Harmonisation and the Brexit effect

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Alberto Núñez-Lagos discusses INSOL Europe's participation in the European insolvency laws harmonisation process and the effects of Brexit on harmonisation

> **THE BREXIT DECISION IN THE UK REFERENDUM WILL MOST PROBABLY FACILITATE THE HARMONISATION PROCESS OF THE REST OF THE MEMBER STATES' INSOLVENCY FRAMEWORKS**

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What is currently understood by the term "harmonisation"?

2016 has been chosen by the EU Commission as the year to study, analyse and eventually determine if and how the harmonisation of European insolvency laws could eventually be achieved.

All relevant European insolvency-related forums and organisations are openly discussing harmonisation. The Joint R3/INSOL Europe Seminar (London, 22 April 2016), the INSOL Europe Eastern European Countries' Committee Conference (Cluj-Napoca, 12-13 May 2016), the R3 Annual Conference (Budapest, 18-20 May 2016), the 5th European Insolvency & Restructuring Congress (Brussels, 16-17 June 2016) and INSOL Europe's Annual Congress (Cascais, 22-25 September 2016) are the main forums in which harmonisation is and continues to be discussed, not counting the EU Commission forums such as the experts' and stakeholders' meetings, the Consultation launched by the EU Commission on an effective insolvency framework within the EU and the conference on convergence of insolvency frameworks within the European Union (Brussels, 12 July 2016).

These forums have not reached any conclusions and did not endorse any specific solution or criteria for harmonisation. Indeed, certain groups with very particular interests are expressing their views of their very specific industry. The INSOL Europe Annual Congress in Cascais will be a very important venue to continue discussing harmonisation. Your participation is very important as it will condition, influence and help to reach conclusions on harmonisation. I would identify three approaches to harmonisation of insolvency laws depending on the intensity of the proposed areas:

1. Pre-insolvency restructuring – capable of full harmonisation.
2. Clawback (avoidance) regulations – capable of at least soft harmonisation.
3. The Insolvency Office Holders regime – difficult to harmonise now.

I propose we discuss each of these areas in an open and non-dogmatic approach in Cascais.

Full harmonisation

Full harmonisation will probably be possible in relatively few areas of insolvency law due to two issues: (i) old traditional insolvency roots of each of the local jurisdictions, and (ii) interrelation with other regimes and areas of law such as corporate law, banking regulations (e.g. capital requirements when lending to insolvency companies) and labour law regulations.

Soft harmonisation

Soft harmonisation would basically mean harmonising through principles to be adopted locally by the Member State's legislation, to be done with a great flexibility and a variety of legal tools.

Difficult to harmonise

There are other areas of insolvency legislation which are so deeply rooted in the legal tradition of each Member State that it would be difficult to obtain the necessary consensus for such harmonisation, at least during the current 2016 consultation process. No doubt that such areas will be harmonised in the future after a longer period of education of the stakeholders involved in the process.

Brexit

In this context, the Brexit decision in the UK referendum will most probably facilitate the harmonisation process of the rest of the Member States' insolvency frameworks.

The UK has a very particular insolvency regime which is efficient and is very deeply rooted in the UK judiciary and among its practitioners. Consequently, if the insolvency framework of the Member State is no longer taken into consideration for harmonisation purposes, the complexity of the harmonisation process is reduced, and more so if such a system is very different than the rest of the systems in Continental Europe. An example is that of the differences on harmonisation of pre-insolvency processes also known as preventive restructuring frameworks.

The UK has always tried to avoid the harmonisation of UK Schemes of Arrangement within an insolvency framework, unlike the rest of the Member States, especially as regards the use of the COMI criteria to determine the competent jurisdiction. Needless to say that coordination between the Continental Europe insolvency systems and the UK insolvency system is desirable and possible in cross border matters. Cross border matters between two jurisdictions should probably be regulated by a bilateral treaty on applicable law, recognition and enforcement similar to the current (recast) European Insolvency Regulation.

It would not make sense for the UK, nor for the rest of the Member States, that the UK would actively participate in the current harmonisation process and not be bound by its result as a consequence of Brexit.

Harmonisation of preventive restructuring frameworks

I did make a proposal for harmonising preventive restructuring frameworks in the last issue of Eurofenix (*#62, Spring 2016*). It seems that the discussion is now focusing on the type of debtor which should benefit from such a preventive restructuring framework. The answer to this question will depend on how a preventive restructuring framework should be promoted in detriment of full insolvency proceedings.

I would suggest that to the extent that classes of creditors are protected (mainly by having each class cast a separate vote with no possibility to cram down the dissenting classes), any debtor should have the right to restructure under these preventive schemes, even if a balance sheet test or a cash flow test is used to determine the solvency or insolvency of the debtor, because the dissenting classes of creditors can block any such restructuring plan by considering it abusive or simply against their interest. In other words, the creditors' right to vote the restructuring plan will prevent opportunistic use of the preventive restructuring framework by debtors.

There is also the possibility I mentioned in my previous article, of allowing the debtor to choose to which classes of creditors to propose the restructuring (e.g. financial creditors, trade creditors), leaving the rest of the creditors unharmed by the restructuring. This would avoid opportunistic policies from debtors who will only restructure depending on the classes of creditors with which they are able to reach agreements by majority.

Harmonisation on avoidance law

Soft harmonisation is possible in areas where the principles of insolvency law are similar while the tools to restructure or apply such principles are not.

Almost all, if not all, Member States' insolvency regimes have avoidance law institutions, generally based on the roman *actio pauliana* in order to protect the *par condition creditorum*. The specific terms of such avoidance actions differ very much from one jurisdiction to another. Some avoidance institutions identify specific transactions, whilst others would leave the decision on which transactions to claw back to the judge or the insolvency office holder. Periods to exercise such actions differ, the party entitled to exercise the action also differs. Such differences do not need to be fully harmonised or could be harmonised to a certain extent.

My proposal would be to harmonise as much as possible such issues, which would give business partners in cross border operations unrelated to the debtor or its directors the possibility to be aware of the risks they take when entering into transactions with counterparties which are on the edge of insolvency. Thus, the objective when harmonising the avoidance laws, is to have the same certainty/risk assessment on claw back all over Europe.

Harmonisation of the insolvency office holders' regime

Harmonisation of the insolvency office holders' ("IOH") regime is extremely complex due to three reasons:

1. The IOH is key to the implementation of insolvency proceedings and thus, the specific regime is tailored to the specific substantive law of each Member State.
2. IOHs' real circumstances, including their relations to the judiciary, make them a very special type of civil servant/professional/practitioner, so their regime is very difficult to harmonise if the whole substantive and procedural system is not harmonised.
3. IOHs have many functions, requisites and relations which make them very different in regard to their background and education.

As to the first area of differences among substantive laws, the IOH's regimes vary if the Member State's insolvency proceedings' purpose is mainly rescue or mainly liquidation (e.g. a different type of IOH is needed for each kind of proceedings) or even if the insolvency proceedings imply both rescuing and liquidation.

Considering the second area of differences, in some jurisdictions the appointment of the IOH is done by the court, while in other jurisdictions the IOHs are appointed by the creditors, the debtors, or by a mixed group. Each jurisdiction can also have a very different selection system, such as lists of professionals, appointed with or without a rotation system or simply by accepting the petition (selection) presented by the stakeholder filing for insolvency or restructuring. Finally, remuneration and the institution deciding upon the IOH's remuneration can also differ very much in each Member State.

Concerning the third area of differences, I would mention (i) the qualification, training and entry into the profession; (ii) the existence of professional bodies exclusively for IOHs or not; and (iii) the continuous education system if any.

There are other areas where differences exist. We will have a passionate discussion on how to address these issues and other areas of harmonisation at INSOL Europe's Annual Congress in Cascais on 22-25 September. The co-chairs of the INSOL Europe IOH Forum, Daniel Fritz, Marc André and Stephen Harris, look forward to a lively discussion with all participants in an exclusive panel, among others. *I promise that it will be a very interesting Congress in this very interesting and decisive year for the European insolvency framework.* ■

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