9. Chapter 9: Conclusion of the JCOERE Project Report 1

9.1 Introduction

The first Report of the JCOERE Project has presented the context within which the project's overall investigation of court-to-court co-operation in cross-border restructuring cases arises. It has considered preventive restructuring frameworks among the Member States along with that provided in the new Preventive Restructuring Directive. In order to fully understand the substantive and procedural issues associated with preventive restructuring frameworks that may cause obstacles to effective court-to-court cooperation, it was necessary to first explore how these are reflected in the contributing jurisdictions, within the PRD, and also within the debates and commentary surrounding the more controversial provisions common to advanced preventive restructuring frameworks. This first Report from the JCOERE project has therefore dealt with core substantive rules and some procedural aspects arising directly from preventive restructuring legal frameworks so that the overall JCOERE hypothesis may be addressed and considered in the second Report. This hypothesis is that given existing experience with restructuring (e.g. the Irish Examinership[1] and the English Scheme of Arrangement) obstacles to court cooperation will arise from substantive rules which are particular to preventive restructuring and that in addition, some of these problems pertain to existing procedural obstacles which will be exacerbated in the preventive restructuring context.

This Report contains 7 substantive chapters ranging from exploring issues arising from the comparative methodology adopted in the study, to the consideration of important concepts such as the regulation of cross-border insolvency and restructuring and on to academic commentary and debates around preventive restructuring. Since the financial crisis of 2006/07 there have been many changes to insolvency and restructuring frameworks at national level within the EU. However, these changes had remained broadly domestic in nature rather than achieving any substantive convergence of legal frameworks within the EU. It is a commonly shared belief that substantive harmonisation in insolvency law will always be difficult to achieve due to the range of differences in legal frameworks which are impacted by, or linked to, insolvency systems. Exceptionally, the PRD introduced an opportunity to harmonise one aspect of insolvency law, namely preventive restructuring. Chapters 4 and 5 of the Report describe the policy discussions surrounding this significant step in the EU.

Following on from that discussion, the three core chapters of this report, namely Chapters 6-8, present a synthesis and comparative discussion of the various jurisdiction-based contributors' responses to the JCOERE Questionnaire which focussed on the state of play regarding restructuring in each jurisdiction. Based on the experience of some European jurisdictions with restructuring, in particular in Ireland and the UK some key aspects of the PRD were used to formulate the JCOERE Questionnaire.

Following our research and analysis of the questionnaire responses, we argue that although the PRD represents an attempt to harmonise approaches to preventive restructuring and to introduce such measures in jurisdictions that do not yet have them, the scope of derogation, and the differences in views at domestic policy level regarding the more controversial provisions, mean that it is unlikely to achieve close harmonisation upon implementation throughout the Member States. The following Chapter will summarise the chief findings in this Report.

[1] Irish Companies Act 2014, part 10 "Examinerships".

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9.2 Summary of Findings

9.2.1 Preventive Restructuring Terminology

Chapter 2 of this Report set out commonly used terms (in English) but also explored some of the discrepancies in the meaning of some terms that are used by several jurisdictions, but at times have slightly (or in some cases) significantly different meanings. There is no need to summarise this Chapter's findings here, apart from pointing out that these terms were identified by the contributors who responded to the JCOERE Questionnaire. During the analysis of these responses, it became clear that sometimes seemingly similar terms are used in different jurisdictions to mean different things, which could present challenges to harmonisation and could also cause confusion when communicating across borders. Three aspects of the PRD which we considered seem to have engendered quite a bit of confusion in a comparative context. These are the threshold question, namely when the preventive restructuring procedure will be available and whether this ought to be available in situations which are described in some jurisdictions as pre-insolvency. The consequent characterisation restructuring as preventive or pre-insolvency seems to cause both linguistic and conceptual difficulties. A second area relates to the involvement of the IP in a debtor in possession model of rescue. Some contributors seem to see this as a binary issue, either the IP is in control or the debtor is in control, whereas this was not seen in such binary terms by others. Finally, the involvement of a court or administrative authority has engendered considerable divergence of opinion.

9.2.2 The Regulation of Cross-Border Insolvency and Restructuring in the EU

The Chapter on the regulation of cross-border insolvency and restructuring in the EU explored the way that cross-border insolvencies are currently regulated within the EU along with a description of this development over time. By the time the EIR Recast was passed, there had been multiple attempts to agree to insolvency conventions that would aid in cross-border insolvencies, beginning in the 1970s. These attempted conventions often failed due to a lack of unanimity among the states negotiating them. It took the EU Institutions negotiating together to create a regulation that could begin to co-ordinate complex insolvency procedures across the Member States.

While the EIR and its Recast did not harmonise insolvency or restructuring frameworks in any substantive sense, they have succeeded in creating a regulatory framework that helps to manage complex cross-border cases efficiently by introducing rules of jurisdiction and instituting rules about the universal nature of primary proceedings, with the option to file secondary domestic proceedings where viewed as necessary to protect domestic interests. Thus, the key features of the EIR Recast include rules of procedural uniformity, the application of the COMI test to establish primary jurisdiction, and the scope of application of the Regulation by reference to procedures situated in Annex A. These provisions aimed in part to prevent forum shopping, though the COMI test can still allow for shifts if certain criteria are met.

Legitimate forum shopping is not likely to be further reduced without real substantive harmonisation within the EU. However, empirically throughout this first stage of our research it did not seem to be the case that whatever the level of forum shopping there currently is in the EU was a barrier to co-operation in insolvency matters.

The effect of the EIR Recast seemed to be clearly understood in the surveys and discussions which we conducted with members of the judiciary and practising professions. All in all, the EIR Recast seemed to have achieved its policy aims. The provisions on recognition are clear. As for co-operation, it did not seem that the issue of positive co-operation and consequently the obligations imposed by the EIR Recast arose frequently in reality. It is not clear how the PRD at the moment how will affect this status quo.

9.2.3 The Context of Preventive Restructuring in the EU

Chapter 4 examined the theoretical and conceptual development of preventive restructuring, pre-insolvency, and some of the more controversial provisions common to advanced preventive restructuring procedures. This Chapter began with a discussion of the theoretical framework within which preventive restructuring has developed, beginning as it does from a basis in insolvency law and theory. It considered the well-known creditors' bargain theory introduced by Thomas Jackson and Douglas Baird. The traditionalist insolvency theory is then contrasted with the creditors' bargain as it

relates to rescue and rehabilitation goals, while the communitarian and insolvency choice theories developed by Korobkin set the scene for a more stakeholder oriented approach, which it could be said more closely reflects the aims of preventive restructuring with its emphasis on job protection and the broader policy issues relating to capital markets as outlined by the EU. A discussion of the justification for corporate rehabilitation is given, focusing on the commonly accepted reasoning that more value can be saved if economic entities are kept intact, rather than sold off piecemeal as would be done in a straight liquidation.

Within the theoretical context, the conceptual evolution of preventive restructuring within the EU was discussed in terms of contrasting academic and scholarly commentary on the subject. One of the key debates in this area revolves around the conceptual problems associated with the use of a collective proceeding for a company in financial distress when that company is not actually formally insolvent. As described above in relation to Chapter 2 the threshold question revolves around the idea that the justification for imposing a collective proceeding in an insolvency (or insolvent restructuring) procedure arises from the fact that the assets are insufficient and would otherwise be dissipated in an inefficient manner to the detriment of all creditors. When a company is not yet formally in a situation of insufficient funds, this justification is not obvious to some commentators. However, this problem may be mitigated by the fact that some view "pre-insolvency" as essentially an insolvency situation in which the likely outcome is a formal insolvency unless a restructuring takes place. It is our view that there is a debate being conducted at cross-purposes aggravated by misunderstandings and mistranslations of different legal systems, a problem inherent in comparative contexts. The Chapter goes on to discuss the definition of preventive restructuring as it is set out in the PRD, which includes pre-insolvency as well as situations where there is "a likelihood of insolvency"[2] with the distinction being only that the procedure instead takes place outside of what would be considered formal insolvency procedures. This question is the subject matter of contributor responses which are described in Chapter 8. It will be returned to in the second JCOERE Report.

A brief discussion of the evolution of the PRD was also presented to lend additional context to the exposition of the PRD discussed in Chapter 5. This section discusses some of the earlier influences on the introduction of preventive restructuring occurring outside of the institutional negotiations, particularly a report by INSOL Europe. It also explains some of the background influences leading to the introduction of a harmonising directive for preventive restructuring frameworks, namely the financial crisis.

The more controversial provisions were discussed in terms of the debate and commentary surrounding them. These include the stay or moratorium; intra-class cram-down; cross-class cram-down; and the protection and priority of new and interim financing. The stay or moratorium is considered a central aspect of preventive restructuring as it avoids the rush to court by creditors for a period of time while negotiation can take place. While true that a stay interferes with creditors' rights and potentially creates a means of abusing the procedure, this is mitigated by the obligation to provide a means to lift a stay. The protection of new and interim financing is also considered a somewhat controversial provision as it also interferes with creditor priorities. However, this provision has been recognised in established processes as being necessary to ensure the success of a restructuring plan. By providing that new financing will not be subject to normal insolvency rules such as avoidance actions and existing priority rules, new lenders can be encouraged to provide funds.

Majority rule within classes is also justified as to require unanimity would give stronger creditors a right of veto over a restructuring plan. The cross-class cram-down has provided European insolvency academics with a rich field of debate around the relative values of absolute as opposed to relative priority. While the academic debate continues and is likely to influence lawmakers in some jurisdictions, the PRD allows a broad scope to adopt either of these tests in addition to a test of unfair prejudice. Absolute priority is supported as it preserves pre-insolvency entitlements and prevents an erosion of creditors' rights by trying to force through a plan. However, absolute priority in its pure form is viewed as too rigid in an effective restructuring framework. Thus, the Commission introduced a relative priority

[2] PRD, art 4(1):
"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, with a view to preventing insolvency and ensuring their viability, without prejudice to other solutions for avoiding insolvency, thereby protecting jobs and maintaining business activity. "

rule, although it would seem that this differs from what is considered relative priority in the United States, according to some. Regardless of the unresolved nature of the debate, the PRD provides for a menu of choices to ensure the fairness of cramming down a plan against dissenting creditors, including one of relative priority.

The consideration of these four controversial provisions provide context for both the discussions in the exposition of the directive in Chapter 5 as well as for the focus of the JCOERE Questionnaire, discussed in Chapters 6-8.

9.2.4 Exposition of the Preventive Restructuring Directive

As outlined in Chapter 5, the PRD, which came into effect on 20th June 2019 and is due for implementation by 17th July 2021, is the culmination of years of communication and negotiation between the various EU institutions. Its primary specific goal was to harmonise certain aspects of EU insolvency and preventive restructuring law with an overall aim of promoting and encouraging cross-border investment and company expansion. This aim was somewhat unsurprising given the financial upheaval within the EU at this time. To achieve agreement from the various member states, however, considerable compromises had to be made, some of which may have arguably weakened the overall goal of the Directive. Chapter 5 outlines the historical development of the PRD, with the goal of giving a clear context for Chapters 6 – 8 and in particular, to explain some of the perceived resistance to change within some member states.

The Chapter highlights the changes made by the various bodies to the Commission Proposal (2016) by the time the Directive was signed in 2019, however, the historical analysis actually begins with a report presented to the European Commission by the European Parliament Committee on Legal Affairs in 2011. This interaction, in addition to the response from the Commission in 2012 and the Commission Recommendation in 2014, presents the background for the subsequent Commission Proposal. Many of the key aims and goals of the Directive were stated and repeated throughout the process. The difficulty in harmonising law of this nature across the Member States, is explained in the context of the more 'controversial' aspects of the PRD, namely, the stay of individual enforcement actions, the protection of new finance, decreased court formality, and the cross-class cram-down. Examining the development of the articles relevant to these provisions provides important background for Chapters 6 – 8.

As implementation of the Directive is not due until 2021 it is difficult to predict how the controversial provisions as outlined in Chapters 4 and 5 will impact on recognition and co-operation under the EIR Recast. With regards to implementation, there is also a prospect that new frameworks may avoid inclusion in Annex A of the EIR Recast in order to retain flexibility to attract cross-border restructuring cases. As the PRD does not require that all frameworks are included in the Annex, nor does it require that the Annex A criteria are satisfied by the frameworks, there is scope for Member States to effectively avoid the more restrictive COMI tests should they avoid inclusion. Such procedures could be introduced to compete with the UK Scheme of Arrangement, which is not an Annex A procedure, and which post-Brexit may no longer be a preferred jurisdiction, opening the way for competing procedures, such as the Irish Examinership and new Dutch WHOA procedure. (That said, the Irish Examinership procedure as with the French *sauve garde procedure* is listed in Annex A). Despite the potential lack of harmonisation of restructuring frameworks and the continued possibilities for forum shopping outside of the EIR Recast, the introduction of more efficient restructuring frameworks will still be beneficial to the EU as a whole.

9.2.5 The JCOERE Questionnaire: Chapters 6-8

Chapters 6-8 of this Report provide a synthesis of the 11 contributors' responses to the JCOERE Questionnaire, the purpose of which was to explore substantive and procedural rules arising in the context of preventive restructuring, which may be challenging in terms of cross-border restructuring cases and in terms of harmonisation and implementation of the PRD. The challenges these present to court-to-court co-operation will be discussed in Report 2 of the JCOERE Project. The questionnaire focused on specific substantive (and procedural) rules arising in a typical restructuring process, particularly those that seem controversial in nature. These three chapters focussed on the substantive provisions of preventive restructuring in the contributing jurisdictions and how they measure up to the new PRD, with some discussion of procedural issues in Chapter 8.

Chapter 6 began by introducing the methodology surrounding the use of the questionnaire which began with the responses to the JCOERE Questionnaire. However, we also followed up a number of times for clarifications and additions in light or the original responses, along with a final review and approval. This was needed due to the challenging nature of comparative law in the context of multiple jurisdictions as well as engaging with contributors from different professional backgrounds. We hope that the fact we engaged with follow up dialogue from our contributors enriches the comparative methodology which the report adopted. The responses to part I of the questionnaire were also discussed in Chapter 6, which interrogated the existing preventive restructuring frameworks in the contributing Member States as well as the aims and functions of their insolvency and restructuring systems. These responses have helped to determine how each jurisdiction's preventive restructuring (or insolvent restructuring) frameworks relate to the terms of the PRD.

Part II of the JCOERE Questionnaire[3] queried the substantive aspects of preventive restructuring, asking the contributors to examine whether specific PRD-style provisions existed in their preventive restructuring frameworks, describe them, and identify what changes, if any, would be needed to bring their legal provisions into line with the PRD. While some Member States did not have truly preventive procedures, with restructuring instead occurring during an insolvency proceeding, the contributors were asked to respond with reference to comparable frameworks. The Member States that have contributed to the JCOERE Questionnaire vary significantly in terms of (1) the existence of preventive restructuring procedures; (2) the provisions common to preventive restructuring, which may currently be associated with insolvency or insolvent restructuring or reorganisation procedures; and (3) the perspective on certain key concepts and principles that are common to preventive restructuring.

The key provisions explored in Part II of the questionnaire as synthesised in Chapter 7 included the stay or moratorium, its existence and duration including extensions, as well as whether this stay was revocable by a court. The cross-class cram-down also generated an important discussion, which required a discussion of the various criteria required for confirmation and approval under the PRD. Rules pertaining to both the adoption and confirmation of restructuring plans had to be examined, including the ability to vote on a plan as well as what conditions were present that could exclude certain creditors from voting; including principles surrounding class formation and recognition; the examination of voting rights; and the application of majority rule within classes. These were necessary precursors to consider leading up to the discussion of the cross-class cram-down. Few jurisdictions provide for a cross-class cram-down in a preventive restructuring procedure and not all even have it in their insolvent restructuring procedure. This provision appears therefore to be one of the greater challenges to implementation. A current academic debate revolves around the menu of rules that can be applied to confirm a plan against dissenting classes of creditors. There are a variety of opinions on which rules are appropriate and most jurisdictions have not yet decided which they will apply when they come to implement the PRD.

The provision of interim and new financing was also queried with the contributors as this is a vital element for the success of preventive restructuring plans. The provision of protection from claw-back manoeuvres, liability for lending, as well as the potential to apply a super priority to such loans in repayment is a vital piece of the restructuring puzzle. The contributing jurisdictions take a varied approach to this concept, with views that it, along with aspects of the cross-class cram-down could lead to abuse of process and moral hazard. However, it is also accepted by others that this is an unavoidable aspect of preventive restructuring if the Member States are to create or adjust procedures that will be effective at rescuing companies from insolvency.

Part III of the JCOERE Questionnaire examined specific procedural aspects that could arise in relation to preventive restructuring frameworks. This part of the questionnaire was divided into two parts, the second of which will be dealt with in JCOERE Report 2 (the role of judicial or administrative authorities). Chapter 8 focussed on the jurisdictional approaches to the threshold of insolvency, which is important as it is at this cusp that the availability of, and accessibility to, a preventive restructuring procedure over an insolvency procedure will be possible. A right of *locus standi* in relation to preventive restructuring frameworks may therefore differ despite the fact that the PRD aims at harmonisation in this area. It also discussed contributor responses in relation to the requirement for insolvency

[3] See Annex 2 of this Report for the full JCOERE Questionnaire.

practitioners in restructuring processes, for which there is currently a range of approaches, some, such as Ireland and Italy, requiring a practitioner to be appointed under all circumstances. Chapter 8 also explores whether the perceived legislative conflict between the EIR Recast on the protection of rights *in rem* and the introduction in the PRD of provisions that potentially interfere with these rights in both the intra- and cross-class cram-down may produce a conflict in practice that could also interfere with the obligation to co-operate. 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. Where these differ across Member State lines, other more flexible jurisdictions may be more attractive, leading to potential COMI shifting.

9.3 Conclusion and Introduction to JCOERE Report 2

Report 1 has explored preventive restructuring in relation to existing domestic provisions and as presented within the PRD through discussion of academic and scholarly commentary and debate, a survey of specialists in 11 jurisdictions, and a synthesis of responses to establish where serious divergences may exist. Such divergences are not only challenges to implementation but may also challenge the recognition provisions under the EIR Recast because of the potential exclusion of restructuring frameworks from Annex A. Once outside the EIR Recast the obligations for co-operation as specified in the Regulation are not applicable. However, even if domestic preventive restructuring provisions are included there will be challenges to court-to-court cooperation arising from the provisions we have discussed in this report. These issues will be further considered in the second JCOERE Report.