Supporting the digital economy: The European perspective

In the second part to Rebecca Parry's article, here she looks at the issues from a wider European perspective

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The problem of insolvent digital service providers was highlighted in the previous part to this work. To recap, in recent years there has been increasing reliance by individuals, business and state bodies on digital services provided by nonstate firms.

As a result, there is the potential for individuals, businesses and state bodies to be vulnerable to the failure of such firms. In a case where a digital service supplier is insolvent without reorganisation prospects, a sudden shutdown would be potentially catastrophic for users. The recovery of content and sourcing of replacement services by customers takes time. Yet most insolvency laws are not equipped to enable a temporary continuation of supply by firms, with the focus instead being on enabling creditors collectively to recover what they can in rateable satisfaction of what they are owed.

This part will consider the issues from a wider European perspective, including how such cases might be handled in the absence of special legislative provision similar to that of the banks.

Handling major failures

Outside the banking sector, measures to handle major failures are largely lacking. There has been considerable focus in recent years on development of restructuring laws, but these tend to be limited in availability so that further losses are not incurred in futile rescue attempts. As a result, insolvency systems are seldom designed to enable a period of temporary ongoing trading in the interests of customers, as might be needed in the case of a failed digital service supply company.

In cases where some consideration is given under insolvency laws to the position of *stakeholders*, customers have not tended to be the focus of attention. For example, the EU Restructuring Directive in Recital 10 highlights that there should be dialogue with stakeholders in the event of a restructuring, particularly one of a major size with large impact and employee representation is mentioned but not engagement with customers. Recital 11 also notes that the digital dimension is growing ever stronger but does not contain any special means to enable this dimension to be handled. The same recital notes potential for "the so-called domino effect of insolvencies", but the paragraph as a whole mostly concerns cross-border aspects and the Directive does not contain any special tools for large scale insolvencies, including those of digital service providers.

There are occasional examples of more general tools that could be used to handle insolvencies with a wide public impact, although their potential application to digital service providers is unclear. Most active in this sector has been Italy which has had a special procedure, *amministrazione straordinaria*, for the extraordinary administration of large enterprises from as far back as 1979.[1] This 1979 law, popularly termed the Prodi Law, had been introduced to overcome the liquidation focus of existing law and enable continued operation of the enterprise and employment during the insolvency procedure whilst a plan was formulated. The procedure has been used in large-scale insolvencies in Italy and, rather than being under judicial control, the proceedings are at the discretion of state authorities. They must therefore tread a fine line under EU state aid rules and there have been modifications of the law in response to a ruling by the European Court of Justice. A special law was enacted in Croatia – *Zakon o postupku izvanredne uprave u trgova kim društvima od sistemskog zna aja za Republiku Hrvatsku* ("Act on Extraordinary Administration Proceedings in Companies of Systemic Importance for the Republic of Croatia".)

This legislation was enacted in response to the difficulties of Croatia's largest company, Agrokor, leading to the law being popularly termed "*Lex Agrokor*". Similar legislation was enacted in Slovenia for similar reasons: "*Lex Mercator*". These laws protect large scale enterprises but are not tied to any particular sector yet they also present potential state aid difficulties.[2] The UK is notable for having a wide range of special insolvency procedures that support continuation of supply of essential services in different sectors, often in industries that have been privatised,[3] although there is no provision for suppliers of digital services.

An exception, where consideration has been given to the position of insolvent digital service companies is Luxembourg. A first mover in efforts to create a robust and secure environment for cloud computing services, Luxembourg enacted an amendment to Art 567 of the Luxembourg Code de Commerce.[4] As originally enacted, this law enabled the recovery of goods entrusted to debtors upon the debtor's insolvency and, in 2012, it was extended to include intangible property, such as software, in recognition of the growing importance of cloud computing. Notably, however, whilst this law clarified property law entitlements of cloud service customers (which would hopefully be addressed expressly or impliedly in contract in other cases), it did not address the broader issue of how a service provider can be kept operating for long enough to enable those customers to recover that property.

Ad Hoc state intervention

Since jurisdictions typically have no special provision for cases involving failed digital service providers, it is likely that there would be reliance on other *ad hoc* means of state intervention to protect customers, notably provision of public funds. In this context, funds to enable a managed closedown in the interests of customers should be permissible under state aid rules, as rescue aid can be used to fund a liquidation.[5]

Since the need for temporary continued service arises in relation to digital service firms that are no longer viable and will exit the market, any support from the state ought not to distort competition nor impact on trade between member states.[6] Stricter conditions would of course apply, if the funds were used to prop up the digital service provider with a view to ongoing trading. Arguably, the protection of the service provided should be the key, rather than using public funds to prolong the entity of an ailing service provider.

Preferably, however, different industrial sectors should develop mechanisms to limit dependence on state finance. For example, travel organisers are required under the EU Package Travel Directive to carry insurance, so that customers can be reimbursed and, if need be, repatriated in the event of the travel organiser's insolvency. State finance can potentially act as a fallback for similar schemes, as a French state fund was recently approved as state aid to support insurers that provide this cover.[7]

The state aid in the French case was found to facilitate economic activities as well as to address a market failure, as there was a shortage of insurers and it was also held to be proportionate. There is therefore effective recognition that insolvent travel service providers can create difficulties for customers and state support for a robust system in place to mitigate these difficulties was permitted. The earlier part of this article considered other sectors where insolvency safeguards have been developed. A similar sectoral approach to digital service insolvencies could also be developed with a levy on service providers or through insurance and preferably such approaches should be considered in order that state bailout finance can be limited.

Conclusion

Aside from the banking sector, little consideration has been given to failures of wide public impact and this article considers only one potential hazard of this kind. Besides digital service providers, there are other nonstate providers of public services that could be at risk of failure and thought might be given from a sectoral perspective to how continued provision of service in such cases might be approached. As regards digital services, there is of course a need for a focus on failure prevention. Here attention is needed to both failure prevention safeguards among service providers and avoiding customer dependence on a single point of weakness. These prudential measures are not likely to eliminate insolvencies, however, and since the insolvency of a digital service supplier could have wide public impact, with damage to businesses and consumers as well as suppliers of state services, forward thinking is needed, again from a sectoral perspective. Examples such that of the travel sector indicate how customers might be protected whilst limiting the need for state finance. ■

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Footnotes:

1 Law no. 95 of 3 April 1979.

2 Case C-890/19 *Fortischem v Commission.*

3 For example, section 94, Energy Act 2011, supplemented by the Energy Supply Company Administration Rules 2013 (SI 2013/104), has been used in relation to energy suppliers in recent months. Similar provisions have been made in relation to e.g. railways, water, postal services, colleges, air traffic control and social housing.

4 Article 567, Luxembourg Code de Commerce, briefly evaluated by Vincent Wellens, "New Right to Reclaim Data from Bankrupt Cloud Computing Providers" (*International Law Office*, 28 June 2013).

5 Communication from the Commission — Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty OJ C 249, 31.7.2014, paragraph 55.

6 Article 107(1), TFEU.

7 European Commission, 'State aid: Commission approves €1.5 billion French scheme to support protection against the insolvency of travel organisers' (6 February 2023), available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_592. See also SA.63063 (2021/N) COVID-19: German Travel Insolvency Fund.