BRUSSELS: protecting the wealth of Europe

Jack Barton, 13 July 2016

Photo credit: istockphoto.com/argalis

The development of pre-insolvency mechanisms alongside formal tools such as schemes of arrangement has been a valuable response to complex financial issues and should be borne in mind by regulators attempting to harmonise regimes, speakers said at a conference in Brussels on 16-17 June.

The 5th annual European Insolvency & Restructuring Congress, held at the Stanhope Hotel in Brussels by the German Bar Association in partnership with Spain's Association of Insolvency Administrators, met to assess developments in restructuring law in European jurisdictions in the context of efforts to harmonise European regimes.

A panel discussion optimistically posed the question: "Pre-insolvency proceedings: the magic cure for all aches and pains?" and featured presentations by practitioners from Spain, Germany and England on the development of their respective pre-insolvency procedures.

Exactly a week before Britain's referendum on EU membership, **Stephen Harris**, a London-based insolvency practitioner at Ernst & Young, began his presentation by saying that "European insolvency law, and meetings such as this, are shining examples of the strengths of the European Union," though he added that he could not promise to speak for his compatriots.

Delving into the history of UK insolvency law, Harris briefly outlined the creation of the "London approach" to debt restructuring in the early 1990s – as companies increasingly began to rely on multibank financing rather than individual lenders, pre-insolvency options became more flexible to ameliorate the risk of complex and drawn-out post-insolvency litigation.

This approach was quickly replicated – developments that might be called the Bangkok Approach or Jakarta Approach effectively mirrored what had happened in London – and came in the wake of periods of financial instability such as the late 1990s, when the risks to stressed debtors in the multibank environment became readily apparent.

Harris' proposition was that pre-insolvency proceedings are simply not insolvency proceedings at all; rather they are a model of sound and established debtor or lender interaction at times of corporate distress.

Multibank turnaround arrangements were encouraged by the Bank of England and became a soft regulatory norm as they fitted in with the legislative obligations on directors. This laid the groundwork for the "scheme renaissance" in insolvency law in England and Wales, which was spurred on by the increased complexity of lending structures.

The panel moderator, **Ruben Garcia-Quismondo**, managing partner of Quabbala Abogados y Economistas in Madrid, summarised developments in pre-insolvency regulations in Spain.

Garcia-Quismondo said that there had been a lot of changes in Spanish insolvency law in recent years, which had allowed the law to evolve and become more appropriate to the current demands in the market.

He described the opening up of the Spanish regime to schemes of arrangement as very successful – as demonstrated by the rise in companies using this scheme, which in turn protects the Spanish regime from losing out to forum-shopping and companies leaving to use English schemes.

Notably, recent developments in the Spanish regime allow cram-downs on dissenting creditors and allow companies to file before they are insolvent, both features of the US's Chapter 11.

Holger Ellers, of Baker & Mckenzie in Berlin then outlined one branch of German pre-insolvency, the informal out-of-court approach.

Ellers described Germany's informal pre-insolvency option as efficient, but bearing the risks to directors that accompany strict directors' liability, risks to shareholders that come with subordination and clawback as well as lenders' liability – there is an option of clawback if a restructuring is done poorly.

These risks are in theory ameliorated by the requirement to have an independent restructuring opinion, but this is undermined a little by a lack of clear guidelines and relevant case law, which adds weight to arguments that Germany could benefit from a formal out-of-court mechanism.

Axel Bierbach of Müller-Heydenreich Bierbach & Kollegen in Munich then outlined Germany's in-court pre-insolvency option, available through the Insolvency Statute and based on principles of "transparency, truth, completeness (of restructuring plan) and equal treatment (of creditors in each creditor group)".

This proceeding is rarely used, said Bierbach, partly because Germany has a good legal environment with a broad acceptance of both insolvency proceedings and the informal pre-insolvency option.

In terms of the broader challenges faced by all of these regimes, the panel agreed that new classes of creditor, such as distressed investors, whose aims are at variance to both the regulator and the other creditors or the debtor, are a relatively new phenomenon.

Harris predicted that European jurisdictions will see further amendments in the near future: "We are still picking up the pieces from 2008-10 and we all want to protect the wealth of Europe. The actual legislation of schemes of arrangements is very short, which will allow it to evolve over time."

One size fits all is a dangerous endeavour

The discussion followed an assessment of harmonisation progress across Europe from prominent practitioners and members of the European Commission.

In the conference's first panel, Miriam Parmentier of the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) and Mihaela Carpus-Carcea, legislative officer at the European Commission, reiterated the commission's commitment to create a "true single market for capital" through the Capital Markets Union initiative, recognising the need to diversify sources of financing, remove barriers to cross-border financing and encourage capital financing.

The speakers said that the commission hopes to make early access to restructuring processes and instruments, combined with an emphasis on distinguishing between viable and non-viable companies, common to all member states.

Enabling early restructures as part of the CMU might include provisions for protection of new financing, ensuring the availability of adequate expertise, and extending the period before a company is required to file for a formal process.

However, Parmentier and Carpus-Carcea said that the commission was aware that the diversity of legal and macroeconomic systems across the (for now) 28 states necessitated flexibility of approach. As such the commission aims to create a set of common insolvency principles, rather than a set code.

"One size fits all is a dangerous endeavour" when it comes to harmonisation, said Daniel Fritz of the German Bar Association and Hermann Wienberg Wilhelm in Frankfurt.

Carpus-Carcea agreed, adding that finding workable systems "doesn't happen at the European level but at the national level – each state faces different problems implementing legislation. This in itself is a major problem which we must overcome."

Thursday's programme also saw a presentation from Jan Schildbach, director of banking, financial markets and regulation at Deutsche Bank Research on the growth of non-performing loans and respective policy responses in various jurisdictions, as well as panel discussions on avoidance law and short-term debt discharge.

Friday featured presentations on directors' liability in cross-border cases and crisis communication for insolvency practitioners, with the conference rounded off by a debate on forum-shopping - "Choice of COMI – US v EU".