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Abstract

Insolvency proceedings and issues relating to personal and business insolvencies are the daily subject of scholarly work and insolvency practice. But what is an insolvency proceeding? And why is this an important question? This article deals with these issues. Its main thesis is that: in a cross-border context, only 'fully collective' proceedings should be characterised as insolvency proceedings such that their effects merit immediate universal recognition. Proceedings are fully collective in that sense if individual claim enforcement of all creditors is interfered with, e.g. by a stay or by the possibility to impose rights modifications. Based on this test, US Chapter 11 and the German Insolvenzordnung are insolvency proceedings. The French procédure de sauvegarde financiére accélérée is not an insolvency proceedings, and the English Scheme of Arrangement typically is not one either.

Keywords: Insolvency Proceedings, Bankruptcy Proceedings, Cross-Border Insolvencies, Chapter 11, Scheme of Arrangement, Procédure de Sauvegarde, Insolvenzordnung

JEL Classifications: G33, K35, K41

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What is an insolvency proceeding?

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Insolvency proceedings and issues relating to personal and business insolvencies are the daily subject of scholarly work and insolvency practice. But what is an insolvency proceeding? And why is this an important question? This article deals with these issues. Its main thesis is that: in a cross-border context, only 'fully collective' proceedings should be characterised as insolvency proceedings such that their effects merit immediate universal recognition. Proceedings are fully collective in that sense if individual claim enforcement of all creditors is interfered with, e.g. by a stay or by the possibility to impose rights modifications. Based on this test, US Chapter 11 and the German Insolvenzordnung are insolvency proceedings. The French procédure de sauvegarde financiére accélérée is not an insolvency proceedings, and the English Scheme of Arrangement typically is not one either.

I. Introduction

Across the globe, procedures to restructure financially distressed businesses are increasing in importance. *Prima facie*, many of these procedures are very different from 'classical' insolvency proceedings. Unlike classical insolvency proceedings, restructuring procedures are now, usually, initiated pre-insolvency (as measured on a cash flow or balance sheet test), are conducted by the debtor in possession (DIP) without the appointment of an insolvency administrator, and often only affect certain creditors or groups of creditors. Thus, should such procedures nevertheless be characterised as insolvency proceedings?

It is important to clarify this question before answering it. The 'characterisation problem' may relate to how insolvency proceedings are defined by a specific legal instrument, such as the recast European Insolvency Regulation (EIR)[1]. Framed in this way, the question would relate to which proceedings are currently within the scope of an instrument such as recast Article 1(1) EIR. However, the characterisation problem can also be interpreted normatively. The question posed would then be directed towards which proceedings should (rightfully) be characterised as insolvency proceedings. This is the perspective adopted in this

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[1] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), OJ EU of 5 June 2015, L 141, p. 19. References in the text are to the recast EIR. According to its Article 92, it applies from 26 June 2017.

paper. It abstracts from existing laws and regulations without disregarding them as an intellectually and practically relevant resource.

The question about the rightful or correct characterisation of a proceeding as an insolvency proceeding is important for both insolvency scholarship and legal practice. A fundamental issue for insolvency scholarship is the problem that insolvency laws attempt to address. This problem defines the scope of the discipline. Scholarly views on this issue differ. Many would be comfortable with the statement that insolvency law is "... a collective response to a debtor's general default ..."[2]. From a practical perspective, the characterisation issue is important given the legal consequences if a proceeding is determined to be an insolvency proceeding. For instance, in a European cross-border context any judgment opening insolvency proceedings, handed down by a court of a Member State that 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 (Article 19(1) EIR). Likewise, judgments handed down by a court (whose judgment concerning the opening of proceedings is recognised in accordance with Article 19), which concern the course and closure of insolvency proceedings, and compositions approved by that court, shall be recognised with no further formalities (Article 32(1)).

This paper deals exclusively with insolvency proceedings in such a cross-border context, in Europe and beyond. Against this background, the research question posed at the beginning of the article can be restated precisely as: which proceedings should, in a cross-border context, be characterised as insolvency proceedings such that their effects merit immediate universal recognition?[3] The importance of this question can be illustrated by the following practical examples: is a Scheme of Arrangement (UK) an insolvency proceeding (for the purposes of Article 1 EIR or Article 1(2)b) Brussels Ia Regulation)? What about a Chapter 11 proceeding under the US Bankruptcy Code? And what about a French *procédure de sauvegarde* (L620-1 et seq. C.comm.), *procédure de sauvegarde accélérée* (L628-1 et seq. C.comm.), or a *procédure de sauvegarde financiére accélérée* (L628-9 et seq. C.comm.)?

This paper proceeds as follows. In Section II, I examine existing approaches to the characterisation problem. Thus, I examine the scope of Article 1 EIR (as recast), Article 2 of

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2 *Westbrook/Booth/Paulus/Rajak*, A Global View of Business Insolvency Systems (Washington, DC: The World Bank, 2010), p. 3.

3 When using the term 'recognition' I have in mind a strong form of recognition as embodied, for example, in Articles 19(1) and 32(1) EIR cited in the text: the effects of the proceeding are legally translated into other jurisdictions immediately without the need for *exequatur* proceedings. This strong form of recognition includes a more weak form in the sense of a requirement for assistance to the proceedings in another jurisdiction such as, for example, on the basis of Chapter 15 of the US Bankruptcy Code (on this see in the text *infra*).

the UNCITRAL Model Law on Cross-Border Insolvency (1997), as well as US case law under Chapter 15 of the Bankruptcy Code. Against this background, I then attempt to develop a new approach in Section III. My main thesis is that: in a cross-border context, only 'fully collective' proceedings should be characterised as insolvency proceedings. A proceeding is fully collective if it attempts to solve a common pool problem by, in one form or another, restricting individual rights enforcement by all the creditors of a debtor. Section IV concludes with a summary of the main results of this article.

II. Existing approaches to the characterisation problem

The existing approaches to the characterisation problem in a cross-border context are an important stepping stone for a critical normative discussion *de lege ferenda*. The European focus certainly is on the recast Article 1 of the EIR.

1. European Insolvency Regulation

The reform discussion in the run-up of recasting the EIR 10 years after it entered into force was very much shaped by considerations to broaden the scope of the EIR to include pre-insolvency proceedings and DIP proceedings[4]. In the end, Article 1(1) EIR was recast as follows (important criteria are underlined): "This Regulation shall apply to 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: (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; or (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). Where the proceedings referred to in this paragraph

[4] See *Hess/Oberhammer/Peiffer*, External Evaluation of Regulation No. 1346/2000/EC on Insolvency Proceedings, JUST/2011/JCIV/PR/0049/A4, pp. 10-12, 36-42; *Thole*, Die Reform der Europäischen Insolvenzverordnung – Zentrale Aspekte des Kommissionsvorschlags und offene Fragen –, *Zeitschrift für Europäisches Privatrecht* 2014, pp. 39, 43 et seq.; *Eidenmüller*, A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond, *Maastricht Journal of European and Comparative Law* 20 (2013), pp. 133, 139-142; *Eidenmüller/van Zwieten*, Restructuring the European Business Enterprise: the European Commission's Recommendation on a New Approach to Business Failure and Insolvency, *European Business Organisation Law Review* 16 (2015), pp. 625, 642 et seq.

may be commenced in situations where there is only a likelihood of insolvency, their purpose shall be to avoid the debtor's insolvency or the cessation of the debtor's business activities. The proceedings referred to in this paragraph are listed in Annex A."

The term 'collective proceeding' used in Article 1(1) is defined in Article 2(1) as follows: "'collective proceedings' means proceedings which include all or a significant part of a debtor's creditors, provided that, in the latter case, the proceedings do not affect the claims of creditors which are not involved in them ...".

From Recital 16 of the EIR it follows that proceedings "... that are based on general company law not designed exclusively for insolvency situations should not be considered to be based on laws relating to insolvency." If Article 1(1) is read with this explanation in mind, it is clear that the UK Scheme of Arrangement which is based on the Companies Act 2006 is not within the scope of the recast EIR. The Scheme of Arrangement also is not to be found in Annex A, and in cases of doubt it is the listing of a proceeding in Annex A that is decisive[5].

Parallel to its work on recasting the EIR, the European Commission has been and is working on reforming the restructuring laws of the EU Member States. Specifically, the Commission is and has been undertaking efforts to harmonise Member States' laws that aim at restructuring financially distressed businesses pre-insolvency and thereby avert insolvency and insolvency proceedings. Thus, in March 2014, the Commission published a 'Recommendation on a new approach to business failure and insolvency' ('Restructuring Recommendation', RR)[6]. Apparently, most Member States chose to ignore the Recommendation. Yet, the Commission persisted: in its 'Action Plan on Building a Capital Markets Union' of 30 September 2015[7], the Commission announced that it will follow up with a "legislative initiative on business insolvency, addressing the most important barriers to

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5 This is clear from Recital 9 of the recast EIR which reads as follows: "... National insolvency procedures not listed in Annex A should not be covered by this Regulation." Under the 'old' EIR it was vividly disputed whether the criteria in Article 1(1) or listing of a proceeding in Annex A are determinative. In the *Bank Handlowy* case, the CJEU adopted the latter view. See CJEU, Judgment of 22 November 2012 (Case C-116/11 – *Bank Handlowy*), margin nos. 31 et seq.

6 Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency (2014/135/EU), OJ EU of 14 March 2014, L 74, p. 65. Recommendations are not binding on the Member States, see Article 288 TFEU. For a critical analysis of the Recommendation see *Eidenmüller/Van Zwieten* (*supra* note 4). See also European Commission staff paper (*Carpus Carcea/Ciriaci/Caballero/Lorenzani/Pontuch*), The Economic Impact of Rescue and Recovery Frameworks in the EU, Discussion Paper 004, September 2015. On the basis of econometric methods, this paper attempts to demonstrate a number of positive effects of efficient pre-insolvency restructuring regimes ('culture' of a timely restructuring and of giving entrepreneurs a 'second chance', promotion of entrepreneurship, timeliness/costs of discharging businesses and/or consumers).

7 COM(2015) 468 final.

the free flow of capital" in the fourth quarter of 2016[8]. This initiative has now been launched in the form of a proposed Directive ('Restructuring Directive', RD)[9].

It appears to always have been, and to be, the goal of the European Commission to make sure that the scope of the recast EIR precisely matches the type of restructuring proceedings recommended to the Member States or directed, as proposed now, that the Member States should adopt[10]. If recasting the EIR was centrally about extending its scope to cover pre-insolvency proceedings and DIP proceedings, then surely it must be made sure that efficient pre-insolvency / DIP proceedings as contemplated by the Commission are under the umbrella of the EIR as recast.

However, the Commission will probably miss this goal, for several reasons. To begin, proceedings according to the RR/RD may (potentially) lead to the appointment of a supervisor (No. 9(b) RR/Article 5(2) and 5(3) RD – cf. Article 1(1)(b) EIR *supra*) or to a temporary stay of individual enforcement actions (No. 10 RR/Article 6 RD – cf. Article 1(1)(c) EIR *supra*). Yet, there is no guarantee that this happens. A similar gap likewise applies with respect to the criterion of 'collectivity' ('collective proceedings'). Proceedings based on the RR/RD may or may not affect all creditors of a debtor. Indeed, such proceedings may be restricted to very few creditors or even only a single creditor (No. 20 RR – cf. Article 1(1) and Article 2(1) EIR *supra*)[11]. Moreover, the RR/RD doe not envisage 'public proceedings' within the meaning of Article 1(1) EIR. To the contrary, the Commission pushes for proceedings which are initiated without formal court involvement (No. 8 RR/Recital 18 and Article 4(3) RD). Such formal court involvement should also be kept to a minimum in the course of the proceedings (No. 7 RR/Article 4(3) RD). The Commission's motives are clear: to avoid or at least contain the negative signal associated with the initiation of formal, court-supervised proceedings and its detrimental effects on restructuring prospects and firm value[12].

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8 COM(2015) 468 final, pp. 25, 30.

9 Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, COM(2016) 723 final (22 November 2016).

10 See COM(2016) 723 final, p. 9.

11 The position of the RD is unclear on this issue. 'Insolvency procedures' are defined in Article 2(1) RD by reference to the criterion of 'collectivity'. Tellingly, this criterion does not appear in the definition of 'restructuring' in Article 2(2). Further, Member States apparently can decide which parties may be 'affected' by a restructuring plan, see Article 2(3). Article 4(1) stipulates that "Member States shall ensure that ... debtors ... have access to an effective preventive restructuring framework that enables them to restructure their debts ...". However, this provision does not seem to require that *all* debts can be restructured. An effective restructuring can be accomplished by restructuring only portions of a debtor's debts.

12 Indirect insolvency costs (reductions in firm value due to the initiation of insolvency proceedings) are typically in the range of 10-20% of firm value; see, for example, *Sautner/Vladimirov*, Indirect Costs of Financial Distress and Bankruptcy Law, available at SSRN: http://ssrn.com/abstract=1101696, p. 2 with further references.

By contrast, the public and appealable decision to open insolvency proceedings handed down by a court of a Member State according to Article 19(1) EIR is a cornerstone of the Regulation.

All in all, it appears that the European lawmaker does not have a clear perspective on which proceedings should, in a cross-border setting, be characterised as insolvency proceedings – with the consequence of universal and immediate recognition – or on what justifies such a characterisation[13]. Rather, the European Commission seems to proceed 'inductively' – *i.e.*, in being confronted with a great variety of different existing procedures in the Member States that increasingly look different from 'classic' collective insolvency proceedings that are initiated upon the debtor's insolvency, the Commission strives to arrive at an intuitively plausible judgment as to which proceedings 'deserve' universal recognition and which do not. This is a pragmatic approach that may be considered appropriate in a political setting. However, from a conceptual and scholarly perspective this approach is unsatisfactory.

2. UNCITRAL Model Law (1997)

Another important resource for the international reform discussion is the 'UNCITRAL Model Law on Cross-Border Insolvency' (1997)[14]. It already existed when the 'original' EIR was negotiated. However, since the 'original' EIR was almost identical with the 'European Union Convention on Insolvency Proceedings' (1995) which failed to receive UK support (because of the dispute over British beef and the 'mad cow disease'), it was rather the EIR that influenced the Model Law than *vice versa*. The Model Law's influence on the US international insolvency regime was much greater, given that it has been shaped by legal concepts originating in US law and scholarship to a significant degree (on this see Section 3 *infra*).

The relevant provision dealing with the scope of the Model Law is Article 2. It reads as follows (important criteria are underlined): "*Definitions*. For the purposes of this Law: *(a)* 'Foreign proceeding' means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which

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13 It is a confirmation of this assessment that the latest attempt of the European Commission to define 'insolvency procedure' in Article 2(1) of the draft RD is completely circular: "'*insolvency procedure*'means a collective *insolvency procedure* which entails a partial or total divestment of the debtor and the appointment of a liquidator" (emphasis added).

14 See http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html.

proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation ...".

If one compares the text of the Model Law with that of the recast EIR, two differences are immediately noticeable: first, the Model Law defines as 'foreign proceedings' only (fully) collective judicial or administrative – hence public – proceedings. By contrast, for the recast EIR it suffices if a significant part of a debtor's creditors are involved. Second, under the Model Law the assets and affairs of the debtor must be subject to control or supervision by a foreign court. By contrast, Article 1 EIR lists this as only one of three options for a Member State to bring a proceeding under the umbrella of the Regulation (appointment of insolvency practitioner, control or supervision of assets and affairs of the debtor, temporary stay of individual enforcement proceedings). As a consequence, the scope of the recast EIR is wider than that of the Model Law. This can be explained by the fundamental changes in the 'restructuring landscape' that we have been witnessing since 1997. The increasing popularity of pre-insolvency DIP proceedings that affect only the interests of some creditors or creditor classes was not yet reflected in the approach of the Model Law. The recast EIR takes account of this development, albeit without a clear conceptual foundation.

3. Chapter 15 US Bankruptcy Code

A better understanding of the Model Law's approach is aided by Chapter 15 of the US Bankruptcy Code. Chapter 15 is a relatively new chapter of the Code. It was added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[15]. The purpose of Chapter 15 is to adopt the Model Law in US law. In cases of doubt, provisions in Chapter 15 should be interpreted in light of the corresponding rules in the Model Law and legal practice in other states that have adopted it. Thereby, legal harmonisation is furthered – a key objective of the Model Law. However, given the dominant influence of US scholarship and legal practice on the development of the Model Law, it is justified to accord this influence a special weight in interpreting the Model Law's provisions.

An ancillary case under Chapter 15 is commenced by the filing of a petition for recognition of a foreign proceeding by a foreign representative pursuant to 11 USC §§ 1504, 1515. With the exception of interim relief, such recognition is a precondition for relief granted by US courts under Chapter 15. A 'foreign representative' is defined in 11 USC § 101(24) as: "[a] person or body authorized in a foreign proceeding to administer the reorganization or the

[15] For an overview see *Chung*, The New Chapter 15 of the Bankruptcy Code: A Step toward Erosion of National Sovereignty, *Northwestern Journal of International Law & Business* 27 (2006), pp. 89 et seq.

liquidation of the debtor's assets or to act as a representative of such foreign proceeding". The term 'foreign proceeding' is defined in 11 USC § 101(23) (important criteria are underlined): "(i) a collective judicial or administrative proceeding in a foreign country, (ii) under a law relating to insolvency or the adjustment of debt in which (iii) the assets and affairs of the debtor are subject to control or supervision by a foreign court, (iv) for the purposes of reorganization or liquidation".

If one compares this provision with the UNCITRAL Model Law, two substantial differences are noticeable in addition to insignificant language differences: first, interim proceedings are not mentioned in 11 USC § 101(23); second, the provision includes laws relating to the 'adjustment of debt' which are not mentioned in the Model Law.

It is also illuminating how US courts interpret the criterion of 'collectivity' that is found in 11 USC § 101(23) as well as in Article 2 of the Model Law. 'Collectivity' is not otherwise defined in these provisions. In this connection, one relevant decision is by the US Bankruptcy Court for the District of Nevada in re Betcorp[16]. This case concerned the recognition of a voluntary winding-up proceeding, *i.e.*, of a voluntary liquidation, according to Australian law (Part 5.5 of Chapter 5 Corporations Act). The US court opined that this was a proceeding within the meaning of 11 USC § 101(23) despite the fact that no petition had been filed with an Australian court. The court further opined that the proceeding was judicial or administrative in nature (primarily it was held to be administrative, but it could potentially also become judicial). The court then turned to the collectivity criterion. On this it opined as follows: "A collective proceeding is one that considers the rights and obligations of all creditors. This is in contrast, for example, to a receivership remedy instigated at the request, and for the benefit, of a single secured creditor. A voluntary winding up fits this 'collective' criterion."

On the further criteria that are relevant under 11 USC § 101(23), the court opined that authorisation under a law relating to insolvency or the adjustment of debt does not require the firm to be technically insolvent or planning to use the Australian rules to adjust its debt. According to the court, the Australian Corporations Act governs the whole lifecycle of a corporation. It stipulates different forms of dissolution of a corporation and, depending on the circumstances of the individual case, a switch from one of these forms to another. Most importantly, however, the Australian lawmaker apparently thought that Chapter 5 Corporations Act would satisfy the conditions of the Model Law: "Accordingly, based upon

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16 In re Betcorp Ltd., 400 B.R. 266 (Bankr. D. Nev. 2009).

the Australian legislature's interpretation of the UNCITRAL Model Law and Australian domestic law, a company engaged in a voluntary winding up is being administered under a law relating to insolvency." Finally, the court also opined that the assets and affairs of the corporation that was dissolved were subject to control or supervision by an Australian court: the liquidators, the US court held, were controlled by the Australian capital markets commission ASIC (Australian Securities and Investments Commission) and – upon a petition by the liquidators and/or by creditors – also by the competent Australian courts.

The decision in re Betcorp is remarkable for at least two reasons. First, the court is rigid (formalistic) with respect to the collectivity criterion: the foreign proceeding must consider the rights and obligations of *all* creditors. However, it is quite unclear what this means in substance. For instance, "considers the rights and obligations of all creditors" might mean that the rights/obligations of all creditors are liable to be modified in principle without necessarily being actually modified in an individual case. However, it might also mean that these rights/obligations must be respected. Second, the court is quite generous when interpreting the criterion of a "law relating to insolvency or the adjustment of debt": the voluntary liquidation of a solvent (!) company is judged to be a foreign (insolvency) proceeding based, *inter alia*, on the remarkable argument that the Australian lawmaker thought so.

Other US courts have followed the decision in re Betcorp with respect to the court's reasoning that the collectivity criterion should be interpreted to require that the rights and obligations of all creditors must be considered. In re Gold & Honey[17] the US Bankruptcy Court for the Eastern District of New York had to deal with a receivership proceeding under the laws of Israel. The court cited the standard developed in re Betcorp and then applied it to the facts before it: "The Israeli Receivership Proceeding is not simply collective in nature. It does not require the Receivers to consider the rights and obligations of all creditors. ... [T]he Receivership is more akin to an individual creditor's replevin or repossession action than it is to a reorganization or liquidation by an independent trustee." Based on this reasoning it is at least clear that proceedings which are conducted primarily in the interest of one creditor or which resemble individual enforcement actions cannot be recognised as foreign proceedings under Chapter 15.

Re Gold & Honey is also an interesting case for another reason. Namely, the court also dealt with the requirement that the assets and affairs of the debtor must be subject to control or supervision by a foreign court: "Here, while the Israeli Court may have jurisdiction over

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17 In re Gold & Honey, Ltd., 410 B.R. 357 (Bankr. E.D.N.Y. 2009).

the assets of GH LP and GH Ltd., the Receivers have not carried their burden of showing that GH LP's affairs are subject to the Israeli Court's jurisdiction. ... FIBI conceded at oral argument that the Receivers were not provided with authority over the business affairs of GH LP." Hence, the Bankruptcy Court for the Eastern District of New York placed a heavy emphasis on that both the assets *and* the affairs of the debtor are to be subject to control or supervision by the foreign court for the proceeding to be recognised under Chapter 15.

Since Chapter 15 entered into force, the US courts repeatedly had to deal with the question whether a Scheme of Arrangement can be recognised as a foreign (insolvency) proceeding. The question is an important one because Schemes can be done before a company is materially insolvent ("Solvent Scheme of Arrangement"). Further, a Scheme typically does not involve all creditors of a debtor but only select groups or classes of creditors[18]. For both of these reasons, the German Federal Supreme Court decided that a Solvent Scheme of Arrangement cannot be recognised as an insolvency proceeding under German law (section 343(1) of the German Insolvenzordnung)[19]. The US courts take a different view. Since 2005, US bankruptcy courts have consistently held that such Schemes should be recognised as foreign insolvency proceedings. All these decisions concerned insurance companies[20].

Reviewing the US case law on the recognition of foreign (insolvency) proceedings under Chapter 15, it appears that the collectivity criterion is applied in a strict manner – the interests of all creditors must be "considered". However, it is quite unclear what this means in substance. Proceedings that clearly do not affect all creditors may be recognised (UK Scheme of Arrangement), provided that they are not conducted primarily in the interest of one creditor alone or resemble more an individual enforcement action (receivership proceeding under the laws of Israel). The material insolvency of the debtor is of no relevance with respect to the recognition issue.

All in all, a comparative analysis of existing approaches to the characterisation problem in a cross-border context yields a disappointing result. A noticeable international trend is to relax both the collectivity requirement and the insolvency requirement. As a consequence, the

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[18] See, for example, *Payne*, Cross-border Schemes of Arrangement and Forum Shopping, *European Business Organization Law Review* 14 (2013), pp. 563, 565 et seq.; *Bork*, Sanierungsrecht in Deutschland und England (Köln: RWS Verlag Kommunikationsforum GmbH, 2011), margin no. 9.17; *Eidenmüller/Frobenius*, Die internationale Reichweite eines englischen Scheme of Arrangement, *Wertpapier-Mitteilungen* 2010, pp. 1210, 1211-1212.

[19] Bundesgerichtshof (German Federal Supreme Court), Judgment of 15 February 2012 – IV ZR 194/09 (*Equitable Life*), margin no. 39.

[20] See In re Petition of Jeffrey John Lloyd, 2005 Bankr. LEXIS 2794; In re Lion City Run-Off Private Ltd., Case No. 06-B-10461 (Bankr. S.D.N.Y. 2006); In re Gordian Runoff (UK) Ltd., Case No. 06-11563 (Bankr. S.D.N.Y. 2006).

contours of "insolvency proceedings" get increasingly blurred. A well-founded conceptual and consistent answer to the question "What is an insolvency proceeding?" cannot be derived from existing laws and regulations, or by the interpretation of these laws and regulations by competent courts.

III. A new approach to the characterisation problem

Against this background I should like to take a fresh look at this question and develop a new approach to 'solving' the characterisation problem. By way of prefacing my considerations I should like to remark that any sort of 'ontological perspective' on the issue should be ruled out at the outset. There is no such thing as 'the nature' of an insolvency proceeding out of which certain characteristics of such a proceeding could be derived. Insolvency proceedings are jurisprudential and legal artefacts. Their normative features are based on a reasoned determination of the lawmaker in every individual case. I should like to further remark that an abstract definition of 'insolvency proceeding' also is not helpful to adequately address the characterisation problem. What is important, rather, are the *legal consequences* that follow from such a definition or characterisation and the conditions under which these consequences can be justified. If one focuses on the cross-border context of the characterisation problem (see Section I *supra*), a differentiation between 'fully collective' and 'less than fully collective' proceedings is the key to 'solving' this problem.

1. Fully collective proceedings

A fully collective proceeding is a proceeding that affects all creditors of a debtor worldwide, irrespective of the law applicable to the creditors' claims and irrespective of whether these creditors have agreed to the jurisdiction of the courts in the country in which the proceeding is initiated. All creditors are affected if, in one form or another, individual rights enforcement of all creditors is restricted by the proceeding (by *procedural* rules or *substantive* changes in creditor entitlements, see *infra*).

A paradigmatic case for a 'fully collective proceeding' in this sense is a German insolvency proceeding based on the *Insolvenzordnung* that is opened as a main insolvency proceeding at the debtor's 'centre of main interests' (COMI) under the (recast) EIR. The opening of such a proceeding is automatically recognised in all other Member States once the opening decision has become effective in the State of the opening of proceedings (Article 19(1) EIR). The proceeding, in principle, affects all creditors of the debtor: once the proceeding has been opened, a stay is imposed on all creditors (sections 80 et seq., 165 et seq.

Insolvenzordnung)[21]. The debtor has the right to propose a restructuring plan that, if adopted, can materially change the entitlements of all creditors (sections 217 et seq. *Insolvenzordnung*). It is immaterial which law governs these entitlements. It is also immaterial whether, based on the applicable rules of international civil procedure found in the Brussels Ia Regulation, the courts in the opening State would have jurisdiction to resolve disputes between a creditor and the debtor.

Thus, the crucial normative question with respect to such a proceeding is: what *justifies* these effects? Or, put differently: what justifies subjecting the claim of a creditor to a (collective) proceeding even though the creditor and debtor might have stipulated that the claim shall be subject to a governing law that is very different from that of the opening state and even though they might have stipulated that the courts of another state shall have exclusive jurisdiction to hear all disputes between the creditor and debtor? Hence, what is needed is a criterion that has sufficient 'normative weight' to counteract, or outweigh, the legitimate expectations of creditors with respect to the forum (jurisdiction) and measuring rod (applicable law) for dispute resolution with the debtor.

I submit that such a criterion can only be found in a situation in which *all* creditors of the debtor have a strategic incentive to try and collect on their claims as soon as possible because the debtor's finances presumptively are not sufficient to meet all outstanding claims[22]. This is the situation of a common pool problem (multi-party prisoners' dilemma) of the creditors that arises upon material insolvency of a debtor[23]. If the debtor is materially insolvent, then all its creditors sit in the same boat. All creditors have a dominant strategy, and this is to collect on their claims as fast as possible and seize the debtor's assets. At the same time, these actions threaten to lead to a suboptimal equilibrium in which the going concern value of a business is dissipated or at least significantly reduced[24]. A suboptimal equilibrium might also result if the firm is economically distressed and should be liquidated: the best liquidation strategy will often require the assets of the firm to be kept together for some time ('deferred liquidation').

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[21] I should note that Article 8 EIR limits the scope of the stay with respect to certain rights *in rem*. However, this is immaterial for the analysis undertaken herein.

[22] To be sure, this criterion tells us only *whether* and *when* an 'insolvency proceeding' as a 'fully collective proceeding' may be opened and not *where* (in which forum) it may legitimately be opened. The latter question is beyond the scope of this paper.

[23] See *Jackson*, The Logic and Limits of Bankruptcy Law (Cambridge, Mass.: Harvard University Press, 1986).

[24] See *Eidenmüller*, Unternehmenssanierung zwischen Markt und Gesetz (Köln: Otto Schmidt, 1999), pp. 19-22.

In this situation, an insolvency proceeding, as a collective proceeding, acts as a contract amongst the debtor's creditors binding them to cooperate (in the common interest) which, because of the strategic incentives of all creditors and prohibitively high transaction costs, the creditors cannot and do not conclude ad hoc. Only if the debtor's creditors are confronted with such a common pool problem is it justified to force them into a fully collective proceeding in a forum which they might not have anticipated – or even deliberately have deselected – and according to material distribution rules which are applied to everybody, regardless of the laws governing the creditors' claims. Only the exceptional case of the common pool problem justifies overriding the legitimate expectations of the creditors with respect to the dispute resolution forum and applicable law.

This case surely exists if the debtor is materially insolvent as assumed in the previous paragraph. However, the common problem can arise already at a much earlier point in time: if all creditors know that the debtor will be insolvent the day after tomorrow, then everybody will attempt to collect on his or her claim tomorrow. Of course, everybody knows this. Hence, all creditors have an incentive to act today (backward induction)[25]. What matters, therefore, is not the material insolvency of the debtor, but rather whether the proceeding attempts to solve a common pool problem of the creditors. This is always the case if it restricts individual enforcement actions by all creditors in one form or another. This restriction may come in the form of *procedural* rules, such as by an automatic stay that is imposed on all creditors upon the initiation of the proceeding: if the lawmaker prohibits individual creditor enforcement actions by imposing an automatic stay, it thereby demonstrates that it seeks to address a common pool problem of the creditors and the 'asset race' associated with it. Alternatively, the restriction of creditor rights enforcement may come in the form of *substantive* changes in creditor entitlements to which creditors may be forced against their will: the lawmaker might stipulate, for example, that creditor rights are subject to a deferment of payment, cuts, swaps in equity positions or other modifications which can be forced upon creditors by a restructuring plan adopted by a creditor majority or sanctioned by a competent court.

Against this background, an insolvency proceeding based on the German *Insolvenzordnung*, for example, clearly is an insolvency proceeding within the meaning of the characterisation problem discussed in this article. As already mentioned in this Section, such an insolvency proceeding comes with an automatic stay, and it also allows forced

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[25] See, for example, *Eidenmüller*, Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts and the Incentives for Shareholders/Managers, *European Business Organisation Law Review* 7 (2006), pp. 239, 242-243.

modifications of creditors' entitlements. The same applies to a Chapter 11 proceeding under the US Bankruptcy Code. Such a proceeding may be initiated independent from a material insolvency of the debtor[26]. However, a Chapter 11 proceeding triggers an immediate automatic stay (11 USC § 362), and it also allows forced creditor rights modifications (11 USC §§ 1121 et seq.). The English High Court got it right, therefore, when it recognised a Chapter 11 proceeding as a foreign main proceeding under the Cross-Border Insolvency Regulations 2006 (CBIR) in Re 19 Entertainment Limited[27]. The French *procédure de sauvegarde* (L620-1 et seq. C.comm.) and the *procédure de sauvegarde accélérée* (L628-1 et seq. C.comm.) are also insolvency proceedings within the meaning of the characterisation problem examined here. While these proceedings do not allow modifications of all creditor claims[28], a universal automatic stay is imposed on all creditors (L622-21 C.comm.)[29].

2. Not fully collective proceedings

A different assessment is warranted with respect to the *procédure de sauvegarde financiére accélérée* (L628-9 et seq. C.comm.). This proceeding affects only financial creditors, and the automatic stay is also restricted to these creditors (L628-9 sentence 2 C.comm.)[30]. A different assessment typically is also warranted for a Scheme of Arrangement (UK): as already discussed (Section II 3 *supra*), a Scheme typically affects only certain groups of creditors or

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[26] See the definition of "insolvent" in 11 USC § 101(32): "… financial condition such that the sum of such entity's debts is greater than all of such entity's property …". For initiating a Chapter 11 proceeding "insolvency" is not a requirement. Absence of insolvency is also not mentioned in § 1112 which lists grounds for rejecting an insolvency petition upon a motion of a creditor or another interested party.

[27] Re 19 Entertainment Limited [2016] EWHC 1545 (Ch). The case involved an English company which had its COMI in the US. Relief was granted under Articles 20 and/or 21 Schedule 1 CBIR. The decision is interesting because the court was satisfied that the company itself and each of its directors was a 'foreign representative' of the foreign proceedings.

[28] The *procédure de sauvegarde* and the *procédure de sauvegarde accélérée* affect only trade creditors with claims exceeding 3% of the total volume of trade creditors' claims, see L626-30 C.comm.

[29] Hence, the European lawmaker got it right when listing both proceedings in Annex A of the recast EIR. In the *Bank Handlowy* case (*supra* note 5), the CJEU had to deal with a *procédure de sauvegarde*. Based on the listing in Annex A, the court found that the proceeding came within the scope of the Regulation. See CJEU, Judgment of 22 November 2012 (Case C-116/11 – *Bank Handlowy*), margin nos. 31 et seq. *Moss*, Principles of EU Insolvency Law, *Insolvency Intelligence* 28 (2015), pp. 40, 42 et seq., agrees that, because of the listing, the court had to treat the proceeding as an insolvency proceeding. However, he asserts that "...[e]veryone knew that the French proceeding was not an insolvency proceeding ...". Based on the analysis in the text, the proceeding *was* an insolvency proceeding.

[30] See also *Gallagher/Rousseau*, French Insolvency Proceedings: *La Révolution a Commencé*, *ABI Journal* November 2014, pp. 20, 64. For this reason, the European lawmaker got it wrong when listing this proceeding in Annex A of the recast EIR. The *procédure de sauvegarde financiére accélérée* was originally created as "pre-pack *à la française*" as a tool to cram down pre-packed debtor plans on dissenting financial creditors, see *Dammann/Podeur*, Sauvegarde financière: le "prepack" à la française, *Recueil Dalloz* 2010, pp. 2504 et seq. Based on the model of the *procédure de sauvegarde financiére accélérée* the (general) *procédure de sauvegarde accélérée* was created later.

classes of claims, and it also does not involve an automatic stay[31]. Hence, both proceedings are paradigmatic examples of typically "not fully collective proceedings"[32]. Proceedings of this type do not attempt to address a general common pool problem. Instead, their purposeis to bring about an early financial restructuring of portions of creditors' claims. Hence, it is not the case that all creditors sit in the same boat in this instance. Nobody has to accept that his or her claim shall be reduced in a forum different from that which was contractually agreed or would be available under the non-insolvency rules of the applicable international civil procedure regime. Further, nobody has to accept a claim modification based on laws and regulations different from the law governing his or her claim. To the contrary, the legitimate expectations of the creditors with respect to the dispute resolution forum and applicable law must be respected. Only if a creditor had to expect adversarial proceedings in the forum of the 'insolvency' or 'restructuring' proceeding, *i.e.*, typically in cases of a contractual forum selection, and only if his or her claim is governed by the substantive laws of the jurisdiction in which the proceeding is conducted, is it normatively justified to subject the creditor's claim to the effects of the proceeding. If the situation is not so exceptional that all creditors are involved irrespective of the law governing their claims and irrespective of the 'regular' (agreed) forum for an adversarial dispute resolution, then their legitimate expectations must be respected.

This has the following consequences for a Scheme of Arrangement: if it applies only to certain groups of creditors or classes of claims, its effects will be limited to those creditors whose claims are governed by English law and who would have been obliged to pursue their claims in an English forum[33]. A different assessment is warranted only with respect to the rare case that a Scheme applies to all creditors of a debtor and modifies their claims. In this exceptional case a Scheme can be characterised as an insolvency proceeding within the meaning of the characterisation problem analysed in this article[34].

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31 See *Bork* (*supra* note 18), margin no. 10.30.

32 Similarly, an English liquidation procedure also is a "not fully collective proceeding" since it does not impose a full stay on secured creditors. The common pool problem arises also in liquidations (see in the text *supra* Section III 1), and the English liquidation does not address it.

33 See *Eidenmüller/Frobenius* (*supra* note 18), pp. 1213-1217.

34 Hence, if one looks at the *typical* case, the European lawmaker got it right when not listing the Scheme in Annex A to the (recast) EIR. Whether we are dealing with a Solvent Scheme or an Insolvent Scheme is not, based on the analysis in this article, a decisive factor.

IV. Summary and conclusion

The question posed at the beginning of this article ("What is an insolvency proceeding?") is relevant only against the background of the legal consequences that are triggered by the characterisation of a proceeding as an insolvency proceeding. Hence, the 'characterisation problem' can be restated as a question that is directed towards the conditions that justify these consequences. Further, the problem is relevant only within a specific legal context in which it is raised. If one confines the analysis to the cross-border effects of a proceeding, the following conclusion emerges: insolvency proceedings are only those proceedings which attempt to address a common pool problem of the creditors. This is always the case if the proceeding restricts, in one form or another, the enforcement of individual creditor rights. The restriction may be procedural in nature, especially in the form of a universal automatic stay that applies once the proceeding is initiated. The restriction can also take the form of substantive modifications of creditor entitlements to which all creditors, in principle, are subject even if they dissent.

If universal recognition[35] of a proceeding as an insolvency proceeding were limited to fully collective proceedings, states would be pressured into 'collectivizing' proceedings to make them more attractive than they would be without such recognition. One may view this as a desirable corollary to the thesis developed in this paper: not every proceeding deserves universal recognition that overrides legitimate creditor expectations with respect to dispute resolution forum and governing law. Only fully collective proceedings merit such grave consequences.

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35 See note 3 *supra*.

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