Council of the European Union

Brussels, 27 March 2023
(OR. en)

7856/23

Interinstitutional File: 2022/0408(COD)

JUSTCIV 49
ECOFIN 286
COMPET 276
JAI 371
CODEC 490
IA 55

COVER NOTE

From:	European Economic and Social Committee
date of receipt:	24 March 2023
To:	General Secretariat of the Council
Subject:	Proposal for a directive of the European Parliament and of the Council harmonising certain aspects of insolvency law [COM(2022)702 final – 2022/0408 (COD)] - Opinion of the European Economic and Social Committee

Delegations will find attached the opinion adopted by the European Economic and Social Committee on the above proposal.

Other language versions, if needed, are available on the following website:

DM Search v4.6.0 (europa.eu)

European Economic and Social Committee

OPINION

European Economic and Social Committee

Enhancing the convergence of insolvency proceedings

Proposal for a directive of the European Parliament and of the Council harmonising certain aspects of insolvency law
[COM(2022)702 final – 2022/0408 (COD)]

INT/1007

Rapporteur: **Sandra PARTHIE**
Co-rapporteur: **Philip VON BROCKDORFF**

www.eesc.europa.eu

EN

www.eesc.europa.eu/facebook www.eesc.europa.eu/twitter www.eesc.europa.eu/linkedin www.eesc.europa.eu/instagram

Referral	European Parliament, 26/01/2023 Council of the European Union, 30/01/2023
Legal basis	Article 114 of the Treaty on the Functioning of the European Union
Section responsible	Section for the Single Market, Production and Consumption
Adopted in section	10/03/2023
Adopted at plenary	22/03/2023
Plenary session No	577
Outcome of vote (for/against/abstentions)	207/0/3

1. Conclusions and recommendations

1.1 The European Economic and Social Committee (EESC) underlines that a properly designed insolvency regime should help viable businesses to remain operational, avoiding their premature liquidation. The aim should be to find a balance between premature insolvency and proceedings starting too late. Transparency of proceedings, as well as easy access to information of a business' performance, are key factors in this context. Furthermore, a properly designed insolvency scheme should also discourage lenders from issuing high-risk loans, and managers and shareholders from resorting to such loans as well as taking other reckless financial decisions[1].

1.2 The EESC believes that insolvency reforms aimed at encouraging debt restructuring and internal reorganisation help to preserve jobs while at the same time reduce both failure rates among small and medium-sized enterprises, as well as the liquidation of profitable businesses. However, the EESC would welcome proposals to address the outstanding issue of the insolvency of natural persons.

1.3 The EESC doubts whether the proposal, which is presented as an important step in closing relevant gaps for the improvement of the EU's Capital Market Union, can actually fulfil this expectation. The proposal falls short of providing a harmonised definition of insolvency grounds and the ranking of claims, both of which are key to achieving greater efficiency and limiting the existing fragmentation in national insolvency rules.

1.4 The EESC therefore urges the Commission, the Parliament and the Council to revise the proposal in Article 27 to oblige counterparties, e.g. suppliers to a business that is entering insolvency proceeding, to sign executory contracts, which are then assigned to the acquirer of the business without the consent of the counterparty. This, in effect, binds them artificially to a contract partner they have never chosen nor vetted and curtails their entrepreneurial freedom. Restraining contractual rights of termination in the case of insolvency will reduce the willingness of vital suppliers to provide credit, especially in the case of MSMEs facing financial difficulties.

1.5 That said, the EESC welcomes the proposal to introduce a special procedure to facilitate and speed up the winding down of microenterprises, allowing for a more cost-efficient insolvency process for such enterprises. These arrangements also support the orderly winding down of "asset-less" microenterprises, and address some Member States' rejection of access to insolvency proceedings if the projected recovery value is below the judicial costs. The EESC underlines that this covers approximately 90% of insolvencies in the EU and therefore considers this procedure to be highly significant.

1.6 While the EESC endorses this special procedure, we caution that the requirements for national courts to carry out these tasks can lead to an overburdening of national judicial systems, if they are made responsible for assessing whether a microenterprise is indeed insolvent, and for conducting the necessary lengthy proceedings, including the realisation of assets and

[1] The World Bank, Resolving Insolvency, accessed 3 January 2023.

distribution of the proceeds. The EESC therefore recommends resorting to other competent players, such as insolvency practitioners, to help reduce the burden on the judiciary[2].

1.7 Finally, the EESC would like to point out that inefficient insolvency proceedings can result in higher levels of non-performing loans (NPLs) putting financial stability at risk and also having an impact on credit, inflation, and real GDP. The EESC is of the view that efficient insolvency and creditor/debtor rights (ICR) regimes are one of the complementary tools in the policy maker's arsenal to contain the growth of NPLs by increasing loan repayment probability and by adjusting NPL levels more quickly.

2. Gist of the Commission proposal

2.1 The objective of the proposal is to reduce differences in national insolvency laws and hence address the issue of potentially inefficient insolvency frameworks in Member States where such differences occur increasing the transparency of insolvency proceedings in general and reducing obstacles to the free movement of capital. By harmonising targeted aspects of insolvency laws, the proposal aims, in particular, to reduce information and learning costs for cross-border investors. More uniform insolvency laws should, it is hoped, thus expand the choice of funding available to companies across the Union.

2.2 The current proposal aims to close some gaps in previous EU legislation on insolvency rules, i.e. Directive 2019/1023 and Regulation 2015/848, in particular as regards the recovery of assets from the liquidated insolvency estate, the efficiency of proceedings and the predictable and fair distribution of recovered value among creditors. This includes issues relating to avoidance actions, asset tracing, directors' duties and liability, the sale of a company as a going concern through "pre-pack proceedings", the insolvency trigger, a special insolvency regime for micro and small enterprises, the ranking of claims and creditors' committees.

2.3 It has been observed that across the existing national insolvency rules in the Member States, there are significant variations in the time it takes to liquidate a company and the value that can eventually be recovered. In some Member States, this leads to lengthy insolvency procedures and a low average recovery value in liquidation cases. According to the European Commission, this constitutes a hurdle for the capital markets union and for cross-border investments within the EU.

3. General comments

3.1 The EESC welcomes the Commission's proposal for more transparency and availability of information concerning cross-border insolvency rules and proceedings. The EESC is of the view, however, that this proposal constitutes only a first step towards achieving convergence of insolvency regimes across the EU Member States. The EESC would also welcome proposals to address the outstanding issue of the insolvency of natural persons.

---

2 The World Bank, Principles for effective Insolvency and Creditor/debtor Regimes, revised Edition 2021, principles c6.1 and c19.6.

3.2 The EESC underlines that a properly designed insolvency regime should help viable businesses to remain operational, avoiding their premature liquidation. It should also discourage lenders from issuing high-risk loans, and managers and shareholders from resorting to such loans as well as taking other reckless financial decisions[3]. A firm impacted by a temporary economic downturn or a wrong decision may still be turned around if the economic situation improves or corrective measures are taken by the firm. When this happens, all stakeholders benefit. Creditors can recover a larger part of their investment, more workers keep their jobs and the network of suppliers and customers is preserved.

3.3 In this context, the EESC points to studies showing that effective reforms of creditor rights are associated with lower costs of credit, increased access to credit, improved creditor recovery and more effective job preservation[4]. The participation rights of a creditors' committee, possibly involving an employee representative, should also be strengthened. If, at the end of insolvency proceedings, creditors can recover most of their investments, they can continue reinvesting in firms and improving companies' access to credit. Similarly, if a bankruptcy regime respects the absolute priority of claims, secured creditors can continue lending and confidence in the bankruptcy system is maintained[5].

3.4 The EESC is of the view that insolvency reforms aimed at encouraging debt restructuring and internal reorganisation, help the preservation of jobs, and reduce both failure rates among small and medium-sized enterprises and the liquidation of profitable businesses.

3.5 The significant disparities in national insolvency laws are often cited as obstacles to cross-border investments, as are taxation regulations. The EESC believes that greater degrees of convergence in insolvency laws would help achieve a better functioning of capital markets, thus facilitating investment across the EU. However, the proposal falls short of harmonising core aspects of insolvency law, such as a harmonised definition of insolvency grounds and the ranking of claims, both of which are key to achieving greater efficiency and limiting the existing fragmentation in national insolvency rules. This does not augur well for achieving the much-needed but ambitious goal of a Capital Markets Union.

3.6 The EESC nonetheless underlines its unwavering support for a more open EU-wide capital market which provides a broader range of access to investment for companies, and acknowledges the Commission's and the World Bank's findings[6] that an increase in the recovery rate of assets in the context of greater insolvency and creditor rights (ICR) effectiveness, widens access to credit for European companies.

---

3 The World Bank, Resolving Insolvency, accessed 3 January 2023.

4 The World Bank, Resolving Insolvency, accessed 3 January 2023.

5 The World Bank, Resolving Insolvency, accessed 3 January 2023.

6 How Insolvency and Creditor/Debtor Regimes Can Help Address Nonperforming Loans - EFI Note-Finance. Washington, DC: World Bank.

4. **Specific Comments**

4.1 The EESC acknowledges that insolvency proceedings differ significantly from Member State to Member State, with national regulation favouring either a more "debtor in possession" or a more "creditor's rights" approach, or one that prioritises employment and employment legislation. This leads to different preferences regarding the liquidation of companies, the ranking of claims by creditors and the roles of company directors, insolvency practitioners and courts. Equally, when designing policies, account must be taken of differences between shareholders and debt-holders; while the former are mostly responsive to prevention and streamlining tools, debt-holders respond more to availability of restructuring tools. It is the EESC's view that the Commission proposals are a first step towards convergence across the EU, but still fall short of effective harmonisation, and leave unaddressed the outstanding issue of insolvency in regard to natural persons.

4.2 The EESC supports the Commission's view that national insolvency laws are a key consideration for foreign investors. However, the EESC points out that the amount of insolvencies with a cross-border provision of credit does not exceed 20% of all cases and that data for the G20 countries show that an effective legal rights system only increases the level of Foreign Direct Investment (FDI) from 2 to 3% of GDP. Furthermore, a significant portion of FDI is due to corporate mergers and acquisitions of existing corporations rather than investment in new enterprises.

4.3 The EESC therefore cautions against expecting too much from the impact of insolvency law convergence on investments. That said, the EESC recognises that the provision of an effective legal rights framework for creditors and more transparency for all potential investors on insolvency laws and equal information on the legal situation may have positive impacts on foreign investment. Certainty regarding rules on creditor and debtor rights and greater harmonisation of collateral removal procedures across Member States would also reduce risks and provide further impetus for cross-border investments and internal trade.

4.4 Furthermore, the EESC believes that providing investors with information and transparency on issues relating to avoidance actions, asset tracing, directors' duties and liability, the sale of a company as a going concern through pre-pack proceedings, the insolvency trigger, a special insolvency regime for micro and small enterprises, the ranking of claims and creditors' committees, are all very important.

4.5 The EESC also welcomes the fact that the proposal introduces a special procedure to facilitate and speed up the winding down of microenterprises, allowing for a more cost-efficient insolvency process for such enterprises. These arrangements also support the orderly winding down of "asset-less" microenterprises, and address some Member States' rejection of access to insolvency proceedings if the projected recovery value is below the judicial costs. The EESC underlines that this covers approximately 90% of insolvencies in the EU and therefore considers this procedure to be highly significant.

4.6 However, while the EESC endorses this special procedure, we caution that the requirements for national courts to carry out these tasks, in line with Article 12ff of the directive, can lead to an

overburdening of national judicial systems if they are made responsible for assessing whether a microenterprise is indeed insolvent and for conducting the necessary lengthy proceedings. In our view, this would defeat in part the purpose of the proposed legislation. In previous opinions[7], the EESC had stated that resorting systematically to the courts may not be the preferred option and the EESC recommended establishing new bodies which would assume responsibility for this task. The effective involvement of independent insolvency practitioners has proved to be beneficial especially for poorly organised micro-entrepreneurs in simplified liquidation proceedings, and the EESC is of the view that engaging insolvency practitioners should be actively considered[8].

4.7 The EESC also recommends that insolvency practitioners, in cases of legitimate interests, have direct and expeditious access to the national asset registers, regardless of the Member State where they have been appointed. The EESC also points out that such registers have not yet been established in all Member States and urges the relevant authorities to rectify this situation quickly.

4.8 In the interest of efficiency, the EESC welcomes the proposal for pre-pack proceedings, where the sale of the debtor's business (or part of it) is prepared and negotiated before the formal opening of insolvency proceedings. This makes it possible to execute the sale and obtain the proceeds shortly after opening the formal insolvency proceedings intended to liquidate a company. However, the EESC warns against the proposal in Article 27 to oblige counterparties, e.g. suppliers to a business that is entering insolvency proceeding, to sign executory contracts, which are then assigned to the acquirer of the business without the consent of the counterparty. This, in effect, binds them artificially to a contract partner they have never chosen nor vetted and curtails their entrepreneurial freedom. This applies all the more to employees, whose freedom of occupation must not be violated by a forced change of employer. The EESC therefore urges the Commission, the Parliament and the Council to revise this proposal. In addition, the possibility of participation and monitoring by a creditors' committee should also be strengthened in pre-pack proceedings.

4.9 The EESC also points out that the directive does not, in fact, address the issue of convergence of the ranking of claims, nor does it provide a definition of insolvency grounds. As these are a key requirement for harmonised insolvency proceedings, the EESC very much regrets that the Commission has not taken these further.

4.10 Similarly, insolvency triggers are not sufficiently taken up by the proposal, despite claims to the contrary in the communication on the directive. The proposal states that the two usual triggers in the Member States for opening standard insolvency proceedings are the cessation of payments test and the balance sheet test.

4.11 With a view to simplifying insolvency proceedings, which the EESC supports in principle, the directive proposes that the inability to pay debts as they mature should be the criterion for opening simplified winding-up proceedings. Instead of providing guidance on how to define the

7 Including EESC opinion on *Business insolvency*, OJ C 209, 30.6.2017, p. 21.

8 The World Bank, Principles for effective Insolvency and Creditor/debtor Regimes, revised Edition 2021, principles c6.1 and c19.6.

specific conditions under which this criterion is met, the proposal asks the Member States to define this point themselves, and foregoes the chance for coherence across the EU.

4.12 The EESC also notes that banks are typically the primary financial intermediaries and are fundamental for a stable financial system. Non-performing loans (NPLs) erode profitability and can threaten the solvency of banks. Insolvency and creditor/debtor rights (ICR) regimes are one of the complementary tools in the policy maker's arsenal to contain the growth of NPLs and to help resolve them when they reach problematic levels. Firm-level analysis shows that reforms of insolvency regimes which reduce barriers to corporate restructuring and the personal cost associated with entrepreneurial failure may reduce the share of capital sunk in so-called zombie firms. These gains are partly realised by restructuring weak firms, which in turn spurs on the reallocation of capital to more productive firms.

4.13 Finally, the EESC recommends that the Commission publishes regular statistics on insolvency cases under the relevant insolvency regulation so that the effectiveness of the system established can be assessed from time to time.

Brussels, 22 March 2023

Christa Schweng
The president of the European Economic and Social Committee