EUROPEAN COMMISSION

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C(2017) 3767 final

Mr Seán Ó FEARGHAÍL T.D.
President of Dáil Éireann
Houses of the Oireachtas
Leinster House
Kildare Street
IRL – DUBLIN 2

Dear President,

The Commission would like to thank the Dáil Éireann for its Opinion on the proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures {COM(2016) 723 final}.

The Commission's proposal falls under two Commission priority policies. First, the Capital Markets Union Action Plan[1] of 30 September 2015 which states notably that the Commission would table a legislative initiative on business insolvency addressing the most important barriers to the free flow of capital and building on national regimes that work well. Second, the Single Market Strategy[2] of 28 October 2015 which mentions that the Commission would support honest entrepreneurs and propose legislation to ensure that Member States provide a regulatory environment that is able to accommodate failure without dissuading entrepreneurs from trying new ideas.

This policy has been supported also by the Council. The Competitiveness Council Conclusions of May 2011 called on Member States to reduce the discharge period and debt settlement for honest entrepreneurs after bankruptcy to 3 years maximum by 2013[3].

The Economic and Financial Affairs Council Conclusions of June 2016 on a roadmap to complete the Banking Union underlined the importance of the work carried out by the Commission on a legislative proposal for minimum harmonisation in the field of insolvency law in the context of the Capital Markets Union, noting that this may also support efforts to reduce future levels of non-performing loans[4].

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1 COM(2015) 468 final.
2 COM(2015) 550 final.
3 Council Conclusions on the review of the 'Small Business Act', for Europe, adopted on 30 May 2011: http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%2010975%202011%20INIT
4 Council Conclusions of 17 June 2016 http://www.consilium.europa.eu/press-releases-pdf/2016/6/47244642837_en.pdf

The Commission regrets that the Dáil Éireann does not share the view that the proposal complies with the principles of subsidiarity and proportionality.

With respect to the principle of subsidiarity, in accordance with Article 5(3) of the Treaty on the Functioning of the European Union (TFEU), the objectives of the initiative are to remove obstacles to the exercise of the freedom of movement of capital and freedom of establishment in the internal market which stem from differences in Member States' laws on preventive restructuring, insolvency and second chance. All these differences translate in additional ex ante costs for investors when assessing the risks of a future investment in (other) Member States and in additional ex post costs of restructuring companies with establishments, creditors or assets in several Member States. In respect of second chance for entrepreneurs, the objective is not only to reduce ex ante and ex post costs of a bankruptcy for both the debtor and his creditors, but also to facilitate the taking up of self-employed activities after a first failure. These objectives cannot be sufficiently achieved at national level, since Member States cannot ensure the overall coherence of their insolvency legislation with that of all other Member States by acting alone.

With respect to the principle of proportionality, the Commission would like to recall that, in accordance with Article 5(4) TFEU, the proposal does not exceed what is necessary to achieve the objectives stated above. The Commission has taken this principle into account for example when deciding on the choice of instrument, the degree of harmonisation as well as on the substantive provisions of the proposal, on which the Commission did not go further than what is necessary, as explained in the following paragraphs and in the Annex.

In the Commission's assessment divergent insolvency regimes in the Member States raise obstacles to the functioning of the internal market and more coherence would improve legal certainty for foreign investors and would therefore make the European Union a more attractive place to do business. Common standards on preventive restructuring frameworks should lead to more companies and jobs being saved rather than lost to insolvency, a more efficient management of non-performing loans and higher recovery rates to creditors. Harmonised rules would also make it easier to restructure cross-border groups of companies in financial difficulties. Finally, common rules would mitigate the domino effect that the insolvency of one enterprise has in the supply chain.

As regards honest entrepreneurs, limiting discharge periods and improving the second chance regime in all Member States would reduce the incentives for and costs of relocating to other jurisdictions and would remove the stigma of failure and give entrepreneurs a chance to re-enter the productive economy.

When drafting the proposal, the Commission was very much aware of the need to build on best practices from those Member States where the restructuring frameworks produce good results. Furthermore, the Commission was careful to balance the interests of debtors, creditors, employees and the society at large. At the same time, the Commission was aware of the need to allow Member States sufficient flexibility to adapt the principles and rules of the proposal to their economic, legal and cultural specificities. This is why the proposal establishes only general principles and minimum standards leaving ample room to adjust the implementation at national level to their respective legal systems and traditions.

In light of the above observations and the elements in the Annex, the Commission considers that the proposal is in line with the principles of subsidiarity and proportionality as enshrined in Article 5 TFEU.

The Commission is pleased to provide more detailed replies to the concerns and views expressed by the Opinion of the Dáil Éireann in the attached Annex.

It hopes that these clarifications address the issues raised by the Dáil Éireann and it looks forward to continuing our political dialogue in the future.

Yours faithfully,

Frans Timmermans
First Vice-President

Věra Jourová
Member of the Commission

ANNEX

The Commission has carefully considered the concerns raised by the Dáil Éireann in connection with the proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures of 22 November 2016 (COM(2016) 723 final).

a. Impact assessment

The Commission has carried out a thorough impact assessment exercise in 2016[5]*. Some of the findings which support the internal market dimension of the proposal are that:*

- there are about 200.000 insolvencies in the European Union each year, 25% of which are cross-border insolvencies

- insolvencies lead to about 1.7 million jobs lost yearly in the European Union

- it is impossible to have a restructuring plan for a group of companies with establishments in more than 2 Member States

- 1 in 5 insolvencies is triggered by the insolvency of another enterprise in the supply chain

- recovery rates vary greatly among Member States

- recovery rates are lower in liquidation than in restructuring by about 25%

- in 10 Member States insolvency procedures last over 2 years, sometimes up to 4 years

- in 21 Member States the most likely outcome for enterprise in financial difficulties is liquidation, while in 7 Member States restructuring is the main outcome.

b. Form of the instrument and degree of harmonisation

By choosing to propose a minimum harmonisation Directive rather than a Regulation, the Commission has opted for the instrument which gives the highest degree of flexibility to Member States while at the same time ensuring that the objectives of the proposal would be attained in each Member State.

Furthermore, the Commission opted for intervention in specific areas of insolvency law only. Most notably, the proposal aims at putting in place an efficient preventive restructuring framework and a second chance regime for entrepreneurs.

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[5] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SWD:2016:0357:FIN:EN:PDF.

In respect of the concrete concerns raised in the Opinion:

- while the proposal lays down a principle that early warning tools should be made available to small and medium sized enterprises and to entrepreneurs, it allows Member States ample flexibility to decide on the most appropriate tools;

- while the proposal requires Member States to make preventive restructuring frameworks containing certain elements available to debtors in financial difficulties, it allows them to transpose the Directive by means of one or several procedures or measures, and to keep in place alternative procedures;

- while the proposal grants debtors the benefit of a stay and creditors the certainty of a limited duration and safeguards against abuse, the exact duration of the stay and possibility to extend it are left to the discretion of Member States;

- the proposal prescribes certain essential elements which need to be part of any restructuring plan in order to adequately inform creditors, but allows Member States to add further requirements as deemed necessary;

- the proposal provides for certain conditions to be met when a cross-class cram-down mechanism is applied in order to ensure that dissenting classes of creditors are not unfairly prejudiced.

c. Balance between the interests of debtors and creditors

The proposal aims at striking a fair balance between the interests of debtors, their employees, creditors and society as a whole. At the same time, the proposal allows Member States sufficient flexibility to adjust that balance to national economic, cultural and social specificities. For example, Member States may decide to put in place a rather short stay period and allow courts to grant it if and to the extent such a stay is necessary for the negotiations on a restructuring plan, or they may allow for the initial stay period to be extended under certain conditions.

Member States should also provide minimum protection from avoidance actions for new financing which is necessary to support the implementation of the restructuring plan, but they may also go further and provide that grantors of new financing should receive payment with priority in relation to pre-exiting claims in subsequent liquidation procedures.

d. Role of the courts

The proposal concerns a procedure which strictly requires the involvement of courts whenever the rights of affected parties are in question. Thus, courts would need to grant a stay if necessary and would need to control that the conditions for extending the stay (if provided for under national law) are met. Courts would also be able to lift the stay when it is no longer necessary.

At the stage of the confirmation of the restructuring plan, courts would need to verify that creditors' rights and shareholders' interest are not unduly affected. The conditions for court confirmation of the restructuring plan are not exhaustively listed in the proposal. However among the minimum requirements to be met is that the restructuring plan needs to comply with the best interest of creditors test. A restructuring plan which cannot bring the enterprise back to viability should not be confirmed by the court.

At the same time, certain steps in restructuring proceedings can be taken out of court, especially when an insolvency practitioner is supervising the process. This is the case for example for the filing and collection of claims, the formation of classes of creditors for the purposes of voting and the voting on a restructuring plan itself.

e. Independence of the judiciary

The effectiveness of insolvency procedures does not depend only on good statutes but also on how procedures are being implemented. Judges play an important role in this process and their expertise and efficient handling of cases are crucial to lend credibility to the judicial process. While the proposal puts in place a general principle that judges should have appropriate training and expertise, it does not prescribe the means by which Member States should implement this principle and again leaves ample flexibility. The proposal does not affect in any way the organisation of the judiciary or even its independence which is a principle common to all Member States' constitutions.

f. The absolute priority rule

When a restructuring plan is confirmed by a court in spite of the dissent of one or several classes of creditors, the Commission considers that there may be a greater risk that the rights of dissenting classes may be unduly affected. The absolute priority rule was meant to put in place additional safeguards for dissenting creditors in such situations.

g. Data collection

High quality, comparable data is indispensable to a proper evaluation of how efficient the Directive would be once it is implemented and applied. Such data could also be used by the Member States themselves to put in place own initiatives in areas not covered by the Directive or in areas going beyond the minimum standards laid down by the Directive. For example, data on consumer insolvencies could lead Member States to decide on extending the discharge regime applicable to entrepreneurs also to consumers.

Putting in place a data collection system does not need to be too costly if procedures are digitalised. Such digitalisation has already started with putting in place national insolvency registers in all Member States.