Consultation on a new European approach to business failure and insolvency

The Commission adopted in December 2012 measures to modernise insolvency rules in the EU: A Proposal for a Regulation amending the Council Regulation (EC) No 1346/2000 on insolvency proceedings and a Communication "A new European approach to business failure and insolvency".

Insolvencies are a fact of life in a dynamic, modern economy. Around half of enterprises do not survive the first 5 years of their existence, meaning that an average of 200,000 firms are going bankrupt across the EU each year, resulting in direct job losses of 1.7 million every year. Around a quarter of these bankruptcies have a cross-border element.

It is therefore essential to have modern laws and efficient procedures in place to help businesses, which have sufficient economic substance to overcome financial difficulties and to give a "second chance" to honest entrepreneurs. Procedures should be speedy and efficient, in the interest of both debtors and creditors, and should help safeguard jobs, help suppliers to keep their customers, and owners to retain value in viable companies. Giving honest entrepreneurs a second chance to restart viable businesses and safeguarding employment are key elements of the new European approach to business failure and insolvency. This approach aims to give a solid boost to European business in the internal market.

The European Parliament Resolution of November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law has identified situations where disparities between national insolvency and restructuring laws create obstacles, competitive disadvantages or difficulties for companies with cross-border activities or ownership within the EU. Such disparities could constitute obstacles to a successful restructuring of insolvent companies as a going concern. The Parliament Resolution asked for harmonisation of some aspects of national insolvency law. The main benefits expected from such harmonisation could be summarised as follows: Protecting the value of the assets of the estate, thereby returning greater value to creditors and shareholders; reducing the costs of the administration of the estate; increasing predictability on the parts of creditors and shareholders, thereby encouraging the provision of increased working capital, reducing the migration of financially troubled companies to other jurisdictions (so-called *"forum shopping")*; and offering benefits in other respects, such as the preservation of employment.

The Commission Communication of December 2012 highlights certain areas where differences between domestic insolvency laws may hamper the establishment of an efficient insolvency legal framework in the internal market. It seeks to identify the issues on which the new European approach to business failure and insolvency should focus so as to develop a rescue and recovery culture across the Member States. It also outlines certain benefits which the approximation of specific areas of national insolvency law could bring.

As stated in the Communication, the Commission intends to deepen its analysis of the impact arising from differences between national insolvency laws. To this end, a public consultation is launched to seek views from stakeholders on areas where approximation of national insolvency law could bring benefits.

Your answers to this questionnaire will help the Commission to determine in which areas of insolvency law there is a specific need for Union action and what would be the most suitable course of such action.

This questionnaire can be filled out online; you also have the possibility to upload a document with comments at the end of the questionnaire.

It is not necessary to answer all questions (with the exception of the background information).

Questions marked with an asterisk * require an answer to be given.

I. Background Information

This consultation is addressed to the broadest public possible, as it is important to get views and input from all interested parties

and stakeholders. In order to best analyse the responses received, there is a need for a limited amount of background information about you as a respondent.

Please indicate your role for the purpose of this consultation *

- ( ) Private individual or self-employed person
- ( ) Company
- ( ) Bank, credit institution or investment fund
- ( ) Judge
- ( ) Insolvency practitioner
- ( ) Other legal practitioner
- ( ) Business adviser or business support organisation
- ( ) Public authority
- ( ) Academic
- ( ) Other

Please indicate the size of your company: *

- ( ) large (more than 250 employees)
- ( ) medium (less than 250 employees)
- ( ) small (less than 50 employees)
- ( ) micro (less than 10 employees)

Please specify *

Have you had practical experience with insolvency proceedings and if so, in what capacity? *

- ( ) Yes
- ( ) No

If so, *

- as a creditor
- as an employee in a case of insolvency of my employer
- as an owner or director of an insolvent business
- as an over-indebted private individual or consumer
- as a judge
- as an insolvency practitioner
- as other legal practitioner
- as business adviser or business support organisation
- other

Please specify *

Please indicate the country where you are located *

- Austria
- Belgium
- Bulgaria
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Estonia
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Latvia
- Lithuania
- Luxembourg
- Malta
- Netherlands
- Poland
- Portugal
- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- United Kingdom
- Other

Please specify *

Please provide your contact information (name, address and email-address) *

II. Selected areas where the divergence of national law may create problems for the internal market

1. Second chance for entrepreneurs in honest bankruptcies

Lengthy and costly bankruptcy procedures can effectively limit a second chance. In many Member States, honest bankrupt entrepreneurs are usually subject to the same limitations as fraudulent entrepreneurs. This means that failed honest entrepreneurs often face not only the social stigma attached to bankruptcy, but also legal and administrative impediments to re-starting a business. Difficulties in finding financing for a new venture are considered as the main problem for re-starters. But those that attempt to re-start, learn from their mistakes and usually experience faster growth than newly established companies.

The Competitiveness Council in May 2011 invited Member States to promote a second chance for entrepreneurs by limiting, when possible, the discharge time and debt settlement for honest entrepreneurs after bankruptcy. The ‘honest’ failure is a case where the business failure was through no obvious fault of the owner or the manager, i.e. honest and above-board, contrary to cases where the bankruptcy was fraudulent or irresponsible. Today in jurisdictions where the concept of "fraudulent" failure is applied courts may consider a number of criteria for this purpose, such as, for example the transfer of debtor's assets to a tax heaven, an advance payment to a single creditor or excessive private expenses.

- ***Supportive measures to promote second chance***

The time it takes to close-down a failed business varies significantly throughout the EU, ranging from 4 months in Ireland to over six years in the Czech Republic. A long winding-up period can act as a deterrent for trying a new start. Fast-track procedures for honest entrepreneurs could remedy that situation. In addition, the stigma which is

attached to failure in many Member States often leads to discrimination against second starters, in particular in terms of access to finance and public procurement; discriminative practices against second starters should be reduced. Thirdly, second starters often lack targeted support for starting up a new business. Supportive programmes for starting up a new business should be available to honest bankrupts without treating those businesses more favourably than the non-bankrupt businesses.

Q1. Which of the following measures would you consider as the most efficient in order to reinforce a second chance for honest entrepreneurs?

- [ ] Eliminate stigma of bankruptcy and reduce discrimination of failed entrepreneurs if any
- [ ] Frame and apply "fast track" liquidation proceedings for honest bankruptcy
- [ ] Develop and expand programmes to mentor, train, advise and support second starters
- [ ] Other

Please specify

- **Discharge periods facilitating a second chance**

An important issue to support an effective second chance is the 'time to discharge', which is the time from when an entrepreneur enters into bankruptcy proceedings to when he can restart its business. A debt discharge is often regarded as crucial for the opportunity to restart. Currently, the discharge time varies greatly from country to country. In some countries, honest entrepreneurs in bankruptcy are automatically granted a discharge immediately after liquidation is finished. In others, bankrupted entrepreneurs have to apply for a discharge; and in yet others they cannot obtain discharge at all.
Member States agreed in 2011 on the need to harmonise the 'time to discharge' to a maximum of three years. Indeed it is crucial that entrepreneurship does not end up as a 'life sentence' if things go wrong.

Q2. Do you support the European objective to limit the discharge and debt settlement period to a maximum of three years in order to facilitate second chance?

- ( ) Yes
- ( ) No

Please justify

2. Conditions for opening insolvency proceedings

- ***Insolvency test and timeframe***

There are significant differences between the criteria for opening insolvency proceedings. In certain Member States, insolvency proceedings may be opened only for debtors that are already affected by financial difficulties and are insolvent. In others, proceedings can be opened for solvent companies that anticipate insolvency in the imminent future. Further differences may be found in insolvency tests (like the liquidity or balance sheet test) adopted in the laws of Member States. As a consequence, companies may have unequal chances to resort to restructuring proceedings at an early stage in order to resolve financial difficulties and avoid liquidation.

There are further divergences between Member States regarding the deadlines a debtor must meet when the opening of insolvency proceedings is mandatory - from two weeks to two months starting from different events. However the length of the timeframe may impact a debtor's ability to solve financial difficulties.

Q3. In your view, do the differences in national law for the opening of insolvency proceedings (insolvency test and/or timeframe) create problems for businesses operating in the internal market?

- Yes
- No

Please specify

Please specify

- ***Entities which are eligible as debtors and which can file for insolvency proceedings***

The laws of Member States differ on the possibilities granted to creditors to commence insolvency proceedings. Some jurisdictions limit the ability of a creditor to initiate insolvency proceedings against his debtor to certain types of proceedings or impose conditions, such as a minimum amount of the claim. The divergence of national law on the creditor's ability to commence insolvency proceedings may lead to situations where creditors are treated differently depending on the Member State(s) where insolvency proceedings are opened. In addition, some Member States grant specific public entities the right to request the opening of insolvency proceedings.

National law also differs when it comes to the ability of particular entities or persons to be subject to insolvency proceedings. For example, in some jurisdictions, it is not possible to open insolvency proceedings for individuals and small entrepreneurs. In others, public law entities cannot be subject to such proceedings.

Q4. In your view, does the divergence of national laws on the following issues create problems?

- [ ] The possibility for creditors to file for insolvency proceedings?
- [ ] the possibility of specific public entities to file for insolvency proceedings?
- [ ] The possibility to open insolvency proceedings against certain entities?
- [ ] No

Please specify

Please specify

Please specify

3. National legal frameworks for restructuring plans

The rules regulating restructuring plans (including contents and related procedural issues) have a crucial role in creating the conditions for successful restructuring in insolvency proceedings. Rigid and impracticable rules may hinder the chances of adopting a restructuring plan, leaving no alternative but to wind up a company. However national rules differ significantly as to the identification of the parties that can act as promoters of the plan. While the laws of Member States generally accept that the debtor and the liquidator may propose a restructuring plan, the rules on whether creditors may also propose the plan or influence its preparation vary. There are also major differences in the rules regarding the procedure for adopting the plan, including whether creditors are divided into classes (ordinary, preferred, secured creditors) and the required majorities for adopting the plan. National law also differs on the standards applied by the courts when approving the plan and the possibility to challenge such approval. Under some laws, the courts have wide discretionary powers, under other laws these powers are rather more limited.

Q5. In your view, is there a need to eliminate all or some of the divergences of national rules regulating restructuring plans?

- Yes
- No

Please specify

- The identification of the parties that can propose a plan
- The composition of classes of creditors
- The required majorities for approving the plan/voting rules
- The possible contents of the plan
- The criteria for apporving the plan by the supervising court
- The possibilities of appeal against a plan
- Other

Please specify

Please specify

4. Special arrangements for SMEs

Restructuring can be extremely costly for SMEs, so much so that often only bankruptcy is a viable option. Solutions should be found to lower restructuring costs for SMEs. Capped fees can be a solution. Alternative procedures should be put in place to make adequate solutions available for all types of SMEs. Procedures should be proportionate to the size of the business. Out-of-court procedures should be open to all types of debtors, regardless of the available funds. While the average time taken for out of court settlements is relatively short, the rate of success in achieving settlements is above 50% in most EU Member States. Even though in many Member States out-of-court settlements and pre-insolvency proceedings are recently introduced mechanisms, they are increasingly used by SME's in the EU.

More generally, the good administration of insolvency proceedings depends heavily on the efficiency and effectiveness of the work of the actors involved (courts, insolvency practitioners and/or other intermediaries).

SMEs can also be affected by economic difficulties as creditors. It is argued that micro businesses as creditors lose an unreasonable proportion of their outstanding claim in insolvency proceedings due to lengthy proceedings and national priority rules.

Q6. Does simplified and cost-efficient insolvency scheme for SMEs exist in your Member State?

- ○ Yes
- ○ No

If yes, do you have any comment or suggestion on how these schemes can be improved?

If no, has the absence of such schemes led to problems? Please specify.

Are you aware of any problems which SMEs as creditors encounter? If yes, please specify.

Q7. Are the following types of procedures available to SMEs in your Member State?

- ☐ Out-of-court settlement and voluntary arrangements
- ☐ Early warning systems and pre-insolvency proceedings
- ☐ Fast-track proceedings?
- ☐ Personal insolvency schemes and civil bankruptcy
- ☐ One-stop-shops with multidisciplinary competences to advise and help businesses in distress
- ☐ No

Q8. Which of the following aspects should be improved in view of making insolvency proceedings more efficient and effective for SMEs?

- [ ] the priority of claims?
- [ ] the costs of procedures (court fees, insolvency practitioner fees)?
- [ ] the efficiency and effectiveness of the insolvency practitioner?
- [ ] the efficiency and effectiveness of the courts and the interactions between courts and the parties?
- [ ] the efficiency and effectiveness of out-of-court procedures?

Please specify how this aspect should be improved from SME perspective.

If no, do you think they should be? Please specify

5. Status, power and supervision of liquidators

Under Regulation (EC) No 1346/2000, the liquidator has a key role in administering insolvency proceedings. The Regulation grants the liquidator in the main proceedings specific powers and imposes duties to cooperate and communicate information in cross-border proceedings. However, it is the State of opening of proceedings which determines the general powers of the liquidator as well as the requirements for his qualification, appointment and supervision. The proposal amending the regulation strengthens the powers and duties of the liquidator but the basic provisions concerning liquidators remain governed by national law.

The laws of Member States have different rules on the qualifications and eligibility for the appointment, licensing, regulation, supervision and professional ethics and conduct of insolvency representatives. The functioning of the single market may be hampered by this diversity. Some harmonisation in this area would support the idea of closer cooperation between the liquidators and enhance the comparability of the profession

Q9. Do you consider that the divergence of national laws with respect to the issues set out below has created problems in cross-border insolvency proceedings?

- [ ] the qualifications required of the liquidator?
- [ ] the procedure, if any, for his licensing?
- [ ] the eligibility criteria for the appointing as liquidator in a specific case?
- [ ] the conditions for dismissal of the administrator?
- [ ] the powers attributed to the liquidator?
- [ ] the rules concerning the supervision of the liquidator and the disciplinary regime, if any?
- [ ] the system of remuneration of the liquidator?

Please specify

Please specify

Please specify

Please specify

Please specify

6. Directors' duties and liability and professional disqualifications

- ***Directors' duties and liability in the vicinity of insolvency***

In a company, directors exercise corporate power. This power is generally balanced with duties of care or loyalty as well as a duty to file for insolvency or to cease trading when the company is encountering severe financial difficulties. Duties in the vicinity of insolvency exist in all Member States. Although the strategies to ensure that creditors' interests are properly taken into account in near-insolvent companies vary, these strategies seem to create similar incentives for directors. Problems have been identified in relation to the enforcement of directors' duties after the company has entered insolvency proceedings. Liquidators may lack incentives to pursue claims against directors; moreover, the costs and duration of court proceedings may deter liquidators from bringing liability claims.

Q10. In your view, are there problems with the enforcement of liability claims against the directors of insolvent companies within the EU?

- Yes
- No

Please specify:

A further problem relates to possible gaps in the liability regime. This problem is due to differences in the qualification of directors' duties in the vicinity of insolvency in private international law. These duties are partly classified as falling under insolvency law, partly as company law and partly as tort law. In a domestic scenario, all three sets of rules apply in a complementary manner. However, problems can arise if the company's registered office is located in another Member State than that of its centre of main interest (COMI) and insolvency proceedings are opened in the latter Member State in accordance with Article 3 of the Insolvency Regulation. In such a situation, the applicable insolvency law would be that of the Member State where insolvency proceedings have been opened, while the applicable company law would be that of the Member State where the registered office is located. This situation may invite regulatory arbitrage in the sense that directors may be tempted to incorporate their company in a State with a relatively lenient liability regime in its company law and move their COMI to a Member State with a relatively lenient liability regime in its insolvency law. Conversely, managers can be faced with contradictory liability rules if moving their COMI to another Member State because of the different liability regime applicable under local insolvency law (over-deterrence).

Q11. In your view, have the regulatory gaps in the liability regime outlined above led to any problems in practice?

- Yes
- No

Please specify (regulatory arbitrage, difficulties of compliance with divergent liability rules for managers, ...) and how should these problems best be solved?

Please specify

- **Professional disqualifications in the context of insolvency proceedings**

The disqualification of directors can create problems in a cross-border context.There is currently no rules at European level which ensures that managers who have been disqualified in one Member State, e.g. because of fraudulent behaviour, are prevented from setting up a new company or from being appointed as director of a company in another Member State. At present, it is not even ensured that a Member State has access to information about whether a director has been disqualified in another Member State when registering his new business activity.

Q12. In your view, is there a need to take action at EU level with a view to preventing disqualified directors from heading companies in another Member State?

- Yes
- No

Please specify

- by ensuring that information on national disqualification orders is available to the relevant authorities in other Member States?
- by ensuring that a disqualification order issued in one Member State is recognised in all other Member States?

7. Avoidance actions

The law governing transactions detrimental to the general interest of the creditors differ considerably between Member States. Differences concern first of all the conditions under which a detrimental act can be avoided and the interpretation given to these conditions by national courts. Thus, for example, while German law is comparatively “avoidance-friendly”, English law imposes relatively strict conditions for the avoidance of a transaction. National law also differs with respect to the period within which detrimental acts can be challenged. For example, under German, Spanish and English law, transactions with connected parties can be challenged if they took place two years prior to the opening of insolvency proceedings; this period is of three years in the Czech Republic and of five years in Estonia but only of three months in Hungary. Such divergence may be problematic because under Article 13 of Regulation (EC) No 1346/2000, a third party may object to an avoidance action on the basis that the law applicable to the transaction does not allow any means of challenging it. As a result, parties may be inclined to choose the law of a Member State for their transaction which least favours avoidance rights and the chances of successful avoidance may be reduced. While the evaluation of the Insolvency Regulation has not revealed any practical cases of abuse in this context, the theoretical possibility exists and may warrant Union action.

Q13. In your view, has the divergence within the EU of the conditions under which a detrimental act can be avoided created problems in practice?

- Yes
- No

Do you think that all or some of the conditions relating to avoidance actions, such as applicable time limits, should be harmonised? Please specify

III. Other Issues

Q14. In your view, are there any other issues where the divergence of national law creates problems for the internal market?

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