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LONG TERM INVESTORS

On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

26 March 2021

Response to the European Commission's Consultation on Enhancing the convergence of insolvency laws

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1. FRAGMENTATION OF INSOLVENCY FRAMEWORKS AS A PROBLEM FOR THE INTERNAL MARKET AND THE NEED FOR GREATER CONVERGENCE

At present, substantive insolvency law is regulated exclusively at the level of EU Member States. Owing to different legal traditions and policy priorities, this leads to considerable discrepancies between the Member States' insolvency laws. This fragmentation may create barriers to the free movement of capital in the internal market in particular in view of diverging time-limits and lengths of procedures as well as diverging overall procedural efficiency which may make it more difficult to anticipate the outcome for value recovery, making it harder to price risks, including for debt instruments. Legal uncertainty and additional costs for investors, companies and other stakeholders may lead to the abortion of viable investment projects, reducing growth and employment opportunities and may stand in the way of optimal capital allocation thus constituting a hindrance to the development of a true Capital Markets Union.

In this section stakeholders are asked to assess whether and to what extent this situation constitutes an obstacle to a functioning internal market and which particular features of insolvency play the biggest role in that respect. In the following sections, stakeholders are asked to comment on policy options concerning the various areas of insolvency law.

Question 1.1. - Do differences in corporate (non-bank) insolvency frameworks in EU Member States pose a problem for the functioning of the internal market?

Select an available ranking scale from 0 to 5: where 0 means 'no problem' and 5 means 'extremely significant problem(s)' (only values of at most 5 are allowed)

Answer:

4

Question 1.1.1. - In particular, do differences in insolvency frameworks in EU Member States deter cross-border investment/lending?

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Select an available ranking scale from 0 to 5: where 0 means 'no problem' and 5 means 'extremely significant problem(s)' (only values of at most 5 are allowed)

Answer:

4

Question 1.2. - Which of the existing differences between the laws of the Member States in the areas mentioned below most affect the functioning of the Internal Market?

Select an available ranking scale from 0 to 5: where 0 means 'no problem' and 5 means 'extremely significant problem(s)'

Answer:

	0	1	2	3	4	5
a) Differences in the definition of insolvency;			X			
b) Differences in how insolvency proceedings are triggered - obligations of debtors and rights of creditors to file for insolvency;					X	
c) Differences in the duties and liabilities of directors in vicinity of insolvency and in insolvency proceedings;				X		
d) Differences in the duties and liabilities of insolvency practitioners;				X		
e) Differences in the identification and tracing of assets that belong to the insolvency estate;			X			
f) Differences in the ranking of claims;					X	
g) Differences in relation to avoidance action			X			

h) Other, please explain

Answer:

In a number of jurisdictions, debt to equity conversions are not possible in restructurings, thereby preserving equity holders (who may have no economic interest) over creditors (and making waterfalls "unnatural").

Question 1.4. - Which measures should be taken at the EU level to bring about greater convergence of insolvency frameworks?

Please choose between: (only one option possible)

- **targeted harmonisation through legislation**
- **recommendation**

- **a combination of both**
- **no measures**

Answer:

A combination of both

Question 1.5. – **Briefly describe the model for corporate insolvency to which Member States should converge**

Answer:

In terms of formal insolvency proceedings the themes identified by this consultation are aspects, which in our view, would contribute to an effective and efficient regime and which would benefit from harmonisation. From the investor perspective, a more harmonised approach across Europe to directors' duties and treatment of stakeholders would be beneficial from a costs and risks perspective.

2. DIRECTORS' LIABILITY IN VICINITY OF INSOLVENCY PROCEEDINGS, DISQUALIFICATION OF DIRECTORS

In the vicinity of insolvency, directors are in a key position and it may have to be clarified that their fiduciary duty to act in the best interest of the company includes taking into account the interest of creditors and all stakeholders. Legal systems have prescribed, in different ways, what directors should do when a company is near to or actually insolvent. The Restructuring Directive 2019/1023 provides a minimum level of harmonisation for directors' duties where there is a likelihood of insolvency (Art. 19), while the Company Law Digitalisation Directive (EU) 2019/1151 provides for the exchange of information on disqualified directors through the system of inter-connection of business registers (BRIS). The question is whether there are additional needs.

Question 2.1. - In your opinion, should there be any minimum harmonization at EU level on the duties and obligations of directors in the event of vicinity of insolvency or when the company is insolvent?

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

Question 2.2. - If your answer to the preceding question is in the affirmative, in which aspects of the question do you consider the harmonization of national laws at EU level beneficial?

Please choose between: (multiple answers possible)

- **A duty of the director in the vicinity of insolvency to formulate plans to take preventative action to avoid insolvency or to identify possible insolvency problems, if necessary to file for preventative proceedings.**
- **A duty of the director, once the company is insolvent, to file for the appropriate insolvency proceedings.**
- **A clarification of the focus of duties of the director when a company is near to insolvency or is actually insolvent to look at the interests of the creditors (instead of looking at the interest of the shareholders). This includes rules against 'wrongful trading'.**
- **Minimum standards at EU level on sanctions for breaches of the duties above. This might include civil and/or criminal liability of the directors.**

- **Minimum standards at EU level on the conditions and proceedings leading to the establishment of liability of the directors for breaches of the duties above.**

Answer:

A duty of the director in the vicinity of insolvency to formulate plans to take preventative action to avoid insolvency or to identify possible insolvency problems, if necessary to file for preventative proceedings.
A duty of the director, once the company is insolvent, to file for the appropriate insolvency proceedings.

4. RANKING OF CLAIMS

With respect to ranking of claims, generally secured creditors are strongly protected and can realise their secured property (collateral). However, some legal systems grant other types of creditors priority status. In some Member States, employee claims are treated as priority claims and may get paid first even ahead of secured creditors. In some Member States tax claims have a preferential status in insolvency proceedings. In some legal systems, a certain carve-out of the proceeds of security rights is used to ensure a minimum satisfaction of unsecured creditors. The question is whether common principles should be introduced by EU measures and what those principles should be.

Question 4.1. - According to your opinion, which aspect of the rules on the ranking of claims would benefit most from a harmonization at EU level?

Please choose between: (multiple answers possible)

- **The relationship between the claims of secured and unsecured creditors**
- **The position of the claims by unpaid employees of the debtor**
- **The status of tax and other public law claims in the event of insolvency**
- **The subordination of shareholder loans and/or other amounts due to shareholders to general creditor claims**
- **The validity of creditor agreements on ranking in non-bank insolvency**
- **The super-priority of "new financing"[1], including the definition of the "new money" and the conditions of such a priority**
- **None of the above**
- **Other, please, elaborate**

Answer:

The relationship between the claims of secured and unsecured creditors.
The position of the claims by unpaid employees of the debtor.
The subordination of shareholder loans and/or other amounts due to shareholders to general creditor claims.
The super-priority of "new financing", including the definition of the "new money" and the conditions of such a priority.

Please elaborate:

Answer:

[1] „New finance" means finance that is provided to a person or company in financial distress or even when insolvent.

There should be no automatic subordination of shareholder loans to general creditor claims, as is presently the case in certain jurisdictions. Genuine shareholder loans ought to be treated in the same way as other third party loans.

Question 4.2. - Should there be harmonized rules on 'carve outs' for the benefit of unsecured creditors? Or in other words: shall a portion of the amounts secured by security rights (rights in rem) be set aside for the satisfaction of general unsecured creditor claims?

Please choose between: (only one option possible)

- **Yes**
- **Yes, provided that such rules are clearly defined, have a sufficiently narrow scope and are proportionate**
- **No, such carve-out rules, even with the narrowest scope, would have a negative effect to credit availability and to the cost of credit**

Answer:

No, such carve-out rules, even with the narrowest scope, would have a negative effect to credit availability and to the cost of credit.

Question 4.5. - Should there be harmonized rules at EU level that subordinate claims arising out of shareholder loans to claims of other creditors (i.e. subordinate shareholder claims to debt claims)?

Please choose between: (only one option possible)

- **Yes, unless creditor claims are met in full (or unless each class of creditors consents), shareholders cannot receive anything for their shares.**
- **Yes, shareholder loans have to be treated in the same way as other unsecured claims.**
- **Yes, but difference has to be made between secured or unsecured loans by shareholders.**
- **No, the current divergence in national solutions is satisfactory in this respect**

Answer:

Yes, shareholder loans have to be treated in the same way as other unsecured claims.

Question 4.6. - **Should there be rules at EU level protecting "new financing" with a view to promoting corporate restructuring in insolvency in addition to the rules in Directive 2019/1023 for pre-insolvency restructuring[2]?**

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

[2] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, OJ L 172, 26.6.2019, p. 18–55.

5. AVOIDANCE ACTIONS

While legal systems in the various jurisdictions of the EU provide for possibilities to set aside suspect transactions, especially due to fraud, allowing additional assets to be distributed to the creditors. There are divergent approaches as to the conditions for a transaction to be set aside and the time-periods determining when a transaction can be challenged.

Question 5.1. - Which kinds of transactions should be covered by the harmonised rules at EU level governing avoidance action?

Please choose between: (multiple answers possible)

- **a) Preferences (transactions benefiting one creditor to the detriment of the general body of creditors)**
- **b) Transactions at an undervalue, including gifts to a creditor or a third party**
- **c) Securities created in the "suspect period" in order to convert a debt from being unsecured to being secured (invalidation of securities)**
- **d) Transactions to defraud creditors[3]**
- **e) Transactions entered into after insolvency proceedings**
- **f) Other [please, indicate!]**
- **g) None of them, there shall not be such harmonized rules**

Answer:

a) Preferences (transactions benefiting one creditor to the detriment of the general body of creditors)
b) Transactions at an undervalue, including gifts to a creditor or a third party
c) Securities created in the "suspect period" in order to convert a debt from being unsecured to being secured (invalidation of securities)
d) Transactions to defraud creditors
e) Transactions entered into after insolvency proceedings;
f) Other [please, indicate!]

Please indicate:

Answer:

There are already similar types of avoidance actions in each of the Member States. If measures are to be taken at EU level, we would find minimum harmonization or recommendations to enhance convergence more feasible than a fully harmonised approach.

[3] „Transaction defrauding creditors" means any transaction that was entered into by a debtor who subsequently becomes subject to formal insolvency proceedings and there was some intention to put creditors at a detriment as a result of the transaction. This derives from the actio pauliana.

Question 5.2. - **What types of condition would you find necessary to determine at EU level for a transaction to qualify as avoided action?** (multiple answers possible, but note that some conditions exclude the acceptation of others. If you consider a condition relevant only in relation to certain types of transaction, please, indicate them in the pop-up free text box by using the letter codes under point 5.1)

Objective criteria

Please choose between: (multiple answers possible)

- **The transaction happened within the "suspect period" (a set time period before the opening of insolvency proceedings)**
- **The transaction is to the detriment of the general body of creditors**
- **The transaction paces the creditor recipient in a better position than he or she would have been in a liquidation**
- **The debtor was insolvent at the time of the transaction**
- **The debtor became insolvent as a result of entering into the transaction**

Answer:

The transaction happened within the "suspect period" (a set time period before the opening of insolvency proceedings)
The transaction is to the detriment of the general body of creditors
The transaction paces the creditor recipient in a better position than he or she would have been in a liquidation
The debtor was insolvent at the time of the transaction
The debtor became insolvent as a result of entering into the transaction

Subjective criteria

Please choose between: (multiple answers possible)

- **The debtor knew or should have known that the transaction benefits the particular creditor or third party over the other creditors**
- **The beneficiary of the transaction (a creditor or a third party) knew that the debtor is insolvent or that the payment is detrimental to the general body of the creditors**
- **The beneficiary of the transaction (a creditor or a third party) knew that the debtor's intention is to prejudice his or her creditors**

Answer:

The debtor knew or should have known that the transaction benefits the particular creditor or third party over the other creditors

The beneficiary of the transaction (a creditor or a third party) knew that the debtor is insolvent or that the payment is detrimental to the general body of the creditors
The beneficiary of the transaction (a creditor or a third party) knew that the debtor's intention is to prejudice his or her creditors

Question 5.2.1. - Shall the fact that the transaction was performed when the payment was not yet due have any effect on the EU rules on avoidance in insolvency proceedings?

Please choose between: (multiple answers possible)

- **Yes, in this case the "suspect period" has to be longer**
- **Yes, presumptions shall apply in favour of the claimant seeking the avoidance of the transaction (e.g. that in such a case the subjective condition on the knowledge of the debtor/ beneficiary of the transaction is considered to be established; or e.g. in such a case the objective condition on the insolvency of the debtor at the time of the transaction is presumed)**

Answer:

Yes, in this case the "suspect period" has to be longer
Yes, presumptions shall apply in favour of the claimant seeking the avoidance of the transaction (e.g. that in such a case the subjective condition on the knowledge of the debtor/ beneficiary of the transaction is considered to be established; or e.g. in such a case the objective condition on the insolvency of the debtor at the time of the transaction is presumed)

Question 5.2.2. - Shall the fact that the transaction was made outside of the normal course of commerce/business of the debtor have any effect on the EU rules on avoidance in insolvency proceedings?

Please choose between: (multiple answers possible)

- **Yes, in this case the "suspect period" has to be longer**
- **Yes, presumptions shall apply in favour of the claimant seeking the avoidance of the transaction (e.g. that in such a case the subjective condition on the knowledge of the debtor/ beneficiary of the transaction is considered to be established; or e.g. in such a case the objective condition on the insolvency of the debtor at the time of the transaction is presumed)**

Answer:

Yes, in this case the "suspect period" has to be longer

Yes, presumptions shall apply in favour of the claimant seeking the avoidance of the transaction (e.g. that in such a case the subjective condition on the knowledge of the debtor/ beneficiary of the transaction is considered to be established; or e.g. in such a case the objective condition on the insolvency of the debtor at the time of the transaction is presumed)

Question 5.2.3. - Shall the fact that the person who benefited from the transaction (the creditor or a third party) is connected (family members, group of companies) with the debtor have any effect on the EU rules on avoidance in insolvency proceedings?

Please choose between: (multiple answers possible)

- **Yes, in this case the "suspect period" has to be longer**
- **Yes, presumptions shall apply in favour of the claimant seeking the avoidance of the transaction (e.g. that in such a case the subjective condition on the knowledge of the debtor/ beneficiary of the transaction is considered to be established; or e.g. in such a case the objective condition on the insolvency of the debtor at the time of the transaction is presumed)**

Answer:

Yes, in this case the "suspect period" has to be longer
Yes, presumptions shall apply in favour of the claimant seeking the avoidance of the transaction (e.g. that in such a case the subjective condition on the knowledge of the debtor/ beneficiary of the transaction is considered to be established; or e.g. in such a case the objective condition on the insolvency of the debtor at the time of the transaction is presumed)

Question 5.2.3.1. - Who shall be considered as a "connected person" in the context of avoidance of transactions according to the harmonized rules?

Answer:

Companies in the same group, equity holders, management, family members related to management.

Question 5.3. - Should the time-periods before the opening of insolvency proceedings in which a transaction must have been entered into for it to be avoidable (the "suspect period") be harmonized at EU level?

Please choose between: (only one option possible)

- **Yes**

- **No**

Answer:

Yes.

Question 5.3.2. - **What shall be the point in time from which the "suspect period" shall be counted from?**
Please choose between: (only one option possible)

- **The opening of insolvency proceedings**
- **The appointment of the insolvency practitioner**
- **Other (please specify)**

Answer:

The opening of insolvency proceedings

Question 5.4. - **In most Member States, the right to file an avoidance action lies with the insolvency administrator, however, in certain Member States, creditors are also empowered to file it under certain conditions. In your view, who should be entitled to take action in the courts in relation to the avoidance of transactions?**

Please choose between: (multiple answers possible)

- **the IP**
- **a government official**
- **a court supervisor**
- **a creditor alone**
- **a creditor subject to approval of a court or some other independent body**

Answer:

The IP.
A creditor alone.

Question 5.5. - **Should there be a harmonized limitation period as far as the institution of avoidance proceedings?**

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

Question 5.5.1. – If your answer to the preceding question was in the affirmative, what shall be the time-period within which avoidance proceedings have to be instituted?

Answer:

Before the insolvency process has been concluded.

6. HARMONISING PROCEDURAL ISSUES RELATING TO FORMAL INSOLVENCY PROCEEDINGS

This section addresses the definition of insolvency, the obligation (of the debtor) and the possibility (for others) to file for insolvency proceedings and the requirements for filing claims against an insolvent debtor. On all those questions, there are divergent solutions in the Member States' legal systems. Insolvency is defined on the basis of either only a cash flow/illiquidity test (a company cannot pay its debts as they fall due) or, as an alternative, a balance sheet/overindebtedness test (the value of a company's liabilities outweigh the value of its assets). Approaches also differ as to whether directors are required to file for insolvency proceedings and as to the conditions for creditors to request the opening. To ensure that their claims are acknowledged and taken into account in the calculation of creditors' pay-out in liquidation and in the voting for arrangements for restructuring, creditors need to file their claims with the insolvency practitioner but the conditions, especially concerning the time allowed for the filing varies significantly across the EU.

Question 6.1. – Should there be a harmonised definition of insolvency at EU level?

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

Question 6.1.1. – Should the definition of insolvency be based on?

Please choose between: (multiple answers possible)

- **Liquidity test?**
- **Balance sheet test?**
- **The possibility to opt for one of both?**
- **Other test (for instance, a combination of elements from both tests)?**

Answer:

Liquidity test
Balance sheet test
The possibility to opt for one of both
Other test (for instance, a combination of elements from both tests)

Please explain:

Answer:

Each of these could be options.

Question 6.2. - In view of procedural economy, would you consider beneficial introducing rebuttable legal presumptions that would facilitate proving that a debtor is insolvent (for instance: if a debtor is unable to meet its financial obligations over a period of time longer than 90 days, it is considered insolvent)?

Select an available appropriate ranking scale from 0 to 5. (only values of at most 5 are allowed)

Answer:

3

Question 6.3. - Should there be harmonised rules on how insolvency proceedings are opened?

Select an available appropriate ranking scale from 0 to 5. (only values of at most 5 are allowed)

Answer:

4

Tick the below replies if you think such rules should: (multiple answers possible)

- **Oblige an insolvent debtor to file for insolvency**
- **Provide creditors with a right to file for insolvency**

Answer:

Oblige an insolvent debtor to file for insolvency.
Provide creditors with a right to file for insolvency.

Question 6.4. - One of the most important issues for legal entities, when they learn that insolvency proceedings have been opened against their debtor, is to learn about this fact in a

timely manner and to acquire certainty about the time-period for lodging their claims in the respective insolvency proceedings.

As regards the information on the opening of insolvency proceedings, are national insolvency registers and the interconnectivity of national insolvency registers at EU level functioning properly?[4]

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

No.

If no, what should be improved?

Answer:

A common approach to what information is accessible may be useful.

Do you see merit in harmonising national rules on the time-limits for creditors as regards the lodging of their claims?

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

If yes, what would be the most appropriate time-limit?

Answer:

In general and to promote efficiency, a one year time limit may be appropriate but with an option to extend in more complex situations and for simple cases, recognition that a shorter period may be appropriate.

[4] Bearing in mind that the EU-wide interconnection of insolvency registers (IRI 2.0, see Article 25 of Regulation (EU) 2015/848) will be fully operational in all Member States only as of 30 June 2021

Question 6.5. - **Given the increasing number of cross-border insolvency cases and the need for specialised legal knowledge, should the rules on minimum training requirements/professional qualifications for judges be harmonised at the EU level?**

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

Question 6.6. - **In your assessment, would it contribute to the efficiency of insolvency proceedings if Member States designated specialised chambers at the appropriate court instances for the handling of insolvency cases?**

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

7. ASSET PRESERVATION, ASSET IDENTIFICATION AND TRACING OF ASSETS BELONGING TO THE INSOLVENCY ESTATE

Asset tracing is a process that enables courts, IP, investigators or parties that demonstrated a legitimate interest to determine a debtor's assets, examine the revenue generated by often fraudulent activity, and follow its trail. EU law has established a specific tool for asset tracing in the area of civil judicial cooperation, in order to obtain information on bank accounts in another Member State in the context of the cross-border freezing of accounts in the Regulation on a European Account Preservation Order[5]*. However, there is no horizontal instrument to assist cross-border asset tracing and enforcement in insolvency cases.*

Question 7.1. - Businesses across the Union often stipulate in contracts among themselves specific "acceleration" or "termination" clauses (also known as "ipso facto clauses") for the event if any of them becomes insolvent. Since rules on such clauses in EU Member States diverge or do not exist and since courts and arbitral tribunals issue very diverging decisions when interpreting such contractual clauses, would you estimate that harmonisation of those rules would enhance legal predictability and security for businesses?

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

Question 7.2. - Should there be EU harmonised rules on assistance (including interconnectivity of relevant registers) in the cross-border tracing of assets of the insolvent debtor?

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

[5] Regulation (EU) No 655/2014 of the European Parliament and of the Council of 15 May 2014 establishing a European Account Preservation Order procedure to facilitate cross-border debt recovery in civil and commercial matters, OJ L 189, 27.6.2014, p. 59.

Question 7.2.1. - **If YES, information on which types of assets is the most useful?**

Please choose between: (multiple answers possible)

- **Real estate**
- **Movables**
- **Company interests**
- **Bank accounts**
- **Claims (other than arising from bank accounts)**

Answer:

Real estate
Company interests

Question 7.5. - **Should insolvency practitioners have full access to property and collateral database?**

Please choose between: (only one option possible)

- **Yes**
- **No**

Answer:

Yes.

Contact

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About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

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