Looking Backwards to Go Forwards? Europe at a Crossroads

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The EU Incremental Approach to Cross-Border Insolvency:

From the Istanbul Convention to the Proposal for a Directive

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1. Introduction

One of the primary objectives underlying the European Union (EU) is the creation of a fully integrated European Single Market. The Treaty of Rome 1957 set out the means by which the Single Market was to be created, through the elimination of internal frontiers and the abolition of restriction both governmental and commercial inhibiting trade flows between Member States.

The European Commission started to tackle the negative impact of divergent national rules on trade in the early 1960s. Initially, it tended to regard uniform or total harmonisation as a means of driving the general process of integration forward. However, after several unsuccessful attempts the Commission adopted a more realistic approach and pursued harmonisation only where it would be specifically justified.

The fundamental freedoms established by the Single Market apply to legal as well as natural persons and therefore they apply to companies.[1] The law protecting the interests of various parties differs substantially from one Member State to another, and this can give rise to obstacles to the development of an integrated Single Market. This holds true for the field of insolvency law as well, since it is an area of law that plays an important role in the economy and in societies of Member States. As one the defining characteristics of the market economy is to encourage enterprises to use competitive methods in order to achieve maximum economic profit, the risk of business failure is an essential feature of entrepreneurial activity. As such, insolvency law is the vital core and provider of strength and resilience of any economic activity. Therefore, the creation of a Union and its Internal Market cannot be regarded as complete without a transparent and solid insolvency system. This submission is not new: it has already been made by Manfred Balz, one of the architects of what is now the European Insolvency Regulation 2000, in that a "functioning bankruptcy system is essential

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[1] As defined by Article 54 TFEU.

to any economy that aspires to achieve the freedoms of establishment of business and the free flow of goods, services and capital, and to integrate national markets into a unitary internal market."[2]

The convergence of European economies towards a single economic cycle leads to insolvency itself becoming a unitary phenomenon affecting the Single Market as a whole. In Europe, therefore, some of the difficulties facing harmonisation initiatives stem from the fundamental distinctions that exist between domestic models of insolvency.

Until its recast in 2015, the main text regarding insolvencies with cross-border implications was the European Council Regulation on Insolvency Proceedings of 29 May 2000,[3] which entered into force on 31 May 2002 and has been in place until 26 June 2017. The EIR project started as a proposal for a convention which was to complement the 1957 EC Treaty. The Regulation was the product of a long negotiation process and successive failed initiatives. The latter led to a change in the European institutions' orientation: they moved away from trying to push for complete, substantive harmonisation of the Member States' insolvency laws and towards a more realistic approach focusing on procedural harmonisation only. Indeed, the main objective was to create a level playing field and to remove unequal domestic barriers[4] and since a more coherent body of substantive law at EU level could not be created because of the numerous disparities between national insolvency laws,[5] the EIR was drafted as an instrument harmonising procedural law exclusively, and rests on the provisions governing jurisdiction for opening insolvency proceedings. In many respects, the EIR can be regarded purely as a mechanism for dealing with the kinds of difficulties raised under conflict of law principles, *i.e.* choice of forum and choice of law, as it does not seek to substantially harmonise insolvency law.

The EIR was the first instrument used by the European institutions when adopting their incremental approach to implementing and reforming insolvency law. Following the 2008 global economic and financial crisis, the cross-border insolvency regime established by the EIR was under a lot of and was deemed not to be sustainable anymore. Indeed,

> [t]he job losses are estimated to be about 1.7 million per year. It is estimated that 25% of European companies (about 5 Million) have customers, creditors or business partnerships […] in other Member States and are therefore […] debtors or creditors in

[2] M. Balz, "The European Union Convention on Insolvency Proceedings (1996) 70 *American Bankruptcy Law Journal* 485, at 490.
[3] Council Regulation 1346/2000/EC of 29 May 2000 on insolvency proceedings, O.J. L160/1, 29 May 2000. [Hereinafter EIR]. The Regulation does not apply to Denmark.
[4] EIR, Recital 5.
[5] EIR, Recital 11.

> case of an insolvency. About 50,000 companies […] per year will be debtors and at least twice as many will be creditors in a cross-border insolvency […][6]

The European institutions' new focus was to bring all Member States' laws up to speed regarding the establishment of efficient rescue laws since too many companies were being liquidated across the EU. The EU found large gaps between the insolvency laws of the Member States: liquidation was still the main procedure available to companies in financial difficulties in many of them. The general feeling was that reforms were extremely needed.

However, the European institutions learnt from their past mistakes, pre-EIR 2000 and chose to pursue on their incremental path, instead of pushing for total harmonisation of European insolvency regimes. It opted for a baby step approach that resulted in the publication of the Restructuring Recommendation in 2014, the EIR Recast in 2015, the Capital Markets Union Action Plan in 2015 and recently the Proposal for an Insolvency Directive. This approach to implementing and later reforming EU insolvency and rescue law should be commended: it shows that the European institutions have a realistic and pragmatic outlook on the situation. They have tried the grand ideal of harmonising the Member States' substantial insolvency laws but since this is a field that touches upon a country's economy and impacts many other legal field and because an important number of various stakeholders are involved in an insolvency, these European initiatives have failed and still remain an ideal not achievable at present time. Additionally, European insolvency law is a competence that is left for the Member States. For these reasons, the author is of the view that the pragmatic and incremental approach that has been chosen is the best solution to improve the current state of affairs.

This article explores the difficulties of drafting and then reforming European cross-border insolvency law across the Member States and seeks to analyse the quality of the European institutions' initiatives in the field. The paper proceeds as follows: section 2 briefly maps the history of European initiatives leading to the implementation of the EIR 2000; section 3 describes and evaluates the incremental approach adopted by the EU when implementing – and later reforming – insolvency and rescue law. The findings of this paper are that such approach should be commended since the European institutions have a pragmatic outlook on the situation: they have tried the grand ideal of harmonising the Member States' substantive insolvency laws but since this is a field that touches upon a country's economy and impacts many other legal fields, and because an important number of various stakeholders are involved in an insolvency, these European initiatives have failed and remain

[6] Commission Staff Working Document, Impact Assessment Accompanying the document Revision of Regulation (EC) No. 1346/2000 on insolvency proceedings, 2012, SWD(2012) 416 final, at p.3.3.

an ideal not achievable at present time. Contrary to the widespread view that the EU institutions keep missing their chances at reforming cross-border insolvency and rescue law, it is demonstrated that the pragmatic and incremental approach that has been chosen is the best solution to improve the status quo.

2. History and Background to the European Initiatives

At European level, both the European Community (later Union) and the Council of Europe have been active in drafting texts seeking to regulate cross-border insolvencies and the 1970s, 1980s and 1990s saw a substantial growth in this area. The background to European initiatives has been described as a particularly "long and arduous tale illustrating the complexities of dealing with the diversity of domestic regimes within Europe"[7] and illustrating the rise of European firms, as opposed to purely domestic ones.[8]

2.1. Early Initiatives and Failures

Regarding the field of insolvency law, the EIR project started as a proposal for a convention which was to complement the 1957 EC Treaty.[9] The original purpose of the Treaty of Rome in establishing the EC was to design fundamental principles providing for the free movement of goods, services, labour and capital. These freedoms, in turn, required the free flow of commerce and the creation of a single market as this was to enhance trading across national boundaries. In this context, a functioning insolvency system was necessary to any economy that aspired to achieve the freedoms of establishment of business and the free flow of commerce. Effectively, the failure of businesses was accepted as affecting the proper functioning of the Internal Market, since the nature of European insolvency law is such as to raise a considerable number of issues – including priorities of creditors and social security matters – the resolution of which may bring national systems into conflict. "The diversity of laws applicable to the transactions of a single company is nowhere more important than at the time of insolvency, when their consequences are felt."[10] Therefore, the process of integration of the Internal Market required a coherent, harmonised body of insolvency law, capable of

[7] P.J. Omar, "Genesis of the European initiative in insolvency law" (2003) 12 *International Insolvency Review* 147, at 147.

[8] See F. Mucciarelli, "Optimal Allocation of Law-Making Power over Bankruptcy Law in 'Federal' and 'Quasi-Fedral' Legal Systems: Is There a Case for Harmonizing or Unifying Bankruptcy Law in the E.U.?" (2011) *Law & Economic Research Paper Series*, Working Paper No.11-28, at 6.

[9] Treaty of Rome 1957. See generally on the history of the proposal for a convention, G. Johnson, "The European Union Convention on Insolvency Proceedings: A Critique of the Convention's Corporate Rescue Paradigm" (1996) 5 *INSOL International Insolvency Review* 80; see also M. Balz, supra n. 2.

[10] P.J. Omar, *European Insolvency Law* (Aldershot: Ashgate Publishing Ldt, 2004), at p.15.

addressing the European dimension of firms and its cross-border implications as interaction between companies located in different Member States became increasingly common.

A working party was formed in 1963[11] in order to look at the possibility of drafting a convention covering insolvency matters.[12] This happened at the time when the insolvency laws of many European countries were undergoing important changes, linked to the economic circumstances at the time. However, "the comparative novelty of the problems being faced in international insolvency, at that point a little developed factor in international commerce, meant that the text… met with almost universal opposition."[13] Additionally, new Member States joined the EU in 1973, requiring a new version of the draft convention.

The working party got back to work and a draft convention was given to the Council in 1980[14] and was published in the Official Journal in 1982.[15] However, the draft convention of 1982 met the same fate as its 1970 predecessor and work within the Community stopped in 1985 after Member States failed to reach a consensus on a second draft.

The abovementioned projects were quietly dropped in the 1980s as the Member States did not reach an agreement, "partly because [their] aims were over-ambitious and partly because [they were] overly-complex and ineptly drafted."[16] Nevertheless, they clearly influenced the following text issued by the Council of Europe few years later.

2.2. The Istanbul Bankruptcy Convention: the first step on the incremental path

These continuous failures in the field of cross-border insolvency law prompted the Council of Europe to act. The idea was that since the membership of the Council of Europe is more extensive, it would allow more States to participate in the project. Some commentators have said that it is the failure of

[11] The Regulation actually began its life in the 1960s as part of the proposals for reciprocal recognition and enforcement of foreign judgments which eventually became the Brussels Convention 1968. The two projects were severed at an early stage.

[12] See Report of the Advisory Committee on the EEC Preliminary Draft Convention on Bankruptcy, Winding-Up, Arrangements, Compositions and Similar Proceedings (1976) Cmnd. 6602 (the "Cork Report"), at para. 8.

[13] *Ibid*., at 152. For criticisms of the draft convention, see Nadelmann, "Clouds over International Efforts to Unify Rules of Conflict of Laws" (1977) 41 *LCP* 54, at 63; I.F. Fletcher, "The Proposed Community Convention in Bankruptcy and Related Matters", in Lipstein (ed.), *Harmonisation of Private International Law by the EEC* (London: Chameleon/Institute of Advanced Legal Studies, 1977), at 122-130; M. Hunter, "The Draft Bankruptcy Convention of the EEC" (1972) 21 *ICLQ* 682.

[14] Commission Opinion 81/1068/EEC of 10 December 1981,O.J. 1981 L391/23, at para.2.

[15] Supplement 2/82, *Bulletin of the European Communities*.

[16] L.S. Sealy and D. Milman, *Annotated Guide to the Insolvency Legislation 2012, Volume 2* (London: Sweet &Maxwell, 2012), at p. 126.

the 1982 draft convention that prompted the Council of Europe to propose a new instrument.[17] The Convention on Certain International Aspects of Bankruptcy, also known as the Istanbul Convention, was adopted in February 1990 and was opened for signature in June 1990.[18]

The Istanbul Convention has not entered into force yet[19] - and it is doubtful whether it ever will -[20] yet it is a significant instrument in the context of the making of European cross-border insolvency law because it contributed greatly to the European Insolvency Regulation 2000. Indeed, it introduced the concept of secondary proceedings as a successful compromise in the universality and territoriality divide. It is also an important instrument since it is the first step of the incremental approach used by the European institutions in the field of cross-border insolvency law. The institutions drafted a Convention which remained quite modest in its scope and focused on establishing "a minimum of legal co-operation"[21] and dealt with some aspects of cross-border insolvency cases only, such as the powers of the liquidators, secondary proceedings and the creditors' lodgement of claims in foreign insolvency proceedings.[22] As pointed out by Professor Paul Omar, "[t]he objectives of the […] work […] rested on maintaining a minimum level of opt out."[23]

2.3. The European Insolvency Regulation 2000

The background to European initiatives has been described as a particularly "long and arduous tale illustrating the complexities of dealing with the diversity of domestic regimes within Europe."[24] The EIR project started as a proposal for a convention which was to complement the 1957 EC Treaty but early initiatives were abandoned as the Member States did not reach an agreement.

The EIR sought to introduce rules for dealing with insolvencies with a cross-border element, particularly because companies' international activities profoundly impact upon the economy of the EU. The aim was to create a level playing field and to remove unequal domestic barriers. Generally, the preamble and Recitals therein refer to the stated global aim of the EU, *i.e.* to create a single legal

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[17] See J. Lowry, "The Harmonisation of Bankruptcy Law in Europe: The Role of the Council of Europe" (1985) *JBL* 73.

[18] European Convention on Certain International Aspects of Bankruptcy, Council of Europe, Istanbul 5 June 1990, ETS No. 136.

[19] Eight Member States have signed the Convention so far (Belgium, Cyprus, France, Germany, Greece, Italy, Luxembourg and Turkey) but only Cyprus has ratified the text (17 March 1994). See http://conventions.coe.int/ (last checked: 30 April 2017).

[20] The Convention requires ratification by three States to enter into force, as stated in Article 34.

[21] See Istanbul Convention Preamble. See also J. Israël, *European Cross-Border Insolvency Regulation: A Study of Regulation 1346/2000 on Insolvency Proceedings in the Light of a Paradigm of Co-operation and a Comitas Europaea* (Oxford: Hart Publishing, 2005), at p. 232.

[22] Istanbul Convention, Chapters II, III and IV respectively.

[23] Omar, supra n.7, at 158.

[24] *Ibid*., at 147.

area based on the ideals of freedom, security and justice. Therefore, the proclaimed aims of the EIR were: (1) to allow for the proper functioning of the Internal Market, which requires efficient and effective cross-border insolvency proceedings; (2) to coordinate the measures taken over the insolvent debtor's assets; (3) and to avoid forum shopping.

It was admitted that as a result of widely different substantive laws in the Member States of the EU, introducing an insolvency regime with universal scope in the entire Community was not practical[25] and as a consequence, the EIR did not harmonise substantive insolvency law and instead contained private international law provisions regarding choice-of-law and choice-of-forum.

Compared with the fragmented and uncertain pre-EIR insolvency system, the regime established in 2000 has been welcomed as a positive innovation in terms of cross-border insolvencies, since European cases have become more predictable. The general impression is that the system created by the EIR worked well overall,[26] and the Regulation needs to be acknowledged for what it is: a pragmatic first step on the harmonisation agenda of the European institutions. It represents a "more than acceptable compromise in the face of the only other option, that of not having an instrument in this area."[27] As explained by Professor Paul Omar, following the failures of previous attempts at a structured insolvency framework in the EU, "harmonisation initiatives [began] assessing the limits of what may be achievable and taking a pragmatic stance at the outset, thus preventing the more obvious rejections that may occur."[28] And for that, the EIR needs to be commended.

However, the Regulation's application and interpretation have not proved unproblematic and that is why suggestions for its reform have been articulated very early on, even as early as few years after the EIR came into force.

3. The European Institutions' Incrementalist Reforms: One Step at a Time

3.1. The Commission Restructuring Recommendation 2014

The core philosophy of the Recommendation[29] is the rescue of viable businesses, which the Commission defines as "changing the composition, conditions, or structure of assets and liabilities of

[25] EIR, Recital 11.
[26] See Bob Wessels, 'Amending the EU Insolvency Regulation: Shaken or Stirred?', in Rebecca Parry (ed.), *The Reform of International Insolvency Rules* (INSOL Europe 2011) 125, 126; Gerry McCormack, 'Reforming the EIR: A Legal and Policy Perspective' (2014) 10 Journal of Private International Law 41, 41.
[27] Omar, supra n.7, at 160.
[28] Paul Omar, 'The new European legal order in insolvency: fundamental legal bases and harmonisation initiatives' (2004) 17 Insolvency Intelligence 17, at s18.
[29] European Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C(2014) 1500 final.

debtors, or a combination of those elements, with the objective of enabling the continuation, in whole or in part, of the debtors' activities."[30]

At a time where the EU is facing one of the biggest crises in its history, European initiatives in the field of rescue law have been sped up. As a result, the Restructuring Recommendation is at the heart of the European Commission's growth program and symbolises the shift from liquidation to rescue, pushing the Member States to reform their national restructuring regimes in anticipation of the reform of the EIR 2000.

In order to reach this goal, the Recommendation asked Member States to implement "preventive restructuring frameworks" within their domestic regimes, which should comply with "minimum standards" provided in the Recommendation.[31] The Restructuring Recommendation has two main objectives: "[t]o ensure that viable enterprises in financial difficulties, wherever they are located in the Union, have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole. The Recommendation also aims at giving honest bankrupt entrepreneurs a second chance across the Union."[32]

3.2. The European Insolvency Proceedings Recast 2015

Alongside the Restructuring Recommendation and the focus on rescuing viable businesses, the lengthy reform process which started in 2011 resulted in a first major outcome in June 2015 with the publication of the European Insolvency Regulation recast[33] which will be applicable in the Member States from 26 June 2017.

Generally, the first objective of the reform was to improve the way the Regulation was operating across the Member States in order to boost the smooth functioning of the Internal Market.[34] The reform codified the case law of the ECJ and inserted some elements of efficient national insolvency regimes that had worked quite well over the years, especially since the start of the economic crisis.

While the concept of the "centre of main interests" (COMI) of a corporate debtor will be retained as the criterion for jurisdiction to open main insolvency proceedings, significant changes have been made widening the Regulation's scope to encompass pre-insolvency and debtor-in-possession

[30] *Ibid.*, at Article 5(b).
[31] *Ibid.,* Article 3.
[32] *Ibid*., Recital 1.
[33] European Parliament and Council Regulation (EU) 2015/848 on insolvency proceedings (recast) of 20 May 2015, O.J. L 141/19.
[34] See Recital 4 EIR Recast.

proceedings; to better secure the coordination of main and secondary proceedings; and to enhance the synergetic run of insolvency proceedings relating to members of a group of companies.

By extending the scope of the Regulation, the EIR Recast tries to promote the rescue of economically viable companies across the EU. The general aim is to shift the focus away from liquidation and help businesses overcome financial difficulties. The prevention of abusive forum shopping is effected by clarifying the concept of the COMI, which is the central element to determine the Member States' jurisdiction. The new rules regarding groups enhance communication and cooperation between EU countries so as to ensure that proceedings are made efficient in order to save assets.

However, although the EIR Recast includes relevant innovations, it has stuck with the framework of the old EIR. Most changes simply codify the ECJ's case law and therefore the general impression is that with few exceptions, the EIR Recast does not drastically alter the former position, and especially, it still does not harmonise substantive parts of EU Member States' insolvency and rescue law. The EIR Recast illustrates the incremental approach taken by the European institutions in this legal field, who decided to reform European cross-border insolvency law baby step after baby step. It explains why even though it will only enter into force in July 2017, another European document has already been released, the Proposal for an Insolvency Directive 2016.

3.3. The Proposal for a Directive 2016

Generally, the proposed Directive is a key deliverable under the wider EU initiatives of the Capital Markets Union Action Plan 2015 (CMU) [35] and the Single Market Strategy 2015[36] and it also follows in the footsteps of the Restructuring Recommendation 2014. Such legislative action was deemed necessary since after the Recommendation's publication, the Commission reviewed its application and found that it had only been partial, preventing the implementation of the desired impacts to facilitate the rescue of financially troubled companies and to offer second chance opportunities to honest entrepreneurs.

As a result, businesses in several EU Member States cannot be restructured before they become insolvent and even in those countries that did implement such preventive procedures, the rules governing them still differ from the Recommendation. The various discrepancies that still exist across the Member States mean that legal uncertainty prevails, investors assessing risks face high costs and barriers against efficient restructuring of viable companies persist. The 2014 Restructuring Recommendation therefore did not achieve the expected goals and therefore a binding instrument in

[35] COM(2015) 468 final.
[36] COM(2015) 550 final.

the form of a Directive was chosen, which would allow the Member States to retain flexibility as to the appropriate means to implement the principles and rules set out in the text in their national regimes.

Regarding the level of harmonisation, the Commission clarifies that the proposal "does not harmonise core aspects of insolvency such as rules on conditions for opening insolvency proceedings, a common definition of insolvency, ranking of claims …"[37] even though such rules are perceived as necessary.[38] The Commission reiterated the long-established argument that "the current diversity in Member States' legal systems over insolvency proceedings seems too large to bridge given the numerous links between insolvency law and connected areas of national law, such as tax, employment and social security law."[39] As a result the Commission decided that minimum standards were the most appropriate approach to ensure that at least, a coherent framework would be established in all the Member States, which would also be free to go beyond the Directive's rules. The Commission justified this approach by explaining that "[t]he objective is not to interfere with what works well, but to establish a common EU-wide framework to ensure effective restructuring, second chance and efficient procedures."[40]

Generally, the main aim of the proposed Directive is to reduce the most significant barriers to the free flow of capital stemming from the divergences in national insolvency and restructuring laws. The general objective is for all Member States to implement key principles on effective preventive restructuring and second chance frameworks, and to make national procedures more efficient by improving their quality and reducing their costs and length. The specific objective is to help increase investment and job opportunities within the single market, to reduce the number of liquidations of viable companies and to allow honest entrepreneurs to have a fresh start. The Commission highlights three main sectors in which legislative action is needed: (a) early restructuring; (b) second chance opportunities; (c) general effectiveness of restructuring, insolvency and second chance.[41]

4. The Realistic and Pragmatic Approach of the European Institutions in the Field of Insolvency Law

[37] COM(2016) 723 final, 6.
[38] COM(2015) 468 final, 23-24.
[39] COM(2016) 723 final, 6.
[40] *Ibid*., 7.
[41] COM(2016) 723 final, at pp. 2-11.

Commentators have had varied responses following the European reforms. Some have criticised the EIR Recast for being too "modest"[42] whereas others have characterised it as "very decent."[43] That can be explained by the fact that in the field of insolvency law, the European institutions seem to have opted for an incremental approach to law-making.

4.1. The Theory of Incrementalism

Incrementalism is defined as the "theory of public policy making, according to which policies result from a process of interaction and mutual adaptation among a multiplicity of actors advocating different values, representing different interests, and possessing different information."[44] Generally, incrementalism focuses on the "amelioration of concrete problems rather than the pursuit of abstract ideals."[45]

The criticisms voiced by some academics against the EIR and its current reform are not confined to the insolvency field only. Critics have observed that international and European law-making tend to develop slowly in general, following a "two steps forward, three steps back, three steps forward, two steps back"[46] type of rhythm, and therefore frustration with the general policy-making development is not restricted to insolvency law only. Other authors, on the other hand, have promoted incrementalism in law-making as being beneficial since

> [r]ather than confront[ing] states immediately with a legal regime that couples challenging goals with strong sanctions for failure to meet them, states can be gradually led toward stronger legal rules. This can be accomplished by starting with relatively weak international rules back by little or no sanctions that all states feel comfortable joining, but then gradually pushing states to accept successively stronger and more challenging requirement.[47]

As explained by Professor Charles Lindblom – legal theorist and early formulator of the theory of incrementalism in policy-making – "the 'best' policy emerges not out of a comparison against an abstract ideal, but out of a pragmatic agreement on a policy that is acceptable for all parties. The goal

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[42] Horst Eidenmüller, 'A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond', ECGI Law Working Paper No. 199/2013, 21.
[43] Gabriel Moss, 'A Very Decent Proposal: The European Commission's proposal for reforming the EC Regulation on Insolvency Proceedings 1346/2000' (2013) 26 Insolvency Intelligence 55.
[44] <https://www.britannica.com/topic/incrementalism> accessed 08 May 2017.
[45] *Ibid.*
[46] Susan Block-Lieb and Terence Halliday, 'Incrementalisms in Global Lawmaking' (2007) 32 Brooklyn Journal of International Law 851, at 851.
[47] Oona Hathaway, 'Between Power and Principle: An Integrated Theory of International Law' (2005) 72 University of Chicago Law Review 469, at 531.

of discussion becomes to find *focal points of agreement*."[48] If we look at the EIR Recast against the backdrop of this theory, it is not surprising that some commentators would call the reform "modest" and "underwhelming." Indeed, an incremental approach to policy making usually result in reforms which do not differ much from the existing state of affairs, because such a method "makes the most of existing knowledge" and the policy-makers' "ability to anticipate the future consequences of their most preferred policy." [49] When too many elements are changing at the same time, it introduces an element of unpredictability regarding the impact of the reform and thus, it is not surprising that recent EU cross-border insolvency law developments are not a complete radical overhaul of the status quo.

Finally, the author agrees with Lindblom's noteworthy statement regarding incrementalism: it is not necessarily "slow moving [and] therefore a tactic of conservatism. A fast-moving sequence of small changes can more speedily accomplish a drastic alteration of the *status quo* than can an only infrequent major policy change.[50]

4.2. Incrementalism Applied to the Current EU Developments

Incrementalism is the path chosen by the European institutions in insolvency law and it has been acknowledged that in this specific area of law, "progress is best achieved by a series of small steps rather than by a great leap forward."[51] This is exemplified through the adoption of several instruments over a short period of time, such as the Restructuring Recommendation 2014, the EIR Recast 2015, the CMU Action Plan 2015 and 2016, and the Proposal for a Directive 2016.

The EIR 2000 is considered a success compared to the fragmented state of affairs that existed before its introduction and the European institutions learnt from their previous, more ambitious agenda, which had failed. The Regulation and its successors the EIR Recast, the Restructuring Recommendation and the proposed Directive, are very pragmatic instruments: the European institutions adopted an indirect approach to implementation and reform and since the "one-step plunge into [harmonisation] … was tried, and failed, with previous [European] efforts…,"[52] the

[48] Aneta Spendzharova, 'Power to the European Supervisory Authorities: Explaining the Incremental Evolution of European Financial Regulation' (2012) Paper prepared for the 2012 UACES conference, Passau, Germany, 3-5 September 2012, at p. 5. See Charles Lindblom, 'The Science of "Muddling Through"' (1959) 19 Public Administration Review 79, at 82-84.

[49] Aneta Spendzharova, 'Power to the European Supervisory Authorities: Explaining the Incremental Evolution of European Financial Regulation' (2012) Paper prepared for the 2012 UACES conference, Passau, Germany, 3-5 September 2012, at p. 5.

[50] Charles Lindblom, "Still Muddling, Not Yet Through" (1979) 39 Public Administration Review 517, at 520.

[51] McCormack, supra n.26, at 41.

[52] John Pottow, 'Procedural Incrementalism: A Model for International Bankruptcy' (2005) 45 Virginia Journal of International Law 935, at 988.

Commission opted for a multi-stage path to reform. When the EIR came into force, the Commission knew at that time already that it was only the first step establishing a coherent framework for European cross-border insolvencies, which would be followed by subsequent reforms, allowing harmonisation to creep in a bit more each time, one instrument at a time.

From the start, the European Commission has opted not only for incrementalism, but for *procedural* incrementalism,[53] which has contributed in receiving widespread support from the Member States, because of the procedural harmonisation-only orientation of the EIR. Indeed, the EIR did not substantially harmonise the insolvency laws of the Member States; instead it focused on procedural harmonisation, mixed with some "baby steps – in discrete, unassuming areas."[54] The European institutions were realistic in that States are generally more willing to relinquish regulatory sovereignty on procedural issues rather than on substantive matters, and therefore the drafters of the EIR astutely designed it as mainly procedural in nature. By adopting such an approach, "skeptical … states might not have been overwhelmed by the complete subjugation of regulatory sovereignty"[55] and it has given time to States to acclimate to each other, because it "recognises the limits beyond which sovereign states are unlikely to go at the present stage of European integration."[56] The European institutions, therefore, have opted for the approach which is the most efficient in the particular broad-reaching field of insolvency law.

Even though the EIR 2000 dealt mostly with peripheral insolvency rules, *i.e.* procedural issues, successor instruments such as the Restructuring Recommendation have shifted the focus away from liquidation towards rescue and the EIR Recast now deals with more pivotal, essential elements of insolvency and restructuring law such as the issue of groups of companies and pre-insolvency proceedings and rules on COMI and forum shopping have been clarified. The European institutions are clearly moving forward and even though they had to compromise and handle the various stages of European integration and the different mindsets of the Member States, what was impossible then is possible now or will be tomorrow.

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[53] Term coined by Professor Pottow regarding the UNCITRAL Model Law, see John Pottow *ibid*.

[54] *Ibid.*, at 992. See for example Bob Wessels, 'On the Future of European Insolvency Law' (2012) INSOL Europe Academic Forum's 5th Edwin Coe Lecture, at p. 10:

> It should be mentioned that several provisions of the Insolvency Regulation are to be characterized as substantive rules and are therefore now accepted throughout Europe as unified rules concerning the topics to which they relate, see for example Article 7(2), 20, 29-35, 39 and 40 of the EU Insolvency Regulation.

[55] Pottow, supra n.52, at 988.

[56] Ian Fletcher, 'The European Convention on Insolvency Proceedings: Choice-of-Law Provisions' (1998) 33 Texas International Law Journal 119, at 124.

As such, the EIR needs is to be commended for two reasons: first because it introduced a coherent legal framework for dealing with cross-border insolvencies in the EU which was greatly lacking before its coming into force; and also because by adopting this Regulation, Member States "took the first step toward subordinating their policies and accepting outcome differences."[57] To summarise, the European institutions adopted a gentle incrementalism approach to infuse some harmonisation measures little by little within the EU in order to allow hesitant jurisdictions to gradually adapt to the new regime. The drafters of the EIR opted for such a method as the previous, more substance-based, harmonisation efforts had been met with strong rejection. This explains why the EIR and its recent reforms have been characterised as "modest" by some commentators.

Additionally, it is important to be reminded of the nature of the EU as an entity: the main concept behind the creation of the EU was that Member States were to transfer competences to the Union, while retaining their sovereignty. Yet EU Member States' sovereignty is more decreased than in the case of participation in other international organisations. Regarding the EU harmonisation process, this decrease of sovereignty may create problems as national political and interests groups may compel domestic governments to retain particular laws.[58] The more countries are involved, the more negotiations become complex and quite often, the European text enacted at the end of a lengthy negotiation process results in a compromise with the lowest common denominator of national interests, far from establishing novel solutions with new standards. Additionally, based on the principle of subsidiarity, insolvency law is a competence that has been retained by the Member States, because they have been deemed to be better able to satisfy the heterogeneous preferences existing across the EU in this legal field.

Furthermore, it should not be forgotten that the reforms accomplished by the European institutions for the past few years are "part of a broader package of measures including a Communication on 'A New European approach to Business Failures and Insolvency'"[59] as well as a the setup of expert groups, a Recommendation, various reports, impact assessment documents and other funded studies and organised conferences on the subject. The Capital Markets Union Action Plan from 2015 has pushed the European institutions to revise their positions and since the Feedback Statement containing the results of the public consultation on such Action Plan[60] showed that many respondents supported a more substantive approach to harmonisation regarding insolvency and rescue law, the

[57] *Ibid*, at 995.
[58] See Kathleen Patchel, 'Interest Group Politics, Federalism and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code' (1993) 78 Minnesota Law Review 83.
[59] McCormack, supra n.26, at 45.
[60] COM(2015) 468 final.

Commission has now put forward the latest step in its incremental approach, *i.e.* the Proposal for a Directive.

Finally, it is interesting to analyse the time at which the reforms have come. A question that can be raised is whether the European institutions are speeding up the reform of the European cross-border insolvency regime now because they find themselves in a period of legitimacy crisis, which forces them to appear more effective than before. Professor Block-Lieb writes that

> incrementalism facilitates legitimacy because it assists an international organization in promoting (a perception of) its effectiveness to the international community. If [it] meets the standards for success that it sets itself, it is more likely to be considered effective… On this ground, success in taking a series of small steps is preferable to having made an unsuccessful attempt at achieving grand plans. Over time the repeated meeting of incremental improvements sets up expectations that its success will occur as a matter of course.[61]

One could argue that when the European institutions realised that the ideal instrument they wished to implement was too broad and decided to opt for a more procedurally focused Regulation instead, it was to (a) solve the problematic situation that multinational corporations found themselves in when their faced financial difficulties within the EU; and (b) to "legitimate themselves and […] ratchet up [their] cachet and reputation as a rightful locus of global norm-making."[62]

To conclude, these developments show that the European Commission, when enacting the EIR Recast, has not been "cautious," has not missed an opportunity to reform the field, but rather deliberately chose to follow a "baby step" approach. Additionally, it is really interesting to note that the incremental approach has been endorsed by Member States: in the CMU consultation responses, "Member State governments and Finance Ministries adopted a rather cautious approach suggesting the performance of a step-by-step approximation based on an impact analysis of the insolvency area."[63] This does not mean that the EIR Recast is the end of the EU's efforts in cross-border insolvency law, as exemplified by the Proposal for a Directive. The European institutions were talking about such a legislative instrument for several years but "the political will for change has increased rapidly since a harmonisation project was included in the Commission's CMU action last year [...] This time there is a greater political will in the right direction."[64] Indeed, the Feedback Assessment on the

[61] Block-Lieb and Halliday, supra n.46, at 855.
[62] *Ibid*., at 898-99.
[63] COM(2015) 468 final, p. 60.
[64] Lizzie Meager, 'EU Insolvency harmonisation gathers steam' International Financial Law Review, 27 September 2016.

CMU reported that a large number of market participants and investors felt that the differing insolvency regimes that exist across the EU "negatively impacts confidence in cross-border investment."[65]

4.3. The Way Forward: Cooperation and Convergence

Generally, commentators have advocated for more cooperation between Member States, claiming that "[i]nternational cooperation is the way out of the financial crisis" and that the "international community must unite to tackle the downturn and set the path toward a sustainable future."[66] The International Monetary Fund (IMF) has also stated that "[h]istory points to integration to overcome a tough crisis."[67] In the field of cross-border insolvency law, the thought is shared by many. Paulus has advocated for a European model based on trust, which is, to him, the most important element for an efficient harmonised European regime. The EIR established such a paradigm, providing for automatic recognition of foreign judgments across the EU, leaving "no more room for scepticism, with the tiny exception of Article 26 EIR and its reservation for violations of the domestic *ordre public.*"[68] However, at the time the EIR was drafted, the Member States' trust in each other's regimes was not at its peak and that is why the EIR also contains provisions in Articles 5 to 15 which are exempted from the law governing the main insolvency proceedings.

The deepening of the trust between Member States proved extremely beneficial for the EU as a whole. For example, when the English courts introduced the concept of "synthetic proceedings," this "imaginative interpretation […] led to a clash with the continent's initial adherence to the legislator's intention and carried with it the danger of causing a trust crisis,"[69] because English courts managed to attract an important number of cases to their jurisdiction. Nonetheless, several Member States started to follow the English approach which proved extremely beneficial for groups of companies.

Importantly, such coming together had a harmonising effect. The vagueness and openness of interpretation of the EIR started a competition among the Member States to attract companies to their jurisdiction. Domestic legislators have had to modernise their insolvency laws to retain their

[65] COM(2015) 468 final, pp. 59-60.
[66] Alistair Darling, 'International Cooperation is the Way Out of the Financial Crisis' The Wall Street Journal, 13 March 2009.
[67] Reza Moghadam, 'Europe's Road to Integration' (2014) 51 Finance & Development.
[68] Chrisoph Paulus, 'A Vision of the European Insolvency Law' (2008) 17 Norton Journal of Bankruptcy Law and Practice 607, at 609.
[69] *Ibid*., at 610.

national corporations and attract foreign ones, which in general have tended to migrate their COMI to the UK to avail themselves of the efficient restructuring procedures that exist.

Therefore, commentators were right when mentioning a competition between Member States since their insolvency laws have noticeably converged over the past few years, especially since the passing of the Restructuring Recommendation. Paulus predicted the development of restructuring law in the EU when stating that "[t]hose features which proved to be successful – i.e., which attract forum shoppers – will form an increasing body of minimum standards that no competitor can afford to go below."[70] These minimum standards have now been codified in the Proposal for a Directive.

It is the author's view that the European institutions' approach has in the end resulted in a race to the top in terms of insolvency standards to be implemented by Member States across the EU. Indeed, as mentioned by Gunther Teubner borrowing the expression "co-evolution" from the science of biology, a "race to the top" can be initiated if the EU legislator sets minimum standards as a "floor of rights,"[71] thereby encouraging States to set superior standards.[72] That is exactly what the European Commission has done, first with the Restructuring Recommendation 2014 and then with the Proposal for a Directive 2016, which both adopt a minimum standards approach, acknowledging that some Member States already have well-functioning systems in place.

Allowing Member States to learn from each other and compete to attract companies to their jurisdiction can only prove beneficial since previous more rigid attempts have seemed to fail. Indeed, it is interesting to note that Member States were invited to implement the Restructuring Recommendation by March 2015, yet Member States' inclination "to accept this invitation has not been strong (to put it mildly)."[73] Some Member States such as the UK, France, Germany or Italy, have not reacted at all to the European Commission's initiative.[74] Therefore, it seems that it is regulatory competition in the field has led to convergence, rather than top-down harmonisation attempts by the European institutions. This has increased innovation, mutual learning and trust between national legislatures. Indeed, it resulted in the implementation of procedures which help in preventing the liquidation of viable companies and which help companies avoid formal insolvency.

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[70] *Ibid*., at 615.
[71] Simon Deakin, 'Regulatory Competition versus Harmonization in European Company Law', in Daniel Esty and Damien Geradin (eds.), *Regulatory Competition and Economic Integration – Comparative Perspectives* (OUP 2001) 190, at p.210.
[72] Gunther Teubner, *Law as an Autopoetic System* (Blackwelll 1993), at p.52.
[73] Horst Eidenmüller and Kirstin van Zwieten, 'Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency' (2015) European Corporate Governance Institute Law Working Paper No. 301/2015, at p.35.
[74] *Ibid*.

This shift in the way harmonisation is achieved is important. Until now, the top-down harmonisation coming from the European institutions was slow, incremental and subject to significant compromises. The sort of regulatory competition that took place in the previous years has shifted the way harmonisation was achieved in the sense that it was not the European institutions imposing top-down harmonisation on the Member States anymore, but rather, the European institutions learning from the convergence happening among the EU States and codifying it. The hope is therefore that this change in the regulation landscape will result in Member States being less recalcitrant to change – as they were to implement the Restructuring Recommendation - and more open to follow the new minimum standards proposed so as to implement more efficient insolvency and rescue law regimes, since it is based on elements already present in their domestic legislation.

5. Conclusion

The EU has acted essentially as a "schoolhouse for the entire world for learning about international cooperation. Its extraordinary efforts have taught lessons in its failures as well as in its more frequent successes."[75]

Even though the ultimate goal of the European institutions is to harmonise cross-border insolvency law, it is not without difficulties in practice, in particular due to the divergences between the different domestic insolvency laws in the Member States. That is why the European institutions quickly realised that substantially harmonising such a political legal field would not be an easy task and opted for an incremental approach to harmonisation.

This article has mapped the historical initiatives in the field of European cross-border insolvency law, from failures of early initiatives, to the passing of the Istanbul Convention in 1968 and lately, to the Proposal for a Directive in 2016. It has focused on the most recent developments: the EIR 2000; the EIR 2015; and the proposed Directive 2016.

The EIR 2000 was welcomed as a positive innovation in the field of cross-border insolvency law compared to the fragmented and uncertain system that existed before its entry into force. However, the main issue regarding the EIR was that it did not harmonise substantive law within the EU. The ECJ has played a pivotal role in shaping insolvency and rescue law in the EU as well. It helped refine the Regulation's understanding and the Court's case law became as important as the EIR itself.

After the 2008 global economic and financial crises, national and European initiatives developed in parallel. At national level, Member States started to reform their domestic insolvency laws adopting

[75] See Donald Trautman *et al*., 'Four Models for International Bankruptcy' (1993) 41 American Journal of Comparative Law 573, at p.625.

more rescue-oriented regimes to save viable companies from unnecessary liquidation. Such convergence was mirrored at the European level by different initiatives, notably the Restructuring Recommendation 2014, the EIR Recast 2015 and the Proposal for a Directive 2016 which all focus on early restructuring, second chance for honest entrepreneurs and general effectiveness of insolvency and rescue regimes.

The different European instruments produced can be described as the "art of the possible,"[76] the "least worst" solutions, limited by the political consensus existing in the EU. Since insolvency law remains a competence of the Member States, the European institutions had no choice but to opt for a step-by-step approach to harmonisation. However, incrementalism is not synonym for lack of initiative and enthusiasm. On the contrary, as can be seen from recent developments, the harmonisation of cross-border insolvency law is a continuum.

Even though the global economic and financial crisis has "distracted the EU"[77] from closer integration, the harmonisation of insolvency law is a long-term game that was not abandoned. Contrastingly, the crisis has also brought to the fore the need for speedy action to tackle more efficient recovery regimes in the Member States and therefore the last few years have seen important developments in the field of cross-border insolvency and rescue law, one new instrument at a time.

The glass half full narrative is that modest reforms will tear down sovereign mistrust and participants' scepticism of the evils of applying foreign insolvency law. The half empty narrative, however, is that these modest reforms will get readily enacted with self-congratulatory back-slapping but then stall without further progress when the truly sovereign concessions have to be made.[78]

This analysis leads to the conclusion that the efforts made by the EU should not be reprimanded for their "modest" contribution, but on the contrary, should be applauded for their pragmatism. These attempts – however timid – are realistic and have made the cross-border insolvency scene more coherent, and therefore, they should not always be measured against the yardstick of full, substantive harmonisation, which was unrealisable at the stage of European integration at which they were drafted.

[76] Fletcher, supra n.56, at 124.
[77] David Phinnemore, 'The European Union: Emerging from Crisis?' (2014) 5 Political Insight 22.
[78] John Pottow, 'Beyond Carve-Outs and Toward Reliance: A Normative Framework for Cross-Border Insolvency Choice of Law' (2015) Law & Economics Working Papers, Paper 115, at p.8.