Observations on cross-border group insolvencies[1]

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Abstract:

This paper observes the treatment of group insolvencies in the European Insolvency Regulation (EIR) and the challenges in achieving efficient solutions for multinational enterprise groups. It discusses the limitations of the EIR in providing powers to insolvency practitioners and the need for a common standard for recognizing foreign proceedings.

Keywords: Cross-border insolvency, group insolvency, European Insolvency Regulation, multinational enterprise groups

A. Main features of the group insolvency treatment in the EIR

The EIR 1346/2000 did not contain any provisions on groups of companies. At the time, many insolvency lawyers thought that this reduced the entire EIR to an irrelevance as most large corporations are divided into units consisting of separate legal entities and there would usually be at least one legal entity for each member state where the corporation is active. Although these insolvency lawyers turned out to be wrong as the EIR was found, in practice, to fulfil a need, the lack of provisions relating to groups was definitely felt and efforts were therefore made to fill the gap. An easy solution would have been to include a provision that, if a court has jurisdiction over one group company, it would also have jurisdiction over the others (similar to 28 U.S.C.§ 1408(2)). In a way, that is what the British courts attempted in the early cases by holding that the COMI was located at the groups management centre, but this approach was halted by the Eurofood case[2], which stressed the importance of the COMI being ascertainable by third parties. A

1 The text of this contribution was licenced by the authors after the conference within the project in October 2024.
2 ECJ 02.05.2006 -case C-341/04, ECLI:EU:C:2006:281- Eurofood IFSC Ltd.

situation in which the insolvency proceedings of one group member created jurisdiction for the insolvency proceedings of the other group companies has never been contemplated: instead, the main proceedings for each group company has to be opened at that companies COMI. Another easy solution would have been to confer powers on the insolvency practitioner of the top company that would enable him to achieve an efficient solution for the entire group. However, corporate structures are sometimes complicated, and control may lie with another group company. The various drafts of the EIR that were circulated prior to its enactment show the Community legislative struggle to reach a politically acceptable solution. Evidently, the member states had difficulty in accepting that courts or insolvency practitioners located in other member states, would be able to take decisions concerning their group companies. When the EIR was finally introduced, in Chapter V thereof insolvency practitioners were given rights to obtain information and give advice with respect to insolvency proceedings of group companies, but no rules were included to regulate which proceeding should take precedence. Similarly, the scope for intervening either directly or through the courts in the insolvency proceedings of group companies was limited. Chapter V also introduced the concept of a group coordinator, who could try to coordinate the negotiation of a restructuring plan. However, the group coordinators powers are also very limited. The whole construct seems to rest on the premise that a restructuring plan should be reached by negotiation between the insolvency practitioners appointed in all the insolvency proceedings and possibly the group coordinator and by subsequent adoption in all these proceedings. Around the time of the adoption of EIR, in 2017, a similar regulation was adopted under German law[3] and incorporated as § 269a – 269i of the German *Insolvenzordnung (InsO).* The provisions of this regulation apply to local German groups of companies. However, contrary to European law, under §§ 3a-3e of the German *InsO* insolvency proceedings can be opened in a single court with respect to all group companies.[4] To our knowledge no EIR group coordinators have yet been appointed and the provisions of Chapter V have not been applied in any substantive cases. As far as we could find out, the same applies to the German equivalent provided for by §§ 269a-269i *InsO,* but here at least the instrument of bringing all the group insolvency proceedings in the same court is available. Obviously on a national level,

3 Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen.
4 These provisions pre-date the act of 2017.

from a sovereignty perspective such instrument is less problematic than on an international level.

As the provisions of Chapter V of the EIR confer certain rights of coordination and advice on insolvency practitioners with respect to insolvency proceedings of other companies belonging to the same group, the definition of a group is relevant. This can be found in Article 2 (13) and (14) EIR. The concept is linked to Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports. Article 2 (13) EIR defines a group of companies as a parent undertaking and all its subsidiary undertakings. Article 2 (14) defines a parent undertaking as an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings. It adds, however, that an undertaking which prepares consolidated financial statements in accordance with Directive 2013/34/EU is deemed to be a parent undertaking. Under that directive shareholdership and control are the key factors taken into account.

Art. 56–60 EIR concern cooperation and communication. These provisions are the complement to Art. 41–43, which provide for cooperation and coordination between insolvency proceedings with respect to the same debtor (main and secondary proceedings). Art. 56 contains an obligation for an insolvency practitioner appointed in proceedings concerning a member of a group to cooperate with any insolvency practitioner appointed in proceedings concerning another member of the same group. An insolvency practitioner's obligation to cooperate as provided for in Art. 56 is subject to limitations which are more restrictive that those applying under the equivalent Art. 41 EIR.

These limitations considerably weaken the obligation to cooperate. In insolvency situations, there are often conflicts of interests between group companies, because they have different sets of creditors. Art. 57 contains a similar provision on cooperation between courts in group proceedings, including the same limitations. Art. 58 provides for cooperation between courts and insolvency practitioners in other group proceedings.

An insolvency practitioner has certain powers in proceedings concerning other group companies. These include the right to be heard in proceedings concerning any other member of the same group and the option for practitioners to request a stay on measures like asset sales across group companies (e.g. one group requesting a stay on another groups asset sale). However, this right is limited. All practitioners are enabled to request stays for the same entity and must be heard. If a group coordination proceeding exist only the group coordinator can request a stay.

Sec. 2 of Chapter V concerns group coordination proceedings. According to Art. 61(1) EIR, group coordination proceedings may be requested before any court having jurisdiction over the insolvency proceedings of a member of the group. The request should be accompanied by a proposal for the person to be appointed as group coordinator. The group coordinator must not be one of the insolvency practitioners appointed in respect of any of the group companies. The group coordination proceedings will thus be opened by the court first seized. The wording of Art. 61 EIR suggests that a request cannot be limited to some of the group members or part of the insolvency proceedings of the group members. A limitation can be created by means of an *opt-out*, as discussed below. Solvent group companies cannot be included in the group coordination proceedings.

After the request for the opening of the group coordination proceedings has been filed, the court considers various criteria. If the court is satisfied that these criteria are met, it notifies the insolvency practitioners involved and gives them an opportunity to be heard.

Subsequently, there is a waiting period of 30 days, during which insolvency practitioners appointed in respect of group companies may object to the person of the proposed group coordinator. An insolvency practitioner may also *opt-out* of the group coordination proceedings altogether (Art. 64 (1) (a) and 65 (1) EIR), in which case the proceedings in which this insolvency practitioner is involved will not be included in the group coordination proceedings. Nevertheless, it is possible that some kind of informal consultation takes place.

Where at least two-thirds of all insolvency practitioners appointed in insolvency proceedings of group companies agree that the court of another member state having jurisdiction is the most appropriate court, that court will have exclusive jurisdiction over the group coordination proceedings. The 30-day waiting period thus gives the insolvency practitioners an opportunity to consider an alternative, both to the jurisdiction and to the group coordinator.

The insolvency practitioners appointed in relation to group members and the group coordinator must cooperate with each other to the extent such cooperation is not incompatible with the rules applicable to the respective proceedings.

The essential tasks of the group coordinator are to make recommendations for the coordinated conduct of the insolvency proceedings and to propose a group coordination plan. A group coordination plan is not a rescue plan in the classic sense of a plan capable of modifying creditors rights and resolving the insolvency, instead it is more about coordinating the proceedings. Such a plan may contain proposals for measures to re-establish the group's economic performance and financial soundness, settling intra-group disputes and agreements between the insolvency practitioners of the group companies. The insolvency practitioners must consider the recommendations of the group coordinator and the content of the group coordination plan, but are not obliged to follow the recommendations of the plan. However, if the insolvency practitioner does not follow the plan, he must give reasons for this. This is actually tantamount to a comply-or-explain rule.

Under Art. 72 (2) EIR, the group coordinator has various important rights, including the right to participate and be heard, mediate disputes between insolvency practitioners, request information from practitioners to aid coordination and request a stay of proceedings to ensure the plan's implementation.

B. Main features of the UNCITRAL Model Law on Enterprise Group Insolvency

The UNCITRAL Model Law on Enterprise Group Insolvency (MLEG) was adopted by UNCITRAL in 2019. So far it has not been enacted in any state.[5] Similarly to the EIR the MLEG provides a group proceeding focused on the development of a group insolvency solution for the whole or part of an enterprise group (as explained by recital (c) of the preamble). The EIR is less clear in respect of its purpose, but it follows from recitals 51 and 52 that the efficient administration of insolvency proceedings relating to different companies forming part of a group of companies must be assured. Additionally, the MLEG provides for cross-border recognition and implementation of the group insolvency solution in multiple states. It should be noted that the MLEG differs fundamentally from the EIR in the sense that within the European Union the principle of union trust applies and that no such principle applies under the UNCITRAL instruments. Therefore, under the EIR reliance is placed on the decisions taken in other member states, although in the case of group companies there is a considerable involvement of the local court. Under the MLEG and the UNCITRAL

5 The table of the status of UNCITRAL texts on the UNCITRAL website does not show the MLEGI.

Model Law on Cross-Border Insolvency the foreign representative needs recognition by the court of the enacting state and in many cases a relief decision by the court of the enacting state, in order to achieve any results there. He will therefore be dependent on a substantive review by that court to a considerably larger extent than the insolvency practitioner from an EU members state under the EIR.

Substantively, to a large extent the EIR and the MLEG have the same approach. Art. 9–18 MLEG contain provisions on mutual coordination and cooperation between the courts and between courts and insolvency representatives.[6] Art. 19–20 provide for the opening of a planning proceeding in the enacting state and Art. 21–26 for the recognition of foreign planning proceedings and the granting of relief to the group coordinator. The planning proceeding is the MLEG equivalent to the EIR group coordination proceeding and the group representative is the equivalent to the EIR group coordinator.

To facilitate the development and implementation of a group insolvency solution, the MLEG provides for enterprise group members to participate in the insolvency proceedings opened in the enacting state (Art. 18). However, such participation is voluntary, and an enterprise group member may commence or terminate participation at any time (Art. 18, par.no. 3).

The planning proceeding is, generally, a 'main proceeding' commenced with respect to an enterprise group member.[7] The MLEG provides that the enterprise group member with respect to which the planning proceeding commences must be one that is likely to be a necessary and integral part of the resolution of the enterprise groups (or a part of the enterprise groups) financial difficulties.

Art. 19 para. 1 MLEG provides that the court may appoint a group representative and thereby open planning proceeding[8]. Contrary to the EIR the MLEG does not contain provisions on the right of the insolvency representatives to have an influence on the appointment of the group

6 These articles also provide for the cooperation with group representatives appointed in a planning proceeding, which is the MLEG equivalent of a group coordination proceeding.

7 The additional text at the end of the definition in subparagraph (g) of the Model Law indicates that a court could, subject to subparagraphs (g) (i) to (iii), recognize as a planning proceeding a proceeding that is separate to the main proceeding, provided that the separate proceeding has been approved by the court with jurisdiction over the main proceeding.

8 Contrary to the structure under the EIR they need not be separate from the main proceedings.

representative or to choose another venue for the planning proceeding, but on the other hand the planning proceeding needs recognition and the granting of relief in the other jurisdictions in order to be effective. Both the EIR and the MLEG provide for the opening of coordination proceedings or planning proceedings, but in the case of the EIR only on voluntary basis. As mentioned above, Art. 64 EIR provides that any insolvency practitioner appointed in respect of any group member may opt out of group coordination proceedings. Under the MLEG, the foreign group representative may seek relief in the enacting state, such as a stay of execution against the assets of the local group company or an examination of witnesses. The court of the enacting state has jurisdiction to grant such relief. Creditors must receive adequate protection (Art. 27) in case of relief. The Legislative Guide clarifies that there must be a balance between relief available under the MLEG and the protection of interests of the persons both natural and legal that may be affected by the relief.

A group insolvency solution may be developed in the planning proceeding (Art. 2 (g) MLEG). Art. 26 establishes that when the group insolvency solution affects an enterprise group member that has the COMI or an establishment in the enacting State, the portion of the solution affecting the enterprise group member which is situated in that State shall have effect once it has received approvals and confirmation required by the law of that State. This means that the approval of all the courts of all the States where procedures referred to enterprise group members, are required.

The *Legislative Guide* clarifies that Art. 26 doesn't provide for a procedure for seeking approval of the group insolvency solution, leaving it to the law of the approving State. Consequently, each State where there is at least one group member will have to take such decision and will apply its own law. Therefore, the general approval of the group solution is likely to need a considerable amount of time and may depend on various conditions.

The result is that the implementation and approval of a planning proceeding is a long trip and a difficult one.

Art. 63 par. 1 b) EIR provides that no creditor of any group member expected to participate in the proceedings is likely to be financially disadvantaged by the inclusion of that member in such proceedings'. This limit may be considered reasonable if read as an expression of the no creditor worse off principle, as compared to the liquidation of the single group member. Under the MLEG there is no such provision, but the creditors of a group company are protected by the duty of the court to look after their interests when deciding on the requested relief.

Art. 72 par. 3 EIR affirms that 'The plan referred to in point (b) of paragraph 1 shall not include recommendations as to any consolidation of proceedings or insolvency estates'. In this way the plan is in conformity with the European civil law tradition where the consolidation may be only procedural, not substantial, respecting the autonomy of the estate of each group member. The MLEG doesn't use the expression ''substantive consolidation", but the Legislative Guide notes that in limited circumstances substantive consolidation could be part of the plan.

C. Efficiency of the EIR and of the MLEG

The Conference on European Restructuring and Insolvency Law ('*Ceril*') issued a statement and a report on 29 June 2021 (*Ceril* statement 2021–2)[9] on EU Group Coordination Proceedings. Statement 2021–2 observes that as matter of fact the coordination proceeding provided by the EIR was never used in any significant case of a cross-border insolvency. The *Ceril Statement* observes that there are several good reasons to appreciate the coordination proceeding. A preliminary stay is possible[10], it is likely that domestic courts respect the coordinator as someone impartial and independent, the reorganization can secure additional value of the group, in the opinion of many scholars the coordination is a good compromise between centralization and preserving the autonomy of the individual procedures and those same scholars think that the coordination proceeding may encourage the participants. The *Ceril Statement* also notes that especially in cases concerning multinationals with a pan European presence (air carriers, groups in automotive), the coordination proceeding could provide a good solution. In the list of the positive reasons for the adoption of the coordination proceeding there is also the need for a strategy for a coordinated solution and the fact that the coordination proceeding benefits from the automatic recognition by all the Member States.

9 Both the statement and the annexed report can be downloaded from https://www.ceril.eu/news/ceril-statement-2021-2-on-eu-group-coordination-proceedings.

10 Art. 72 par. 2 (e): request a stay for a period of up to 6 months of the proceedings opened in respect of any member of the group, provided that such a stay is necessary in order to ensure the proper implementation of the plan and would be to the benefit of the creditors in the proceedings for which the stay is requested; or request the lifting of any existing stay. Such a request shall be made to the court that opened the proceedings for which a stay is requested.

However, it seems that there have been no cases since the enactment of the Regulation. The Recast of the EIR has been in force since 2017 after five years of the instrument lying bare the conclusion may be inferred that the coordination proceeding does not resolve the exigence for which it was developed.

The *Ceril Report* annexed to the statement provides several explanations for the failure that has so far occurred. It should, however, be noticed that these explanations to some extent are guesses for the reasons, as there are no reliable and consistent sources demonstrating why insolvency practitioners did not invoke the coordination proceeding. Furthermore, it is conceivable that some of the reasons provided by *Ceril* may be overcome in due time when the instrument becomes better known and initial application proves successful. However, we are not optimistic in this respect as insolvency practitioners dealing with large cases already are very much aware of its existence.

Nevertheless, *Ceril* observes that as some countries have a quite small economy, not all courts and insolvency practitioners will understand the concept of coordination. Mostly courts, sometimes even insolvency practitioners, have an inward culture and therefore won't constructively look and assist to go for cross-border solutions. Judges and insolvency practitioners remain reluctant to (simply) cooperate. Moreover, many courts have a somewhat passive attitude, they only use specific instruments they are acquainted with and their know-how of the EIR is low.

It has also been observed that corporate groups often look very different, from highly integrated vertical groups with cash pools to loosely cooperating companies in connected markets. It is difficult to coordinate such complexity. Furthermore, the *Ceril Statement* observes that 'from a legal perspective corporate groups are multiple companies acting (contracting) individually and thus liable to their creditors separately. Therefore, it might appear difficult to align coordination with national professional rules and develop a meaningful plan, as a variety of requirements for commencing insolvency or restructuring proceedings exist[11]'.

Although this may be true, it is not specific to international cases and equally applies in a domestic setting. Several countries have considered it necessary to introduce legislation concerning groups of companies. In general, group legislation has been inspired by the necessity to reestablish the centralized administration that existed prior to the opening of insolven-

11 Annex to CERIL Statement 2021–2, page 8.

cy proceedings and that was interrupted thereby if separate insolvency proceedings were opened with respect to each group member. This is the reason for a group restructuring proceeding or a group liquidation proceeding almost everywhere. The disruptive effect however is exacerbated in international groups because of the applicability of the insolvency law of the countries where each of the insolvent group companies has its COMI.

The added complexity of achieving an international group solution has not restrained European States like Italy or Spain from developing legislation dealing with international cases. Of course, the situation is more complicated in an international setting, but more difficult doesn't mean impossible if there is a serious reason to find a solution.

As a downside of coordination proceedings, it should be noted that creditors don't have voting rights in respect of the coordination proceeding. Creditors have no right to request the opening of those proceedings nor do they have rights of participation. This flaw may need to be addressed. Understandably, the decision to limit creditors' rights resulted from the desire to reduce the complexity of the proceeding, but creditors rights must be protected and moreover, creditors may be expected to try to avoid the opening of the coordination proceeding if they know that they will not have any possibility to participate.

Art. 73 EIR expressively addresses the issue of which language to use. A voluntary agreement on a common language is preferable. If participants are not able to agree, the coordinator has to communicate with each insolvency practitioner in the language they both agree on, and in the absence of such an agreement, in the official language or one of the official languages of the institutions of the Union, and of the court that opened the proceedings for the respective group member. Although there is a realistic chance that English will be accepted as the common working language, there is no guarantee that a common language for all included group members will be found.

In our opinion the language issue is not really an obstacle to the opening of the coordination proceeding, because English is commonly used, and it's well known between practitioners.

More serious is the argument that insolvency practitioners tend to act in a self-centred way (and fee-hungry) or to play out that they represent the most economically dominant company owning the most part of the assets or a large part of information or the largest part of the employees. If the insolvency practitioner doesn't want to lose control, he will fight against the appointment of a coordinator.

There are more important reasons that explain why insolvency practitioners do not request the opening of coordination proceedings. Two of these reasons are the costs and the time involved with such proceedings. The stay that the coordinator may ask for according to Art. 72 EIR stops for six months any liquidation of assets which is irreconcilable with the coordination project. The insolvency practitioner may prefer to avoid or opt-out of the coordination proceeding in order to reduce the interference of the coordination proceeding with the domestic one. This mechanism is very similar to the controversies we are used to see between the main proceedings insolvency practitioner and the insolvency practitioner who deals with the secondary proceedings.

Costs are also important. Making a preliminary estimate of the costs of the coordination proceeding is difficult. To these costs must be added the indirect costs coming from the delay of the proceeding. For the coordinator there is also the risk that an insolvency practitioner of individual proceedings may leave him exposed delaying or disputing a payment as he may have no interest in supporting the coordination proceeding.

The more serious reason that convinces the insolvency practitioner not to open the coordination proceeding is the lack of power of the coordinator. As we mentioned before, the coordination proceeding has to be opened on a voluntary basis. Moreover, it has been observed that the group coordination proceeding in the EIR is unlikely to be particularly helpful, as it lacks certainty and predictability[12]. More importantly, the lack of powers also constitutes an obstacle for the implementation of the proposed coordination plan. The construction and execution of individual restructuring plans for each group company need the cooperation of the majority of participants in the individual proceedings. Otherwise, the group proceeding will not be effective[13].

The experience in the application of the EIR with respect to single enterprises shows that local creditors sometimes prefer to obtain protection from secondary proceedings. Discussions and fights between local creditors and the insolvency practitioner of the main proceeding are frequent. It also happens that the secondary proceeding is secondary only in name, as the largest part of assets and activities is located in the member state of the secondary proceedings. The EIR provides the main proceeding insolvency practitioner with powers to coordinate the procedures and to obtain protec-

12 Cohen/ Dammann /Sax IILR 2015, 120.
13 Madaus ZRP 2014, 194; Cohen/ Dammann /Sax, IILR 2015, 120.

tion from the local court. He may also offer to local creditors the same treatment which the local law would provide for in secondary proceedings, if they agree not to open such secondary proceedings. According to Art. 36 EIR the insolvency practitioner may give a unilateral undertaking in respect of the assets located in the Member State in which secondary insolvency proceedings could be opened. Such undertaking would mean that he would comply with the distribution and priority rights under national law that creditors would have if secondary insolvency proceedings were opened in that Member State.

The experience with the secondary proceeding where the EIR provides duties of cooperation between the insolvency practitioner of the main and secondary proceedings, shows that there are bugs and conflicts. The root of these conflicts comes from the creditors interests that may differ from each other. Some groups of creditors may be interested in the liquidation instead of restructuring, can expect a more favourable treatment from local law than from the *lex concursus* of the main proceeding, can disapprove of major costs of the main proceeding, and may have many other good reasons to look at the local proceeding as something more practical, closer to them and more efficient.

We will not discuss these issues here in more detail as they fall outside the scope of this contribution.

The system of EIR secondary proceedings is the result of a compromise between universalism and territorialism. If we compare that system with the EIR system of the provisions relating to groups of companies, it appears that the latter system does not give sufficient powers to the coordinator in order to ascertain certainty and efficiency to the coordination plan. It has been argued that as a result of the dynamics of group insolvencies, resistance will especially be acute when gains from cooperation and universalism are less evident. If facilitation of foreign insolvency-related judgments as provided for in the UNCITRAL Model Law for Enforcement of Insolvency Judgments is at stake, courts that are asked to turn over assets to a main proceeding abroad, may yield to the frustration of local creditors in a situation where the longer-term benefits or reorganization, increased international trade, certainty and so forth are less evident and harder to quantify. This can also be perceived as an existing endowment of sovereignty and vested rights[14].

14 Mevorach, European Business Law Review, 2022, p. 283–315.

The EIR legislator decided that voluntary coordination was the best way to support the efficiency of the coordination proceeding. However, coordination can be obtained on a voluntary basis also without opening a coordination proceeding. The EIR therefore provides for coordination between proceedings opened on a standalone basis. Art. 56 limits cooperation in the sense that it should not be incompatible with the rules applicable to the proceeding and doesn't entail any conflict of interest. Pursuant to Art. 56 no. 2 agreements may be reached, between the insolvency practitioners of the group companies and one or several of them may be charged with specific tasks to be accomplished if it's allowed by the local law. Insolvency practitioners may also enter into specific agreements and protocols amongst themselves.

So, the question is whether the EIR coordination proceeding doesn't work, or that all needs of coordination are satisfied by the spontaneous coordination permitted by Art.56 a stay may be asked in any proceeding opened with respect to another member of the group according to Art. 60 and by agreements and protocols that insolvency practitioners may join.

The answer is clear. Spontaneous coordination is possible when there are enough skills and experience in the insolvency practitioners and there is no conflict of interests, except where such conflict of interest may be solved in an easy way. In more difficult situations coordination may be desirable, but the coordination proceedings need teeth and claws to be effective.

If we compare the groups planning proceeding in the MLEG with the EIR coordination proceeding, we can find some differences that may assure more efficiency of the Model Law solution. The concept of a group insolvency solution as expressed by Art. 2 (f) and referred to in many articles of the MLEG is an objective that may be reached only through the approval of the relevant courts. Art. 26 provides that the portion of the group insolvency solution affecting an enterprise group member that has its COMI or an establishment in the enacting state must be approved by the local court to have effect in the state according to the local law, However it is not required that with respect to all these group companies insolvency proceedings are opened in these relevant jurisdictions.[15] Art. 22 and 24 provide provisional relief and relief upon recognition of a foreign planning proceeding in a wide manner. Here again it is not required that with respect to the group company concerned insolvency proceedings have been opened. As mentioned above, pursuant to Art. 36 EIR the insolvency

15 MLEG Guide to Enactment, nr. 43.

practitioner of main proceedings may give a unilateral undertaking in respect of the assets located in the Member State in which secondary insolvency proceedings could be opened. Such undertaking would mean that he would comply with the distribution and priority rights under national law that creditors would have if secondary insolvency proceedings were opened in that Member State. No such provision exists in the EIR with respect to group companies, which would be an entirely different matter, because in the Art. 36 EIR proceedings there are insolvency proceedings in place which encompass the local assets, i.e. the main proceedings, whereas in case of such undertaking with respect to a group company there would not. MLEG however seems to provide for such solution in Art. 30, although the wording of that article is not quite clear.

The function of the group coordination plan is that of a mere reference plan. Art. 72, par. 1, under b, EIR lists non-exhaustively topics which can be dealt with in the group coordination plan, i.e.: 1. measures to be taken in order to re-establish the economic performance and the financial soundness of the group or any part of it; 2. settlement of intra-group disputes as regards intra-group transactions and avoidance actions; and 3. agreements between the insolvency practitioners of the insolvent group members. Apparently, this plan is not a rescue plan, which might deal with such issues as impairment of claims, but a plan that only deals with coordination proper.

Art. 70 (2) subpara. 1 EIR explicitly states that the group coordination plan is not binding upon the insolvency proceedings and that the insolvency practitioner appointed in those proceedings does not have to follow it either in whole or in part. The EIR relies on a ‘comply or explain’ mechanism. Article 70 (2) subpara. 2 provides that if the insolvency practitioner doesn’t follow the coordinator's recommendations or the group coordination plan, he shall give reasons for not doing so to the persons or bodies that he is to report to under his national law, and to the coordinator. If an insolvency practitioner does not follow a sensible group coordination plan without a valid reason, this may have consequences under his national law. It may constitute a violation of his/her duties, creditors or other interested parties may have the right to ask the court for an order to comply with the group coordination plan or it may lead to (civil or even criminal) liability for damages or even the revocation of the insolvency practitioner's appointment.

What has been created was a compromise solution that does not work. There is no interest to ask for the opening of the coordination proceeding. The stakeholders know that it does not provide an efficient solution.

The MLEG is founded on voluntary participation by the receiving state, possibly through the mechanism of the relief provisions. Still, in fact each part of the group solution plan must be approved by local courts and become binding in each State which enacted the MLEG.

Both the EIR and the MLEG contain elaborate provisions on cooperation and coordination. It is questionable whether these provisions are really necessary and whether they solve a problem. In some group insolvency cases protocols are agreed and the insolvency practitioners achieve some level of cooperation. Such cooperation may not require a statutory obligation. Moreover, where such obligation exists, like in the Art. 56–58 EIR, it is questionable whether it really adds anything as the insolvency practitioners or courts may refer to the exceptions. The time required to obtain the plan's approval by a local court may be long and actually too long to save the business. If we multiply this time for all proceedings in various member states necessary to get the plan to be binding in all the states concerned, the result may very well jeopardize the feasibility of the plan.

D. Proposals

How to solve the problem?

The easiest and most obvious way is to amend the EIR. Art. 90 (2) of the Regulation provides that no later than 27.06.2022, the Commission shall present to the European Parliament, the Council and the European Economic and Social Committee a report on the application of the group coordination proceedings. The report shall be accompanied where necessary by a proposal for adaptation of this Regulation.

Until now there is no evidence that the Commission prepared the report or submitted a proposal to deal with the difficulties to apply the coordination proceeding.

It should be noted that there is a lack of coordination between EIR and the EU Directive 1023/2019 on the early restructuring framework. The Directive aims to promote the rescue of the enterprise hit by a crisis or insolvency, but still viable. The EIR in the Art.10 extends the Regulation's scope to proceedings promoting the rescue of economically viable but distressed businesses. Most of the Regulation however is still very similar to the previous regulation 2000/1346[16].

Regarding the choice between restructuring and liquidation, the EIR should express a general rule of favour for the solution aimed at rescuing the enterprise and protecting the employees, when creditors receive not less than they could get in a liquidation proceeding. And this rule should be applied also in the relationship between the coordination proceeding and the other group company proceedings. Protection of local creditors should be regulated within the terms provided for by Art. 38 EIR for the decision to open a secondary proceeding.

The rules for insolvency proceedings of companies of a corporate group in Art. 56 to 77 EIR assume the opening of parallel main insolvency proceedings for group companies. In contrast, the preventive restructuring approach to a group's financial debt structure would commonly entail a single point of (judicial) entry at the level of the contracting or bond issuing group company. In the case of group companies which are jointly and severally liable for the same debt or group companies which have given guarantees for the repayment of the debt by the main debtor, some insolvency laws allow for intra-group third party release clauses in restructuring plans. Third-party releases entail a total or partial discharge or amendment of claims against third parties, such as co-obligors, guarantors and collateral providers (typically, group members) in the insolvency or restructuring proceeding of the principal debtor. Such clauses entail that the group company is released jointly with the insolvent debtor, without insolvency proceedings having to be opened with respect to this group company. Both Dutch and German law on preliminary restructuring plans which implement Directive 2019/1023/EU provide for such tools, although under the Dutch provision[17] such release is possible only if the court which confirms the plan would also have jurisdiction if the third party-group company would offer a plan itself. In the United Kingdom co-debtor releases were used to enable English schemes of arrangement to be used in cases where the principal debtor was not an English company. Examples

16 CERIL, Report 2022–2 on Cross-Border Effects in European Preventive Restructuring, 7.

17 Article 372 Dutch Bankruptcy Act.

thereof are the *Lecta Paper* judgments[18] and the *Port Finance Investment Ltd.* convening judgment.[19]

Lecta Group was the largest manufacturer of specialty and wood-free paper products in southern Europe. The company's ultimate parent was a Luxembourg company, *Lecta SA*. *Lecta SA* had issued notes in the amount of 600 million EUR, which were governed by New York law and subject to the jurisdiction of the New York court. In order to scheme these notes, an English group company, *Lecta Paper UK*, became a co-debtor of the notes. With respect to this company a scheme of arrangement a restructuring plan was adopted. The scheme provided not only that *Lecta Paper UK* was released from its obligations under the notes[20], but it provided for the release of *Lecta SA* as well. Under a scheme of arrangement, it is possible to stipulate a release of ancillary claims against guarantors and co-debtors and that is the purpose of this scheme. The question whether there is a sufficient connection with the UK is answered in the affirmative. The *English High Court* agrees with an earlier judgment in which the same technique was applied and in which the court considered:[21] 'In cases such as the present, however, what is being attempted is to achieve a position where resort can be had to the law of a particular jurisdiction, not in order to evade debts but rather with a view to achieving the best possible outcome for creditors. If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping.' The *Lecta Paper*[22] court furthermore considers: 'I am satisfied that in the present case the structure that has been devised involves good forum shopping, (…), designed to produce the best possible outcome for the creditors as a whole.'

The *Port Finance Investment Ltd* case[23] concerned a leading cruise operator. The scheme concerned notes which were issued by a Turkish group company, and which were governed by New York law and which contained a forum clause favouring the New York courts. An English scheme company was created merely in order to offer the scheme. The court considers in

18 Re Lecta Paper UK Ltd [2019] EWHC 3615 (Ch) (19 December 2019) and Re Lecta Paper UK Ltd [2020] EWHC 382 (Ch) (28 January 2020).
19 Re Port Finance Investment Ltd [2021] EWHC 378 (Ch) (23 February 2021).
20 And junior notes to a lower amount would be issued.
21 Re Codere Finance (UK) Ltd [2015] EWHC 3778 (Ch) (17 December 2015) § 18.
22 Re Lecta Paper UK Ltd [2019] EWHC 3615 (Ch) (19 December 2019) and Re Lecta Paper UK Ltd [2020] EWHC 382 (Ch) (28 January 2020).
23 Re Port Finance Investment Ltd [2021] EWHC 378 (Ch) (23 February 2021) § 58.

the convening judgment that 'It is settled law that a scheme under Part 26 may include a mechanism providing for the release or variation of creditors' rights against third parties such as guarantors.'[24]

Other examples of cases in which use was made of a created co-debtor *are Re Codere Finance (UK) Ltd*[25], *NN2 Newco Ltd, Re Politus BV*[26] and *Re Selecta Finance UK Ltd*[27].

The *Ceril* 2022–2 *Report* comments on the use of third-party releases in preliminary restructuring plans. It notes that EIR does not contain any provision to safeguard this approach. Instead, the entity-by-entity principle enshrined in the group insolvency provisions might potentially provide an argument against the compliance of such releases with EIR principles[28].

Third party releases in restructuring plans can be forced upon the creditors concerned and may frustrate legitimate expectations of those creditors relying on cross-guarantees and other forms of cross-liability arrangements. Extending the effects of debt reorganization to third parties in the absence of a separate insolvency proceeding may also run contrary to the longstanding views on corporate insolvency and entity shielding[29].

An extensive and highly profiled debate in US is taking place about the use of the third-party release orders from the American Bankruptcy Courts that can jeopardize the creditors' actions against subjects that are not object of the proceedings.

The use and legitimacy of these clauses in an international context may be more controversial than in a national setting. In any case the group reorganization involves more complex problems that those that could be solved by resorting to third-part release clauses. For example, the third-party release affects only part of the claims against the co-debtor (i.e. the claims for which the principal debtor is liable) and if the group company is not a co-debtor, the instrument cannot be used at all, even though the restructuring of the group company may be an essential part of the group solution.

The present instruments do not provide an adequate solution for reorganizations involving groups of companies with activities in multiple jurisdic-

24 Re Port Finance Investment Ltd [2021] EWHC 378 (Ch) (23 February 2021) § 58.
25 EWHC 3778 (Ch) (17 December 2015).
26 EWHC 1917 (Ch) (22 July 2019).
27 EWHC 2689 (Ch) (14 October 20.20).
28 CERIL, Report 2022–2 on Cross-Border Effects in European Preventive Restructuring, p. 9.
29 Kokorin, European Company and Financial Law Review, 2021.

tions. Presently a reorganization by way of a restructuring plan involving group companies having their COMIs in different jurisdictions, requires that main proceedings are opened in each of those jurisdictions and, more importantly, that the plan is voted on in each of those jurisdictions and is approved by each of the courts. It is understandable that the member states are reluctant to entrust important decisions with respect to their 'own' companies to the courts of other member states. However, without some degree of transfer of these powers an encompassing group-solution cannot be achieved, and unnecessary loss of capital and employment is the result. In fact, some degree of transfer is already present where member states accept that the rights of creditors against co-debtors in other jurisdictions than the jurisdiction of the insolvency proceedings can be impaired.

INSOL Europe, in its 2012 Proposal[30], has proposed provisions for a unified European Rescue Plan. One feature of that plan is that it is adopted in the jurisdiction of the parent company of the group. The question which company is the parent company is determined in accordance with the provisions of the Seventh Council Directive 83/349/EEC on consolidated accounts (now Directive 2013/34/EU) and it is the highest European company in the company tree in respect of which insolvency proceedings have been opened. The structure of the plan is similar to the structure of a plan pursuant to the Restructuring Directive 2019/1023/EU or the U.S Chapter 11 bankruptcy plan. That system is useful for the adoption of a plan involving multiple companies, as it involves placement of creditors with diverging interests in separate classes and, in case one or more classes reject the plan, the balancing of the interests of the individual classes against each other. In the context of a single company plan this principle means that preferred creditors will be placed in another class than ordinary creditors or secured creditors and that, where necessary, distinctions can be made between e.g. groups of ordinary creditors, justifying placing them in different classes. If one or more classes rejects the plan the court will have to determine whether the plan is fair nevertheless and the absolute or relative priority rule will constitute an important test in this respect. In the context of a multi-company plan, classification of the creditor in classes can take place in a similar way, albeit that creditors of different companies should be placed in different classes. If one or more classes reject the plan, the determination whether the plan is fair is somewhat more challenging than in the case of a single-company plan, because the absolute or relative priority rule cannot

30 INSOL Europe, passim.

be applied with respect to classes of creditors of different companies. However, it is not impossible to make such determination, taking into account the value of the assets of each of the involved companies. After all, also in the case of single-company plans, there is not always a strict application of the absolute priority rule, but there are escape provisions.

The INSOL Europe proposal involves a strict criterion for the determination of the parent company which will define the venue of the group rescue plan and there is mandatory participation by the subsidiaries as decided by the insolvency practitioner of the parent company. If the sovereignty transfer involved in such solution is too severe, other solutions are conceivable. For example, a system similar to the one for the opening of group coordination proceedings may be an alternative, in which the first court seized will open the unified plan proceedings and a majority of the insolvency practitioners involved may decide on another venue. Also, it is conceivable that group companies can opt in or opt out at the onset of the plan proceedings, as determined by their insolvency practitioners or the supervising courts.

E. How to deal with non-EU insolvency proceedings

Amending the EIR will not solve a different problem: the absence in the EU system of the possibility to recognize an insolvency or restructuring proceeding opened abroad as the coordination proceeding for all the groups enterprises located in the EU member states. This problem could be solved by the EU implementing the provisions of the MLEG on recognition of a foreign planning proceeding and relief.

As noted earlier, the MLEG has not yet been adopted anywhere, but this legislative text appears to address the groups restructuring issues adequately, where non-EU proceedings are involved and therefore the principle of union trust does not apply. It would be preferable to combine adoption of the MLEG with adoption of the 1997 UNCITRAL Model Law on Cross-Border Insolvency ('MLCBI').

There has been a serious debate whether adoption of the MLCBI falls within the scope of the powers of the European Union. The question is whether the TFEU provides a sufficiently solid basis for building a regime for recognition of non-EU insolvency proceedings as envisaged by the MLCBI and now also by the MLEG.

The answer given by the 2012 Insol Europe study[31] is that the EU has these powers on the basis of Articles 3(1)(e), 4(2)(a) and 81 TFEU because the Union created a system for the recognition of EU insolvency proceedings. The Lisbon Treaty recognized in Art. 3(2) TFEU the EU's implied exclusive external competence[32]. This provides a strong argument that the EU can assume the same powers as regards non-EU insolvency proceedings, pursuant to theory of the implied powers. EU institutions may exercise any power reasonably necessary to the achievement of an objective set forth in the EU Founding Treaties (in this case Art. 81 TFEU) even in the absence of an express power of action provided for in relation to that objective. To incorporate the UNCITRAL Model Law provisions in the EU law, likely as part of the EIR, is essential to improve the functioning of the EU insolvency proceedings. The incorporation is useful to eliminate obstacles to the proper functioning of the insolvency and restructuring proceeding in the EU as far as extraterritorial proceedings can have a fundamental influence within European Union.

It should be added that EU Directive 1023/2019 indicates the need for coordination between the insolvency legislation of the Member States in the context of restructuring of still viable enterprises. It's highly probable that in the future the harmonization will be extended to other issues related to insolvency proceedings.

In recent years some member States recognized the MLCBI (Poland, Greece, Romania and Slovenia). It's highly undesirable that some Member States recognize the powers of a foreign insolvency practitioner on the basis of the MLCBI, whereas other States apply their own international private law, conventions with individual other States or the Lugano convention or other international instruments. There is a growing need for a common standard for the recognition of a foreign proceeding opened outside EU.

31 Insol, p. 109; On the evolution of the principle of Implied External Powers of EU since the ERTA case: Butler/ Wessels, Happy Birthday Erta! 50 Years of the Implied External Powers Doctrine in Eu Law, in European Law Blog, 31 March 2021 <https://www.europeanlawblog.eu/pub/happy-birthday-erta-50-years-of-the-implied-external-powers-doctrine-in-eu-law/release/1>; Chamon, Common Market Law Review, 2018, p. 1101–1141.

32 TFEU art. 3(2): '2. The Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or in so far as its conclusion may affect common rules or alter their scope'.

It seems to us that the MLEG does constitute a useful instrument for dealing with group insolvencies, involving group companies which are located outside the EU and that therefore it is recommended that the EU adopts the MLEG for such cases. More importantly still it should also adopt the MLCBI. Alternatively, these model laws could be adopted by the individual member states. It has been noted[33] that the MLEG and the Model Law for Enforcing Insolvency Judgments are connected also. There is an argument that the Model Law for Enforcing Insolvency Judgment is actually superfluous and was only drafted because UK courts gave a very narrow interpretation of the MLCBI. With a somewhat more generous interpretation of the MLCBI, adoption of the rather complex Model Law for Enforcing Insolvency Judgments may not be needed.

The conclusion is that EU should amend the EIR and include rules for the recognition and facilitation of foreign proceedings. Those rules should constitute an adoption of the MLCBI and the MLEG.

Until this day the debate on this issue has not been deemed urgent, but in our view the importance and urgency are growing by the day.

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33 Mevorach, passim.