Submission

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To **European Commission**

Re **Response to the Consultation on a new European approach to business failure and insolvency**

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About the EVCA

The European Private Equity and Venture Capital Association (EVCA) is a member-based, non-profit trade association that was established in Brussels in 1983. The EVCA is a member of the Transparency register (ID: 60975211600-74).

The EVCA is the voice of European private equity. Its membership covers the full range of private equity activity, from early-stage venture capital to the largest private equity firms, investors such as pension funds, insurance companies, fund-of-funds and family offices and associate members from related professions. We represent 700 member firms and 500 affiliate members.

The EVCA shapes the future direction of the industry, while promoting it to stakeholders such as entrepreneurs, business owners and employee representatives.

We explain private equity to the public and help shape public policy, so that our members can conduct their business effectively.

The EVCA is responsible for the industry's professional standards, demanding accountability, good governance and transparency from our members and spreading best practice through our training courses.

We have the facts when it comes to European private equity, thanks to our trusted and authoritative research and analysis.

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Introduction

The EVCA welcomes the opportunity to respond to the European Commission consultation on a new European approach to business failure and insolvency. This response has been prepared with input from a number of legal practitioners and insolvency lawyers across Europe (including Germany, Portugal and the United Kingdom).

The EVCA stands ready to provide whatever further contribution to this work the European Commission might find helpful, including attending meetings and contributing further materials in writing.

We understand that having a robust approach to business failure and insolvency across Europe will encourage access to finance, enable viable businesses to be rescued, and will improve growth and sustainability in the overall economy. The proposals for harmonisation aim to achieve this by protecting the value of the insolvent estates, reducing costs, increasing predictability for creditors and shareholders, reducing forum shopping and preserving employment.

Whilst we are in agreement with these laudable aims, we are not persuaded that harmonisation is necessarily something that will deliver these improvements. We note that there has already been a natural convergence in the promotion of pre-insolvency/rescue procedures across Europe, and that this, in conjunction with proposals to extend the scope of the European Regulation on Insolvency Proceedings to pre-insolvency and rescue type procedures, may be more feasible than a harmonised approach. Harmonisation will require the development of common standards applicable in all member states, which we envisage may be difficult to achieve.

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Consultation response

1. Selected areas where the divergence of national law may create problems for the internal market (Section II)

1.1. Second chance for entrepreneurs in honest bankruptcies

Supportive measures to promote second chance

Q1. Which of the following measures would you consider as the most efficient in order to reinforce a second chance for honest entrepreneurs?

- *Eliminate stigma of bankruptcy and reduce discrimination of failed entrepreneurs if any*
- *Frame and apply "fast track" liquidation proceedings for honest bankruptcy*
- *Develop and expand programmes to mentor, train, advise and support second starters*
- *Other*

EVCA RESPONSE:

We consider that perhaps the greatest challenge to being able to reinforce a culture of a second chance for honest entrepreneurs is to eliminate the stigma of bankruptcy and reduce discrimination against failed entrepreneurs. This change will take time to deliver, not just by way of access to the different types of rescue and speed of the processes, but also in the mind-set and culture of the member states.

Discharge periods facilitating a second chance

Q2. Do you support the European objective to limit the discharge and debt settlement period to a maximum of three years in order to facilitate second chance? If no, please justify.

EVCA RESPONSE:

In general, we support the European objective to limit the discharge and debt settlement period to a maximum of three years in order to facilitate a second chance. If a maximum is used (i.e. 3 years) the variance between member states would be reduced. But in those member states with shorter discharge periods, for example the UK (which is currently 12 months), there may still be sufficient incentives for unscrupulous debtors to manipulate jurisdictional requirements and get the benefit of the shorter discharge period. For certain cases, e.g. fraud, there should be some flexibility to extend the period.

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1.2. Conditions for opening insolvency proceedings

Insolvency test and timeframe

Q3. In your view, do the differences in national law for the opening of insolvency proceedings (insolvency test and/or timeframe) create problems for businesses operating in the internal market? Please specify.

EVCA RESPONSE:

Yes. Due to the existing differences (between member states) there is a degree of uncertainty for practitioners which would be mitigated if these aspects are harmonized.

However, it should be noted that the most significant difficulties in this respect are not the intricacies of the specific tests for insolvency themselves, which are broadly based on similar triggers (i.e. liquidity or balance sheet), but the application in certain jurisdictions of mandatory time periods in which management is required to open insolvency proceedings. These may prompt management to file for insolvency protection rather than explore opportunities for restructuring, for fear of attracting personal liability. In some restructurings this prompts management to seek out a more favourable restructuring regime in another jurisdiction in order to try to rescue the business, rather than use *unsuitable* processes (and risk of liability) in the Member State most naturally aligned with the business.

In addition, differences in national laws of Member States could create problems for companies operating on a multi-jurisdictional basis. For example, a debtor may be required to file for insolvency in the Member State where the debtor's COMI (centre of main interest) is located, whereas in another Member State, he is not (yet) required to do so. This might cause problems when multiple proceedings (primary or secondary) are envisioned simultaneously. Furthermore, where groups of companies are concerned, certain members of the group may be required to file for insolvency, whereas other members in other jurisdictions might not be able to file, which can hinder a coordinated insolvency process.

Entities which are eligible as debtors and which can file for insolvency proceedings

Q4. In your view, does the divergence of national laws on the following issues create problems? Please specify.

- *The possibility for creditors to file for insolvency proceedings?*
- *The possibility of specific public entities to file for insolvency proceedings?*
- *The possibility to open insolvency proceedings against certain entities?*
- *No*

EVCA RESPONSE:

There are usually good policy reasons for having special insolvency processes for certain types of entity, e.g. public entities. These are normally linked to national policies and the provision of services required to facilitate the proper functioning of the local or national communities. For certain types of entities, for example banks and insurers, there are already frameworks for recognition which operate at an EU level.

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With regard to the ability of individuals to be subject to insolvency proceedings, there is first a general concern that denying natural persons this ability could impede a bankrupt individual's prospects of a second chance. Individuals who are not able to benefit from a discharge of debt are limited in their ability to contribute to society's welfare. Second, the divergence of national laws in this respect may create a feeling of unfairness among citizens, depending on the laws of the Member State in which they have their place of abode. This creates incentives to engage in forum shopping and poses a potential obstacle for the efficient functioning of the single market.

With regard to other entities, as mentioned above, the ability to be subject to insolvency proceedings is in many cases a question of national policy. It can be appropriate to limit the possibility to file for insolvency in respect of certain public sector entities or entities whose functioning is relevant to the economy as a whole.

1.3. National legal frameworks for restructuring plans

Q5. In your view, is there a need to eliminate all or some of the divergences of national rules regulating restructuring plans?

If yes, please specify:

- *The identification of the parties that can propose a plan*
- *The composition of classes of creditors*
- *The required majorities for approving the plan/voting rules*
- *The possible contents of the plan*
- *The criteria for approving the plan by the supervising court*
- *The possibilities of appeal against a plan*
- *Other*

EVCA RESPONSE:

[Tick the following options]

- the composition of classes of creditors;
- the required majorities for approving the plan/voting rules;
- the possible contents of the plan.

It should be noted that there is nothing to prevent individual member states from promoting restructuring plans that offer flexibility to stakeholders already. In many European jurisdictions there has already been a convergence and development of rescue procedures. Some of the perceived limitations in certain jurisdictions are linked with underlying company legislation, and security rights that have been enshrined nationally and which may make the flexible processes available in one jurisdiction less suitable in another.

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1.4. Special arrangements for SMEs

Q6. Does a simplified and cost-efficient insolvency scheme for SMEs exist in your Member State?

If yes, do you have any comment or suggestion on how these schemes can be improved? If no, has the absence of such schemes led to problems? Please specify.

EVCA RESPONSE:

There are no simplified and cost-efficient insolvency schemes for SMEs in Portugal or Germany.

- Portugal: A simpler process for SMEs (lower costs, less bureaucracy, fewer formalities) would help for the conclusion of these processes, therefore being an incentive to apply for insolvency.

- In Germany, the absence of such schemes which are designed in particular for SMEs has not led to problems. Generally, German insolvency laws after several reforms in the 1990s and in 2012 provide sufficient flexibility to deal with the insolvency of SMEs.

- In the UK, whilst there are no bespoke procedures available for SMEs, company voluntary arrangements (with a small company moratorium), administration and liquidation are all available and may be used in an efficient and cost effective way for SMEs.

Are you aware of any problems which SMEs as creditors encounter? If yes, please specify.

EVCA RESPONSE:

In general, insolvency proceedings are expensive and lengthy and are collective processes, aimed at benefitting the creditors as a whole. There is no advantage in SMEs commencing a process as creditors as there will be little guarantee that they will make any recoveries. In addition, SMEs may be frequently prevented from commencing insolvency proceedings (even taking the risks e.g. abusive lending as creditors, or in the case of SMEs as debtors, management may face personal liabilities for not applying for insolvency within the required time established by insolvency law with the consequences arising therefrom) due to such difficulties.

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Q7. Are the following types of procedures available to SMEs in your Member State?

- *Out-of-court settlement and voluntary arrangements*
- *Early warning systems and pre-insolvency proceedings*
- *Fast-track proceedings?*
- *Personal insolvency schemes and civil bankruptcy*
- *One-stop-shops with multidisciplinary competences to advise and help businesses in distress*
- *No*

EVCA RESPONSE:

Not in Portugal or Germany.

In the UK there are flexible processes available, see response above.

Q8. Which of the following aspects should be improved in view of making insolvency proceedings more efficient and effective for SMEs?

- *the priority of claims?*
- *the costs of procedures (court fees, insolvency practitioner fees)?*
- *the efficiency and effectiveness of the insolvency practitioner?*
- *the efficiency and effectiveness of the courts and the interactions between courts and the parties?*
- *the efficiency and effectiveness of out-of-court procedures?*

Please specify how this aspect should be improved from an SME perspective.

If no, do you think they should be? Please specify.

EVCA RESPONSE:

Access to recognised consensual or pre-insolvency processes without court involvement would be of most benefit.

Often the costs of procedures (court fees, insolvency practitioner fees) and time that formal proceedings take are unattractive features. Many member states have recognised this and have recently introduced more flexible procedures.

Generally, the costs of procedures should be reduced in jurisdictions where such costs are a reason for deterring SMEs to file for insolvency, or to file for insolvency at an early stage, which increases the likelihood of a liquidation.

Please also see answer to Question 6.

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1.5. Status, power and supervision of liquidators

Q9. Do you consider that the divergence of national laws with respect to the issues set out below has created problems in cross-border insolvency proceedings? Please specify.

- *the qualifications required of the liquidator?*
- *the procedure, if any, for his licensing?*
- *the eligibility criteria for the appointing as liquidator in a specific case?*
- *the conditions for dismissal of the administrator?*
- *the powers attributed to the liquidator?*
- *the rules concerning the supervision of the liquidator and the disciplinary regime, if any?*
- *the system of remuneration of the liquidator?*

EVCA RESPONSE:

[Tick the qualifications required of the liquidator.]

It should be noted that the fact that liquidators gain recognition under the European Insolvency Regulation, goes some way to assist in reducing the effect of any national divergence. Whilst we appreciate that some harmonization in relation to the qualifications required of the liquidator may be ideal, we recognise that the make up of practitioners and practices in individual Member States will make this very difficult. For example in some member states lawyers take on the role of liquidators, in others it is accountants, and in a third group it may be business professionals. In addition, having a broad range of liquidators with differing skill sets is not necessarily an issue of concern, as long as they are allocated to appropriate cases. In this regard in the UK, the ability to select the insolvency practitioners with not just the appropriate qualifications but also the relevant experience works well in practice.

1.6. Directors' duties and liability and professional disqualifications

Directors' duties and liability in the vicinity of insolvency

Q10. In your view, are there problems with the enforcement of liability claims against the directors of insolvent companies within the EU? If yes, please specify.

EVCA RESPONSE:

Yes. Court proceedings can be lengthy and costly. This poses a deterrent to the enforcement of claims against directors.

More specifically, the duration and costs of a litigation to enforce liability against directors frequently prevent stakeholders (shareholders, creditors, workers, etc.) from starting proceedings against them, even in cases where such liability resulted from the insolvency proceeding (fraudulent / tort insolvency). Also, due to the fact that proceedings are usually lengthy, unscrupulous directors may "protect" their assets in such a way that creditors may face difficulties in recovering their debts.

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Furthermore, the positive drivers to enforce claims are limited as liquidators have only insignificant incentives to wage such burdensome proceedings with uncertain outcome.

In the UK there are high evidential burdens in terms of attributing liabilities for company failure to directors. In general the UK courts are reluctant to impose liability (or use hindsight in their judgement) in cases where insolvency has arisen as a result of honest failure. Although cases are rare, there is little to suggest that enforcement is an issue, save in limited cases where there is a deliberate avoidance or fraud committed by the directors, which in our view cannot be legislated for.

Q11. In your view, have the regulatory gaps in the liability regime outlined above led to any problems in practice? If yes, please specify (regulatory arbitrage, difficulties of compliance with divergent liability rules for managers ...) and how should these problems best be solved?

EVCA RESPONSE:

No, we do not consider that the differences in the different regimes in the various member states have led to any problems in practice, save for the mandatory filing obligations which we have already mentioned above.

Professional disqualifications in the context of insolvency proceedings

Q12. In your view, is there a need to take action at EU level with a view to preventing disqualified directors from heading companies in another Member State? If yes, please specify

- *by ensuring that information on national disqualification orders is available to the relevant authorities in other Member States?*
- *by ensuring that a disqualification order issued in one Member State is recognised in all other Member States?*

EVCA RESPONSE:

[Tick the first option.]

We are not aware of any issues in practice and we suspect that the number of disqualified directors seeking management positions in different member states is relatively small.

Having said that, ensuring that information on national disqualification orders is available so that in appropriate cases recognition can be sought in other member states may be useful.

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1.7. Avoidance actions

Q13. In your view, has the divergence within the EU of the conditions under which a detrimental act can be avoided created problems in practice? If yes, do you think that all or some of the conditions relating to avoidance actions, such as applicable time limits, should be harmonised? Please specify.

EVCA RESPONSE:

No. Member states tend to have similar rules applying in relation to avoidance actions. We are not aware of any cases where a difference in the conditions relating to the avoidance of actions has promoted business being carried out in one jurisdiction as opposed to another. There are often practical and more significant legal reasons (i.e. tax) for seeking a particular jurisdiction to determine issues that arise when things go wrong.

2. Other Issues (Section III)

Q14. In your view, are there any other issues where the divergence of national law creates problems for the internal market?

EVCA RESPONSE:

DIP (Debtor-in-Possession) financing

We think that in order to promote business rescue in Europe, there should be recognition of and promotion of access to funding in a distressed situation; in addition any funding should be given a priority ranking recognising the increased risks in lending to distressed businesses. The concept of abusive lending that exists in certain jurisdictions needs to be expressly carved out for this type of lending.

Shareholder loans

We think that there should be a harmonised approach to shareholder loans in an insolvency situation across Europe; in particular there should not be any automatic equitable subordination on an insolvency where, investors have provided funding on commercial terms prior to the insolvency.