Taking European insolvency law reform to the next level

Paul Omar traces the development of modern insolvency law developments from the inception from the Brussels Convention 1968 to the modern day

PAUL OMAR
INSOL Europe Technical Research Coordinator

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At its inception, the place of insolvency in the architecture of the European Community (later Union) was conceived of as being ancillary to the overall purpose of complementing (and completing) the four freedoms.

Judgments resolving commercial and contractual disputes would circulate in the European space and be recognised and enforced wherever debtors could be located. However, the Brussels Convention 1968, emerging out of a working party formed in 1963, excluded in its Article 1(2) the following: "*bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings*". Insolvency had been found to be more complex than at first thought, necessitating the formation of a further working party and some delay in its functioning, which led to a draft only appearing in the early 1970s.

The 1970s text contained jurisdiction and conflict of laws rules alongside a recognition and enforcement framework referring to the Brussels paradigm, as well as, perhaps surprisingly, a very brief Model Law focusing on harmonisation in targeted and discrete areas of family and property law. A later draft, produced in 1979, carried over the jurisdiction, conflict of laws and other procedural rules, but truncated further the scope of the Model Law, reducing its content to a presumption in connection with spousal property, set-off and retention of title. Alongside, but unrelated to all this, there occurred some legislative activity looking at the role of insolvency in connection with TUPE[1] and state guarantee schemes for employee wages.[2] Much of the outline of the framework known today, its definitions and structure, owe their genesis to the preparatory work culminating in the two drafts.

Competition: The race to legislation

At this point in the story, the European Community seemed to lose its way with insolvency, activity being suspended for over a decade, while a rival institution, often mistaken for it in popular minds, the Council of Europe, pushed for its own version that resulted in the Istanbul Convention 1990. Despite its lack of success, as the requisite number of ratifications necessary for it to come into force was never reached, its existence was sufficient to persuade the European Community of the need to continue work, which ultimately bore fruit in the shape of the European Bankruptcy Convention 1995. Alas, this too was doomed to failure, allegedly infected by the political tensions around the BSE[3] crisis that arose at the time.

Against the background of similar work by UNCITRAL building on the same set of definitions, concepts and architectural model, and that resulted in the Model Law on Cross-Border Insolvency 1997,[4] the dust had barely settled before Germany and Finland proposed a resumption of work in 1999. The preparatory work for the 1995 text simply ended up being recycled into the text of a Regulation that saw light in 2000.[5] By then, however, the Model Laws annexed to the first two drafts had fallen by the wayside and only the procedural aspects of insolvency jurisdiction, recognition, enforcement and coordination remained in the various texts that resulted, UNCITRAL's and the European Union's alike.

The proliferation of insolvency texts

Since that time, interestingly, insolvency texts have proliferated. UNCITRAL's work has seen the production of a Legislative Guide 2004, to which parts have been added over the years on enterprise groups, directors' liability in the twilight zone and insolvency for MSEs,[6] two further Model Laws on insolvency-related judgments (2018) and enterprise group insolvency (2019), the whole accompanied by a host of Guides to Enactment and a case-law repository illustrating the use of the 1997 text. Moreover, new projects are on the way in the fields of applicable law and asset-tracing and recovery.[7]

Other international organisations have not shied away from this area either, with the work they have undertaken resulting in the G22 Key Principles and Features of Effective Insolvency Regimes 1998, the World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights

Systems 2001 (revised 2015), the EBRD Core Principles for an Insolvency Law Regime 2004 (revised 2020)[8] and the World Bank-IMF Joint Initiative on Creditor Rights and Insolvency Standards 2005.

In the European Union, following on from the Best Project on Restructuring 2003, which examined the case for fresh starts, discharges and the attenuation of the stigma of bankruptcy, and set also against the background of reforms in the member states, the focus moved on quickly to the generation of new measures. These included Directives on the coordination of insolvencies of insurance bodies and credit institutions.[9] Moreover, in the wake of the ample case-law of the European Court of Justice (later CJEU) on the operations of the EIR, the ensuing review of the cross-border framework saw the production of a recast Regulation,[10] which added, *inter alia*, group insolvencies, virtual secondary proceedings and enhanced avenues of cooperation and communication to its diet.

Of note, none of these texts strayed much beyond procedural coordination with a template usually according primacy to the laws of a home state, but with carve-outs preserving competence in the case of key assets and transactions.

It is interesting that, at about the same time, the interest of the Commission narrowed in on the possibility of further harmonisation through its focus on the idea of upstream rescue. Based on a 2014 recommendation, the way was paved for a Directive embodying a preventive restructuring procedure for adoption by Member States.[11] The working group,[12] formed to move the project forward, did so on the basis that member states could "adopt or adapt", leaving the member states to determine how the procedure would sit within their domestic frameworks. Ostensibly a measure to further promote the formation of the Capital Markets Union ("CMU"), the PRD has pushed the envelope of what was seemingly possible further down the road towards harmonisation. No longer would the idea solely be about coordination of diverse procedures, but in fact would aim at the introduction of new ways of doing things.

The renewed quest for harmonisation

In the short period since the PRD was adopted, which has mostly been taken up with its implementation, ideas seem to have moved on considerably. The Insolvency III (or 3.0) Initiative[13] emerged through expansion of the same working group that laboured on the PRD. It operates on the assumption that efficient insolvency laws are one of the key criteria for cross-border investors. As such, discrepancies in national corporate insolvency laws (outside the banking sector) are recognised by many as potential obstacles to a well-functioning CMU. In this process, closer integration of insolvency law is believed ultimately to boost the European Union's capital markets and investor confidence in cross-border financing.

The proposals mentioned a number of areas of interest, including a definition of insolvency and entitlement to file for insolvency; the conditions for determining avoidance actions and the effects of claw-back claims; asset-tracing and recovery frameworks, including in the context of avoidance actions; a focus on directors' duties in the vicinity of insolvency; the position of secured creditors in insolvency and the right balance between secured creditors and the protection of other creditors (e.g. employees, suppliers); as well as the issue of court expertise and the training of judges.

More issues were added during the meetings of the working group, including a focus on pre-packs and special procedures for MSEs. The draft directive that emerged towards the end of 2022 contained a selection of these issues, but has not to date made sufficient progress such that enactment is guaranteed.

Is there a need?

Going back to the beginning, it was thought then that some harmonisation, but narrowly targeted, was desirable. Today, with the latest initiative, we are in the same position, albeit the list of desirables has increased and the rationale is now the completion, not of the Single Market, but of the CMU.

Whatever the "peg" on which this "coat" is hung, some questions remain:

- How far does/should insolvency take us down the road of European integration?
- What are the parameters (if any) of this process, particularly insofar as the scope and methodology of harmonisation are concerned?
- What are the strategic objectives of the process: modernisation pure and simple; building resilience into the framework to withstand future crises, such as the pandemic that has recently impacted economies globally, etc.?

These are issues that the contemporary literature begins to deal with, but that are not as yet fully answered.[14] That said, some support for the Commission can be gleaned from a survey conducted by CERIL in May 2023,[15] but there is still insufficient overall data on whether the proposals will necessarily lead to the objectives sought. Is it enough to believe, as the Commission clearly does, that the initiative will bear fruit? Only time will tell. ■

Footnotes:

1 Transfer of undertakings and protection of employment.

2 TUPE: Directive 77/187/EEC (now 2001/23/EC); state guarantee schemes: Directive 80/987/EEC (now 2008/94/EC).

3 Bovine spongiform encephalitis, also known as "mad cow" disease.

4 For this and other UNCITRAL texts mentioned here, see: https://uncitral.un.org/en/texts/insolvency.

5 Council Regulation (EC) 1346/2000 of 29 May 2000 ("EIR").

6 Micro- and small-enterprises.

7 See reports and papers from the 59th session onwards of Working Group V on insolvency at: https://uncitral.un.org/en/working_groups/5/insolvency_law. See also P. Omar and J. Gant, 'Observing at UNCITRAL: The Creation and Development of Insolvency Norms' (2023) *Eurofenix* (Autumn) 28.

8 See P. Omar, 'Cooperation with the EBRD: Advancing Insolvency Norms' (2023) *Eurofenix* (Spring) 30.

9 Insurance bodies: Directive 2001/17/EC (recast in Solvency II Directive 2009/138/EC); credit institutions: Directive 2001/24/EC.

10 Regulation (EU) 2015/848 of 20 May 2015 ("Recast EIR").

11 Commission Recommendation of 12 March 2014; Directive (EU) 2019/1023 of 20 June 2019 ("PRD").

12 The present author was a member of this group.

13 See: https://commission.europa.eu/strategy-and-policy/policies/justice-and-fundamental-rights/civil-justice/civil-and-commercial-law/insolvency-proceedings_en.

14 See E. Ghio, *Redefining Harmonisation: Lessons from European Insolvency Law* (Elgar, 2022).

15 See: https://www.ceril.eu/news/ceril-statement-2023-2-on-the-european-commission-proposal-for-a-directive-harmonising-certain-aspects-of-insolvency-law.

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