# **Insolvency Issues in the European Union**

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ABSTRACT: The material presents an analysis of the evolution of the insolvency approach at the level of the European Union as a result of the economic-financial crisis from 2009-2013 and beyond. As is well known, the Member States of the European Union have different legal systems, and their harmonization has been and is a desideratum of the management of this entity of public international law, but the practical materialization encounters a series of difficulties. Insolvency is an area of commercial law, and it has undergone a remarkable evolution lately, given on the one hand the evolution of the economy, but also the strong influence of Anglo-Saxon legislation that has proven to be much more effective. In practice. Hardly, but surely, the traditionalist legal systems for which bankruptcy is a punishment, have embraced the idea that a remedial bankruptcy is much more beneficial to the economy and have changed domestic law. At this stage, with similar domestic insolvency laws at Member State level, the European Union's leadership is in a position to adopt uniform and extremely useful rules for its economy.

KEYWORDS: insolvency, restructuring, second chance, honest debtor, risk prevention, debt remission

## **Short history**

At the level of the European Union leadership, more and more voices referred to the notion of insolvency, given the period of economic and financial crisis in 2009-2013.

Thus, Ms. Viviane Reding, former Vice-President and Commissioner for Justice of the European Union, pointed out the following: *Businesses are essential for creating prosperity and jobs, but it is difficult to set up a business and keep it afloat, especially in the current economic context. The insolvency rules we currently have need to be updated to help viable businesses facing financial difficulties stay afloat, instead of being subject to liquidation. Every year, due to insolvency proceedings, 1.7 million people lose their jobs. We want to give companies and the people they hire a second chance.* 

Mr. Antonio Tajani, another former Vice-President of the European Commission and Commissioner for Industry and Entrepreneurship, said: *We need to put in place an effective mechanism to differentiate between honest and dishonest entrepreneurs, which is essential to reduce the stigma currently associated with bankruptcy. (...) This distinction should eliminate discrimination against those entrepreneurs who they have gone bankrupt without committing fraud so that they can benefit from any market support available to start a new business.* 

On 12 March 2014, the European Commission adopted an Insolvency Recommendation, which was based on objective findings regarding the economic situation in the Member States of the European Union. It was based on public consultations held in 2013 on a European approach to insolvency and on a proposal to revise European Union rules on cross-border insolvency cases, which was approved in 2014 by the European Parliament. Thus, it was found that insolvency situations are an inherent component of a dynamic and modern economy. At European Union level, about half of the companies have a lifespan of less than five years and about 200,000 companies go into insolvency every year, ie about 600 companies every day. A quarter of these bankruptcies have a cross-border element, and their number is growing, doubling since the beginning of the economic and financial crisis, and this trend was maintained in 2014.

The European Commission Recommendation of 12 March 2014 established a set of common principles applicable to insolvency proceedings initiated at national level applicable to companies in financial difficulty. The aim of these principles was to focus more on encouraging the early restructuring of viable enterprises, thus preventing them from going into insolvency, than on liquidating those enterprises.

The European Commission aims to give viable businesses a chance to restructure and stay in the market. The recommendation of 12 March 2014 emphasized that the reform of national insolvency rules would be to the benefit of all parties, namely: it would allow viable companies to continue their work and protect jobs, while also creating a more favorable environment, for lending institutions, which could thus recover a larger share of the investment. Honest entrepreneurs who have gone bankrupt should be given a second chance quickly, as they have proven to be more successful a second time.

In conclusion, it was noted that it is essential to have modern laws and efficient procedures that allow companies with sufficient economic substance to overcome financial difficulties and have a "second chance". Insolvency practice has shown that the earlier companies in difficulty have the opportunity to restructure, the better their chances of survival (Bufan 2001, 31).

The European Commission's recommendation of 12 March 2014 helped to establish a coherent framework for national insolvency rules, requiring Member States to allow: facilitating the restructuring of companies in financial difficulty, at an early stage or before the start of the procedure insolvency officials and without establishing lengthy or costly procedures; enabling indebted companies to restructure their business without the need to officially start legal proceedings; allowing financially distressed companies to request a temporary grace period of up to four months (which can be extended to a maximum of 12 months), during which time they can adopt a restructuring plan before lending institutions may initiate enforcement proceedings against them; facilitating the process of adopting the restructuring plan, taking into account the interests of both debtors and creditors, so as to increase the chances of saving viable businesses; reducing the negative impact that bankruptcy would have on an entrepreneur's future chances of starting a new business, in particular by relieving them of debt within a maximum of three years.

European rules on cross-border insolvency were initially established by EC Regulation no. 1346/2000 on insolvency proceedings, which was replaced by Regulation CUE/EP no. 848/2015 on insolvency proceedings. This regulation contains rules on jurisdiction, recognition and applicable law and governs the coordination of insolvency proceedings opened in several Member States of the European Union. The Regulation applies when the debtor has a "commercial presence" or creditors in a Member State of the European Union other than his home Member State (Comşa 2017, 81).

In December 2012, the European Commission presented a package of measures to modernize insolvency rules. On 5 February 2014, the European Parliament voted in favor of the Commission proposal.

In parallel, the European Commission launched a public consultation in July 2013 on a European approach to business failure and insolvency, in order to gather views on key issues, such as the period required for debt relief, the conditions for initiation of insolvency proceedings, rules on restructuring plans and measures required for Small and Medium-sized Enterprises.

Several EU Member States have received recommendations in the context of the European Semester - the European Union's economic policy coordination cycle - and are invited to reform their approach to several aspects of national insolvency systems (such as: Spain, Latvia, Malta and Slovenia).

Other Member States of the European Union have started the process of reforming national legislation to improve the chances of rescuing companies in financial difficulties, to

reduce the debt relief periods granted to entrepreneurs or, more generally, to improve their framework insolvency law (such as the Netherlands, Poland, Latvia, Cyprus, Estonia, Croatia and the United Kingdom).

Given that the American model of insolvency prevention and insolvency proceedings has become increasingly entrenched in the Member States of the European Union and has contributed to the recent significant change in domestic law, even in European countries where the legislative tradition in this matter seemed unchanged, we appreciate that in the field of insolvency a unique legislation can be foreseen at the level of the European Union, in this sense an integrated community legal order can be achieved (Ispas 2011, 39).

### Legislative coordination by the World Bank and the International Monetary Fund

In 2013-2014, the World Bank assessed the legal framework applicable to insolvency and the rights of creditors / debtors in Romania based on a joint initiative of the International Monetary Fund with the World Bank on compliance with standards and codes, based on World Bank Principles on Insolvency Efficiency and Creditors' Rights Debtors.

This evaluation materialized through the elaboration of the ICR - ROSC Report, and it aimed at a broader legislative framework regarding the crediting of enterprises.

In this report it was noted that the Romanian authorities, in the last 20 years, have made progress, including by taking over and implementing European regulations.

Regarding the legal framework of insolvency in this evaluation report (part C of the report) it was noted that the Romanian insolvency law provides a relatively comprehensive and modern legal framework, which would still lead to improvements in several respects. The legal framework applicable to insolvency proceedings includes legal rules designed to prevent the improper use of the insolvency system by both the debtor and the creditors, respectively to avoid fraud in law, and to avoid the premature dismantling of the debtor's assets.

This report highlighted that the draft Insolvency Code, which was adopted by Law no. 85/2014 on insolvency prevention and insolvency procedures, took over the UNCITRAL model on cross-border insolvency, and the EU Regulation on insolvency proceedings is directly applicable in Romania.

This report concluded that the Romanian legal system on insolvency and creditors' rights has been significantly reformed, and is now a modern and comprehensive system. A sound legal system on creditors' and insolvency rights is an essential element of any market economy, and its role is extremely important in times of financial crisis (Fuerea 2006, 131).

A well-thought-out insolvency system can provide companies facing financial difficulties with the necessary resources to restore economic order, thus maximizing their value by continuing to operate and maintaining jobs (Bufan 2012, 65). It also facilitates a homogeneous relocation of resources for more productive use for companies that cannot become profitable again through restructuring. The predictability of an efficient insolvency system and improved procedures for setting up, registering and enforcing creditors' collateral help to increase the confidence of credit providers, leading to lower lending costs, especially for Small and Medium-sized Enterprises (Adam 2014, 117).

The report found that although there are a number of credit instruments in Romanian domestic law, "uncertainties" remain regarding the treatment of the property reserve clause and many "weaknesses" regarding the establishment of mortgages. Regarding the institution of the property reserve, it is regulated in the Romanian Civil Code contained in Law no. 287/2009 implemented by Law no. 71/2011, within the contract of sale, respectively when transferring the property or the right sold. The reservation of title is a form of guarantee of the obligation to pay the price for the good sold by the seller to the buyer.

With regard to the reservation of title, it was noted in the report that although by contract one of the parties may reserve ownership of some goods, transferring only possession

to the other party, the sale of the property by the buyer to a bona fide third party has the effect transfer of ownership. In the case of insolvency of the person who owns the property, respectively the buyer, the effectiveness of booking the property for the seller is low.

The report also found that the implementation of European Union regulations (Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions) on late payment had a beneficial effect, in particular on the chash-flow.

Romanian law supports the use of a wide range of lending methods, including the establishment of personal guarantees and guarantees on the debtor's assets, with or without dispossession, either fixed or variable, on a mass of movable or immovable property, including the entire property of an enterprise.

The report also noted that at European level there are opinions in the sense that the new Romanian Civil Code combined several doctrines, which were originally intended to ensure consumer protection and not commercial entities that trade from comparable positions on the market. According to these opinions, the new Romanian Civil Code contained too many provisions in favor of the debtor, such as the invalidation of the contingency clauses. The rules originally designed to protect consumers are inexplicably applicable to large commercial enterprises as well.

The report showed that Romanian legislation suffers from a "critical fragility" in terms of informal culture of reorganization and treatment of non-performing loans (Dinu 2014, 732). The insolvency code, however, tries to solve several of the problems that have arisen in the field of insolvency. The financial sector would be strengthened by implementing reforms in insolvency law, pre-insolvency measures and risk management, which could help reduce / eliminate non-performing loans.

The development of the private sector can be accelerated provided that a coherent and well-implemented insolvency system is able to ensure the efficient management of companies in financial difficulty, their wealth is maximized, resources are used properly, and jobs to be maintained.

An efficient insolvency system, improved procedures for setting up, rating and enforcing creditors 'guarantees would help increase creditors' confidence, while simultaneously reducing credit costs and attracting investment into the economy.

The report concludes that the essence of insolvency law is to strike a balance between debtor and creditors. Thus, insolvency law must establish both collective rights for creditors and individual rights for creditors. The debtor must have access to the rights conferred by law and not be able to be stopped by creditors through hidden procedures, respectively by exercising procedural rights in bad faith. The bad faith debtor must be sanctioned, and creditors who trust the honest debtor must be given individual compensation.

## The evolution of European Union insolvency law

On December 18, 2018, the Council of the European Union, at the level of ambassadors, announced that the European Union will adopt new rules on corporate insolvency, the message being to give a second chance to bankrupt entrepreneurs with a good reputation. This facilitates the access of viable enterprises facing financial restructuring frameworks at an early stage to prevent insolvency.

The Council of the European Union has reached an agreement with the European Parliament on the adoption of a Directive on preventive restructuring frameworks, second chances and measures to increase the efficiency of restructuring, insolvency and debt remission procedures. The overall objective of the text is to reduce the most important barriers to the free movement of capital resulting from differences between Member States in restructuring and insolvency frameworks and to strengthen the culture of rescuing companies in the EU. In addition, the directive also aims to reduce the volume of non-performing loans in banks' balance sheets and prevent their accumulation in the future. The proposal thus seeks to ensure an appropriate balance between the rights of debtors and those of creditors (Gavrilescu 2020, 1).

Mr. Josef Moser, Austria's Justice Minister, said: Every year, 1.7 million people lose their jobs because their business goes bankrupt. Consequently, we need strong EU-wide insolvency rules to reduce bankruptcies and ensure that reputable entrepreneurs have a second chance. I am glad that we have reached an agreement with Parliament so quickly that the new rules can be adopted before the European elections.

Thus, Directive No. 1023/2019 on frameworks for preventive restructuring, debt remission and forfeiture was adopted, as well as measures to increase the efficiency of restructuring, insolvency and debt remission procedures and amending EU Directive no. 1132/2017. Member States of the European Union have two years from the date of publication in the Official Journal of the European Union to implement the new provisions, but in duly justified cases they may request an additional year from the Commission for implementation, the deadline being 17 July 2021.

The content of the Directive was achieved by analyzing comparative studies of applicable European insolvency laws that have promoted a culture of rescue, taking into account the importance of implementing insolvency prevention procedures. A source of reference inspiration was an American legislation, which was the basis for the elaboration of the UNCITRAL Legislative Guide "Directors' obligations in the period approaching insolvency". The challenges involved in adopting the directive were presented at the Academic Forum "Harmonization of Insolvency and Restructuring Laws in the EU" at Insol Europe, held in Copenhagen in September 2019 (Miloş and Diaconescu 2020, 2).

The Directive requires the adoption of rules on: preventive restructuring frameworks that may be used by debtors in financial difficulty when there is a probability of insolvency, in order to prevent insolvency and ensure the viability of the debtor; the procedures leading to the remission of the debt incurred by insolvent entrepreneurs; and measures to increase the efficiency of restructuring, insolvency and debt relief procedures.

Preventive restructuring frameworks must enable debtors to restructure effectively at an early stage in order to avoid insolvency, thus limiting the unnecessary liquidation of viable companies.

A number of debtors are excluded from the scope of the Directive, such as: insurance undertakings or reinsurance undertakings; credit institutions; investment firms or collective investment undertakings; central counterparties; central depositories of securities; public bodies set up under national law and natural persons who are not entrepreneurs. However, it is possible to apply the provisions of the Directive in the case of convictions for serious breaches of accounting obligations.

The main measures proposed by this Directive are: ensuring early warning means and access to information; strengthening preventive restructuring frameworks; facilitating negotiations on preventive restructuring plans; encouraging extrajudicial proceedings, streamlining restructuring plans; suspension of individual forced executions; continuation of ongoing contracts; debt remission and cessation of forfeitures; protection of new and interim funding; streamlining insolvency proceedings.

Theoretical standardization has required the concentration and approximation of regulations in national legislation that have proven to be the most effective in preventing and giving a second chance to viable entities. In practical terms, the process of standardization will continue even after the transposition of the provisions of the directive into the domestic law of the states (Ogarcă 2011, 91). The divergences of approach to the problems in economic and social plan will also generate specific difficulties of legal treatment, with implications of the deepest in the plan of transposition.

### Conclusions

Insolvency is a mixed field, summing up an economic part, a legal part and a social part. The success of insolvency proceedings contributes to the efficiency of resources, especially financial resources, but also to ensuring a social balance. From this perspective, in order to ensure a stable economic and social environment at the level of the European Union, a more rigorous coordination of the legislation has been tried, but its efficiency is to be verified in time, during its application.

Personally, I consider that one of the problems of applying European Union law is its knowledge in a broad, correct and complete way at the level of law practitioners in the Member States (judges, lawyers, insolvency practitioners, experts, but also economic agents). The prioritization of the legal norm in European Union law is not always ensured even by the legislature of the member states, but also by the courts of the member states.

Despite all these difficulties, the field of insolvency at EU level has an important evolution, taking into account the necessary coordination from the international institutions, which is more strongly felt in times of crisis.

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