

PRINCIPLES OF EUROPEAN INSOLVENCY LAW-1445 wds

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The Council Regulation (EC) No. 1346/2000 on insolvency proceedings in Europe entered into force May 2002. The Regulation, direct binding for 14 Member States, merely deals with issues of jurisdiction and the recognition of insolvency proceedings, opened by a court in another Member State and other related judgments. The law of the Member State of the opening of the proceedings (*lex concursus*) determines all procedural and substantive effects of the insolvency proceedings in the EU community. To protect legitimate expectations and the certainty of transactions in Member States however a number of exceptions to the general rule of applicability of the *lex concursus* have been made. The Regulation is limited in its scope.¹ Why didn't Europe devise a single exclusive universal form of insolvency proceedings for the whole of the Community? The answer is: diversity. It has been felt too difficult to implement a universal proceeding without modifying, by the application of the law of the State of the opening of proceedings, pre-existing rights created before insolvency under the different national laws of the Member States. The main reason lies in the absence of a uniform system of security rights in Europe and in the great diversity of national insolvency laws as regards criteria for the priority to be given to the different classes of creditors. In fact, basic elements of a countries' insolvency law framework still differ widely from country to country, even in legislation that has been revised in the last decade, like in France and Belgium and – in 1999 – in Germany² and Italy. Both England and Scotland have substantially revised its insolvency laws, and Spain and Poland are expected to follow this year, while The Netherlands a substantial revision is underway. Nevertheless, some Member State provide for a variety of insolvency proceedings (e.g. Denmark, England, Italy, Netherlands, Scotland) often laid down in several different statutes and regulations, where other countries have only one (comprehensive) proceeding (e.g. Germany, France). To give an impression: the EU Insolvency Regulation coordinates 54 types of proceedings. A principle difference furthermore is the scope of application. In France and Belgium for instance insolvency law applies only to debtors with commercial or professional activities, but in England, Germany and the Netherlands insolvency law applies in principle to all type of debtors, be it that the last two countries treat the insolvency of e.g. banks and insurance companies quite differently.

The International Working Group on European Insolvency Law has concluded that it is remarkable that even the more recent European insolvency laws continue to show substantial differences in underlying policy considerations, in structure and in content. The Working Group is founded in 1999, consists of an academic group of fifteen professionals, originating from ten EU countries³, and is chaired by Sebastian Kortmann (University of Nijmegen). The Group has studied the question how the aforementioned differences can be reconciled with the ongoing economic integration of Europe, especially where the activities of companies that transgress national borders are regulated by European legislation. It holds the view that the

¹ See: Bob Wessels, European Union Regulation on Insolvency Proceedings, in: ABI Journal, November 2001, p. 24/25, 31; Gabriel Moss, Ian I. Fletcher, Stuart Isaacs (eds.), The EC Regulation on Insolvency Proceedings. A Commentary and Annotated Guide, Oxford University Press, 2002, and Bob Wessels, European Union Regulation on Insolvency Proceedings: An Introductory Analysis, 2003 (published by the American Bankruptcy Institute).

² See: Ziechman, Business Bankruptcy in Germany, 1997, published by American Bankruptcy Institute.

³ Belgium, Denmark, England, France, Germany, Italy, Luxembourg, The Netherlands, Scotland, Spain. EU-Member States Austria, Finland, Greece, Portugal and Sweden are not represented.

development of a European market requires (i) an understanding of the differences between legal systems, (ii) a move towards uniformity in legal terminology and concepts and (iii) the avoidance of diversity resulting from a lack of knowledge about other European jurisdictions. Even though the idea of establishing in the short term one single universal insolvency proceeding for the entire European Union may perhaps seem illusive, the Working Group concluded that this does not mean that national insolvency laws do not share common characteristics. These common elements have been captured in the *Principles of European Insolvency Law*, that have been presented in Brussels in June. The Principles are the result of looking beyond and behind these differences in structure, scope, concepts and formulation. The Working Group presents the Principles as ‘..... the *essence* of insolvency proceedings in Europe as they reflect, on a more abstract level, the common characteristics of the insolvency laws of the European Member States.’ The other aim of the Principles is to provide a foundation for greater harmonization.

The Working Group has spelled out fourteen Principles which deal with the following topics:

- § 1 Insolvency proceeding
- § 2 Institutions and participants
- § 3 Effects of the opening of the proceeding
- § 4 Management of the assets
- § 5 Obligations incurred by, and fees of, the administrator
- § 6 Treatment of contracts
- § 7 Position of employees
- § 8 Reversal of juridical acts
- § 9 Security rights and set-off
- § 10 Submission and admission of insolvency claims
- § 11 Reorganization
- § 12 Liquidation
- § 13 Closure of the proceeding
- § 14 Debtor in possession

The Principles are followed by a General Commentary.⁴ It starts with a brief introduction to the problem, followed by an explanation of the Principle itself. The Commentary does not provide exhaustive comparative reflections, but sketches in charcoal with references to approaches and solutions of national insolvency law systems. It furthermore indicates where these systems substantially deviate from a particular Principle and refers, where appropriate, to articles of the EU Insolvency Regulation.⁵ The Principles focus mainly on business insolvency, do not deal with insolvency proceedings concerning e.g. insurance undertakings and credit institutions, do not address voluntary debtor-creditor-arrangements (‘work outs’) outside insolvency law, do not include obligatory information systems which have been set up in some countries and do not address the issue of liability of directors and shareholders, as the grounds of liability can be manifold and vary from country to country.

The Commentary is followed by ten National Reports. These reports are all structured in more or less the same manner and contain information on the most important types of insolvency proceedings, the players (institutions and participants involved in these proceedings), the protective effect of insolvency proceedings, the position of creditors and other important issues such as the reversal of juridical acts, set-off, the effect of insolvency on existing contracts and the adoption, contents and effects of reorganization plans and compositions. These National Reports are written with admirable oversight and clarity. The Principles, with its Commentary and the National Reports, here serve two other aims. They will enable lawyers with different national backgrounds to better understand the existing systems of

⁴ Written by professors McBryde (Scotland) and Flessner (Germany).

⁵ The EU Insolvency Regulation has chosen – not unquestionably – to refer to the ‘liquidator’ a the person who administers or liquidates assets. The Principles use the term ‘administrator’.

insolvency law in Europe.⁶ With the coming into effect of the EU Insolvency Regulation there clearly is a need to understand the insolvency laws of the Member States better. It therefore may be regretted that the publication⁷ lacks reports from Austria, Greece, Finland, Portugal and Sweden. The Working Group furthermore aims to provide working material for further study, which could result in proposals for legislation on a supranational level and – in the shorter term – provide support in the efforts to modernize national insolvency laws by serving as a European framework. I think that this goal could be extended to those European countries that will join the EU in the coming years.

The columns of this Journal do not allow to further expand on the contents of the Principles. It may be noted however that Principle 14 recognizes the DIP principle, where according to the Commentary every jurisdiction covered nowadays provides for an alternative, next to the classic insolvency (liquidation) proceeding, where the debtor is left in possession during a reorganization of his liabilities.

The Principles, although limited in scope and concerned countries, are a first attempt to tackle an area of (international trade) law which is of great commercial importance. After several decades of discussion and studying the differences some would never have thought that common foundations in Europe in this domain could be revealed. As this is a modest attempt for some design in the present European insolvency hodgepodge the Working Group has taken the realistic approach not to provide model provisions for a national legislations, as currently is underway in the project of UNCITRAL's Legislative Guide on Insolvency Law. On the other hand the Group does not shy away to mention the C-word in that it refers to a 'European Insolvency Code'. It recognizes that the Principles do not try to reflect the ideal rules for such a Code, but the Group is firm in its belief that the Principles state the areas of conformity and divergence and may thus be helpful when such a Code should come on the agenda. In the much shorter term the Principles, its Commentary and the National Reports provide scholars and practitioners with a much needed *catalogue raisonné*, bringing to the surface common foundations, policies and effects in constituent parts of Europe's insolvency law.

⁶ In this aim one can recognize the result of the approach chosen by American Law Institute (ALI) to describe, although much more extensively, the Bankruptcy Laws of Canada, Mexico and USA, in: *Transnational Insolvency: Cooperation Among the NAFTA countries*, Juris Publishing, Inc., Huntington, NY, 2003 (4 Volumes).

⁷ W.W. McBryde, A. Flessner and S.C.J.J. Kortmann (eds.), *Principles of European Insolvency Law*, Series Law of Business and Finance, Volume 4, Kluwer Legal Publishers, Deventer, The Netherlands, 2003; ISBN 90 130 0597 7. The text of the Principles of European Insolvency will be posted on the website of International Insolvency Institute (www.iiiglobal.org).

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(Source: W.W. McBryde, A. Flessner and S.C.J.J. Kortmann (eds.), Principles of European Insolvency Law, Series Law of Business and Finance, Volume 4, Kluwer Legal Publishers, Deventer, The Netherlands, 2003; ISBN 90 130 0597 7).

§ 1 **Insolvency proceeding**

§ 1.1

In an insolvency proceeding ('proceeding') the assets of an insolvent debtor are collected and converted into money to be distributed among the creditors ('liquidation'), or the liabilities of an insolvent debtor are restructured in order to re-establish the debtor's ability to meet liabilities ('reorganisation'). The proceeding can be a combination of liquidation and reorganisation.

§ 1.2

A proceeding can be opened when the debtor is unable or is likely to become unable to pay debts as they become due.

§ 1.3

The debtor or a creditor or a public authority can apply for the opening of the proceeding.

§ 1.4

Appropriate publicity must be given to the proceeding.

§ 2 **Institutions and participants**

§ 2.1

The proceeding is opened and supervised by the court. The law may provide that, when the debtor is a legal person, the proceeding can be opened by a formal declaration of the debtor.

§ 2.2

An administrator is appointed in order to carry out the liquidation or the reorganisation. The administrator must be independent and must act impartially.

§ 2.3

The debtor is under a duty to co-operate with the court and the administrator. If the debtor is a partnership, a company or other legal entity, this duty applies to its managing partners or directors.

§ 2.4

The creditors' collective interests may be represented by a meeting of creditors, a creditors' committee or a creditors' representative.

§ 3 **Effects of the opening of the proceeding**

§ 3.1

Assets belonging to the debtor at the time of the opening of the proceeding and assets acquired thereafter are included in the proceeding. When the debtor is a natural person certain assets are excluded from the proceeding.

§ 3.2

Upon the opening of the proceeding the powers to manage and dispose of the assets are transferred to the administrator.

§ 3.3

A claim against the debtor existing at the time of the opening of the proceeding ('insolvency claim') can be pursued only through submission and admission under the conditions of the proceeding, without prejudice to security rights and rights of set-off.

§ 3.4

Upon the opening of the proceeding a creditor with an insolvency claim cannot improve that creditor's position to the detriment of other creditors.

§ 3.5

Between the filing of the application and the opening of the proceeding, the court can take interim measures to preserve the debtor's assets.

§ 4 **Management of the assets**

§ 4.1

The administrator collects and manages the debtor's assets.

§ 4.2

Management actions of major importance may be subject to the consent of the court or the creditors.

§ 5 **Obligations incurred by, and fees of, the administrator**

§ 5.1

Obligations incurred by the administrator during the proceeding and the administrator's fees are to be funded from the debtor's assets and satisfied as they fall due, in priority to insolvency claims. If the assets are not sufficient to satisfy these obligations and fees, they are satisfied according to their ranking.

§ 6 **Treatment of contracts**

§ 6.1

The opening of the proceeding does not automatically terminate a contract to which the debtor is a party.

§ 6.2

The other party cannot enforce performance by the administrator.

§ 6.3

If the administrator demands performance of a contract which at the time of the opening of the proceeding neither party has fully performed, the debtor's obligations arising out of the contract must be satisfied as they fall due and in priority to insolvency claims.

If the administrator has decided not to perform such a contract, any claim of the other party based on non-performance of the contract is an insolvency claim.

The other party can demand that the administrator decides within a reasonable time whether to adopt the contract or not.

§ 7 **Position of employees**

§ 7.1

The administrator or the employee may terminate a contract of employment following special rules.

§ 7.2

An employee has a preferential ranking in respect of certain insolvency claims for wages and other sums due under the contract of employment or arising from its termination.

§ 7.3

A public fund is available to meet certain insolvency claims of employees for wages and other sums due under the contract of employment or arising from its termination. If the public fund pays the employee, it is subrogated in the rights of the employee.

§ 7.4

If the enterprise of the debtor, or any part of it, is transferred, the contracts of employment are automatically transferred to the purchaser of the enterprise.

§ 8 **Reversal of juridical acts**

§ 8.1

A juridical act unfairly detrimental to the creditors performed by the debtor within a certain period of time before the opening of the proceeding, is subject to reversal. The administrator can recover or seek annulment of any benefit which has been obtained from the debtor.

§ 8.2

Juridical acts subject to reversal include:

- a) A transaction with the intent of defrauding creditors;
- b) A transaction for inadequate countervalue;
- c) A transaction with a creditor for which no enforceable obligation existed;
- d) A transaction with a creditor after the filing of the insolvency application or in a situation of imminent insolvency;
- e) The creation of a security right to secure a pre-existing obligation.

§ 9 **Security rights and set-off**

§ 9.1

A security right continues to exist after the opening of the proceeding. Enforcement may be subject to special rules.

§ 9.2

An asset subject to a security right is realised by the administrator or the secured creditor. The secured creditor is entitled to the proceeds of such asset, up to the amount of the secured claim and subject to the rights of creditors with higher ranking claims.

§ 9.3

The opening of the proceeding does not prevent set-off.

§ 10 **Submission and admission of insolvency claims**

§ 10.1

Creditors must be informed of the time and place for submission of claims, the authority where claims must be submitted and whether secured claims must be submitted.

§ 10.2

A claim is submitted by a notification indicating the amount and nature of the claim and stating whether a preference or security right is invoked.

§ 10.3

An insolvency claim can be disputed by the administrator.

A disputed insolvency claim is admitted if and to the extent that the dispute is decided in favour of the creditor.

Pending the dispute, a disputed insolvency claim can be admitted conditionally.

§ 10.4

An unmatured insolvency claim is admitted for its discounted value.

An illiquid insolvency claim is admitted for its assessed value.

A conditional insolvency claim is admitted for its discounted value or conditionally for its full amount.

A non-monetary insolvency claim is converted into a monetary claim for its assessed value.

§ 10.5

A secured insolvency claim is admitted to the extent that it cannot be satisfied from the proceeds of the assets subject to the security right.

§ 11 **Reorganisation**

§ 11.1

In a reorganisation, the liabilities of the debtor are restructured on the basis of a reorganisation plan, stating the extent and the manner of such restructuring. A reorganisation plan may include further measures.

§ 11.2

A reorganisation plan can be presented by the debtor or the administrator.

§ 11.3

A reorganisation plan is approved or rejected by a vote of the persons affected by it, or by the court.

The approval of the reorganisation plan by a vote of the persons affected by it may be subject to:

- a) quorum requirement;
- b) the requirement of a qualified majority;
- c) the persons affected by the reorganisation plan voting in separate categories;
- d) certain categories of affected persons having blocking votes.

A reorganisation plan approved by a vote of the persons affected by it needs the confirmation of the court.

§ 11.4

The confirmed reorganisation plan binds all persons affected by it, including persons who have not agreed and creditors who have not submitted their claims.

§ 11.5

The reorganisation plan does not affect the rights of creditors against third parties.

§ 12 **Liquidation**

§ 12.1

If and to the extent that there is no reorganisation the administrator converts the debtor's assets into money and distributes it among the creditors. The assets can be realised separately or together, whether or not as a going concern.

§ 12.2

Creditors with insolvency claims have an equal right to be paid in proportion to and in accordance with the ranking of their claims. They are entitled to a distribution only if higher ranking insolvency claims can be satisfied to their full amount admitted.

§ 13 **Closure of the proceeding**

§ 13.1

In a reorganisation, the proceeding is closed either upon the confirmation of the reorganisation plan or upon its performance.

In a liquidation, the proceeding is closed after the realisation of all the debtor's assets and the distribution of the proceeds.

The proceeding is closed if there are insufficient assets to fund the proceeding.

§ 13.2

The debtor, if a natural person, may be discharged from debts remaining after liquidation. The discharge does not affect the rights of creditors against third parties.

When the debtor is a legal person it will cease to exist following the closure of the liquidation.

§ 13.3

Assets discovered after the closure of a liquidation may give rise to a further liquidation.

§ 14 **Debtor in possession**

§ 14.1

The debtor may, subject to supervision, be allowed to manage and dispose of the assets. In this case the proceeding follows the Principles of §§ 1 -13, except to the extent that they presuppose an administrator.

§ 14.2

In §§ 4.1, 5.1, 6.3, 7.1 and 10.3 references to the administrator are to be read as references to the debtor.

§ 14.3

The debtor does not have the power of the administrator to obtain reversal of a juridical act.