Towards harmonisation of transactions avoidance laws

Reinhard Bork outlines a proposal for a new Model Law and discusses the most important regulations

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The EU strives for the harmonisation of transactions avoidance laws. Based on the new Capital Markets Union Action Plan of 24 September 2020,[1] on 11 November 2020, the European Commission (EC) published the initiative "Increasing the convergence of insolvency laws", addressing (*inter alia*) the "conditions for determining avoidance actions and effects of claw-back rights".[2]

It is generally agreed that this is, in principle, a laudable endeavour. However, as early as October 2018, a proposal was presented to the academic conference of INSOL Europe in Athens to launch a research project on the harmonisation of transactions avoidance laws.[3] This proposal met with great approval from both academics and practitioners. It led to the formation of a working group composed of leading avoidance law experts from all EU Member States and the UK. The research project was massively supported by the German Research Foundation (*Deutsche Forschungsgemeinschaft*), the University of Hamburg/DE and the Radboud Business Law Institute of Radboud University Nijmegen/NL. The group was chaired by professors Reinhard Bork (Hamburg/Nijmegen) and Michael Veder (Nijmegen) – both INSOL Europe members – and has now finished its work by presenting to the European Commission a proposal for a Model Law comprising nine sections on transactions avoidance, intensively reasoned in the final report which will be published by the end of this year.[4]

The project aimed at elaborating a proposal for harmonising transactions avoidance laws in the EU Member States by presenting rules which should be implemented in all national insolvency laws in order to ensure legal certainty as to which transactions should (or should not) be challengeable in all Member States under the same conditions. It was drafted as an independent exercise, rather academic than driven by a political or interest group. That is why a Model Law and not a Directive was elaborated. Above all, the project was not concerned with identifying advantages or disadvantages of national laws but was rather aimed at finding recommendable solutions in the field of transactions avoidance law. The scope of the study was restricted to this special field of law, leaving aside other important topics (e.g. the definition of insolvency or the ranking of claims), although they are in interplay with the transactions avoidance law. Most importantly, the proposed Model Law is based on a "minimum harmonisation" approach. It seeks to unify the conditions for challenging typical cases with relevance for the internal market, such as payments or the establishment of security rights for creditors in the run up to insolvency, leaving stricter (i.e. more avoidance-friendly) rules to the discretion of the national legislators.

Principles

The central feature of the research project is its methodological approach. Although the members of the working group drafted extensive reports on their national avoidance rules, the analysis did not start with the national laws but approached the subject from a principle-based perspective.[5] For this reason, the principles – where "principles" are understood as fundamental and basic standards, i.e. as tenets rather than important topics or major issues – which support and shape the transactions avoidance laws were elaborated, the topics to be addressed from a principle-based

perspective were identified, and adequate solutions for every single topic were found by weighing and balancing the relevant principles involved.

The principles of transactions avoidance law can be identified in nearly all jurisdictions and can be grouped as *supporting* and as *restricting* transactions avoidance. Transactions avoidance is *supported* by the principle of best possible satisfaction of creditors' claims, the principle of equal treatment of creditors, the principle of collectivity, the fixation principle and the principle of efficiency. It is *restricted* by the principle of protection of trust, the principle of predictability (legal certainty), and the principle of proportionality.

How these principles operate can be illustrated with two examples. First, when dealing with the question as to whether the debtor's substantive insolvency at the point in time when a creditor is paid is a necessary prerequisite for challenging preferences, one should consider that the underlying principle for challenging preferences is the principle of equal treatment of creditors. This is a principle of insolvency law and cannot be enforced where the debtor is not substantively insolvent. Second, it follows from the principles of proportionality and protection of trust that a claim which was satisfied in a challengeable way must revive upon the return of the received, since the creditor must not be put in a worse position than he or she would be in without the voidable transaction.

Challenges

The working group met with some major challenges. The first was to get involved with the methodological approach, i.e. to take the principles of transactions avoidance law as yardsticks. This method was new territory for most members of the working group. Initially, it was met with scepticism, but in the end it was generally agreed that this approach was quite helpful for avoiding a battle of nationalisms and for agreeing on solutions based on common values rather than political compromises. Nevertheless, it was a second challenge not to discuss national laws and to "take off the national glasses". The third was to focus on the intended Model Law and thus on the main issues, leaving aside peculiarities of national laws such as the German rule on repayments to silent partners (§ 136 *Insolvenzordnung*) or the Polish rule on blatantly excessive contractual penalties (Art. 130a *Prawo upadło ciowe*). Finally, and this was the fourth challenge, discussing the proposed rules requires intensive examination of the rationale for every single norm. The explanatory notes need to be read in order to fully understand and appreciate the proposed Model Law.

The scope of this Model Law comprises classical insolvency proceedings. However, the rules may also be applied to restructuring proceedings provided they require the debtor's substantive insolvency (i.e. at least imminent inability to pay debts): transactions avoidance is a specific tool of insolvency law and cannot be applied without the debtor's insolvency.

As regards systematics, it was supported by the principle of legal certainty to distinguish general prerequisites from typical avoidance grounds and from the legal consequences. Transactions avoidance should only be possible where a legal act which was perfected prior to the opening of insolvency proceedings caused a disadvantage for the general body of creditors. Typical avoidance grounds are preferences, transactions at an undervalue, and transactions intentionally disadvantaging creditors. Regarding the legal consequences, not only the content of the avoidance claim needs clarification but also the corresponding rights of the opponent and third parties to which the opponent has transferred the received.

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Solutions

It is not possible here to describe the Model Law in its entirety and to explain the reasons for the solutions favoured by the authors. But three examples for controversially discussed topics may suffice.

First, concerning the term "transaction" (or "legal act" respectively), there has been intense debate in the working group regarding a restriction to transactions performed by the debtor exclusively as opposed to the inclusion of transactions performed by the opponent or a third party. A wide understanding, which would include satisfaction by individual enforcement, is supported by the principle of equal treatment of creditors, since it makes no difference – neither for the creditor nor for the estate – whether the benefitted creditor is satisfied by the debtor's payment or by individual enforcement.

Second, similar deliberations speak in favour of the inclusion of forbearance (omission). Again, it makes no significant difference whether a debtor (e.g.) actively waives a claim against his or her obligor or whether he or she remains passive and accepts the claim to become time-barred. The detriment to the general body of creditors and the advantage for the opponent is the same, since in both cases the value of the debtor's claim against the obligor cannot be realised. Hence, there is no justification, particularly not under the principle of protection of trust, to treat opponents who benefitted from the debtor's passivity better than those who benefitted from the debtor's active performance.

Third, it follows from the principle of collectivity that the main legal consequence is the opponent's duty to compensate the estate for the detriment caused by the voidable transaction. Under the principle of efficiency, the legal consequences must be shaped in a way that this objective can be reached as simply as possible. At the same time, the principle of legal certainty must be taken into account. This requires the legal consequences to be as predictable and clear as possible, which speaks against a rule that leaves the consequences to the discretion of the court or that provides for automatic nullity of the transaction ex lege. The principle of proportionality also has an impact, since the consequence should not put more burden on the opponent than necessary for compensating the estate for the disadvantage suffered. This compensation can be done in various ways: by returning an asset transferred by the debtor, by paying the amount of money the estate is lacking, by surrendering surrogates and emoluments, by waiving a right acquired from the debtor, or by simply ignoring the legal position which resulted from the challengeable transaction.

Next move

What happens next? Our proposal has been submitted to, and discussed by, the EC's Group of experts on restructuring and insolvency law (E03362).[6] They will probably give a recommendation to the Commission by March 2022. The Commission has scheduled a decision for the end of June 2022. They have the choice to propose a Regulation, a Directive, a Recommendation, or no action at all to the legislative bodies of the EU. In this context, it might be helpful that the research project comprises impact assessments regarding the consequences for national insolvency laws in case the Model Law should become the blue print for a Directive. These impact assessments would prove the feasibility of efforts to harmonise the transactions avoidance laws, based on the Model Law described here. However, the way to harmonisation is a bumpy road. Once the subject is out of the hands of academics and experts, other influences will gain weight. *On verra!* ■

Footnotes:

1 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - A Capital Markets Union for people and businesses-new action plan, Brussels, 24.9.2020, COM/2020/590 final, p. 13.

2 European Commission, Inception Impact Assessment Initiative "Increasing the convergence of insolvency laws", available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12592-Insolvency-laws-increasing-convergence-of-national-laws-to-encourage-cross-border-investment_en (last accessed 4 August 2021), at B.

3 See Reinhard Bork, *Clash of Principles: A New Approach to Harmonisation of Transactions Avoidance Laws?*, in: Jennifer L. L. Gant (ed.), Party Autonomy and Third-Party Protection in Insolvency Law (INSOL Europe 2019), p. 179-192.

4 Reinhard Bork/Michael Veder, *Harmonisation of Transactions Avoidance Law*, Cambridge/Antwerp/Chicago (Intersentia), 2021. The text of the Model Law is already available at https://www.intersentiaonline.com/

5 This method has been developed by Reinhard Bork, *Principles of Cross-Border Insolvency Law*, Cambridge/Antwerp/Portland (Intersentia) 2017, para. 1.1 et seq., 1.28 et seq., 1.35 et seq. and passim.

6 For this expert group, see https://ec.europa.eu/transparency/expert-groups-register/screen/expert-groups/consult?do=groupDetail.groupDetail&groupID=3362 (last accessed 4 August 2021).