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International Element in Insolvency Proceedings with an Emphasis of Recent Recommendations of the European Commission

Abstract

As companies become increasingly international, there has also been a growing need to regulate insolvency proceedings, includingthe international element that will undoubtedly satisfy needs for businesses focused in more than one country.

The EU Insolvency Regulation[2]was adoptedin 2002 in response to these needs for an effective approach to cross-border insolvency. Although this Regulation does not cover all issues of insolvency, it is a big step forward in the effective dealing with insolvency proceedings within the EU.

The purpose of this paper is to analyze EU Insolvency Regulation and recent Recommendation of the European Commission, emphasizing their main goal, to present a package of measures to modernize these insolvency rules.

Key words: insolvency regulation, bankruptcy, cross-border insolvency, recommendation

1. Defining the international insolvency

"Merchants have no country. The mere spot they stand on does not constitute so strong an attachment as that from which they draw their gains". – Thomas Jefferson[3]

People and businesses accept risks in order to make profit. If too many of these risks materialize, however, people may become unable to pay all their debts as they fall due. In such instances legal systems, usually make available insolvency proceedings. One thing these proceedings have in common is that they are collective proceedings: so as to prevent the chaos and inequity that would result from individual creditors seeking to collect on their debt; and where possible, to enable rehabilitation of the debtor. In international life, the chances are that people and businesses have assets or liabilities in

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[2]Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000, p. 1–18, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:en:PDF (accessed April 4, 2014).

[3]Letter to Horatio G. Spafford (18 March 1814)

more than one state. If insolvency occurs in this case, the same collectivity cannot be attained by a single state alone.[4]

Due to the increasing globalization of the world economy, many companies have branches and assets located in more than one jurisdiction. While this can be seen as a benefit during solvent periods of trading, bringing prosperity and run off businesses to other areas, the harsh reality is that the impact of insolvency proceedings is no longer limited by geographic boundaries and can strike a devastating blow to creditors located across the globe. A number of difficulties arise when insolvency proceedings commence in respect of a company with assets located in many jurisdictions. [5]

The crossborder insolvency problem is not limited to, the failure of major international businesses. Even in small cases, assets may be located in various countries, for good or for bad reasons. A domestic business may have foreign branches or subsidiaries, or a foreign business may have foreign branches or subsidiaries. Property located in a foreign country may provide security for a debt so that domestic assets can be used to pay unsecured creditors. Foreign creditors may have valid claims in domestic bankruptcy cases, and domestic creditors may have valid claims in foreign bankruptcy cases. Any one of these situations raises a transnational insolvency problem. The increase in transnational insolvency arises from the growth in international trade.[6]

The growth of international enterprise over the past two decades has been truly prolific. While business has encountered relatively few obstacles in transcending national borders, the same cannot be said for the legal regimes that attempt to govern such activity. For a cross-border system to effectively address the failures of a multinational company it must recognize the need for cooperation and coordination.[7]

In a society that facilitates the use of credit by companies, there is a degree of risk that those who are owed money by a firm will suffer because the firm has become unable to pay its debts on the due date. If a number of creditors were owed money and all pursued the rights and remedies to them a chaotic race to protect interests would take place and this might produce inefficiencies and unfairness. A main aim of insolvency law is to replace this free-for-all with a legal regime in which creditors' rights and remedies are suspended and a process

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[4]Israël, Jona. *European cross-border insolvency regulation: a study of regulation 1346/2000 on insolvency proceedings in the light of a paradigm of co-operation and a ComitasEuropaea*. Antwerpen: Intersentia ;, 2005.

[5]Bolger, Laura. "No Frontiers: An Analysis of the EC Insolvency Regulation and the UNCITRAL Model Law on Cross Border Insolvency and how each will apply to a cross border insolvency." Consulegis. http://www.consulegis.com/wp-content/uploads/2013/06/Laura.Bolger_Paper.pdf (accessed April 5, 2014).

[6]Bufford, Samuel L.. *International insolvency*. Washington, D.C. (Thurgood Marshall Federal Judiciary Building, One Columbus Circle, N.E., Washington, 20002-8003): Federal Judicial Center, 2001. 6.

[7] Neil Thomas, *The Need for an Effective Approach to Cross-Border Insolvency,* International Corporate Rescue Vol.7, 2010 http://www.chasecambria.com/site/journal/article.php?id=510 (accessed 02.04.2014).

established for the orderly collection and realization of the debtors' assets and the fair distribution of those according to creditors' claims.[8]

2. EU Legal Framework in the area of the Insolvency

European rules on cross border insolvency are laid down in Regulation (EC) No 1346/2000 on insolvency proceedings (the Insolvency Regulation), which has applied since 31 May 2002. The Regulation contains rules on jurisdiction, recognition and applicable law and provides for the coordination of insolvency proceedings opened in several Member States. The Regulation applies when the debtor has an establishment or creditors in another Member State than his own.[9]

The purposes of the Regulation are to set rules governing where in the EU, insolvency proceedings should be opened, which country's laws would apply to those proceedings and to ensure that the proceeding and the effect of the proceedings are recognized throughout the EU. The overall effect of those rules is to make it easier to deal with the affairs of an insolvent who has affairs in more than one EU country.[10]

The Regulation needs to improve the efficiency and effectiveness of cross-border insolvency proceedings within the EU by simplifying or removing formalities concerning the recognition and enforcement of insolvency orders.[11]

The main objective is to avoid the transfer of assets or judicial proceedings from one EU country to another, which can improve the legal position of companies or individuals. [12]

Jurisdiction and choice of law – Chapter I of the EU Regulation (articles 1-15) provides for jurisdiction to open main insolvency proceedings and secondary insolvency proceedings. The EU Regulation recognizes two types of proceedings: a main proceeding that may affect all creditors and property of the debtor, and a secondary proceeding that affects only creditors ans property of the

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[8]Finch, Vanessa. "The roots of corporate insolvency law."In *Corporate insolvency law perspectives and principles*. Cambridge: Cambridge University Press, 2009. 1.

[9]"Insolvency: Commission recommends new approach to rescue businesses and give honest entrepreneurs a second chance." Europa.eu. http://europa.eu/rapid/press-release_IP-14-254_en.htm (accessed April 14, 2014).

[10]"The insolvency service."Cross-border insolvency.http://www.insolvencydirect.bis.gov.uk/casehelpmanual/C/Cross%20Border%20Insolve.htm (accessed April 7, 2014).

[11]"History and background to the EC Regulation od Insolvency Proceedings." insolvencydirect.bis.gov.uk. http://www.insolvencydirect.bis.gov.uk/TechnicalManual/Ch37-48/chapter41/part1/part_1.htm (accessed April 14, 2014).

[12]"Insolvency proceedings RSS. "Insolvency proceedings. http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm (accessed April 6, 2014).

debtor that are located in a country different from that where a main proceeding may be filed. A main proceeding must be opened in the member state where the center of main interests of the debtor is located. The concept of "center of main interests" is new for EU law and the law of its member states. The EU Regulation explains it in part as follows: "In the case of a company or legal person, the place of the registered office shall be presumed to be the center of its main interests in the absence of proof to the contrary."[13] In addition, the preamble explains, the "center of main interests" should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.[14]

The best way to achieve harmonization in the area of cross border insolvencies is to give insolvency proceedings to a single court for each cross-border insolvency case. This will also fit in the unity principle. The Insolvency Regulation's basic rule in Article 3(1) does just that. The connecting factor used to determine which court will have jurisdiction is 'the center of a debtor's main interests'. This flexible criterion is thought to provide a link to the place where the debtor was economically active and where one is likely to find assets. The Insolvency regulation gives the courts of the member state on the territory of which this center of the debtor's main interests in situated jurisdiction to open insolvency proceedings. The aim is to have one court that is competent to open a single set of insolvency proceedings, leading to a single worldwide insolvency case. If the center of main interests concept is used to identify this court, it should lead to a single place. The use of the word 'main' helps in this respect, as it leaves on one side all places where the debtor has a center of his ancillary interests and as temporary places where the debtor establishes the center of his main interests are also ruled out as Recital 13 refers to the place where the administration of the debtor's interests is conducted on 'a regular basis'. Every debtor is therefore supposed to have only a single 'center of main interests'.[15]

Article 3 (1)of the Insolvency Regulation only establishes the insolvency jurisdiction of the court of a member state. It does not deal with the issue which court in that member state will have jurisdiction. 'Territorial jurisdiction within (each member state) must be established by the national law of the (member state) concerned.[16]

Recognition of main proceedings. Chapter II of the EU Regulation (articles 16-26) provides recognition of a main insolvency proceeding, the effect of recognition, the powers of officials to act on behalf of the estate in the proceeding, and the formalities required for

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[13] Art. 3 of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[14]Bufford, Samuel L.."International Conventions and Other Sources of International Bankruptcy Law."In *International insolvency*. Washington, D.C. (Thurgood Marshall Federal Judiciary Building, One Columbus Circle, N.E., Washington, 20002-8003): Federal Judicial Center, 2001. 78.

[15]Omar, Paul J.."Coming to terms with the COMI concept in the European Insolvency Regulation."In*International insolvency law themes and perspectives*.Aldershot, England: Ashgate, 2008. 174.

[16]Ibid p.178.

such officials to act abroad. Under the EU Regulation, a court order opening an insolvency proceeding must be automatically recognized in all other member states.[17]Automatic recognition means that, except in a country where a secondary proceeding has the same effects in all EU countries as it has in the country where the proceeding is opened.[18] However, if an insolvency court judgment in another European Union country conflicts with a state's public policy, the state may refuse to recognize the insolvency proceeding and may refuse to enforce a judgment thereunder. [19]Such a refusal may be invoked to protect constitutional rights or fundamental liberties in the forum state.[20]

*Secondary proceedings.*Chapter III *(articles 27-38)* regulates secondary insolvency proceedings in European Union countries apart from the country where the main insolvency proceedings in pending. Following the opening of a main insolvency proceeding, a secondary insolvency proceeding may be brought my the liquidator in the main insolvency proceeding or by any party with standing under local law.[21]

Where the center of main interests is located in one EU country, another country has jurisdiction to open a secondary insolvency proceeding only if the debtor has an "establishment" in that country. The opening of a secondary insolvency proceeding makes the domestic law of theforum stateapplicable, instead of the law of the state where the main insolvency proceeding is opened.[22]

Once secondary proceedings have been opened in another member state, the liquidator in the secondary proceedings is attributed exclusive (domestic) power over the assets situated in that member state depriving the main liquidator of his domestic powers in the respect. This does not involve that the secondary proceedings are completely separated from the main proceedings and that the main liquidator has become broken-winged. On the contrary, as the main insolvency proceedings and the secondary proceedings are interdependent proceeding, the liquidator in the secondary proceedings has to fulfill his task under the dominance of the main

[17] Article.16, Article 25 of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[18] Article 17(1) of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[19] Article 26of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[20]Bufford, Samuel L.."International Conventions and Other Sources of International Bankruptcy Law."In *International insolvency*. Washington, D.C. (Thurgood Marshall Federal Judiciary Building, One Columbus Circle, N.E., Washington, 20002-8003): Federal Judicial Center, 2001. 80.

[21]Article 29 pmbl.parag. 18 of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[22]Bufford, Samuel L.."International Conventions and Other Sources of International Bankruptcy Law."In *International insolvency*. Washington, D.C. (Thurgood Marshall Federal Judiciary Building, One Columbus Circle, N.E., Washington, 20002-8003): Federal Judicial Center, 2001. 82.

liquidator. Coordination of the secondary proceedings and the main proceedings is essential for the effective realization the total assets. [23]

Chapter IV of the Regulation provides for the *provision of information to creditors and their entitlement to lodge claims in the proceedings*. Any EU creditor will have the right to lodge a claim. Officeholder in one set of proceedings will be entitled to be treated as creditors in proceedings against the debtor in another state.[24]

This provision is meant also for the tax authorities and social security authorities.[25]The chapter further provides for a duty to inform known creditors in the other Member State and the language to be used in the specific notice.[26]

The payment of creditors from the assets in secondary insolvency proceedings may result in the unequal treatment of equally ranked creditors. While the EU Regulation permits a creditor to keep a distribution that temporarily gives that creditor more than other creditors of equal rank, it disqualifies such a creditor from receiving any further distributions to the other creditors of the same class have caught up.[27] Thus a consolidated schedule of distributions must be prepared, with the goal of providing equal treatment to all creditors of the same class wherever they may be located in the European Union. The various liquidators in the main insolvency proceeding and in related secondary insolvency proceedings are required to exchange information and to cooperate in many respects. [28]

Entry into force and Retroactivity. The EU Regulation will take effect on May 31, 2002.[29] It does not apply to insolvency proceedings opened before that date. [30]

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[23]Omar, Paul J.."The Dominance of Main Insolvency Proceedings under the European Insolvency Regulation."In *International insolvency law themes and perspectives*.Aldershot, England: Ashgate, 2008. 207.

[24]Tolmie, Fiona M.."An introduction to cross-border issues."In *Corporate and personal insolvency law*. 2nd ed. London, U.K.: Cavendish Pub., 2003. 203.

[25] Article39 of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[26]Bob Wassels., "*European Union Regulation on Insolvency Proceedings: An Introductory Analysis*", American Bankruptcy Institute; 2006. 9.

[27] Article 20(2) of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[28]Bufford, Samuel L.."International Conventions and Other Sources of International Bankruptcy Law."In *International insolvency*. Washington, D.C. (Thurgood Marshall Federal Judiciary Building, One Columbus Circle, N.E., Washington, 20002-8003): Federal Judicial Center, 2001. 83-84.

[29] Article 47 of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

[30] Article 43 of the Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30/06/2000

3. Commission Recommendation of 12.03.2014 on a new approach to business failure and insolvency

"Businesses are essential to creating prosperity and jobs, but setting one up – and keeping it going – is tough, especially in today's economic climate" – Viviane Reding[31]

The Regulation[32] contains rules on jurisdiction, recognition ad applicable law and provides for the coordination of insolvency proceedings opened in several Member States. The Regulation applies when the debtor has an establishment or creditors in another Member State than his own. It is therefore essential to have modern laws and efficient procedures in place to help businesses, which have sufficient economic substance, overcome financial difficulties and entrepreneurs get a "second chance".

The European Commission on 12.03.2014,has set out a series of common principles for national insolvency procedures for businesses in financial difficulties. The Commission wants to give viable enterprises the opportunity to restructure and stay in business. Reforming national insolvency rules would create a "win-win" scenario: it will help keep viable firms in business and safeguard jobs and at the same time improve the environment for creditors who will be able to recover a higher proportion of their investment than if the debtor had gone bust.[33]

The objective of the Recommendation is to encourage Member States to put in place a framework that enables the efficient restructuring of viable enterprises in financial difficulty and give honest entrepreneurs a second chance, thereby promoting entrepreneurship, investment and employment and contributing to reducing the obstacles to the smooth functioning of the internal market. [34]

A second chance policy that enables formerly bankrupt entrepreneurs restart may represent one of the most promising and under exploited policy options for company creation and job growth. Some research shows that business set up by re-starters grow faster than business set up by first timers in terms of turnover and jobs created. But acting on second chance would bring an even larger

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[31] Vice-President, the EU's Justice Commissioner in press releases, Brussels, 12 March 2014

[32]*Council Regulation (EU) No. 1346/2000 on insolvency proceedings,* OJ L 160, 30/06/2000, p. 1–18 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:en:PDF (accessed April 4, 2014).

[33]"Insolvency: Commission recommends new approach to rescue businesses and give honest entrepreneurs a second chance." europa.eu. http://europa.eu/rapid/press-release_IP-14-254_en.htm (accessed April 13, 2014).

[34]"COMMISSION RECOMMENDATION of 12.3.2014 on a new approach to business failure and insolvency." ec.europa.eu.http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf (accessed April 13, 2014).

impact on entrepreneurship: many would-be entrepreneurs do not start a company because of their fear of the consequences of business failure.[35]

The distinction between honest and dishonest entrepreneurs should translate into non-discrimination of those entrepreneurs which are non-fraudulent bankrupts in becoming beneficiaries of any support programs available on the market for starting up a new business whilst simultaneously avoiding any preferential treatment of "reborn" entrepreneurs, as this may lead to unfair competition and moral hazard.[36]

The Recommendation has 20 recitals and 36 recommendations. Within 12 months Member States are invited to implement the recommendation's 'principles' and therefore to:

1. Facilitate the restructuring of businesses in financial difficulties at an early stage, before starting formal insolvency proceedings, and without lengthy or costly procedures to help limit recourse to liquidation;
2. Allow debtors to restructure their businesses without needing to formally open court proceedings;
3. Give businesses in financial difficulties the possibility to request a temporary stay of up to four months (renewable up to a maximum of 12 months) to adopt a restructuring plan before creditors can launch enforcement proceedings against them;
4. Facilitate the process for adopting a restructuring plan, keeping in mind the interests of both debtors and creditors, with a view to increasing the chances of rescuing viable businesses;
5. Reduce the negative effect of a bankruptcy on entrepreneurs' future chances of launching a business, in particular by discharging their debts within a maximum of three years.[37]

Recommendation from the Commission do not have any legal force (unlike regulations, directives and decisions) and are not binding on member states. However, they do have a political weight. The aim of a Recommendation is to encourage member states to prepare legislation to address the issues identified. The Recommendation asks member states to enact appropriate measures within one year, The Commission will assess the situation 18-months after adoption of the Recommendation, based on the yearly reports from member states, to evaluate whether further measures are needed to strengthen the harmonization.[38]

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[35]*A second chance for entrepreneurs: prevention of bankruptcy, simplification of bankruptcy procedures and support for a fresh start*. Luxembourg: EUR-OP, 2011. 3.

[36] Ibid. p. 11

[37]Wassels, Prof. Dr.Bob. "European Commission's Recommendation 'New Approach to Business Failure and Insolvency'." bobwessels.nl. http://bobwessels.nl/2014/03/2014-03-doc4-european-commissions-recommendation-new-approach-to-business-failure-and-insolvency/ (accessed April 13, 2014).

[38]Stones, Kathy. "The challenges of harmonising insolvencies and restructurings." lexisweb.co.uk.http://lexisweb.co.uk/blog/randi/the-

4. Conclusion

The aim of the Insolvency legislation is to balance two contrary sides. Protection of creditor's interests on one hand and giving support of viable businesses which are also valuable for the society to another.This paper presents the EU legal framework created for insolvency proceedings, by making brief, analyze of Council Regulation (EU) No. 1346/2000 on insolvency proceedings and presenting resent Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency.Regulation of cross border insolvency means creating effective and efficient tools for harmonization insolvency law regimes between member states and coordination between institutions which are empowered for the proceedings.Although it's an enormous effort to create a solid legal system which have to perform coordination between multinational insolvency proceedings, current Regulation despite of her gaps successfully accomplished her goals. In order to overcome the obstacles that came to the contemporary business activities, the European Commission presented Recommendation which emphasizes her support for return of honest failed entrepreneurs to the market. Resent legal reforms represent a major step forward for the merchants and greater optimism about future traders and most importantly, guaranteed security for creditors.

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13. "The insolvency service." Cross-border insolvency. http://www.insolvencydirect.bis.gov.uk/casehelpmanual/C/Cross%20Border%20Insolve.htm;
14. "Insolvency proceedings RSS." Insolvency proceedings. http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm;
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