HARMONISATION OF EU LAWS ON BUSINESS FAILURE AND RESCUE. A CASE STUDY ON THE INTERNAL MARKET AND EUROPEAN INTEGRATION

Emilie Ghio *

A. INTRODUCTION

(1) Background and Context of Cross-Border Insolvency

Insolvency laws and regulations play a hugely important role in the economy and wider society, given that a defining characteristic of a market economy is the use of competitive methods in order to achieve maximum profit. Indeed, the risk of business failure is an essential feature of economic activity, and the sole way to avoid this risk is by not doing business at all.1

The failure of a company affects a wide range of interests, and thus, insolvency legislation closely interacts with other areas of law. It is therefore of increasing importance, not only in its own right, but also in its impact and influence on a host of other sectors, such as employment, tort, environmental, pension and banking law.2 With the accelerated growth in international trade in recent decades, the paradigm of national economies has been transformed into a more open, increasingly interconnected, and interdependent arena. While increased globalisation can be perceived as a benefit during solvent periods of trading, the impact of insolvency proceedings is no longer limited by geographic frontiers. It can have devastating effects on stakeholders in a number of EU member states, each of which may claim to be competent in governing the entire insolvency proceeding or, at least, in liquidating domestic assets and protecting domestic creditors. In the European arena, therefore, the question arises as to which jurisdiction should be competent to govern insolvencies.3

The 2008 financial crisis and the following global economic downturn adversely affected businesses around the world, resulting in financial difficulties for many firms. The consequent increase in the number of insolvencies highlights the need for corporate bankruptcy laws to liquidate unviable firms and reorganise viable ones, so as to maximise the total value of proceeds received by creditors, shareholders, employees and other stakeholders.

After a debtor becomes insolvent, the relationship between corporate stakeholders changes dramatically: shareholders become the residual claimants of corporate activities.4 Usually, creditors

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* PhD candidate, University College Cork.
1 R Goode, Principles of Corporate Insolvency Law (2011) 57.
3 See e.g. International Monetary Fund Legal Department, ‘Orderly and Effective Insolvency Procedures, Key Issues’ (1999), available at http://www.imf.org/external/pubs/ft/orderly/
cannot coordinate themselves and, therefore, often collect their debts individually, seizing a debtor’s assets as soon as financial distress becomes apparent. This “race to the grab” leads to inefficient outcomes for the creditors as a group, especially if the going concern value of debtors’ assets is higher. Indeed, the probability of a successful rescue is reduced because there are returns for secured creditors in liquidation, which may reduce returns over a longer period of time. Moreover, as it affects many areas of the legal landscape in adjusting rights among creditors and other owners, bankruptcy law must address issues in a wide variety of disciplines, including employment law, environmental law, and tax law. Further, it must reconcile the rights of secured creditors with other property claimants. All these stakeholders have contractual or statutory rights to assert claims against a debtor and their assets, and as such, are inevitably affected by bankruptcy law.

These issues of variability surrounding bankruptcy law are complex when confined to one jurisdiction, but they inevitably become even more delicate when the debtor’s creditors and assets are spread over different European countries. This results in insolvencies having cross-border implications. In that case, the conceptual matrix of private international law will be applied, so as to identify the issues which may have to be resolved, i.e. (1) in which jurisdiction(s) may insolvency proceedings be opened?; (2) which country’s bankruptcy law should be applied?; (3) what international legal consequences should be accorded to insolvency proceedings conducted in a particular country?

(2) The Underlying Issue: Diversity of National Bankruptcy Laws

Because of the complex and comprehensive nature of insolvency law, the practical difficulties encountered in a cross-border case may be considerably greater than those found in the more usual context of international litigation between solvent parties. Indeed, even though it is possible to depict the factual elements of insolvency in global terms which are internationally understood, national attitudes towards bankruptcy are extremely diverse, since the consequences for the debtors vary greatly from one country to another. Bankruptcy law can be described as “meta-law”; it impacts upon the entire patrimony of the debtor and, in addition, the range of parties and the legal interests involved are extremely extensive. Therefore, the link between insolvency law and public policy within a country is an intimate one and as such, despite numerous general resemblances, national insolvency laws and procedures differ significantly.

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6 However, some creditors are “involuntary creditors”, i.e. they do not have statutory or contractual claims against a debtor, e.g. tort victims.
7 See P Omar (ed), International Insolvency Law, Themes and Perspectives (2008), at x: “European insolvency is a ... branch of the study of insolvency that owes much to the phenomenon of cross-border incorporations and the conduct of business in more than one jurisdiction. It is, like insolvency, also a study of law and economic rules, to which is added the extra complication of EU law and the conflict of legal rules because of the involvement of more than one legal order.”
Over recent decades, the increasing frequency and extent of European cross-border insolvency cases have exposed the limitations of the existing body of law in this field, both at national and European Union (EU) levels. When one examines the parts of each country’s private international law dealing with insolvency, the conflicting views are even more deeply-rooted than in any other types of conflict of laws.\(^{10}\)

(3) **Outline**

This paper generally focuses on the efforts at the EU-level to provide a legal framework for dealing with cross-border bankruptcies, notably through the European Council Regulation on Insolvency Proceedings of 2000 and the recast Regulation of 2015. Indeed, notwithstanding the new recast of the European Insolvency Regulation (EIR), the 2000 text is still applicable until 2017, and therefore, it is necessary to explore it. The paper considers the issue of harmonisation of corporate insolvency and rescue law at the European level, and the tensions between different solutions for the reform of cross-border insolvency and business rescue.

The first section examines the adequacy of the existing rules against the framework of EU law, as the EIR was adopted under Title IV of the EC Treaty. The legal basis for harmonisation of insolvency law will be analysed to determine whether the choice of this form of regulation effectively promotes the proper functioning of the internal market.

Secondly, the paper looks at the specific issue of primary and secondary proceedings, since the EIR was oriented more towards facilitating liquidation than rehabilitation. This section is located within the broader doctrinal distinction between universal and territorial approaches to resolution of international conflict of laws.\(^{11}\)

Finally, the latest European reforms are considered. More than ten years after the adoption of the EIR, the European Commission has linked its amendment with the EU’s current primary concern of promoting economic recovery and sustainable growth. This paper examines the two events that are currently changing the landscape for business restructurings in the EU: the

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“Restructuring Recommendation” of the European Commission, issued in 2014, and the 2015 recast of the EIR, assessing whether the reforms address the issues of the previous regime.

B. SETTING THE SCENE: INSOLVENCY LAW IN THE EUROPEAN UNION

(1) An Efficient European Insolvency Law

Harmonisation within the EU has been subject to alternating policies and approaches since the creation of the European Community (EC). Initially, the process of market integration was predicted to be realised through market liberalisation, i.e. the elimination of trade barriers between member states. It was also thought that extensive regulation would be needed at a later stage and in the mid-1980s, the Delors Commission launched its agenda for the completion of the internal market. In the insolvency field, both the European Community (later European Union) and the Council of Europe have been active in drafting texts seeking to regulate cross-border insolvencies; indeed, the 1980s and 1990s saw a substantial growth in this area. The background to European initiatives in insolvency is a particularly long and arduous one, illustrating the complexity in dealing with the diversity of domestic regimes within Europe and the rise of European firms, as opposed to solely domestic ones.

The nature of European insolvency is such as to raise a considerable number of issues – including priorities of creditors or social security matters – the resolution of which may bring national systems into conflict: “The diversity of laws applicable to the transactions of a single company is nowhere more important than at the time of insolvency, when their consequences are felt.” Therefore, the process of integration of the internal market required a coherent, harmonised body of insolvency law, capable of addressing the European dimension of firms and its cross-border implications as interaction between companies located in different member states became increasingly common.

Until its recast in 2015, the main text regarding insolvencies with cross-border implications was the European Council Regulation on Insolvency Proceedings of 29 May 2000, which entered into force on 31 May 2002. The EIR project started as a proposal for a convention which was to complement the 1957 EC Treaty. The original purpose of the Treaty of Rome in establishing the EC was to design fundamental principles providing for the free movement of goods, services, labour and capital. These freedoms in turn required the free flow of commerce and the creation of a single

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12 See e.g. W Molle, The Economics of European Integration (2006) at 3; 346; 349.
13 See J Delors, Our Europe (1996).
market as this was to enhance trading across national boundaries. In this context, the point was made that a functioning bankruptcy system was essential to any economy that aspired to achieve the freedoms of establishment of business and the free flow of commerce. Effectively, the failure of businesses was accepted as affecting the proper functioning of the internal market.

The use of the regulation form, which is a type of institutional legislation as opposed to the convention form that reflects an inter-governmental initiative, was permissible because of the changes to the structure of the EC Treaty through the inclusion of a new Title IV, which authorised the adoption of measures in the field of judicial cooperation in civil matters so as to “establish progressively an area of freedom, security and justice.” This definition included, by virtue of Article 65 of that title, measures in the field of judicial cooperation having cross-border implications insofar as these would be necessary for the proper functioning of the internal market and would include the recognition and enforcement of decisions in civil and commercial cases, and the promotion of the compatibility of rules concerning conflict of laws and jurisdiction. Article 81 TFEU (formerly Article 65 TEC) was chosen as the legal basis for the harmonisation of insolvency laws within the EU as it was felt that the use of the Regulation form was necessary to promote the proper functioning of the internal market. Indeed, as firms do not restrict their activities to the territory of their home jurisdiction and would often have creditors and assets in different jurisdictions, each of the member states involved would have legitimate interest in regulating the insolvency if a firm becomes insolvent. Nationality of the debtor and the insolvent firm’s place of incorporation are irrelevant. The EIR would still apply.

(2) Purpose of the European Insolvency Regulation

The EIR sought to introduce rules for dealing with insolvencies with a cross-border element, particularly because companies’ international activities profoundly impact upon the economy of the EU. A need for regulation by common rules applicable throughout the single market was quickly realised, with the result that only a supranational measure coordinating European proceedings was deemed to have the necessary weight to harmonise insolvency law. The aim was to create a level playing field and to remove unequal domestic barriers.

The preamble and the thirty-three paragraphs of the EIR describe the objectives that justified an action at the European level, establishing a procedure that is directly applicable in the member states. Generally, the preamble and the recitals therein refer to the stated global aim of the EU, i.e.

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19 Art 61 of the EC Treaty.
20 Now art 81 Treaty on the Functioning of the European Union.
22 See Re BRAC Rent-A-Car International Inc [2003] 1 WLR 1421, where the UK courts were declared to have jurisdiction as the Centre of Main Interest (COMI) of the company was located in the UK even though the company was incorporated in the US. See also Re Ci4net.com Inc. [2005] BCC 277, where two companies incorporated in Jersey and the US were held to have their COMI in England.
23 Recital 5 European Insolvency Regulation.
to create a single legal area based on freedom, security and justice.\textsuperscript{24} Thus, the essential purposes of the EIR are:

(1) To allow for the proper functioning of the internal market, which requires efficient and effective cross-border insolvency proceedings;
(2) To coordinate the measures taken over the insolvent debtor’s assets; and
(3) To avoid forum shopping.

The EIR is the product of a long and complex negotiation process. A more coherent body of substantive insolvency law at the EU level could not be created because of the numerous disparities between national insolvency laws.\textsuperscript{25} Thus, the EIR stands as an instrument harmonising procedural law exclusively, and rests on the provisions governing jurisdiction for opening insolvency proceedings. In many respects, the EIR can be regarded purely as a mechanism for dealing with the kinds of difficulties raised under conflict of law principles, i.e. choice of forum and choice of law, as it does not seek to harmonise insolvency law across jurisdictions in any way. The EIR focuses on the facilitation of reciprocal recognition and enforcement of insolvency proceedings.

\textbf{(3) Jurisdictional Issues under the Regulation}

\textit{(a) The Universalism vs Territorialism paradigm}

In order to achieve proper functioning within the internal market, two approaches have traditionally been deployed to solve the issues generated by cross-border insolvencies: universality and territoriality.

Universalism refers to a multinational insolvency system in which a single court, that of the debtor’s home country, has jurisdiction of a debtor’s assets, wherever located, and distributes them in accordance with the law of that country. The pure form of universalism advocates an ideal world, where courts and legal systems are bound to enforce the orders of the court of the home country; and out of respect for international comity, they do so. Most advocates of universalism do not advance the pure form of universalism because of the practical recognition of the enduring differences among political and economic systems, legal regimes, and court systems, as well as among enforcement of those regimes.\textsuperscript{26} The universalist model envisions that local courts in each affected country will be obligated by domestic law or international convention to enforce the orders of the home country court. Universalism has been described by Professor Jay Westbrook as “the administration of multinational insolvencies by a leading court applying a single bankruptcy law”,\textsuperscript{27} while “[t]he case for universalism relies on efficiency grounds: clear rules decrease lending costs and do not skew investment choices, and a single forum provides a number of administrative savings.”\textsuperscript{28}

However, to fashion such a system would require international consensus on many questions that

\begin{itemize}
\item \textsuperscript{24} Recital 1 European Insolvency Regulation. This is the statement common to Title IV and the Third Pillar on Justice and Home Affairs, as amended by the Treaty of Amsterdam.
\item \textsuperscript{25} This is acknowledged in Recital 11 European Insolvency Regulation.
\item \textsuperscript{26} J Westbrook, “Universal Priorities” (1998) 33 Texas International Law Journal 27 at 28.
\item \textsuperscript{27} Westbrook, “A Global Solution” (n 11) at 2277.
\item \textsuperscript{28} R K Rasmussen, “A New Approach to Transnational Insolvencies” (1997) 19 Michigan Journal of International Law 1 at 27.
\end{itemize}
could not be left to domestic law anymore. Even with the current global legal convergence, such a consensus may take a long time to achieve.

On the other hand, classical territoriality relies on territorial notions of sovereignty common in the nineteenth century. The actors in classical territorial proceedings therefore have exclusive authority over all assets within the jurisdiction, but cannot act on assets outside the jurisdiction. Classical territorial courts are aloof to parallel proceedings in other jurisdictions. Because of what John Pottow has aptly labelled “pride,” countries have a tendency to assert a substantial interest in the assets within their territorial boundaries and not defer to decisions made elsewhere.\(^{29}\) Territoriality enters the international realm when a multinational firm’s financial problems affect its entities in multiple countries. Territoriality takes the pessimistic view that local claimants ultimately will not receive their fair share of the assets in a foreign insolvency. Consequently, under this approach, a local court must provide for these creditors as well as possible, given the assets within the court’s jurisdiction. At this stage, territorialists invoke a cooperative territorialist approach. Essentially, advocates of this view maintain that in such cases, the necessary international cooperation takes place.\(^{30}\) The parent firm or respective government authority initiates bankruptcy proceedings in each country where the corporate group has substantial assets.\(^{31}\) Each court appoints a representative for the estate of each entity filing in its jurisdiction and those representatives negotiate a solution to the debtor’s financial problems.\(^{32}\) In the absence of an agreement, conflict of laws rules and priority rules of the country where an asset is located will determine who has a stake in the asset and to what extent this is the case.\(^{33}\)

(b) Modified Universalism in the EIR and the Concepts of the “Centre of Main Interest”

The general principle of universality has been compromised in the EIR, including some elements of territoriality. The EIR therefore combines the two concepts into what is called “modified” universalism, “a system of satellite secondary bankruptcies which revolve around and give assistance to a main core proceeding.”\(^{34}\)

The fundamental idea of the EIR is that the member state where a debtor has its “centre of main interests” (COMI) should be competent to regulate its main insolvency proceedings and that these proceedings should have universal effect in all member states. The law of the state of the COMI applies to all of a debtor’s assets and creditors, regardless of their location. In particular, the state of the COMI is competent not only to govern the insolvency proceedings, but also to regulate distribution criteria.\(^{35}\) The Regulation specifies that the COMI is in the place where the debtor

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\(^{29}\) Pottow, “Greed and Pride” (n 11) at 1901.

\(^{30}\) LoPucki, “The Case for Cooperative Territoriality” (n 11) at 2219.

\(^{31}\) Ibid.

\(^{32}\) Ibid.

\(^{33}\) Ibid.


\(^{35}\) Art 4(2) European Insolvency Regulation. Additionally, all actions deriving from an insolvency, such as board liabilities for delaying the filing for insolvency and wrongful trading, should be governed by courts of the State of the COMI: Case C-133/78 Gourdain v Nadler [1979] R-I 733 (on the French action en comblement du passif); Case C-330/07, Frick Teppichboden Supermarkte GmbH v Deko Marty Belgium B [2009] ECR I-767 (the courts of
“conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.” Consequently, a debtor’s COMI is likely to be in the member state where most of its stakeholders are located and is therefore the most interested in governing a debtor’s insolvency. These rules were meant to form a well-ordered system granting clarity and legal certainty. A closer look, however, reveals that application of the EIR provides for numerous exceptions to the law of the COMI in order to deal with the interests of other member states in regulating specific local issues.

Despite the fact that the EIR follows the universality principle, the regulatory powers of the state of the COMI suffer a number of carve-outs and exceptions that favour member states where certain assets, stakeholders or activities are located. The underlying logic is that another member state is “closer” to the interests involved than the state of the COMI. Politically, these carve-outs signal that member states are reluctant to entirely defer to others the regulation of specific issues or of proceedings having a significant “local” impact. The first and most significant exception to the competence of the state of the COMI is the power granted to member states where the debtor has an “establishment” to open secondary proceedings with territorial effects and liquidation purposes. The scope of such proceedings is limited to the assets situated within the member state – an exclusively territorial, as distinct from universal, effect. Secondary proceedings safeguard the position of local preferential creditors whose claims are non-preferential under the law of the main proceedings. A truly universal system would give all power to the liquidator in the main proceeding and provide that a secondary liquidator was a “mere minion to collect assets and transfer them to the main proceedings for distribution according to the law of the main proceedings instigated in that forum, whether main or secondary proceedings. The fact that proceedings may be started in two or more jurisdictions with the application of different laws means that the principle of universality has been partially abandoned and conflicts between different priority rules will inevitably arise. This mechanism, usually labelled as “modified universalism” is a pragmatic solution to the main obstacle in the way of full acceptance of universalism, namely the different creditors’ priorities across jurisdictions. This compromise, however, is also a significant breach in the logic of the universality principle, and a big concession to the “territoriality” idea, according to which the state where a debtor’s assets are located should be competent to govern their liquidation and distribution to creditors. Indeed, after the opening of secondary proceedings, assets located in the member states where these proceedings have been commenced are not available under the main proceedings and are to be distributed according to creditors’ priorities set by the member state of establishment. The very opening of secondary proceedings may therefore disrupt the effectiveness of the main proceedings.

the State of the COMI are competent in respect of avoidance actions); Case C-444/07 MG Probud Gdnia sp. z. o.o. [2010].
36 Recital 13 European Insolvency Regulation.
37 Mucciarelli (n 5) at 186.
39 McCormack, ibid, at 174.
Under a second major exception to universalism, there are certain insolvency matters not
regulated by the law of the forum. Article 5 of the EIR 2000, for example, recognised the rights of
secured creditors with a valid claim to assets under the law of the place where the assets are
situated. Creditors can acquire security by fulfilling the relevant conditions under this law, safe in the
knowledge that their secured status will not be disturbed by the commencement of insolvency
proceedings in another EU state. Article 6 preserves certain set-off rights. Article 4(2)(d) states that
the law of the insolvency forum shall govern the conditions under which set-offs may be invoked, but
under Article 6 set-off rights can still be claimed if they are permitted by the law applicable to the
insolvent debtor’s claim. Article 7 preserves sellers’ rights under reservation of title clauses where
the assets are situated in a different member state than the insolvency forum. Article 8 reiterates the
norm of private international law that questions of title to immovable property are governed
exclusively by the lex situs. Article 9 is designed to protect the integrity of payment systems and
financial markets. It provides that the effects of insolvency proceedings on the rights and obligations
of the parties to a payment or settlement system or to a financial market shall be governed solely by
the law of the member state applicable to that system or market.

To conclude, the EIR subscribes to a general universalist vision based on the market
integration ideals underpinning the EU. According to McCormack, the EIR is “an emanation from the
European Union, whose member states have agreed to pool their sovereignty and agreed to work
towards an ever closer Union.”41 Europe is seen as a single market and in this context it makes sense
to have a single set of main insolvency proceedings rather than a hodgepodge of separate territorial
proceedings that will have the effect of partitioning corporate assets along national lines.42
Therefore, at first glance, the EIR could be perceived as embedded within the concept of
universalism, at least in terms of procedural law. However, the approach taken is actually more
complex, and some exceptions to universalism can be found within the EIR, which strives to protect
the diversity of interests arising in insolvency.

(c) Conclusion: Main Drawbacks of European Insolvency Law

The EIR has established a uniform procedural framework regarding the opening of insolvency
proceedings. It makes provision for a mandatory set of jurisdictional rules, thereby enhancing the
harmonisation of insolvency law provisions. It improves harmonisation notably because of its direct
applicability in the different member states, i.e. its automatic binding effect on all member states,
without requiring any transposition through domestic legislation. Based on the above explanation, it
can be argued that the EIR has played a significant role in the development of a harmonised set of
insolvency rules, governing cross-border insolvency cases. Nevertheless, despite this commitment to
uniformity and unity, some significant drawbacks persist, diminishing the overall impact of the EIR.

The member state in which the debtor company has its COMI is competent to govern the
main insolvency proceedings and the law of this country will be applied to all creditors and assets,
regardless of their location. This is of great importance because this member state will be competent

41 McCormack (n 38) at 175.
42 Westbrook, “A Global Solution” (n 11) at 1284 on market symmetry as referred in McCormack, ibid.
also to regulate distribution criteria. Nonetheless, even though the EIR states that the COMI is where the debtor “conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties,” the EIR did not reach its initial goal of creating a well-ordered system granting legal certainty. First, a number of exceptions to the rule of the COMI are provided for in the EIR so as to preserve member states’ interests in regulating local issues and assets. Additionally, the evolution of case law of the European Court of Justice (ECJ) on companies’ freedom of establishment has allowed different forms of forum shopping to develop.

C. CORPORATE MOBILITY, REGULATORY ARBITRAGE AND INSOLVENCY LAW

At its very core, the objective of the EIR was to avoid forum shopping. Despite this goal, two assumptions were made by the EIR drafters: (1) European firms would not substantially spread their activities outside their home state, therefore, their COMI would be easily determined; and (2) European firms could not reincorporate from one member state to another without first liquidating the business. However, these hypotheses are no longer realistic, notably due to the process of European integration and the development of EU law providing for the freedom of establishment of corporations. These developments have placed the EIR in a functional crisis.

Company law and insolvency law interact with each other to form coherent regulatory systems at a national level. Nevertheless, the increase in corporate mobility has the potential to tear these systems apart as inconsistencies in the application of private international rules fail to create a complete regulatory framework. European companies have competitively expanded their activities across the EU. This needs to be celebrated as a success of market integration – a step towards the single internal market. However, the situation needs to be carefully regulated because this extension of activities increases uncertainties as to the location of a corporation’s COMI due to the vagueness surrounding single internal market regulation. If the presumption regarding the location of the COMI is not rebutted, the same member state will be competent to deal with both company and insolvency issues. However, this provides legal certainty only insofar as discrepancies between the registered office and the real COMI are limited and cross-border mobility of the registered office is made difficult. In light of the interconnectivity of businesses today, the development of EU law, and the evolution of the ECJ case law, these assertions are neither accurate nor pragmatic especially given the description of corporate mobility as “the very essence of the internal market,” the heart of European company law.

43 Article 4(2) European Insolvency Regulation. Additionally, all actions deriving from an insolvency, e.g. wrongful trading, should be governed by courts of the State of the COMI: see Case C-133/78 Gourdain v Nadler [1979] R-I 733; Case C-330/07 Frick Teppichboden Supermärkte GmbH v Deko Marty Belgium B [2009] ECR I-767.

44 Recital 13 European Insolvency Regulation.

45 Mucciarelli (n 5) at 188.


Beginning with the decision in Centros in 1999, the ECJ has developed a mutual recognition approach for EU-incorporated companies by holding that a company's headquarters can be located in a member state different from the state of incorporation. It based its decision on Articles 49 and 54 TFEU, ruling that companies can conduct their business entirely from a member state different from the state of incorporation since TFEU contains “a very broad mandate to tolerate companies formed under foreign law operating within their territory.” The Court made clear that this recognition of foreign-incorporated companies does not require them to carry out activities in their jurisdiction of incorporation: a corporation’s choice of company law is “inherent in the exercise, in a single market, of the freedom of establishment.” It followed that the line of cases prompted by Centros opened the door to choice-of-law and thus regulatory arbitrage across the EU.

Additionally, since 2005, re-incorporations within the EU have been made easier due to Directive 2005/56/EC which regulates cross-border mergers: a company can incorporate a shell company and merge into it from one member state to another. Finally, in 2008, the ECJ definitively declared that companies' freedom of establishment grants corporations the right to reincorporate from one member state to another.

Regarding insolvency, the COMI is determined in the moment at which insolvency is filed. As a consequence, if a company reincorporates in another member state, it will indirectly select the applicable insolvency law unless creditors can prove that the COMI is still located in the jurisdiction of the company's formation. Therefore, even though one of the primary aims of the EIR was to avoid forum shopping, this development of EU law has transformed the legal landscape and opened possibilities for achieving that exact purpose.

Following this evolution, the EIR has been transformed into a sort of optional regime, as the premise that the COMI and the registered office coincide is no longer realistic. Therefore, the presumption of the location of the COMI does not produce the effects envisaged by the EIR drafters, because debtors can now indirectly choose the forum and the law applicable to their potential future insolvency, which precludes creditors from legal certainty and predictability. Evidently, this is hugely inconvenient and impedes development, particularly with respect to the promotion of the recent “rescue culture”. Professor John Armour argues that corporate rescue procedures are critical for ensuring regulatory competition at the EU level. He contends that it is desirable to permit companies

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52 Case C-167/01 Kamer van Joophandel en Fabrieken voor Amsterdam v Inspire Art [2003] ECR I-1095 at para 121. See also Case C-212/97 Centros Ltd v Erhervsog Selskabsstyrelsen [1999] ECR I-1459 at para 27.


54 Case C-210/06 CARTESIO Oktato es Szolgaltato [2008] ECR I-09641.
to select their own company law regime and further to select the associated corporate insolvency law, so as to adhere a better “fit” with their corporate governance requirements.\textsuperscript{55}

At first glance, the EU bankruptcy regime does not permit debtors to choose their preferred insolvency forum and law, yet a second look reveals a number of uncertainties. First, although the main insolvency proceedings are conducted in the jurisdiction where the COMI is located, the EIR allows for secondary proceedings with territorial effects to be opened in other member states where the debtor has an establishment. Additionally, the development of EU law alongside ECJ jurisprudence has enabled forum and law shopping because companies can reincorporate in another member state by means of cross-border mergers. Thus, the EIR has been described as:

\begin{quote}
\hspace{0.5cm}a hidden choice model, whereby corporations can opt for their preferred insolvency law by transferring their registered office into another member state, unless creditors give evidence that the COMI is still in the original country.\textsuperscript{56}
\end{quote}

\section*{D. THE REFORM OF THE INSOLVENCY REGULATION}

\textbf{(1) Incentives for Reform}

The EIR has been in force for close to 15 years and its achievement needs to be measured against its initial aims: (a) the promotion of the smooth functioning of the internal market;\textsuperscript{57} (b) the avoidance of forum shopping;\textsuperscript{58} (c) the improved efficiency and effectiveness of European cross-border insolvencies;\textsuperscript{59} and (d) the introduction of uniform rules on conflict of law.\textsuperscript{60} Compared to the fragmented and uncertain pre-EIR system, the regime has been welcomed as a positive innovation in terms of cross-border bankruptcies. European insolvencies have become more predictable, not least due to the modified universality model having introduced more clarity.

However, the EIR has not harmonised substantive insolvency laws within the EU. Instead, the EIR is confined to harmonising procedural international rules regarding conflicts of law in insolvency matters. This is due to the fact that domestic insolvency regimes touch upon a multitude of individual rights and a balance must still be struck between protecting creditors’ rights and safeguarding debtors’ interests. Consequently, the scope of the EIR is limited to how such rules are to be implemented and administered at a national level, as opposed to the substance of rules that would be passed.

Additionally, as it fails to make provision for the insolvency of groups of companies and lacks a clear definition for the concept of COMI, the Regulation renders the coordination of proceedings difficult to organise and ultimately hinders corporate rescue. As Professor Ian Fletcher observed:

\begin{quote}
55 Armour (n 47).
56 Mucciarelli (n 5) at 38.
57 Recital 2 European Insolvency Regulation.
58 Recital 4 European Insolvency Regulation.
59 Recital 8 European Insolvency Regulation.
60 Recital 23 European Insolvency Regulation.
\end{quote}
[i]nternational insolvency law has arrived at the threshold of an exciting period of development... There is now a necessity to build bridges between the individual national systems, and to create adaptable structures that will enable communication and cooperation to take place in response to the particular elements present within each case – [this] requires a new vision, and new modes of thought, from all participants.61

(2) Substance of the Reform

Two events are currently changing the landscape for business restructuring in the EU: the Restructuring Recommendation of the European Commission, issued in 2014 (“Restructuring Recommendation”), and the 2015 recast of the EIR.

Firstly, regarding the Restructuring Recommendation, the Commission based it on an International Association of Restructuring, Insolvency, and Bankruptcy Professionals (“INSOL”) Study,62 which found large gaps between the laws of the member states. For example, in several countries, liquidation is still the most common outcome and this is in conflict with the EU’s objective of helping ailing companies to recover. Therefore, the aim of the Restructuring Recommendation was to implement frameworks that strengthen the rescue culture of viable companies:

Evidence suggests that failed entrepreneurs learn from their mistakes and are generally more successful the second time around. Up to 18% of all entrepreneurs who go on to be successful have failed in their first venture.63

The Restructuring Recommendation primarily addressed two critical points: (1) the prevention of failures and (2) the concept of a second-chance, i.e. the possibility for a failing business to recover and be offered a fresh start. The INSOL Study noted that enterprises do not enjoy the same latitude or flexibility to handle and assess financial difficulties everywhere in the EU. This is why the Commission decided to implement fast, effective and low cost measures to enable companies to restructure at an early stage.

From 2009 to 2011, an average of 200,000 firms went bankrupt per year in the EU, resulting in direct job losses each year of 1.7 billion.64 Therefore, it was no surprise that the European Parliament raised the issue of reforming the Regulation in October 2011. The first step involved requesting INSOL Europe65 to deliver a report on the feasibility of such harmonisation.66 Published in

64 Creditreform, Insolvencies in Europe 2009/10 (2010).
65 The Association of European Insolvency Practitioners and Scholars
April 2010, the INSOL Report stated that the differences in insolvency rules between member states allowed firms to undertake forum shopping, which jeopardises legal transparency and predictability and decreases the chances of restructuring insolvent firms. Subsequently, it was proposed that domestic insolvency laws across member states be harmonised. In response to the INSOL Report, the European Parliament adopted a resolution requesting the European Commission to submit one or more legislative proposals aimed at partially harmonising insolvency law in the EU and at amending the EIR.67

Secondly, regarding the recast Regulation, the European Commission started proposing amendments to the EIR in 2012. This reform process was completed in June 2015 with the publication of the recast Regulation that will be applicable in member states from 26 June 2017.68 On 20 May 2015, the European Parliament approved the new EIR in the text adopted by the Council at first reading on 12 March 2015. The recast Regulation is published in the Official Journal of the EU of 5 June 2015 as Regulation (EU) 2015/848 of 20 May 2015 on insolvency proceedings. The primary aim of the revision was to improve the operation of the EIR with a view to ensuring the smooth functioning of the internal market and its resilience in economic crises, having regard to national insolvency laws and to the case law of the ECJ on the old EIR.

In short, the revised text: (a) extends the EIR scope to proceedings aimed at giving the debtor a second chance; (b) strengthens the current jurisdictional framework in terms of certainty and clarity; (c) improves the coordination among insolvency proceedings opened in respect of the same debtor and strikes a better balance between efficient insolvency administration and protection of local creditors; (d) reinforces the publicity of the proceedings by compelling member states to provide for insolvency registers and by providing for the interconnection of national registers; (e) deals with the management of multiple insolvency proceedings relating to groups of companies. Additionally, while the COMI of a corporate debtor will be retained as the criterion for jurisdiction to open main insolvency proceedings, significant changes will be made to widen the Regulation’s scope to encompass pre-insolvency and debtor-in-possession proceedings (Article 1);69 to better secure the coordination of main proceedings with any rival local proceedings opened in other member states in relation to the same debtor (Chapter III);70 and to enhance the coordination of insolvency proceedings relating to members of a group of companies (Chapter V). The extended scope of the recast Regulation means that some national restructuring procedures previously excluded from the

68 Art 92 Council Regulation 2015/848 OJ 2015 L141/19
69 However, pre-insolvency proceedings will be covered by the Regulation only if they “...are based on laws relating to insolvency...”.
70 Note particularly new arts 36, 38, 42 and 43 of the recast European Insolvency Regulation.
Regulation will now fall within its scope, such that they are subject to its burdens, but eligible for its privileges – including those conferred on main proceedings to ensure EU-wide effectiveness.

However, what the recast Regulation does not require is the substantive harmonisation of member states’ insolvency or restructuring laws. Like the original Regulation, the recast Regulation is essentially designed to work with the existing insolvency and restructuring procedures of the member states, and in particular to enhance the effectiveness of such procedures in cross-border cases.71

The main issue is that at the present time there is substantial divergence in both the design and operation of insolvency and restructuring procedures across member states. Recent studies suggest that one consequence of this divergence is that some financially distressed debtors are better positioned than others to achieve a value preserving restructuring, as a consequence of their location or their superior ability to engage in restructuring migration.72 If so, divergences in member states’ restructuring regimes imply different degrees of efficiency in the resolution of financial distress ex post, hence, they will influence the financing costs of businesses ex ante and, as a consequence, possibly distort investment decisions.73 Further, differences between member states’ substantive insolvency and restructuring regimes create obstacles for cross-border restructurings. Restructuring a multinational enterprise involves multiple jurisdictions whose laws have to be observed. The greater the differences between these laws, the greater the frictions and costs associated with the resolution of financial distress. The 2000 Regulation was designed to ameliorate some of these costs, but it does not – not even in its recast form, with widened scope – apply to all forms of national restructuring procedures.

Finally, member states were invited to implement the Restructuring Recommendation by March 2015. However, member states’ inclination “to accept this invitation has not been strong (to put it mildly).”74 Some member states such as the UK, France, Germany or Italy75 have not reacted at all to the European Commission’s initiative. A recent evaluation by the Commission of compliance with the Restructuring Recommendation suggests that only two member states, Slovenia and Hungary, have introduced reforms that resulted in legislation complying with the Restructuring Recommendation (or at least partly complying).76 As mentioned recently by some insolvency law academics, “[i]f the Recommendation is to form at least part of the basis for the Commission’s next

71 See M Arnold QC, “The Insolvency Regulation: A Service or an Overhaul?” [2013] South Square Digest 28.
73 Bebchuk & Guzman (n 11) at 799.
75 Current bankruptcy reforms in Italy relating primarily to non-performing loans have not been triggered by the Recommendation, see “Beautifying Bankruptcy” (4 July 2015) The Economist at 62-63.
step – its proposal for a new legislative instrument to harmonise member state laws – then the Commission would do well to take these issues seriously.”  

(3) **Evaluation of the Reform**

Regarding proposals for reform of cross-border insolvency in the EU, typically two opposing arguments are presented: on the one hand, whether there ought to be a community commitment to reach full harmonisation of insolvency law, and on the other, whether companies ought to be granted the scope to choose the insolvency law of their preference. The latter is referred to as the “choice model.”  Neither solution has been recommended by EU institutions in their amendment project, yet they shed some light on potential developments.

For efficiency reasons, some legal commentators have pointed out that regulatory arbitrage and forum shopping need to be regulated in a transparent way, and should not be uniformly prohibited as the current Regulation requires. It is believed that under such a “choice model,” companies would not be bound by inefficient domestic proceedings but instead could opt for another member state's more efficient legislation or, if such foreign law allowed, a restructuring could be made impossible under the original national law. Companies could then make use of the legal diversity available across the EU and avoid inefficient domestic procedures.

Two options are available for implementing such a choice model in the EU. The first solution would involve disregarding the applicable company law and allowing free choice of insolvency law to companies. The second possibility, more popular among legal scholars, would be to replace the COMI criterion with the registered office determining the law and forum. Both alternatives would introduce more predictability for creditors who would be better able to predict the legal rules and therefore adjust the cost of credit more efficiently.

However, the choice model is not without its weaknesses. This is because a company, by choosing the applicable insolvency law, would change its risk profile having previously been taken into account by the creditors when negotiating the credit contract. This should not pose a problem for adjusting creditors who can protect themselves through covenants or guarantees, yet non-

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77 Eidenmüller & Van Zwieten (n 74).
78 Mucciarelli (n 5) at 176.
80 Rasmussen (n 28); Rasmussen (n 11); H Eidenmüller, “Free Choice in International Company Insolvency Law” (2005) 6 EBOLR 423 at 429; S Franken, “Three Principles of Transnational Corporate Bankruptcy Law; A Review” (2005) 11 ELJ 232 at 241-46; W G Ringe, “Forum Shopping under the EU Insolvency Regulation” (2008) 9 EBOLR 579 at 585-86.
82 Armour (n 47) at 407-408; Eidenmüller (n 80) at 438; M Szydlo, “Prevention of Forum Shopping in European Insolvency Law” (2010) 11 EBOLR 253 at 270-71.
83 Franken (n 80) at 245.
adjusting creditors may be at a real disadvantage because they cannot adjust the terms of their loan to reflect the effect on them of this choice of bankruptcy law. Thus, although this “choice model” produces several advantages, notably the possibility for companies to choose the most efficient regulation, it also introduces legitimacy issues and comes at a substantial social cost.

A fully harmonised body of insolvency law would, on the other hand, block negative externalities generated by the member states' national legislations. Under the current Regulation, the member state in which the debtor's COMI is located has jurisdiction over the matter and its legislation applies to assets and creditors, even those situated in another member state. This situation can produce negative externalities, specifically by causing negative economic outcomes for member states' non-parties to the insolvency issue at stake and more generally by producing widespread spill-over effects.

As such, full harmonisation of corporate insolvency law would be a desirable choice and it is further justified by the subsidiarity principle underpinning EU law. If certain issues are better dealt with at supranational level, the EU is given competence in the matter and harmonisation is justified by the need to internalise negative externalities. Spill-over effects would be avoided by implementing identical rules regarding creditors' priorities across the EU so that all creditors would know ex ante and with certainty which principles apply in case of default. By leaving the issue of full harmonisation of corporate insolvency to the EU, European policy-makers would certainly have to consider the interests of non-adjusting creditors in order to obtain their political support.

Yet, full harmonisation is not always perceived as the best solution either, notably because European populations' preferences are heterogeneous and vary greatly from one member state to another. In these cases, smaller territorial units may be better equipped to address local interests and needs.

What is more, full harmonisation of insolvency law does not seem possible under the current EU legislative mechanisms. The so-called “democratic deficit” of European institutions and the EU decision-making mechanism raise scepticism about the potential of EU institutions to enact redistributive insolvency laws. Pursuant to the TFEU, instruments related to the harmonisation of laws should be adopted following the ordinary legislative procedure, which requires negotiations between the Commission, the Council and the Parliament, and reflects the dual basis of democratic legitimacy in the EU institutions, i.e. involving both the member states through the Commission and the Council and the citizens through the European Parliament. The complex voting process calls for a broad consensus to be reached among member states and due to the nature of insolvency law, the harmonisation of such rules is quite likely to protect strong interests groups i.e. those able to bargain at the highest EU level. Thus, a fully harmonised body of EU corporate insolvency law will most likely alter the manner in which member states currently balance values and interests. This could hinder the process of total harmonisation which ultimately is not only an issue of efficiency, but mainly of politics and European integration.

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85 Mucciarelli (n 5) at 198.
86 Article 294 TFEU (ex Article 251 EC).
That is why, the general consensus reflected in the Commission’s reforms seems to be that the 2000 Regulation on the whole worked well; that fundamental reform is not needed and could in fact be destabilising; but that some reform would be beneficial to improve the practical operation of the EIR. Leading commentators have described the reforms as “very decent” and as a “modest attempt ... to improve the status quo.” The recast EIR has stuck very much within the framework of the existing EIR. The recast EIR does not set off on a new path or try to disturb the essential balance of interests at the heart of the political compromises that make up the 2000 Regulation.

The Commission highlighted the importance of insolvency rules in supporting economic activity and, as a first step towards achieving its ambitious goals, it put forward “the modernisation of the EU Regulation on Insolvency proceedings.” According to Professor McCormack, the rhetoric seems overblown and far divorced from the quite modest changes made in the recast EIR. While the modern tendency may be to hype everything and to herald eagerly rafts of new initiatives, this approach sows the seed of disillusionment and disappointed expectations. More prosaically, the Commission missed out on the opportunity for desirable clarifications of the EIR, for example, in the context of Article 5 and security rights over property. It suggests that the previous provisions “apply sufficiently smoothly within the EU and the respective fields of the lex fori and the lex situ strike the right balance.” According to McCormack, it is “difficult to concur with this conclusion when the provisions [of the Recast Regulation] are unclear.”

E. CONCLUSION

The creation of the internal market has created a heated debate around whether harmonisation is the most appropriate law-making process, notably because globalisation and the increasing transnational character of corporations raised questions about whether there is one adequate method that can lead to an optimal outcome for the EU regulatory landscape that would satisfy the member states’ need while further promoting the European integration project.

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90 F Mucciarelli, “Private International Law Rules in the Insolvency Regulation Recast: A Reform or A Restatement of the Status Quo?” (2015) 13 ECFR 1; McCormack (n 87) at 65.
91 Mucciarelli (n 5).
93 McCormack (n 87) at 67
95 McCormack (n 87) at 67
European restructuring laws are undergoing significant changes. The jurisdictional and private international law framework of the Insolvency Regulation 2000 has been revised, leading to a wider scope in the Recast Regulation 2015, better coordination between main and secondary proceedings and new rules on insolvencies affecting multiple entities in a corporate group structure. In the meantime, the substantive rules for restructuring businesses in distress have also caught the attention of the European Commission. In 2014, the Commission published a recommendation which calls upon the member states to modernise their restructuring laws so as to ensure their compliance with the European Commission’s “minimum standards.”

The Commission is of the opinion that differences between the member states’ insolvency laws are an obstacle to the effective functioning of the internal market. This is generally true. Currently, firms in different member states have different opportunities to access efficient restructuring proceedings – either domestically or by engaging in forum shopping. However, the harmonisation proposed by the Restructuring Recommendation is superficial since important issues are not dealt with and important concepts are not (re)defined. Adopting “minimum standards” rather than full harmonisation is not ideal because the level of harmonisation that can be reached is unlikely to solve the current disparities in restructuring laws in the member states. In this respect, the Commission’s recent announcement that it will now move to propose stronger harmonisation in the form of a legislative instrument is an encouraging development.96

The Restructuring Recommendation invited the member states to adopt the Commission’s recommendations within the year of its publication. However, the member states’ inclination to comply has been quite weak. Member states have not, of course, had much time to comply and it may be that reforms are on their way. It may also be, however, that “some Member States are reluctant to wholeheartedly embrace the restructuring recommendations of the European Commission.”97

97 Eidenmüller & Van Zwieten (n 74).