DeutscherAnwaltVerein

Berlin, June 2012
Position Paper No. 53/2012
www.anwaltverein.de

Position Paper of the German Bar Association

(Deutscher Anwaltverein)

by the Legislative Committee "Insolvency Law",

and the European Affairs Working Group of the Section of "Insolvency and Restructuring Law"

on the

Consultation on the future of European Insolvency Law

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Redaktion Anwaltsblatt / AnwBl, Berlin

Redaktion Juristenzeitung / JZ, Tübingen

Redaktion Monatsschrift für Deutsches Recht / MDR, Köln

Redaktion Neue Juristische Wochenschrift / NJW, Frankfurt a. M.

Redaktion Zeitschrift für Wirtschaftsrecht / ZIP, Köln

Redaktion InDat-Report, Köln

Redaktion Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht / DZWIR, Berlin

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Redaktion Zeitschrift für das gesamte Insolvenzrecht / ZInsO, Recklinghausen

Redaktion (Print) Zeitschrift für Verbraucher- und Privat-Insolvenzrecht / ZVI, Köln

Redaktion (Internet) Zeitschrift für Verbraucher- und Privat-Insolvenzrecht / ZVI, Köln

This position paper is also available on the following website: http://www.anwaltverein.de/03/05/index.html.

The German Bar Association (Deutscher Anwaltverein – DAV) is the professional body comprising more than 67.000 German lawyers. Being politically independent the DAV represents and promotes the professional and economic interests of the German legal profession.

This position paper has been created in form of an online consultation and has therefore an unusual layout.

Consultation on the future of European Insolvency Law

The Commission has put the revision of the Insolvency Regulation in its Work Programme for 2012. The revision is one of the measures in the field of "Justice for Growth" set out in the Commission's Action Plan implementing the Stockholm Programme. The revision links in with the EU's current political priorities to promote economic recovery and sustainable growth, a higher investment rate and the preservation of employment, as set out in the Europe 2020 strategy, and to ensure a smooth development and the survival of businesses, as stated in the Small Business Act.

Insolvencies are an important issue for the European economy. About fifty percent of enterprises do not survive the first five years of their life. In 2010, a total of 220 000 businesses went into liquidation in the EU. This means that some 600 companies in Europe went bust every day. This trend continued in 2011. Given these figures, it is essential that insolvencies in Europe are governed by modern laws and efficient procedures. A modern insolvency law helps good companies to survive, encourages entrepreneurs to take risks and permits lenders to lend on more favourable terms. A modern insolvency law allows entrepreneurs to get a second chance. And if necessary, it provides an orderly way for businesses to close down.

European Insolvency Law is laid down in Regulation (EC) No 1346/2000 on insolvency proceedings (the “Insolvency Regulation”) which applies since 31 May 2002. The Regulation contains rules on jurisdiction, recognition and applicable law and provides for the coordination of insolvency proceedings opened in several Member States. The Regulation applies whenever the debtor has assets or creditors in more than one Member State.

In general, the Insolvency Regulation has improved legal certainty and facilitated judicial cooperation in the treatment of cross-border insolvency cases. However, after ten years of ap-

plication, important developments in national insolvency law and considerable changes in the economic and political environment call for a review of the Regulation:

Firstly, in most Member States bankruptcy laws have been modernised: besides traditional collective insolvency proceedings decided by the court on the basis of the debtor's insolvency, various pre-insolvency or hybrid schemes have been put in place. These protect the debtor from its creditors and allow the business to continue to operate. These procedures are also considered to be more effective at preserving jobs.

Furthermore, companies and the economic environment have changed. Companies are incorporated in international groups (parent company and subsidiaries), apply corporate governance rules and have access to capital in the global financial markets. Small companies increasingly operate cross-border. European companies have to adapt continuously to a changing business environment (globalisation, relocation of businesses, financial crisis), which increases the risk of financial difficulties.

Moreover, case-law and a number of academic publications point to certain difficulties in the practical application of the Insolvency Regulation. These difficulties result from the imprecision of some of the legal concepts and criteria in the text of the Regulation, the difficulty to strike a balance between the universality of the debtor's insolvency and the territoriality of proceedings, the variety and disparity of national bankruptcy laws, the relationship between insolvency law and other branches of law (procedural civil law, securities law, company law, labour law) and the limits of the coordination of proceedings.

In addition, in October 2011, the European Parliament published a report with recommendations on the revision of the Insolvency Regulation, in particular to improve the coordination of insolvency proceedings involving a group of companies. The report also recommends the harmonisation of specific aspects of insolvency law and company law and the creation of an EU register for insolvency cases.

Your answers to this questionnaire will help the Commission to determine whether and how the existing legal framework should be improved and modernised.

Background Information

This consultation is addressed to the broadest public possible, as it is important to get views and input from all interested parties and stakeholders. In order to best analyse the responses received, there is a need for a limited amount of background information about you as a respondent.

Please indicate your role for the purpose of this consultation*

Other

Please specify*

German Bar Association (Deutscher Anwaltverein), Berlin
represented by the Legislative Committee "Insolvency Law",
and the Working Group Europe Section "Insolvency and Restructuring"

Have you had practical experience with cross-border insolvencies and if so, in what capacity?*

Yes

If so,

as an insolvency practitioner

Please indicate the country where you are located*

Germany

Please provide your contact information (name, address and email-address)*

German Bar Association, c/o Ms. Eva Schriever, Director, Avenue de la Joyeuse Entrée 1, 1040 Brussels, Belgium

I. General Assessment

1. In your view, does the Insolvency Regulation operate effectively and efficiently to coordinate cross-border insolvency proceedings?

Yes

Which main problems have you faced or noticed?

- *Lack of implementation in various EU member states (in particular in Eastern and Southern Europe)*
- *Lack of cooperation between courts*
- *Lack of European insolvency register and centralized publication tool*
- *Ineffective cooperation between main and secondary proceedings caused by fundamental disparities in national insolvency laws*
- *No rules for coordination in case of insolvencies of groups of companies*

2. Which principal changes, if any, would you suggest to improve the existing legal framework for cross-border insolvency in the EU?

- *Centralized European insolvency register, serving for unionwide publications*
- *Clear legal authorization for courts to communicate and coordinate*
- *Rules for better communication & coordination between administrators to be recognized by national insolvency courts*
- *Strenghten and harmonisation of the position and rights of creditors*

II. Scope of the Insolvency Regulation

Types of proceedings covered

The Insolvency Regulation applies to collective insolvency proceedings which entail the partial or total loss of the debtor's control over his affairs and the appointment of a liquidator or administrator ("insolvency practitioner"). It contains a list of national procedures which fulfil these criteria. The Insolvency Regulation does not, in principle, cover national procedures which provide for the restructuring of a company at a pre-insolvency stage ("pre-insolvency

proceedings") or leave the existing management in place ("hybrid proceedings"). However, such proceedings have recently been introduced in several Member States because they are considered to increase the chances of successful restructuring of businesses. Some of these proceedings are nevertheless listed in the Insolvency Regulation but the extent to which they are covered by it is subject to controversy. When the Insolvency Regulation does not apply, companies do not benefit from the automatic recognition of the effects of the procedure, for example, the suspension of payment obligations, throughout the EU. There is also no coordination with proceedings in other Member States.

3. In your view, has it created problems that the Insolvency Regulation does not, in principle, apply to pre-insolvency or hybrid proceedings and that the effects of such proceedings are therefore not recognized EU-wide?

No

- *It is a general problem to find a definition for hybrid proceedings in general*
- *A proceeding should only be recognized under the EIR if*
  - *the debtor is insolvent, according to national law (including imminent insolvency)*
  - *the proceeding includes <u>all</u> creditors*
  - *the proceeding is overseen by a court*
  - *an independent person or party is appointed as administrator, trustee, custodian et.al.*

4. Should the Insolvency Regulation accommodate national legal procedures which provide for the restructuring of a company at a pre-insolvency stage or which leave the existing management in place?

Yes

If so, which type of pre-insolvency or hybrid proceedings should be covered by the Insolvency Regulation and recognised in other Member States?

Such debtor-in-possession proceedings should only be recognized under the EIR if

- *a court oversees the proceedings*
- *<u>all</u> creditors are included*

- *a third party/independent individual is appointed to oversee the activities of the debtor*
- *the debtor is insolvent or illiquid or in need of restructuring in order to avoid (imminent) insolvency*

Due to the fact that companies are financed not any longer exclusively by the classical "credit" but increasingly by bonds a special regime for the restructuring of bonds should be considered.

In recent years, new procedures for dealing with over-indebtedness of private individuals and self-employed persons have been put in place in many countries. Most of these schemes are not covered by the Insolvency Regulation because they do not fulfil the Regulation's conditions for insolvency proceedings because the debtor often maintains full control over its assets and not all Member States provide for the appointment of an insolvency practitioner. Moreover, certain of the Insolvency Regulation's provisions are not adapted to deal with "private bankruptcy".

5. Should the Insolvency Regulation be applicable to over-indebted private individuals and self-employed persons?

No

The EIR should be applicable for any natural person and/or entrepreneur as far as they can be subject to insolvency proceedings under national insolvency law.

International dimension of insolvency proceedings

In geographical terms, the Insolvency Regulation is limited to the recognition and coordination of cases within the European Union. It contains no provisions on the recognition of or coordination with insolvency proceedings commenced outside the European Union if there are assets located or litigation pending in a Member State. Likewise, the Insolvency Regulation does not govern the coordination of insolvency proceedings commenced in parallel inside and outside the EU. The effects of the foreign proceedings in these cases are currently determined solely by national law.

6. In your view, has it created problems in practice that the Insolvency Regulation does not contain provisions for the recognition of insolvency proceedings outside the EU or the coordination between proceedings inside and outside the EU?

No.

The Regulation should not include such provisions. Within the EU a recognition of proceedings commenced in other member States is in line with the principle of Comitas. It should however be up to the discretion of each member State whether to recognize proceedings of non-EU countries or not.

III. Competent court to open insolvency proceedings

The Insolvency Regulation provides that only the courts of the Member State in which the debtor has the centre of its main interests ("COMI") have jurisdiction to open main insolvency proceedings. In the case of a company or a legal person, the centre of its main interests is presumed to be at the place of the debtor's registered office unless it can be shown that the debtor "conducts the administration of its interest on a regular basis and in a manner ascertainable by third parties" in a different Member State. The concept of "COMI" has given rise to controversy and is a frequent source of litigation. There have also been cases where debtors have transferred their COMI in order to benefit from a more favourable insolvency regime.

7. In your view, is it appropriate that jurisdiction for opening main insolvency proceedings is determined by the location of the debtor's centre of its main interests ("COMI")?

Yes

In most of the cases the COMI concept was useful in order to avoid forum shopping.

8. Does the interpretation of the term “COMI” by case-law cause any practical problems?

Yes

If so, please describe these problems

The ascertainability for third parties should be enhanced. The COMI definition should reflect operational centre of debtor and not merely its head office in the sense of the mind of management doctrine only. This should help to secure the ascertainability for third parties.

9. Is there any evidence of abusive relocation of "COMI" by the debtor to obtain a more favourable insolvency regime?

Yes

If so, please give examples, and suggest how such abuse could be prevented.

The number of known abusive cases (like Brochier) is limited.
In several cases an attempted forum shopping was not accepted by the courts, the courts of appeal at least.

The Insolvency Regulation is silent on whether the court competent for opening insolvency proceedings also has jurisdiction for insolvency-related proceedings. Case-law has established that the court opening proceedings also has competence to hear and determine actions that "derive directly from insolvency proceedings and are closely linked to them". Jurisdiction for all other actions is not determined by the Insolvency Regulation but by Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (so called "Brussels I Regulation").

10. Are there problems with the interaction of the Insolvency Regulation with the Brussels I Regulation which have not been solved satisfactorily by case-law?

Yes

If so, how should the Regulation be amended?

Hybrid proceedings which allow the restructuring of debt by majority vote but are not listed in Annex A of the EU-Insolvency Regulation, e.g. a Scheme of Arrangement (pursuant to Sect. 425 UK Companies Act (1985)), are looking for recognition under the Brussels I Regulation in other jurisdiction based on the argument that the ap-

proval of such a Scheme of Arrangement qualifies as a decision in the meaning of Art 32 of the Brussels I Regulation. Lately, the German Federal Court of Justice (Bundesgerichtshof) rendered a decision (dated 15 February 2012, court reference IV ZR 194/09 - Equitable Life) stating that an English law Scheme of Arrangement does not constitute an insolvency proceeding in the meaning of the EU Insolvency Regulation and is not to be recognised as insolvency proceeding pursuant to German general conflict of law rules. The Federal Court of Justice was not required to express a final view if and to what extent a scheme of arrangement is to be regarded as decision in the meaning of the Brussels I Regulation and left this qestion expressively open - a question which is to our understanding also discussed in other jurisdictions.

A still ongoing conflict between the Insolvency Regulation and the Brussels I Regulation is the competent forum for a legal action based on actio pauliana. The European Court of Justice (inter alia, the court decision "Deko/Seagon" rendered on 12 February 2009, C-339/07) has confimed that the insolvency court is the competent forum, however, the details are still subject to clarifying court decisions (see lately the decision NPLC of the European Court of Justice, 1st chamber rendered on 19 April 2012, C-213/10 or the submission for a preliminary ruling (Vorabentscheidung) dated 25 November 2010 by the regional court of Essen, Germany, (court reference 43 O 129/09) the later of which is currently pending at the European Court of Justice).

IV. Group of companies

Although a large number of cross-border insolvencies involve groups of companies, the Insolvency Regulation does not contain specific rules dealing with the insolvency of a multinational enterprise group. The Insolvency Regulation treats each individual member of the group as an independent entity for which main proceedings can be opened. There is no compulsory coordination of the independent insolvency proceedings opened for a parent company and its subsidiaries which would allow maximising both the value of the group’s assets and the prospects for successful restructuring.

Several recommendations have been put forward in legal literature to cater for the insolvency of groups of companies in the Insolvency Regulation. Some suggest to maintain the principle

that main insolvency proceedings can be opened for every member of the group, but want to improve the communication and coordination of the independent insolvency proceedings, and/or strengthen the powers of the insolvency practitioner in the insolvency proceedings of the parent company to intervene in the proceedings of the subsidiaries, for example, by proposing a restructuring plan. Others advocate a more far-reaching modification of the Insolvency Regulation by recommending that there be only a single insolvency proceeding for the entire group at the place of the parent's registered office.

11. In your view, does the Insolvency Regulation work efficiently and effectively for the insolvency of a multinational group of companies?

No

If so, how could the insolvency of a multinational group of companies be dealt with in the Insolvency Regulation?

At this stage it is only advisable to include rules for the coordination and communication between proceedings within a group.

The introduction of multinational group insolvency proceedings with one asset pool only, a Group COMI or Group Administrator would cause more practical problems and would not be beneficial to creditors, employees and stakeholders because of significant disparities in national laws.

V. Coordination between Main and Secondary proceedings

Under the Insolvency Regulation, main insolvency proceedings have EU-wide effect and aim at encompassing all of the debtor's assets. In addition, the Insolvency Regulation permits the opening of secondary proceedings which run in parallel with the main proceedings in order to protect the interests of local creditors or to facilitate the administration of complex cases. Secondary proceedings can be opened in any other Member State where the debtor has an establishment.

The Insolvency Regulation provides for the coordination of proceedings opened in several Member States by obliging the insolvency practitioners to communicate information and co-

operate with each other. It does not contain a duty of communication and cooperation between insolvency practitioners and the courts involved in a case or between the courts themselves. Such communication could be useful, for example, in order to ensure that the judge in the main proceedings is informed of relevant developments in the secondary proceedings before deciding on further actions.

Finally, the Insolvency Regulation grants the insolvency practitioner in the main proceedings certain powers, for example, to request a stay of liquidation in the secondary proceedings or to propose the closure of the proceedings by a rescue plan. Some commentators argue that these powers should be strengthened.

12. Has the system of secondary proceedings in general been helpful to protect the interests of local creditors or to facilitate the administration of complex cases?

Yes

- *the power of the administrators of the main proceedings should be enhanced*
- *the possibilities of secondary administrators and courts of secondary proceedings to block solutions in the best interest of all creditors across the union should be limited*

13. Does the coordination between main and secondary proceedings work satisfactorily overall?

No

If so, how could it be improved?

See above

14. Does the duty to cooperate between insolvency practitioners work efficiently and effectively?

No

If so, how could cooperation be improved?

See above

15. Has it created any problems that the Insolvency Regulation does not contain a duty of cooperation between the insolvency practitioners and the foreign court or between the relevant courts themselves?

Yes

If so, on which issues and how should communication take place?

See above

VI. Applicable Law

As a general rule, the applicable law is that of the State where the insolvency proceedings in question are being conducted. However, certain legal relationships are governed by a different law. For example, in order to protect employees and jobs, the effects of insolvency proceedings on the rights and obligations arising out of employment contracts are determined by the law applicable to the contract.

Similarly, the opening of insolvency proceedings in one Member State does not affect creditors with security interests in moveable or immoveable property (rights in rem) located in another Member State. Rights in rem continue to be governed by the law of the State where the property is situated. This rule protects the value of security interests in property, thereby enabling companies and individuals to obtain credit under conditions which could not be offered without this kind of guarantee. However, the rule has been criticised for causing a somewhat imbalanced situation between the interests of secured creditors and other creditors because it may in certain situations protect secured creditors not only from the effects of a foreign insolvency law but also from the effects of their domestic law.

The law of the State of the opening of proceedings also determines the conditions under which the insolvency practitioner can attack transactions at an undervalue (so-called "detrimental acts"). However, the person benefitting from the detrimental act can, under certain

circumstances, oblige the court to apply the law applicable to the transaction instead. This rule has been criticised as creating significant legal uncertainty.

16. Do you consider that the Insolvency Regulation's provisions on applicable law are in general satisfactory?

Yes

17. In particular, are the exceptions to the general rule justified by the need to protect legitimate expectations and the legal certainty of transactions?

Yes

18. Does the provision on rights in rem operate satisfactorily in practice?

Yes

19. Does the provision on detrimental acts operate satisfactorily in practice?

No

If so, how should it be amended?

The current version of Art. 13 EIR is including a double test hurdle making avoidance actions too complicated.

VII. Recognition and enforcement

The Insolvency Regulation provides that the decision opening main insolvency proceedings is recognised in the other Member States without further formalities; Member States can only refuse recognition of this decision on grounds of public policy. Decisions concerning the course and closure of proceedings are enforced according to the procedure for the recognition and enforcement of foreign decisions set out in Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("the Brussels I Regulation" as amended) which specifies additional grounds on which recognition and enforcement of a foreign decision can be refused.

The Insolvency Regulation presumes that insolvency proceedings are always opened by a court's decision. However, there are certain insolvency proceedings under national law where the effects of insolvency are set in place upon the filing of the case and there is not necessarily a court order intervening. Some national procedures also provide for the nomination of a provisional administrator prior to the opening of insolvency proceedings. In such cases, it is currently unclear whether and at what time the opening of such proceedings is to be recognised in the other EU Member States.

20. Are there any problems of recognition of the decision opening the proceedings or with the recognition and enforcement of further decisions during the proceedings?

Yes

Please specify

As the national laws stipulate various formats for such decisions, the recognition caused problems in several cases. The EIR should include a provision how courts should clearly identify a proceeding as main or secondary proceeding under the EIR.

21. Are you aware of cases where a Member State has refused to recognise insolvency proceedings or to enforce a decision on the grounds of public policy?

No

22. Should the definition of the decision "opening insolvency proceedings" be amended to take into account national legal regimes where there is not or not always an actual court decision opening the proceedings?

No

Proceedings not based on a court order should not be recognized under the EIR.

VIII. Publication of insolvency proceedings and the lodging of claims

The good functioning of cross-border insolvency proceedings relies on the exchange of information between insolvency practitioners, courts and creditors. In particular, a court opening insolvency proceedings needs to know whether the company is already subject to insolvency proceedings in another Member State. However, the Insolvency Regulation leaves it up to the insolvency practitioners to decide whether to request publication of the opening judgment in another Member State. At present, EU law does not contain an obligation to publish the opening of insolvency proceedings in an insolvency register nor does it provide for a way to search insolvency registers in other Member States.

23. Do you agree that the absence of mandatory publication of the decision opening insolvency proceedings is a problem?

Yes

If so, how would you like the situation to be improved?

- *date of decision / case number / court*
- *name of office holder (administrator et.al.)*
- *requirements for filing of claims*
- *type of proceedings*
- *registration /publication of: (i) first hearing; and (ii) enforcement, liquidation and sale of material assets, e.g. real estate.*

The Insolvency Regulation guarantees creditors the right to equal access to insolvency proceedings opened in another Member State. It obliges the court opening the proceedings or the insolvency practitioners to inform all known creditors of the conditions for lodging their claims. The information is to be provided in the language of the Member State of the opening of proceedings. Foreign creditors may lodge their claims in their own language but be ready to provide translation upon request.

24. Are there any problems in general with the lodging of claims in another Member State or the treatment of foreign creditors?

Yes

Please specify

(i) evidence of transfer of debts (original or copy or certified copy of transfer certificates; (ii) treatment of guarantees, co- and joint debtor/creditorship.

25. Are there any difficulties with the Insolvency Regulation's rules on languages for information to creditors and the lodging of claims? In particular, have you experienced difficulties with lodging claims in a foreign language, for example, delays or high translation costs?

No

IX. Differences in national insolvency laws

The Insolvency Regulation contains rules on jurisdiction, recognition and enforcement and the law applicable to insolvency proceedings. It does not, in principle, harmonise substantive insolvency law. National insolvency laws vary widely among Member States and, according to recent studies, these disparities can create obstacles to the proper administration of cross-border insolvencies and difficulties for companies having cross-border activities or assets in the EU.

Studies have also analysed the relation between the efficiency of national legal regimes on insolvency and entrepreneurial activity and have highlighted that a number of inefficiencies in insolvency law can hamper doing business in the country in question. At the same time, an expedited national insolvency procedure may not sufficiently grant the parties the possibility to contest decisions taken by the court, thereby preventing them from asserting their rights.

26. In your view, do the differences in national insolvency law create obstacles to the proper administration of cross-border insolvency proceedings or difficulties for companies having cross-border activities or assets in different Member States?

Yes

Problems are mainly caused because of

- *various definitions of insolvency*
- *disparities re. the ranks of creditors, treatment of employees' claims in particular*
- *different levels of court involvement re most important issues like sale or transfer of the debtor's business*
- *public law preferences*

27. In your view, are there important inefficiencies in your national insolvency law?

No

28. Do you consider that your national insolvency law strikes an adequate balance between the need for efficient proceedings and the parties' right to an effective remedy?

Yes

But the average duration of insolvency proceedings is too long.

X. Cost of Proceedings

29. In your view, are the costs of cross-border insolvency proceedings disproportionate with respect to the debt?

No

30. In your view, are the costs of cross-border restructuring or reorganisation disproportionate?

No

31. Should there be simplified insolvency regimes at reduced costs for certain debtors, in particular self-employed persons and SMEs?

No

- *a simplified regime for SMEs is not advisable. This should be up to the member states.*
- *A harmonization of abbreviated proceedings re natural persons could help to avoid insolvency tourism, at least the duration of such proceedings should be harmonized*