

INSOL Europe Technical Series

Comparative and International Insolvency Law Central Themes and Thoughts

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13. *The Role of Courts in Cross-border Insolvency Cases*

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### 13. The Role of Courts in Cross-border Insolvency Cases

Ulrich Ehricke

#### *Introduction<sup>1</sup>*

The European Insolvency Regulation (EIR) is based on a concept of parallel proceedings, whereby main proceedings can be instituted in the Member State where the debtor has its centre of main interest and secondary proceedings can be instituted in any other Member State where the debtor has an establishment within the meaning of Article 2 (h) of the Insolvency Regulation. The problem that lies at the heart of a system that allows secondary proceedings to be opened in other Member States that are legally independent from the main proceedings is that it entails - by definition - a partial dissolution of the debtor's total assets. According to Recital No 20 of the Insolvency Regulation the main objective of the duty to cooperate is to facilitate the effective and optimal realization of the total assets of the debtor. To avoid a situation where liquidators in secondary proceedings might make a decision that is detrimental to the goal of equal treatment of *pari passu* creditors, Article 31 of the European Insolvency Regulation allocates substantive law obligations to the liquidators responsible for parallel proceedings under the umbrella of a general duty to cooperate. As the European Legislator has rightly noticed when enacting Article 31, a concept that intends to deal with the problem of cross-border insolvencies based on a system of parallel proceedings is bound to fail if it does not provide for adequate and efficient means of cooperation.

#### *Article 31 – The legislative framework*

Article 31 InsReg provides the legislative framework for ensuring cooperation between the liquidators in the main proceedings and their counterparts responsible for conducting secondary proceedings in other Member States. The provision includes three distinct yet interconnected obligations. First, Article 31(1) means that liquidators are under a duty to immediately communicate all information that might be relevant to the liquidator in the parallel proceedings.<sup>2</sup> This duty forms the basis for an effective cooperation between liquidators pursuant to Art 31(2).<sup>3</sup> The duty to cooperate under paragraph 2 not only requires the liquidators to settle any dispute that might arise during the course of the proceedings, but to actively coordinate the proceedings in the interests of all creditors. There has been some debate regarding what methods ought to be used by liquidators to coordinate proceedings. There are several competing models that might be endorsed in this context, e.g. the use of protocols or insolvency proceedings contracts, which I will return to later. Article 31(3) emphasizes the dominant role of the main proceedings with regard to the duty to cooperate by obliging liquidators in secondary proceedings to give the liquidator in the main proceedings an early opportunity to submit proposals on the liquidation or use of the assets in the secondary proceedings. The right to submit proposals also entails a duty for the liquidator in the secondary proceedings to adopt the proposal. This follows from the binding nature of Article 31(3) and the supporting character of secondary proceedings under the Regulation.<sup>4</sup> Despite not giving the liquidator in the main proceedings a right to give directions,<sup>5</sup> the duty is backed by the

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<sup>1</sup> To our regret the scheduled Honours Class had to be conducted without prof. Ehricke, due to illness. We thank him for providing a report of the lecture envisaged (the editors).

<sup>2</sup> Pannen/Riedemann, Pannen (ed.), *European Insolvency Law*, 2007, 453

<sup>3</sup> Ehricke, *Die Zusammenarbeit der Insolvenzverwalter bei grenzüberschreitenden Insolvenzen nach der EuInsVO*, WM 2005, 397

<sup>4</sup> *Ibid*, 400

<sup>5</sup> Paulus, *Komm EuInsVO Art 31*, [18]

extensive powers of the liquidator in the main proceedings under Article 33 of the Insolvency Regulation.

#### *Methods of communication and cooperation*

Article 31 Insolvency Regulation merely provides for an abstract obligation to cooperate, without specifying which methods of cooperation ought to be used by liquidators. In practice, courts and liquidators make use of both formal and informal methods of communication. CoCo Guidelines 6 and 7 can serve as a starting point in setting out general standards on how communication between liquidators is to be conducted. Generally, all methods of modern communication are used. Some have even suggested setting up a special server accessible to all involved in the liquidation or a special chat room or other information pools.<sup>6</sup>

In practice, cooperation mainly takes the form of the procurement of documents, carrying out of liquidation transactions, exercising voting rights, presentation of insolvency plans, assertion of avoidance claims or the filing of further insolvency requests in respect of other establishments.

In order to synchronize parallel proceedings in view of an optimal realization of the debtor's assets it has been suggested that European courts might use protocols to coordinate parallel insolvency proceedings, following the American model. However, the adoption of such a model of protocols, especially if they are to be given binding force by a court order, is faced with tremendous dogmatic and practical difficulties under German law, as I have pointed out elsewhere. Nevertheless, allowing the use of protocols and giving them binding force under national law might serve the needs of creditors in certain cases, as *In Re Eurodis Electron Plc* demonstrates.<sup>7</sup>

The same is true for the introduction of a model of Insolvency Proceeding Contract, setting out the respective rights and obligations between liquidators in parallel proceedings by way of a binding agreement.<sup>8</sup> Although an insolvency proceedings contract might serve as a supporting weapon in a liquidator's armoury, it is suggested that liquidators will only rarely resort to this method of cooperation, for two main reasons: potentially extensive transaction costs and a lack of flexibility.

#### *Article 31 and the role of the courts*

Courts across the Member States share the common role of supervisors of insolvency proceedings (cf. for Germany §58 InsO). Despite the fact that under the respective national regimes of insolvency law courts are allocated varying roles in terms of the intensity and frequency of their involvement during insolvency proceedings, it might nonetheless be said that with regard to their supervisory role they are at least the guardians of the duty to cooperate, if not its guarantors. Effective supervision by the courts is therefore vital for an effective cooperation. It shall be suggested that the German insolvency regime provides for an effective enforcement of the duty to cooperate, so that the lack of explicit sanctions under the European Insolvency Regulation does not impede the effectiveness of EU Law in this regard. It will furthermore be argued that, although it does not provide for a binding duty of court-to-court cooperation, Article 31 in conjunction with Art 10 EC has created a strong presumption in favour of cooperation between courts.

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<sup>6</sup> Staak, NZI 2004, 480, 481; Paulus, ZIP 2002, 729, 735

<sup>7</sup> Unreported, High Court, November 21, 2008, cf. Al-Attar, Using and losing secondary proceedings, [2009] *Insol. Int.* 76

<sup>8</sup> Ehrlicke, WM 2005, 397

### *Enforcement of the duty to cooperate*

In the absence of any applicable sanction contained in the Insolvency Regulation in case a liquidator does not fulfil his obligations under Article 31, the question arises whether or not the courts are under an obligation to enforce the Article 31 duties. Lücke has suggested that courts are only under an obligation to intervene using coercive measures if the assets are at risk as a result of a breach of an Article 31 duty on the part of the liquidator.<sup>9</sup> The more appropriate view, however, seems to be that with regard to the supervisory function of German courts in relation to insolvency proceedings under section 58 of the German Insolvency Code (InsO), the courts are bound to enforce the duty to cooperate because the Insolvency Regulation as a whole is immediately and directly applicable under EC Law (Art 249 EC).<sup>10</sup> According to Section 60(1) sentence 1 of the German Insolvency Code a liquidator may be held personally liable for negligently infringing a duty “incumbent on him according to the applicable law”. In conformity with the principles of EU Law, section 60 InsO is to be read as providing a remedy not only against the infringement of a liquidator’s duties stemming from national law, but also against the infringement of any of the duties contained in the EIR.<sup>11</sup>

### *Towards a ‘presumption’ in favour of cooperation?*

Unlike the UNCITRAL Model Law on Cross-Border Insolvencies, which in Article 25 provides for a duty of courts to cooperate to the maximum extent possible with foreign courts or foreign representatives and which in paragraph 2 enables courts to request information and assistance from foreign courts, the Insolvency Regulation does not address the cooperation of courts directly. However, it now seems to be generally recognized that despite its clear wording, Article 31 also provides the basis for the cooperation between courts. One of the questions surrounding Article 31 has been whether the provision does not only enable courts to cooperate but, in addition, provides for a legally binding duty of court-to-court cooperation. The High Court of England and Wales has followed the Vienna Higher Regional Court in *In Re Nortel Group SA* [2009] EWHC 206 (Ch) in holding that Article 31 does in fact place legal obligations on courts to cooperate. In *Re Nortel* concerned an application to the court to issue a letter of request to insolvency courts in several Member States asking *inter alia* for the administrators to be heard, should an application for the opening of secondary insolvency proceedings be lodged in another Member State. Patten J held that the High Court has an inherent jurisdiction to issue a letter of request to a foreign court. He said that “[although] framed in terms of co-operation between office-holders, the duty has been treated by the courts of Member States as incorporating or reflecting a wider obligation which extends to the courts which exercise control of insolvency procedures in their respective jurisdiction.” It is doubtful whether the view expressed by Patten J is correct. His interpretation of Article 31 as placing a duty on the courts to cooperate seems to be contrary to the wording of the Regulation, since Article 31 only obliges liquidators to cooperate and a court is not necessarily a liquidator in all Member States within the meaning of Article 2(b) read in conjunction with Annex C to the Regulation. There are, however, two points regarding Patten J’s judgement that can easily be missed and that make his *obiter dictum* (it was not strictly necessary to decide on the point whether or not Article 31 provides for a duty for courts) of universal interest to courts across the Union. First, his reasoning applies equally to courts across the EU, because it is based on the supervisory function of courts

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<sup>9</sup> ZJP 111 (1998), 305

<sup>10</sup> Cf. Duursma-Kepplinger/Duursma/Chalupsky, EIR, 2002, Art 31, [31], Vallender, Aufgaben und Befugnisse des deutschen Insolvenzrichters in Verfahren nach der EuInsVO, KTS 2005

<sup>11</sup> Ehricke, Verfahrenskoordination bei grenzüberschreitenden Unternehmensinsolvenzen (Coordination of Proceedings in Cross-border Insolvencies) in Basedow, Aufbruch nach Europa (On the Path towards Europe), 2001, 337, 349

only. Second, he points out that the duty incorporates or reflects a wider obligation. From this perspective it might be argued that Article 31 - as far as it applies to courts - only reflects their general duty of sincere cooperation under Article 10 of the EC Treaty. However, Article 31 of the Insolvency Regulation cannot be read as placing courts under an obligation to cooperate, even if viewed in the light of the courts' wider obligation under EU Law. Consequently, the correct thing to do seems to be taking a mediating position between the view held by Patten J and the Vienna Higher Regional Court on one hand and the view predominantly held in academia on the other.<sup>12</sup> This third view would not place courts under an absolute duty to cooperate, but would - in accordance with a purposive interpretation of the Regulation having regard to the principles of sincere cooperation and *effet utile* - argue that Article 31 has introduced a strong presumption in favour of cooperation. This would mean that courts would in general be asked to cooperate unless there are overriding legal considerations that trump the interests of creditors in individual cases. Such considerations might, for example, include respect for data protection laws. The courts can only fulfil their role as guardians of the interests of creditors and all other stakeholders if they take their own quasi-duty of cooperation seriously.

To this end, the Guidelines applicable to Court-to-Court Communication in Cross-Border Cases developed by the American Law Institute (ALI) serve a useful role in clarifying the channels of cooperation open to courts in cross-border insolvency proceedings for all concerned and providing a common frame of reference to courts across the Member States. As Prof. Vallender has argued, it might be helpful to implement the Guidelines into the Insolvency Regulation by including them in an Annex to the Regulation.<sup>13</sup> This would also tackle the current problem of legal uncertainty in relation to Article 31. Regardless whether the ALI or CoCo Guidelines are taken as a starting point, the current lack of legislative clarification concerning what exactly the duty to cooperate requires courts to do, has to be solved by the European Legislator. Legislative action is called for in the light of two fundamental legal principles: the rule of law and *effet utile*. The latter might be at stake because courts can all too easily avoid making active use of Article 31 of the Insolvency Regulation. In a Union of 27 the introduction of a binding legal framework for the duty to cooperate, mapping out at least some general principles and methods of communication and cooperation, could in due course create a judicial climate wherein cross-border cooperation is felt to be obligatory in the interests of creditors, regardless of their nationality or country of residence.

### *Conclusion*

The introduction of the CoCo Guidelines developed by professors Wessels and Virgós and endorsed by INSOL Europe and the Guidelines on Court-to-Court Cooperation published by ALI have gone some way towards creating an effective legal framework for the cooperation between courts and between liquidators. However, these guidelines might not provide an altogether satisfying legal basis for cross-border cooperation, especially owing to their non-binding character. In this regard they suffer from the same deficiencies that I pointed out in 2005 in relation to my proposal concerning the development of a non-binding Codex of best practice. For German courts in particular, a binding Annex to the EIR might be better placed to accommodate a judicial mind-set founded on the understanding that a court always needs an enabling provision to assert jurisdiction. To assess whether the current legislative framework around Article 31 is

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<sup>12</sup> cf. Herchen, Das Übereinkommen über Insolvenzverfahren der Mitgliedstaaten der Europäischen Union vom 23.11.1995 – Eine Analyse zentraler Fragen des Internationalen Insolvenzrechts unter besonderer Berücksichtigung dinglicher Sicherungsrechte, 2000, 146 (arguing for a duty), Vallender, Aufgaben und Befugnisse des deutschen Insolvenzrichters in Verfahren nach der EuInsVO, 320 (arguing against a duty).

<sup>13</sup> Vallender, Fn 10

sufficient in providing all concerned with the tools necessary for effective communication and cooperation and at the same time setting a clear standard of care that liquidators must live up to in practice, the Institute of European and International Insolvency Law is currently conducting research on the practical impact that Article 31 of the Insolvency Regulation has made so far and how, if at all, courts and liquidators across the Member States make use of the duty to cooperate.