

## Initial appraisal of a European Commission Impact Assessment

### European Commission proposal for a Regulation on insolvency proceedings

Impact Assessment (SWD (2012) 416, SWD (2012) 417 (summary)) for a Commission proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (COM (2012) 744)

#### • Background

This note seeks to provide an initial analysis of the strengths and weaknesses of the European Commission's Impact Assessment (IA) accompanying the proposal for a revised Regulation on insolvency proceedings, submitted on 12 December 2012.

Regulation (EC) No 1346/2000 on insolvency proceedings (EIR) establishes a legal framework for cross-border insolvencies in the EU, unifying private international law rules relating to insolvency proceedings. It applies since 31 May 2002 in all Member States, with the exception of Denmark, which chose to exercise its opt-out on judicial cooperation in civil matters under the TFEU. From 2009-2011, an average of 200,000 firms went bankrupt per year in the EU, resulting in direct job losses each year of around 1.7 million. About one quarter of these bankruptcies have a cross-border element (IA, p. 7).

The proposal under consideration seeks to amend the EIR by: (1) extending its scope to pre-insolvency and hybrid proceedings, as well as to debt discharging proceedings and other insolvency proceedings for natural persons, (2) clarifying jurisdiction rules, (3) introducing rules on secondary proceedings and extending cooperation requirements to the courts, (4) requiring Member States to publish relevant court decisions, and (5) providing for coordination of the insolvency proceedings concerning different members of the same group of companies.

The Commission proposal is accompanied by an IA and by an evaluation report on the application of the EIR so far, as foreseen after 10 years of its operation.

The review of the EIR not only links in with the issue of improving the efficiency of justice, but also with the more general objectives of promoting growth, employment and investment in the EU economy as a whole.

The European Parliament, in its Resolution of 15 November 2011<sup>1</sup>, requested the Commission 'to submit one or more proposals relating to an EU corporate insolvency framework, ... in order to ensure a level playing-field, based on a profound analysis of all viable alternatives'. An Annex to the Resolution sets out detailed recommendations as to the content of the proposal requested. A number of these recommendations regard the revision of the EIR, and are reflected

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<sup>1</sup> European Parliament Resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)), P7\_TA(2011)0484.

in the proposal under consideration, for example on the scope of the EIR and on the definition of 'centre of main interest'.

## • Problem definition

The IA contains an elaborate description of the problems in need of EU intervention, but limited to the key problems identified as such in the evaluation of the EIR. The problems are described, their interrelation is explained, and they are illustrated by case examples.

Problem group 1 relates to problems regarding the scope of the current Regulation, generating obstacles to the rescue of companies and to the free movement of entrepreneurs and debt-discharged persons. The EIR does not cover national insolvency proceedings aimed at rescuing companies. Consequently, there is no EU-wide recognition of the effects of such pre-insolvency or hybrid proceedings, notably the stay of individual enforcement actions. The EIR does not effectively cover the full range of personal insolvency schemes in the Member States. This results in a lack of recognition of such schemes in other Member States and debtors remaining liable to foreign – but not domestic – creditors. Moreover, the EIR does not effectively deal with the insolvency of groups of companies. A piecemeal liquidation of a group of companies diminishes the prospects of successful restructuring.

Problem group 2 relates to problems in the implementation of the Regulation, concerning i) difficulties with the definitions, and ii) difficulties when the main and secondary proceedings run in parallel. There is no definition of the concept of 'centre of main interest' (COMI), leading to difficulties in determining jurisdiction for opening insolvency proceedings, forum shopping, and even a phenomenon termed 'bankruptcy tourism', when natural persons move to another Member State in order to get a quicker discharge of their debts. The EIR allows secondary proceedings to be started where the debtor has an establishment, but these secondary proceedings can only be liquidation or winding-up proceedings, excluding restructuring or rehabilitation. Finally, there are also practical difficulties relating to the lack of publicity for the decisions relating to an insolvency procedure and to the lodging of claims.

The Commission explains which stakeholders are affected by the problems in question and attempts to quantify their extent, but does not provide a detailed description of the baseline scenario, in which no further EU action would be taken.

## • Objectives of the legislative proposal

The *general* objective of the proposal is 'to improve the efficiency of the European framework for resolving cross-border insolvency cases, in view of improving the functioning of the internal market and its resilience in economic crises' (IA, p. 30).

The following *specific* objectives are derived from the general objective and the described problems:

- to ensure EU-wide recognition of national insolvency-related proceedings contributing to rescuing businesses, protecting investments, preserving jobs and encouraging entrepreneurship, and providing a second chance to honest entrepreneurs and over-indebted consumers;
- to increase legal certainty for creditors, thereby encouraging cross-border trade and investment;
- to improve the efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;

- to improve the efficiency of handling the insolvency of members of a multi-national group of companies, thereby maximising the value of their assets and facilitating rescue.

The IA also lists a number of *operational* objectives. These are, for example, to reduce the number of cases where the determination of jurisdiction has been an issue, and to reduce the number of secondary proceedings opened outside the main jurisdiction.

## • Range of options considered

Apart from the 'status quo' option, the IA only put forward two options, but each option is composed of several elements (or sub-options).

### *Status quo option*

The IA contains a description of how the situation and the described problems are expected to evolve, in the case that no further action at EU level is taken. Both problems relating to the scope of the EIR and in its implementation are expected to remain or even increase. The recently adopted Directive 2012/17/EU on the interconnection of central, commercial and companies' registers will, from 2017, only partially solve the problem of lack of publicity of insolvency decisions. The Directive does not include natural persons, the information to be provided under the Directive is not sufficient in case of insolvency, and in most Member States the register covers only limited liability companies (IA, p. 36).

### *Option A*

Option A would entail a modernisation of the existing Regulation while preserving the current balance between creditors and debtors and between universality versus territoriality. It contains the following six elements:

- 1) The scope of the EIR is to be extended to include hybrid proceedings, pre-insolvency proceedings and personal insolvency proceedings, and the requirement that secondary proceedings have to be winding-up proceedings is to be abolished.
- 2) In case of the insolvency of a group of undertakings, the entity-by-entity approach is retained but with coordination of the main proceedings through general cooperation mechanisms, with the possibility, when appropriate, to nominate a lead insolvency practitioner.
- 3) Member States will be required to publish decisions opening and closing insolvency proceedings, as well as other decisions issued in the proceedings in a national electronic register, and to define common categories for the interconnection of national registers through the e-justice portal.
- 4) Procedures and mechanisms will be introduced at EU level for the lodging of claims and Member States will be encouraged to set up electronic means for the lodging of claims.
- 5) The procedural framework of the EIR will be improved, for example by a clarification of the concept of 'centre of main interest', and judges will be trained.
- 6) Secondary proceedings will be maintained, but there will be improved coordination with the main proceeding prior to the opening and during secondary proceedings.

### *Option B*

Option B would involve a modification of the fundamentals of the Regulation and some approximation or convergence of national insolvency laws and proceedings.

The first, third and fourth elements of Option A - extension of the EIR scope, publication of decisions in a national register, and procedures and standardised form for lodging of claims - are common to both options.

The following elements are specific to Option B:

- 2) A single court would be competent for all main proceedings and a single insolvency administrator would be appointed for all members of the group ('procedural consolidation').
- 5) Certain elements of national insolvency laws would be harmonised, in particular, debt discharge periods, conditions and rules for opening procedures, rules on hearing of creditors and affective remedy.
- 6) Secondary proceedings would be abolished and only a single main insolvency proceeding with EU-wide effect would be retained, dealing with the parent company and all branches and establishments.

The Commission indicates that it has discarded one possible sub-option that was proposed by stakeholders as a remedy for the problem of forum shopping. In particular, following a shift in 'centre of main interest' (COMI) to another Member State, it was proposed that there would be a suspension period of one year, during which the jurisdiction for insolvency proceedings would remain with the courts of the Member State of origin. The Commission deems this option not sufficiently effective and says that it would create new legal uncertainty, relating to the exact time the COMI has shifted.

**The Commission's preferred option is Option A.**

#### • **Subsidiarity / proportionality**

The proposal is based on Article 81 TFEU (judicial cooperation in civil matters).

The Commission justifies action at EU level on the basis that, as the issue to be addressed has transnational aspects, the latter cannot be satisfactorily dealt with by the Member States. Moreover, the need to establish rules for the insolvency of companies operating on a cross-border basis, including groups of companies, is well recognized by all Member States and the international community (IA, p. 29).

At the time of the provision of the current initial appraisal, no national parliament has issued a reasoned opinion, raising problems with respect to the subsidiarity principle.

The proportionality of the proposed policy options is not explicitly dealt with, but seems to be taken into account in two respects. First, Options A and B substantially differ in the degree to which they interfere with national insolvency law and national judiciary systems. In fact, although Option B (entailing a certain harmonisation of insolvency law and giving single jurisdiction to the court of the COMI) would be more efficient in meeting the objectives of the proposal, and would more completely address the European Parliament's Resolution of November 2011, Option A is preferred implicitly on the ground of proportionality (IA, p. 45-46).

Moreover, Option B, in particular the element of having a single procedure for companies with establishments and for groups of companies, would have significant negative repercussions on the right to property of the creditors of establishments or subsidiaries. In the absence of European provisions on the treatment of foreign creditors, depriving these creditors of the possibility of opening local insolvency proceedings, governed by the law of the state of the establishment/subsidiary, would have an impact on their right to property that seems, to the Commission, disproportionate with respect to the objectives (IA, p. 43).

- **Scope of the Impact Assessment / Quality of data, research and analysis**

The IA does not examine the impact of the individual elements of the two retained policy options, but describes the possible impacts (called 'strengths' and 'weaknesses') of the packages. With exception of the 'specific costs for Member States', all impacts are described in a purely *qualitative* manner.

The options are first compared for their effectiveness in achieving the objectives. Both options would be effective in achieving a more efficient handling of insolvency proceedings, with Option B (single proceeding with EU-wide effect) producing the best result.

The impact of the options on fundamental rights is examined, namely the right to property, freedom to conduct business and the right to engage in work, freedom of movement and of residence, protection of personal data and the right to an effective remedy.

The economic impacts of both options are said by the Commission to be mainly positive, because of increased legal certainty and prevention of unnecessary bankruptcies. At the request of the Commission's IA Board, the potential risk that giving a second chance to debtors might also negatively impact other entrepreneurs' access to affordable credit is mentioned. However, there is no further explanation of how serious this risk might or might not be. The Commission limits itself to stating that 'rescue procedures, second chance and discharge of debt are deemed to encourage moral hazard, debt forgiveness and subsequent increase of credit cost where such procedures would not be sufficiently tightened and closely monitored. However, the organisation of the judicial systems is a competence of the Member States' (IA, p. 39).

The Commission says that both options would have positive social impacts, in the sense that they would facilitate the preservation of jobs, as viable businesses will be able to continue.

However, the options substantially differ as far as their impact on Member States is concerned. Option A would have an impact on the development of rescue schemes in all Member States, but would otherwise have a low impact on national insolvency laws, as it contains only procedural measures. Option B would entail a substantial element of harmonisation and would therefore have an important impact on national insolvency laws and judicial systems.

The IA also briefly mentions that the implementation of Option B might facilitate investments from third countries. This is because, in general, businesses, as debtors and creditors, would benefit from more harmonised rules.

The Commission has used the results of two external studies to support the IA: an evaluation study, performed by the Consortium Heidelberg / Vienna University, and an impact assessment study by the Consortium GHK/Milieu. Further input was provided by a group of 20 individual experts in cross-border insolvencies.

- **SME test / Competitiveness**

Annex 3 to the IA usefully provides data on the size of the enterprises involved in insolvency proceedings in the EU and on the degree of 'internationalisation' of European SMEs. The IA also indicates that 'the great divergence of discharge periods in national laws, and in particular the excessive length of discharge periods in certain Member States, has been identified as a major obstacle to providing a second chance to SMEs' (IA, p. 44). However, the harmonisation of the discharge periods is not part of the preferred policy option.

A formal SME test, in the format prescribed by the Commission's IA Guidelines, is not provided in this IA. Also a 'competitiveness proofing' exercise is not given. One could imagine that Option B, finally not retained by the Commission, might score better under both the SME and competitiveness tests.

- **Budgetary or public finance implications**

Option A would entail specific costs for Member States and for the EU budget, related to the training of judges and to the development, upgrading, and interconnecting of national insolvency registers. Training of judges would cost between 7 and 10 million euro for all Member States. Depending on whether the Member State already has an insolvency register in place, upgrading this register or creating a new one would cost between 100,000 euro and 1 million euro per Member State. The cost of maintenance of the register would amount to 100,000 to 150,000 euro per Member State annually.

The development of the interconnection of national registers would cost 0.5 to 1 million euro, and maintenance between 100,000 and 300,000 euro from the EU budget. The cost to Member States of developing and maintaining this interconnection would amount to 50,000 euro per year.

- **Stakeholder consultation**

A public stakeholder consultation was held between March and June 2012, resulting in a rather limited number of responses (134 answers from stakeholders in 25 Member States). A summary of the responses is provided in Annex 2 to the IA.

The Commission's IA Board asked the originating service, DG JUST, to explain whether the fact that a high percentage of the replies to the public consultation came from a small number of Member States (indeed, more than 50 per cent of replies come from the UK, Romania and Italy - see Annex 2, p. 50) had an impact on the analysis. Such clarification seems not to have been included in the IA.

The Commission states that 'the opinions of the stakeholders have been taken into account throughout the IA process', but these opinions are not presented systematically in the report when analysing and comparing the options.

- **Monitoring and evaluation**

The Commission states in general that regular evaluation and reporting will take place. No concrete indicators for such evaluation are proposed.

- **Commission Impact Assessment Board**

The Commission's IA Board considered the draft impact assessment and issued a critical opinion in October 2012. The Board requested the originating service, DG JUST, to present the problem drivers and the policy options in greater detail and to simplify the presentation of objectives and options. The stakeholder opinions had to be more clearly presented and the assessment of the impacts needed to be strengthened, in particular by greater quantification. This last part of the recommendation of the IA Board seems not to have been fully followed up.

- **Coherence between the Commission's legislative proposal and IA**

The IA and the proposal seem to correspond, as the proposal is clearly based on the preferred option.

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This note, prepared by the Impact Assessment Unit for the Committee on Legal Affairs (JURI), analyses whether the principal criteria laid down in the Commission's own Impact Assessment Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work.

This document is also available on the internet at:

<http://www.europarl.europa.eu/committees/en/studies.html>

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