LEGAL DEVELOPMENTS

The EU Council Regulation in Insolvency Proceedings should make it easier to recover the debts of failed companies across the European Union. But a harmonised EU insolvency law is still some way off, writes Devi Shah

Integrating insolvency

The European Union (EU) Council Regulation on Insolvency Proceedings came into force in the UK on 31 May, 2002. Its stated objective is to improve the "efficiency and effectiveness of insolvency proceedings" having cross-border effects within the EU.

The regulation applies in all member states, except Denmark. Provisions in member states' national laws which conflict with the Regulation will be superseded by it. Amendments have also been made to the principal insolvency legislation in the UK by a number of statutory instruments.

The Regulation applies to most insolvency proceedings of a debtor which has its centre of main interests (CMI) within the EU. This is described as "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties" and is a key new concept.

Debtors can be individuals or corporations. If one group company becomes the subject of insolvency proceedings governed by the regulation, this will not affect the status of other group companies. As many large multinational undertakings are structured so that businesses are operated in different countries through local subsidiaries, this is likely to be a significant limitation on the application of the regulation.

The regulation does not apply to banks or insurance undertakings or to any type of receivership or solvent reconstructions. It will only apply to a creditor's voluntary liquidation (CVL) where this has been "confirmed" by the court. A new procedure has been introduced for confirmation of CVLs which, although streamlined, will add to their cost.

The EU Council has not sought to harmonise the member states' national insolvency laws. Rather, the regulation addresses the issues arising in cross-border insolvencies, by imposing a structure of primary ("main") insolvency proceedings and secondary or territorial insolvency proceedings and regulating the relationship between them, setting out the basis of the jurisdiction of member states' courts to open such proceedings and establishing uniform choice of law provisions. It is also providing for the recognition and enforcement of judgments in insolvency proceedings and giving creditors rights to prove in insolvency proceedings in other member states as if they were nationals.

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From the perspective of an English registered company, a number of changes have been effected. Previously, the English courts regarded themselves as having sole jurisdiction to open primary insolvency proceedings in respect of such a company. The proceedings would be governed by English law. They would be intended to effect a global administration of its business, applying to all assets wherever situated and all creditors, including foreign creditors.

In practice, the power of the English office holder to realise assets located in other member states and administer the claims of creditors domiciled or resident outside England would depend on the law of the member states in question. Recognition of authority would usually require a local court order, with attendant cost and delay.

Key developments

1. Automatic recognition

The judgment opening insolvency proceedings within the regulation and judgments by the same courts in the course of those proceedings are to be recognised in all member states without further formalities (unless manifestly contrary to public policy). Further, the office holder's powers (determined by the law of the member state in which the proceedings are opened) may be exercised throughout the EU, although they will be limited where other insolvency proceedings are ongoing.

2. Jurisdiction

Only the courts of the member state in which a debtor has its CMI will have jurisdiction to open main proceedings. In relation to a company, its registered office will be presumed to be its CMI in the absence of proof to the contrary.

The only other basis for opening insolvency proceedings (which will be secondary or territorial proceedings) is where the debtor has an "establishment" within the territory of a member state, defined as "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods". This is similar to the English company law concept of an 'established place of business'.

Any party contemplating bringing insolvency proceedings in England will have to consider whether England is the debtor's CMI and, failing that, whether it has an establishment here. In the relevant forms by which insolvency proceedings are initiated, parties will now have to state whether the regulation will apply and whether the proposed proceedings will be main, secondary or territorial.

There is no guidance as to what steps need to be taken by parties and their advisers to satisfy themselves as to these matters. There is also no common EU register of insolvency proceedings. It may be necessary to make enquiries in other member states where the debtor has operations and search registers there.

The jurisdiction to wind up foreign registered companies on the wider basis previously applied by the English courts (that is, where they have a "sufficient connection" to this jurisdiction, for example, the presence of assets) will now be displaced by the regulation as regards debtors with their CMI in the EU. However, where their CMI is in the UK, an advantage of the Regulation is that rescue procedures will now be available to them.

If companies go into insolvency it should now be easier for people to try and recover their debts across the EU

3. Main, secondary and territorial proceedings

Main proceedings have universal scope, except where secondary or territorial proceedings are on foot in other member states. Secondary and territorial proceedings are restricted to the assets of the debtor situated in the member state in which those proceedings are on foot. Those assets are not, however, ring-fenced in favour of local creditors: the Regulation gives creditors (including tax and social security authorities) throughout the EU the right to receive information regarding insolvency proceedings and to prove concurrently in all insolvency proceedings governed by the Regulation. Further, office holders in main and secondary proceedings will "lodge" claims they are administering in all other proceedings and may exercise rights extended under the applicable local law to creditors in those proceedings. However, votes and dividend entitlements will only count once on each relevant occasion.

Office holders in parallel insolvencies are required to co-operate and share information. However, the dominance of the main proceedings is evidenced by the fact that the main office holder can initiate or request a stay of secondary proceedings and propose or veto an exit from secondary proceedings through a rescue plan or composition with creditors under local law.

Once main proceedings have been opened, the question of whether the debtor is insolvent will not be reconsidered if any secondary proceedings are initiated. One implication of this is that companies with their CMI in England faced with a statutory demand for more than £750 will risk insolvency proceedings here and in other member states where they operate, even if the law of the member states where they operate and where their registered office is would not deem them to be insolvent if the demand is not met.

Territorial proceedings may only be opened before main proceedings where the latter cannot be opened because of local legal restrictions or where the application is by local creditors. If they are opened after main proceedings, they will be 'secondary' proceedings, and, importantly, can only be involved in winding up or bankruptcy proceedings and not rescue procedures. This is an unfortunate limitation — where there is only an establishment in a member state — but a viable business, unless territorial proceedings are opened first, it may not be possible to preserve and realise the value in that business. A director, or a creditor who is not local, may not be able to save a viable business unless he can enlist the support of local creditors.

Once main proceedings are opened, the office holder in those proceedings can apply for the conversion of any territorial proceedings to winding up or bankruptcy proceedings.

4. Applicable law

The law applicable to insolvency proceedings within the scope of the regulation will be the law of the member state of the opening of the proceedings (the "law of the forum"). There are a number of key exceptions, where the laws of other member states will have to be considered. For example, insolvency proceedings in one member state will not affect property rights over property situated in another member state, such as charges over or beneficial interests in the debtor's assets.

Creditors will be entitled to rely on set-offs available to them under the law applicable to the debtor's claim against them even where the law of the forum does not. Creditors will also be entitled to enforce reservation of title clauses which are valid in the member state where the assets are situated.

The effect of the insolvency proceedings on contracts of employment and on pending lawsuits will depend on local laws and, finally, where the law of the forum provides for a transaction to be set aside (for example, because it is an undervalue transaction), the other party will have a defence if the law of another member state applies to the relevant transaction and does not permit it to be challenged.

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