X-Part II-Memo07

[…]
I now turn to Article 36 itself.

[10836k] Article 36, without any doubt, results in the most voluminous text of all articles in the EIR 2015. It counts eleven paragraphs. They relate to
(a) the undertaking (particularly (1) definition, (2) law applicable, (3) language, (4) form of the undertaking);
(b) its approval ((5) to be approved by qualified majority of known local creditors, (6) binding on the estate), and
(c) the undertaking's execution ((7) duty to inform regarding local distribution; creditors may challenge non-compliance with undertaking, (8) local creditors have remedy with COMI court, (9) local creditors have remedy with the 'as if' court, and (10) liability of IP in main proceedings).
The last paragraph (11) deals with the 'synthetic' authority to guarantee payments to employees.
Literature. Article 36 and the original proposal for the undertaking, taking just two paragraphs (see Wessels, *Contracting Out of Secondary Insolvency Proceedings: The Main Liquidator's Undertaking in the Meaning of Article 18 in the Proposal to Amend the EU Insolvency Regulation*, in: 9 Brooklyn Journal of Corporate, Financial & Commercial Law, Fall 2014, number 1, pp. 63 – 110; Arts (2015)) has attracted much attention resulting in a spread of interpretations. I am referring to Arts (2015), Madaus (2015a); Fritz (2015); Mankowski (2015); Pluta/Keller (2015); Skauradzun (2016). Delzant, in: Braun (2017), Art. 36. Laukeman/Arts, Implementation Report March 2017, 56ff. Below I can only touch upon a few aspects.

[10836l] Article 36(1) provides a long description for what an 'undertaking' is. It takes together in one bottled up sentence (i) its goal, (ii) its issuer, (iii) the nature of the undertaking, (iv) the scope (the assets) the undertaking covers, and (v) its substance.
Goal. Subparagraph 1 starts off with the goal of an undertaking '… to avoid the opening of secondary insolvency proceedings'. I refer to the paragraphs above. Issuer. The issuer of the undertaking is '… the insolvency practitioner in the main insolvency proceedings', which also covers the situations that two IP's are appointed (rather common in the UK) and indirectly confirms that only the main IP exclusively has this power. Only an IP or the provisional IP (in the meaning Article 2(5) EIR 2015) may give an undertaking, the debtor in possession does not have this power. See Reinhart, MüKoInsO (2016), Art. 36, nr. 18 and 19. Legal basis in EU law. The power itself is not derived from the national law of the opening state (lex concursus), but it has its basis in EU law. If under a certain national law a rather similar national power (e.g. making a promise to creditors elsewhere) would be subject to the approval of a national court, that would not apply to the undertaking in the meaning of Article 36. It would therefore be logical also to exclude any powers a national creditors committee may have in that regard. It may, however, be advisable that the IP assesses whether it would be helpful that this committee indeed is informed, especially as the effect of the undertaking is that 'foreign local creditors' by distributions may receive more than other creditors.
Exclusivity of the undertaking? In Germany authors are divided whether an undertaking prejudices the rule that all creditors have to be treated equal, see Mankowski, in: Mankowski/Müller/J.Schmidt (2016), Art. 36, nr. 3. The main IP 'may' use this power to give an undertaking. It is to the discretion of the main IP to assess whether the use of this power

under the given circumstances is the most appropriate one, given its goal: avoiding the disruptive effect a full-fledge secondary proceeding would have. The exclusive position of the undertakings' issuer does not reflect in his powers: will Article 36 EIR 2015 deprive an English IP of giving an undertaking in the traditional way, an English style undertaking? With Madaus (2015b) and Fritz (2015), 1888, I submit that his national powers remain untouched by Article 36. However, Mankowski, in: Mankowski/Müller/J.Schmidt (2016), Art. 36, nr. 3, defends the other view on the basis that Article 36 does not refer to national law. In the same way Moss/Smith, in: Moss/Fletcher/Isaacs (2016), 8.659 and – with hesitation – Laukeman/Arts, Implementation Report March 2017, 63. In my view this is incorrect, as the undertaking in the meaning of Article 36 differs in quite a few aspects of its national English origine, for instance in the matters of (i) approval, (ii) effect, and (iii) formal requirements. These aspects all the more support the view that the undertaking in the meaning of Article 36 reflects an autonomous substantial norm.

[10836m] *Legal character of the undertaking: its basis.* The main IP '… may give a unilateral undertaking (the 'undertaking') …' It is manifest that the 'undertaking' originally is based on an English legal concept. As I understand English law, the idea behind giving such an undertaking is the insolvency office holder's obligation to temper his strict adherence to the rules with a respect for honest dealing and justice. See *Re Condon ex parte James* [1874-80] All ER Rep 388. In England, from this principle in ex parte James it follows, that the insolvency office holder must not take advantage of creditors without giving credit for their debts nor insist on taking windfalls from another's mistake. See *Re T & N Ltd* [2004] EWHC 2361; [2005] 2 B.C.L.C. 488. Furthermore, under English law as I understand it, an administrator can be sued by creditors or subsequent office holders if it is found that he has misapplied or retained money or other property of the debtor-company, has become accountable for money or other property of the company, has breached a fiduciary or other duty in relation to the company or has been guilty of misfeasance. See para. 75, Schedule B1 Insolvency Act 1986. For the equivalent provision in the case of liquidators, see s.212 Insolvency Act 1986. However, with the 'undertaking' included in the text of the EIR 2015 these 'English' explanations do not bear consequences, not only because of the fact that not all insolvency office holders in other EU Member States are 'officers of the court', but for the reason that an 'undertaking' has to be regarded and interpreted as an 'autonomous' term. The Court of Justice of the EU held in 2012 in CJEU 22 November 2012, Case C-116/11 (*Bank Handlowy w Warszawie SA, PPHU 'ADAX'/Ryszard Adamiak, V Christianapol sp. z o.o*.):
'49 Although it is true that, where there are doubts with respect to their wording, provisions of European Union law must be given an autonomous and uniform interpretation, having regard to the context of the provision and the objective pursued by the legislation in question, the Court has nevertheless held that that principle holds true only for those provisions which make no express reference to the law of the Member States for the purpose of determining their meaning and scope (see, to that effect, Case C-396/09 Interedil [2011] ECR I-0000, paragraph 42 …).
Thus, I conclude, the legal nature of an undertaking is unrelated to English law; it is an autonomous term.

[10836n] *Legal character of the undertaking: its form.* Article 36(1), however, is silent on what an undertaking is. It only sets out its goal: the undertaking aims to avoid the opening of secondary insolvency proceedings. Nevertheless, the legal nature of an undertaking is important, as its characterisation may determine some of its effects and may indicate weather certain measures can be taken against it. Several options come to mind. Is an undertaking (i)

an offer, leading to – if accepted according to the reqirements – an agreement, (ii) a procedural measure or (iii) a legal concept in its own right?
On first sight an 'as if' undertaking can be regarded as a unilateral promise. However, its result would be a (multi-party) agreement between the IP (giving the undertaking) and the creditors which may be in the best interest of 'local' creditors, but getting their consent will be indeed cumbersome (how to treat hold out creditors?), rather complicated (where to find them?), time-consuming and therefore costly, and ultimately against the underlying idea that the undertaking is to be regarded as a measure of improving the efficient administration of the debtor's estate in situations where the debtor has an establishment in another Member State. A separate query to deal with is the possibility (leaved untouched here) of the application of Rome II.
The undertaking is addressed to, or at least should be approved by 'known local creditors' (see Article 36)(5), first sentence. On the word 'known' the commentary to Article 54(1). A local creditor (see Article 2(11) EIR 2015) means a creditor whose claims against a debtor arose from or in connection with the operation of an establishment (in the meaning of Article 2(10) EIR 2015), situated in a Member State other than the Member State in which the centre of the debtor's main interests is located. See para. 10537a.
Unilateral. The term 'unilateral' is not clear. Moss/Smith, in: Moss/Fletcher/Isaacs (2016), 8.660, presume it means to emphasize that the undertaking is not a matter of contract. In the same way Mankowski, in: Mankowski/Müller/J.Schmidt (2016), Art. 36, nr. 15, submitting that a unilateral undertaking is a unilateral legal act ('*einseitiges Rechtsgeschäft'*), but not a contract ('*Vereinbarung*') (although in nr. 4 referring to '*vertraglich*', 'contract'). Mangano, in: Bork/Van Zwieten (2016), 36.10, remains vague. He notes that the main IP is the only person empowered '… to initiate this procedure', which seems to indicate that he regards an undertaking as initiating a procedural method. Also Laukeman/Arts, Implementation Report March 2017, 58, are in doubt (a binding undertaking '… approximates a contractual-related mechanism'). Reinhart, MüKoInsO (2016), Art. 36, nr. 20, expresses a different view: where the addressees are the local creditors, the receiver of the undertaking only can be the court that is concerned with the request to open secondary insolvency proceedings.
Saying that the binding undertaking has a *sui generis* character does not add much, but accentuates that known national legal concepts (like 'contract') have shortcomings as indeed the undertaking in its nature is a mix of contractual and procedural elements, which overarches national law systems, as it only exists in the area of European cross-border insolvency law.

[10836o] *Assets.* The undertaking relates to '… the assets located in the Member State in which secondary insolvency proceedings could be opened'. The location-rules of Article 2(9) EIR 2015 are decisive in this context. Recital 43 provides that for the purposes of '… giving an undertaking to local creditors, *the assets and rights located in the Member State where the debtor has an establishment should form a sub-category of the insolvency estate* [italics by me; Wess.], and, when distributing them or the proceeds resulting from their realisation, the insolvency practitioner in the main insolvency proceedings should respect the priority rights that creditors would have had if secondary insolvency proceedings had been opened in that Member State.' *Reference time for locating assets.* The relevant point in time for determining the assets to be included in the hypothetical sub-estate shall be the moment at which the undertaking is given, see Article 36(2), second sentence. See Mankowski, in: Mankowski/Müller/J.Schmidt (2016), Art. 36, nr. 23 (discussing other possible reference moments), who (in nr. 24 and 25) mentions as the most important legal consequences:
(i) that the main IP is not allowed to 'overbid' the total value of the assets in its effort to buy in the approval of the creditors, and

(ii) that he is allowed to remove (see Article 21(1), second sentence) the assets from the 'as if' territory, if he needs these assets to succeed in a reorganisation (the IP should include in its undertaking that he would transfer the value of these assets to the local creditors).
An important legal consequence of an undertaking is that it is binding on the estate (see Article 36(6)) and – but this is not provided for in Article 36 – that any application for opening of secondary insolvency proceedings in null and void and consequently should be dismissed by the 'as if' court, see Mankowski, in: Mankowski/Müller/J.Schmidt (2016), Art. 36, nr. 10. On the relation between this consequence and Article 37(2), see that article's commentary.

[10836p] *Creditors and their distribution and priority rights under national law.* The substance of the undertaking, in relation to the local assets is '… that when distributing those assets or the proceeds received as a result of their realisation, it will comply with the distribution and priority rights under national law that creditors would have if secondary insolvency proceedings were opened in that Member State.' *Which creditors?* As explained, a local creditor (see Article 2(11) EIR 2015) means a creditor whose claims against a debtor arose from or in connection with the operation of an establishment (in the meaning of Article 2(10) EIR 2015), situated in a Member State other than the Member State in which the centre of the debtor's main interests is located. The criterion, therefore, is not 'local creditor', rather 'local claim', the owner of which could also by a creditor having its location in another Member State. *Local creditors.* It is noted that Article 36(1) does not include the term 'local'. Also paragraphs 2 and 5 just use the plain term 'creditor'. It is however evident that Article 36 focuses on 'local creditors', as is expressed in recital 42 and in paragraphs 5, 7, 8, 9, 10 and 11. Local creditors, in the given meaning of those holding 'local claims', may therefore include creditors of claims already lodged in the main proceedings.
Distribution and priority rights. These 'rights' are to be determined by the lex concursus of the Member State where (fictionally, virtually) secondary proceedings are opened. The term 'distribution' is known in Article 7(2)(i) EIR 2015, the term 'priority right' does not appear in the EIR 2015. Reinhart, MüKoInsO (2016), Art. 36, nr. 6, defends a broad interpretation for 'distribution and priority rights'. It is submitted that applying the lex concursus of the main insolvency proceedings, including that Member State's 'distribution and priority rights' may not lead to the same outcome in cases where there may be two or more Member States which could have opened secondary proceedings.
Creditors with distribution and priority rights under national law. The scope of creditors with distribution and priority rights under national law does exclude creditors with separation rights (often secured creditors), potential creditors of the secondary estate (if there would be any) and creditors with a claim on the basis of national avoidance rules, thus Reinhart, MüKoInsO (2016), Art. 36, nr. 7ff.

[10836q] *Rights to be respected in the main proceedings?* In the original proposal, it was included that these 'distribution and priority rights' '… will be respected in the main proceedings'. It may therefore be the case – in simple words – that an employee in another Member State is much better off than an employee in the main insolvency proceedings. This result may be tolerable to a certain extent, but it may be regarded as being against the imputation-rule of Article 23(2) EIR 2015 or the enforcements of a judgment of this nature may be regarded as manifestly contrary to a Member State's public policy (Article 33 EIR 2015). For that reason, I suggest that words to the effect that in such a situation paritas creditorum/equal treatment is not breached should be included.

[10836r] *Assumptions.* In Article 36(1), second sentence, some minimum criteria of an 'as if' undertaking are formulated. The provision says that the undertaking '… shall specify the factual assumptions on which it is based, in particular in respect of the value of the assets located in the Member State concerned and the options available to realise such assets'. The European Parliament wished more specified criteria, including: (i) the factual assumptions upon which it is based, in particular with respect to the distribution of local claims over the priority and ranking system under the law governing the secondary proceedings, (ii) the value of distributable assets within the secondary proceedings, (iii) the options available to realise such value, (iv) the proportion of creditors in the main proceedings participating in the secondary proceedings and (v) the costs that would have to be incurred by the opening of secondary proceedings. It is clear that the 'factual assumptions' in Article 36(1), second sentence, are more limited. The topics mentioned by the EP would fall under the category 'information', see the next paragraph. *Uncertainties in practice.* The 'factual assumptions' described create their own concerns. For instance, 'value of assets' will in many cases be hard to predict, so the better term would have been 'an estimate value'. Will the required information be available at the relevant time? (see Article 36(2), second sentence). In as far as the specified criteria are mandatory ('shall specify'), it is uncertain what the consequences will be when one of these criteria is not or just vaguely taken into account. Would it lead to liability of the IP in the meaning of Article 36(10) EIR 2015? For an instructive overview of elements which determine the 'value of the assets', see Skauradszun (2016).
In addition, it may be the case that under certain circumstances other facts may be of relevance too, e.g. the rescue of a debtor with cross-border operations, the additional value it may have as the total enterprise can be sold (without disturbing secondary proceedings) to a third party and the value it would have for maintaining employment and operational activities forming a base for corporate tax in the other Member State. I agree with Mankowski, in: Mankowski/Müller/J.Schmidt (2016), Art. 36, nr. 20, that rules with regard to misrepresentation of related to change of circumstances, available in the lex concursus of the main insolvency proceedings should be decisive here.

[10836s] *Key information.* An undertaking should at least be based on the assumptions mentioned. These function as minimum requirements. The undertaking should also provide information on the question why it has been taken and what its effects will be and the intended distributions. Other information should include (see Pluta/Keller (2015); Mankowski, in: Mankowski/Müller/J.Schmidt (2016), Art. 36, nr. 19):
(i) the number of local creditors,
(ii) the amount of their claims,
(iii) a description of the 'sub-category of the insolvency estate', in the meaning of recital 43,
(iv) the amount of the claims of the secured creditors in case it would come to opening of secondary proceedings,
(v) a prognosis of the costs, and
(vi) a prognosis of the likely percentage available for distribution.
It is this information that should be communicated to the local creditors too, see Article 36(7) first sentence. It is the information that under the circumstance a local creditor would need to make an informed decision. That information could also include:
(a) a presentation of the reasons to avoid secondary insolvency proceedings (this could be the general of more specified advantage of a going concern sales, but also the wish to prevent conflicts with an IP, to be appointed, with regard to the uncertain location of assets (e.g. regarding the commencement of an avoidance action or or fee conflicts to be expected), or
(b) the quota of creditors in the main proceedings who also will be an 'as if' local creditor.

Rightly, Mangano, in: Bork/Van Zwieten (2016), 36.13, notes: 'This means that the IP cannot formulate the undertaking in generic terms but must propose a detailed plan showing the legal treatment that will be applied, asset by asset or block of assets by block of assets.'

[10836t] *Qualifications?* It seems that a qualified undertaking is not allowed. Including a qualification reflects general practice and would make the provision more flexible, with the inclusion of words as '… to the extent reasonably practicable at the time the undertaking is given.' A 'no worse off' rule in an 'as if' undertaking? A more principled criterion seems to lack. The idea of the possibility of enhancing the net value of all assets available for distributions in the main proceedings (and the 'as if' proceeding) could be guaranteed (to warrant the idea of creditor protection) when the content of the undertaking also includes as a minimum that local creditors will be treated no worse than creditors in the main proceedings. Such a condition is not mentioned in Article 36. However, protection of local creditors is available in art 38(2), see Reinhart, MüKoInsO (2016), Art. 36, nr. 8 (the undertaking should adequately protect the general interests of the local creditors). Other critique is well possible. *A conditional 'as if' undertaking?* If the unilateral promise should lead to an acceptance by local creditors several questions pop up. Is the main IP allowed to include conditions to its undertaking? For instance: my undertaking should be accepted by 80 % of the local creditors, or: my undertaking is ready for acceptance only when third party X offers an amount of Y for all or certain described assets. Moss/Smith, in: Moss/Fletcher/Isaacs (2016), 8.664, submit that there does not seem to be the possibility of an undertaking conditional upon the local creditors not requesting opening of secondary proceedings, but the authors add that the words '… in accordance with Article 36', in Article 38(2) expresses that based on Article 36(5) only undertakings given and approved by (all) local creditors and therefore binding on the estate under Article 36(6) can block the opening of a secondary proceeding. *Only one undertaking?* In this area, it is also important to assess whether the main IP only may make the undertaking once, or whether he is allowed – when the undertaking is rejected – to present another undertaking a second or a third time. The latter possibility creates the danger of 'undertaking shopping', being bargaining or horse-trading (what the Dutch by the way call cow-trading, koehandel). Honest dealing would include, I think, that the undertaking is unconditional and should at least be made for a period of x days (5 working days?), without the possibility of revoking it. For form requirements, see below. Another unanswered question is whether an undertaking may be revoked (and if so, within what number of days).

[…….]