AN OUTLOOK ON EUROPEAN INSOLVENCY LAW HARMONIZATION IN THE CURRENT SOCIO-ECONOMICAL CONTEXT

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Abstract - This paper reviews the socio-economic relevance of insolvency frameworks from an EU perspective, discusses design issues of insolvency regimes and presents the main features of insolvency frameworks and the importance of harmonizing the laws across the EU Member States. It also reviews recently enacted reforms and examines remaining reform priorities. The statistics of the last 5 years are also discussed, analyzing the main causes for the distribution of the number of insolvent companies in Western Europe across different regions. As a conclusion, we summarize the importance of creating a harmonized approach across the EU when opening insolvency proceedings in order to protect creditors and ensure the best possible outcome for businesses, while taking into consideration countries' individual situations.

Keywords - insolvency, framework, harmonization, reorganization

I. INTRODUCTION
The economic literature has long studied the characteristics of insolvency frameworks and attempted to identify the key efficiency indicators. In the past two decades, the economic literature considers as efficient an insolvency framework that prevents fire-sale liquidations([1]), ensures continuation of businesses ([2]), and guarantees creditors' rights ([3]) while ensuring that the owners have the right incentives to preserve the value of the company in distress ([4], [5]).

Business failure is one of the most essential problems in the field of finance. The phenomenon of insolvency appears to be more complicated in emerging capital markets, perhaps due to the relatively shorter history of firms and the increased likelihood of companies disappearing in a situation of high economic growth. At European level, legislation aims at protecting creditors' rights, while safeguarding the interests of shareholders and customers on the one hand and at avoiding liquidation of potentially viable companies on the other hand.

II. PERSPECTIVES OF INSOLVENCY FRAMEWORKS
The European Commission, through the Regulation No. 1346/2000 Recital 11, states that: “This Regulation acknowledges the fact that, as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening
of proceedings would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors in the insolvency proceedings are, in some cases, completely different” [6].

The purpose of the harmonization of insolvency laws across the European Union resides in:

- Protecting the value of the assets of the estate, thereby returning greater value to creditors and shareholders;
- Reducing the costs of the administration of the estate;
- Increasing predictability on the parts of creditors and shareholders, thereby encouraging the provision of increased working capital;
- Reducing the migration of financially troubled companies to jurisdictions with more workable restructuring provisions;
- Offering benefits in other respects, such as the preservation of employment.

The main problems that might occur in the absence of common rules on insolvency are:

- The eligibility and criteria for the opening of an insolvency proceeding.
- The general stay on the creditors’ powers to assert and enforce their rights after the commencement of insolvency and reorganization proceedings.
- The ranking of creditors and enabling settlement of claims – minimizing the cost and time required to enforce debt contracts, in the event of a corporate insolvency.
- The responsibility for the proposal, verification, adoption, modification and contents of reorganization plans - vital when trying enable a restructuring plan for the company’s survival

- The liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor.

A harmonized approach could result in a convergence of best practices which could be achieved through issuing minimum standards for each of the elements referred to above, which are then applied to national insolvency regimes across Europe. In this respect, similarly situated stakeholders involved in insolvency proceedings should be able to expect reasonably similar rights, obligations, protections and outcomes across all EU jurisdictions. Otherwise, as is currently the case, we will continue to see an aggregation of negative country specific effects resulting from specific reforms in different jurisdictions.

Important practical and political judgments have to be made on the priorities and phasing of further insolvency reform in the EU. The Association for Financial Markets in Europe advocates pursuing a fairly narrow and focused EU legislative initiative to embed the key minimum standards of an effective insolvency law into national systems. In 2012 a New European Approach to Business Failure and Insolvency underlined the need to eliminate legal uncertainty and an “unfriendly business environment”, deemed to constitute obstacles to cross-border investment [7].

In 2014 the European Commission published a, “Recommendation on a New European Approach to Business Failure and Insolvency” [8] that outlines reforms aimed to deal with four particular concerns:

- The availability of a framework to facilitate preventive restructuring;
- Assisting restructuring negotiations through enabling the appointment of a mediator and for stays to be available;
• Ensuring the success of restructuring plans through certain minimum content and by clarifying creditor and court involvement in the adoption process;
• Providing protection for new financing arrangements.

III. UNCERTAINTIESPOSE RISK TO ECONOMIC RECOVERY

There is a clear tendency of economic recovery recently, as shown by the charts below, though Europe has not really come to rest. Some social and political factors threaten the economic stability of the continent, events such as the terrorist attacks in November 2015 and March 2016 which hit the continent’s political center, the referendum in the UK in June over the Brexit, and there is the influx of refugees from civil war regions that is impacting on both the south and the north of Europe. The majority of asylum seekers are headed towards Western Europe, where the majority of refugees intend to find a home. All these factors combined may affect local businesses and may increase the risk of corporate failure.

TABLE 1. NUMBER OF INSOLVENT COMPANIES IN WESTERN EUROPE PER COUNTRY

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<tbody>
<tr>
<td>Austria</td>
<td>5.422</td>
<td>5.600</td>
<td>5.626</td>
<td>6.266</td>
<td>6.194</td>
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<tr>
<td>Belgium</td>
<td>9.762</td>
<td>10.73</td>
<td>11.73</td>
<td>10.58</td>
<td>10.22</td>
</tr>
<tr>
<td>Denmark</td>
<td>4.029</td>
<td>4.049</td>
<td>4.993</td>
<td>5.456</td>
<td>5.468</td>
</tr>
<tr>
<td>Finland</td>
<td>2.574</td>
<td>2.954</td>
<td>3.131</td>
<td>2.956</td>
<td>2.944</td>
</tr>
<tr>
<td>France</td>
<td>61.37</td>
<td>60.85</td>
<td>60.98</td>
<td>59.55</td>
<td>49.50</td>
</tr>
<tr>
<td>Germany</td>
<td>23.18</td>
<td>24.03</td>
<td>26.12</td>
<td>28.72</td>
<td>30.12</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.049</td>
<td>1.164</td>
<td>1.365</td>
<td>1.684</td>
<td>1.638</td>
</tr>
</tbody>
</table>

Western Europe has returned to the growth track and the number of corporate insolvencies has continued to decline. In 2015, they totaled 174,702 – nearly 7,100 or 4% fewer than in 2014 (181,802). The year before there had already been a reduction in the number (minus 10,500 cases; minus 5.8%). All the same, despite the appreciable advances in this respect in the past two years, the volume of insolvencies in Western Europe remains higher than it was before the financial crisis (in 2008: 155,581).
Insolvencies usually represent only a fraction of the total number of business liquidations. In many countries, tiny firms are simply erased from the commercial register (closures in Western and Eastern Europe: 2.2 million firms, 620,000 of them in Eastern Europe). The extent of such occurrences outside the realm of insolvency legislation varies from one country to another. Bankruptcies of self-employed people are also treated differently in insolvency statistics. In some cases, these are not included in corporate insolvency figures but counted as private bankruptcies. In other countries, the size of the company or the number of creditors plays an important role in the firm’s registration as insolvent.

*Spain, Portugal, Italy

Figure 2. Number of insolvent companies per region within Western Europe

When analyzing the distribution of companies that opened the insolvency procedure in the last 5 years, the continental part of Western Europe leads the other regions with more than 50% of the total insolvent companies of each year. At the other end of the spectrum, the Benelux region registered the least number of companies needing a structural reorganization due to inability to pay their debt.

The current socio-economic circumstances do not favor the decrease in insolvent companies in the near future. The insecurities caused by the recent vote in the UK, find companies reacting to the prevailing uncertainty with contingency planning. Businesses will be disrupted once the UK exists the EU and therefore, for many CEOs, it is important that they plan different scenarios to hedge against future disruption. This, combined with the high inflow of refugees coming from war zones can lead to an increase in business failure therefore, increases the need of careful planning and strict regulation on insolvency proceedings.

IV. CONCLUSIONS

Stimulating convergence in insolvency regulations across the EU is the main purpose of the Commission’s proposal for a new approach to insolvency and business failure. This can be achieved through developing a set of minimum standards with which national insolvency legislation would be required to comply. The standards would reflect a view on what constitutes best-practice regulation and, in particular, the view that facilitating opportunities for restructuring early on, or prior to, the commencement of formal insolvency proceedings is desirable from the point of view of creditors and debtors, and thus ultimately the economy as a whole.

At this point, while almost all Member States recognize the need for a mix of informal and formal procedures, only some have an explicit requirement to use them sequentially. All countries have regimes that target the survival of viable businesses, nevertheless the most common outcome of insolvency in many countries tends to be liquidation. One of the big discrepancies that can be observed throughout the Member States is the handling of insolvency of small entrepreneurs. In some countries they are handled under corporate insolvency, while in others it follows the rules in
Priorities for reform of insolvency frameworks going forward reflect to a large extent countries’ individual situations. This heterogeneity that can be observed in some Member States, is a result of both very different starting positions regarding the existing frameworks, as well as different reform dynamics in the recent past. Moreover, countries’ current situations also greatly differ as regards their economic and financial conditions, in particular the extent to which social conditions weigh on economic activity. The reform priorities looking forward need to be articulated taking into account such country-specific situations.

Looking ahead, including in light of the only partial achievements of the Commission Recommendation on a new approach to business failure and insolvency, convergence of national insolvency frameworks towards best practices would contribute to reducing legal uncertainty and costs for investors in assessing their risks, and to removing persisting barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups. Progress could be achieved over time in terms of reducing large asymmetries in insolvency frameworks across EU countries, with a view to fostering cross-border investment within the framework of Capital Markets Union.

V. REFERENCES


