

A Vision of the European Insolvency Law

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A. Specifications

The present topic actually offers enough leeway to fill out a whole conference. „The European Insolvency Law“ in the title could indicate a somewhat summarizing overview over the national laws or could hint at the European Insolvency Regulation; and the term „vision“ in this title seemingly permits the author to bring forward his dreams about the future. For obvious reasons, the latter cannot be meant so that the following remarks will be restricted to what the present author believes to be the direction into which the European Insolvency Regulation and its practical application will direct the European national laws. For the sake of seriousness, the time horizon will be restricted (more or less) to the year 2012. Since it is this year (June 1 – to be precise) in which, according to art. 46 of the Regulation, the first report of the Commission of the European Union to the European Parliament, The Council and the Economic and Social Committee on (success or failure of) the Regulation’s application will be due. It is to be presumed that this report will play a decisive role for the further development of the European insolvency law but also on international insolvency law in general.

B. The Starting Point

I. The unifying effect of the Regulation

1.) It took quite a long time to get a European law on insolvency matters in place.¹ In a somewhat strange contrast to an agreement on civil procedure law, the evolution of the European Insolvency Regulation (henceforth: EIR) took roughly 40 years. This is remarkable insofar as there existed at least some preceding models for regional fusions of jurisdictions with respect to cross-border insolvency law.²

At this place it deserves a strong emphasis that the Latin American states had been the forerunners: As early as 1889 some of these States entered into a Treaty, which was called “Montevideo Treaty on Commercial International Law”. This Treaty was updated in 1940 but was then ratified only by Argentina, Paraguay, and Uruguay. Independently, and therefore, additionally another Treaty – the Bustamante Code from 1928 (based on the Havana

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¹ On the historical development of the Regulation cf. Fletcher in: Moss / Fletcher / Isaacs, *The EC Regulation on Insolvency Proceedings* (OUP 2002), p. 1 ff.; Paulus, *Europäische Insolvenzverordnung* (2d Ed. *Recht und Wirtschaft* 2007), p. 45 ff.

² See also Fletcher, *Insolvency in Private International Law* (2d Ed. OUP 2005), p. 274 ff.

Convention on Private International Law) – was entered into by 15 states. However, all these efforts were unfortunately bound to fail their goal; it appears that the commonalities existed more on paper than in practice.

In 1933, the Scandinavian countries followed the example and signed the “Nordic Bankruptcy Convention”; it seems to have been (and still is) more successful than its Latin American predecessors. Insolvency proceedings with assets located in more than one member state are dealt with until today in a quiet and obviously highly effective manner. It is only thereafter that the European endeavours started to present the next example for a regionalisation of this kind which by itself served, at least to a certain degree, as a model for UNCITRAL’s model law on Cross-Border insolvency from 1997, the central African’s OHADA, enactment of the Acte uniforme portant organisation des procédures collectives d’apurement from 1997, and the American Law Institute’s Transnational Insolvency Project from 2000.

It is worthwhile to look a bit closer at this somewhat strange pattern of attempts to achieve more efficient cross-border insolvency cooperation; quite likely, some lessons can be drawn therefrom. Leaving aside for a moment the UNCITRAL model law, the regionalisation is the first peculiarity that is noticeable. Neighbouring countries seem to be good candidates for such cooperation attempts. But obviously that is not enough; otherwise, neither the restricted success of the South American endeavours could be explained nor the fact that many other regions in the world – be it, for instance, the Balkan in South East Europe, the South East Asian countries or the North African States – seemingly have not yet even thought of introducing such kind of legislative tools. Therefore, something else must come along with the mere neighbourship – surprisingly not a common language, even though that will undoubtedly be helpful and advantageous; but neither the NAFTA states nor the OHADA and the member states of the European Insolvency Regulation are blessed with it (contrary to the Latin American States!). Instead, it appears to be indispensable that there is a kind of common market and, resulting therefrom, the mutual confidence and trust that the insolvency laws of the neighbours are more or less equivalent and share a certain common standard.

2.) Taking the European experience as a model, such mutual trust³ seems to be the single most important criterion for success or failure of any cross-border insolvency harmonization attempt. The European Insolvency Regulation is particularly far reaching in that it

³ On the importance of this issue, see Paulus/Udink, European Law and Trust, Eurofenix Spring 2004, 8 f.

establishes an automatic recognition of any insolvency proceeding listed in Annex A, cf. artt. 16 and 17 EIR, plus the general extension of the domestic insolvency law all over the other member states, cf. art. 4; thus, when an insolvency proceeding is opened in Latvia or in Portugal, in Greece or in Ireland, it is recognized in all other 25 member states and the respective insolvency law, basically speaking, is the relevant one for such proceeding.

The almost dramatic dimension of this evolutionary step becomes visible when one looks, for instance, at the decision of the Tribunal Supremo in Madrid from 1999 (i.e. only three years before the European Regulation entered into force) which ultimately declared a German insolvency proceeding as executable in Spain – but did so only after more than three years of quite intense investigation.⁴ Under the European Regulation there is no more room (or admission) for such scepticism – with the tiny exception of art. 26 EIR and its reservation for violations of the domestic ordre public.

On the other hand, the importance of trust, as essential as it might be, must not be overstated either. Not only that the European Regulation itself contains a number of exceptions from the general applicability of the *lex concursus*. In artt. 5 through 15 EIR, numerous issues are spotted which are exempted from the governing law and which, generally speaking, are subject to the applicability of the domestic law. Thus, when it comes, for instance, to questions of “employment contracts and relationships”, art. 10 EIR, or to questions of avoidance rules, art. 13 EIR, a law different from the *lex concursus* might overrule and interfere with the pure doctrine of the universality principle. The justification given for these exceptions is mostly the alleged need for protecting pre-existing trust. As questionable as this argument might be in some (if not most) of these cases it demonstrates that the aforementioned trust into the neighbours’ insolvency laws is not so strong that it would not permit – or maybe even demand – constraints.

But also the first experiences with the European Regulation within the last six years have demonstrated that there is an element of such mutual trust that still is in demand of learning, improvement, and strengthening. This time period can be described as one in which practitioners as well as academics had to build up the trust which the political legislators had claimed before as something already in existence; it was a time full of irritations, complaints and more often than not even distrust.

⁴ Tribunal Supremo, decision from May 5, 1999 – 8/96, annotated in: *Entscheidungen zum Wirtschaftsrecht (EWiR)* 2000, 889 by Paulus.

The English lawyers from the Common Law system were the ones who taught their continental counterparts a thorough lesson in how to interpret the written law!⁵ The English insolvency practitioners discovered the openness and flexibility of the concept of what might constitute the „centre of main interest“ (comi); they used it to modernize the Regulation by implementing rules about group insolvencies which, according to the explicit statements of the drafters of the Regulation text, were meant to be ignored deliberately.⁶ However, by ignoring the specifics of group insolvencies – whereby it does not matter in the present context that it is quite unclear what exactly this term might mean – the European Regulation suffered right from the beginning from a serious deficit; after all, the economic reality in almost each one of the member states was and is to an ever growing degree that companies are group members. This is even more so when these companies act in a borders crossing way. Accordingly, it had already been experienced for quite a time that cross-border insolvencies in 99 out of 100 cases are group related cases.

The English practitioners understood the term „centre of main interest“ as group related – i.e. by partially ignoring the legal separatedness of a company they saw such centre where the „head office function“ were executed. This interpretation directed in surprisingly many cases towards England – even when the parent company was not registered there. This imaginative interpretation combined with the sturdy self-interest lead to a clash with the continent’s initial adherence to the legislator’s intention and carried with it, thus, the danger of causing a trust crisis. However – and this deserves strong emphasis in the present context –, after a period of outcry and blaming, continental jurisdictions such as Germany, Italy, Hungary, and France soon followed the English example and made use of this newly discovered „group insolvency-tool“.

The bad side of the subsequent development is that the European Court of Justice did not fully grasp the implications of a lacking group insolvency law and established in its famous „Eurofood“ decision⁷ hurdles on the way towards a modernized Regulation. The good side of this story is, however, that the court did not close this path entirely – when and if the said head office function is assigned to the parent company in a (objective) way that this is recognizable by third parties (whoever that might be) the English approach still is valid

⁵ Cf. Paulus, Group Insolvencies – Some Thoughts About New Approaches, 42 Texas Intl.L.J. 819, 821 ff. (2007).

⁶ Cf. Virgós-Schmit Report on the Convention on Insolvency Proceedings, par. 76; reprinted at Moss / Fletcher / Isaacs (as in fn 1), 263, 282. See additionally, Virgós / Garcimartín, The European Insolvency Regulation: Law and Practice (KLI 2004), p. 46 ff.

⁷ Available in the internet under: <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en> (parties: Eurofood). For a critical interpretation see, e.g., Moss, Asking the Right Questions? Hints and Lows of the European Court of Justice (ECJ) Judgment in Eurofood, Insolvency Intelligence 19, 2006, 97, 101.

under European law. Presently, the huge case „Eurotunnel“ and its concentration in France is based on this interpretation.

3.) The short history of the European Regulation is telling insofar as one of the predominant reasons for introducing this law was, according to its consideration no. 4, to cut off forum shopping; seen in a retrospective, this declaration was nothing less than an eye-opener. It attained the contrary of what it wanted to achieve by drawing everybody's attention to the possibility and sometimes the attractiveness of such shopping.

Along with this history, there is (for reasons to which I will return below) an approximation of the commercial law and insolvency law. There is no better demonstration of this tendency imaginable than the two cases in which German companies transferred their centre of main interest from Germany to the U.K. before filing there a petition to open an insolvency proceeding.⁸ They did so because the CVA proceeding (company voluntary arrangement) is deemed to be more attractive and advantageous than its German counterpart. This form of a forum shopping is not the one addressed in the Regulation; it is rather making use of the European Union's fundamental right of freedom of establishment – but, of course, with a strong eye on the insolvency legislation in the new surrounding. Again, after initial irritation and blaming of the other side, Germany only recently followed the English example and „pulled“ a Luxemburg holding company into the pan-German proceeding by transferring the head office function to Cologne before the Luxemburg filing (but after the filing for most of the German affiliates). This case is noticeable insofar as it is, so to speak, located exactly on the border line between the admissible freedom of establishment and the proscribed forum shopping.

4.) With all these introductory narrations, the ground is laid for explaining the unifying effect of the European legislation. The European Regulation has initiated a competition in Europe between the various domestic insolvency laws. The national legislators are brought under pressure to improve, modernize, or just amend their laws if they do not want their „customers“ to go to another, more attractive „shop“. This development became already apparent some decades ago when the European Union started to unify the commercial law; it has now reached the insolvency laws, too. In Germany, for instance, the responsible Ministry of Justice has reacted to the abovementioned two cases of pre-insolvency movement of the centre of main interests to England by establishing a so-called expert group. It is commissioned to find solutions, amendments, or improvements for re-gaining

⁸ For a short description see, e.g., Willcock, German Restructurings Head to London, *INSOL World* – 4th Qu. 2006, 14 f.

the German law's attractiveness and, thereby, to prepare it for other competition attacks, as it were.

But it is not Germany alone which is in search for improving her insolvency legislation. There is an almost feverish hectic among most of the European states to outdo the others in amending their laws: To name but a few of the recent reform efforts, there is, for instance, Spain, Italy, France, the Netherlands, Greece, and the Czech Republic. Each one of these jurisdictions is striving for improvement; thereby, however, always keeping in mind the status of the competitors' laws and, thus, restricting the competition to a playing field which is located on a solid block of numerous commonalities and uniformity.

However, it is to be admitted that there are definitely different levels of such competitive actions in Europe. Latvia, for instance, has enacted on Jan.1, 2008, its new insolvency law. It is a paradigm for a misunderstood function of a modern and effective insolvency legislation. By repressing almost entirely the creditors' interests, it is over-emphasizing the debtor's interest in becoming rescued or even saved from going through an insolvency proceeding. Moreover, in an attempt to make judges, practitioners and other insolvency related stakeholders aware of the European Regulation's existence, the new Latvian law inserts rules of the Regulation into the domestic law – thereby using its own language and ignoring the Regulation's systematic coherence. Needless to say that this is a violation of the European law – after all, it is a fact well known to all lawyers worldwide that changing the wording of a law and putting rules into another context leads immediately to different interpretation and falsifies, thus, the original.

II. National Developments

The preceding remarks dwelled already on national developments in Europe. They deserve a closer look insofar as they unveil a trend beyond the abovementioned competitive activity. However, since this trend is not restricted specifically to the European development it is appropriate to approach this phenomenon from a broader, actually from a global angle.

1.) From there it becomes visible that, roughly speaking, the last decade has brought with it a stunning degree of worldwide unification in insolvency legislation.⁹ Caused by the East Asia crisis in the mid-nineties, the International Monetary Fund was identified by politicians to come up with something that would modernize insolvency legislation and effectuate greater practical application in the various member states. It is well known that the result of the

⁹ For what follows see Paulus, *Global Insolvency Law and the Role of Multinational Institutions*, 32 *Brooklyn J.Intl .L.* 755 ff. (2007).

IMF's efforts was the publication of the booklet on „Orderly & Effective Insolvency Legislation“ from 1999; it contains in an admirably dense, concise, and handy manner those principles that constitute something like the least common denominator of modern insolvency legislation in the developed countries. Supported by the powerful conditionality that is bestowed upon both Bretton Wood institutions, the said publication of the IMF served as a unifying tool in quite a number of countries.

It is similarly well known that the development did not stop there: The responsibility for insolvency legislation shifted from the IMF to its sister institution – the World Bank. It broadened the field of inspection, as it were, by its „Principles and Guidelines for Effective Insolvency and Creditor Rights Systems“ from 2001 and uses this guidebook ever since as a kind of benchmark for its ROSCs (i.e. Reports on the Observance of Standards and Codes). Needless to state that this – in combination with the conditionality – brings with it a good deal of worldwide harmonisation in insolvency laws.

And finally, the UN as the third of the big multilateral institutions did not stand behind this development. Encouraged by the success of its model law on international insolvency law, the U.N Commission on International Trade Law (UNCITRAL) decided to come up with its „Legislative Guide on Insolvency Law“. Free from the economic and financial pressure of any conditionality, this book unfolds worldwide influence through its kind of democratic authority; after all, it is the result not of the work of a single unit but of a long lasting discussion process among numerous U.N. members. Based on this fundament, UNCITRAL feels encouraged to intensify its efforts with regard to insolvency legislation and engages at this present time in finding some guidelines for the regulation of the insolvency of groups of companies.

2.) Even if one leaves the respective efforts of some of the regional institutions such as the European Bank for Reconstruction and Development or the Asian Development Bank aside, the achievements of the three abovementioned multilaterals alone make it evident that there is a – historically speaking – unique tendency towards unification. The probably single most important feature of this modernization is the breaking open of the bankruptcy law's traditional and immemorial one track option of liquidation by adding the alternative of the debtor's reorganisation. The highly interesting question of what might be the reason for the almost global acceptance of this new option can be answered on different levels. The most ostensible (and somewhat superficial) one is the political and economic pressure from these multilaterals as described supra; another one would be that it is the model function of the U.S. law which is recognizable in many areas.

A deeper rooted (but not more than just likely) answer, however, is that this development might be inherently related to the increasing importance and predominance of the service economy in this world. Its main assets are not any longer mobiles, immobiles, and receivables – or, as the ancient Roman jurists would have called them: *mobiles, immobiles, et nomina*. This historical reminiscence is mentioned here not without reasons; since the Romans have already fully developed the tools necessary for trading with these kinds of assets. This is remarkable insofar as a receivable – in stark contrast to movables and immovables – is nothing that exists in the real world – it is just a virtual thing. Unlike a book (movable) or the beach of Puerto Vallarta (immovable), no one has ever seen a receivable – since this is something that is a mere emanation of the lawyers' imagination. Nevertheless, the Romans coped already with this phenomenon in a way that the „tradability“ of this asset is usually deemed to be as self-evident as that of a car or a real estate.

What the Romans, however, did not know – or, at least, what they did not classify as legal concepts – are assets such as good will, knowhow, charisma, or a list of customers. These are goods that have become invaluable only and particularly in the context of the said service economy. For them we have not (yet?) developed a market (or tradability) comparable to that of *mobiles, immobiles et nomina*. Their peculiarity is their strong dependence on and interrelationship with an individual person – they are by far not as de-individualized as receivables. It is for this very reason that liquidation will not be a considerable help in a surrounding where these modern assets are the prevailing type of goods. If this is true then there is obviously only one way of reactivating the value of such assets – namely by helping the individual to re-enter the path of economic success and, in other words, to reorganize or rescue it.

Once this shift has been broadly acknowledged and widely internalized, it is only a small step towards a further and almost dramatic move within the insolvency field – namely from insolvency law as an ex post-mechanism to insolvency law as a preventive ex ante-remedy.¹⁰ This is exactly the tendency that can be observed in recent modern European insolvency legislation. Under the leadership of the English CVA, the French, Greek and Italian new amendments have adopted a similar type of proceeding; the new Dutch law is said to have it also and the German legislator as well is right now considering to go into the

¹⁰ Cf. Finch, *The Recasting of Insolvency Law*, 68 *Modern L.R.* 713 ff. (2005).

same direction. It is a common feature of all these incidents that a liquidation shall be banned to the extent possible and that instead the debtor's rescue be made possible.

Seen from this stance insolvency law gains numerous commonalities with seemingly disparate areas such as certain capital market tools or corporate governance; they all serve the purpose to avoid the traditional concept of bankruptcy – based on the assumption that the economic assets should be brought back to their highest productivity potential as rapidly as possible. It is in the same line of thinking that insolvency is losing much of its previously predominant flaw and that this proceeding's bad ramifications are little by little replaced by an understanding according to which an insolvency proceeding is seen and understood as a chance for reorganisation.

C. The Future

The latter observation leads directly to the final deliberations about the possible or even likely future of the European insolvency law – at least that of the next four years or so. It follows quite naturally from the abovegiven description of the recent development that the competition between the European legislators will continue. But it is similarly likely that the margins within which this competition takes place are narrowing. Those features which prove to be successful – i.e. which attract forum shoppers¹¹ – will form an increasing body of minimum standards that no competitor can afford to go below. Thereby, the insolvency laws will converge to a still higher degree than the harmonization that we encounter already today.

This convergence is more than likely to have some impact on the proposals of those who will draft the report about the practical experiences with the European Regulation in 2012. First of all, this report will take into consideration the judgments rendered until then by the European Court of Justice. Therefore, there will be a recommendation to provide a rule according to which changes regarding the competent court which take place after the filing of a petition are irrelevant with respect to such competence; in the matter „Staubitz-Schneider“ the European Court adhered to the traditional rule of „perpetuatio fori“. Similarly, there will be some reference to the problem of group insolvencies – very likely in that shape that the „centre of main interests“ is dependent on objective elements which are recognizable by third parties. This is what the ECJ required in its abovementioned „Eurofood“ decision – thereby, unfortunately leaving undecided whether such „third parties“

¹¹ Presently, numerous German consumers are attracted by the French, English and Swiss law of discharge; the reason is that the waiting period there is much shorter than the six years of the German law.

are creditors, anyone else, or just the deciding judge¹² – but, after all, opening the possibility for instituting a group related court competence.

And finally, there will be some clarification about the courts' jurisdiction in matters that are only indirectly insolvency related – such as, e.g., law suits based on avoidance actions. This is a question pending right now in Luxemburg which results from the lacking mutual alignment of the European Insolvency Regulation and the one on Jurisdiction, Recognition and Enforcement of Judgements; it is likely that the decision will ultimately derive such jurisdiction from the competence to open an insolvency proceeding – and, thereby, pretend that such jurisdiction is implicitly included in the existing rules that talk about the competence to open a main or a secondary proceeding but that say nothing about related law suits.

Additionally, the abovementioned report is quite likely to reduce the number of exceptions from the applicability of the *lex concursus*. There are right now those articles 5 through 15 of the European Insolvency Regulation which undermine the universality principle by establishing the applicability of the law of another jurisdiction than the one of the main proceeding. Pursuant to art. 15, for instance, the effect of the opening of an insolvency proceeding on pending law suits is governed by the law where this law suit is pending – and not by the one where the main proceeding has been opened. The currently almost dramatically increasing body of European Civil Procedure law will probably reduce the justification for such exception so that art. 15 is a likely candidate for deletion. The same might be true for further articles which are based on an alleged trust of the parties – which is of diminishing persuasiveness in an ever converging legal surrounding such as the European Union. However, the possible braking element in this development might be the abovementioned Europe of different speeds – be it recalled that there are still many member states who lack the same length of experience with a functioning market economy and a corresponding insolvency law.

And finally, when and if the drafters of the 2012 report are courageous they will extend the numbers of provisions which are directly applicable and are, thus, constituting something like an European insolvency law. What is probably needed for such a step, however, is a common effort of many experts to come up with a work about the common principles of the insolvency laws of all the member states. Preparatory work has been done for this

¹² Cf. Paulus, *Der EuGH und das moderne Insolvenzrecht*, *Neue Zeitschrift für Gesellschaftsrecht* 2006, 609 ff.; *idem* (as *supra* in fn 5), p. 824.

undertaking by the publication of a number of academics in 2003 on such principles¹³ – but not with a full coverage of all member states.

Whatever the future development in insolvency matters will be in Europe, it is to be hoped that the Latin American states feel encouraged by this – not only that they share an old tradition, much older than the one in Europe, they have also the invaluable advantage of sharing a common language. Where else in this world a better preconditions for a trust-based cooperation in trans-border insolvency matters?

¹³ See McBryde / Flessner / Kortmann, Principles of European Insolvency Law (KLP 2003).