HARMONISATION OF INSOLVENCY LAW IN EUROPE

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In April 2010, at the request of the European Parliament's Committee on Legal Affairs, a report was presented on the harmonisation of Insolvency Law at EU level.1 In the report disparities between several national insolvency laws are described, which can create obstacles, competitive advantages and/or disadvantages and difficulties for companies having cross-border activities or ownership within the EU. The core of the report is the display of a number of areas of insolvency law where harmonisation at EU level is worthwhile and achievable. The H-word (harmonisaton) has been avoided the last decade. Is any form of harmonisation possible?
Until at least a decade ago, the combination of "harmonisation" and "insolvency law" in Europe was regarded just as impossible as a combination of water and fire. Ten years ago, in the first edition of his book, professor Ian Fletcher concluded: 'National attitudes towards the phenomenon of insolvency are extremely variable, as are the social and legal consequences for the debtors concerned'.2 And eight years ago, when in 2002 the EU Insolvency Regulation came into effect, the Regulation expressly stated – in recital 12 – that the regulation is based on the acknowledgment of 'the fact that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening of proceedings would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors in the insolvency proceedings are, in some cases, completely different.' In the meanwhile it has been submitted that the 'chaos' of preferential rights and securities should be dealt with on a European level.3 In addition, the insolvency proceedings available, still differ to a large extent, be it that concepts of continuity (or 'corporate rescue') in Europe generally have found their legal form only since the mid 80s of last century.4

Does harmonisation has any basis in the TFEU?

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1 Available via: www.europarl.europa.eu/activities/committees/studies/searchPerform.do. The report was issued by INSOL Europe. Its authors are Georgio Cherubini, Neil Cooper, Daniel Fritz, Emmanuelle Inacio, Katarzyna Ingielewicz, Guy Lofalk, Myriam Mailly, David Marks Q.C., Anna Maria Pukszto, Barbara F.H. Rumora Scheltema, Robert Van Galen, Miguel Virgós, Bob Wessels and Nora Wouters. The views expressed here are my own and not necessarily those of INSOL Europe or the authors mentioned.

2 These words also appear in the second edition, see Fletcher, Insolvency in Private International Law. National and International Approaches, Oxford Private International Law Series, Oxford University Press, 2nd ed, 2005, 4.

3 See Drobnig / Snijders /Zippro (eds.), Divergencies of Property Law. An Obstacle to the Internal Market?, München: Sellier 2006. For a comparative overview, see Piekenbrock, *Insolvenzprivilegien im deutschen, ausländischen und europäischen Recht*, in: 122 Zeitschrift für Zivilprozess 2009-1, 63ff.

4 'Compared to U.S. bankruptcy laws, many countries' laws read like penal codes', is however still a recent observation of Martin, The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation, in: 28 Boston College International & Comparative Law Review 2005, 46.

At first, it should be noted that harmonization in the EU needs a solid basis in the Treaty on the Functioning of the European Union (TFEU). Indeed, Article 81 TFEU (the former Article 65 of the EC Treaty, provides in paragraph 1: 'The Union shall develop judicial cooperation in civil matters having cross-border implications, based on the principle of mutual recognition of judgments and of decisions in extrajudicial cases. Such cooperation may include the adoption of measures for the approximation (Dutch version: '*aanpassing*', meaning 'adaptation') of the laws and regulations of the Member States.' Does 'approximation' 'in civil matters having cross-border implication' include 'insolvency law'.? Recital 2 of the Insolvency Regulation expresses that its rules are needed to achive its objective (efficient proceedings) 'which comes within the scope of judicial cooperation in civil matters within the meaning Article 65 of the Treaty'. So 'approximation' includes forms of convergence or harmonisation on matters of insolvency law.
Now, let's leave aside differences (in 27 EU Member States) in historical, legal, economic and cultural contexts[5] and the differences in receptiveness of domestic legal systems to changes (IT, new ways of financing business, sales through internet, etc.). One distinction thought is notable. In the Member States, the goals of insolvency proceedings may differ, e.g. plain liquidation of assets or in addition reorganisation in an aim to rescue the enterprise and/or to preserve existing employment. Some insolvency law systems do not provide for insolvency proceedings for certain types of debtors or have (only recently) introduced specific proceedings, e.g. debt discharge proceedings for natural persons. Some cherish a strong system of security rights, others are open for certain limitations to their enforcement. Fletcher states: '… the dissimilarities are so numerous, and so substantial, as to oblige the realist to accept that the world essentially consists of separate, self-contained systems'.[6]

Common features of insolvency law

Nevertheless, during the last decade in legal literature some common features of insolvency law have been identified, which may be regarded as quite generally accepted prominent principles of insolvency law, such as the principle of collectivity, the notion of a common pool, the principle of equal treatment of creditors[7], the principle of respect for pre-insolvency rights and the idea of flexibility of insolvency legislation. Many countries have come to understand that the existing legal framework does not meet the challenge 'to achieve economic results that are potentially better than those that might be achieved under

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5 See e.g. Martin, Common-law Bankruptcy Systems: Similarities and Differences, in: 11 American Bankruptcy Institute Law Review 2003, 403; Efrat, Legal Culture and Bankruptcy: A Comparative Perspective, in: 20 Emory Bankruptcy Developments Journal 2004, 351; Smits, The Europeanisation of national legal systems: some consequences for legal thinking in civil law countries, in: Mark van Hoecke (ed.), Epistomology and Methodology of Comparative Law, Oxford: Hart Publishing, 2004, 229.

6 Fletcher, Insolvency in Private International Law. National and International Approaches, Oxford Private International Law Series, Oxford University Press, 2nd ed, 2005, 10.

7 See recital 21 to the Insolvency Regulation: 'Every creditor, who has his habitual residence, domicile or registered office in the Community, should have the right to lodge his claims in each of the insolvency proceedings pending in the Community relating to the debtor's assets. This should also apply to tax authorities and social insurance institutions. However, in order to ensure equal treatment of creditors, the distribution of proceeds must be coordinated. Every creditor should be able to keep what he has received in the course of insolvency proceedings but should be entitled only to participate in the distribution of total assets in other proceedings if creditors with the same standing have obtained the same proportion of their claims.'

liquidation, by preserving and potentially improving the company's business through rationalization'.8 Substantial revisions have taken place in countries like England and Scotland, France and Belgium and in 1999 Germany and Italy. Poland followed in 2003, Romania in 2003 (and 2006), Spain in 2004, France (again) in 2006 and Belgium (2009). In Germany a substantial revision is underway. Although even the more recent insolvency laws in several European countries continue to show substantial differences in underlying policy considerations, in structure and in content of these laws, in most of these jurisdictions there is openness towards corporate rescue procedures, which are an alternative to liquidation procedures. In many of these countries the US Chapter 11 procedure has served as a model for legislators.

Furthermore, several EU Member States' legislations contain proceedings – in addition to liquidation – which are based on the principle of a composition or an arrangement concluded between the debtor and his creditors, which is binding upon a (given percentage) of a dissenting minority of creditors (sometimes referred to as 'cram-down'). Characteristic feature for these types of proceedings, aiming at reorganization of the debtor's business, is the fact that attempts to restructure or reorganise enterprises only can be initiated by the debtor himself or at least not against his will. The traditional 'post-mortem autopsy' approach is, slowly, supplemented by instruments which allow for 'real time action' and domestic laws contain several proceedings which reflect different goals of a company in a rescue. For code-based nations the law wins as its functionality has improved. See for instance legislation in France, which came into force early 2006, which contains a *procédure de sauvegarde* in which the debtor is still solvent, but expects in the near future to be in financial trouble.

Also the approach, compared to some ten years ago, of states' attitude regarding cross-border insolvency cases has changed dramatically. Fletcher's observation of countries with 'separate, self-contained systems' has turned as far as cross-border insolvency problems are concerned into rules to coordinate these cases, e.g. within the EU since the adoption of the Insolvency Regulation in 2002, but also by creating rules which deal with these issues in relation to non-EU countries, sometimes (indirectly) inspired by the UNCITRAL Model Law (e.g. UK, Poland, Spain, Romania and Greece) or by introducing their own rules with comparable concepts (Germany and Belgium). This break through is the most significant development in the early 21st century.

Finally, renewed rules on accounting and reporting, increased attention for rules regarding integrity of corporate directors, elements of implemented good governance systems and improvements made to create an efficient framework of creditor protection against business risks (combatting late payments; improving wrongful trading rules) are just some characteristics of a 21st century commercial and corporate law in almost all well developed countries.9 To conclude, on several levels and in different forms several concepts and norms meet er even match.10

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8 Parry, Introduction, in: Katarzyna Gromek Broc and Rebecca Parry (eds.), Corporate Rescue. An Overview of Recent Developments from Selected Countries in Europe, The Hague / London / New York: Kluwer Law International 2004, 2.

9 See Kraakman (et al.), The Anatomy of Corporate Law. A Company and Functional Approach, Oxford University Press, 2004.

10 See further Bob Wessels, Europe Deserves A New Approach To Insolvency Proceedings, contribution to the Colloquium 'Two hundred years Commercial Code of Belgium', March 23, 2007, Brussels, Belgium, published in: A. Bruyneel et al., *Bicentenaire du Code de Commerce – Tweehonderd jaar Wetboek van Koophandel*, Larcier, Brussel, 2007, pp. 267-281. See also on tendencies of harmonisation Konecny, *Europäische Insolvenzkultur(en) – Kampf oder Harmoniserung?*, NZI 7/2008, 418ff., and Linna, Europeanization of

EU Insolvency Regulation contains bits of harmonisation

As explained, the EU Insolvency Regulation is drafted with the presumption that harmonisation of domestic rules relating to insolvency was impossible given the differences in substantive laws, including preferential rights. It should nevertheless be mentioned that several provisions of the Regulation are characterized as substantive rules and are therefore now accepted throughout Europe as unified rules concerning the topics to which they relate, see for instance Articles 7(2) (reservation of title), 20 (return and imputation), 29 (right to request the opening of secondary proceedings), 30 (advance payments of costs and expenses), 31 (duty to cooperate and to communicate), 32 (exercising creditors' rights), 33 (stay of the process of liquidation in secondary proceedings), 34 (measures ending secondary proceedings), 35 (assets remaining in the secondary proceedings), 39 (right to lodge claims) and 40 (duty to inform creditors). The EU Insolvency Regulation has taken account to these differences amongst others by introducing in Europe a miniature code of uniform conflict of law rules (Articles 4-15 InsReg).11

The UNCITRAL's Legislative Guide on Insolvency Law – a comprehensive exposition of the core objectives and the structure of an effective and efficient commercial insolvency system – has been assessed as a very helpful tool of best practices for legislators.12 An 'International Working Group on European Insolvency Law' (founded in 1999, representing 10 Member States) has studied the question how these differences can be reconciled with the ongoing economic integration of Europe, especially where the activities of companies that transgress national borders are regulated by European legislation. After thorough study it concluded that aforementioned diversities do not mean that national insolvency laws do not share common characteristics. These common elements were captured in the Principles of European Insolvency Law (2003). They are forteen in number, being presented as reflecting '….. the essence of insolvency proceedings in Europe as they reflect, on a more abstract level, the common characteristics of the insolvency laws of the European Member States'.13

Selected topics for harmonisation

In the light of all this, INSOL Europe – the european insolvency practitioners association – is of the opinion that the main problems emanating from the present system of unharmonised insolvency laws are that the laws of the member states contain:

Insolvency Law, in: Laura Ervo, Minna Gräns, Antti Jokela (eds.), Europeanization of Procedural Law and the New Challenges to Fair Trail, Groningen: Europa Law Publishing 2009, 151ff.

11 More general: Barnes, The Role of the European Union in the Harmonisation of International Private Law: A Theoretical Perspective, Cambridge Student Law Review 2009, 124ff.

12 See for instance Vallens, Towards an Ideal System, the UNCITRAL Guide on Insolvency Law, in: Peter / Jeandin / Kilborn (eds.), The Challenges of Insolvency Law Reform in the 21st Century. Facilitating Investment and Recovery to Enhance Economic Growth, Zürich: Schultess 2006, 489ff, and Klauser / Pogacar, *Der UNCITRAL Legislative Guide on Insolvency Law – Ein Denkanstoss auch für das österreichische Insolvenzrecht*, in: Konecny, Insolvenz-Forum 2005, Wien-Graz, 2006, 179ff.

13 McBryde / Flessner /Kortmann (eds.), Principles of European Insolvency Law, Series Law of Business and Finance, Volume 4, Deventer: Kluwer Legal Publishers 2003. For a short comment, see Wessels, Principles of European Insolvency Law, in: American Bankruptcy Institute Journal, September 2003, 28ff.

(i) different entry criteria (insolvency tests or requirements to start insolvency or reorganisation proceedings), different rules on who is allowed to file, different criteria on who can be a debtor, widely different goals of individual proceedings, different rules on the effect of the commencement of proceedings on the suspension of creditor's powers to assert and enforce their rights and e.g. on cooling off periods during insolvency proceedings;
(ii) different rules on the management of the insolvency proceedings, including (a) the powers of the insolvency office holder and the possibility to leave the debtor or the management of the debtor in possession of the assets, (b) the divestment of the debtor or the management of the debtor, (c) the degree of supervision of the insolvency proceedings by the court and/or other agencies, (d) the extent of the influence of the creditors on the insolvency administration, (e) the influence, if any, of the shareholders on the insolvency administration, and (f) the degree of transparency and accountability of the management of the insolvency administration;
(iii) different rules on the ranking of specific creditors, on the role of secured creditors, on set-off, retention of title, on creditors with the right of rescission, on the roles of creditors who are connected parties, on administrative expenses, whilst in the laws of many of these states different rules apply on the process of filing and verification of claims;
(iv) different rules on the responsibility for the proposal, verification, adoption, modification and possible contents of reorganisation plans including the adoption of such plans outside formal insolvency proceedings;
(v) different rules on the establishment of the insolvency estate, that is the scope of insolvency proceedings with respect to assets (e.g. which assets are included and which exempted from the proceedings) and on the management and disposal or sale of assets;
(vi) contain different rules on annulment of transactions which have been entered into prior to the opening of the insolvency proceedings (avoidance actions), on the periods during which such transactions can be liable for consideration for annulment and on the existence of special rules, if any, relating to the onus of proof where connected parties are concerned in the transactions in question, and on termination of contracts and mandatory continuation of performance under contracts;
(vii) different rules on practitioner's qualification and eligibility for the appointment as insolvency representative, different rules regarding licensing, regulation, supervision and professional ethics and conduct and different rules regarding the practitioners' fees and costs;
(viii) different rules on the liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor, different rules on the availability and modalities of post-commencement finance, whilst presently there are no rules on the coordination of insolvency proceedings with respect to different companies belonging to the same group of companies.

Harmonisation of substantive and procedural insolvency laws will, in the opinion of the report, be worthwhile, necessary and attainable, because the present system of different insolvency regimes often cause in a specific situation the laws of one member state to be more beneficial for one stakeholder and the laws of another member state to be more beneficial for another stakeholder. This may lead to 'insolvency tourism' (forum shopping) by the attempted shift of the centre of main interests of a company or a race to the courts in different jurisdictions, to the detriment of large groups of creditors or other stakeholders.14 A climax has been reached with Re Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC 3199 (Ch), of which it is entirely understandable that The Sunday Times, March 7, 2010,

14 See with regard to the *Schefenacker* case: Wessels, Corporate migration or COMI manipulation?, in: Ondernemingsrecht 2008-1, 28 januari 2008, pp. 34/35.

writes: “Firms flock to ‘bankruptcy brothel’ UK”15 and that in the English parliament concerns have been expressed about this form of “pre-pack tourism”.16

Moreover, harmonisation of insolvency regimes will lead to greater transparency and therefore to more predictability when negotiation agreements of financing of activities as well as a better grasp of all parties involved on the available means to address the needs of commercial entities that get into financial difficulty and of the remedies available to the creditors and other stakeholders of those entities. Finally, harmonisation of insolvency regimes will further a level playing field and will increase the efficiency of the insolvency and business reorganization processes in the EU and as a consequence, increase confidence that the commercial and financial sectors have in the efficiency of the legal-financial infra-structure of the EU.

With respect to some insolvency issues, the need for harmonisation is greater than for other issues. At present, INSOL Europe doubts whether full harmonisation would be attainable, but striving for partial harmonisation would be very worthwhile. The most important issues that could be included in the harmonisation would be:

(i) the responsibility for the proposal, verification, adoption, modification and contents of reorganisation plans;

(ii) avoidance actions including the provisions relating to connected parties;

(iii) rules on termination of contracts, in particular labour contracts;

(iv) rules on the coordination of insolvency proceedings with respect to different companies belonging to the same group of companies;

(iv) rules for practitioners and courts to communicate and coordinate insolvency matters having effects in two or more member states;17

One of the other sets of recommendations in the report relates to harmonisation of some of the company law provisions in the different EU Member States, subsequent to a harmonisation of substantive insolvency law. As a consequnce of the Cartesio case18 the reports submits that there is a need for harmonisation of company law in order to avoid national legislation preventing a company from transferring its operational headquarters from one EU Member State to another (where the company wishes to retain its registration in the first state) and restricting the right of establishment and or the right of liquidation. The report notes that traditionally insolvency laws are rather abstracted from the rules of company law applying to an insolvent company-debtor. Harmonisation of insolvency law, however, may have some effect on the further harmonisation of company law, in particular if the harmonisation includes: (i) rules on capital adequacy for the protection of creditor, (ii) a clear definition of the corporate interest of the individual company versus the group interest, (iii) the “collective” liability of directors and shadow directors in case of a negative equity, restructuring or insolvency situation, in line with the collective directors’ liability for the drafting and the publication of the annual report and accounts as provided in the Fourth and Seventh Company Law Directive, (iv) the liability/or rights of the shareholders in the event a company goes into a restructuring or insolvency situation, and (v) the rules on the lifting of the corporate veil, for example in case of abuse of company goods. In the report these topics are further elaborated upon.

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15 The Sunday Times, March 7, 2010, see www.timesonline.co.uk.

16 www.publications.parliament.uk/pa/ld200910/ldhansrd/text/100311-0002.htm#10031134000693.

17 The report also provides some recommendations concerning harmonisation of company law within the EU, in particular on the liability of directors, shadow directors and shareholders, rules on capital adequacy for the protection of creditors and rules on subordination of loans of shareholders.

18 C-210/06.

In conclusion, the H-word is out! What the next step will be is to be awaited. The recommendations of INSOL Europe seem modest, but in the light of history and the experience of any process of reviewing insolvency legislation sensible, meaning by baby steps.[19] What is needed for the first step in this area of law is genuine European legal scholarship, based on historic and comparative study.[20] As harmonisation is a continuous process, without a beginning or an end, the above reflects only the unsplit present.

[19] See for instance Block-Lieb and Halliday, Incrementalism in Global Lawmaking, Paper presented at the symposium 'Bankruptcy in The Global Village – The Second Decade, in: 32 Brooklyn Journal of International Law 2007, 851-903.

[20] In this way for the process of 'Europanisation' of contract law Reinhard Zimmerman, The Present State of European Private Law, 57 The American Journal of Comparative Law, Spring 2009, 479ff.