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INSTYTUT ALLERHANDA

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INSO Section of the Allerhand Institute
position towards

Proposal for a
DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
harmonising certain aspects of insolvency law
(Text with EEA relevance)
{SEC(2022) 434 final} - {SWD(2022) 395 final} - {SWD(2022) 396 final}

- EU (European Commission) document

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1. INTRODUCTION / BRIEF EXECUTIVE SUMMARY OF THE KEY ISSUES ADDRESSED

In the opinion of the INSO Section of the Allerhand Institute, the issue that requires the most thought is the issue of simplified proceedings for micro-entrepreneurs, as the planned regulations in the Proposal for a Directive will significantly increase the administrative burden on the courts, which may lead to a significant decrease in the efficiency of the procedure.

Instead, it seems advisable to involve restructuring advisors, as the most professional entities in the context of conducting this type of proceedings, as well as having experience and the necessary competence.

2. A GENERAL INTRODUCTION ABOUT THE NEED FOR A DIRECTIVE AND A GENERAL PROPER LEGISLATIVE DIRECTION

INSO – Section of Insolvency and Restructuring Law of the Allerhand Institute (the INSO Section; INSO Section of the Allerhand Institute) is an independent centre for analysis and research of insolvency-related law. It brings together judges, restructuring advisors, attorneys as well as managers and entrepreneurs, as well as numerous practitioners and theoreticians of insolvency and restructuring law.

In the opinion of the INSO Section, the adoption of the proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law (proposal or Directive) is generally a step in the right direction, as insolvency law, for its effectiveness and efficiency, requires some harmonization at the EU level, especially as legal issues and trading with an international element will become increasingly popular.

Within this document, the INSO Section intends to comment on the proposal for a Directive, also presenting when deemed beneficial Polish perspective and experience within restructuring / insolvency law field.

3. AVOIDANCE ACTIONS (Title II)

An important area addressed in the proposal for a Directive is the issue of avoidance actions or ineffectiveness of legal actions, which is a certain standard in bankruptcy law, and indeed the intention to harmonize this issue as well, in order to protect the bankruptcy estate.

a. Adequacy of Polish regulations

Analyzing the provisions on avoidance actions or ineffectiveness in Poland, it should be noted that, in principle, the Polish provisions meet the proposals of the EU legislator provided for in the proposal for a Directive, which in this regard is based on the system of the German model, proven in practice, but leave the Member States the possibility of introducing more far-reaching regulations.

b. Ex lege voidable transactions and actions

However, it would be desirable to introduce into the proposal for a Directive the possibility for the bankruptcy court, as a specialized court, to declare an act ineffective by operation of law (ex lege), if the prerequisites for declaring it as such on the basis of a specific factual situation are met. Only the bankruptcy court should have the authority to declare voidability or ineffectiveness (by operation of law) – and similarly, in cases of actio pauliana.

c. Actio pauliana within the court jurisdiction in international (cross-border) cases

Referring to the regulation of an action pauliana claim and possible cross-border situations, it seems advisable to prejudge that the applicable law is determined by the court where the bankruptcy was declared. Such a solution seems to prevail at present in the case law of the Court of Justice of the EU, although it would be advisable, for the sake of security of legal transactions, to unambiguously prejudge this issue.

d. Deadlines

A condition for effective harmonization would generally be the introduction of maximum time limits to create opportunities for receivers to protect and increase the bankruptcy estate with legal certainty, for example, a statute of limitations of 3 years - that is, the trustee should have a period of three years from the declaration of bankruptcy to take actions related to ineffectiveness/voidability or avoidance actions.

The issue of the relatively broad definition of related parties in the proposal for a Directive will need to be harmonized, which is important, if only for the adoption of appropriate presumptions, for example, in issues related to actio pauliana complaint/claim.

4. ASSET TRACING (Title III)

Another area is the issue of tracing assets belonging to the bankruptcy estate and being able to efficiently identify and recover them.

a. Access for insolvency practitioners (restructuring advisors) to asset registries - including bank registries

In the opinion of the INSO Section, it would be desirable to explicitly indicate the access of restructuring advisors to bank accounts and their history, which may also help to identify possible ineffective actions. Restructuring counsel's arrangements for tracking bank accounts should be similar to the capabilities that judicial officers have in this regard. Related to the above issues is also the question of trust in restructuring advisors, and in this regard it is advisable to consider the establishment of a professional self-government for them, which can also facilitate the continuous improvement of competence and supervision of the appropriate level of proceedings conducted.

b. Issues of electronification of received and obtained data

The issues of asset tracing are also relevant in terms of the electronification of data, analogous to the enforcement authority. It should be clearly regulated that the predominant form of requesting, receiving and analyzing data is done electronically. This will not only facilitate organizational issues, but also contribute to improving the efficiency and speed of the information obtained and its use.

5. PRE-PACK PROCEEDINGS (Title IV)

The introduction of prepared liquidation at the EU level should be viewed very positively, as the rapid sale of assets in an insolvency situation can significantly increase the satisfaction of creditors and also the efficiency of the procedure.

The procedure for selling assets in a prepared liquidation (pre-pack) should be both efficient and as transparent as possible.

On the one hand, it is worth ensuring that creditors obtain information about the planned transaction, but also that mechanisms are put in place to enable it to be carried out smoothly in accordance with the principle of efficient use of time and the absence of incentives to prolong proceedings over time.

a. A negative example of changes in Polish law that practically weakened the overtone and application of the pre-pack

The Polish example of the solutions for the prepared liquidation shows that the overregulation of the procedure by, among other things, the obligation to inform a very wide circle of materially secured creditors – not even by allowing them to easily obtain information, but to send correspondence by traditional means without granting them the attribute of participant in the proceedings – has not contributed to improving the efficiency of the proceedings, but has even led to a collapse in this area and a significant decline in interest in these proceedings.

The alternative to a pre-pack should be a liquidation arrangement with the effect of an execution sale, and this should be decided by the creditors and only approved by the court.

b. Auction – is it necessary?

An auction to obtain the highest possible price for the object of the transaction in a pre-prepared liquidation seems like a good idea, provided that it is conducted in an efficient manner and, in the opinion of the INSO Section, using electronic systems.

A condition, however, would be to ensure that the investor who incurred the costs of preparing the pre-pack is at least partially reimbursed. Otherwise, this will discourage real investors and encourage speculative investors. This is also important with cross-border issues and increased internationalization of economic trading, which may also affect the interest of foreign investors.

As indicated above, in the procedures related to the prepared liquidation, the appropriate technical design and electronification of the proceedings are of considerable importance. This is the only way to ensure the efficiency of the proceedings at this time for the benefit of all participants.

As part of the prepared liquidation, it is also advisable to explicitly stipulate that contracts related to the operation of the business, which is the subject of the transaction, fall within its scope and the buyer becomes a party to them. However, in order to safeguard possible conflicting interests, the option should be left to terminate the cooperation after the change of the entity that is party to the agreement.

c. Issues of investor rights - not addressed further in the Proposal

An important issue, albeit not addressed more extensively in the proposed Directive, is the question of the rights of an investor who is not a creditor of the entity affected by the prepared liquidation proceedings.

Such rights as, for example, the right to challenge a negative decision on a prepared liquidation, or to obtain information should be guaranteed at the EU level.

It is expedient to grant the investor powers similar to the status of a participant.

6. THE DUTY OF DIRECTORS TO SUBMIT A REQUEST FOR THE OPENING OF INSOLVENCY PROCEEDINGS (Title V)

The proposal for a Directive also touches on the responsibilities of executives at companies that are in insolvency. In the opinion of the INSO Section, while it seems advisable to maintain the deadline for filing a bankruptcy petition, with the proviso that the provisions providing for liability in the event of failure to file on time will be tightened. We also propose that the bankruptcy court, along with the termination of the proceedings, ex officio assess the prerequisites (and, if applicable, adjudicate) for the prohibition (ban) of business activity.

The prejudgment of the nature of liability as indemnity to creditors seems a good solution, although it should be remembered that different countries with different legal traditions may have different regulations here.

7. SIMPLIFIED WINDING-UP PROCEEDINGS FOR MICROENTERPRISES (Title VI)

Given the increasing number and importance of the small and medium-sized enterprise sector in the European economy, it is desirable to introduce an efficient and relatively inexpensive liquidation procedure for the insolvency of micro-entrepreneurs. In the opinion of the INSO Section, in such realities involving the courts does not seem to be the right direction.

a. Transfer of administrative duties from courts to receivers – a positive experience

A good example of effective solutions that worked in practice in Poland was the transfer of consumer bankruptcy proceedings from being conducted in bankruptcy courts to the offices of restructuring advisors. Within these proceedings, most are conducted under a simplified procedure, which is efficient in doing so, and has relieved the burden on bankruptcy courts. However, the possibility has

been left for the courts to handle more complicated cases, or those with larger assets, under the ordinary procedure. As has already been hinted at, restructuring advisors are individuals who, by definition, are well versed in insolvency law, are prepared and properly educated to do so, and are also characterized by practical experience.

Therefore, simplified bankruptcy proceedings (winding-up) for micro-entrepreneurs should include, in the opinion of the INSO Section, also the involvement of restructuring advisors - and optimally even the conduct of these proceedings by them, with judicial supervision, but without excessive involvement of the courts, for example, for administrative actions.

Also, the repayment plan in such proceedings should be simplified and established by the trustee at a meeting with the participation of the creditors, while the court's involvement should be made only in the event of objections raised by any participant in the proceedings. If objections are filed, the repayment plan falls and is drawn up by the court.

b. In Polish realities, transferring tasks to courts may prove counterproductive and inefficient

The Second Chance Directive already calls for an efficient and effective judicial system in bankruptcy and restructuring cases. Placing emphasis on this aspect should be clearly made in the Directive's proposal, since only with efficient courts, the proceedings can be conducted in an optimal way and ensure a satisfactory course for all.

Therefore, it is expedient to recommend that, for example, consumer cases or simpler cases of micro-entrepreneurs be handled by lower in the hierarchy judicial centers, and that cases requiring more attention be moved to a higher level of the judicial structure. Higher courts would also be courts of appeal in appeals from the lowest level of the judicial structure. This court structure will also preserve the professional experience of judges in the area of bankruptcy and restructuring.

Also, the jurisprudence of the higher courts in the hierarchy would have the opportunity for uniformity and greater weight, with the benefit of uniformity of cases in similar factual situations.

In Poland, since the 2016 reform, we have seen a steady increase in the number of consumer bankruptcies, as well as a strong interest among entrepreneurs in restructuring proceedings.

An important change in this regard was the introduction of an electronic system for handling bankruptcy and restructuring proceedings – the National Debtors Register – as of 01/12/2021.

During the period of its operation, until 12/03/2023, entrepreneurs filed 1,523 bankruptcy applications, while only 196 were declared bankrupt. Applications for judicial restructuring (i.e. expedited arrangement proceedings, composition proceedings and sanctioning proceedings) are 438 cases, and open proceedings 183.

During the same period, there were 2,974 notices of opening proceedings for the approval of an arrangement, which in some 1,269 cases resulted in the approval of the arrangement. As of 12.03.2023, Polish courts had approved 422 arrangements, and refused approval in only 51 cases.

Such high popularity of the procedure for approval of an arrangement shows that Polish entrepreneurs need an efficient restructuring tool they can use when courts are becoming less and less efficient due to the significant number of consumer proceedings - 15.6 thousand in 2022 and as many as 18.2 thousand in 2021. The decrease in 2022 was due to the entry into force of the National Debtors Register system.

Statistics show that restructuring and bankruptcy can be effectively and efficiently carried out, however, with the provision of adequate infrastructure, but most importantly, the retention of competent and qualified staff.

In addition, it is worth pointing out that the regulation ordering the conduct of proceedings also in the absence of funds – the so-called poverty of the bankruptcy estate – does not seem apt. In such situations, the bankruptcy court could inform the competent registry court about the materialization of the premise for deletion of the entity without conducting liquidation proceedings. Dismissal on the grounds of so-called poverty of the mass should not be applied to sole proprietors, since in their case it is reasonable to dismiss (discharge) debt.

In the context of a simplified procedure for micro-entrepreneurs, it would also be possible to introduce a model of a consumer arrangement or liquidation arrangement - that is, essentially an out-of-court procedure for making arrangements, agreements with creditors, in which the burden of administrative conduct of the proceedings would be on restructuring advisors, and the effects of the sale of assets in such an arrangement would be linked to the effects of an execution sale, with minimal court involvement (approval of the arrangement).

8. CREDITORS' COMMITTEES (Title VII)

As a rule, bankruptcy proceedings are aimed at recovering creditors' funds in an orderly procedure. Therefore, it is most expedient that creditors take an active part in these proceedings, e.g. through participation in creditors' councils. Creditors' councils in the case of proceedings of large entrepreneurs should be mandatory, while they should be optional in the case of SME entrepreneurs.

a. Members' liability issues

Serving on creditors' committees is also related to liability. The proposal for a Directive in this regard signals some solutions, which seems like a good idea, while it should, in our opinion, be thought through more carefully, with the introduction of the issue of culpability. The issue of introducing liability insurance for members of creditors' committees remains to be considered.

b. Incentives for taking part

Given the low popularity observed in certain countries for creditors to function on creditors' councils, it seems advisable to introduce additional incentives for serving in the function, such as remuneration for holding a meeting, in addition to just reimbursement of expenses.

c. Issues of effectiveness of the right to judicial review of resolutions of the board of creditors

The proposal for a Directive rightly indicates that the resolutions of the creditors' committees should be subject to judicial review, but in the opinion of the INSO Section, emphasis should be placed on properly – only in the clearest cases – linking the effectiveness and enforceability of the resolution, from its challenge. A different regulation of this issue could lead to paralyzing the work of creditors' committees and, consequently, even denying the point of their appointment.

d. Access to information and confidentiality issues

Members of creditors' committees should have greater access to information related to the debtor and its financial situation, however, with guarantees that such information will be kept confidential. These issues may also be a matter of indemnity liability for board members. In addition, it is worth noting that the supervisor or administrator should have access to bank secrecy data in doing so.

e. Issues of differences in composition and size depending on the size of the proceedings and the number of creditors

A solution that seems desirable in the context of the diversity of proceedings is to provide for differences in the composition and number of councils, depending on the size and number of creditors in a particular bankruptcy proceeding.

For example, one can imagine a statutory regulation that for smaller proceedings the number of members of creditors' councils should be, for example, 3, while for larger ones it should be 5.

f. Leaving as an exception the possibility for multiple creditors' committees to function in a single bankruptcy proceedings

The general principle of creditors' committees is that they are guided by the interests of the general body of creditors, at the expense of particular interests. Thus, it is right that the proposal of the Directive addresses, as an exception, the permissibility of leaving the institution of several creditors' committees in a single proceeding, but the issue of aligning these interests in the case of a plurality of committees should be more clearly discussed.

In the opinion of the INSO Section, however, such a solution is objectionable due to praxeological considerations and a possible conflict of competencies.

9. THE DRAWING-UP OF A KEY INFORMATION FACTSHEET BY MEMBER STATES ON CERTAIN ELEMENTS OF THEIR NATIONAL LAW ON INSOLVENCY PROCEEDINGS (Title VIII)

The proposal for a Directive also touches on the issue of transferring key information on insolvency cases at the EU level, it can help with harmonization and at possible further stages of the development of the law and legislative process, and is relevant to cross-border insolvencies.

The issue of efficient transmission of information is of the greatest importance in cross-border situations, so it is postulated to provide for the transmission of information not only in the individual official languages of the EU, but also in a unified form, including additionally at least in English, which currently seems to be the most widespread in business within the European Union.

10. THE SCOPE OF THE DIRECTIVE AND THE QUESTION OF WHAT ELSE IT COULD COVER

The INSO section identifies the following areas that are not included in the scope of the Proposed Directive, but nevertheless remain relevant to the realization of its goals and objectives - and may become the subject of work by the relevant entities in the future as well.

a. Basis (premise/grounds) for bankruptcy – common European understanding of insolvency as a permanent condition

In the abovementioned context, it is expedient to draw attention to the circumstance of different definitions of insolvency in the legal orders of individual Member States. In the opinion of the INSO Section, it would be worthwhile to consider the possibility of unifying the definition of insolvency precisely as a state of permanence and associated with the inability to satisfy mature/ due monetary liabilities/ obligations.

Such a definition would also be desirable in the case of cross-border issues or group insolvency, since it is currently possible that the same entity – if treated individually – could turn out to be insolvent in one country, while in another it will not meet the definition of insolvency.

b. Issues of approximation / unification of categories of satisfaction

Also, it would be desirable to unify - or at least approximate - the various categories of satisfaction in bankruptcy proceedings, since these issues are also relevant in cross-border bankruptcies/ insolvencies.

c. Facilitation and organizational improvements – what should an insolvency practitioner (restructuring advisor)/ trustee (administrator) have?

From the point of view of restructuring advisors, one of the key issues is to ensure the appropriate level of education, competence and experience and also the continuous improvement of professional qualifications, optimally in the formula of establishing a professional self-government. Licenses in this regard could be granted by a public authority.

Although these issues remain in the regulatory area of the Restructuring Directive – or the Second Chance Directive – It would seem advisable to pay attention to these issues in the Harmonization Directive as well.

d. What about restructuring? - Will the Second Chance Directive be enough?

The area of insolvency-related law is increasingly regulated by EU legislation. However, it is necessary to consider whether the integration of the legal systems of individual Member States should not go in an even further direction, taking into account certain distinctiveness of individual jurisdictions.

It is not uncommon for the areas of bankruptcy and restructuring to intermingle, and increasingly involve international organisms or groups, so there may be a need to further adjust the regulations related to these issues in the near future.

The issues of providing a compilation of key information are of importance especially for future further harmonization, so it is expedient to ensure that this information is properly collected and processed.

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