Proposed EU Regulation creating a European Account Preservation Order to facilitate cross-border debt recovery in civil and commercial matters

Insolvency Lawyers’ Association’s response to Ministry of Justice Consultation

1. Introduction

1.1 This is the ILA’s summary response to the Ministry of Justice consultation on the proposed EU Regulation creating a European Account Preservation Order (“EAPO”) to facilitate cross-border debt recovery in civil and commercial matters (the “Consultation”). It has been prepared on behalf of the ILA by its Technical Committee (the “Committee”).

1.2 The ILA provides a forum for c.450 full, associate, overseas and academic members who practise insolvency law. The membership comprises a broad representation of regional and City solicitors, barristers and academics, and overseas lawyers. The Committee is responsible for identifying and reporting to members on key developments in case law and legislative reform in the insolvency marketplace.

1.3 The Committee welcomes the opportunity to provide its view on the Consultation. However, given the short time that the Consultation has been open for we have restricted ourselves in our response to raising what we would regard as “big picture” issues with particular relevance to insolvency and restructuring, rather than commenting on points of detail or specific drafting. We understand that other respondents will address the latter points, which we have not been able to do in this response. We remain available to do so in further consultation.

2. General points

2.1 If introduced in its present form, the Regulation will enable a claimant to make a single application to the courts of one Member State to obtain an order to “freeze” monies held by a defendant in bank accounts in other Member States, without further intervention by the courts of those Member States. Applications for EAPOs will usually be made on an ex parte basis using standard form documentation and can be granted before proceedings are initiated, during proceedings or after a judgment is obtained. As drafted, it appears that an EAPO will not involve judicial scrutiny, and will be an administrative act of the granting court, unlike the English freezing order, which raises concerns as to the proper balance between claimants and defendants.

2.2 While freezing orders are an established part of English law and have not negatively affected the development of the UK’s business rescue culture to a significant extent, the introduction of EAPOs in their current form would raise substantial concerns for UK restructuring and insolvency professionals, and the business of business rescue. Certainly, given the current fragility of European economies, business rescue is a policy which ought to command greater weight than debt recovery procedures. The former has an impact on creditors as a whole as well as the business, its employees, customers and counterparties, communities, and local and central government, whereas the latter operates bilaterally.

2.3 In particular, we are concerned by: (i) the threshold in the Regulation for a claimant to obtain an EAPO is too low; (ii) the checks and balances between claimant and defendant in relation to obtaining and overturning an EAPO are weighted too far in favour of the claimant; (iii) the insolvency exclusion is drafted too narrowly and the current wording leaves room for varied interpretations; (iv) the inter-relation between insolvency proceedings and EAPOs is unclear; and (v)
a pan-EU regime raises the prospect of inconsistencies in how the new law is applied and how EAPOs take effect, potentially causing areas of legal inconsistency and uncertainty.

3. **Is it in the national interest for the Government, in accordance with Protocol 21 on the position of the United Kingdom and Ireland in respect of the Area of Freedom, Security and Justice annexed to the Treaty on the Functioning of the European Union, to opt in to negotiations on the Commission’s proposed Regulation? Please explain the reasons for your decision.**

3.1 While the aims of EAPOs are laudable, the ILA has concerns that the scope and workings of the Regulation have been inadequately thought through and that many provisions in the Regulation are currently poorly drafted. The Regulation raises fundamental concerns in relation to the impact EAPOs may have where a company is involved in an informal restructuring or work out situation. As currently drafted the Regulation is problematic as it is likely to enable vexatious creditors to derail genuine restructurings or to force distressed debtors into formal insolvency proceedings. EAPOs would leave companies in financial distress, though not yet in formal insolvency proceedings, vulnerable to speculative creditor actions that would restrict their ability to manage cash and pay their creditors. Such a restriction, even for a matter of days, can be seriously problematic for a company already in distress and could destroy value to the detriment of creditors as a whole. The Regulation would have to be substantially re-drafted so as to address these concerns or EAPOs could pose a risk to the UK business rescue culture. Indeed at present we consider that the Regulation could achieve the opposite of its stated objectives and result in increased risks in respect of cross border trade and reduce cross border activity. Far from increasing the efficiency of the enforcement of judgments, it will impose a high burden on the courts and could encourage resort to the courts to be the first step, rather than as a last resort, in relation to cross border disputes.

3.2 While the proposed terms of the Regulation appear to identify, in principle, some of the problems raised from an insolvency/restructuring perspective, the current draft of the Regulation gives rise to serious concerns and therefore needs to be revisited. For example, ensuring that restructuring and workout situations (both formal and informal) are adequately excluded from the scope of the Regulation and/or revising the drafting of the Regulation so as to redraw the balance between defendant and claimant in a way that mitigates the risks that EAPOs could pose to distressed debtors.

3.3 It is not an option simply to opt out of the Regulation on the basis that doing so would mean that the UK would not be affected by EAPOs. This is because even if the UK were to opt out of the Regulation at this stage, the EAPO regime, if implemented in anything like its current form, would still unavoidably affect informal restructurings carried out from the UK. This is simply a by-product of the cross border nature of modern commerce; many businesses will have assets (including bank accounts) in other Member States. The decision on whether to opt in or out of the proposals should therefore be taken with this in mind, as it is fundamental to the UK national interest that the Regulation's deficiencies are addressed whether or not the UK opts into the Regulation at any stage. Given the fundamental problems with the current version of the Regulation, the UK's decision on whether to opt in or opt out will depend on how the UK Government thinks it can best influence the future negotiations in relation to the Regulation. If an opt in commits the UK to the eventually negotiated outcome, even if still unsatisfactory, then it should consider opting out rather than being bound by an unsatisfactory and unbalanced Regulation.

4. **What are your views on the specific issues raised in this paper concerning the proposal being made by the European Commission?**

4.1 What is significant about the Regulation is that it appears to make it much easier for a claimant to obtain an EAPO than it would be for the same claimant to obtain a freezing order under the existing English law regime.
An EAPO will be granted (with little apparent discretion available to the relevant court to take account of the context in which the defendant finds itself) if the claimant presents "relevant facts, reasonably corroborated by evidence" to satisfy the court that:

(i) the claim "appears to be well founded"; and

(ii) without the order, subsequent enforcement "is likely to be impeded or made substantially more difficult, including because there is the real risk that the defendant might remove, dispose of or conceal assets held in the bank accounts sought to be preserved".

This is much less stringent than the test applied by the English courts on an application for a freezing order where an applicant must satisfy the court (amongst other things) that there is a "real risk of dissipation" of the assets, that there is a "good arguable case" on the underlying claim, that there is prima facie jurisdiction and that it is "just and convenient" to make the order. Under English law the applicant is also under a duty of full and frank disclosure, a requirement which is not contained in the Regulation and may not apply in other jurisdictions, thereby creating an uneven playing field (see further paragraph 4.5 below). Given that freezing orders have been described as one of the law’s nuclear weapons, the proposed Regulation looks like “nuclear arms for all”, with as much capacity for harm, but without any of the attendant responsibilities that applicants for freezing orders must discharge in English law.

In addition, the Regulation includes a different threshold depending on whether the applicant is seeking an EAPO prior to obtaining "an enforceable title" or after such title has been obtained. How these thresholds operate is not clear but on one interpretation a claimant that has obtained judgment may, without any requirement to demonstrate a risk of dissipation, request (on an ex parte basis) that the court issuing the judgment also issue an EAPO freezing the amount of the judgment debt in the unsuccessful defendant's bank accounts. Therefore it may be the case that, in certain circumstances, an EAPO could be obtained with no need to demonstrate any risk of dissipation of assets. This would amount to a short-cut debt enforcement mechanism and enable judgment creditors to freeze a judgment debtor's bank accounts as of right with, apparently, few, if any safeguards. In this regard we agree with the Government's observations at paragraph 34 of the Consultation, that the risk of dissipation should be the only reason for the granting of an EAPO. In the same vein, please also see the comments upon the Scots law procedure of “arrestment on the dependency” at 6 below.

It is also possible that, at least until ECJ guidance was available, UK courts may be more reluctant to grant an EAPO (because of its historic approach to freezing orders) than courts in other Member States (who may not have such an established practice as regards freezing orders). This could potentially lead to forum shopping. For a defendant faced with such a potentially serious measure as an EAPO this would not be welcome.

The lower thresholds in the Regulation and the lack of overall discretion given to the court when granting an EAPO are problematic to the extent that it is likely to enable vexatious creditors to derail genuine restructurings and to force distressed debtors into formal insolvency. When a company is in financial distress there is large pressure on cash flows and the ability to access funds to enable the business to continue, while a solution to the financial problems is negotiated with its creditors, is crucial. Further, in the restructuring context, as a result of a claimant's apparent automatic right to an EAPO over a judgment debt: (i) judgment creditors would have too much leverage in the negotiations and may be able to take a ransom position; and (ii) banks may be more reluctant to fund cash flow for distressed companies if the funds they provide are at risk of being frozen by a judgment creditor.

These potentially serious effects on restructurings are exacerbated by the fact that: (i) the process to revoke an EAPO could take up to 30 days from the date of service of the application on the claimant;
and (ii) a distressed debtor would usually have to bring any challenge to the EAPO before the courts which granted the order and only in the Member State where enforcement is taking place upon more limited grounds (this may add to the cost of challenging an EAPO at a time when pressure on cash flow and management time is most acute and ought more properly be directed in restructuring the business for the benefit of all creditors as a whole).

4.8 For these reasons it is the ILA’s view that the thresholds for obtaining an EAPO must be higher and the process more robust. The ability to grant an EAPO must not be simply mechanistic. There must be a duty on the claimant of full and frank disclosure of all material facts to the court and the court must be given an overall discretion in the circumstances of the case as to whether or not to grant an EAPO. Further, EAPOs should only be granted if the claimant is able to satisfy the court of a real risk that the debtor is likely to put assets held in its bank accounts beyond the reach of its creditors. We would suggest that there be a presumption that actions which would ordinarily be taken in a restructuring in order to manage cash flow are legitimate unless the claimant can demonstrate otherwise. In short, the claimant should, in all cases concerning the granting of an EAPO, be subject to the obligation to show that there is an element of impropriety in the defendant’s conduct.

4.9 In addition, because of the possibility of irreparable harm to a company in financial distress in the period between an EAPO being granted and successfully challenged, it may be preferable if the standard form EAPO application include an obligation for the claimant to disclose whether he is aware of the debtor company being engaged in debt restructuring negotiations with its creditors or being otherwise in financial distress. This would if nothing else encourage a court minded to grant an EAPO to seek further information from the debtor as to the amount which should be left exempt from enforcement to allow the debtor to "pursue a normal course of business" under proposed Art. 32(3). For financially distressed companies, the difficulties in setting the level of exempted funds, illustrates itself the fact that the making of an EAPO is at odds with and could potentially derail an otherwise orderly restructuring. As drafted, this exempted level appears to be a “one size fits all” approach, determined by Member States, rather than by reference to the business or person affected, and the actual needs they have. As mentioned above, the issue of an EAPO will also act as a disincentive for lenders to advance further funds that may be necessary for a restructuring. This again supports the case for a wider exclusion to the application of EAPO to encompass debtors that are involved in formal and informal work outs.

The exclusion for insolvency proceedings

4.10 The Regulation applies to civil and commercial matters. As in Council Regulation 44/2001 (EC) (the "Judgments Regulation"), "bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, composition and analogous proceedings" are excluded from its scope. The precise scope of this exclusion is unclear. Presumably, it is intended to mean that EAPO applications against companies subject to formal insolvency proceedings are prohibited. However, the exclusion could also be interpreted as meaning that: (i) companies in insolvency proceedings could not apply for EAPOs against their own debtors; and/or (ii) an EAPO which has been granted falls away once formal insolvency proceedings have been commenced. In addition, the existing concerns regarding the interpretation of the Judgments Regulation exclusion would also be incorporated into the EAPO. The Regulation needs to be clear as to precisely how the exclusion for insolvency proceedings operates.

4.11 Even if the insolvency exclusion is not intended to prevent companies in insolvency proceedings from applying for EAPOs (and in our view it should not do so) one, probably unintended, consequence of importing the Judgments Regulation exclusion is that insolvency officeholders would not be able to obtain EAPOs to back up antecedent transaction or wrongful trading style

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2 The meanings of terms such as "debt restructuring negotiations" and "financial distress" could be discussed in guidance notes that would accompany the Regulation. And even now, there is no central register for European restructuring proceedings, even for formal proceedings under the European Insolvency Regulation (1346/2000).
actions. This is because, pursuant to ECJ case law, all matters directly derived from and closely connected with insolvency proceedings fall within the Judgments Regulation exclusion. Clearly in these types of cases, EAPOs may be a useful tool for an insolvency officeholder to have. Insolvent parties are, or can be, creditors or claimants too.

4.12 Another problem with the Judgments Regulation exclusion is that it is not always clear whether a formal reorganisation procedure would fall within its scope as it does not specifically refer to reorganisation measures. Illustrating this problem the position of schemes of arrangement is far from straightforward. Recent case law on the Judgments Regulation exclusion suggests a distinction between solvent and insolvent schemes and this position would also be applicable to the Regulation. This would mean that schemes of arrangement in respect of insolvent companies may fall within the insolvency exclusion and those companies would be protected from EAPOs while companies undertaking solvent schemes may not benefit from the exclusion and would be exposed to the risk of having their bank accounts frozen by an EAPO. Schemes in relation to distressed companies would likely be classed as solvent schemes given the view expressed in Rodenstock. In relation to administration proceedings, while there is no case law we are aware of, it is generally accepted that administration does fall within the Judgments Regulation exclusion as a judicial arrangement, composition or analogous proceeding. This view is strengthened by the fact that a court may only make an administration order if it is satisfied that the company is or is likely to become unable to pay its debts. We expect that administration proceedings would therefore fall within the exclusion in the Regulation, but it would of course be preferable to have this possible ambiguity cleared up while the Regulation is still in draft form. In relation to special insolvency and rescue regimes, such as the Special Resolution Regime created by the Banking Act 2009, the position may not be straightforward and should be clarified.

4.13 One possible solution would be to amend the Regulation so that all formal insolvency procedures (including schemes of arrangement in relation to insolvent and distressed companies) and all pre-insolvency restructurings (whether formal or informal) were carved out of its scope. The precise wording of such an exclusion would require detailed thought and negotiation. The formal insolvency proceedings set out in the appendices to the European Insolvency Regulation (1346/2000/EC) are perhaps not wide enough to address the business rescue concerns adequately.

Creditor rights

4.14 The Regulation does not provide sufficient certainty as to the legal effect of an EAPO on third party rights or how EAPOs will interrelate with creditor priorities in formal insolvency proceedings. Proposed Art.33 simply provides that an EAPO "confers the same rank as an instrument with equivalent effect under the law of the member state where the bank account is located".

4.15 In England, the "instrument with equivalent effect" is most likely a freezing order (although the wording "equivalent effect" is not entirely clear). An English freezing order does not confer a proprietary interest or any other form of priority on the applicant. A freezing order simply ensures that the assets remain where they are and are available, subject to previously existing rights of security over the assets and subject to priority claims, for the claimant to enforce against should it obtain judgment in the underlying action. By obtaining a freezing order, a claimant is not put in any better position than any other creditor, and the mere fact that the defendant’s creditworthiness is doubtful does not alone justify making the order. In other Member States it is possible that the grant of an EAPO would confer security or priority rights that would enable a claimant in effect to "jump the queue" ahead of other creditors. This would clearly be contrary to established principles of

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3 See for example Gourdain v Nadler [1979] E.C.R. 733 (Case 133/78) and Seagon v Deko Marty Belgium NV (Case 339/07).
4 [2011] EWHC 1104 (Ch).
5 It should be noted that the position in relation to the preservation of set-off rights as a matter of English law is not clear. Set-off is normally preserved by the terms of the freezing order rather than as a legal right, so it is possible that on the granting of an EAPO an English bank would lose its rights of set-off. Protection would need to be provided to prevent this risk.
insolvency law in the UK and it is not clear whether the UK would need to recognise these priorities nor how they might interact with insolvency proceedings commenced in the UK. Art.33 as currently drafted is liable to create significant difficulties in practice. One solution would be to provide that the granting of an EAPO will not confer any priority on the claimant (in any circumstances) and that an EAPO does not affect any existing third party rights, including security rights.

**Other points to note**

4.16 The Regulation creates a large number of other areas of concern. Among these concerns are: (i) that it is not clear conceptually how EAPOs could work in relation to bank accounts containing certain types of financial instruments or why EAPOs should apply to such a wide class of financial instruments; (ii) the application of EAPOs to joint and nominee accounts is not clear and, as a matter of principle, funds of third parties should not be caught by an EAPO; (iii) the lack of a mandatory requirement for a security deposit (or equivalent assurance) from the claimant will likely lead to inconsistencies between Member States that may prejudice defendants; and (iv) it is not clear how the proposed exemption in Art.32 will work in practice or whether each Member State will take the same approach as to the amount which should be exempt from the EAPO order.

4.17 It is also unclear how in practice the EAPO would operate where more than one bank account is sought to be frozen and how any necessary apportionment would take effect so as to avoid destabilising the business altogether. In addition, we also concur with the Government's observations that the provision of information on bank accounts is largely unworkable, onerous and costly and we think that there are serious issues about making such information accessible to anyone who has a potential claim against another party. It is not difficult to envisage that it could be exploited by the unscrupulous and potentially lead to abuse and fraud.

5. **Do you agree with the impact assessment? If not, please explain why.**

5.1 We have not considered the impact assessment in any detail.

6. **Are there any other specific comments you may wish to make?**

   **Scotland**

6.1 In Scotland, they already have the option of arresting bank accounts (etc) on raising a court action and that this is also readily available in support of foreign court actions. On a judgment being issued this "arrestment on the dependence" turns automatically into an "arrestment in execution" enabling the arresting creditor then to realise the arrested asset and providing the arresting creditor with a secured preference (which can sometimes be undermined by later insolvency proceedings). An arrestment on the dependence is probably available slightly more readily than a freezing order and, indeed, until a decision a few years ago which cast doubt on the compliance of the practice with the Human Rights Act, it was almost a matter of administrative routine to get warrant to arrest on the dependence in debt recovery actions. Now claimants have to show cause, but lately it has become increasingly common to be able to do this, and evidence of specific risks of fraudulent asset dissipation has retreated slightly.

6.2 Scots priority issues also raise concern: should an EAPO be given priority equivalence with an arrestment on the dependence (which seems inferred by the draft Regulation) and how would an EAPO interact with arrestments in execution and other proprietary interests (or arrestments on the dependence if not accorded equivalence)? Given the relative power of arrestment on the dependence, Scots lawyers would be reluctant to cede control of something equivalent to a foreign court on lightweight evidence of a claim - particularly if there isn't scope to object very quickly and effectively locally.
6.3 Scottish lawyers report that banks there are currently quite anxious about branches in far off parts of Scotland not knowing about arrestments served on head offices and paying out in ignorance. This anxiety will be multiplied with EAPOs being granted in far corners of the EU - though this is obviously part of the overall information and systems arrangements for EAPOs that banks will have to get used to and fund.

Other

6.4 The draft Regulation refers to “pecuniary claims”. The concept is not entirely clear. The Commission’s stated aim is to assist cross border debt recovery, but it is far from clear whether a pecuniary claim is limited to a debt or liquidated sum arising out of a consensual obligation, or if it is intended to cover unliquidated claims, including damages claims in tort as well as contract. If the EAPO is to freeze funds in an account for a specific figure, perhaps the better view is that unliquidated claims are not pecuniary claims.

6.5 As mentioned at 4.4 above, article 7 refers to the enforcement of an existing or future “title”. A claimant generally has no title to or other proprietary interest in any asset of a defendant, even when it becomes a judgment creditor. If this expression means a judgment or order, it ought to so say. In English, Irish and Scots law, the word connotes a proprietary interest, which is not the same as a judicial determination of an enforceable obligation.

ILA Technical Committee
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