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NOTE

From:	Presidency
To:	Permanent Representatives Committee/Council
Subject:	Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law - Policy debate

I. INTRODUCTION

1. On 7 December 2022 the Commission submitted to the Council and the European Parliament a proposal for a Directive harmonising certain aspects of insolvency law[1]. The proposal for a Directive is one of the initiatives included in the 2020 Capital Markets Union (CMU) action plan, which aims to encourage cross border investment within the single market through the targeted harmonisation of insolvency proceedings.

2. The draft Directive is based on Article 114 of the Treaty on the Functioning of the European Union (TFEU) (ordinary legislative procedure).

[1] 15896/22.

3. The European Data Protection Supervisor delivered its opinion on the proposed Directive on 6 February 2023[2].

4. The European Economic and Social Committee delivered its opinion on the proposed Directive on 24 March 2023[3].

5. In the European Parliament, the Committee on Legal Affairs (JURI) has the lead responsibility. Emil Radev (EPP, Bulgaria) was appointed rapporteur.

6. This proposal is a key element of the EU's broader efforts to strengthen the CMU. The Euro Summit statement of 22 March 2024 emphasised the need for 'the rapid completion of the outstanding legislative work on the 2020 Capital Markets Union action plan'. Additionally, in April 2024 the European Council further underscored the urgency of advancing the legislative work on all identified measures needed to establish integrated European capital markets, expressly referring to this proposal.

7. In the Council, the proposal is being examined in the Working Party on Civil Law Matters (Insolvency).

8. The first examination of the proposal began on 7 March 2023, and was carried out over twelve consecutive meetings of the Insolvency Working Party during the Swedish, Spanish and Belgian presidencies. A first compromise proposal on certain titles of the proposal - I to V and VII - was presented during the Belgian Presidency.

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[2] 6147/23.
[3] 7856/23.

9. The Hungarian Presidency decided to focus its efforts on a set of core titles in order to secure an agreement on part of the proposal by the end of its semester. A partial general approach was achieved on titles II, III, V and VIII, as well as related provisions in Title I.

10. The Polish Presidency recognises the urgent need for the EU to act swiftly to regain and strengthen its competitiveness. Improving competitiveness and productivity requires addressing various areas, as highlighted in key policy documents, including the Letta and Draghi Reports and the January 2025 Competitiveness Compass. All of these documents identify insolvency law as an important component of the broader set of requirements that are necessary to boost competitiveness.

11. Consequently, the Polish Presidency has planned a number of meetings of the Insolvency Working Party, and immediately began work with a commitment to reach an agreement on the remaining parts of the proposal at the June JHA Council in order to close discussions at Council level on the file and launch negotiations with the European Parliament.

II. ASSIGNMENT OF CONTRACTS IN PRE-PACK PROCEEDINGS

12. The primary objective of the proposed Directive is to harmonise certain aspects of insolvency proceedings in the Member States to ensure that they exhibit comparable efficiency, both in terms of the time required for business liquidation and the amount creditors can ultimately recover from such liquidation. The lack of harmonisation in this area has been pointed out as a significant obstacle to the free movement of capital within the European Union, thereby reducing the competitiveness of the European economy.

13. One of the most significant innovations proposed in the Directive, and one that is still under discussion, is the introduction of pre-pack proceedings, as outlined in Title IV. Pre-pack proceedings are aimed to achieve the swift liquidation of an insolvent debtor and the sale of its business as a going concern at the highest price available on the market, and therefore to provide a more effective procedure for achieving recovery value for creditors.

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14. In pre-pack proceedings, the sale of the debtor's business, or part thereof, as a going concern is negotiated and prepared before the formal opening of insolvency proceedings. This permits the sale to be executed and the proceeds distributed shortly after the formal opening of insolvency proceedings.

15. Most Member States support the objectives of Title IV and agree that introducing such a mechanism across the EU would help strengthen the CMU. However, certain questions have been raised about this procedure, which, as proposed, would constitute a novelty in many Member States. Specifically, concerns have emerged regarding one of the most important elements of pre-pack proceedings, namely the assignment of executory contracts, which are necessary for the continuation of the business from the debtor to the acquirer of the debtor's business (Article 27).

16. Under this provision, contracts essential for the continuation of the business are automatically transferred from the debtor to the buyer of the business without the consent of the debtor's counterparty. This mechanism enables the buyer to seamlessly continue the operations of the acquired business. It can, therefore, make the sale more attractive, expand the pool of potential buyers and lead to higher bids. Furthermore, if the crucial operational counterparties of the debtor travel with the business to the acquirer and are not affected by the bankruptcy proceedings, the pre-pack will not have the stigma of bankruptcy attached to it.

17. During discussions at technical level, different views have emerged on this issue. Some Member States support the automatic assignment of contracts necessary for the continuity of the business, arguing that only with this mechanism in place will the pre-pack proceedings have a meaningful added value and achieve the main goal of the Directive.

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18. However, other Member States contend that this provision would undermine the freedom of contract, as a principle of civil law, as it does not adequately consider the interests of the counterparty upon whom a new contractual relationship is imposed. They argue that insolvency law should not facilitate sales that are fundamentally different from those involving solvent businesses.

19. Contractual freedom is a fundamental principle of all EU legal systems, yet it is not absolute in nature, but subject to limitations where such limitations are justified and proportionate. To address this issue, the Presidency has proposed maintaining the assignment of contracts as a general rule, while expanding the room to provide for exceptions. This approach would grant Member States necessary flexibility to deviate from the rule, based on criteria such as the type of contract, the quality of the parties involved, or the specific interests of the business in question.

20. Member States have generally welcomed the improvements brought by the Presidency to the text of the proposal and the more balanced approach. Nevertheless, several Member States have reiterated that the Directive should provide sufficient flexibility to better balance the freedom of contracts with the efficiency of the pre-pack proceedings. Different views were also expressed on how such flexibility should be ensured, either by defining in the Directive only general criteria for possible exceptions or by also specifying certain exceptions in the Directive itself.

21. To move forward on these issues with the objective of preserving the added value of the pre-pack proceedings, the Presidency would like to seek political guidance on this matter.

22. Bearing in mind the principle that *nothing is agreed until everything is agreed*, the Presidency is of the view that discussions at political level will facilitate the future work on the Directive.

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III. CONCLUSION

23. Ministers are invited to express their views on

- *how can the objective of pre-pack proceedings, which is to facilitate the sale of a business as a 'going concern', notably through the automatic transfer of executory contracts, be best achieved within the context of the principle of freedom of contracts?*
- *additionally, what flexibility would Member States need in applying the general rule of automatic transfer of executory contracts in order to accept this rule as part of the pre-pack proceedings proposed in the Directive?*

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