The EU Proposal for Insolvency Law Harmonisation: An Austrian perspective

Susanne Fruhstorfer and Andreas Howadt review the mixed feedback to the proposals in Austria

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A little more than two years after the initiative was announced, the European Commission published its proposal for a Directive harmonising certain aspects of insolvency law on 7 December 2022 ("Proposal").

The feedback from Austrian stakeholders so far has been mixed, to say the least, with one Austrian association for creditor protection – essentially watchdog entities participating in every Austrian insolvency proceeding – heading their press release with "No, thank you! EU Insolvency Directive to the Detriment of Austria".

Micro-enterprise insolvency

A particular opinion among Austrian stakeholders, regarding the proposed simplified procedure for micro-enterprises, is that there are significant issues. This criticism is particularly vehement, given that a large proportion of corporate insolvencies in Austria would potentially be affected by this. Statistics indicate that 90 % of debtors in Austrian insolvency proceedings concerning business entities would qualify as microenterprises (i.e. enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed € 2 million), which would make the proposed simplified proceedings likely to become the most widely used insolvency regime.

Under the Proposal, the objective for simplified proceedings is to ensure that "*microenterprises, even those with no assets, are wound up in an orderly manner, using a swift and cost-effective proceeding*".

In a commendable effort to reduce the costs of insolvency proceedings for microenterprises, the Commission has identified insolvency administrators as the biggest cost driving factor. It suggests that, in most cases, the lack of complexity of microenterprise proceedings does not warrant appointing an insolvency administrator. Consequently, Article 39 of the Proposal provides that insolvency administrators may only be appointed upon an application by either the debtor or a creditor and only if either the insolvency estate can fund the costs of the intervention of the insolvency administrator or the party requesting the appointment of an insolvency administrator bears the costs.

While it is true that the remuneration of the insolvency administrators is in Austrian insolvency proceedings the biggest part of the costs of the proceedings, the central mechanisms of the proposed proceedings appear to be mostly suitable for either softening the protection of creditors offered in current Austrian proceedings, or would, by virtue of forgoing the appointment of an insolvency administrator, significantly increase the workload of the insolvency courts.

Establishment of the Insolvency Estate

A central task of the insolvency administrator in Austrian proceedings is the identification and subsequent realisation of assets. According to Article 48 of the Proposal, the insolvency estate is to be "determined" by the "competent authority" (or the appointed insolvency administrator) on the basis of the list of assets submitted by the debtor and "relevant additional information received thereafter".

Practical experience thus far has shown that the information provided by debtors in insolvency proceedings is usually incomplete. This is, not only due to the fact that debtors strive to "keep" certain assets, but often also because they lack the legal knowledge necessary to determine what, if any, assets other than physical goods might exist.

In particular, with regard to claims resulting from violations of the strict Austrian capital maintenance rules (according to which a shareholder is only entitled to the duly determined annual profit and all other transactions must take place at arm's length), debtors (or rather their management) are usually reluctant to provide information that leads to the personal liability of shareholders or corporate bodies. Such claims are in practice only uncovered by the insolvency administrators.

Given that the individual creditor usually does not have the necessary information on the actual assets of the micro-enterprise in order to be able to make a reasoned assessment whether the application for an insolvency administrator - with the corresponding potential costs - makes economic sense for them, it seems rather unlikely that any individual creditor would apply for the appointment of an insolvency administrator.

In turn, this means that either the courts would have to take over the "research" carried out by insolvency administrators up to now, which is hardly feasible given their current (lack of) resources, or any assets the debtor is not willing to disclose would be left out of proceedings and consequently reduce the recovery rate of the creditors.

Avoidance actions

Avoidance claims often constitute a significant portion of the insolvency estate in Austrian insolvency proceedings. According to Article 47 of the Proposal, in simplified proceedings, it is essentially the creditors, or an insolvency administrator (to be appointed only in exceptional cases), who decide on the filing of avoidance actions. This means that – if no insolvency administrator is appointed, creditors have to assess (i) whether an avoidable transaction may have happened and (ii) whether recovery action makes economic sense.

The experience and legal expertise necessary to assess these questions is usually not available to creditors in insolvency proceedings. The creditors would therefore have to obtain and pay for outside counsel in most cases.

The proposal also does not provide any clear information on who will ultimately represent the insolvency estate in avoidance proceedings and finance the action for avoidance, if no insolvency administrator is appointed. Will this be creditors retaining legal counsel for that purpose? Will the insolvency estate end up paying for the avoidance action? What if the estate is not sufficient to pay for the fees and costs?

From the creditors' point of view, this seems to be a rather unsatisfactory solution. Up to now, the insolvency administrator - without additional costs for the creditors - has taken care of tracking down and - if reasonable - pursuing avoidance claims. Under the Proposal, creditors will have to examine avoidance claims themselves, at their own expense, or forgo the higher insolvency quota that might result from recovery actions.

Lodgement and admission of claims

Article 46 of the Proposal provides that only those claims filed by creditors that are not included in the list of claims submitted by the debtor are open to inspection by the court (or the insolvency administrator to be appointed, if any). The liabilities disclosed by the debtor himself would thus be recognised quasi automatically. This approach, however, disregards the fact that a protective mechanism for creditors is precisely the independent verification of claims whose acceptance would be in the interest of the debtor (such as subordinated shareholder loans).

Conclusion

In short, the procedure proposed by the Commission for micro-enterprises is a significant downgrade of the existing procedural system in Austria and could end up abolishing established mechanisms in Austria that ensure the balance of interests of all stakeholders. ■

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