

Opening secondary insolvency proceedings in the EU from 2017

Bernard P.A. Santen, Fabian A. van de Ven and Gert-Jan Boon follow up their previous article with further analysis based on the text of the European Insolvency Regulation 848/2015 (EIR Recast) which will come into force on 26 June 2017



BERNARD SANTEN
Senior Researcher in International Insolvency Law, Leiden Law School (The Netherlands)

In the Autumn 2015 edition of *eufofenix*¹ we introduced the subject and described the present situation as to the considerations to be made by a court when asked to open secondary proceedings.

This is important since courts often lack experience in international insolvency proceedings and needlessly opened secondary proceedings cost extra money, take extra time and may result in less efficient solutions. The Autumn article concluded with a list of observations to be made by a court when called to open secondary proceedings. This article continues the analysis based on the text of the European Insolvency Regulation 848/2015 (EIR Recast) which will come into force on 26 June 2017. The EIR Recast is an extension of the EIR, rather than a new concept. For the purpose of this paper two new features are important: that of court-to-court and court-to-IOH² communication, coordination and cooperation and that of the ‘undertaking.’

Court-to-court communication, coordination and cooperation

Communication, coordination and cooperation between courts across borders in the EU is arranged for in Article 42 EIR Recast.³ It requires a court before which a request to open insolvency proceedings is pending, or which has opened such proceedings, to cooperate with any other court before which a request to open insolvency

proceedings is pending, or which has opened such proceedings. Article 43 EIR Recast provides for cooperation and communication between IOHs and courts. It requires an IOH in main, secondary or territorial insolvency proceedings to cooperate and communicate with any court before which a request to open main or (other) secondary or territorial insolvency proceedings is pending or which has opened such proceedings.

Chapter V (Articles 56-77) of the EIR Recast concerns insolvency proceedings of members of a group of companies, and provides for detailed arrangements on IOH-to-IOH, court-to-court and court-to-IOH communication, coordination and cooperation in cross-border insolvency proceedings of members of a group of companies.

It should be noted that the court related coordination duties come to exist even when the proceedings are only in the phase when the request for opening them is pending.⁴

Regarding the subject of this article, for the opening of secondary proceedings, the ‘communication and cooperation’ provisions add new obligations for a court. A court knowing of or having good reason to presume an international character of the insolvency petition at hand must perform according to the EIR Recast. It must start cooperating and communicating with other courts involved as described in Article 42 EIR Recast, or organise this via already appointed IOHs, as described in Article 43 EIR Recast.

The ‘undertaking’

The second important extension of the EIR Recast related to our subject is the newly created right of giving an undertaking in order to avoid secondary insolvency proceedings, as provided in Article 36 EIR Recast.⁵

This is essentially an incorporation of the concept of ‘synthetic secondary proceedings’ into the text of the EIR Recast, a concept we described in our Autumn article. The idea is to grant the IOH in the main insolvency proceedings the possibility of giving an undertaking (unilaterally) to local creditors stating they will be treated as if secondary insolvency proceedings had been opened.⁶ Most notably, the IOH will agree to respect the distribution rules and the priority rights which would have been applicable when secondary proceedings would have been opened. Where such an undertaking has been given, the court seized with the request to open a secondary insolvency proceeding should be able to refuse that request if it is satisfied that the undertaking adequately protects the general interests of local creditors.⁷ To that effect, an IOH in the main proceedings should be given notice of such a request and be given the opportunity to be heard by the court.⁸

Article 36 EIR Recast contains numerous requirements for an undertaking to be valid, e.g. that it shall be made in the official language of the Member State where secondary proceedings could have been opened; that it shall be made in writing; that it shall be approved by a qualified



FABIAN A. VAN DE VEN
Master student business law, Leiden Law School, intern at TRI Leiden (The Netherlands)



GERT-JAN BOON
Researcher, Leiden Law School, TRI Leiden (The Netherlands)



majority of local creditors according to the local law. Subsequently, local law governs the distribution of the proceeds; the ranking of creditors' claims; and the rights *in rem*.⁹ The IOH has to inform local creditors of the undertaking, of the rules and procedures for its approval, and of the approval or rejection of the undertaking.¹⁰ Local courts may play a role in guarding the proper execution of the undertaking.¹¹ Obviously, there exists interplay between the extended duties for cooperation and communication and the possibility of opening an undertaking. It exemplifies the more pro-active role that is expected of courts in cross-border insolvency cases in the EIR Recast.

New provisions for secondary proceedings

Although the heading of Article 38 EIR Recast ('Decision to open secondary insolvency proceedings') would suggest otherwise, the article does not contain a central provision on the

decision to open secondary proceedings. Such a provision would not have been illogical, given the discussion presented in our Autumn article on the consequences of the Bank *Handlowy/Christianapol* case and especially the *Burgo/Illochroma* case. We would hold, that the decision elements mentioned in the Autumn edition of *eurofenix*¹², will still be valid under the EIR Recast since they refer to EU law, general principles and the insolvency regulation itself. There is absolutely no reason to suppose that these arguments would differ under the EIR Recast.

Articles 38, 39, 42 and 43 EIR Recast contain, however, some additional provisions for courts considering a request to open secondary proceedings:

1. The mandatory provision to give notice to the IOH in the main proceedings and to give this IOH the opportunity to be heard on the request;¹³
2. The mandatory refusal ('shall') to open secondary proceedings if the court is

satisfied that the undertaking adequately protects the general interests of the local creditors;¹⁴

3. The option to stay the opening of the secondary proceedings for a period not exceeding three months, well embedded by the right to order protective measures for protection of the interests of local creditors;¹⁵
4. The option, at the request of the IOH in the main proceedings, to open another type of insolvency proceedings on Annex A than requested,¹⁶ e.g., one that is better suited to serve reorganisation purposes;
5. The IOH has the right to challenge the decision to open secondary proceedings before the courts of the Member State in which the secondary proceedings have been opened;¹⁷
6. The duty to communicate and cooperate with any court before which a request to open secondary insolvency



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proceedings is pending or which has opened such proceedings, even if the request for the court itself to open insolvency proceedings is still pending.¹⁸

Concluding remarks

The leading question of this study was what judges should consider when deciding on a request to open secondary insolvency proceedings. This article demonstrates that even where the debtor's insolvency has to be legally dealt with as a given, as main proceedings have already been opened, the request to open secondary proceedings needs careful consideration, both under the EIR and under the EIR Recast.

In the present situation, the CJEU considers court discretion in the decision to open secondary proceedings a matter governed by national law. However, the CJEU provides that this must comply with (a) EU law; (b) in particular with its general principles, e.g. that of sincere cooperation and non-discrimination, and (c) the EIR. In applying its national law, the court must have regard to the objectives underlying the possibility of opening such proceedings i.e. protection of local interests (Recital 12 EIR) but such opening may serve different purposes as

well (Recital 19 EIR). Furthermore, it must have regard to the objectives of the main proceedings and take account of the overall scheme of the EIR. Moreover, we feel that the court should observe the general objective of the EIR, which is, according to Recital 2, 'that cross-border insolvency proceedings should operate efficiently and effectively.' As a consequence, refusing a request to open secondary proceedings is acceptable if it fits within that objective and the protection of local interests is guaranteed.

In the EIR Recast the above touchstones will remain valid since neither the text nor the nature of the EIR Recast indicate otherwise. The synthetic secondary proceedings will be given official standing as a so-called 'undertaking'. Besides, the EIR Recast provides the courts with the formal right of refusal, of staying the opening of the secondary proceedings during a period of negotiations not exceeding three months or by opening another type of insolvency proceedings more suitable to the case. Furthermore, the EIR Recast makes the courts duty bound to communicate, coordinate and cooperate with others courts and IOHs, even before the opening of secondary

proceedings.

By introducing the 'undertaking' in Chapter III of the EIR Recast, the European legislator has created a suitable, not over-regulated mechanism to avoid unnecessary secondary proceedings. In all this the courts play an important role, since opening of secondary proceedings cannot be seen as a given but will require independent scrutiny and a more active role of the court. If applied by courts with the central objective of both the EIR and the EIR Recast to operate more efficiently and effectively in mind, this will likely lead to less secondary proceedings, less costs and higher recovery rates. ■

Footnotes:

- 1 Edition 61, pages 20-22.
- 2 This comprises also IOH-to-court cooperation and communication.
- 3 The EIR currently only includes a duty for communication and cooperation among IOHs (Article 31 EIR). For more on communication, coordination and cooperation see B.P.A. Santen, *Communication and cooperation in international insolvency: on best practices for insolvency office holders and cross-border communication between courts*, 2015, Springer, ERA Forum/Journal of the Academy of European Law (2015) 16:229-240, DOI 10.1007/s12027-015-0398-8. Also: H. Vallender and E. Nietzer, *Cooperation and Communication of Judges in Cross-border Insolvency Proceedings*, in: Perspectives on international insolvency law, a tribute to Bob Wessels, Bernard Santen and Dick van Offeren eds., 2014, Kluwer Deventer. For an introduction to the EIR Recast, see: Samantha Bewick, *The EU Insolvency Regulation, Revisited*, *International Insolvency Review* (2015), DOI: 10.1002/iir.1240.
- 4 However, as far as IOHs are concerned, coordination duties only come to exist once the proceedings have been opened, Articles 41 and 56 EIR Recast.
- 5 The original articles 27 and 28 EIR on the opening of secondary proceedings become Articles 34 and 35 EIR Recast.
- 6 Recital 42 and Article 36(1) EIR Recast.
- 7 Recital 42 and Article 38(2) EIR Recast.
- 8 Article 38(1) EIR Recast.
- 9 Article 36(2) EIR Recast.
- 10 Article 36(5) EIR Recast.
- 11 Article 36 (7-9) EIR Recast.
- 12 page 22.
- 13 Article 38(1) EIR Recast.
- 14 Article 38(2) EIR Recast. Article 37(2) EIR Recast specifies that 'Where an undertaking has become binding in accordance with Article 36, the request for opening secondary insolvency proceedings shall be lodged within 30 days of having received notice of the approval of the undertaking.'
- 15 Article 38(3) EIR Recast.
- 16 Article 38(4) EIR Recast.
- 17 Article 39 EIR Recast.
- 18 Article 42(1) and 43(1) EIR Recast. We do not believe that these Articles require an active investigating role of the court. However, the court should ask the petitioner for more detailed information if a petition gives rise to suspicions of an EU angle to a case.

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