland, employing local staff. French insolvency proceedings (*liquidation judiciaire*) are opened against Débiteur S.A. *Liquidation judiciaire* is applicable to insolvent debtors.
- situation under Art. 27 of the old EIR?
- situation under Art. 34 EIR?

Grounds to open secondary proceedings

- both old EIR and recast EIR

- ▶ other conditions of the law of the State of the opening of secondary proceedings apply in all cases:
 - valid request for the opening of proceedings,
 - sufficiency of assets
 - applicability of national insolvency law to the debtor in question
 - etc.
- 

Right to request opening of secondary proceedings

- ▶ Art. 37 EIR:
 - liquidator/insolvency practitioner in the main proceedings
 - any other person or authority empowered to request the opening of insolvency proceedings under national law

Effects and recognition of secondary proceedings

- ▶ territoriality: effects limited to the assets located in the Member State where the proceedings are opened (Art. 3(2) EIR; Art. 20(2) EIR)
- ▶ automatic recognition (Art. 19(1) EIR) upholds the position of the insolvency practitioner in the territorial proceedings → right of the insolvency practitioner to pursue assets moved to another Member State; right to bring actions to set aside (avoidance actions) – Art. 21(2) EIR.

Old EIR: winding-up proceedings

The old EIR: Secondary proceedings had to be winding-up proceedings listed in Annex B to the old EIR!

(Art. 3(3), Art. 27 old EIR)

reason: practical difficulties in coordinating two different sets of restructuring proceedings

criticism: inflexible solutions, may hamper restructuring efforts, in particular if a substantial part of debtor's assets is included in the secondary proceedings

The recast EIR: the limitation has been dropped, secondary restructuring proceedings are allowed

Example

- ▶ Débiteur S.A., a French company, has a production facility in Poland, employing local staff. French pre-insolvency proceedings (*procédure de sauvegarde*) are opened against Débiteur S.A. *Procédure de sauvegarde* is applicable to debtors who are not yet insolvent but they are threatened by insolvency. Its purpose is to prevent insolvency and to restructure the debtor.
 - situation under Art. 27 old EIR?
 - situation under Art. 34 EIR?

Coordination between main and secondary proceedings

- ▶ Art. 31 old EIR – cooperation between liquidators
- ▶ no explicit provision on cooperation between courts in the old EIR
- ▶ cf. Art. 25 – 27 of the UNICTRAL Model Law on Cross-Border Insolvency
- ▶ in practice: a specific agreement (‘protocol for cooperation’) can be concluded to establish rules on cooperation between courts and/or liquidators in a particular case
- ▶ a „soft law” initiative – European Cooperation and Communication Guidelines for Cross-Border Insolvency (CoCo Guidelines)

Coordination between main and secondary proceedings

- ▶ Significant changes in the recast EIR – explicit provisions on cooperation:
 - between insolvency practitioners (Art. 41 EIR), including exploring restructuring possibilities and coordinating restructuring plans, as well as coordinating administration of the estate,
 - conclusion of agreements or protocols expressly mentioned (Art. 41 (1) EIR);
 - between courts (Art. 42 EIR)
 - between courts and insolvency practitioners (Art. 43 EIR)
- ▶ limits: rules applicable to each of the proceedings and conflicts of interest

Creditor satisfaction in main and secondary proceedings

- ▶ right to lodge claims in both proceedings (Art. 45(1) EIR)
- ▶ cross-submission of claims by insolvency practitioners in both proceedings (Art. 45(2) EIR)
- ▶ right of the insolvency practitioner to participate in other proceedings as a creditor (Art. 45(3) EIR)
- ▶ partial coordination of payouts to creditors – every creditor to keep amounts obtained in one set of proceedings but it is taken into account in the other proceedings (Art. 23 EIR) – „hotchpot rule” or equalization of dividends
- ▶ assets remaining after liquidation in the secondary proceedings → transfer to the liquidator in main proceedings (Art. 49 EIR)

Case of a solvent debtor under the old EIR

- ▶ main proceedings (listed in Annex A) against a solvent debtor, aimed at restructuring
examples: French *sauvegarde*, but also in some cases German *Insolvenzverfahren*
- ▶ secondary proceedings as winding-up proceedings listed in Annex B (Art. 3(3) and Art. 27 old EIR), opened automatically upon request
but see Opinion of Advocate General J. Kokott of 24 May 2012 in Case C-116/11, Bank Handlowy and Adamiak vs. Christianapol
- ▶ cases where an „establishment” includes the major part or all of the debtor’s estate → controversial rulings on COMI after Eurofood
- ▶ see case study in one of the next courses

Restructuring in secondary proceedings in the recast EIR

- ▶ stay of liquidation under Art. 46 EIR
- ▶ closure by a rescue plan, a composition or a comparable measure under Art. 47 EIR
 - the plan can be proposed by the insolvency practitioner in main proceedings
 - scope of the rescue plan

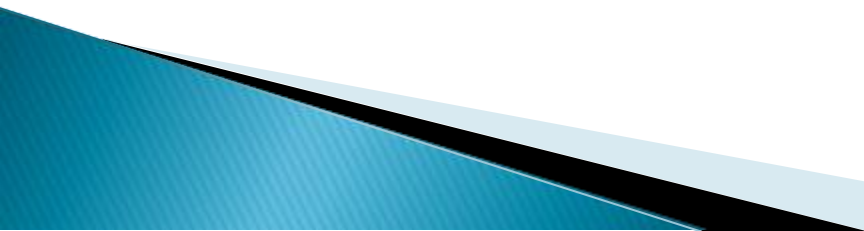
Substantial changes in the recast EIR

- secondary proceedings can be opened as restructuring proceedings;
- reexamination of the debtor's insolvency possible in the secondary jurisdiction if the main proceedings did not require insolvency (Art. 34 EIR).

„Synthetic secondary proceedings”

- ▶ Concept used by English insolvency practitioners and courts in MG Rover and Collins & Aikman cases (2005–2006).
- ▶ In both cases a UK-based holding company had several subsidiaries in other Member States. The UK courts assumed that COMIs of all subsidiaries were located in the UK and opened English insolvency proceedings against all subsidiaries → effort to coordinate proceedings against the whole group of companies.
- ▶ Opening secondary insolvency proceedings against any subsidiary in another Member State would make restructuring or coordinated liquidation barely possible, as secondary proceedings would need to be territorial winding-up proceedings (under Art. 3(3) and Art. 27 old EIR).
- ▶ In order to convince local creditors in other Member States not to file for secondary proceedings, English administrator gave them assurances that they would respect their financial position under local insolvency laws, even within the framework of English insolvency proceedings.
- ▶ This assurance has been subsequently confirmed by English courts.

Avoiding secondary proceedings under the recast EIR

- ▶ Introduction of the concept of „synthetic secondary proceedings” into the recast EIR – unilateral undertaking (= binding promise) of the insolvency practitioner in main proceedings to satisfy creditors in the secondary jurisdiction as if secondary proceedings were opened (Art. 36 EIR)
 - ▶ application of law of the secondary jurisdiction to distribution of proceeds, ranking of creditors and creditors’ rights on assets (Art. 36(2) EIR)
 - ▶ approval by local creditors according to rules applicable to restructuring plans (Art. 36(5) EIR)
 - ▶ If the undertaking has been given under Art. 36 EIR, the court shall refuse to open secondary proceedings if it is satisfied that the undertaking adequately protects the general interests of local creditors (Art. 38(2) EIR)
 - ▶ see recitals 41–45 to the recast EIR
- 

Grounds for the opening of independent territorial proceedings

- ▶ Independent territorial proceedings as opposed to secondary proceedings (no main proceedings in parallel)
- ▶ all requirements of the applicable national law (Art. 7(2) EIR), including the examination of insolvency
- ▶ subject to Art. 3(4) EIR:
 - if main insolvency proceedings cannot be opened because of conditions of the law of the State where the debtor's COMI is situated; or
 - if territorial proceedings are requested by a creditor whose claim arises from the operation of the establishment in question or is connected to the operation of this establishment or by a local public authority → protection of local interests

Example

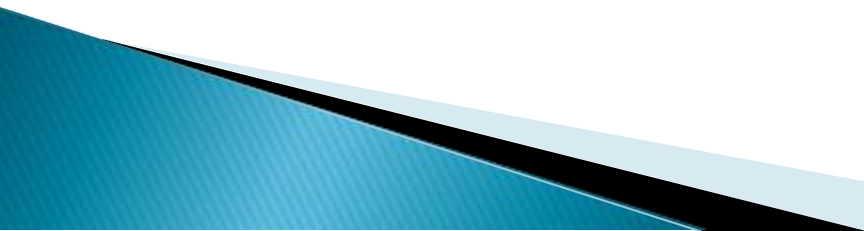
- ▶ 1. Fabryka Dyplomów S.A., a private academy in Poland, has opened a branch in Košice, Slovakia. After some time it became insolvent. Under Art. 6(6) of Polish Bankruptcy Law, academies/universities are not subject to bankruptcy proceedings.
- ▶ 2. Dłużnik S.A., a company based in Poland, has a production facility in Košice, Slovakia. After some time it became insolvent but nobody has filed for bankruptcy in Poland.

Can independent territorial insolvency proceedings be opened in Slovakia?

Right to request independent territorial proceedings

- persons entitled to request the opening of proceedings under the law of the Member State concerned (Article 7 EIR), subject to Art. 3(4)(b) EIR → in case of Art. 3(4)(b): creditor from the Member State concerned; creditor whose claim arises from the operation of the establishment concerned; public authority which has the right to file for insolvency proceedings under the law of the jurisdiction concerned

Subsequent opening of main proceedings

- ▶ previously opened independent territorial proceedings are converted into secondary proceedings (Art. 3(4), last sentence EIR)
 - ▶ limitations to application of provisions on secondary proceedings (Art. 50 EIR)
 - ▶ conversion into another type of insolvency proceedings is possible (e.g. between restructuring and winding-up proceedings), provided that conditions for opening proceedings of that type under national law are met (Art. 51 EIR)
- 

Example

- ▶ Dłużnik S.A., a company based in Poland, has a production facility in Košice, Slovakia. After some time it became insolvent but nobody has filed for bankruptcy in Poland.

On request of a Slovak creditor, independent territorial insolvency proceedings have been opened against Dłużnik S.A. in Slovakia.

Subsequently, a creditor has filed for bankruptcy in Poland and Polish bankruptcy proceedings have been opened against Dłużnik S.A.

Additional reading

- R. Bork, R. Mangano, European Cross–Border Insolvency Law, Oxford University Press 2016, pp. 229–271, chapter 7 'Secondary insolvency proceedings' (paras. 7.01 – 7.91)
- B. Wessels. M. Virgos, European Cooperation and Communication Guidelines for Cross–Border Insolvency , July 2007 (CoCo Guidelines):

<http://www.insol.org/INSOLfaculty/pdfs/BasicReading/Session%205/European%20Communication%20and%20Cooperation%20Guidelines%20for%20Cross-border%20Insolvency%20.pdf>

- M. Porzycki, Secondary Insolvency Proceedings against a Solvent Debtor: A Polish Case Highlights Weak Points of the European Insolvency Regulation, International Corporate Rescue 2010, Volume 7, Issue 2, p. 118

In Polish:

- ▶ P. Filipiak in: F. Zedler, P. Filipiak, A. Hrycaj, Europejskie prawo upadłościowe. Komentarz, Wolters Kluwer 2011, commentary to Articles 27–37 of the EIR