

UK “schemes of arrangement” are “outside” the scope of the European Regulation on Insolvency Proceedings. What does “outside” actually mean?

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1. The characterisation of art. 1(1) ERIP and role of the Annex

Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast, hereinafter ERIP bis) includes within its scope pre-insolvency proceedings, defined as “*public collective proceedings, including interim proceedings, which are based on laws relating to insolvency and in which, for the purpose of rescue, adjustment of debt, reorganisation or liquidation, [...] (c) a temporary stay of individual enforcement proceedings is granted by a court or by operation of law, in order to allow for negotiations between the debtor and its creditors, provided that the proceedings in which the stay is granted provide for suitable measures to protect the general body of creditors, and, where no agreement is reached, are preliminary to one of the proceedings referred to in point (a) or (b)*”. [Points (a) and (b) refer to proceedings where (a) a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed; (b) the assets and affairs of a debtor are subject to control or supervision by a court].

However, the new text retains the system of Annexes according to which Member States must bring to the Commission’s notice those proceedings they deem included in ERIP bis; to those not thus notified, the European text shall not apply. Such derogation means, among other things, that the excluded proceedings may not benefit from the automatic recognition system provided for in art. 19 ERIP bis (“1. Any judgment opening insolvency proceedings handed down by a court of a Member State which

has jurisdiction pursuant to Article 3 shall be recognised in all other Member States from the moment that it becomes effective in the State of the opening of proceedings. [...]”).

Spain has notified, and had included in Annex A, in addition to the “*concurso*”, the “*procedimiento de homologación de acuerdos de refinanciación*”, the “*procedimiento de acuerdos extrajudiciales de pago*” and the “*procedimiento de negociación pública para la consecución de acuerdos de refinanciación colectivos, acuerdos de refinanciación homologados y propuestas anticipadas de convenio*”, despite the fact that the fit of some of these in ERIP bis’ definition is at the very least debatable. The UK, for its part, has not notified its schemes of arrangement.

2. The problem

Since non-inclusion of the schemes of arrangement in Annex A means the impossibility of automatic recognition at the EU level, the question arises as to whether such schemes can be recognised by way of another avenue or, to the contrary, cannot be recognised extraterritorial effects (at least in the EU).

The answer to this question depends on whether, in spite of the exclusion from the Annex, it is understood that the schemes fit the general definition of “insolvency proceedings” provided in art. 1 ERIP bis. If so, UK’s non-notification cannot have any impact on its characterisation; i.e. proceedings are characterised as insolvency proceedings if they meet the requirements of art. 1. That a State should fail to notify, for inclusion in the Annex, proceedings that meet

such characteristics does not render these non-insolvency proceedings, but simply places them in a “no man’s land” where extraterritorial effects are impossible as they cannot rely on the only legal text that could recognise them.

3. The Annex does not perform a “negative” characterisation role

From that perspective, the Annex only serves to enable States to benefit from a “safe niche” of automatic recognition, it plays a role of “positive integration” in conceptual terms, but in no case does it mean that court or out-of-court management of insolvency is not possible outside the proceedings therein envisaged. This interpretation is confirmed by recital 9, according to which ERIP bis applies to the proceedings listed in the Annex “*without any further examination by the courts of another Member State as to whether the conditions set out in this Regulation are met.*” It is true that the same recital states that insolvency proceedings which meet the conditions set out in ERIP bis are listed *exhaustively* in the Annex, but it is equally true that it later adds that “[n]ational insolvency procedures not listed in Annex A should not be covered by this Regulation”, thereby admitting that there may be insolvency proceedings other than those expressly listed.

This can also be explained from another perspective. Where the EU country *A* forsakes notifying certain proceedings for the purposes of Annex A of ERIP bis, it cannot demand that a decision to “open” (or “close”) the proceedings in question be recognised in the EU country *B*. But if country *B* is a country that according to ERIP bis can open main proceedings, inasmuch as the insolvent debtor’s centre of main interests (COMI) is located in its jurisdiction, country *B* is entitled to consider such to be insolvency proceedings if the conditions for the characterisation under art. 1(1)(c) ERIP bis are met. That country *B* cannot require country *A* to include said proceedings in the Annex to the Regulation or, as a result, to aspire to automatic recognition, on the one hand, and that country *B* cannot consider insolvency proceedings consistent with the characterisation of art. 1(1)(c) to fall under its jurisdiction, on the other hand, are two different things. The country where the COMI is located has a legitimate claim according to ERIP bis to have the law of the COMI determine the conditions listed in art. 7. In fact, country *B* may very well seek such

a thing because the exclusion of said proceedings from the Annex deprives country *A* from having its decision to “open” or “close” recognised in other jurisdictions. Any other outcome would be absurd. Otherwise, country *B*, the COMI jurisdiction, would *only* have a claim to automatic recognition of proceedings carried out in country *B*, notified by country *B* and included in Annex A. But it could not prevent recognition in its own jurisdiction of pre-insolvency proceedings conducted in country *A*, which is not the COMI country (or country where secondary insolvency proceedings could be opened), and this only because country *A* has dismissed or missed notifying its own proceedings for inclusion in Annex A.

In short, the insolvency nature of proceedings is determined by the fulfilment of the requirements under art. 1, at least in respect of the country where the debtor’s COMI is situated. To that effect, art. 1 is the only provision that contains the characterisation’s factual requirements. The notification by a State of all or some of its proceedings for inclusion in the Annex may be debatable (as in the case of art. 71bis(1) of the Spanish Insolvency Act [abbrev. LCON]), but it produces the effect of “curing” possible deficiencies for the purposes of characterisation and the obligation by the other Member States to recognise their insolvency nature. However, this reasoning does not work in the opposite direction; the Annex does not also play a role of negative integration, turning into non-insolvency all that which the State decides to not notify. That which meets the requirements of art. 1 is insolvency and a great number of the schemes of arrangement meet such requirements.

4. Schemes and “insolvency proceedings”

In an earlier paper (CARRASCO PERERA, A./TORRALBA MENDIOLA, E.C., “*Schemes of arrangement ingleses para sociedades españolas: una crítica*”, RCP 14 (2011), pp. 349-362) we argued for the characterisation as “insolvency proceedings” of those schemes seeking an insolvency-related objective. The amendment to ERIP advocates the need to maintain that interpretation, especially now that, unlike what happened with the previous text, pre-insolvency proceedings can be included within its scope. If the characteristics of the schemes of arrangement, as shaped by UK law, are analysed, once can see that despite being regulated by corporate legislation, namely the

Company's Act, they may have different aims including restructuring the debts of a financially distressed company, an aim that is not only fuelling the adoption of most of the schemes in recent years, but which also triggered the creation of the construct, even though the list of functions it could perform was later expanded.

Thus, the main appeals of the schemes are precisely that they (i) avert the opening of insolvency proceedings by enabling company debt restructuring and (ii) provide a quick response to distress, especially relevant in "rescue" scenarios, by cramming down on dissenting creditors within the same class as the majority who voted in favour of the arrangement (thereby accepting a characteristic rule of insolvency law, far removed from the unanimity that a contractual characterisation would require) (J. PAYNE, *Schemes of arrangement*, Cambridge University Press, 2014, pp. 175 *et seq.*). In fact, despite considering that the schemes were not formally insolvency proceedings, UK doctrine prior to the entry into force of the new ERIP did not cease to highlight the possibility of their adoption, in respect of foreign companies, being conditioned by the EU text's limits in the conferring of jurisdiction to its national courts. This is so because, according to UK law, UK courts have jurisdiction to sanction a scheme if it refers to a company that could be wound up in the UK in accordance with the provisions of the UK Insolvency Act. Beyond this point, it is a subject of debate whether the latter must adapt to these effects and in regard to competition as provided in ERIP or if the response must be in the negative. Regardless of the possible arguments in this respect, the debate highlights the connection of schemes with insolvency.

Moreover, whether or not schemes are insolvency proceedings is a contrived debate. Of course, there may be schemes that are not insolvency proceedings, just as there may be collective arrangements of the type provided in art. 71 bis (1) LCON which do not intend to refinance a debtor. The problem only arises when they effectively are and act as insolvency proceedings. It would be absurd to deny that a scheme is such when conducted as proceedings of the type described in art. 1(1)(c) ERIP bis.

Such being the situation, the only avenue open for recognition of schemes with a scope

of insolvency is ERIP bis, but this remains off limits because of the UK being against the regulation being applied to them. Consequently, insolvency schemes will not be able to produce extraterritorial effects *because the only pathway to recognise insolvency proceedings in respect of debtors with their COMI in the EU is ERIP bis.*

Hence, aside of the recognition of insolvency schemes not being provided for by ERIP, there is nor room to look for other avenues of recognition, otherwise difficult to find given the exclusion from the respective scopes of the Brussels I Regulation bis and the Lugano Convention of "*bankruptcy, proceedings relating to the winding up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings*" and in Spain, the residual nature of the LCON, recognised in art. 199 therein, in respect of ERIP, so that the former applies if the European text does not (and this, as we have seen, would extend to the scheme as insolvency proceedings, but only to exclude it from its system) and the inability also to apply the rules of the Spanish Civil Procedure Act (abbrev. LEC), which has been reserved for non- insolvency cases. All this would only leave the option – uncommon in our legal system – of a recognition based on conflict-of-laws rules.

Faced with the above, there are those who defend that it is not only that the schemes are not included in Annex A, but that they really do not fit the definition of "insolvency proceedings", with the result that their recognition cannot be prevented in other Member States of the EU (F. GARCIMARTÍN, "El nuevo Reglamento europeo de insolvencia (II): ámbito de aplicación" in www.almacendederecho.org, published 9 June 2015). The latter, however, raises a number of doubts about the system by which such can be done: if by Regulation Brussels I bis, which is hardly defensible, since it applies to the recognition either of court decisions made in contentious proceedings or of in-court settlements, and the actions of the judge in the schemes does not fit, in principle, in any of the two categories, or by other mechanisms (in Spain LCON, LEC or recognition based on conflict-of-laws rules).

The non-insolvency characterisation is defended using the following arguments: ERIP bis requires, for inclusion in its material scope,

that the proceedings are based on insolvency legislation, which, in view of art. 1, means that: (i) the objective of the proceedings should be the rescue of the debtor, its reorganization, liquidation or a restructuring of its debts; (ii) if they can be commenced with a mere likelihood of insolvency, they must be to prevent insolvency proceedings or the cessation of activities; (iii) they must be truly prior to insolvency proceedings, so that, if unsuccessful, they may end up as such. Furthermore, Recital 16 of the Explanatory Notes clarifies that proceedings that are based on general company law not designed *exclusively* for insolvency situations should not be considered to be covered by RIP bis. Schemes, it is stated, do not always meet the first three requirements and, of course, are regulated by corporate legislation that is not designed exclusively for insolvency, but serves many other potential purposes. The formalism of the last argument is truly unnerving, to the extent that continuing in this game of fictions could well lead to the pitiful state of the sycophantic populace in Andersen's tale "The Emperor's New Clothes": *they all go along with what they do not really trust*.

To this "non- insolvency" characterisation we may object that while not all schemes meet all three requirements, those that do must be regarded as insolvency and that the requirement of "exclusivity" in the regulation, which only appears in the Explanatory Notes, should have been included in the body of the articles if it is really is an essential requirement. This is not a mere interpretative clarification (unlike what happens with that included in Recital 9), but a requirement added to the essential elements in the definition of insolvency proceedings.

It is true that this requirement of the recital was introduced precisely in order to leave

the schemes outside the regulation's scope. As indicated by part of the UK doctrine, there was no incentive for the UK to include schemes in the Annex since such inclusion would limit the possibility of using them in the case of companies whose COMI was not in that State (J. PAYNE cit., pp. 293-294). The solution finally adopted is a clear example of how the European legislative process often requires such a number of reciprocal concessions to eventually produce a final text that it leads to completely unsatisfactory results from a technical point of view, and from a practical point of view more problems are created than solved by generating legal uncertainty. ERIP bis' system creates for creditors the opportunity of objecting to any insolvency proceedings or claims that come from a State other than that in which the debtor has its COMI (or establishment, but in this case with only a territorial scope); frustrating such expectation on the basis of a simple lack of notification of proceedings for inclusion in an annex by a State, which has obvious economic incentives to not notify, is a mockery of the system as a whole and a breach of one of its basic tenets.

5. Conclusion

The final outcome is clearly indicative of the lack of regulatory quality and the superfluity of ERIP bis. Beyond that, however, the situation described above has fractured the uniform EU treatment of proceedings to safeguard companies. In such a situation, no one can demand that the COMI country make any comity effort to recognise a scheme conducted in the UK on the basis of an apparent or spurious territorial connection. If years ago we postulated that the schemes could not be recognised in Spain, as COMI country, we believe this conclusion is strengthened by ERIP bis.