"Synthetic" insolvency proceedings

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Regulation 2015/848 of the European Parliament and the Council on insolvency proceedings (recast) replaces Regulation 1346/2000 and shall apply to insolvency proceedings opened after 26 June 2017 (OJ L 141, 5 June).

Among other things, this new text aims to limit the possibility of territorial insolvency proceedings under the premise that they are not always conducive to a better resolution of the insolvency proceedings as a whole. In this regard, art. 36 thereof provides that the insolvency practitioner (trustee in insolvency) in the main insolvency proceedings may give an undertaking, to local creditors in the Member State in which secondary insolvency proceedings could be opened, that it will comply with the distribution and priority rights that said creditors would have in respect of the assets located in the Member State in which said secondary insolvency proceedings could be opened (the relevant point in time for determining which are those assets shall be the moment at which the undertaking is made). For this purpose, a sub-category, in respect of the assets and rights located in the Member State where territorial insolvency proceedings could have been opened, is created in the insolvency proceedings with universal scope.

"Local creditor" means "*a creditor whose claims against a debtor arose from or in connection with the operation of an establishment situated in a Member State other than the Member State in which the centre of the debtor's main interests is located*" (art. 2(11)). Although the wording of the provision is somewhat unfortunate, it does not seem to allow for any interpretation other than if what justifies the possibility of opening territorial proceedings is the presence of an establishment in a Member State of the Union European different from the one where the debtor's COMI lies, local creditors are those whose claims arise from the operation of that particular establishment (and not, as the provision reads, "an" establishment situated in a Member State - whichever? - other than that where the COMI is located).

Allowing these "**synthetic proceedings**" is the result of a practice that has been adopted in the UK in cases where the opening of secondary proceedings was considered unduly burdensome, but it introduces a degree of complexity and financial and time-related costs that are likely to render the same only marginally useful. They may make sense in those cases where, in the State in which the territorial proceedings to be avoided could be opened, the value of the assets that could form part of those available for distribution does not justify the opening costs, but there is nevertheless a local creditor - social security agency, tax agency, etc. – intent on ensuring collection over such assets and avoidance of the uncertainty that might result from the classification of its claims in foreign proceedings. In this case, the agreement referred to in art. 36 may be useful, but in more complex situations the opposite would be true. The working of these proceedings raises quite a few doubts:

1. The first question that arises relates to the treatment of "non-local" creditors that, despite not voting for the undertaking, are affected by it. To properly understand their situation, we must take into account that under the Regulation's scheme, if proceedings with a universal scope (in the Member State where the COMI is located) and a set of territorial proceedings (in the

Member State where there is an establishment) are opened, the assets are divided amongst both in such a way that the assets and rights of the territorial proceedings only contain assets situated in their territory, but the claims payable on distribution are always universal in scope, with all creditors entitled to submit claims for payment in both insolvency proceedings.

That being the case, synthetic proceedings arise from an agreement only with local creditors, but that affects all claims payable on distribution. Naturally the assets in the State where territorial proceedings could be opened is not reserved to such local creditors, but the undertaking is approved only by the "*known local creditors*", which shall also be the only ones to which the insolvency practitioner is required to report (art. 36(5)). Once the undertaking has been approved, the insolvency practitioner shall inform local creditors, and not even all of them, on the "intended distributions", and these local creditors may challenge such proposed distribution. If local creditors believe that the distribution does not comply with the terms of the undertaking or the applicable law, they may challenge it, but must do so before the courts of the Member State in which the main insolvency proceedings have been opened.

Things being so, it is difficult to imagine what incentives the remaining creditors may have to accept the outcome of such undertaking and not request the opening of territorial proceedings, but for the sake of protecting the undertaking given under art. 36, this possibility is restricted. According to art. 37(2), "*[w]here an undertaking has become binding in accordance with Article 36, the request for opening secondary insolvency proceedings shall be lodged within 30 days of having received notice of the approval of the undertaking*". That is, the request for the opening of territorial proceedings must be made in that 30-day period, otherwise such possibility is precluded. As the article states, the time limit starts running as of "*having received notice of the approval of the undertaking*", but the person who must serve such notice is not expressed. Is it the insolvency practitioner? But such person is only required to report to "*known local creditors*". Is it the judge presiding over the proceedings with a universal scope? If so, the Regulation does not provide for this.

Aside from setting a time limit, it provides for the rejection of the request to open territorial proceedings if the court seised of such request "*is satisfied that the undertaking adequately protects the general interests of local creditors*" (art. 38), neglecting the interests of remaining creditors which, however, should also be protected in the event of opening territorial proceedings.

It is true that, since it is the insolvency practitioner in the main proceedings who can propose this undertaking, such practitioner should not be able to do so without taking into account the interests of the creditors as a whole, so that even if not all are involved in the approval of the undertaking, their interests should not be worse off than in the event of territorial proceedings being opened. On the other hand, the fact that art. 36(10) provides that "*the insolvency practitioner shall be liable for any damage caused to local creditors as a result of its non-compliance with the obligations and requirements set out in this Article*" does not mean that remaining creditors cannot seek liability if they are also harmed by the practitioner.

2. One of the reasons supporting the possibility contained in art. 36 of the Regulation is the reduction of costs as a result of not opening territorial proceeding. However, in cases where the number of local creditors may be high, it is not clear that these costs would not be similar to those of territorial proceedings, as the cost of conducting the proceedings with universal scope would be increased. In addition to direct costs (notices, translation of the undertaking "*in the official language or one of the official languages of the Member State where secondary insolvency proceedings could have been opened, or, where there are several official languages in that Member State, the official language or one of the official languages of the place in which secondary insolvency proceedings could have been opened*" - art. 36(3) - and which, presumably, must be translated into the language of the State of the proceedings with universal scope, etc.), there are those costs resulting from the information on foreign law and the complexity added to the proceedings with universal scope, where the judge is required to not only know the insolvency law of his or her own State, but also to apply foreign law in relation to some of the insolvency assets.

   Thus, the law governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors in respect of the assets is that of the Member State where

secondary proceedings could have been opened, shall also govern the calculation of the required majorities and those required for the adoption of restructuring plans shall be taken into account; if the possibility of several restructuring plans are envisaged in that State, the one being used would have to be previously indicated. In return, the undertaking, that must be made in writing, is subject, in addition to the requirements under the Regulation, to any other requirement regarding the form and approval of the distribution provided by the legal system of the Member State with the main proceedings. That is, two different systems shall apply in the main proceedings, cumulatively where appropriate, which necessarily increases the material and temporal costs of the same.

3. Nor is it clear what the 'assurance' in art. 36(8) consists of, according to which "*[l]ocal creditors may apply to the courts of the Member State in which main insolvency proceedings have been opened, in order to require the insolvency practitioner in the main insolvency proceedings to take any suitable measures necessary to ensure compliance with the terms of the undertaking available under the law of the State of the opening of main insolvency proceedings*".

4. In addition to the above, it would have been necessary to clarify the relationship of this art. 36 with other provisions in the Regulation, such as art. 8. The latter provides a 'shield' against insolvency to rights *in rem* situated within the territory of another Member State at the time of the opening of proceedings, with the consequence that if proceedings with a universal scope are opened in A, but the asset is found in B, the proprietor of the right *in rem* can proceed with separate enforcement. That possibility is frustrated if territorial proceedings are opened in B because in that case the asset is no longer outside the State where proceedings have been opened. The question is what will happen in the event of one of the undertakings to which art. 36 refers: if for these purposes we regard them as equivalent to the opening of insolvency proceedings, they will prevent the possibility of separate enforcement, or the opposite otherwise. If the former stands, it should have been expressly provided; if the latter stands, in all cases where there is a valuable asset encumbered with a right *in rem* there will be a clear incentive to not accept the undertaking referred to in art. 36 and to request the opening of secondary proceedings.