Harmonisation of European insolvency law: Operation Patchwork has commenced, but where will it take us?

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1. Introduction

On 7 December 2022, the European Commission published its long-awaited proposal for a directive to harmonise certain aspects of insolvency law (Proposal).[2] This Proposal includes seven distinct topics that the Commission considers fit for harmonisation across the European Union (EU). For a long time, harmonisation in this area was thought to be impossible, primarily because of the large substantive differences between the insolvency regimes of the Member States, but also because of the coherence of national insolvency law with various other areas of (national) law which would make harmonisation very difficult.[3] The EU Restructuring Directive (2019/1023)[4] seems to have changed the thinking in this regard, as the divergences no longer hold the Commission back, in fact, it considers the time ripe for some steps forward.

The Commission has not been idle. Since a legislative initiative on harmonisation of insolvency law was announced in 2020, already two public consultations have taken place on what topics could be harmonised. In addition, there have been stakeholder meetings, three reports have been prepared at the request of the Commission,[5] and there have been regular consultations with an EU-wide group of experts.[6] On several occasions also, Member States have been consulted in preparing the Proposal.[7]

The Proposal is an important step towards more coherent European insolvency laws; however, it comes with several limitations. The Proposal focuses on seven clear-cut topics only – (i) avoidance actions, (ii) asset tracing, (iii) pre-pack proceedings, (iv) duty to file for insolvency, (v) proceedings for micro companies, (vi) creditors' committees and (vii) measures to increase the transparency of national insolvency rules – which are mostly standalone topics with limited coherence. Furthermore, several topics – such as a definition of 'insolvency' and the ranking of creditors – that were initially signalled by the Commission and others for harmonisation, but have been left out from the Proposal. This limits the scope of the Proposal, as well as its coherence.

This contribution focuses on the objectives and background of the Proposal. The seven substantive topics of the Proposal are discussed by other authors in the contributions of this issue. In our analysis, we find that the Proposal may best be considered a patchwork. It is a collection of provisions aimed at converging separate parts of insolvency laws. Whereas there may be good reasons to pursue harmonisation this way, it also raises questions. Is this the right way forward for Europe? Are the proposed topics for harmonisation sufficiently substantiated? Will the Proposal be able to achieve its objectives? We argue that the Proposal is a step in the right direction, although the rationale and effects of the chosen topics require further discussion and justification.

In our contribution, we will critically assess the purpose and need for the proposed harmonisation of insolvency

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2 Proposal for a directive of the European Parliament and of the Council harmonising certain aspects of insolvency law, 7 December 2022, COM/2022/702 final. References to the Proposal relate to the English language version unless stated otherwise.

3 See, for example, Recital 22 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (EIR 2015), which notes that '[…] as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope throughout the Union. The application without exception of the law of the State of the opening of proceedings would, against this background, frequently lead to difficulties.'

4 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Restructuring Directive).

5 Proposal, pp. 8-9; Deloitte/Grimaldi, Study to support the preparation of an impact assessment on a potential EU initiative increasing convergence of national insolvency laws, draft final report, DG JUST, March 2022, available at: https://commission.europa.eu/system/files/2023-02/Insolvency%20laws_IA%20support%20study_Final%20Report.pdf; Spark/Tipik, 'Study on the issue of abusive forum shopping in insolvency proceedings, DG JUST, February 2022 (JUST/2020/JCOO/FW/CIVI/0160); Spark/Tipik, 'Study on tracing and recovery of debtor's assets by insolvency practitioners', DG JUST, March 2022 (JUST/2020/JCOO/FW/CIVI/0172; available at: https://commission.europa.eu/system/files/2023-02/Final Report – Study on tracing and recovery of debtor%E2%80%99s assets by insolvency practitioners – March 2022.pdf).

6 Proposal, pp. 7-9; Group of experts on restructuring and insolvency (European Commission Expert Group) (E03362), available at: https://ec.europa.eu/transparency/expert-groups-register/screen/expert-groups/consult?lang=en&groupID=3362.

7 Proposal, p. 8.

laws. We do so by first providing some background on the origins of the Proposal and try to answer the question of what issues the Proposal ought to resolve (Section 2). Subsequently, in Section 3, we discuss the objective and structure of the Proposal in more detail. Next, we will discuss several considerations on the need for the Proposal in Section 4, which is followed by concluding remarks (Section 5).

2. Background of the Proposal

The Proposal has its origins in the Capital Markets Union (CMU).[8] In 2015, the Commission announced its intention to work toward a CMU, through which the EU aims to achieve a *single market* for capital investment and the movement of capital.[9] A stronger and more united capital market would strengthen cross-border investment and make the European economy more resilient.[10] This has instigated the EU legislature to develop several legislative initiatives. Many barriers to cross-border investments have, according to the Commission, their origin in insolvency laws, as well as property laws and national laws regarding securities.[11] In particular, the large differences between national restructuring and insolvency regimes in the EU are unnecessarily restricting cross-border investment.[12] According to the Commission, this involves questions on 'who owns security rights in the event of a default' and 'whose rights take precedence in the event of an insolvency'.[13] Convergence of restructuring and insolvency regimes would make it easier for investors to assess credit risk and therefore facilitate greater legal certainty for cross-border investments.[14]

In 2020, the CMU received a new impetus with the report of the High Level Forum – established by the Commission – with 'A New Vision for Europe's Capital Markets'.[15] This group of experts made recommendations, also touching upon the area of insolvency law. It invited the Commission to adopt a 'legislative proposal for minimum harmonisation of certain targeted areas of core non-bank corporate insolvency laws'.[16] Core elements that could be harmonised include, according to the report, for instance a definition of the trigger for insolvency procedures, rules for the ranking of claims (more specifically the position of secured creditors), and avoidance actions. Furthermore, the Commission is invited to develop a common terminology of key concepts of national insolvency laws.[17]

In 2021, the Commission followed up on this report by announcing in a communication that it 'will take action regarding insolvency proceedings by enhancing convergence and removing discrepancies, aiming to increase efficiency, facilitate cross-border investments and reduce burden'.[18] This was elaborated with the publication of an 'inception impact assessment' and a subsequent public consultation.[19] The inception impact assessment specified several topics were considered that would 'address those aspects of insolvency proceedings that had been identified as barriers to cross-border investment'.[20] The Commission identified a non-limitative list of six topics for a legislative initiative, including: (i) requirements for opening insolvency proceedings (including a definition of 'insolvency' and provisions on who is entitled to file for insolvency), (ii) conditions for invoking transaction avoidance and the effects of clawback rights (bankruptcy *pauliana*), (iii) directors' duties in the event of imminent/actual insolvency, (iv) the position of secured creditors, taking into account the specific needs for the protection of other types of creditors (e.g. employees and suppliers) in insolvency (ranking), (v) court capacity when it comes to expertise and necessary training of

8 For the European political context and background of the Proposal, see also Commission Staff Working Document, Impact Assessment Report, accompanying the document, Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law, 7 December 2022, SWD(2022) 395 final, pp. 5-7 (Impact Assessment). These ideas for harmonisation are not new and find their origin in earlier initiatives, see further Ian Fletcher & Bob Wessels, *Harmonization of Insolvency Law in Europe*, Preadvies 2012 uitgebracht voor de Vereniging voor Burgerlijk Recht, Deventer: Kluwer 2012, para 3; Michael Veder, 'Europese ontwikkelingen in het insolventierecht', *TvI* 2013/32; Gert-Jan Boon & Stephan Madaus, 'Toward a European Business Rescue Culture', in: Jan Adriaanse & Jean-Pierre van der Rest (eds.), Turnaround Management and Bankruptcy. Routledge Advances in Management and Business Studies nr. 69, New York: Routledge 2017, para 13.2.

9 Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union, 30 September 2015, COM(2015) 468 final (Action Plan 2015).

10 Action Plan 2015, pp. 4 and 6.

11 Action Plan 2015, pp. 6, 23-24.

12 Completing Europe's Economic and Monetary Union', Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz (so-called Five Presidents'), 22 June 2015, p. 10; Action Plan 2015, pp. 6 and 23-25; Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 28 October 2015, COM(2015) 550 final, p. 7; Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, 14 September 2016, COM(2016) 601 final, p. 3; Proposal for a Directive of the Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, 22 November 2016, COM(2016) 723 final, pp. 2, 4 and 8-9. See also: A new Vision for Europe's Capital Markets, Final Report of the High Level Forum on the Capital Markets Union, June 2020, pp. 23, 29 and 58-59 (A new Vision for Europe's Capital Markets 2020); Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Capital Markets Union – Delivering one year after the Action Plan, 25 November 2021, COM(2021) 720 final, p. 4.

13 Action Plan 2015, p. 24.

14 Action Plan 2015, p. 24.

15 A new Vision for Europe's Capital Markets 2020.

16 A new Vision for Europe's Capital Markets 2020, pp. 114-115.

17 A new Vision for Europe's Capital Markets 2020, p. 114.

18 Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Commission work programme 2022, Making Europe stronger together, 19 October 2021, COM(2021) 645 final, p. 6; Annexes to the Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Commission work programme 2022, Making Europe stronger together, 19 October 2021, COM(2021) 645 final, p. 2.

19 Inception impact assessment, Enhancing the convergence of insolvency laws, 11 November 2020, Ares(2020)6597479 (Inception Impact Assessment 2020).

20 Inception Impact Assessment 2020, p. 2.

judges, and (vi) asset tracing, in particular in the context of avoidance actions.[21]

At the end of 2021, a second communication was published in which the Commission announced its intention to publish a proposal on a legislative initiative to harmonise targeted aspects of insolvency frameworks by 2022. This legislative initiative would be a directive, possibly complemented by a recommendation, and was aimed at achieving the objective of 'integrating national capital markets into a genuine single market'.[22] On 7 December 2022, the Commission published the Proposal, accompanied by an extensive impact assessment.

In the upcoming legislative process, the Proposal may generate quite some discussion between the European Parliament and the Council, in particular, because it has already raised some controversy in its preparation. The public consultation also showed that ideas about the usefulness and necessity of substantive harmonisation vary widely, both when looking at responses from different Member States, and between different sectors.[23] Notwithstanding a broad support for convergence and harmonisation of insolvency law in general,[24] some Member States have written to the Commission expressing their concerns, especially where it concerns binding legislation.[25] In response to concerns of Member States, the Commission organised two dedicated workshops with governmental experts from Member States in March and October 2022. Member states emphasised that an in-depth problem analysis of the Proposal was necessary.[26] Although it is not clear to what extent changes were made, the Commission has evidently considered it appropriate to publish the Proposal. The reactions to the proposal show broad support for convergence and harmonisation of insolvency law in general, although some critical remarks have been made on certain specific topics.[27]

21 Inception Impact Assessment 2020, p. 3.

22 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Capital Markets Union – Delivering one year after the Action Plan, 25 November 2021, COM(2021) 720 final, pp. 4 and 18.

23 Impact Assessment, paras. 2.1.3, 2.3.4 and Annex 2 showing, among other things, that Dutch respondents were relatively reluctant and that among researchers there is reasonably strong support for harmonisation, but both insolvency practitioners and governments were reluctant. Incidentally, the public consultation suffered from limited representativeness, with 129 respondents from 17 Member States, of which 58 were from Germany, see also pp. 81 and 84-85. The same applies to the reactions to the public consultation of the Proposal, with 49 reactions, of which 15 were from Germany, see https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12592-Insolvency-laws-increasing-convergence-of-national-laws-to-encourage-cross-border-investment/feedback_en?p_id=31731599.

24 Proposal, p. 8.

25 Proposal, p. 8; BNC-Fiche 3: *Beoordeling Richtlijn materieel insolventierecht*, 2023Z01871, 3 February 2023 (available at: https://open.overheid.nl/documenten/ronl-5c06013edf7d652555e5354dca75a95259e11999/pdf), p. 11.

26 Proposal, pp. 8-9. Compare also Ben Schuijling, 'Het commissievoorstel voor een nieuwe insolventierichtlijn', *FIP* 2023/2, para 9.

27 See: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12592-Insolvency-laws-increasing-convergence-of-national-laws-to-encourage-cross-border-investment/feedback_en?p_id=31731599.

3. Objectives and structure of the Proposal: partial harmonisation in response to fragmentation among insolvency proceedings

3.1 *Objectives*

The Commission observes two key problems with the current national insolvency regimes: (i) costly and lengthy insolvency proceedings are leading to low recovery values, and (ii) a low predictability of (the outcome of) insolvency proceedings which leads to high information costs and creates barriers to cross-border insolvency.[28] The main drivers for these problems are on the one hand the recurring and extensive differences between national substantive insolvency regimes, and on the other hand that certain jurisdictions are inadequately designed or are missing certain features.[29] In particular, the cross-border divergences (i) bring different outcomes across Member States, (ii) result in different degrees of efficiency of insolvency proceedings, (iii) amount to legal uncertainty on the outcomes of insolvency proceedings, and (iv) bring about higher 'information and learning costs', especially for cross-border creditors.[30]

In response to that, and in the Commission's policy language,[31] harmonisation of insolvency is considered to be a 'key tool for a more efficient functioning of the capital markets in the European Union, including greater access to corporate finance'.[32] The Proposal has the objective to 'contribute to the more efficient allocation of capital in the single market and enhance market integration under the CMU'.[33] The Proposal should converge insolvency regimes on those topics that inefficiently allocate capital and negatively impact the capital market.[34] More specifically, the Proposal aims to develop more uniform rules in Member States for better value recovery (notably in the fields of transaction avoidance, asset tracing, directors' duties and pre-pack procedures), more efficient insolvency proceedings (notably with respect to Micro- and Small Enterprises (MSEs) procedures, insolvency triggers and transparency) and efficient and fair distribution of recovered values (notably in the field of creditor committees and – although this is not included in the Proposal – the ranking of claims).[35]

Existing EU legislation in the field of insolvency law – in particular formed by the EIR 2015 and the Restructuring

28 Impact Assessment, p. 18 et seq.

29 Recitals 2-3 Proposal; Impact Assessment, p. 26 et seq.

30 Proposal, pp. 1-2. Impact Assessment, p. 18, in which the Commission discusses two main problems with the current fragmented insolvency law in Europe. The problems identified are: (i) costly and lengthy insolvency proceedings lead to low recovery value and (ii) low predictability of insolvency proceedings leads to high information costs and limits cross-border investment.

31 See further: Emilie Ghio, Gert-Jan Boon, David Ehmke, Jennifer Gant, Line Langkjaer & Eugenio Vaccari, 'Harmonising Insolvency Law in the EU: New Thoughts on Old Ideas in the Wake of the COVID-19 Pandemic', *International Insolvency Review*, 2021, 30(3), pp. 427-459.

32 Recital 4 Proposal.

33 Impact Assessment, p. 38.

34 Impact Assessment, p. 34.

35 Impact Assessment, p. 37.

Directive[36] – provides already for harmonisation of particular cross-border insolvency law, as well as 'pre' insolvency and 'post' insolvency law, but hardly deals with (core) elements of substantive insolvency law.[37] Therefore, the Commission considers additional legislation necessary.[38]

The Commission has opted for a European directive with minimum standards, as the other legal instruments (a regulation and/or a recommendation) were considered less suitable to achieve the desired results. A regulation, on the one hand, would not offer enough flexibility to introduce common standards, given the variety and diversity in legal cultures and legal systems in the Member States. A recommendation, on the other hand, would be too noncommittal, leading to insufficient convergence.[39] The Proposal has its legal basis in Article 114 of the Treaty on the Functioning of the European Union (TFEU), which gives the European Parliament and the Council the power to adopt legislation aimed at adapting national legislation affecting the establishment and functioning of the internal market.[40] The scope of the Proposal is not restricted to cross-border matters, since the approximation of the various national insolvency regimes also applies to pure domestic situations within the boundaries of Member State. Therefore, and in contrast to the EIR 2015, Article 81 TFEU is not fit to serve as the legal basis in this case.

3.2 *Scope and structure*

The Proposal focuses on non-bank corporate insolvency law and, therefore, excludes insolvency proceedings concerning financial institutions, consumers or public bodies (under national law).[41] The Proposal broadly covers three themes which it considers 'targeted' aspects of insolvency law or 'targeted' elements of Member States' insolvency rules. These themes are: (i) recovery of assets from the insolvent estate, (ii) efficiency of insolvency proceedings, and (iii) predictable and fair distribution of recovered value among creditors.[42] The topics within these themes aim to maximise the recovery of value from the insolvent company for creditors, strengthen procedural efficiency and ensure a fair and predictable distribution of values among creditors.[43]

In the Proposal, after a preamble of 63 recitals and an introductory title (I General provisions with a scope of application and definitions), the Commission has divided the targeted aspects of insolvency law – based on the abovementioned themes – into seven titles (II-VIII), followed by a final title (IX with final provisions). The core of the Proposal (Titles II-VIII), which is discussed in more detail in the following contributions by other authors, includes provisions on: (i) transaction avoidance, (ii) asset tracing, (iii) pre-packs, (iv) directors' obligation to request the opening of insolvency proceedings, (v) simplified resolution of micro enterprises, (vi) the creditors' committee, and (vii) measures to increase the transparency of national insolvency rules.

4. Some considerations on the need for the Proposal

4.1 *Definitions*

As a starting point, we consider it, least to say, quite remarkable and in some respects certainly problematic that a legislative proposal that deals with the harmonisation of substantive insolvency law does not define the core concept of insolvency. The need for a definition in the process of harmonisation was already identified by the High Level Forum as one of the core elements on which harmonisation should focus.[44] All possible practical and political difficulties aside, the absence of such a definition seems a major limitation in achieving the stated harmonisation goals. Without a definition, it is left to the Member States to interpret this concept as they see fit during the implementation which might impede achieving predictability and uniformity. This is likely to result in definitions which might negatively affect the appetite of investors and creditors for cross-border investment, hamper the single market and thereby infringe on the objectives of the Proposal.

Not only does the Proposal lack a definition of 'insolvency', similarly, the Proposal is also missing another core definition, namely 'insolvency proceeding'.[45] In doing so, it remains unclear when avoidance actions will be justified, as the Proposal links the possibility to declare avoidance actions void to the opening of 'insolvency proceedings' (Title II). The same can be said with respect to the directors' duty to file for the opening of insolvency proceedings (Title V), the establishment of creditors' committees (Title VII) and the measures for enhancing transparency of national insolvency laws in view of the obligations for the Member States to create national factsheets on certain elements of national law on insolvency proceedings (Title VIII). Therefore, with this approach, core topics are potentially not harmonised.[46]

In this context, reference should be made to the Restructuring Directive in which several key concepts such as

36 For a further introduction to the development of European insolvency law, see Bob Wessels, 'On the Future of European Insolvency Law' in Rebecca Parry (ed.), *European Insolvency Law: Prospects for Reform*, Nottingham: INSOL Europe 2014, pp. 131-158; Gert-Jan Boon, Harmonising European Insolvency Law: The Emerging Role of Stakeholders, *IIR* 2018, 27(1303), pp. 162-163.

37 Proposal, p. 3. In contrast, the Restructuring Directive, according to the Commission, provided for 'pre' (Title II) and 'post' insolvency law (Title III). See also: Impact Assessment, pp. 6, 12-14.

38 Impact Assessment, pp. 35-38.

39 Proposal, p. 6. See also Impact Assessment, p. 46.

40 Proposal, pp. 5-6 and 21.

41 Article 1 Proposal; Impact Assessment, p. 7.

42 Proposal p. 9.

43 Proposal, p. 12 et seq.

44 A new Vision for Europe's Capital Markets 2020, pp. 23 and 114.

45 With the exception of the liquidation phase in the pre-pack proceedings, which is considered to be an insolvency proceeding as defined in Article 2(4) EIR 2015, according to Article 20(1) Proposal.

46 There have been similar considerations in this regard with the transposition of the Restructuring Directive, see for instance: David C. Ehmke, Jennifer L.L. Gant, Gert-Jan Boon, Line Langkjaer & Emilie Ghio, 'The EU Preventive Restructuring Framework: a hole in one?', *International Insolvency Review*, 2019, 28(2), pp. 184-209.

'likelihood of insolvency' were also left undefined.[47] Consequently, this has not only led to much academic debate but also to a great variety – *i.e.,* limited harmonisation – in the varied national implementations of the Restructuring Directive.

4.2 *Subject matter and (in)coherence*

In addition, and contrary to the genesis of the EIR 2015 and the Restructuring Directive, the Proposal does not consider an all-encompassing and well-defined subject of insolvency and/or restructuring law. Rather, the Proposal is a kaleidoscope comprising several different and quite incoherent topics that are proposed for harmonisation. The Proposal is not only diverse content-wise, but the different provisions also have wide-ranging standards for harmonisation. The provisions of some of the topics seem quite detailed while others are hardly developed. Parts of the Proposal clearly introduce minimum harmonisation standards, as is the case with the 'additional grounds' that Member States may introduce for avoidance actions if it leads to greater protection of the interests of joint creditors,[48] and with the directors' duty to timely request the opening of insolvency proceedings.[49] However, (most of the) other topics are regulated in quite detail with less flexibility for Member States. Consequently, Member States will be restricted in choosing the way how to implement the Proposal upon its adoption. This result is remarkable since, as noted earlier, harmonisation of substantive insolvency law has so far been seen as problematic.[50]

At the same time, it should be noted that the Commission initially, in addition to harmonisation of the aforementioned topics, considered a more ambitious and far-reaching harmonisation of insolvency law.[51] From that perspective, the Commission has taken a cautious approach to the Proposal. The ranking of claims, for example, was considered essential to achieve a CMU in earlier stages,[52] but the option to introduce a comprehensive harmonisation of the ranking of claims was discarded as potentially problematic from a subsidiarity perspective and was also considered politically non-feasible. The disparate starting position of Member States regarding the ranking of claims, also because of its embeddedness with other parts of the national legal regimes and legal traditions would make harmonisation infeasible.[53]

47 Article 2(2)(b) Restructuring Directive.
48 Article 5 Proposal.
49 Article 37(2) Proposal.
50 Impact Assessment, p. 13.
51 For example, the Commission has also considered harmonisation of, inter alia, (i) definitions of key terms (including 'insolvency'), (ii) ranking of claims in insolvency (harmonisation of the treatment of public claims), (iii) procedural aspects of insolvency proceedings, (iv) regulation of insolvency practitioners, (v) enhancing the ability of insolvency practitioners to seize assets in other Member States, (vi) change of fiduciary duties of the directors in the vicinity of insolvency, (vii) harmonisation of liquidity criterion for the latest possible triggering of the procedure, (viii) priority for certain groups of creditors, and (ix) protection of new funding; see Impact Assessment, para. 5.2 and 5.3 (Table 3).
52 Action Plan 2015, p. 24; Inception Impact Assessment 2020.
53 Impact Assessment, p. 46.

4.3 *Subsidiarity and proportionality*

The Commission is treading new territory with the proposal for substantive harmonisation of insolvency law. These proposals need to pass the subsidiarity and proportionality test, also when the envisaged harmonisation is limited to specific aspects only.[54] This follows from the fact that insolvency law is an area where the EU has no exclusive competence.[55] A careful consideration of the feasibility of the Proposal is all the more so important, as several Member States have shown reluctance for EU actions in this area.[56]

The subsidiarity test requires that any action by the EU in an area where it has no exclusive competence, is only allowed 'if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at a regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.'[57] The Commission submits that the 'different starting points, legal traditions and policy preferences' in the Member States with regard to their insolvency regimes are unlikely to result in an effective convergence of those insolvency systems.[58] Furthermore, as the Commission states: 'The harmonisation of national insolvency laws can lead to a more homogenous functioning of the EU capital markets, reducing market fragmentation and ensuring better access to corporate financing. Action at the EU level is better placed to substantially reduce the fragmentation of national insolvency regimes and ensure convergence of targeted elements of Member States' insolvency rules to an extent that would facilitate cross-border investment across all Member States. Action at the EU level would also ensure a level playing field and reduce the risk of distortions to cross-border investment decisions caused by actual differences in insolvency regimes and a lack of information about these differences.'[59]

The proportionality test requires that any measure proposed by the EU will not exceed what is necessary to achieve the objective of the Treaty on the European Union (TEU) and the TFEU.[60] The legislative basis is Article 114 TFEU, which also determines the general objective of the Proposal, namely the establishment and functioning of the internal market. The Commission argues that the Proposal is set to contribute to the proper functioning of the internal market, in particular by taking away barriers to the free movement of capital and freedom of establishment. The Proposal is also held to be proportional because it contains only minimum harmonisation requirements and is focused on specific, targeted areas of substantive insolvency law.[61]

54 Article 5(3) and 5(4) TEU.
55 Compare Proposal, p. 6.
56 Proposal, pp. 8-9; see also the response of Member States to the public consultations in: Impact Assessment, p. 81 et seq.
57 Article 5(3) TEU.
58 Proposal, p. 6.
59 Proposal, p. 6.
60 Article 5(4) TEU.
61 Proposal, p. 6.

Since the Commission has adopted a 'patchwork approach', our view is that an analysis of whether the Proposal is in line with the principles of subsidiarity and proportionality is to be decided for each topic separately. In particular, to what extent is a more homogenous functioning of the capital markets and cross-border investments facilitated by the detailed regulation of the winding-up of microenterprises (Title IV) and creditors' committees (Title VII)? Especially, the requirement of proportionality may be considered at odds with the rather extensive and detailed provisions dealing with avoidance actions (Title II; Article 4-12), but also pre-packs (Title IV; Article 19-35), winding-up of microenterprises (Title VI; Article 38-57) and creditors' committees (Title VII; Article 58-67).

The Dutch Ministry of Justice and Security has prepared a 'Fiche' in preparation for the discussion of the Proposal in the Council.[62] This document entails, in principle, broad support by the Dutch government for strengthening the internal market and the capital market, but shows a certain reluctance[63] – especially concerning the pre-pack, directors' duties to file for the opening of insolvency proceedings, the winding-up of micro-enterprises and the creditors' committee – because of possible damage to the current efficient Dutch insolvency practice, mostly due to the elaborated details of the Proposal and its burdensome effects on the judiciary.[64] As a result, according to the Dutch government, the Proposal in parts '[…] goes further than necessary to achieve this objective'.[65]

4.4 *Justification for harmonisation?*

In the Impact Assessment of some 240 pages, the Commission elaborates on the background and envisaged impact of the Proposal. It draws on economic and legal academic research, multiple studies that were commissioned and the results of (public) consultations with various stakeholders. It provides a foundation for the ambitions laid down by the Commission with the Proposal. Still, the Proposal raises questions.[66] For instance, on its scope (what is and what isn't proposed for harmonisation), but also to what extent the patchwork of topics presented in the Proposal will be able to positively influence cross-border investments. For anyone well-versed in European insolvency laws, it will be clear that harmonisation certainly has the potential to reduce some of the existing divergences and bring more legal certainty. However, both the suggested (negative) impact of the defined problems on cross-border investment as well as the (positive) effects of the Proposal on those investments remain difficult to assess. It is unclear, for example, whether the alleged 'home bias', meaning that large variations in insolvency systems would encourage forum shopping-abuse and therefore negatively impact cross-border investment,[67] is a common problem. In addition, the stated relationship between the elements of the Proposal and cross-border investment is based on assumptions suggested by several survey responses.[68] Surveys alone cannot give insight into the effects of different measures. This methodological caveat is acknowledged in the impact assessment but not addressed.[69]

The patchwork approach itself imposes a significant limitation to achieving the objectives of the Proposal. There is limited coherence between the respective topics covered by the Proposal. Furthermore, achieving the objectives with harmonisation is hampered when key concepts are left outside the scope of the Proposal, such as introducing an EU-wide definition of insolvency or insolvency proceeding and a comprehensive harmonisation of the ranking of claims, even though the latter was considered as highly ambitious.[70]

Due to the lack of coherence in the topics of the Proposal and the difficulties that brings to assess the impact of the Proposal as a whole, it remains unclear whether and to what extent the different topics will contribute to reach the Commission's objectives. Therefore, we encourage Member States to provide further evidence for the (alleged) impact that certain topics of the Proposal have or are expected to have in their jurisdiction. Not only would this make the suggested provisions more effective, it will also provide Member States with a better justification to amend their substantive insolvency laws. It must be noted that this is already the case for some topics proposed for harmonisation, in particular, because they find their origin in a detailed EU-wide study of domestic laws, as is the case with the provisions on avoidance actions.[71] Our suggestion here also builds on prior research arguing for a broader understanding of the concept of harmonisation which should not be perceived merely as a top-down approach. As Ghio et al pointed out (italics in original): 'the EU must *acknowledge* the role played by existing domestic rules and practices in the top-down harmonisation process, for its own sake, as it will result in decreased resistance to the EU measure.'[72]

62 BNC-Fiche 3: *Beoordeling Richtlijn materieel insolventierecht*, 2023Z01871, 3 February 2023 (available at: https://open.overheid.nl/documenten/ronl-5c06013edf7d652555e5354dca75a95259e11999/pdf).

63 Such reluctance from Member States is in general not a surprise, this was witnessed also in consultations leading up to the Restructuring Directive, see: Boon 2017, pp. 3-29.

64 BNC-Fiche 3: *Beoordeling Richtlijn materieel insolventierecht*, 2023Z01871, 3 February 2023, pp. 7-9, 12-14, 16.

65 BNC-Fiche: *Beoordeling Richtlijn materieel insolventierecht*, 2023Z01871, 3 February 2023, p. 12.

66 Although it falls outside the scope of this paper, this also relates to the more general questions of what is harmonisation (and how does it relate to concept such as convergence and approximation also used in the Proposal) and what strategy would most effectively be adopted to achieve harmonisation. For instance, does harmonisation – as the Proposal seems to suggest – involve top-down harmonisation, or might it also – simultaneously – be the result of bottom-up harmonisation, for instance, because of regulatory competition. See further on this: Ghio et al., 2021, pp. 427-459.

67 Impact Assessment, pp. 10 and 23. See also: A new Vision for Europe's Capital Markets 2020, p. 114.

68 Impact Assessment, pp. 47-69, especially table 8 and Annex 3 and 4.

69 Impact Assessment, pp. 111-112.

70 Impact Assessment, p. 46.

71 Reinhard Bork and Michael Veder, 'Proposal for a Harmonised Transaction Avoidance Law for the EU', *Cambridge University Press*, 2022.

72 Ghio et al., 2021, pp. 450.

5. Final remarks

With its Proposal, the Commission commenced a new voyage for harmonisation of European insolvency law. After waves of harmonisation of cross-border insolvency and preventive restructuring and the discharge of entrepreneurs, the focus has now shifted to insolvency itself. In its endeavour to strengthen the European single market and further boost the Capital Markets Union, harmonisation of insolvency law is considered key. The legal uncertainty associated with the great disparity of national insolvency regimes is considered an important impediment to promoting cross-border investments in the EU. This legislative initiative, even when the Proposal involves putting forward minimum harmonisation of targeted aspects of insolvency only, is by and of itself ground-breaking and will – if successful – be a catalyser for transforming our understanding of the room for harmonisation of insolvency law in the broad sense in years to come.

The Proposal is – as usual for legislative texts – a (political) compromise based on many consultations with numerous stakeholders: Member States, sector stakeholders, European community bodies, experts, practitioners, as well as European citizens, etc. The Proposal has now been submitted by the Commission to the European community at large, with an explicit call for comments. At the same time, the EU legislative process has started with the so-called 'trilogue' which involves negotiations to be commenced between the European Parliament and the Council.

The Proposal, as it stands, entails a mere patchwork of selective aspects that are proposed for harmonisation. We've discussed several concerns regarding the lack of definitions and coherence of the Proposal and raised questions regarding the proportionality and justification of the proposal. However, the impact of the Proposal should not be underestimated as it intervenes with certain core topics of insolvency law, requiring Member States to amend the laws on avoidance actions, but also introduce mandatorily (new) proceedings for pre-packs and liquidation of microenterprises, as well as introducing a duty to file for directors and requiring minimum involvement of creditors' committees. In addition, the Proposal extends the possibilities for insolvency practitioners to access various registers, which may prove a valuable asset tracing tool.

Critiques on these and other measures of the Proposal may be based on the fact that it proposes a deviation from the *status quo* in domestic insolvency regimes, and therefore bring a change to the current practice. However, this should not prevent us from considering the upside that a new or amended insolvency regime may provide for the domestic and European markets. Therefore, the debate that is about to unfold, also in this issue, should promote an open, but most of all constructive dialogue of what harmonisation of insolvency laws may bring.