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NOTE

From:	The Services of the Commission
To:	Working Party on Civil Law Matters (Insolvency)
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Subject:	Non-paper on the relationship between the proposal for a Directive on preventive restructuring and second chance (COM (2016) 723 final) and the revised Insolvency Regulation (Regulation (EU) No 848/2015)

Delegations will find attached a non-paper from the Services of the Commission on the relationship between the proposal for a Directive on preventive restructuring and second chance and the revised Insolvency Regulation (Regulation (EU) No 848/2015).

ANNEX

Commission Services Non-paper

on the relationship between the proposal for a Directive on preventive restructuring and second chance (COM (2016) 723 final) and the revised Insolvency Regulation (Regulation (EU) No 848/2015)

I. INTRODUCTION

In discussions in the Council Working Party on Civil Matters (Insolvency) and in subsequent written comments, Member States stressed the need for more clarity on the relationship between the proposed Directive on preventive restructuring and second chance[1] ('proposed Directive') and the revised Insolvency Regulation[2] ('Insolvency Regulation') and called on the Commission to provide further input. In addition to the explanations given orally in the Council Working Party meetings, the Commission Services could bring the following clarifications.

II. GENERAL CONSIDERATIONS

II. 1. The Insolvency Regulation

The Insolvency Regulation is a private international law instrument. It contains rules on conflicts of laws and jurisdiction for insolvency proceedings and ensures the recognition of related judgments across the EU. It covers a wide range of insolvency procedures which fulfil certain conditions and are listed in Annex A to the Regulation.

The Regulation does not have the aim of covering all insolvency proceedings in the Member States and allows them the possibility to maintain or introduce procedures which do not fulfil all the conditions for notification under Annex A of the Insolvency Regulation. To be notified under the Insolvency Regulation, an insolvency procedure must be:

- public as from the moment the judgment opening the procedure becomes effective, as provided for in Article 2(7) and (8) of the Insolvency Regulation;
- collective, as defined in Article 2(1) of the Insolvency Regulation;
- based on laws related to insolvency;
- provide for
    - either the total or partial divestment of the debtor and the appointment of an insolvency practitioner (Article 1(1)(a) of the Insolvency Regulation),
    - or for debtor-in-possession (Article 2 (3) ? and the control or supervision by a court of the debtor's assets and affairs (Article 1(1)(b) and Recital 10 of the Insolvency Regulation),
    - or, in the case of a temporary stay of individual enforcement procedure, this is granted by a court or by operation of law, provides for suitable measures to protect the general body of creditors and is preliminary to a procedure providing for total or partial divestment or a debtor-in-possession procedure (Article 1(1)(c) of the Insolvency Regulation).

1 COM(2016) 723 final.
2 Regulation (EU) No 848/2015.

Where procedures which do not fulfil these conditions exist in Member States, they fall between the 'fault lines': on one hand, to the extent they are insolvency law measures, they are excluded from the scope of the Brussels I Regulation on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters[3] by virtue of its Article 1(2)(b); on the other they are also not covered by the Insolvency Regulation and therefore do not enjoy recognition under this instrument.

II.2. The proposed Directive

The proposed Directive will harmonise certain aspects of the substantive insolvency laws of the Member States, e.g. essential features for a preventive restructuring framework and for a procedure leading to a discharge of debt for natural persons who are entrepreneurs.

In respect of preventive restructuring measures, the proposed Directive makes provisions for 'frameworks' which can be made up of one or more procedures and which:

- are collective procedures in the sense of Article 2(1) of the Insolvency Regulation, i.e. comprise either a totality of creditors or only a significant part;
- are debtor-in-possession procedures, as defined in Article (2)(3) of the Insolvency Regulation, i.e. the debtor is left totally or partially in control of its assets and affairs and the appointment of an insolvency practitioner is not therefore necessary in every case.

No provision on the publicity of preventive restructuring procedures is made in the proposed Directive.

In respect of procedures leading to a discharge of debt for entrepreneurs, the proposed Directive harmonises the access of insolvent entrepreneurs to a procedure leading to a full discharge of debt in no more than three years, subject to limitations. It also caps the period of disqualification orders which are linked to the insolvency of the entrepreneur.

The Directive also harmonises certain measures which ensure the efficiency of the full range of restructuring and insolvency procedures (i.e. preventive restructuring procedures, procedures leading to a discharge debt, as well as other insolvency procedures, such as liquidation procedures), not least in view of the communication and cooperation duties in cross-border proceedings established in the Insolvency Regulation.

[3] Regulation (EU) No 1215/2012.

II.3. Link between the proposed Directive and the Insolvency Regulation – basic approach

The proposed Directive does not intend to change the approach taken in the Insolvency Regulation of allowing Member States the possibility to maintain or introduce procedures which do not fulfil all the conditions for recognition and notification under Annex A of the Insolvency Regulation. The proposed Directive will have no impact on the scope of application of the Insolvency Regulation. The proposed Directive aims at being fully compatible with and complementary to the Insolvency Regulation, by requiring Member States to ensure that their preventive restructuring procedures comply with certain minimum principles of effectiveness (see Explanatory Memorandum, p. 9). Although the proposed Directive does not require that procedures within its scope fulfil all the conditions for notification under Annex A of the Insolvency Regulation, it aims at facilitating the cross-border recognition and enforcement of procedures falling within its scope of application.

III. Preventive restructuring frameworks

III.1. Publicity v. confidentiality

The aim of the preventive restructuring framework in the proposed Directive is to enable debtors in a likelihood of insolvency and their creditors to have access to an effective preventive restructuring framework in all Member States which could consist of one or several procedures or measures which together present certain efficiency features (e.g. a stay of individual enforcement actions, a cram-down, a cross-class cram-down). While there are undoubtedly intrinsic virtues in the public character of insolvency proceedings broadly speaking, a degree of confidentiality at the beginning of the negotiations on a preventive restructuring plan has proved useful in exploring and preparing the support of certain key creditors for such restructuring. For this reason, the proposed Directive does not contain a requirement that procedures implementing it are public procedures.

According to the Insolvency Regulation, the publicity is triggered by the 'judgment opening of the insolvency proceedings', which includes – but is not limited to – the decision to open insolvency proceedings or confirm such opening, or the decision to appoint an insolvency practitioner. Where restructuring efforts begin with a confidential procedure, they could be brought within the scope of the Insolvency Regulation by means of a separate confirmation procedure, where the decision to open the procedure to confirm a restructuring plan is public (as is already the case with some Member States' procedures notified under Annex A of the Insolvency Regulation which enable a court confirmation of pre-packaged restructuring plans).

III.2. Collective character

According to Article 2(1) of the Insolvency Regulation, collective proceedings means those which include all or a significant part of the debtors' creditors, provided that, in the latter case, the non-involved creditors are not affected by the restructuring plans.

The proposed Directive leaves Member States the choice of whether to provide for fully collective procedures only, or to allow debtors to restructure with only a significant part of their creditors.

III.3. Debtor-in-possession

According to Recital (10) of the Insolvency Regulation, its scope extends to proceedings which leave the debtor fully or partially in control of its assets and affairs. Since such proceedings do not necessarily entail the appointment of an insolvency practitioner, they should take place under the control or supervision of a court. According to Recital 10 of the Insolvency Regulation, this control or supervision should include situations where the court only intervenes on appeal by a creditor or other interested party.

Article 4 of the proposed Directive provides for limited court involvement, making it possible – but not obligatory - that a court intervenes only on appeal by an interested party. The revised text proposal of 20 December 2017 provides further flexibility to the Member States on the subject of court involvement.

Article 5 of the proposed Directive requires the appointment of a practitioner on a case by case basis, without prejudice to the ability of Member States to provide for cases where a practitioner must always be appointed (e.g. where a general stay against all creditors is granted). The revised text proposal makes it clear that the Member States can decide in which cases the appointment of a practitioner should be obligatory.

III.4. Jurisdiction, applicable law and protection of rights *in rem*

Should Member States decide to implement the proposed Directive via one or more procedures which are then listed in Annex A of the Insolvency Regulation, those procedures will need to be open in the Member States where the debtor's center of main interest is located (COMI) according to Article 6 of the Insolvency Regulation. The law applicable to those procedures will be the law of the Member State of the COMI according to Article 7 of the Insolvency Regulation. Articles 8 of the Insolvency Regulation would apply accordingly for the protection of creditors' and third parties' rights *in rem.*

In order to avoid legal uncertainty and disruptions likely to lead to inefficiencies when restructuring negotiations fail and a liquidation procedures ensues, the grounds for international jurisdiction for preventive restructuring procedures covered by the proposed Directive and which also fall within the remit of the Insolvency Regulation would be the same as for liquidation and other insolvency procedures.

Should Member States decide to implement the proposed Directive by means of one or more procedures which do not fall within the scope of the Insolvency Regulation, those procedures will not enjoy recognition and enforcement in other Member States. Jurisdiction and applicable law will be determined by private international law rules of the Member States. In the case of rights *in rem* located in another Member State than the Member State where such procedures take place, Article 8 of the Insolvency Regulation would not apply. While the ensuing legal uncertainty is a suboptimal situation, it is already the case today.

IV. Procedures leading to a discharge of debt for entrepreneurs

The proposed Directive aims at putting in place in each Member State at least one procedure which presents the possibility for insolvent entrepreneurs to obtain a full discharge of debt within three years, with appropriate limitations in cases such as dishonesty and bad faith. Such procedures leading to discharge can be notified under Annex A of the Insolvency Regulation: Recital (10) of the Insolvency Regulation explicitly mentions procedures leading to a discharge of debt for natural persons as falling within its scope of application.

The proposed Directive contains no provisions in respect of procedural aspects relevant for the scope of application of the Insolvency Regulation, such as the opening of procedures, the appointment of practitioners, the involvement of court, the publicity of procedures or their collective character.

Annex

The graph below illustrates *in a simplified manner* the scope rationae materiae of the two instruments when compared: