Leave those debtors alone?: Towards a coherent framework for the DIP

Paul Omar discusses the status of the debtor-in-possession (DIP) in the EIR Recast

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> *Article 76 elevates a debtor-in-possession to the same status as any insolvency practitioner for the purposes of Chapter V*

An intriguing provision in the European Insolvency Regulation (Recast)[1] ("EIR Recast") in Article 76 elevates a debtor-in-possession ("DIP") to the same status as any insolvency practitioner for the purposes of Chapter V and the rules governing group coordination proceedings.

In fact, the DIP first receives mention in Recital 10, which sets out the intention of the text to extend not just to "orthodox" rescues of viable businesses and second chances for entrepreneurs, but also to procedures intervening at a stage where insolvency is only a likelihood or that leave the DIP partially or fully in control. The Recital also recognises that it is not necessarily the case that an insolvency practitioner is appointed in some scenarios, but is willing to bring these procedures within the ambit of the EIR Recast, provided that they are subject ultimately to the control or supervision of a court, even if that control or supervision is only engaged on a challenge by a stakeholder. This explains why Article 1 is drawn, disjunctively, to include procedures involving divestment of control and appointment of an insolvency practitioner *or* those that involve control or supervision by a court of a debtor and/or its affairs, but which leave the debtor in charge.[2]

Elsewhere in the text, the DIP features, albeit sporadically. The cooperation and communications provisions in Article 41 apply *mutatis mutandis* to the DIP;[3] so too, the facility in Article 55 to require a translation or further proof of a claim by a creditor. Article 6 authorises DIPs to bring actions deriving directly from insolvency proceedings, while Articles 28-29 state that publication in any member state of the notice of an opening judgment, including on any specialist register, may be mandated by a DIP. Article 38, designed to give advance notice to those likely to object to the opening of secondary proceedings (i.e., those conducting main proceedings), also applies to provide DIPs with forewarning. Moreover, under the same provision, the impact of any stays or protective measures ordered will equally apply to a DIP in that position.

When contrasted with the position of the insolvency practitioner, who is named in

many more provisions, the mentions of the DIP barely constitute a framework, let alone a coherent one. Why is this the case? Furthermore, what impact might this have on such DIP-led procedures, which are becoming increasingly common?

Origins of the EIR (Recast)

It is perhaps with knowledge of the origins of the text that one can provide part of the answer to those questions. With roots in the 1960s, but whose provisions only became fully-formed in the 1990s, the embryo of what would become, successively, the European Bankruptcy Convention 1995 and European Insolvency Regulation 2000[4] ("Original EIR") (the predecessor to the EIR Recast) post-dated the advent of DIP procedures, commonly believed to have been promoted (if not introduced) by Chapter 11 of the US Bankruptcy Code 1978 ("Chapter 11"). However, the paradigm it encapsulated was a very traditional one: i.e., proceedings of an entity whose centre of main interests grounded the jurisdiction of a particular court, but which also allowed for satellite proceedings at the location of an establishment, all of which proceedings were ostensibly under the care of appointed insolvency practitioners[5] and were coordinated by the same with view to a better return for all creditors, wherever located.

This paradigm, nonetheless, barely acknowledged the reality of group structures, which arguably were the necessary liability-limiting choice to help protect the unprecedented increase in foreign direct investment that had been seen since the 1960s and that had spurred the growth in the number of multinational corporations from the 1970s onwards.[6] The case has been made that the text also inhibited restructuring, whether of single or group entities, because of the limitation in the choice between rescue or liquidation depending on where the proceeding was within the overall hierarchy.[7] And, in the definition of what constituted an insolvency proceeding, Article 1(1) of the Original EIR (boosted by the rationale set out in Recital 10) stated that the text extended to "collective insolvency proceedings which entail the partial or total divestment of the debtor *and* the appointment of a liquidator". No room for DIPs there!

That said, one cannot entirely blame the Original EIR for not keeping up with the times, because the assumption that the DIP formula in Chapter 11 was reflective of modernity may be misplaced. At the time, it was seen as very much of a curiosity and the embodiment of the very different views Americans were thought to have of business risks, second chances and the role of the bankruptcy process, views that, some would insist, are still prevalent today. This perspective appeared to be dissonant, when contrasted with the conception of insolvency in Europe, where centuries of stigma and distrust of the debtor had seemingly combined to create a world in which the debtor could not be trusted to manage his/her own insolvency, given his/her likely authorship of his/her own predicament.[8] The only acceptable solution was divestiture and the entrusting of suitably qualified professionals with the management of the debtor's estate for the benefit of creditors.[9] Despite recognition of the need to remove stigma,[10] this arguably continues to be the paradigm that informs European texts.

Back to the modern age: The rise of the Debtor-in-Possession

While the origins of DIP-type procedures may be disputed, there is no denying that they are experiencing an uplift in use. Chapter 11 continues to hold sway in its jurisdiction of origin and has had an influence in many other countries in the shaping of modern insolvency procedural variants, albeit some might argue only because of its perceived economic impact, rather than as a genuinely thought through attempt at transplanting a workable procedure. Nonetheless, DIP-style processes have proliferated, the French *sauvegarde* (preservation) and the UK moratorium procedure being examples, albeit with hybridity involved.[11] Arguably, even the UK company voluntary arrangement (in which a monitor is appointed to oversee the application and the formulation of proposals) leaves the debtor's management largely in place, thus cleaving close to the DIP model. However, only scheme-like processes,[12] which can be seen in near-insolvency situations and where the management ostensibly formulate proposals, albeit with advice, are the closest to the ideal of the DIP as imagined in Chapter 11.[13]

More recently, in the shift towards preventive restructuring, the Preventive Restructuring Directive[14] ("PRD") has provided that the procedures it seeks to introduce should be available before insolvency, when the text asserts debtors enter collective insolvency proceedings that "normally entail a total divestment of the debtor and the appointment of a liquidator."[15] Moreover, the PRD contains a requirement that Member States ensure debtors can retain control over assets and the day-to-day running of their business.[16] It does, however, also introduce optionality, in that an insolvency practitioner need not be appointed, unless a stay is requested or a cross-class cram-down is required. In these cases, ostensibly to protect the parties, and also where the debtor requires an appointment, an insolvency practitioner can be involved in the drafting of the restructuring plan.[17]

All this seems to suggest that the framework in the EIR Recast dealing with DIPs is weak, especially given the development by Member States of procedures that seek to give the DIP more scope to manage and to manoeuvre out of insolvency. However, as asked above, does this weakness matter?

In the author's view, it matters

While the origins of DIP-type procedures may be disputed, there is no denying that they are experiencing an uplift in use

because of the need for coherence. The EIR Recast reflects very well the "orthodoxy" of the PIP model, but seems only to selectively acknowledge the DIP, whose capacity to act thus appears to be circumscribed. This is not helpful, given that many of the powers to coordinate instances and to take action appear to be denied to the DIP. This can end up giving DIPs a "shadow" status, in that their actions may not be recognised unless mediated via an insolvency practitioner. In this scenario, although in keeping with the "hybridity" seen in some countries, an appointment would appear to negate the rationale for DIPs and DIP procedures. And, if that is the case, then why include DIPs within the text at all? It smacks of a half-measure or afterthought: DIPs are becoming popular; how do we take them on board? If that were the only reason, that would be very unsatisfactory indeed.

> *The DIP model can indulge self-serving behaviour, in that there may be few checks on the DIP or guarantees of objectivity*

Summary

In the short term, there is an opportunity to cure the lacunae occasioned by the half-light into which the EIR Recast has thrown DIPs. Its Article 90 mandates the first review of its workings by 27 June 2027. Arguably, this offers a short period of time in which to suggest a proper treatment of DIPs that could sit within a revised text. This would be an area of reform worth pursuing, given that DIP-type procedures are not going to go away, but may well see a further resurgence, especially with the prompt given by the PRD.

Nonetheless, there are risks. The DIP model can indulge self-serving behaviour, in that there may be few checks on the DIP or guarantees of objectivity. Any supervision by a court, vaunted in the EIR Recast as justifying the inclusion of DIPs, may be wholly notional. There are, at present, no Codes of Conduct, professional and ethical rules or indemnity insurance, which are just some of the advantages of the PIP model. Even in the Chapter 11 model, concerns have been raised about self-serving behaviour and the appointment of compliant CROs. These issues would need to be addressed if a coherent framework were to be the outcome, especially one that offered DIPs comparable status to insolvency practitioners in their scope of action and participation in the coordination of cross-border cases under the EIR Recast (and any eventual successor texts). ■

Footnotes:

1 Regulation (EU) No. 2015/848 of 20 May 2015.
2 The text's definition of the DIP in Article 2(3) follows this logic.
3 Those in Articles 56 and 58 are presumably encompassed by the general wording of Article 76.
4 Regulation (EC) No. 1346/2000 of 29 May 2000.
5 Sometimes referred to as the practitioner-in-possession ("PIP") model.
6 See Stephen Cohen, 'From Obscurity to International Economic Powerhouse: The Evolution of Multinational Corporations', Chapter 3 in *Multinational Corporations and Foreign Direct Investment: Avoiding Simplicity, Embracing Complexity* (OUP, 2007) (41-61) and statistics cited at 47.
7 See, by this author, 'The European Insolvency Regulation: Milestones and Celebrations' (2024) Eurofenix (Autumn) 00 (to be published).
8 In *Re Citro* [1991] Ch 42, the judge describes the loss of the family home, given by way of security for a business debt, as being merely "…the melancholy consequences of debt and improvidence with which every society has been familiar."
9 One of the earliest formulations of this paradigm is in Articles 442 (divestiture) and 480 (appointment of trustees), French Commercial Code 1807.
10 See the Expert Group Report from the EU Best Project on Restructuring, Bankruptcy and a Fresh Start (2003).
11 In *sauvegarde*, DIP is an option for businesses below a determined threshold, while, for the moratorium, an insolvency practitioner is nominated to oversee it, even if the directors remain in charge, subject to restrictions.
12 Parts 26 and 26A, Companies Act 2006 (UK). In the *Dutch Wet Homologatie Onderhands Akkord* ("WHOA"), the scheme-like structure includes an option for the nomination of a restructuring expert, ostensibly to increase confidence in the process and avoid any conflict of interest.
13 Even in a Chapter 11 procedure, the appointment of a professional as Chief Restructuring Officer ("CRO") may be required to retain creditor confidence in the process.
14 Directive (EU) No. 2019/1023 of 20 June 2019.
15 Ibid., Recital 24; Article 4(1).
16 Ibid., Article 5(1).
17 Ibid., Recital 31; Article 5(3). Article 5(2) also provides an interesting get-out clause for Member States to be able to require mandatory appointments in certain circumstances.
18 See Clifford J. White III, 'United States Trustee Program's Agenda on Chapter 11 Corporate Reorganisation Issues' (2017), available at: <https://www.justice.gov/archives/ust/file/abi_201707.pdf/dl>.