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Status Report on the Regulation of Insolvency Law at an EU Level and Its Trends of Transformation and Development

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Abstract. In the last almost one decade, a number of initiatives were launched in the European Union to reinforce the development of treating cross-border insolvency cases in a unified manner and to strengthen cooperation in the field. The primary aim of this study is to review the results of legislation in the field of insolvency law and to provide an analytical assessment of the level of cooperation based on the legal sources in force. Beyond a critical appraisal, the author intends in this status report to foreshadow a comprehensive picture of the anticipated trends for development too.

Keywords: insolvency, European Union, international cooperation, reorganization, bankruptcy

1. Introduction

Both in the European[1] and in the Hungarian literature,[2] several authors have pointed out that since December 2012 a change of concepts has been tangible in the consultation and legislation initiative of the European Commission to settle insolvency procedures at an EU level: '[...] the interest of the Commission shifted from liquidation proceedings to preventive restructuring procedures [...]'.[3] In conjunction with the view of these authors, this research study aims to explore in a comprehensive way what other changes and trends of transformation can be

1 Jaufer 2017. 255.
2 Nagy 2018.
3 Nagy 2018. 12. Translation by the author. Unless otherwise specified in the footnotes, all translations from non-English source materials are from the author.

traced as a result and beyond the preventive restructuring procedures gaining the foreground and what consequences the current level of cooperation bears on the regulation of Hungarian substantive and procedural law.

2. Levels of Cooperation

The need for a unified regulation of insolvency law in the European Community first arose in the 1990s, as a result of which Member States signed the Convention on Insolvency Proceedings in 1995. Although this convention did not take effect owing to the United Kingdom,[4] it meant the reinforcement of integration and the initial milestone for creating Council Regulation (EC) No 1346/2000 on insolvency proceedings.[5] During the compilation of the first insolvency regulation, it became clear that the material law regulations of certain Member States are so different that they do not enable the unification of insolvency proceedings,[6] and, secondly, the cooperation mechanism cannot lead to civil material law unification. Between 2002 and 2017, the coordination of Member State insolvency proceedings was implemented in the field of insolvency law that was rooted in the definition of the applicable law and the acknowledgment of the common principles of insolvency proceedings in the Member States. Pursuant to Article 46 of Council Regulation (EC) No 1346/2000, the Commission is obliged to review the practical application of the insolvency regulation until 1 June 2012 and thereafter every five years and submit the results of the review and its proposals to amend the regulation to the European Parliament, the Council and the Economic and Social Committee. Based on the authorization granted by this article, a consultation mechanism was initiated on 30 March 2012 to execute the necessary amendments of insolvency rules.[7] Taking into consideration the results of the consultation mechanism, the Commission submitted its report[8] and its proposals on the amendment of the European insolvency regulation.[9] The report found that the regulation fulfils its purpose in terms of ensuring creditor demands appearing in cross-border insolvency proceedings and the measures related to the assets of insolvent debtors. Nevertheless, increasing the efficiency of insolvency proceedings raised the necessity for a reformulated regulation.

4 Kengyel 2009. 193.
5 Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings. Official Journal of the European Communities L 160/1. 30.06.2000.
6 Kengyel 2009. 193.
7 Hess–Oberhammer–Pfeiffer 2014.
8 Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee COM(2012) 743 final 12.12.2012.
9 Proposal for a Regulation of the European Parliament and of the Council Amending Council Regulation (EC) No 1346/2000 on Insolvency Proceedings /COM/2012/0744 final – 2012/0360 (COD) / 12.12.2012.

Besides the applicable law and the rules of acknowledging the insolvency proceedings of Members States, the revamped insolvency regulation published in the Official Journal of the European Union on 5 June 2015[10] also realized a deeper level of cooperation in the following areas: 1. The exact definition of the material scope of the new regulation: the material scope of the new EU Insolvency Regulation does not include only insolvency proceedings aimed at the actual insolvency of a debtor but so-called proceedings treating imminent insolvency. 2. The further clarification of the connecting factor pertaining to the jurisdiction governing the main insolvency proceeding: definition of the debtor's centre of main interest.[11] 3. A supplemented system of rules on jurisdiction: Article 4(1) of the regulation sets forth the court's obligation of examining ex officio its jurisdiction and naming the grounds for jurisdiction in the resolution to open an insolvency proceeding; the active involvement of creditors in the definition of the jurisdiction of an authority;[12] integrating the jurisdiction rules pertaining to claims closely related to and derived from insolvency proceedings into the regulation. 4. Placing limitations on the opening of secondary insolvency proceedings. 5. Creating insolvency records. 6. Unified EU-level treatment of insolvency cases concerning groups of companies or certain members of a group. When drawing up the balance on the regulations applicable from 26 June 2017, it can be stated that the primary aim of the revamped insolvency regulation is still the coordination of insolvency proceedings among Member States through procedural law tools and institutions. In spite of the regulation, the further reinforcement of the procedural law regulation forming the base of judicial cooperation did not lead to the unification of the rules of either the civil material laws or the procedural laws of Member States. At the same time, in my opinion, limiting the opening of secondary insolvency proceedings can be viewed as the first step of intervening in Member State procedural law regulations.[13]

10 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings. Official Journal of the European Union L 141/19. 05.06.2016.

11 According to Article 3, paragraph (1): 'The centre of main interests shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. […] In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary. […] In the case of an individual exercising an independent business or professional activity, the centre of main interests shall be presumed to be that individual's principal place of business in the absence of proof to the contrary. […] In the case of any other individual, the centre of main interests shall be presumed to be the place of the individual's habitual residence in the absence of proof to the contrary.'

12 If the circumstances of a given case question the jurisdiction of the court, beyond the court calling on the debtor to submit evidence in support of their statements, the debtors must be provided with the opportunity to elaborate their standpoint about jurisdiction pursuant to paragraph (32) of the Preamble.

13 See i) determining the persons entitled to initiate secondary proceedings [Article 37 paragraph (1)]; ii) fixing the time limit for opening secondary insolvency proceedings [Article 37 paragraph (2)]; iii) the possibility of suspending the opening of secondary proceedings [Article 38 paragraph (3)].

The Commission Recommendation (No 2014/135/EU) on the new approach to business failure and insolvency was published in the Official Journal of the European Union on 14 March 2014.[14] The *Entrepreneurship 2020 Action Plan*[15] formed the preamble of the recommendation and was approved on 9 January 2013, where the Member States were invited to reduce the discharge time and debt settlement for honest entrepreneurs after bankruptcy to a maximum of three years by 2013 and to continue offering support services to businesses for early restructuring. Although a recommendation as a European Union legal source does not have a legally binding effect,[16] it still foreshadows the future legislative policy of the Commission. In my view, based on the action plan, it was clear already in 2013 that besides the Commission's legislative direction switching from insolvency proceedings aimed at liquidation to preventive restructuring[17] and beyond the previous procedural law of harmonization, it was also pointed into the direction of material law harmonization. Although the recommendation about a new approach to business failure and insolvency promoted the strengthening of the level of mostly procedural law cooperation through the harmonization of other procedural law institutions, as set forth in Council Regulation (EC) No 1346/2000, the implementation of the proposals in the recommendation implied the necessity of fine-tuning and amending the civil material law legislation of Member States. The focal point of the recommendation was establishing and ensuring the framework for preventive restructurings and the provision of a so-called 'second chance' for entrepreneurs. In my view, the time limit for the rescue built in the 'second chance' element can be considered as the harmonization of material law regulations.

The Preventive Restructuring and Insolvency Directive constituted another stage of judicial cooperation in insolvency law.[18] Preamble paragraphs (12) and (13) of the Restructuring and Insolvency Directive defined the relation of the new insolvency regulation to the directive. The directive does not affect the scope of the regulation; it stipulates that by overriding the preventive proceedings under the scope of the regulation (which reinforces the rescuing of economically viable debtors and entrepreneurs and constitutes procedures discharging the debt of other natural persons), it prescribes the implementation of restructuring procedures which in effect fall under the scope of Member State material law. Preamble paragraph (12) of the Restructuring and Insolvency Directive openly sets forth that while the new insolvency regulation is aimed at settling cross-border situations, the directive intends to foster the unified treatment of clearly domestic insolvency cases by prescribing minimum standards. The obligations

14 COM(2014) 1500 final, 12.03.2014.
15 COM(2012) 795 final, 09.01.2013.
16 Harsági 2009. 42.
17 Nagy 2018. 12.
18 Official Journal of the European Union L 172/18, 26.06.2019.

formulated in the directive will give rise to legislative and legal amendment obligations for the Member States upon the deadline expiring on 17 July 2021 in three areas: 1. implementing and providing preventive restructuring frameworks for debtors struggling with financial difficulties to prevent insolvency and ensuring the viability of the debtor in the event of imminent insolvency; 2. the harmonization of procedures leading to the discharge of the insolvent entrepreneur's debt; 3. establishing measures aimed at increasing the efficiency of restructuring, insolvency proceedings as well as the discharge of debts. The question arises in me as to whether the so-called minimum standards laid down in the directive truly result in appropriate legal harmonization at the level of legislative acts (directives).

3. Interpretative Complications regarding the Concepts of Likelihood of Insolvency, Imminent Insolvency, and an Undertaking in Difficulty

By reviewing the European Union legislative actions primarily dominant in the field of insolvency law and the definitions therein, it can be stated that just as insolvency proceedings do not have a single autonomous definition independent of national laws, so the definition of imminent insolvency was not constituted at an EU level either. Although the strengthening of cooperation is carried out through the harmonization of the material law provisions pertaining to reorganization proceedings, the likelihood of insolvency, imminent insolvency, and an undertaking in difficulty are concepts posing interpretative difficulties.

Both the new insolvency regulations[19] and the Restructuring and Insolvency Directive set forth Member States' domestic law as being the one governing the interpretation of insolvency proceeding and the likelihood of insolvency.

The Commission published its guidelines on state aid for rescuing and restructuring non-financial undertakings in difficulty on 31 July 2014,[20] in which it provided a detailed definition of the concept of an 'undertaking in difficulty'. Highlighting the core of the definition, '[...] an undertaking is considered to be in difficulty when, without intervention by the State, it will almost certainly be condemned to going out of business in the short or medium term'.[21] The guidelines provide an exhaustive definition of the conditions that must arise in a business for it to be listed under the term of an undertaking in difficulty. Nevertheless, the need for an interpretation of this notion was raised in front of the Court of Justice of the European Union.

19 See Article 2, paragraph (2).
20 Official Journal of the European Union 31.07.2014 – C 249/01.
21 Point 20 of the 2014 guidelines.

The *Tribunale amministrativo regionale per le Marche* (Regional Administrative Court for Le Marche, Italy) submitted a request for preliminary ruling in the ongoing proceeding between Nerea SpA and the Regione Marche with the cooperation of the Banca del Mezzogiorno – Mediocredito Centrale SpA.[22] The request for a preliminary ruling was submitted with regard to the interpretation of Article 1, Section (7) c) of Commission Regulation (EC) No 800/2008[23] on declaring certain categories of aid compatible with the common market in application of articles 87 and 88 of the Treaty on the Functioning of the European Union. In the procedure for a preliminary ruling, the interpretation of the concept of an undertaking in difficulty was of key importance. In the Opinion of the Advocate General published on 5 April 2017, Manuel Campos Sánchez-Bordona pointed out that '[a]t the time when the 2004 Guidelines were adopted, the Commission acknowledged that "there is no Community definition of what constitutes a firm in difficulty". As a result, the conceptual features of that term needed to be set out in a text, for on it depended the application of other provisions of EU law […].'[24] Based on the opinion of the Advocate General, the Commission used ad hoc conceptual constructions in its 2014 Guidelines, which became legally binding criteria constituting a normative concept through Regulation 800/2008, which referenced the guideline and transferred the concept.[25]

I believe that based on the findings of the Advocate General in the Nerea SpA v Regione Marche case, it can be clearly stated that the concept of an undertaking in difficulty is an autonomous EU concept independent of Member State laws, which can form the basis of interpretation for the terms of likelihood of insolvency and imminent insolvency applied in prevailing regulations and guidelines. This is because the conceptualization of these concepts has not yet happened not only at the European Union level but also at a national level in many Member States, including Hungary.

4. The Impact of Strengthening Cooperation in Hungarian Substantive and Procedural Law

Hungarian legislation complied with the content of the 2014 Commission Recommendation on a new approach to business failure and insolvency by drafting Act No CV of 2015 on the debt settlement of natural persons (the Debt

22 *Nerea SpA* v *Regione Marche*, Case *C-245/16*.

23 Official Journal of the European Union 09.08.2008 – L 214/3.

24 *Nerea SpA* v *Regione Marche*, Case *C-245/16* – the Opinion of the Advocate General, point 45.

25 It is important to highlight point 50 of the opinion submitted by the Advocate General, which calls the attention to the fact that 'the definition of "undertakings in difficulty" adopted by Regulation No 800/2008 is not exactly the same as that adopted by the Commission in the 2004 Guidelines but rather […] a *simplified* version thereof'.

Settlement Act).[26] Personal bankruptcy is a legal institution helping indebted private individuals to get out of the debt trap with the primary aim of restoring the solvency of the debtor through the harmonization of the debtor's and their creditors' interests. The Act allows for gaining private bankruptcy protection in a non-litigious civil proceeding at court or in an extrajudicial procedure.

Pursuant to Article 34 of the Restructuring and Insolvency Directive, Member States have until 21 July 2021 to ratify and publish the laws and make any necessary law amendments which provide adequate restructuring frameworks for debtors in financially difficult positions and grant a second chance for insolvent or excessively indebted yet honest undertakings.

Based on prevailing regulations, in Hungary, business entities may receive a payment moratorium based on Act XLIX of 1991 on bankruptcy and liquidation proceedings (Bankruptcy Act), whereas private individuals may be granted a moratorium pursuant to the Debt Settlement Act. The personal scope of the directive does not extend to insurance companies, credit institutions, investment undertakings or collective investment forms, other financial institutions and organizations, public law bodies established in conjunction with national law, and natural persons who are consumers. By extending the personal scope of the Debt Settlement Act, Zoltán Fabók would make it possible to apply 'private bankruptcy' to a wider scope,[27] whereas Adrienn Nagy sees the possibility of implementing the obligations set out in the directive in the further development of the rules pertaining to bankruptcy proceedings.[28] Supporting Adrienn Nagy's viewpoint, I believe the amendment and further development of the rules in the Bankruptcy Act[29] would make it possible to execute the provisions of the regulations the most effectively. In my view, by considering the primary goal of the Debt Settlement Act – i.e. providing private bankruptcy solutions for consumers –, the institution and the established procedures are not suitable for rescuing businesses in financial difficulties, and the extension of the personal scope of the act would only result in the institution of private bankruptcy becoming emptied out.

The Hungarian legislator is in a long delay with providing a definition for the concept of a situation threatening with imminent insolvency. Based on Zoltán Fazakas's approach, sections 27 (2) and 33/A (3) of the Bankruptcy Act do formally define the case of imminent insolvency, but do not do so in effect

26 The Debt Settlement Act § 106/A determines which source of EU law the legislation serves to comply with. The Act does not refer in this respect to the 2014 Commission Recommendation. Thus, the question may also arise as to whether the debt settlement of natural persons and business failure and insolvency are indeed the same platform.

27 Fabók 2016.

28 Nagy 2018. 30.

29 Nagy 2018. 31–32.

or in a correct way.[30] Based on Section 33A (3) of the Bankruptcy Act, 'the onset of a position threatening with imminent insolvency is the time from which the leaders of the economic operator could have or should have foreseen, as it is to be expected from persons in such positions, that the economic operator will not be capable of fulfilling its liabilities when they become due'. Therefore, it can be observed that if the formal conditions set out in the Bankruptcy Act exist and there is provided proof of them, the court rules for insolvency.[31] In agreement with Fazakas's approach, this definition '[...] may only provide a good starting point for the court proceeding to define the time aspect at most, but it is unable to grasp the essence of the threat'.[32]

In my view, during the implementation of the transposition obligations set forth by the directive, the Hungarian legislator must first establish the preventive restructuring framework for economic entities in financial difficulties by transforming the concept of imminent insolvency. Besides compiling a comprehensive concept, I find it worth considering the concept of an undertaking in difficulty as defined in the 2014 Guidelines of the Commission, which differentiate among the various company forms when defining the aspects of determining a 'difficult position'.

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30 Fazakas 2020. 98.

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