8. Chapter 8: Mapping of Preventive Restructuring Frameworks and the EU Directive Part III Specific Procedural Aspects of Preventive Restructuring in Domestic Processes and in the Directive

8.1 Introduction to Part III of the Questionnaire Mapping Preventive Restructuring Frameworks

Part III of the JCOERE Questionnaire Mapping the Preventive Restructuring Frameworks and the EU Directive examines specific procedural aspects that may arise in relation to preventive restructuring frameworks, whether in current domestic processes, new domestic processes, or processes which will be introduced as a result of implementing the provisions of the PRD.[1] The questions in this part of the questionnaire focus on aspects of the PRD that relate to procedural matters. As an example, this includes the requirement for the appointment of insolvency practitioners in restructuring processes as set out in article 5 Debtor in Possession. It also explores the interface between provisions in the EIR Recast on the protection of rights *in rem* and the provisions in the PRD on both intra- and cross-class cram-down. In addition, a question about insolvency and restructuring thresholds was raised with the contributors. Differences between Member States on this issue may affect the commencement of preventive restructuring processes leading to difficulties with the operation of the EIR Recast. Part III of the questionnaire also queried certain procedural aspects relating directly to challenges to court-to-court co-operation. However, this Chapter will confine itself to rules deriving directly from the PRD, leaving those that deal with the characteristics of the courts and judiciaries throughout the Member States to be discussed in the JCOERE Report 2.

This Chapter seeks to satisfy the second need addressed by the JCOERE Project: *viz.* identifying procedural rules associated with preventive restructuring that could present as obstacles to judicial co-operation. The topics discussed in this Chapter are informed, in part, by strong concerns expressed in some member states regarding what is perceived to be the potentially abusive nature of restructuring or rescue processes. Throughout the Chapter these concerns will be balanced against the clear policy imperatives expressed by the European Commission for the need to introduce rescue processes throughout the EU.

Further, the flexibility of involving insolvency practitioners as described in article 5 of the PRD may also be problematic, both in terms of the perception of oversight of a potentially morally hazardous process, as well as the nature of court co-operation extending as it tends to do through communication between practitioners and the courts. The flexibility of article 5 appears to make it possible to have an entirely debtor-run restructuring procedure without the aid of an insolvency practitioner. In such cases, court co-operation may be difficult as there will not be practitioners representing all jurisdictions between which co-operation is needed. Finally, where practitioners are officers of the court the cooperative relationship will potentially be different from those jurisdictions who have insolvency practitioner who are not as there will be differing levels of obligation and trust between courts and practice.

Rights *in rem* also cause a potentially difficult problem in the way foreign security rights are protected by article 8 of the EIR Recast, a protection that does not extend to local creditors of a cross-border

[1] European Commission DG Justice Grant Agreement 800807 – JCOERE – JUST-AG-2017/JUST-JCOO-AG-2017, Annex 1 Part B section 1.2 "The needs Addressed by this Project."

proceeding. In other words, wherever a preliminary proceeding is opened, the secured creditors in that jurisdiction will not have the same protection as secured creditors in foreign jurisdictions under the same proceeding by operation of the absolute protection provided by article 8. While these differences and inequities may not prevent recognition of a preliminary proceeding that is within Annex A of the EIR Recast, it could give judges pause when they consider the need to cooperate in relation to local claims that are stayed or otherwise impeded by a foreign preliminary proceeding.

8.2 The Threshold for Insolvency and Restructuring

EU Member States adopt a range of gatekeeping approaches for companies to access insolvency and restructuring procedures. These differences start range from having no threshold test at all to having a restrictive approach setting out express debt percentages, sometimes at a very low threshold, that define when a company can and at times *must* file under a relevant procedure. The academic debate in this area revolves around the potential for abusing flexible restructuring procedures that could allow a company to use them simply to escape some of their debt obligations by holding its creditors hostage to a procedural cram-down. On the other side of this moral hazard is the potential for using flexible restructuring procedures to try to save hopelessly insolvent companies, wasting court time and causing greater hardship for creditors. Currently, there does not seem to be any agreement between the Member States on this issue, but where different approaches to insolvency and restructuring thresholds persist, it could lead to the unequal treatment of creditors from one jurisdiction to another, with some being roped into procedures much earlier or potentially too late, causing delay in payment and expenses for creditors.

There also appears to be a lack of a pan-European acceptance of preventive restructuring, which can, to some extent, be attributed to the varying strictness of insolvency thresholds, which are in turn linked to the distrust of debtors generally. The PRD introduces a seemingly flexible test of entry, which has caused ample debate in academic circles. As discussed at length in Chapter 4 of this Report, there are questions as to whether a collective proceeding occurring prior to insolvency can actually be justified when one considers the principles that govern the justification of collective insolvency proceedings generally. The question, then, is why might the differing threshold tests of insolvency make a difference in relation to court-to-court co-operation? How available and accessible should preventive restructuring be when balanced against the moral hazard and potential for abuse feared by many academic commentators?

There are certain thresholds determining functional insolvency that a debtor must generally meet in order to access insolvency procedures. The same applies to a number of existing preventive restructuring procedures. The PRD sets the "likelihood of insolvency" as the threshold at which preventive restructuring procedures should be available:

> "This Directive lays down rules on: (a) preventive restructuring frameworks available for debtors in financial difficulties where there is a likelihood of insolvency, with a view to preventing the insolvency and ensuring the viability of the debtor."[2]

Generally, insolvency is determined by reference to a company's inability to pay its debts,[3] which different Member States assess by reference to a variety of criteria. The inability to pay debts is often assessed through two common insolvency threshold tests: the balance sheet and cash flow tests. The balance sheet test refers to a situation where a companies' liabilities exceed the value of its assets.[4] Under this test, any number of companies may be definitionally insolvent at many points during their lifecycle, however, this does not necessarily mean the company cannot continue as a viable enterprise if these situations of imbalance are temporary in nature. The cash flow test is simply the debtor's inability to pay its debts as they fall due. As noted in Chapter 4, the PRD aims to make restructuring procedures available to debtors prior to circumstances in which a debtor would be considered insolvent. This raises the question of what is meant by "pre-insolvency" in a preventive restructuring context.[5] It is sufficient to point out here that the definitions for "likelihood of insolvency" have been left entirely

[2] PRD, art 1(1)(a).
[3] Kristin van Zweiten, *Goode on Principles of Corporate Insolvency Law* (5th edn, Sweet & Maxwell 2018) 134-135.
[4] *idem* 167-176.
[5] The concept of pre-insolvency was discussed in greater detail in Chapter 4 of this Report.

to the national law of Member States,[6] which may result in procedures in different jurisdictions that can be used at a diverse number of points along the stream of financial distress. A key determination must be where on the stream of financial distress "pre-insolvency" begins and to find this, it must first be determined the threshold at which insolvency procedures are available to a debtor company.

8.2.1 Threshold of Insolvency and Restructuring in the Contributing Jurisdictions

JCOERE Questionnaire Question (Additional):

> *How does your jurisdiction define the "threshold for insolvency", for example, is it when a company is unable to pay its debts, when liabilities exceed assets, or something else? How does this threshold then relate to your restructuring framework as described in your response to our questionnaire?*

In Ireland, the Scheme of Arrangement can be used in circumstances of solvency or insolvency, so there is no relevant threshold to consider.[7] The threshold for insolvency for Examinership is that the company is, or is likely, to become unable to pay its debts,[8] so it can be used notionally in either solvency or insolvency, which facilitates its use for preventive restructuring objectives in line with the PRD.

In Austria, the threshold for insolvency is either illiquidity or over-indebtedness. Illiquidity is assumed when a debtor is unable to repay debts that are due within a reasonable time, essentially the "cash-flow test". Further, illiquidity is presumed if a company is unable to immediately liquidate assets in order to pay its liabilities, even if there are sufficient assets to cover the debts. Illiquidity was recently given definition by the Austrian Supreme Court, which found that if a company defaults on more than 5% of its due debts, it will be presumed to be illiquid. Over-indebtedness is essentially defined as the balance sheet test mentioned above, tempered by the requirement that there is no positive forecast for the continued existence of the company. The value of assets over liabilities is determined by actual or potential sales of those assets under normal circumstances, rather than liquidation value. The "positive forecast" is predicated on the ability of the company to fulfil all due liabilities within the current and following financial year.

Denmark defines insolvency based on the cash flow test: *when the debtor is unable to meet its liabilities as and when they fall due, unless such inability must be deemed to be only temporary*.[9] The Danish insolvency threshold does include what is sometimes referred to as "anticipated insolvency". A debtor is considered insolvent when it is inevitable that the debtor in the near future will not be able to pay his debts.[10] Spain takes a similar approach, deeming a company insolvent if the debtor cannot meet debts due, whether or not the inability to pay is only on a temporary basis. Impending insolvency is when a debtor has not yet stopped paying, but it is foreseeable that it will eventually be unable to do so.[11]

The threshold for insolvency in the Netherlands depends on the insolvency proceeding. In a bankruptcy, a liquidity test is applied. When the debtor is unable to pay its debts (in practice there should be two outstanding debts, of which at least one is due and payable) in order to be declared bankrupt.[12] For the suspension of payment, a liquidity test is applied; this is identified as the debtor in circumstances in which it foresees that it will not be able to continue to pay its debts as and when they become due and payable.[13]

In England and Wales, both the CVA and Scheme of Arrangement can be used prior to the debtor becoming functionally insolvent by reference to the balance sheet or cash flow tests. The Scheme of Arrangement can be used for the reorganisation of a solvent or insolvent company so there is no

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[6] PRD, art 2(2)(a&b).
[7] Irish Companies Act 2014, chapter 1, part 9. See further Irene Lynch Fannon and Gerard Murphy, *Corporate Insolvency and Rescue* (2nd edn, Bloomsbury 2012) chapter 8; and L McCann and Thomas B Courtney (eds), *Bloomsbury Professional's Guide to the Companies Act 2014* (Bloomsbury 2015) chapter 9 on Mergers and Acquisitions.
[8] Irish Companies Act 2014, s 509(1).
[9] Danish BA, s 17(2).
[10] Betænkning II nr 606/1971 om konkurs og tvangsakkord, 72.
[11] Spanish Bankruptcy Code, art 2.
[12] Dutch BA, art 1 and 6(3).
[13] Dutch BA, art 214(1).

threshold test to be applied, which also explains why it remains a procedure available under the Companies Act 2006, rather than under the Insolvency Act 1986. It only needs court approval of an arrangement agreed between the company and its creditors or a class of them.[14] The CVA may also be made whether or not the company is insolvent or likely to become insolvent,[15] so there is no threshold test here either. However, if the Scheme or the CVA is being used in the context of an Administration procedure, which often happens so that a moratorium is available, then the company will need to meet the relevant threshold, which is that the debtor is or is likely to become unable to pay its debts.[16]

The threshold for insolvency in France is defined as "*cessation de paiements*". Article L631-1 of the Commercial Code defines "*cessation de paiements*" as the inability of a company to meet its payable liabilities with the assets available ("*l'impossibilité de faire face au passif exigible avec [l']actif disponible*"). This concept is important as it is from the moment the business satisfies this criterion that some preventive restructuring procedures become closed to the debtor. The ad hoc mandate is only available to debtors that are not in *cessation de paiements*. The conciliation procedure is only available to debtors, which have not been in *cessation de paiements* for more than 45 days.[17] The safeguard procedure is also unavailable to debtors in *cessation de paiements*.[18] However, what constitutes a situation of *cessation de paiements* is not straightforward and has been the subject of debate in the courts and among commentators over the years, in particular the accounting basis of the concept. Following the introduction of the Law of 1967,[19] French case law referred to the concept of *cessation de paiements* as an essentially accounting-based notion, reliant on a comparison of available assets to meet the due liabilities.[20] Yet, many courts have departed from this accounting view and have interpreted elements of the concept, such as what constitutes an asset[21] and a liability[22] and whether the debt is in fact due.[23] Overall, some courts have disputed the purely accounting nature of the concept and stated that it is, rather, a concept which takes into account the treasury of the business and which includes "dynamic elements" of the company's life that are not reflected in the accounts, such as temporary credits and the use of occasional overdrafts. Solely relying on the balance sheet test, therefore, would not be a true reflection of the reality of the business.[24]

German insolvency law defines insolvency as the inability to pay debt as it falls due.[25] Case law further explains that the relevant inability must extend to more than 10 per cent of debt over more than 3 weeks. Any cessation of payment indicates unequivocally the inability to pay. In addition, German law offers two further insolvency tests for specific debtors. First, the debtor can initiate insolvency proceedings early (in order to use it for a restructuring).[26] Here, any foreseeable inability to pay suffices. Case law provides that the forecast may include a timeframe of up to two years in the future, for example, at the time a bond is to fall due. Secondly, any limited liability company (corporation) is insolvent under a balance sheet test once it has no prospect of continuation (viability test).[27] So balance sheet insolvency in itself does not suffice anymore (since 2008) in order to prevent a duty to file for insolvency due to a crash in market value of relevant assets as experienced in 2008. Only a balance sheet insolvent corporation that is also unable to continue trading would be insolvent under sec. 19 InsO and thereby be required to file.[28] Any future preventive restructuring framework would interfere with the purpose of section 18 of the InsO (voluntary petition). It would probably not be available for debtors that are already unable to pay their debt. Corporations in the process of promising restructuring negotiations protected

[14] England and Wales Companies Act 2006, s895(1).
[15] England and Wales Insolvency Act 1986, part I.
[16] *idem* schedule B1, para 11(a).
[17] Commercial Code, art L611-4.
[18] Commercial Code, art L621-1.
[19] Law No 67-563 of 13 July 1967.
[20] See C Saint-Alary-Houin, *Droit des Entreprises en Difficulté* (Montchrestien 2001) para 344.
[21] See *e.g.* Cassation Commerciale, 22 January 2002, RJDA 2002.5 no 516; Cassation Commerciale, 17 May 1989, Bull Civ IV no 152.
[22] See *e.g.* Cassation Commerciale, 22 June 1993, D 1993.somm.366; Cassation Commerciale, 8 March 1994, RJDA 1994.7 no 847; CA Nancy, 20 May 1987, JCP 88 éd E.II.15114; Cassation Commerciale, 22 February 1994, Bull Civ IV no 75; CA Aix, 16 April 1985, D 1987.somm.389; CA Paris, 18 February 2000, Cah Dr Aff (actualité jurisprudence) 170.
[23] See the 'due and demanded' doctrine, cf Cassation Commerciale, 17 June 1997, RJDA 1997.11 no 1393.
[24] CA Aix, 5 June 1987, D.1988.somm.41.
[25] InsO, s 17.
[26] InsO, s 18.
[27] InsO, s 19.
[28] InsO, s 15(a).

by the new framework would probably not be seen as being unable to continue trading, so no conflict should arise there. Currently, two ideas dominate the discussion in Germany: (1) Access to any preventive tool would be based on a foreseeable inability to pay that is combined with a minimum requirement for liquidity to finance the restructuring, or (2) access to any preventive tool would not include a separate test; instead these tools (stay, plan) would only have non-collective effects, thus guiding viable debtors to them while more troubled debtors (requiring collective redress) would need to file for insolvency plan proceedings. Which of these ideas will become law or whether both or none of them are adopted was, at the time of this questionnaire, impossible to forecast. Indeed, given the current obligatory nature of filing for insolvency in Germany, the introduction of a flexible but robust procedure such as the PRD has been controversial.

In Poland, insolvency is defined by article 11 of the BL[29] and covers both liquidity and asset to liabilities tests. Meeting any one of the two implies that a debtor is insolvent and that its representatives have a duty to file for a declaration of bankruptcy. On the other hand, restructuring proceedings can also be opened in relation to an already insolvent debtor. A court will not open restructuring proceedings if their effect is detrimental to creditors. Moreover, in the case of arrangement and remedial proceedings, the court will not open proceedings if a debtor's ability to pay current costs of proceedings and obligations arising after opening has not been rendered credible."[30] There is no specific test for restructuring proceedings not to be opened in case of deep insolvency.

In the new Italian code (CCI), insolvency is defined as the debtor's inability to meet its obligations as they fall due, a situation which usually manifests itself in defaults or other signs[31] According to well-established case law, a firm that is being wound up, either piecemeal or as a going concern, may be declared insolvent only provided that its debts exceed the value of its assets, a balance sheet test. When the proceeds of the assets of a non-insolvent liquidation are assessed as sufficient to pay all creditors in full, the company may not be declared insolvent although not able to pay claims as they fall due, relying on a cash-flow test. The CCI also distinguishes between insolvency and crisis; the latter is defined as the situation of economic and financial difficulty making it probable that the debtor will become insolvent from a cash flow standpoint.[32] Crisis manifests itself as the inadequacy of *prospective* cash flow to meet planned obligations as they fall due. That said, both the judicial composition with creditors (*concordato preventivo*) and to debt restructuring agreement (*accordo di ristrutturazione dei debiti*) are available to debtors that are either in a crisis or in an insolvency situation, as described above. Therefore, it is not necessary for businesses to be insolvent in order to be able to access these procedures, being in a "crisis" situation is sufficient. This approach seems to be aligned with the PRD, which requires, under art. 4, par. 1, that "Member States shall ensure that, where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework that enables them to restructure".

In Romania, insolvency is understood as insufficiency of cash available to pay the undisputed, liquid and enforceable debts, as follows: (a) The debtor is presumed insolvent when it fails to pay its debt to the creditor after sixty (60) days from the due date; this presumption is relative; (b) Insolvency is imminent when the debtor is proven unable to pay its debts when due, out of the cash available on the due date.[33] The threshold value is defined as the minimum amount that the claim must meet in order to allow a petition for opening of the insolvency proceeding to be filed.[34] Romanian law contains a positive definition of insolvency, it introduces the criterion of over-indebtedness as a ground for opening the proceeding. It is defined as the so called *"imminent illiquidity"*; this is established if the debtor will be unable to satisfy the claims when they become due. Romanian law also defines a threshold for pre-insolvency proceedings, which is applicable to debtors in financial difficulty.[35] A debtor is undergoing financial difficulty if, despite fulfilling or an ability to fulfill its obligations when due, it has a low short term liquidity ratio and/or a high long term indebtedness ratio, which may adversely affect its possibility

[29] BL, art 11.
[30] Art. 8 of the RL.
[31] CCI, art 2, para 1(b).
[32] CCI, art 2, para 1(a).
[33] Law no 85/2014, art 5(29).
[34] Law no 85/2014, art 5(72).
[35] Law no 85/2014, art 6.

to fulfill its contractual obligations by means of the resources generated from operations or the resources attracted from the financial activity.[36]

The balance sheet test and cash flow tests are common among the contributing jurisdictions in the assessment of functional insolvency, which then allow a debtor to access the relevant insolvency procedures. However, the current state of affairs at the time of writing does not dispel the questions as to how a "likelihood of insolvency" will be determined under the Member States' national restructuring frameworks at implementation time. As noted in Chapter 4, there are certain principles at play when a debtor accesses a collective procedure, a term that also applies to the new preventive restructuring procedures. It remains to be seen how the insolvency principles that justify collective action will be reconciled with the use of collective preventive restructuring procedures when a debtor is not technically or functionally insolvent. However, given the approach of some of the contributing jurisdictions, for example Italy, which differentiates insolvency and "financial crisis", and Austria, which tempers a finding of insolvency with a viability forecast, an aligned access to restructuring frameworks is unlikely to be created with the implementation of the PRD, which means not all restructuring frameworks will be available to the same debtors at the same points in their financial distress.

8.3 Insolvency Practitioners in Preventive Restructuring (Article 5 – Debtor in Possession)

8.3.1 Purpose and Spirit of Article 5: Debtor in Possession (Qn 9)

Article 5 aims to encourage the development of a debtor in possession ("DiP") style of restructuring procedure along the lines of what the American Chapter 11 provides (and which the Irish Examinership has fully adopted). Essentially, DiP should limit the control that an insolvency practitioner, where appointed, or other body might exercise over the daily decision-making and activities of a company, to merely advising on aspects of the restructuring plan, rather than replacing the company management or taking control of the running of the business of the company. As such, the question seeks to determine the level of involvement required by insolvency practitioners in a restructuring and circumstances under which those requirements arise. Critically, the PRD states the following:

(1) "Member States shall ensure that debtors accessing preventive restructuring procedures remain totally, or at least partially, in control of their assets and the day-to-day operation of their business." [37]

This section clearly emphasises that a debtor should remain in control of the business during the restructuring proceeding, meaning that they continue to make decisions about how assets will be allocated, as well as any decisions about how the business should run. Essentially, a restructuring proceeding *could* proceed under the PRD framework without the involvement of a practitioner at all, depending on the circumstances. Article 5 goes on to state:

(2) "Where necessary, the appointment by a judicial or administrative authority of a practitioner in the field of restructuring shall be decided on a case-by-case basis, except in certain circumstances where Member States may require the mandatory appointment of such a practitioner in every case."[38]

This second sub-section presents an optional appointment by judicial or administrative authority of an insolvency practitioner when it is considered necessary, which gives Member States some flexibility in determining what may necessitate that appointment. An appointment then becomes an obligation in certain specified minimum circumstances: (a) where a general stay is granted, and the authority decides a practitioner is necessary to safeguard party interests; (b) where a cross-class cram-down is required for confirmation; or (c) where it is requested by the debtor or by a majority of the creditors.[39]

The Directive emphasises the fact that a preventive restructuring procedure is essentially characterised by a true "debtor-in-possession" element, reflecting the framework of the American Chapter 11 procedure. Debtor in possession refers to a situation wherein a corporate debtor has filed under an

[36] Law no 85/2015, art 5(27).
[37] PRD, art 5(1).
[38] PRD, art 5(2).
[39] PRD, art 5(3) (a-c).

insolvency or, in this case, preventive restructuring procedure, while the pre-petition management remain in control of the assets and the business of the company.[40] While this element is not particularly contentious in itself, article 5 also provides an option to, where necessary, have a judicial or administrative authority appoint an insolvency practitioner on a case by case basis. By predicating such an appointment on the vague criteria of "where necessary", article 5(2) gives fairly wide discretion for Member States to choose when the appointment of an insolvency practitioner will be necessary. However, it has been noted that the spirit of article 5 aims to avoid the practitioner (or indeed courts) being involved in all cases involving a restructuring plan. The following recitals of the PRD support this idea. In relation to court involvement, recital 29 states:

> "To promote efficiency and reduce delays and costs, national preventive restructuring frameworks should include flexible procedures. Where this Directive is implemented by means of more than one procedure within a restructuring framework, the debtor should have access to all rights and safeguards provided for by this Directive with the aim of achieving an effective restructuring. Except in the event of mandatory involvement of judicial or administrative authorities as provided for under this Directive, Member States should be able to limit the involvement of such authorities to situations in which it is necessary and proportionate, while taking into consideration, among other things, the aim of safeguarding the rights and interests of debtors and of affected parties, as well as the aim of reducing delays and the cost of the procedures."[41]

In relation to practitioner involvement, recital 30 states:

> "To avoid unnecessary costs, to reflect the early nature of preventive restructuring and to encourage debtors to apply for preventive restructuring at an early stage of their financial difficulties, they should, in principle, be left in control of their assets and the day-to-day operation of their business. The appointment of a practitioner in the field of restructuring, to supervise the activity of a debtor or to partially take over control of a debtor's daily operations, should not be mandatory in every case, but made on a case-by-case basis depending on the circumstances of the case or on the debtor's specific needs. Nevertheless, Member States should be able to determine that the appointment of a practitioner in the field of restructuring is always necessary in certain circumstances, such as where: the debtor benefits from a general stay of individual enforcement actions; the restructuring plan needs to be confirmed by means of a cross-class cram-down; the restructuring plan includes measures affecting the rights of workers; or the debtor or its management have acted in a criminal, fraudulent, or detrimental manner in business relations."[42]

These two recitals seem to indicate a preference towards court and practitioner involvement only when strictly necessary, in other words, when their involvement benefits the best interests of creditors and the efficiency of the restructuring process. While IP and Court supervision and/or involvement in all cases may not be factually contrary to the wording of article 5 of the PRD, it may be that the underlying intentions of the provisions surrounding court and practitioner involvement are lost if involvement is required in all cases. That said, the nature of some procedures - the Irish Examinership, for example - are such that the mandatory involvement of both practitioners and courts is justified due to the robust nature of the procedures themselves. If considered on a case-by-case basis, there would always be justification for the involvement of IPs and courts, thereby aligning with both the provisions of article 5 and the recitals set out above.

There are different views about the latitude that Member States have been given to derogate on the case-by-case appointments of an insolvency practitioner. The scope of the derogation in the PRD is vague and appears to allow for a blanket appointment of an insolvency practitioner, however there are also strong grounds to maintain that a mandatory appointment of an insolvency practitioner in all cases may not be compliant with the PRD. Thus, the PRD may set a ceiling to the scope of such derogation, which might preclude a domestic provision mandating the appointment of an IP in all circumstances. The

[40] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press 2017) 231.
[41] PRD, extract from recital 29.
[42] PRD, recital 30.

wording of the article, however, does not make this clear. A further relevant consideration is that if the EU had wished to allow a general derogation from the "case-by-case appointment rule", it likely would have just added a paragraph along the following lines: "Member States may derogate from paragraph 2" (as has been done with respect to other optional provisions).[43] Without a clear statement in the operational provision, however, the ambiguity will allow for a much wider scope of implementation than may have been intended.

Article 5 also provides an obligation to appoint of a "practitioner in the field of restructuring, to assist the debtor and creditors in negotiating and drafting the plan" in at least the three specific cases set out above. There are some problems with the timing inferred by this provision. At the time that a plan is being negotiated and drafted, it may not be evident that a cross-class cram-down will be a necessary part of the process, so the mandatory nature of the appointment may not become apparent until after the negotiation has begun. Furthermore, there are a range of circumstances that are not described as requiring the appointment of an IP, but which are currently included as criteria for obligatory appointment by some of the Member States, as will be discussed below.

The purpose of question 9 of the JCOERE questionnaire was to determine the level of practitioner involvement in current restructuring proceedings in the contributing jurisdictions and the depth of their roles in controlling the enterprise. While the appointment of an insolvency professional does not necessarily take a debtor out of possession, the power retained by the debtor will depend on the level of power transferred to an insolvency practitioner in such cases.

8.3.2 Jurisdictional Contributions (Article 5 – Debtor in Possession)

JCOERE Questionnaire Question

Article 5 includes an option for the involvement of an insolvency practitioner in relation to preventive restructuring processes.

a. *What is the current position regarding insolvency practitioners in restructuring processes in your jurisdiction? Please specify relevant legislative provisions or rules and describe the terms of these provisions and how they compare with the terms of Article 5 of the Directive.*

b. *Will your jurisdiction have to make changes to comply with the requirements regarding the involvement of insolvency practitioners in relation to preventive restructuring processes?*

While the Irish Scheme of Arrangement could be carried out without the assistance of an insolvency practitioner, as is the case Scheme of Arrangement in the England and Wales this is unlikely (see below). Critical to the examinership procedure is the appointment of an examiner by the court, if the court declined to appoint, then the procedure comes to an end.[44] Therefore, a question can be raised regarding the requirement that an examiner be appointed in all cases. Article 5(3) goes on to state, however, "that Member States shall provide for the appointment of a practitioner in the field of restructuring, to assist the debtor and creditors in negotiating and drafting the plan, *at least* in the following cases" which include when a stay is imposed, when cross-class cram-down is used or when the appointment is requested. The Irish legislation provides for the appointment of an examiner, pursuant to a court petition (which is equivalent to a request). The framework also includes a mandatory stay and the use of cross-class cram-down. In that context the particular procedure cannot have these features without the appointment of an IP. In totality, therefore, there seems to be compliance.

In Italy, when a debtor files for a *concordato preventivo*[45]the court is required to nominate an insolvency practitioner who, before the confirmation of the plan, is entrusted with the role of monitoring and overseeing the debtor, as well as supporting creditors in their assessment of the proposal through the provision of independent information. After the confirmation, the insolvency practitioner may be vested

[43] Thank you to the Italian team at Universite degli Studi di Firenze for their explanation of this argument in relation to the spirit of article 5(2).
[44] The examiner is regulated under the Irish Companies Act 2014, s 519 – in short, an examiner must possess the same qualifications as a liquidator in order to act as an examiner.
[45] CCI, art 44 para 1b: *commissario giudiziale*.

with the power to enforce the plan in case of non-spontaneous implementation by the debtor (see below). Recent reforms (by means of Art. 118) have also widened the power of the IP in cases of non-implementation of a (confirmed) restructuring plan. The IP's powers in this instance will generally include all those normally reserved to the shareholders'meeting. The *concordato* has many characteristics that align well with the provision of the PRD. In the *concordato*[46] an insolvency practitioner is required to inform the court of any misconduct of the debtor or any other circumstance that might have a negative impact on the restructuring process. The insolvency practitioner is not given a right of administration in this case, leaving the debtor in control of the running of the business. Any operations falling outside of ordinary business activity, however, may need *a priori* authorisation by a judge.[47] For the debt restructuring agreement, unless an involuntary liquidation petition has been filed, the court is not required to nominate an insolvency practitioner. This circumstance is not unusual, as the filing of a confirmation request for a debt restructuring agreement can also aim to block the petition for involuntary liquidation but it is not the norm. The insolvency court previously had discretion on the appointment of an insolvency practitioner in cases of restructuring agreements, which were binding on dissenting creditors, with a view to ensuring that the negotiations were made in good faith and lawful.[48] It is unclear if following the recent reforms that will enter into force in 2020.With regard to the PRD, the *concordato preventivo* does not appear to be fully in line with the requirements to "assist the debtor and creditors in negotiating and drafting a plan" as the role in the Italian procedure is largely one of oversight only. Also, the mandatory appointment of an insolvency practitioner in all cases is unlikely to comply with article 5(2) given the limited scope of the derogation (see above).

All Romanian restructuring processes require the appointment of an expert or administrator and are therefore more restrictive than the provisions of the PRD article 5. The practitioners do not take over the business, rather the management stays in control; as such, the Romanian pre-insolvency procedures are "debtor in possession" mechanisms. However, the training of these crises' managers leaves much to be desired, as the practitioner generally knows far less about the management of a business than the former management of those businesses. As such this is supervision without a sound basis in business knowledge. This has often resulted in a loosely managed reorganisation ultimately resulting in an insolvency.

The French conciliation and ad hoc mandate procedures, the insolvency professionals do not interfere with the management of the company. The Directors remain in place and in control of the assets and the day to day operations of the business. A conciliator may not necessarily be a practitioner in insolvency but rather may be appointed by the court provided that they have experience that is likely to facilitate the course of the proceedings. This is conditional on them having not received any remuneration from either the debtor or its creditors in the 24 months prior to opening proceedings. The role of the conciliator is to help the debtor reach an agreement with its main creditors in order to end the financial difficulties of the company.[49] Similarly, a debtor remains in possession during the safeguard and related procedures, but the administrator is appointed to supervise and/or assist the management while preparing the plan.[50] The *Loi Pacte* will introduce an obligation for the court to justify the choice of administrator and of the creditors' representative, in order to bring the French framework closer in line with the PRD, article 5(2); this will amend the Commercial Code in respect of the mandate ad hoc, conciliation, and the *sauvegarde*.

In Germany, insolvency practitioners are always appointed in insolvency proceedings, even if the debtor remains in possession, and this is likely to apply to any newly introduced preventive restructuring procedure. Such practitioners act as a supervisor and may be authorised to co-sign or approve acts of the debtor, which conflicts with the debtor-in-possession concept to some extent. The position appears

[46] Pursuant to CCI, art 118 para 4, after the confirmation of a *concordato* plan, if the insolvency practitioner detects that the debtor is unduly omitting or delaying the implementation of the plan, it must be reported to the court, which can authorise the IP to carry out the acts needed to implement the plan.
[47] CCI, art 44, para 4.
[48] Art 182 *septies* para 4 of the previous Insolvency Law; the recently enacted provision CCI, art 61 regarding the *accordi di ristrutturazione ad efficacia estesa* (debt agreement binding on dissenting creditors) has extended the scope of this procedure, making it available also to bind dissenting creditors, but has not replicated the provision empowering the court to appoint an IP (thereby making the possibility to appoint an IP uncertain in the new framework).
[49] Commercial Code, article L611-7.
[50] Commercial Code, L622-1.

to be similar in Austria. The provisions of 5(2) allow for an appointment *when necessary,* therefore while the blanket requirement for the appointment of an insolvency practitioner may not be in conflict with the PRD, it is contrary to the spirit of the compromise that led to the drafting of article 5(2), which aimed at preventing an insolvency practitioner being blindly involved in all cases.

In the Netherlands, the suspension of payment procedure always requires the appointment of an insolvency practitioner, who conducts the administration of the debtor's affairs together with the debtor.[51] For any act of disposal related to the estate, the debtor must have the co-operation, authorisation, or assistance of the insolvency practitioner.[52] Where the debtor fails to appropriately include the insolvency practitioner in its decision-making, the insolvency practitioner can do whatever is necessary to prevent any loss in the estate,[53] which will not be liable for obligations entered into by the debtor after the commencement of the suspension of payment without the involvement of the insolvency practitioner.[54] These provisions appear to make the suspension of payment a procedure that essentially removes the debtor from full possession of the decision-making of the company, given the onerous results should the debtor fail to comply. The WHOA will provide for a proceeding in which, in principle, no involvement of an insolvency practitioner is required, except for those situations noted in article 5(3) of the PRD. In line with article 5(2), the Netherlands has provided a few exceptions that will require the involvement of a practitioner. A creditor, shareholder, works council, or the debtor may request the appointment of a so-called 'plan expert' (*herstructureringsdeskundige*')[55] to propose a restructuring plan. The expert will negotiate a restructuring plan with the creditors and shareholders for the debtor.[56] There is also a provision that allows the court upon request or at its own discretion to take specific measures necessary for the protection of the interests of the creditors and shareholders.[57] This could include the appointment of a specific practitioner in the field of restructuring called the 'observer'.[58]

For the Netherlands, as mentioned above, in the suspension of payment proceeding a joint administrator is appointed by the court when the proceeding is commenced.[59] This allows the debtor to be in partial possession during the full suspension of payment proceeding.[60] This proceeding therefore meets the requirements of article 5(3). When the debtor is no longer able to meet current and new obligations as they fall due, the joint administrator will ask for conversion of the suspension of payment proceedings in bankruptcy proceedings, which ends a phase where the debtor is in possession. As proposed in the WHOA, appointment of either an observer or a plan expert is possible in the three circumstances mentioned in article 5(3), when the proceeding is commenced by the debtor. In those cases where a plan expert has not (yet) been appointed, the court will – in line with article 5(3)(i) – consider the appointment of an observer. Its appointment is not obligatory, but will be subject to whether or not the court considers it necessary to safeguard the interest of creditors.[61] Furthermore, when setting the date for the hearing on confirmation of a restructuring plan that involves a cross-class cram-down, the court will appoint an observer in case no plan expert or observer has yet been appointed (in line with article 5(3)(ii)).[62] The court will appoint a plan expert in particular in those cases where the WHOA is commenced at the request of a creditor, shareholder or works council. In this case the plan expert will be involved for the

[51] Dutch BA, Art 215(2) and 228.
[52] Dutch BA, Art 228.
[53] Dutch BA, art 228(1).
[54] Dutch BA, art 228(2).
[55] The original Dutch text refers to '*herstructureringsdeskundige*', which could be translated into 'restructuring expert' or 'plan expert'.
[56] WHOA, art 371(1).
[57] WHOA, art 379(1).
[58] WHOA, 376(9), 380 and 383(4). See also the explanatory memorandum to the WHOA (2019) 40-41 and 66-67 <https://www.rijksoverheid.nl/documenten/kamerstukken/2019/07/08/tk-nader-rapport-wet-homologatie-onderhands-akkoord> accessed 12 December 2019. In accordance with WHOA, art 381(1), the observer's task is to supervise the realization of the restructuring plan and, in so doing, to take into account the interests of all creditors. Once the court appoints a so-called 'plan expert', the observer will be removed (WHOA, art 380(3)).
[59] Dutch BA, art 215(2).
[60] Dutch BA, art 228.
[61] WHOA, arts 376(9), 379 and 380. See also the explanatory memorandum to the WHOA, 2019, p. 24 and 61-62.
[62] WHOA, art 383(4).

full proceeding.[63] The request to appoint a plan expert may also be made at a later, when the debtor commenced the WHOA. This request can also be made by the debtor (in line with article 5(3)(i)).[64]

In Poland, the involvement of an insolvency practitioner is governed by the RL; in each restructuring proceeding, an individual who has passed a state exam and is entered on a list of restructuring advisers can act in any of the four restructuring proceedings and perform different roles in them depending on the type of proceeding (such persons also act as receivers during bankruptcy proceedings).[65] In approval arrangement proceedings, a restructuring advisor acts as an arrangement supervisor and the debtor enters into an agreement with the restructuring advisor which defines its duties.[66] In accelerated arrangement and arrangement proceedings, the court nominates a court supervisor in a decision opening proceedings,[67] whereas in remedial proceedings the debtor, as a rule, loses possession and the court appoints an administrator who takes over administration of a remedial estate and manages it independently in favour of the debtor. If the success of remedial proceedings requires involvement of the debtor or his representatives, a court may permit a debtor to administer all or part of an undertaking if a guarantee of proper performance and no exceeding of ordinary administrative tasks is provided.[68] In accelerated arrangement and simple arrangement proceedings, a court supervisor approves acts exceeding ordinary administration.[69] In arrangement approval proceedings, the conclusion of an agreement with an arrangement supervisor does not limit the debtor in management of his property.[70] In addition, debtor sale of real estate or other assets worth more than PLN 500,000 always requires authorisation of the creditors' committee or is otherwise invalid[71] It seems that the Polish Restructuring law is already compliant with article 5 of the Directive.

The appointment of a restructuring administrator and a restructuring accountant is mandatory for the opening of the restructuring proceedings in Denmark.[72] The debtor remains in possession during the restructuring proceedings and continues to control the day-to-day operations of the business. The debtor is not, however, entitled to enter into any transactions of material significance without the consent of the restructuring administrator.[73] The restructuring administrator can take over the management of the debtor if a majority of the creditors do not vote against such a takeover or if it necessary to protect the value of the business. Both of the takeover options are examined and confirmed by the Bankruptcy Court.[74] While Denmark does have a debtor in possession style of procedure, some changes are necessary to align with the directive. The current Danish frameworks requires the appointment of an insolvency practitioner, which may not be in the spirit of the case-by-case basis enshrined in the PRD. In addition, the forced takeover option in the Danish framework appears to be in conflict with the requirement to ensure that the debtor stays in control, at least in part.

The extra-judicial payment composition in Spain provides for the appointment of an independent insolvency mediator in commercial cases; this is a professional who must meet certain personal requirements and who receives remuneration as governed in express rules.[75] Refinancing agreements do not require independent expert professionals as the procedures are developed and directed by the judicial authority. In view of article 5 of the PRD, the Spanish legislator will need to introduce procedures that leave the debtor in possession with the simple involvement or supervision in an advisory capacity of insolvency practitioners. However, in all these cases, the debtor can be considered to be in possession, as control of the business is retained.

For both the Scheme of Arrangement and the CVA in England and Wales, insolvency practitioners play an important role, but they do not take over the running of the business as they would in an administration, leaving the debtor in possession. The new restructuring plan is likely to reflect the

[63] WHOA, art 371(1). See also the explanatory memorandum to the WHOA (2019) 43-44.
[64] WHOA, arts 371(1) and 370(5). See also the explanatory memorandum to the WHOA (2019) 21.
[65] Companies with the involvement as representatives of restructuring advisers are also allowed to be appointed as insolvency practitioners.
[66] RL, art 210.
[67] RL, art 233(1&2).
[68] RL, ss 3, 51, 52, 53, and 288.
[69] RL, s 39.
[70] RL, s 36.
[71] RL, s 129(2).
[72] Danish BA, s 11(a).
[73] Danish BA, s 12.
[74] Danish BA, s12(a) & 12(b).
[75] Law 22/2003 of 9 July, arts 232 *et seq.*

framework already provided by the Scheme of Arrangement. However, the provisions in the PRD state that an insolvency practitioner shall be assigned where there is a general stay, cross-class cram-down, or at the request of the creditor or debtors, so the new restructuring plan may need to account for this aspect should Brexit not occur.

It should be noted that article 5(3) has some obligatory provisions that all Member States will need to accommodate. Namely, that a practitioner shall be appointed in a minimum of three circumstances: where there is a moratorium; when there is a cross-class cram-down; or at the request of the debtor or creditors. While a number of the Member States require the appointment of a practitioner in all restructuring circumstances, that does not necessarily deprive the debtor of possession and therefore is not contrary to this article. It depends entirely on the role assigned to that practitioner and what freedoms the debtor's management continues to wield during the process. The appointment under article 5(3) may not (fully) transfer the right to administer the debtor's affairs to the insolvency practitioner appointed. article 5(2)2 only states that the IP tasks include "taking partial control over the assets or affairs of the debtor during negotiations", without providing further details on the actual scope of such powers. So indeed, the preconditions mentioned here may only lead to a practitioner with powers similar to where the debtor remains in possession but under the supervision and some co-administrative powers of the insolvency practitioner. However, in those Member States that allow a full absence of practitioner guidance, these three elements will need to be incorporated.

The JCOERE Report 2 will explore in more depth the issues surrounding the responsibilities and requirements for the involvement of insolvency practitioners in the context of

8.4 Rights in Rem (Question 10)

8.4.1 Introduction to the Concept of a Right *in Rem*

Before the question as to whether the EIR Recast and the provisions of the PRD conflict with regards to the treatment of rights *in rem*, it is important first to define what is meant by this phrase. Conceptually, it seems to differ from jurisdiction to jurisdiction, but if one looks to original fundamental concepts, it can be defined thus:

> "Rights in rem may be defined in the following manner – 'rights residing in persons and availing against other persons generally.' Or they may be defined thus: 'Rights residing in persons, and answering to duties incumbent upon other persons generally. By a crowd of modern civilians, *jus in rem* has been defined as follows: '*facultas homini competens, sine respect ad certam personam*,' a definition I believe invented by Grotius."[76]

More simply stated, a right in rem is a "right against a thing", meaning that it pertains to the rights held over a specific piece of property, such as a house in the case of a mortgage. Following the evolution of the concept of the legal person residing in a corporate entity, rights in rem are also now held by lenders and banks who engage in secured lending, which establishes a right owned by the person of the lending entity over the property against which the funds are secured.

8.4.2 Contributor Definitions of a Right *in Rem*

JCOERE Questionnaire Question 10.1

How are rights in rem *defined in your jurisdiction? Please describe a type of right in rem which arises in insolvency proceedings.*

In most jurisdictions, rights are classified as either real (*in rem*) or personal. Possession and ownership of a chattel are considered real rights with the main significance being that they survive the insolvency of the entity against which they are asserted so that the asset can be held against or reclaimed from the administrator or other insolvency practitioner in charge of the procedure. Goode explains that the distinction between real and personal rights may also be expressed as the distinction between property

[76] John Austin, *Lectures on Jurisprudence or the Philosophy of Positive Law* (first published in 1885, 4th edn, John Campbell (ed), The Lawbook Exchange Ltd 2005) a cited in A Kocourek 'Rights in Rem' (1919-1920) 68 U Pa L Rev 322.

and obligation, i.e., between what I own and what I am owed.[77] The common law in Ireland and elsewhere has always maintained this distinction strictly. A contract to transfer an asset is not the same as an actual transfer. Until the actual transfer is made, the transferee has no proprietary interest in the asset, merely a contractual right to have it transferred. So, if the transferor becomes insolvent before executing the transfer, the transferee's status is just that of an unsecured creditor. The impact of this distinction is lessened by the intervention of equity and the development of equitable real rights under the common law, drawing a potential distinction to treatment of rights *in rem* in civil law countries, which do not generally use equity to extend interpretation and definition in law. Thus, in equity, the agreement to transfer is treated as if it was an actual transfer and the proprietary interest that is created is as effective as a transfer at law except that it will be defeated by a *bona fide* purchaser for value without notice of the interest. Equitable proprietary rights play an important part in the creation of security in the provision of finance in commercial transactions.[78]

The Italian jurisdiction defines rights *in rem* in line with what has been set out above: rights purported to bind a certain asset to guarantee the reimbursement of a certain claim.[79] The French define it similarly as a right attached to an object or property, such as a fixed charge or a mortgage. The Dutch add that such property rights cannot be infringed by a third party. The Polish definition aligns with that quoted above by Austin, including that such rights are effective against everyone (*erga omnes)* and cover typical rights *in rem* such as a hypothec, registered pledge, treasury pledge, pledge under civil law, maritime mortgage. The RL and BL also treats claims secured by a transfer of ownership of an asset, claim or other right to a creditor as a secured claim."[80] The Romanian and Spanish position largely reflects all of these elements. The most obvious right *in rem* that exists in insolvency is what most jurisdictions would consider a retention of title clause, wherein a creditor retains title over the property that has been delivered to the debtor but has not yet been paid for. While this may seem a simple means of protecting property by keeping it outside of the cumbersome collective recovery procedure, not every jurisdiction treats this as a right *in rem*. For example, in the Netherlands, a retention of title clause does not bestow upon the creditor a right *in rem*,[81] whereas in the UK it is accepted that the purpose of a retention of title clause is to protect the property by keeping it outside of an insolvency procedure. In Romania, however, a hybrid approach is taken in which a creditor benefitting from a retention of title clause will be able to make its claim as a creditor holding a mortgage-like preference rather than by exercising the prerogatives of the property right on the subject matter of the clause.[82] In order to avail of this, such a clause must be registered before the commencement of insolvency. In contrast, were such a clause treated like this in the UK (viewed as a charge and required to be registered), the clause would be rendered inoperable and the goods would be deemed to have been transferred and form a part of the insolvency estate. While the scope of this Project does not extend to a detailed analysis of the different treatment of retention of title clauses among the Member States, this is an important example of how the same legal mechanism can be treated very differently in different national systems.

8.4.3 A Right *in Rem* under the EIR Recast

The EIR Recast discusses rights *in rem* in the Recitals, which is instructive in terms of how the concept is viewed under the Regulation:

> "There is a particular need for a special reference diverging from the law of the opening State in the case of rights in rem, since such rights are of considerable importance for the granting of credit. The basis, validity and extent of rights *in rem* should therefore normally be determined according to the *lex situs* and not be affected by the opening of insolvency proceedings. The

[77] R M Goode, *Commercial Law* (Penguin 1995) 31. See also R M Goode, 'Ownership and Obligation in Commercial Transactions' (1987) 103 LQR 433.
[78] Caterina Gardiner 'National Report on the Transfer of Movables in Ireland' in Wolfgang Faber & Brigitta Lurger (eds) *National Reports on the Transfer of Movables in Europe: Volume 2* (Sellier Publishers 2009) 165-166.
[79] In Italy, rights in rem include a *pegno* (pledge), which is a right on a moveable asset granted by the debtor or by a third party, as a collateral for credit; an *ipoteca* (mortgage), a right on an immoveable asset or on some goods included in public registries as a guarantee for credit; and some special liens provided for by banking law.
[80] RL, art 151.
[81] See Dutch Country Report, Annex 3: Contributor Responses to the JCOERE Questionnaire, section 12.4, response 11.1.
[82] Law no 85/2014, art 213 para 6; See Romanian Country Report, Annex 3: Contributor Responses to the JCOERE Questionnaire, section 12.3, response 11.1.

> proprietor of a right in rem should therefore be able to continue to assert its right to segregation or separate settlement of the collateral security."[83]

Thus, a right *in rem* clearly covers those cases in which security is held against collateral, such as fixed and floating charges in common law legal systems and other securities in civil law legal systems; essentially, this segregates those creditors from the operation of an insolvency procedure and allows such security holders to exercise their rights against the relevant collateral. Recital 69 goes on to recommend that the holders of a right *in rem* should also be exempt from the operation of a stay or moratorium.

Rights *in rem* will often have procedural rights attached to them by virtue of the agreement granting the security, such as the right of a floating charge holder to proceed with a receivership or other type of insolvency procedure. Such procedures are governed by the law of the Member State in which preliminary proceedings are commenced insofar as they pertain to "the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right *in rem*."[84] This indicates that a rights holder may have exercised their security in another Member State prior to the opening of preliminary proceedings, but has been unable to obtain full repayment locally, leaving them to rely on the outcome of preliminary insolvency proceedings and the law governing it to recover what remains.

Finally, article 8 of the EIR Recast provides that:

> "The opening of insolvency proceedings shall not affect the rights *in rem* of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets, both specific assets and collections of indefinite assets as a whole which change from time to time, belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings."[85]

The article goes on to specify the particulars of what rights are implicated, including:

> "(a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;
>
> (b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;
>
> (c) the right to demand assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;
>
> (d) a right in rem to the beneficial use of assets."[86]

Some would interpret this as effectively placing rights *in rem* outside of the reach of insolvency and restructuring procedures when those rights reside in a Member State other than the state of preliminary proceedings,[87] with the consequence in principle being that the holder of the assets, although a part of the estate, will retain his rights in respect of the asset in question. Such a creditor should therefore be able to exercise the right to separate the security from the estate and, where necessary, realise the asset individually to satisfy his claim.[88] That said, an alternative view is that article 8(1) specifies the *opening of insolvency proceedings* as shielding rights in rem from those procedures qualifying under article 1 of the EIR Recast. A restructuring plan is not, in effect, an opening of insolvency proceedings. It is a separate measure with a separate mechanism for recognition and enforceability of judgments set out in article 32. While article 8 will protect creditors with a right *in rem* on assets of the debtor situated abroad, it would depend on the applicability of the EIR Recast to preventive restructuring plans. It is just a matter of whether Member States will or will not implement the PRD using a proceeding already included in that Annex or will activate the process to have it included therein. article 1(1) leaves this

[83] EIR Recast, recital 68.
[84] EIR Recast, art 7(2)(i).
[85] EIR Recast, art 8(1).
[86] EIR Recast, art 8(2).
[87] Automatically recognised under EIR Recast, arts 19-21
[88] See Romanian Country Report, Annex 3: Contributor Responses to the JCOERE Questionnaire, section 12.3, response 11.2.

decision effectively to Member States. However, if the new preventive restructuring processes are scheme-like, deriving from company law, article 8 will not be able to provide protection as the EIR Recast would not cover such procedures.[89] This view asserts that an interpretation of article 8 along these lines would not shield rights *in rem* on foreign assets from a restructuring at all.

On the other hand, where a restructuring is carried out under a new procedure added to Annex A of the EIR Recast it would seem that rights *in rem* held in relation to assets situate in a second jurisdiction will be outside the restructuring process. And to be clear, the idea of article 8 shall not be expanded to any restructuring in proceedings not listed in Annex A.[90]

The EIR does not itself define rights *in rem* in any detail and individual Member States may have different definitions for such a concept. There is a potential conflict between these provisions of the EIR Recast and the operation of provisions under the Preventive Restructuring Directive, if they purport to interfere with the ability of the holders of rights *in rem* to exercise their rights fully outside of relevant insolvency procedures. As noted in the Italian response, the provision of article 8 of the EIR Recast, since it allows to foreclose on a collateral situated in a different Member State, may pose a contrast between the restructuring framework under which a plan has been conceived and the other Member State's rules on the enforcement of security rights (rights *in rem*).[91]

8.4.4 Rights *in Rem* under the PRD

The PRD has introduced a number of provisions that may imperil rights *in rem* subject to restructuring procedures. For example, the stay of individual enforcement actions may potentially interfere with the ability of a right holder to enforce its rights within the time frame stipulated by the contract. While a hindrance to enforcement, this does not affect property rights; by contrast, the majority rule provisions for the adoption of restructuring plans, and most significantly, the cross-class cram-down against dissenting classes of creditors have the potential to deprive rights holders of their full rights to repayment. The Directive does not give any particular special treatment to the position of secured creditors or rights *in rem* holders, as they are to be treated in a class and subject to a plan as agreed under the relevant procedure. This means that a plan may have the effect of impairing a secured creditor's rights, depending on the priority rules applied. For example, the plan is agreed such that it deviates from absolute priority, a secured creditor may not benefit from full repayment whole more junior creditors are receiving something, which certainly impairs the rights they would normally have in a liquidation procedure. While theoretically restructuring procedures must respect the provision of article 8 of the EIR Recast and should not include secured creditors, the Directive appears to allow for the impairment of the rights of secured creditors,[92] depending on how the frameworks are implemented within the Member States. That said, from a pragmatic perspective, excluding an important preferential creditor from the negotiations and approval of a preventive restructuring plan may lead to the ineffectiveness of the plan as a whole.[93]

8.4.5 Jurisdictions Allowing Potential Impairment of Rights *in Rem*

JCOERE Questionnaire Question 10.2:

Given the interaction of Article 8 of the Recast Insolvency Regulation (see Annex B) on the protection of rights in rem and Article 11 of the Preventive Restructuring Directive allowing for a cross-class cram-down, there is a potential conflict between the protection of rights in rem and the application of a cross-border cross-class cram-down. *Consider Article 8 in Annex B and Article 11 in Annex A and indicate whether or not this conflict is present in your jurisdiction. Please provide examples, reference to policy, principles, and legislative texts where relevant.*

[89] See German Country Report, Annex 3: Contributor Responses to the JCOERE Questionnaire, section 12.7, response 11.2
[90] Thank you to Professor Stephan Madaus for his synopsis of this viewpoint, which is common among German commentators.
[91] See Italian Country Report, Annex 3: Contributor Responses to the JCOERE Questionnaire, section 12.2, response 11.2
[92] See Romanian Country Report, Annex 3: Contributor Responses to the JCOERE Questionnaire, section 12.3, response 11.2.
[93] *ibid*.

a) Ireland

In Ireland, the most common exercise of a right *in rem* is the right of a secured lender to appoint a receiver over an asset or assets of a debtor. A receiver can either be court-appointed or appointed by a debenture holder, the latter being considerably more common; where it is the latter, the terms of the debenture (contract) will dictate the circumstances that give rise to his appointment. It is common to have a receiver appointed as a receiver-manager, despite the fact that this right has been severely curtailed under English law. A receiver-manager takes control of the business, effectively suspending the powers of the directors, and realises the assets in order to repay the creditor. Alternatively, he manages the business in order to salvage some or all of it. The debenture holder has a contractual right to appoint the receiver. Irish law, however, permits the displacement of the receiver by the appointment of an examiner provided that the receiver has not been in situ for more than 3 continuous days. [94] In this regard, the ability of a secured lender to exercise its rights over a secured asset is compromised by a rescue procedure. Whilst this might give rise to a conflict between the examinership procedure, the EIR Recast article 8 and the fact that examinership is registered in Annex A, this conflict will only arise in relation to assets situate outside the jurisdiction.

b) Italy

Italian law also provides for the automatic creation of certain rights *in rem* when parties enter into particular transactions or relationships. These liens concern, for instance, some tax claims and costs incurred to enforce against an asset in the context of a litigation. There are also cases in which creditors will automatically enjoy a general priority over all of the assets of a debtor. These are not technically considered rights *in rem* under the Italian framework, as the collateral is not represented by a specific asset or a collection of indefinite assets; rather, it is extended over an entire estate. Further, it is contended that these should not be considered rights *in rem* under the EIR Recast either

The Italian moratorium extends to secured claims if granted upon the filing of a petition for judicial composition with creditors or the confirmation of a restructuring agreement.[95] Deferral of payment under the plan, which provides for the continuation of the business, may last for a maximum of 2 years after confirmation. [96] This deferral of payment of secured claims may be imposed overcoming the dissent of relevant classes through a cross-class cram-down.

It is also permitted in general under the Italian restructuring frameworks for the debtor to create a plan that pays a secured claim less than its face value, provided that a payment of at least equal value of the collateral is granted, essentially a case in which the creditor would be in no worse position if it were faced instead with liquidation. The deficiency in the claim can then be treated as an unsecured claim (described as a "bifurcation"). Significantly, the consent of the affected secured creditors is *not* required under the Italian framework. This is clearly out of keeping with the protection intended by article 8 of the EIR Recast.

The right to enforce against the secured asset situated within the territory of another Member State, a right protected under article 8 of the EIR Recast, may allow the relevant secured creditor to use that asset as a hostage, whenever the disposal value (*i.e.*, the value the debtor would bear to replace the asset) is significantly higher than the market value (*i.e.,* the value the creditor would obtain foreclosing on the asset), and thereby obtain a higher recovery by threating foreclosure. This adds costs to the struggling business in terms of the need to replace the asset and potentially loss of revenue during the intervening

[94] It is often the case that the company as debtor in possession applies to have an examiner appointed as a defensive mechanism to the appointment of a receiver. Per Irish Companies Act, s 512(4) "The court shall not give a hearing to a petition if a receiver stands appointed … for a continuous period of at least 3 days prior to the date of the presentation of the petition." This short "window of opportunity" has occasionally given rise to last minute petitions by companies for the appointment of an examiner; in *Re Belohn & Merrow Ltd* [2013] IEHC 157 for example, the Receiver was appointed to Merrow Ltd – the sole registered shareholder of Belohn Ltd – on a Friday and when they became aware of this on the following Sunday, the directors of Merrow Ltd petitioned the court *ex parte* for the appointment of an examiner.

[95] CCI, art 54 para 2.

[96] CCI, art 86 – only one year under the Insolvency Code, art 186 *bis,* although a longer deferral is allowed if secured creditors are given the opportunity to vote on the plan and the plan is confirmed by the court (possibly overcoming the dissent of the relevant classes of secured creditors, if the proposals complies with the requirements for cross-class cram-down). Under CCI, art 86 due to entry into force on August 2020, a deferral of payment is allowed for a period of up to 2 years and, in all cases, secured creditors are entitled to vote on the plan (thus, no deferral of secured claims beyond 2 years seems to be allowed under the new rules).

period, which may threaten the success of a restructuring plan. In addition, the protection of article 8 may put the creditor with the asset outside of the primary jurisdiction in a much stronger position than a creditor with property in the jurisdiction of procedure; article 8 does not offer the same protection in the latter case. Such a dynamic, especially if applicable on a plurality of assets or if the disposal value is much higher than the market value (in case of "tailor-made" assets etc.) will erode the margins available to successfully achieve a restructuring. The view of the Italian respondent is that this is clearly at odds with the purposes of the preventive restructuring framework.

German insolvency law continues to respect security rights in terms of a priority in access to the value of encumbered assets. The process of liquidating the asset outside of insolvency proceedings and thus controlling its timing is only granted to the secured creditor where the asset is immovable, or the creditor is currently in possession of a moveable asset. If, however the debtor was in possession of a moveable asset, the right to foreclose is assigned to the insolvency practitioner who may sell the asset with proceeds going to the secured creditor, less a deduction of legal costs. Still, even the enforcement of security rights outside of insolvency proceedings can be stayed in favour of securing a going concern of the debtor's business in Germany. A German insolvency plan may even permanently modify security rights provided that the secured debtor agrees or receives the value achievable in a liquidation.

According to Romanian insolvency legislation, the secured creditors have a general priority where the proceeds obtained from the sale of their duly perfected collateral are concerned. This is provided that such proceeds first satisfy taxes, fees, costs, expenses arising from the sale of the assets and claims of secured creditors which arise after the opening of the insolvency procedure (including the principal, interests and ancillary rights). If the secured creditors are not fully satisfied following the sale of their collateral, the outstanding amounts will be deemed to be unsecured claims.

The Austrian, Polish, Spanish, and Dutch positions are quite similar to the German approach. Rights cannot be infringed in an insolvency or restructuring, without express and unanimous consent by the secured creditors. Currently in France, there is no conflict in French insolvency law, though this could change following the implementation of a law under the *Loi Pacte*, which does not currently indicate if there will be a conflict with the protection of rights *in rem* under article 8. Similarly, if the UK introduces a new restructuring framework following on from the consultation, there may be a conflict with article 8 and the eventual introduction of the cross-class cram-down, depending on the nature of the rights that are permitted to be infringed in a plan. As the UK does not currently espouse a cross-class cram-down element, this conflict is not at issue. However, given the willingness of the UK government to introduce this provision and its current application of majority rule in the Scheme of agreement, which can affect secured creditors, it is not likely that this conflict will be problematic in the UK. Further, given that the scheme is not covered by the EIR, the protection of rights *in rem* would not extend to plans derived under this procedure in any event. As the EIR Recast does not apply to Denmark, there is no conflict.

Effectively, a cross-border restructuring in which a lender has a right in rem in a second jurisdiction, will access to the assets covered by the right be limited by the absolute terms of Art 8 of the EIR? Is this a significant practical issue?

8.5 Conclusion and Transition

Chapter 8 has given a synopsis of the first half of Part III of the JCOERE Questionnaire, focussing on thresholds of insolvency, debtor in possession as set out under article 5 of the PRD, and the interrelationship between article 8 of the EIR Recast protection rights *in rem* and the potential to impair secured creditors rights under the PRD. The concept of thresholds of insolvency is important as it is at this cusp that the availability of a preventive restructuring procedure over an insolvency procedure will be possible. Where these differ across Member State lines, other more flexible jurisdictions may be more attractive, leading to potential COMI shifting. While the PRD aims to reduce court and practitioner involvement, it has made this aspect broad in scope. This means that Member States have discretion to choose a higher level of involvement of courts, authorities, and practitioners, perhaps more than the spirit of the PRD may have initially intended. Finally, while the protection of rights *in rem* seem to be absolute under the EIR Recast as it relates to foreign property, the wording of the regulation does not necessarily cover secured property in the primary insolvency jurisdiction, which will mean potentially differential treatment of secured creditors across borders. As the PRD was aiming to approximate and harmonise Member State laws in preventive restructuring, the broad scope given to adopt its provisions may potentially fail to achieve this aim.

The next Chapter will offer a simple conclusion of the discussions had in this Report to summarise the main ideas and findings.