EUROCHAMBRES

Position Paper

October 2013

European Commission's consultation on a new approach to business failure and insolvency

Executive Summary

EUROCHAMBRES recognises that a balanced approach to business failure and insolvency proceedings is a crucial aspect in developing the EU's entrepreneurial culture.

EUROCHAMBRES welcomes the Commission's consultation and supports its aim to start a positive dialogue with all stakeholders on the Commission proposal to revise the Council Regulation 1346/2000 on insolvency proceedings.

EUROCHAMBRES considers that viable businesses should be supported when facing difficulties and that failure and winding up of companies should be confined to cases where the rescue and recovery of companies is no longer possible. The closure of a company represents a social and financial loss and brings significant consequences to the economic system, notably the loss of employment and tax revenues. However, it must be recognised that failures are endemic in the business environment as a consequence of healthy economy dynamics.

As highlighted in a 2013 OECD study[1], bankruptcy legislation plays an important role in the entrepreneurial environment. According the study, both debtor and creditor-friendly insolvency legislation affect economic outcomes in terms of patent creation, number of start-ups and innovation.

In Europe, based on the Commission's Eurobarometer 2012 survey's findings, more than four out of ten respondents asked about what they would fear the most if they were to set up a new business, referred to bankruptcy as their main concern, while more than a third say the risk of losing their property/home would concern them the most.

[1] *OECD (2013), Supporting Investment in Knowledge Capital, Growth and Innovation, OECD Publishing.* accessible at http://www.oecd-ilibrary.org/industry-and-services/supporting-investment-in-knowledge-capital-growth-and-innovation_9789264193307-en

Moreover, in Europe, more than one third of the 50% of companies that fail within the first five years in the EU go bankrupt.

As many business transactions are now carried out beyond domestic boundaries and the cross-border dimension of many companies implies dealing with different national legislation, the Commission considers that differences in national insolvency regulations are considered obstacles to the full development of the single market.

EUROCHAMBRES considers that:

- **Article 81 and 114 TFEU cannot be used as legal basis to harmonize national insolvency laws**
- **Any harmonization would go beyond the subsidiarity principle any subjective concept as honest bankruptcies should not be given a legal value**
- **Prevention is better than cure: early warning systems and support programmes should be set up. Chambers 'network best practises and proposals**
- **A thorough assessment on how the creditors' interests would be protected In case of a discharge period limitation is required.**
- **Balanced protection of creditors' and debtors' interests in out of court proceedings**
- **A European register of insolvencies based on existing national registers should be established**

EUROCHAMBRES' priorities

Preliminary observation

EUROCHAMBRES is unconvinced about the need to fully harmonize the insolvency legal framework at European level and about the legal basis underpinning any future European initiative.

Legal basis

EUROCHAMBRES believes that before any European legislative initiative to harmonize insolvency law is taken, its legal basis must be scrutinized.

In EUROCHAMBRES' view art. 81, paragraph 1 TFEU on *"judicial cooperation in civil matters"*, already used as legal basis for Regulation 1346/2000, is not the correct legal basis. Indeed, by harmonizing national insolvency laws, the European Commission would not only regulate cross-border insolvency proceedings but the new legal framework would also apply to domestic bankruptcies and insolvency proceedings.

Consequently, harmonized insolvency rules would not only affect companies which activities or organization have cross-border implications as large multinational companies, but it would also apply to

small companies that, as highlighted by the European Commission, do not have a branch in another Member State or which activity does not have any cross-border dimension.

EUROCHAMBRES is convinced that harmonization of insolvency laws could not be pursued on the basis of art. 114, paragraph 1 TFEU either. Art 114 TFEU implies that the harmonization is necessary to prevent any obstacle endangers the free movement across the internal market and to avoid competition is distorted. Harmonization of national insolvency laws would not be justified on this basis as investment decisions of enterprises are unlikely to depend on different features of insolvency law in a specific Member State and the legal effects of such an harmonization would also affect small companies with no or limited cross-border economic activities and domestic cases.

EUROCHAMBRES believes that forum shopping and "insolvency tourism" could be more correctly prevented through the revision of the rules on the applicable law and jurisdiction rather than via a complete harmonization of substantive law.

EUROCHAMBRES appreciates the actual aim of the Commission to strengthen companies in financial difficulties with a "second chance". However Chambers considers that any initiative to intervene on reduction of the debtors' obligations and insolvency proceedings' costs must be considered as an independent policy goal with no direct relation with the functioning of the internal market.

Such measures, in EUROCHAMBRES' view, may only be based on a substantive competence, but not on Article 114 TFEU.

Subsidiarity

In EUROCHAMBRES' view the harmonization of national insolvency law could not be justified under the subsidiarity principle.

EUROCHAMBRES considers that many issues addressed in the consultation launched by the European Commission (i.e. discharge periods, procedures, professional requirements for liquidators and their liability) are directly or indirectly linked to other areas of law (such as civil law, corporate law, labour law and tax law) as well as to professional rules.

For this reason, and in consideration of the fact that the European Union has no or very limited competence in such areas of law, EUROCHAMBRES considers that any EU initiative to harmonize national insolvency laws would impinge national legislative power and would go beyond the subsidiarity principle.

Honest bankruptcies

The European Commission states that honest and fraudulent or culpable failed entrepreneurs should not be subject to the same insolvency rules and that "honest entrepreneurs" should take advantage of fast-track procedures and ad hoc measures to support them in restarting a new business.

In the Commission's view, the stigma of bankruptcy should be removed and programmes to mentor, train, advise and support second starters should be developed.

EUROCHAMBRES generally agrees that failed entrepreneurs should not be discriminated against because of the stigma. On the contrary, failure in a previous business and the lessons learned might be viewed as potential success factors for a new entrepreneurial initiative. However, this demands a cultural rather than a legislative change in Chambers' view.

With regard to the adopted terminology and its legal consequences, **EUROCHAMBRES considers that it should not give any legal value to subjective concepts, such as "honest entrepreneur".**

According to the Commission, a bankruptcy shall be considered as honest, when the enterprise has failed without the director's or the entrepreneur's culpability and in case its failure has not been induced with intent to defraud or negligently.

However, relevant statistics of the Austrian Association for the protection of Creditors (Kreditschutzverband – KSV) have shown that 80% of insolvencies among companies are due to negligent action or default. Moreover, experience has shown it is always very difficult to clearly and swiftly define whether a case should fall under the definition of "honest entrepreneur" as given by the European Commission.

EUROCHAMBRES is convinced that, in case the definition of "honest entrepreneur" has to be applied to failure, it can only be done if an evaluation on a case by case basis is carried out as in most cases bankruptcies are caused by negligence and mismanagement.

Prevention is better than cure

EUROCHAMBRES believes that, apart from an ex post evaluation about what could be done to ensure failed entrepreneurs are allowed a second start, an ex ante consideration of what needs to be done to avoid companies' bankruptcies, is also required.

According to a study[2], best performing countries complement an efficient legal framework for bankruptcy with early warning systems and, generally, countries with an efficient early warning system also have a relatively high level of companies' birth rate (12.2 % as compared to 10.7% for the other countries).

EUROCHAMBRES is convinced that prevention, since the moment a business is created, is the key element when fighting against bankruptcies and supports the setup of effective early-warning systems and mechanisms to support enterprises in tackling situations of financial distress.

Some **initiatives carried out at national and local level by Chambers of Commerce and Industry** demonstrate that companies can get back on track when warning signs of trouble are identified at an early stage and a professional support aimed at mentoring, training and advising entrepreneurs in financial distress is provided.

The **« Centre pour entreprises en difficulté » (CED)** organised by the Brussels Chamber of Commerce, for example, brings together different professionals (lawyers, accountants, psychologists, marketing experts etc.) and in 2012 assisted 1.837 companies of which 29% less than 2 years old, and 1.951 in 2011. Le CED estimated that 35% of assisted companies have no other option than failure, compared to a range of between 25% and 30% that are able to get back on track following the mentoring they receive. The remaining 40% are cases that still need an assistance from the centre (15%) and entrepreneurs that did not follow the programme proposed by the centre or that were satisfied with the information they received during the first meeting (20%-25%).

Other examples of similar initiatives implemented by Chambers include the programme **"S.O.S."**, organised by the High Council of Chambers of Spain (co-financed by the European Regional

[2] *Business Dynamics: Start-Ups, Business Transfers And Bankruptcy* accessible at http://ec.europa.eu/enterprise/policies/sme/business-environment/files/business_dynamics_final_report_en.pdf

Development Fund - ERDF) and an initiative implemented by the **WIFI Wien (Wirtschaftsförderungsinstitut Wien)**, in Austria.

Specifically "SOS" is a programme set up by the experts of the Spanish Chamber network to implement a set of prevention activities to support companies at risk of failure in case of insolvency and to provide failed entrepreneurs willing to restart with a second chance. The programme concerns 3 Spanish regions.

WIFI Wien, a service organization of the Viennese Chamber, offers consulting services for businesses in financially difficult situations[3].

Based on the positive outcomes of such initiatives **EUROCHAMBRES recommends the European Commission to develop a set of common indicators to facilitate early identification of companies in difficulty.**

EUROCHAMBRES also considers such tools and measures would be beneficial to second starters and that initiatives to extend or implement similar programmes to failed entrepreneurs are to be supported.

Discharge period

In the Commission's view, to help failed entrepreneurs get a second and fresh start, shorter discharge periods are needed Europe wide.

Even if short discharge periods could lead to faster re-starts, **EUROCHAMBRES considers that an unconditional limitation of the discharge period could trigger situations where all financial risks are transferred solely to the entrepreneurs' creditors and entrepreneurs are encouraged to incur relatively risk free debts.**

Before shorter discharge periods are further considered, a thorough assessment of how the divergent interests of creditors and debtors are dealt with at national level should be carried out.

Chambers also worry that shorter discharge periods would unintentionally influence banks' lending policies as a consequence of an increase in the default risk, thus creating negative effects for many entrepreneurs seeking credit.

Special arrangements

EUROCHAMBRES considers that access to pre-insolvency or hybrid proceedings and the recognition of their effects throughout the European Union should be promoted when they ensure a balanced protection of creditors' and debtors' interests by including the greatest number of creditors whilst preserving the public credibility of concerned entrepreneur (e.g. appointment of a mediator, out-of-court agreement, reorganisation proceedings, etc…).

The establishment of flexible out-of court procedures would probably be beneficial to the economic system as out-of-court procedures have demonstrated to be an efficient and viable solution both in terms of success rate that in terms of duration.

As demonstrated by a survey[4] the rate of success of out-of-court settlements is approximately 42% and lower rates of insolvencies coupled with higher survival rates of firms are to be found in countries with efficient out-of-court settlements.

[3] http://www.wifiwien.at/default.aspx/Unternehmenssicherung/@/menuId/2420/

European Electronic Register

To ensure that creditors are timely informed about the commencement of the insolvency proceedings involving one or more of their debtors, **EUROCHAMBRES calls for a European register of insolvencies based on existing national registers**

The register would be beneficial particularly in cross-border cases, as creditors could be informed about the opening of an insolvency proceedings against their debtor in another Member State and would be informed about the terms for their full participation in the procedure (i.e. failure to meet provided national time limits, knowledge about procedural rules, no public information available about the opened insolvency proceeding, etc.)

Further information: Ms. Alexia Hengl, Tel +32 2 282 08 884, **hengl@eurochambres.eu**
Press contact: Ms. Guendalina Cominotti, Tel +32 2 282 08 66, **cominotti@eurochambres.eu**

All our position papers can be downloaded from www.eurochambres.eu/content/default.asp?PageID=145

EUROCHAMBRES – The Association of European Chambers of Commerce and Industry represents over 20 million enterprises in Europe – 93% of which are SMEs – through members in 44 countries and a European network of 2000 regional and local Chambers.

ASSOCIATION OF EUROPEAN CHAMBERS OF COMMERCE AND INDUSTRY
Chamber House, Avenue des Arts, 19 A/D • B - 1000 Brussels • Belgium
• Tel +32 2 282 08 50 • Fax +32 2 230 00 38 • eurochambres@eurochambres.eu • www.eurochambres.eu

[4] *Business Dynamics: Start-Ups, Business Transfers And Bankruptcy* accessible at http://ec.europa.eu/enterprise/policies/sme/business-environment/files/business_dynamics_final_report_en.pdf