THE HARMONIZATION OF THE AVOIDANCE RULES IN EUROPEAN UNION INSOLVENCIES

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Abstract Cross-border transactions and resultant legal proceedings often cause problems. One major problem is knowing which law should govern the transaction and any legal proceedings. Cross-border insolvencies in the EU are subject to the European Regulation on Insolvency Proceedings (EIR) but this legislation does not determine which substantive insolvency law rules apply in a given insolvency. There are many differences in the insolvency rules applicable in the various EU Member States and this has caused concern in relation to the avoidance of transactions entered into by an insolvent prior to the opening of insolvency proceedings. In light of this, the paper examines options to address divergence between national avoidance rules. One option, harmonization, is analysed as well as its possible benefits and drawbacks.

Keywords: avoidance rules, European Union, harmonization, insolvency.

I. INTRODUCTION

Cross-border transactions and resultant legal proceedings often cause problems for the parties involved. Inter alia, the problem is knowing which law should govern both the transaction and any subsequent legal proceedings. To address this issue to some degree in the area of insolvency the European Regulation on Insolvency Proceedings ('EIR') was introduced and became law across the European Union (EU), with the exception of Denmark, on 31 May 2002. It was felt that the EIR was needed because national legal systems could not achieve the proper functioning of the internal market.[1] The EIR effectively contains the same provisions as the ill-fated European Convention on Insolvency Proceedings, which was constructed in 1995 but never came into force. The goal of the EIR was to provide for a universalist insolvency model[2] founded on one law applying to an insolvency proceeding and for

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[1] Council Regulation on Insolvency Regulations (EC) (1346/2000), 29 May 2000, Recital 5 (recast).

[2] Although Tung referred to the Regulation as providing for a territorialist scheme with universalist pretentions: F Tung, 'Is International Bankruptcy Possible?' (2001) 23 MichJIntlL 31, 77.

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that law to apply to all matters that related to that proceeding across the breadth of the EU. This was designed to improve the effectiveness and efficiency of insolvency proceedings having cross-border effects.[3] The EIR's objective was to produce a marked reduction in costs incurred in the administration of any insolvency. The EIR provides clear guidelines that ensure stability and consistency in relation to areas of jurisdiction, applicable law and the recognition and enforcement of judgments.[4] The EIR deals with the problems of jurisdiction, applicable law, recognition and enforcement of insolvency decisions, as well as coordination of cross-border insolvency proceedings, but it does not oblige Member States to introduce specific types of procedures or rules, or to ensure that their procedures and rules achieve specific aims. The EIR has been subject to review in recent years and now a recast version of it has been drafted[5] and approved by the European Council and will come into effect in June 2017,[6] but while it has made important changes to the EIR it does not provide for substantive insolvency law.

The EU became involved in insolvency proceedings because there is a need for effectiveness and legal certainty so as to avoid 'a complicated legislative framework which discourages financial transactions within the European Union'.[7] Recital 5 of the recast EIR (all references to the EIR are to provisions in the recast version) provides that it is necessary to enable the proper functioning of the EU's internal market to prevent people having incentives to transfer assets or judicial proceedings between Member States and thereby obtaining a more favourable legal position. The EIR, while it lays down some European standards in relation to the way foreign creditors are treated and the notification of proceedings, is essentially a private international law mechanism and not an instrument of substantive harmonization.[8] While it went some way towards harmonizing the private international law rules as far as insolvency proceedings are concerned in the Member States of the EU,[9] it clearly did not purport to seek to harmonize substantive insolvency law, save in a very limited way. The EIR ensures that decisions on cross-border insolvencies are recognized across the EU, and designates both the courts that will have the power to open insolvency

[3] Council Regulation on Insolvency Regulations (EC) (1346/2000), 29 May 2000, Recital 8.

[4] *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [59].

[5] Described by Horst Eidenmüller as making overly modest changes: 'A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond' (2013) 20 MJ 133, 150. For a recent discussion of the recast regulation, see M Weiss, 'Bridge over Troubled Water: The Revised Insolvency Regulation' (2015) 24 International Insolvency Review 192; G McCormack, 'Something Old, Something New: Recasting the European Insolvency Regulation' (2016) 79 MLR 121.

[6] See art 16 of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) Official Journal of the European Union, L141/19, 5 June 2015.

[7] *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [59].

[8] McCormack (n 5).

[9] T Bos, 'The European Insolvency Regulation and the Harmonization of Private International Law in Europe' (2003) NILR 31, 33.

proceedings and what law will be applied to the insolvency proceedings. The upshot of the EIR is that all Member States (except for Denmark, which opted out of the EIR) share the same bases for a court's international jurisdiction to open insolvency proceedings.[10] While the EIR did not harmonize substantive insolvency law, and during the first decade of this century the issue of harmonization was avoided,[11] there has been some mention in more recent times of the possibility of harmonization of substantive insolvency law or, at least, elements of it due to problems with divergences in national laws.[12]

A most important aspect of administering the affairs of an insolvent (company or individual) is for the person appointed to administer the affairs and property of the debtor (in this paper referred to as 'the liquidator'[13]) to accumulate as many assets as possible that are owned by the insolvent or to which the insolvent has rights in order to augment the size of the insolvent estate. This process sometimes includes seeking to take advantage of rules that permit the avoidance of transactions that occurred prior to the insolvent's entry into insolvency proceedings ('pre-insolvency transactions'). If the transaction can be avoided then this might mean that additional assets or funds will become available to the liquidator and can be distributed to the creditors in general. The rationales for the existence of these rules are discussed later, but in general terms it is felt that setting aside certain, but not all, pre-insolvency transactions is fair and just.

Under the EIR insolvency proceedings have to be opened in the Member State where the company has its centre of main interests ('COMI'),[14] and the law of the place of the COMI is then competent to determine the main proceedings and this law will apply across the EU. This implements a critical principle that underpins

[10] ibid 52.

[11] B Wessels, 'Harmonization of Insolvency Law in Europe (2011) 8 ECL 27, 27.

[12] See European Commission, DG Justice and Consumer Affairs, 'Study on a new approach to business failure and insolvency' Tender No JUST/2014/JCOO/PR/CIVI/0075, 1 January 2016. <http://ec.europa.eu/justice/civil/files/insolvency/insolvency_study_2016_final_en.pdf>.

[13] This is not meant to refer only to those who wind up companies in liquidation but to all those qualified to oversee the affairs of an insolvent company. The use of 'liquidator' as in the EC Regulation on Insolvency Proceedings is adopted. The Regulation provides in art 2(b) that a liquidator is a person or body whose function is to administer or liquidate assets of which a debtor has been divested or to supervise the administration of the debtor's affairs. In Annex C 'liquidator' covers a host of roles that are played by those who administer the estates of insolvents. The recast of the Regulation omits reference to liquidator and substitutes the more neutral term, 'insolvency practitioner'. See art 2(5) (Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) Official Journal of the European Union, L141/19, 5 June 2015.

[14] There has been significant criticism of the COMI concept as providing the foundation for the opening of main insolvency proceedings (see eg M Szydlo, 'Prevention of Forum Shopping in European Insolvency Law' (2010) 11 EBOR 579; G McCormack, 'Jurisdictional Competition and Forum Shopping in Insolvency Proceedings' (2009) 68 CLJ 213), and the recast Regulation has endeavoured to address some of them. For perhaps the leading cases on this issue, see *Re Eurofood IFSC Ltd* (Case C-341/04); [2006] ECR 1–701, [2006] BCC 397, [2006] BPIR 661; *EC Interedil Srl v Fallimento Interedil Srl* ((C-396/09); [2011] BPIR 1639.

the EIR, namely that there will be greater certainty where cross-border activities have occurred. Actions to avoid or set aside transactions are clearly a critical part of insolvency proceedings.[15] In insolvencies governed by the EIR the law of the place where insolvency proceedings were opened applies to the administration of the insolvency, and this means that the law of this Member State, including its avoidance rules, will apply to the insolvency. Concern has been expressed in several quarters that the present position concerning the avoidance of pre-insolvency transactions in European insolvencies is not satisfactory.[16] Consequently a number of options to remedy the situation have been mooted. One of the options is the harmonization of avoidance rules. It is on this issue that this article focuses.

The article's principal aims are threefold. First, to identify and then examine options that are available to address the problems that exist where there is divergence between the avoidance rules of the Member States. One of the options is to introduce a form of harmonization and so the second aim of the article is to consider the different forms of harmonization that might be considered as appropriate as far as the avoidance rules in insolvency are concerned. The forms of harmonization are relevant to any area of law that might be harmonized. The third aim is to analyse how feasible is the total harmonization of avoidance rules and what are the possible benefits and drawbacks in implementing this form of harmonization.

The article is structured in the following manner. First, there is a discussion of the rationale behind avoidance rules and what they seek to achieve. Second, the paper includes a short explanation of how the EIR provides for avoidance and how the rules on avoidance might not be applied because of Article 16 of the recast EIR.[17] This discussion includes identifying the concerns that exist about the operation of Article 16 and the consequential non-application of avoidance rules. Third, there is an outline of the options that appear to be available to remedy the problem that presently exists. Next, the article identifies the various forms of harmonization that might be employed in reforming avoidance rules. This is followed by an examination of the benefits and drawbacks of implementing total harmonization. Finally, there are some concluding remarks.

While an insolvent can be a company entity or an individual, and the EIR covers both, the article, for ease of exposition, primarily deals with companies.

II. AVOIDANCE RULES

The origin of the avoidance of transactions in insolvency law is usually traced back to Roman times where there were up to four legal processes that could be used to recover property, with the most well-known action being the *actio*

[15] *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [39].
[16] For example, see European Commission, DG Justice and Consumer Affairs (n 12) 168–77.
[17] Art 13 of the EIR that is presently in effect (until June 2017).

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pauliana. This action provided for the avoidance of transfers of property that were made to defeat or delay the claims of creditors or to put the property beyond the reach of creditors. The others actions were: *interdictum fraudatorium* which is similar to the *actio pauliana* and involved the right to have set aside transactions that were entered into by a person to the detriment of his or her creditors; the action *in factum* which was an action given by the Roman praetor on the facts of the case alone where no standard civil law action was applicable; the action *in integrum restitutio* which is known to English law and involved an action to restore parties to their original positions.[18] The main features of the *actio pauliana* action have survived to the present day.[19] Having said that, it is recognized that there has been some dispute about the nature of the *actio pauliana* and in fact there might have been more than one kind of *actio pauliana*.[20] As one would expect, the various jurisdictions in Europe developed their rules on avoidance in different ways and these rules include divergent elements, and place emphasis on multifarious approaches. This is due to many factors, not least being the sources of a country's law, its history, culture and the kind of legal system that was fostered. Nevertheless, we find today that while legal systems in the various jurisdictions of the EU differ, the solutions which these systems provide for in relation to transactions involving the loss of assets of insolvents have many commonalities.[21]

When administering the affairs of an insolvent a liquidator will usually investigate what transactions were entered into by the insolvent before the advent of insolvency proceedings to see if any of them are suspect from an insolvency law perspective. Perhaps the most notable and unusual feature of avoidance rules is that they provide for the setting aside of transactions that were, at the time that they were made, generally valid and not vulnerable to challenge under the general law of the relevant jurisdiction. For the most part they were not illegal or in breach of any legal rules, and, on the whole not even tainted in any way. Outside of insolvency an insolvent is usually permitted to deal with property in the way that it deems appropriate.

There does not appear to be any one standard theory which has been developed in Europe as to the reason for the existence of avoidance provisions, such as creditor bargain theory,[22] but there are clear policies that underpin them. First, the property of an insolvent is to be distributed fairly and rateably among its creditors,[23] subject to any statutory

[18] H Roby, *Private Roman Law* (CUP 1902) 273.

[19] *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [26].

[20] See J Moyle, *Imperatoris Iustiniani Institutiones* (Clarendon Press 1949) 547. Other writers demur to this viewpoint. For instance, see Roby (n 18).

[21] *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [26].

[22] A theory popularized by Thomas Jackson: *The Logics and Limits of Bankruptcy Law* (Harvard University Press 1986).

[23] V Finch, 'Directors' Duties: Insolvency and the Unsecured Creditor' in A Clarke, *Current Issues in Insolvency Law* (Stevens 1991) 87; E Warren, 'Bankruptcy Policymaking in an

exceptions.[24] Avoidance actions might be seen as promoting collectivism and fairness among creditors. The underlying aim of the inclusion of avoidance provisions for reasons of equality is to produce fairness.[25] But fairness does not mean absolute equality because any distribution of funds recovered in avoidance proceedings is undertaken subject to any statutory requirements, such as those giving priority to certain creditors to be paid before others, most often employees. So, avoidance provisions exist in order to protect the general body of creditors from the unfair diminution of the insolvent's estate which can result from the debtor having given an advantage to one party prior to the opening of insolvency proceedings, thereby distorting the distribution of the property of the insolvent. In this respect, such provisions are designed to prevent the unjustified enrichment of one individual party to the detriment of all other creditors and to prevent one or more creditors benefiting at their expense. They aim to counter two possible situations. First, insolvents may sell some of their assets, prior to entry into insolvency proceedings, at below value market, or buy assets at above market value, in order to benefit some third party, often an associate or connected party, and this action might be characterized as debtor misbehaviour.[26] Second, individual creditors may be paid by an insolvent while other creditors are not, and therefore this is detrimental for the general body of creditors.[27] This latter action often occurs, where non-connected creditors are involved, as a result of pressure from creditors for payment of outstanding debts and might be characterized as creditor misbehaviour, although what they are doing is perfectly legal.

A second policy argument in favour of such provisions, that arguably has only been prominent in the past 30 years, is that it aims to prevent the dismemberment of the insolvent's estate[28] that occurs as a consequence of the entry into pre-insolvency transaction. This is because a loss of assets might reduce the chances of the insolvent being able to continue doing business efficiently or at all, and reduces the possibility of the insolvent being able to be restructured effectively, or at all.[29] The value of the assets of the debtor might be greater when employed in a business that is a going concern

Imperfect World' (1993) 92 MichLRev 336, 353; J McCoid, 'Bankruptcy Preferences and Efficiency: An Expression of Doubt' (1981) 67 VaLRev 249, 260; A Keay, 'In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions' (1996) 18 SydLR 56.

[24] The most prevalent exception that is found is that the employees of the insolvent are entitled to be paid a part or all of outstanding wages owed to them before other creditors are paid.

[25] McCoid (n 23) 271; T Ward and J Shulman, 'In Defence of the Bankruptcy Code's Radical Integration of the Preference Rules Affecting Commercial Financing' (1983) 61 WashULQ 1, 16. Recital 21 to the EIR provides that equal treatment of creditors is an important element of the Regulation.

[26] A Keay, *Avoidance Provisions in Insolvency* (Law Book Co 1997) 35.

[27] EU Briefing Note, 'Harmonization of Insolvency Law at EU Level: Avoidance Actions and Rules on Contracts' (2011) 11.

[28] J Westbrook, 'Two Thoughts About Insider Preferences' (1991) 76 MinnLR 73, 77; Keay (n 23).

[29] EU Briefing Note (n 27).

than when disposed of separately.[30] Transaction avoidance might be regarded as having a significant role in an insolvency law framework developed to act as a preventative measure and a critical element in protecting creditors and the estate, as well as exacerbating the debtor's insolvency problems.[31] This policy has become more evident as restructuring of companies has become of greater concern to many nations within the EU and is something on which the European Commission (EC) has placed emphasis.[32] The fact is that the existence of avoidance rules are not likely to stop dismemberment as they only apply ex post and parties are likely to grab what they can when a debtor is insolvent or close to insolvency and hope that the liquidator does not seek to avoid the transaction. If they get paid in full or even close to it, creditors might not be overly concerned that payment could contribute to the demise of the debtor unless the continuation of the life of the company is likely to benefit them in some substantial way, such as the fact that the company is a critical customer.

It might argued that there is a third policy, namely that avoidance rules are designed to deter the entry into transactions that could be avoided if a company becomes subject to insolvency proceedings. It is debatable whether this is indeed a policy, given the present state of avoidance rules around the EU and the fact that many parties will take the benefit of such transactions because the company might not enter insolvency proceedings, and even if it does the liquidator who has been appointed might decide not to initiate avoidance actions for reasons such as lack of funding. And even if the liquidator does commence proceedings and succeeds there is no penalty imposed on the party who benefited from the impugned transaction save for having to return the benefit received. Then even if a creditor has to return a benefit that is regarded as a preference he or she is entitled to claim in the insolvent estate for what is owed.

The rules in most national legal systems acknowledge the fact that at the core of avoidance actions is not to obtain compensation but to ensure that creditors in general retain their rights over the property of a debtor who has entered insolvency proceedings.[33] The successful end result of a transaction avoidance action will be the swelling of the corpus of property that is available to the creditors as a whole, and, it is hoped, ultimately, a better payout for creditors.

Other important issues relating to avoidance, and which are considered in this article concern predictability and certainty. Parties need to know the effect of

[30] If this is the case then the outcome is clearly inefficient: F Mucciarelli, 'Not Just Efficiency: Insolvency Law in the EU and Its Political Dimension' (2013) 14 EBOR 175, 179.

[31] L Piñeiro, 'Towards the Reform of the European Insolvency Regulation: codification rather than modification' (2014) 2 Nederland Internationaal Privaatrecht 207, 212.

[32] European Commission, 'Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency' C(2014) 1500 at <http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf>.

[33] *Seagon v Deko Marty Belgium NV* (Case C-339/07) [2009] BCC 347, [26].

entering into transactions and when there will be interference in the normal processes of commerce.

III. AVOIDANCE UNDER THE EUROPEAN INSOLVENCY REGULATION

Article 7 of the recast EIR[34] provides that the *lex concursus*[35] will apply in relation to the affairs of the insolvent once insolvency proceedings have been opened. If a liquidator of an insolvent against whom insolvency proceedings have been opened is minded to attack a pre-liquidation transaction and seeks to avoid it, whether or not he or she can actually do so will be determined, according to Article 7(2)(m) of the EIR, by the law of the Member State where the proceedings were opened. Prima facie, if the law of this State permits the transaction to be avoided the liquidator can apply to the courts for an order of avoidance. But, presently a defendant to an avoidance action could raise Article 16 as a possible defence. This Article provides that:

> Point (m) of Article 7.2 shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that—
> (a) the act is subject to the law of a Member State other than that of the State of the opening of proceedings, and
> (b) the law of that Member State does not allow any means of challenging that act in the relevant case.

Article 16 is one of a number of articles which provide exceptions to the requirement that the law of the place where proceedings were opened applies to determining issues in the insolvency.

The rationale for the inclusion of Article 16 is found in Recital 67 of the recast EIR,[36] namely to protect legitimate expectations and certainty of transactions in other Member States. In particular there is a desire to protect the expectations of creditors or third parties as far as the validity of transactions is concerned from being prejudiced by the rules of a different *lex concursus*,[37] one that was not envisaged when the transactions were entered into. Effectively, Article 16 provides a defence against the application of the avoidance rules in the law of the Member State where insolvency proceedings were opened. The *Report on the Convention of Insolvency Proceedings* referred to the article as acting as a 'veto' against the invalidity of the act decreed by the law of the Member State in which proceedings were opened,[38] and said that it was there to uphold the legitimate expectations of creditors and others concerning the validity of the security.[39]

[34] Art 4 of the EIR that presently applies (until June 2017)
[35] The law of the place where insolvency proceedings have been opened
[36] Recital 24 of the EIR that presently applies (until June 2017)
[37] *Report on the Convention of Insolvency Proceedings* (the Virgos-Schmit Report) para 138.
[38] ibid, para 136.
[39] IF Fletcher, *Insolvency in Private International Law* (2nd edn, OUP 2005) 401.

Article 16 will only operate if two situations exist. First, the transaction being impugned by the liquidator is 'subject to a law' of a Member State other than the State where proceedings were opened and this is usually regarded as a reference to the law that is said to govern the transaction.[40] Second, the law of the place must not permit the transaction to be avoided by 'any means', and this is normally construed as referring to the fact that the defence is only permissible if the act being attacked is not able to be avoided under any part of the insolvency and non-insolvency law of the Member State.[41] The reference to 'relevant case' in the second limb of the article is taken to mean consideration of avoidance given the specific facts that are before the court.[42] As one would expect, the party who seeks to rely on Article 16 as a defence to an avoidance action brought in the Member State where main proceedings were opened has the onus of proving that the article applies.[43]

It was not until 2015 that the first European Court of Justice (CJEU) decisions dealing with avoidance rules were handed down. Whilst they provided some guidance, they did not provide much solace for liquidators considering bringing avoidance actions. The first decision to be decided on Articles 7(2)(m) and 16 was *Lutz v Bauerle*,[44] and it illustrates, perhaps, the potential unfairness and uncertainty of the present state of affairs.[45]

In this case a company registered in Germany sold cars in Austria through a subsidiary registered in Austria. Lutz paid the subsidiary for a car but the car was never delivered. Lutz initiated legal proceedings against the subsidiary in Austria, seeking repayment of the purchase price of the car. On 17 March 2008 the Austrian court heard the proceedings and ordered repayment. On 13 April 2008 the subsidiary sought to open insolvency proceedings. Proceedings were opened on 4 August 2008 in Germany. Previously, on 20 May 2008, the Austrian court had granted leave to Lutz to enforce the payment order and three bank accounts of the subsidiary at an Austrian bank were attached. The bank was notified of the attachment on 23 May 2008. On 17 March 2009 the bank paid Lutz from the subsidiary's accounts. Prior to this, the subsidiary's liquidator had, in a letter of 10 March 2009, notified the bank that he reserved the right to challenge any payment made in favour of the subsidiary's creditors. On 3 June 2009 the liquidator informed Lutz that he was going to challenge the enforcement of Lutz's rights authorized on 20 May 2008 by the Austrian court as well as the payment that had been made to him on 17 March 2009, relying on the earlier equivalent of Article 7(2)(m). On 23 October 2009, a new liquidator instigated proceedings against

[40] J Alexander, 'Avoid the Choice or Choose to Avoid? The European Framework for Choice of Avoidance Law and the Quest to Make it Sensible' (March 2009) <http://ssrn.com/abstract=1410157> 16. [41] ibid 16–17. [42] Virgos-Schmit (n 37) para 137.
[43] *Nike European Operations Netherlands BV v Sportland Oy* C-310/14, [2016] 1 BCLC 297 [25], [31], [38], [42]. [44] C-557/13, [2015] EUECJ, [2015] BCC 413, [30].
[45] The second decision was: *Nike European Operations Netherlands BV v Sportland Oy* C-310/14; [2016] 1 BCLC 297.

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Lutz in Germany. She sought to have the payment of the money to Lutz set aside and to recover the amount paid. At first instance and on appeal the courts found for the liquidator. Lutz then asked the German Federal Court to determine a matter of law in relation to the interpretation of Article 16. German law, the *lex concursus*, provided that the right to attach the credit balance on the subsidiary's bank accounts became invalid on the date when the insolvency proceedings were opened. This was because the attachment was not authorized and put into effect until after the application to open the insolvency proceedings, and so the payment made to Lutz was invalid. But Austrian law provided that a liquidator only has a period of one year, from the date of insolvency proceedings being opened, to commence an action to avoid a transaction. But German law allowed for three years. So, the liquidator had fulfilled the German requirement but she had not complied with the Austrian. So, under Article 7(2)(m) German law would permit the transaction to be avoided. However, Lutz argued in defence that Article 16 applied as Austrian law did not permit the transaction to be avoided on the basis that proceedings to avoid had not been instituted within a year of the opening of insolvency proceedings. The matter was referred to the CJEU (First Chamber). According to the Court, Article 16 makes no distinction between substantive and procedural provisions,[46] and thus it applies to limitation periods or other time-bars relating to actions to set aside transactions pursuant to the law governing a transaction.[47] Thus in this case the Austrian limitation period was applicable and Article 16 prevented the operation of the German avoidance rule.

In the second relevant case, *Nike European Operations Netherlands BV v Sportland Oy*,[48] S, a Finnish company, purchased goods from N, a Dutch company. S paid N €195,000 for the goods by way of a number of payments between 10 February 2009 and 20 May 2009. Subsequently, on 26 May 2009 insolvency proceedings were opened against S in Finland, and thus Finnish law was to apply to the insolvency. Following the opening of insolvency proceedings S brought proceedings, based on the Finnish avoidance rules, against N seeking an order setting aside the payments and recovery of the amounts it had paid to N. The basis for this was that under Finnish law payments of debts within the three months of the opening of insolvency proceedings may be challenged if the payment are made by way of an unusual means, are paid prematurely or are in amounts which, given the debtor's estate, are significant. In defence N relied on Article 16 of the EIR and claimed that payments were governed by Dutch law and this did not require the payments to be avoided. The Dutch law[49] provided that payments of debts may be challenged only if it is proven that when they were received

[46] C-557/13, [2015] EUECJ, [2015] BCC 413, [47], [53].
[47] ibid [49].
[48] *Nike European Operations Netherlands BV v Sportland Oy* C-310/14, [2016] 1 BCLC 297.
[49] Art 47 of the Bankruptcy Act

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the recipient was aware that the application for insolvency proceedings had already commenced or that the payment was agreed between the debtor and the creditor in order to give the latter priority over all of the other creditors of the debtor. At first instance the Finnish court found that the payment was unusual when compared with other payments as it was quite substantial in relation to the assets of S. The Court held that N had not established that, for the purposes of Article 16, the transactions could not be challenged. Nevertheless, a Finnish appellate court deemed it appropriate to refer several questions to the CJEU. Its answers means that Article 16 certainly provides opportunity for a defendant to rely on the law governing the transaction to defend an avoidance claim.

The CJEU made a number of comments that clarified the situation when a party seeks to rely on Article 16. First, the court said that the application of Article 16 requires all of the circumstances of the case to be taken into account.[50] Second, it was up to the defendant to an avoidance action to provide proof that the act impugned by the applicant is not able to be challenged.[51] Thus, a burden is imposed on the defendant to prove 'both the facts from which the conclusion can be drawn that the act is unchallengeable and the absence of any evidence that would militate against that conclusion'.[52] Third, the court has held that while Article 16 indicates where the burden lies as far as showing that an act that is complained of is not able to be challenged, it does not provide for procedural matters, such as how the evidence relied on by the defendant is elicited, what evidence is actually admissible before a domestic court or the principles that govern the domestic court's evaluation of the probative value of the evidence that is adduced.[53] The CJEU then said that if a domestic court's rules of evidence were not sufficiently rigorous, and this led, effectively, to a shifting of the burden of proof to the defendant in an avoidance claim, it would not be regarded as being in line with the principle of effectiveness,[54] for this principle, together with the principle of equivalence, must be taken into account in any case.[55] The principle of effectiveness has been constructed by the CJEU in an effort to ensure that EU law actually takes effect in Member States. It means that domestic private law or civil procedure is not able to be applied in a relationship or might be interpreted differently from what the parties in the relationship expected.[56] The principle of equivalence emanates from the

[50] C-310/14, [2016] 1 BCLC 297, [20]. [51] ibid [25], [31], [38] and [42]. [52] ibid [25].
[53] ibid [27] and [43]. [54] C-310/14, [2016] 1 BCLC 297, [43]. [55] ibid [44].
[56] P Rott, 'The Court of Justice's Principle of Effectiveness and Its Unforeseeable Impact on Private Law Relationships' in D Leczykiewicz and S Weatherill (eds), *The Involvement of EU Law in Private Law Relationships* (Studies of the Oxford Institute of European and Comparative Law, Hart Publishing 2013); K Lenaerts, 'Effective judicial protection in the EU' <http://ec.europa.eu/justice/events/assises-justice-2013/files/interventions/koenlenarts.pdf>. This is a way of upholding the primacy of EU law and restricting the scope of national procedure law: I Lianos, 'The Principle of Effectiveness, Competition Law Remedies and the Limits of Adjudication' (2014) CLES Research Paper No 6/2014 available at <http://ssrn.com/abstract=2542940>.

principle of freedom of establishment in EU law, providing that businesses are to be able to establish themselves in any Member State and should not be the subject of discrimination because of their location. So, a Member State must not make it more difficult for a foreign person or company to exercise rights than for a domestic person or company which makes a similar claim.[57]

The CJEU said that a defendant who relies on Article 16 is entitled to prove that the act impugned by the claimant cannot be challenged 'by any means',[58] and this is to be construed to mean that non-insolvency law provisions are as potentially relevant in making out a defence as are insolvency law provisions.[59]

While the divergence between the Member States in *Lutz v Bauerele* related to a procedural issue, there clearly is divergence among the substantive avoidance rules that exist in Member States of the EU that can lead to the kind of situation occurring in *Lutz* being replicated, as illustrated by *Nike European Operations*.

IV. REFORM OPTIONS

The existence of Article 16 and the way that it has been interpreted has led to concern that avoidance actions are unduly restricted because of the way that the EIR is framed.[60] It has even been suggested that the effect of the article is that transactions will generally escape being set aside unless both the *lex concursus* and the law of the place that would otherwise govern the transaction permit avoidance.[61] A recent EC commissioned report based on an EU-wide study of avoidance rules (as part of a broader study of insolvency law in the EU) has identified problems for cross-border insolvency caused by the divergence in national avoidance laws, and illustrated to a degree in the *Nike European Operations* case, and suggested that a different approach should be considered.[62] There appear to be a number of options to address the present situation, which are sketched below.

First, the EIR could be amended so that the avoidance rules of the *lex concursus* apply exclusively. This appeared to be favoured by the *Report on the Convention of Insolvency Proceedings*[63] on the basis that the main

[57] VAT Directive.com, 'Effectiveness and equivalence' <http://www.vatdirective.com/EU-domestic-VAT-Manual/1-9-effectiveness-and-equivalence>; DJ Rhee, 'The principle of effective protection: reaching those parts other [principles] cannot reach?' BEG/ALBA conference, Athens, 2011, and available at <http://www.adminlaw.co.uk/docs/sc%2012%20Deok%20Joo%20Rhee.pdf>. [58] C-310/14, [2016] 1 BCLC 297, [35]. [59] ibid [39].

[60] See G McCormack, 'Conflicts, avoidance and international insolvency 20 years on: a triple cocktail' (2013) JBL 141, 156–7; A Keay, 'Security rights, the European Insolvency Regulation and Concerns about the Non-application of Avoidance Rules' (2016) 41 ELRev 72.

[61] McCormack ibid, 157.

[62] European Commission, DG Justice and Consumer Affairs, 'Study on a new approach to business failure and insolvency' (n 12) 176–82.

[63] It has also been supported more recently by the Group for International and European Studies at the University of Barcelona: 'Proposals on the reform of the Council Regulation No 1346/2000 of 29 May 2000 on insolvency proceedings', 160 and presented at the *Conference on the Future of The*

proceedings are only able to be opened if the debtor's COMI is in the Member State where proceedings are opened. This option would entail the abolition of Article 16. Such an approach might be attractive as it would make it easier for liquidators to pursue avoidance proceedings since only the *lex concursus* would have to be taken into account, and there would not have to be an interpretation of the laws of other Member States in order to assess whether they do in fact prevent the challenging of pre-insolvency transactions. This approach also retains some certainty, as the insolvency law to be applied under Articles 3 and 7 is determined by the COMI and that is a foreseeable and certain standard. But the adoption of this approach has been criticized because it would mean that conduct regarded as inappropriate under the law of the Member State where the conduct had its effect would not be relevant to the determination.[64]

A second option would be for Article 16 to provide that the avoidance rules of both the place where proceedings were opened and the place where the transaction was effected would apply. This would mean that neither the *lex concursus* nor the *lex causae*[65] could be relied on in order to veto the avoidance action. If that were the case then it would not affect any expectations of the parties regarding the nature of their legal relationship.[66] It would mean that Article 7(2)(m) would become otiose and the *lex causae* alone would determine questions of avoidance.[67] The difficulty with this is that it would potentially result in the application of a great number of different avoidance laws, which would render avoidance a more complicated issue for a liquidator.[68] Nevertheless, this is a problem which liquidators already have to encounter in relation to the EIR as it exists at present (and under the recast), because insolvency proceedings could be opened in any one of the Member States and thus the avoidance rules of any one of these States could be applicable under Article 7(2)(m).

Thirdly, the avoidance rules of the *lex causae* could apply.[69] One of the arguments against the first option also applies to this approach, namely that liquidators would have to deal with a significant number of different avoidance rules. Furthermore, it derogates from the concept introduced by the EIR that the law applicable to insolvency proceedings should be that of the *lex concursus*.

A fourth approach would be to permit avoidance if either the *lex concursus* or the *lex causae* allowed for it. Since this would enable the liquidator to select 'the

European Insolvency Regulation, 28 April 2011, Amsterdam—see <http://www.eir-reform.eu/>; and in S Kolmann, 'Thoughts on the governing [sic] insolvency law' presented at the *Conference on the Future of The European Insolvency Regulation*, 28 April 2011, Amsterdam—see also <http://www.eir-reform.eu/>.

[64] Alexander (n 40) 25.

[65] In private international law, the system of law applicable to the case in dispute. In the context of this article it would be the law that is applicable to the transaction that is under challenge.

[66] P Pfeiffer, 'Article 13 EIR: Avoidance, Avoidability and Voidness' in *External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings*, JUST/2011/JVC/PR/0049/A4, para 6.10.3.

[67] ibid.

[68] ibid.

[69] Piñeiro (n 31) 212.

battlefield',[70] it has its attractions for liquidators, but it does little to enhance predictability.

Fifthly, a rule could be introduced that the avoidance provisions of the law most closely connected to the facts of the claim are to apply.[71] This is flawed in two respects. The first is that it is vague. It would suffer from some of the problems that have arisen in relation to the ascertainment of the COMI in determining where insolvency proceedings under the EIR should be opened. The second concern is that it does not assist certainty as it is difficult to know which law would apply and is particularly onerous for liquidators who would still have to deal with 27 different laws.

A sixth option would be for the EC to issue a Directive requiring all Member States to have certain minimum standards so as to ensure that avoidance regimes reach a certain level. While financial sanctions can be levied by the CJEU if Member States fail to implement directives, we know that in a number of areas directives have not really worked in securing the required goal. Directives might work well in situations where some or many Member States have not developed rules that address a particular matter, but this is not the case with avoidance rules as Member States, for the most part, have enacted substantial rules that address the issues. Rather, the main problem appears to be that there are divergent approaches and this can lead to uncertainty, some confusion and, arguably, has the potential for injustice, particularly to the general body of creditors of insolvents.

A seventh option would be to harmonize the rules on avoidance so that there is one set of rules applying across the EU and contained in a regulation (probably the EIR). The advantages of this approach are discussed shortly. While harmonization could simply involve prescribing either the application of the *lex concursus* (with omission of Article 16) as per the first option, it is likely that the EC would be more interested in the formulation and application of specific rules provided for in the EIR and applying across the EU. This approach involves the convergence of non-uniform national laws on the basis of an agreed international standard.[72]

V. HARMONIZATION

Harmonization is the most common of the many instruments which the EU has available to achieve its aims.[73] It is considered necessary in order to support the common market and facilitation of trade.[74] When the EC Treaty (Treaty of

[70] McCormack (n 60) 146.

[71] ibid.

[72] S Block-Lieb and R Halliday, 'Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law' (2007) 42 TexIntlLJ 475, 494.

[73] V Magnier, 'Harmonization Process for Effective Corporate Governance in the European Union: From a Historical Perspective to Future Prospects' (2014) 41 JLS 95, 105.

[74] L Del Duca, 'Developing Global Transnational Harmonization Procedures for the twenty-First Century: The Accelerating Pace of Common and Civil Law Convergence' (2007) 42 TexIntlLJ 625, 650.

Rome) was drafted, the only area in which harmonization occurred was indirect taxation.[75] When the Convention on Insolvency Proceedings was finalized in 1995 it was clear that there was little immediate prospect of harmonizing national laws of Member States concerning insolvency.[76] When the EIR was embraced in 2000 there was little harmonization in respect of substantive law: harmonization was limited to recognition of proceedings and choice of law rules. At that time the EU consisted of 15 States. With currently 28 States, the task is more difficult still.

Article 3(h) of the EC Treaty provides for harmonization to be one of the mechanisms to be used to attain the aims of the Treaty.[77] Attempts to harmonize civil law in earnest can be traced back to the late 1980s.[78] Harmonization was used in addressing several private law matters in the Single European Act in 1987.[79]Any harmonization could be achieved by the use of a directive, but as mentioned above, it might not be attractive in relation to avoidance rules.

If avoidance rules are to be harmonized, this has to be based on a legal power and the most likely would be Article 81 (1) of the Treaty on the Functioning of the EU (formerly Article 65 of the EC Treaty) which states that:

> The Union shall develop judicial cooperation in civil matters having cross-border implications, based on the principle of mutual recognition of judgments and of decisions in extrajudicial cases. Such cooperation may include the adoption of measures for the approximation of the laws and regulations of the Member States.

Another possibility might be Article 114 of the Treaty on the Functioning of the EU which addresses the approximation of internal market laws. Certainly, an EC Staff Working Document accompanying Commission Recommendation of 12 March 2014 on a New Approach to Business Failure and Insolvency seemed to favour this basis.[80] The word 'approximation' used in both these articles is considered as synonymous with harmonization, and refers to 'the European Union's ability to adopt binding legislative measures setting out common regulatory standards across Member States'.[81] It is seen as involving the harmonization of national legislation to the EU *acquis*

[75] Art 99.

[76] G Moss, IF Fletcher and S Isaacs (eds), *The EC Regulation on Insolvency Proceedings: A commentary and Annotated Guide* (2nd edn, OUP 2009) 12.

[77] P Slot, 'Harmonization' (1996) 21 ELRev 378, 378.

[78] H Schulte-Nolke, 'Arbeiten an einem Europaischen Privatrecht – Fakten und populare Irrtumer' (2009) 62 Neue Juristische Wochenschrift 2162 at 2162 and referred to in B Zeller, 'Anatomy of EU contract harmonization: where do we stand?' (2015) 21 International Trade Law and Regulation 41, 41.

[79] W Van Geren, 'Harmonization of Private Law: Do We Need It?' (2004) 41 CMLRev 505, 505.

[80] SWD(2014) 61 final, at 24, <http://ec.europa.eu/justice/civil/files/swd_2014_61_en.pdf>.

[81] M Dougan, 'Approximation of Laws in the EU' in P Cane and J Conaghan (eds), *The New Oxford Companion to Law* (OUP 2008) 42.

communautaire.[82] Wessels has submitted that approximation in civil matters having cross-border implications does include forms of harmonization on matters of insolvency law.[83] Also, and perhaps more importantly, paragraph 2(f) of Article 81 of the Treaty on the Functioning of the EU empowers the European Parliament and the Council to adopt measures to ensure the 'elimination of obstacles to the proper functioning of civil proceedings, if necessary by promoting the compatibility of the rule on civil procedure applicable in the Member States'.[84]

It has been asserted that avoidance rules should be consistent with the aims of insolvency law.[85] Those aims arguably have not been articulated in any official report from the EU, although there have been indications from commentators what the aims are, as discussed earlier in the article. It would seem that in devising avoidance rules there must be a balance between ensuring that the regime complies with the scheme of distribution that applies in insolvency and ensuring that there is not an unreasonable derogation from contractual certainty.[86]

Harmonization refers to efforts to change the laws of two or more countries to be more substantively similar to each other.[87] The United Nations Committee on International Trade Law (UNCITRAL) has defined harmonization as: 'the process through which domestic laws may be modified to enhance predictability in cross-border commercial transactions'.[88] In the EU context harmonization has been seen as an instrument that is complementary to the general articles in the Treaty of Rome when free movement of capital, goods, person and services has not been achieved.[89] Harmonization should be employed to realize market integration.[90] Only the harmonization of laws is seen as being able to solve legal uncertainty resulting from legal diversity.[91]

[82] Europeanprofiles SA, 'EU Legal Approximation' <http://www.europeanprofiles.gr/index.php?option=com_content&view=article&id=57&Itemid=65&lang=en>. [83] Wessels (n 11).

[84] Accessible at: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A12008E>. It might be argued that harmonization of avoidance rules might not be able to be seen as promoting rules on civil procedure.

[85] R Parry, 'The Rationale of the Transaction Avoidance Provisions of the Insolvency Act 1986' in R Parry, J Ayliffe and S Shivji (eds), *Transaction Avoidance in Insolvencies* (2nd edn, OUP 2011) 15 and referring to T Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 StanLRev 725, 726.

[86] Parry, ibid and referring to World Bank, Principles for Effective Creditor Rights Systems, 2005, c11.3; L Ponoroff, 'Evil Intention and Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time' [1993] WisLRev 1439, 1444–5.

[87] Draft Common Frame of Reference Outline Edition 2009, Annex (Definitions) 555 and referred to in American Law Institute and the International Insolvency Institute, 'Transnational Insolvency : Global Principles for Co-operation in International Insolvency Cases' (American Law Institute 2012) n 209.

[88] FAQ – Origin, Mandate and Composition of UNCITRAL and quoted in in Block-Lieb and Halliday (n 72) 493. [89] Slot (n 77) 379. [90] ibid 382.

[91] M Haentjens, 'Harmonisation of Securities Law: custody and transfer of securities in European private law' (2007) unpublished PhD thesis submitted to the University of Amsterdam, 240.

There are different forms of harmonization. It is beyond the scope of this article to discuss these in any depth, but it is pertinent to explain them briefly to see which, if any, might be appropriate for the harmonization of avoidance rules.

Minimum harmonization involves the EC setting minimum rules, a 'floor of rights',[92] and Member States may individually or jointly establish more strict or demanding rules or standards.[93] The use of minimum harmonization is a consequence of the tensions that exist in the EC's economic and political evolution,[94] and has been widely used.[95] Alternative harmonization involves the provision in directives of alternative methods of harmonization to attain goals, allowing Member States to choose which alternative to adopt.[96] Optional harmonization occurs if a directive permits a person to either follow harmonized rules or national rules.[97] Partial harmonization exists where harmonized rules only govern cross-border transactions,[98] thus in the current context there would be one set of rules for insolvency covered by the EIR and dealing with cross-border insolvencies and another set for what are totally domestic insolvencies.

The last kind of harmonization is total harmonization (variously called exhaustive, hard, maximum or strong harmonization), meaning that the harmonized rules must be adhered to, unless safeguard measures are needed.[99] This approach was favoured in the early years of the EC's harmonization programme[100] but it later tended to be less favoured by Member States as it is did not permit them sufficient flexibility and sufficient power to determine the law at a national level.[101]

If harmonization is to occur then it is going 'to lead to the transparency of the execution of the procedure, to greater trust of the parties involved and also, for the parties involved, better understanding of the available means and methods with a view to satisfy the needs of commercial entities that are in a difficult situation'.[102] Harmonization would provide for greater transparency so that all parties are able to know what will happen on the insolvency of a debtor.[103]

A. What Might the European Commission Do?

Recital 11 to the presently drafted EIR acknowledged that because of the widely differing substantive laws it was not practical to introduce insolvency laws for the entire European Community. The recast EIR repeats this sentiment in its Recital 22. While there is clear apprehension about drafting a harmonized

[92] Dougan (n 81) 42.

[93] Slot (n 77) 384; F De Cecco, 'Room to Move? Minimum Harmonization and Fundamental Rights' (2006) 43 CMLR 9, 9. Also see P Rott, 'Minimum Harmonization for the Completion of the Internal Market? The Example of Consumer Sales Law' (2003) 40 CMLRev 1107.

[94] M Dougan, 'Minimum Harmonization and the Internal Market' (2000) 37 CMLRev 853, 856.

[95] Slot (n 77) 384. [96] ibid 386. [97] ibid 383. [98] ibid 384. [99] ibid 382. [100] ibid 383.

[101] A Mattera, *Le Marche unique Europeen* (Jupiter 1990) and referred to by Slot (n 77) 383.

[102] L Iancu, 'Projects of Harmonization of the Laws on Insolvency' <http://fse.tibiscus.ro/anale/Lucrari2012_2/AnaleFSE_2012_2_091.pdf>.

[103] Wessels (n 11) 30.

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insolvency law there are indications, as indicated below, that the EU is interested in harmonizing some aspects of insolvency law so as to help fulfil certain of its critical aims. Total harmonization in the context of the avoidance rules would involve the EU composing a set of avoidance rules that would apply across the EU (except, presumably, in Denmark). This would have the clear advantage of producing greater certainty (especially for liquidators) and would contribute to the prevention of forum shopping. It would also induce a feeling of fairness in that one rule would apply to all insolvencies no matter: where assets were located, the law that was said to govern the transaction, and where the insolvency proceedings were opened. And, as discussed below, the idea of having harmonized laws appears not to be unrealistic in today's climate.

The EIR was introduced to ensure there is greater cooperation and recognition of insolvency proceedings and not to harmonize the substantive insolvency rules that apply across the EU. However, in the past five years there have been moves to consider the possible introduction of at least some harmonization.[104] In 2010, following a request from the European Parliament, INSOL Europe[105] prepared a report which examined the need for and the feasibility of the harmonization of European insolvency law. The report concluded that several topics were apt for harmonization and that harmonization in relation to these topics was desirable and achievable.[106]

Whilst the report did not endeavour to provide any possible harmonized rules applicable to avoidance, it did consider the issue of avoidance actions was one of the most appropriate matters for harmonization.[107] However, this is not the view of several other bodies, such as the UK's Insolvency Lawyers' Association.[108] In its response to the EC's consultation on revision of the EIR,[109] the Association, as well as some individual commentators,[110] questioned whether harmonization was a good option. Nevertheless, the publication of the INSOL Europe report, 'Harmonization of Insolvency Law at EU Level', led one commentator to proclaim that 'Insolvency Law has finally become a field of law for which harmonization at a European level is considered both important and feasible.'[111]

[104] Interestingly, UNCITRAL had proposed harmonization of the law of secured credit: 'Draft legislative guide on secured transactions – Report of the Secretary-General' A/CN 9/WG viwp 2 (2002) para 2 and referred to by G McCormack, *Secured Credit and the Harmonisation of Law* (Edward Elgar 2011) 56.

[105] The European Association of Insolvency Practitioners and Scholars.

[106] INSOL Europe, 'Harmonization of Insolvency Law at EU Level' PE 419.633 (April 2010) <http://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/empl_study_insolvencyproceedings_/empl_study_insolvencyproceedings_en.pdf> 20.

[107] ibid 27.

[108] <www.ilauk.org/docs/ila/ila_response_insolvency_regulation_copy.pdf>.

[109] *Consultation on the future of European Insolvency Law* <http://ec.europa.eu/justice/newsroom/files/insolvency_en.pdf>.

[110] For example, A Cohen and G Ruiz, 'Living in perfect harmony? A new European approach to business failure and insolvency' (2013) CRI 151, 151.

[111] RJ de Weijs, 'Harmonization of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool & Anticommons' (19 October 2011) <http://ssrn.com/abstract=1950100> 1.

Following the INSOL Europe report, the European Parliament suggested partial harmonization, focusing on specific types of acts that are detrimental to creditors. It said that even if the creation of a body of substantive insolvency law at EU level is not possible, there are certain areas of insolvency law where harmonization is worthwhile and achievable.[112] The Parliament stated in a resolution of 15 November 2011 that the lack of harmonization inhibits predictability of the results of court proceedings.[113] It resolved that there be harmonization of aspects of avoidance actions and it stated the following:

- the laws of the Member States provide for the possibility of challenging acts done before the opening of the proceedings which are detrimental to the creditors;
- acts that can be the object of an avoidance action are transactions in a situation of imminent insolvency, the creation of security rights, transactions with connected parties and transactions carried out with the intention of defrauding creditors;
- the periods during which an act can be challenged by an avoidance action vary according to the nature of the act at issue; the periods start with the date of the request for the opening of proceedings; the periods could be between three and nine months for transactions carried out in a situation of imminent insolvency, between six and twelve months for the creation of security rights, between one and two years for transactions with connected parties, and between three and five years for transactions carried out with the intention of defrauding creditors;
- the onus of proof to show whether or not an act can be challenged lies in principle with the party who claims that the act can be challenged; for transactions with connected parties, the onus of proof lies with the connected person.[114]

While the harmonizing of avoidance rules and other aspects of insolvency law that INSOL Europe identified as constituting possible areas for harmonization has not occurred there has been some support for the harmonization of insolvency laws generally. The aforementioned European Parliament Resolution of 15 November 2011[115] included recommendations for harmonizing specific aspects of national insolvency law, including the

[112] European Parliament resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)) at recital C, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0484+0+DOC+XML+V0//EN>. [113] ibid recitals A and B.

[114] Annex to European Parliament resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)), para 1.3 and available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0484+0+DOC+XML+V0//EN>. [115] At 3.

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conditions for the establishment, effects and content of restructuring plans. Then the EC Recommendation of 12 March 2014,[116] titled 'on a new approach to business failure and insolvency' referred, in Recital 6, to the European Parliament Resolution and, in Recital 11 said that:

> It is necessary to encourage greater coherence between the national insolvency frameworks in order to reduce divergences and inefficiencies which hamper the early restructuring of viable companies in financial difficulties and the possibility of a second chance for honest entrepreneurs, and thereby to lower the cost of restructuring for both debtors and creditors.

So there does appear to be an appetite in the EC for some degree of the harmonization of insolvency laws, in line with the fact that European integration has generated more cross-border harmonization.[117] Also, the recent EC commissioned report on substantive insolvency law in the EU indicated that harmonization was a distinct possibility for avoidance rules.[118]

If harmonized rules are to be introduced will they only apply to insolvencies that are covered by the EIR, that is, cross-border insolvencies, with Member States retaining their own avoidance rules for domestic insolvencies? If so that would mean that liquidators would have to be conversant with at least two sets of rules, the rules prescribed by the EC and the national rules in the Member State in which they practise. Also, if this occurred, it causes one to wonder if there would there be any claims that creditors in domestic insolvencies were being discriminated against as they are subject to different rules from creditors in the same Member State who might have claims in an insolvency that is subject to the EIR. Because of these concerns it is possible that the EC would seek to formulate a set of avoidance rules that would apply across the EU in all situations, whether or not there was a cross-border element or not. Such an approach would bring certainty to a difficult area of insolvency law.

The difficulty is that any total harmonization that is attempted will need to balance the conflicting matters of predictability, perceived fairness and maximization of asset recovery.[119]

B. Advantages of Total Harmonization

Concern over the way that the EIR presently operates and the not insubstantial criticism of Article 16 might well be said to justify the total harmonization of avoidance laws. The difficulty is in drafting rules that will work, that are

[116] C(2014) 1500 final and available at <http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf>.

[117] H Wagner, 'Is harmonization of legal rules an appropriate target? Lessons from the global financial crisis' (2012) 33 EJLE 541, 541.

[118] European Commission, DG Justice and Consumer Affairs, 'Study on a new approach to business failure and insolvency' (n 12).

[119] McCormack (n 60) 143.

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generally agreed to, and are fair and reasonable. It is difficult to see anything short of total harmonization either making a big difference to the present situation or being practicable. But leaving that aside, what advantages are there in total harmonization?

In his report for UNCITRAL in relation to the harmonization of international trade law, Clive Schmitthof said that harmonization would reduce conflicts and divergences,[120] and arguably a harmonized avoidance law would also do this for insolvency law. Total harmonization has the advantage of uniformity and consistency. It has been said that the tests on avoidance remain burdensome and not completely predictable 'and it is arguable that some kind of harmonization of the avoidance remedies, at least in the context of business insolvency, might be advantageous to further integration and development of the European common market'.[121] Creditors might be more ready to extend loans and give credit to companies if they know which law will apply if the company was to become subject to insolvency proceedings. Harmonization could lower costs and increase trade because of greater certainty. The Commission Communication of December 2012 to the European Parliament on a new European approach to business failure and insolvency[122] highlighted certain areas where differences between domestic insolvency laws may hamper the establishment of an efficient internal market. Those differences affect the principle of free movement, in particular free movement of capital, competitiveness, and overall economic stability. The INSOL Europe study commissioned by the EP had shown that disparities between national insolvency laws can create obstacles, competitive advantages and/or disadvantages and difficulties for companies with cross-border activities or ownership within the EU.[123]

Perhaps a major benefit of total harmonization is that it fosters equality in that the same rules of avoidance will apply to all insolvencies that occur in the EU. Thus, like cases will be treated in the same manner no matter where the proceedings were opened or what is said to be the law of the contract that led to the voidable transaction. This should provide uniform benefits to creditors across the EU.

One of the primary quibbles of liquidators with the existing law is that it is uncertain what law will apply and this complicates the winding up of the affairs of insolvents. Harmonization provides liquidators and creditors with certainty concerning when and how rules are applied to specific situations. It could well reduce the possibility of lenders dodging the effect of any avoidance rules applied by the *lex concursus* and might well foster the more equal treatment

[120] The Secretary-General, 'Report of the Secretary-General' delivered to the General Assembly, UN doc A/6396 & Add.1 and Add.2 (23 September 1966) at para 8 and referred to in Block-Lieb and Halliday (n 70) 493.

[121] Alexander (n 40) 38.

[122] COM(2012) 742 final and accessible at <http://ec.europa.eu/justice/civil/files/insolvency-comm_en.pdf>.

[123] INSOL Europe, 'Harmonization of Insolvency Law at EU Level' PE 419.633.

of creditors and generally provide for a level playing field. The creation of a level playing field of national insolvency laws should lead to greater confidence of companies, entrepreneurs and private individuals operating in the internal market.[124] It has been asserted that total harmonization is the instrument best able to achieve the internal market.[125]

A harmonized avoidance regime could have specific efficiency benefits. It might well provide a remedy against negative externalities produced by the provisions in the national legislation of Member States.[126] That is, harmonization would ensure that the interests of creditors were not prejudiced by the operation of national provisions that failed to permit, or only allow limited, avoidance in certain situations. In addition it has been said that harmonizing processes can help increase the efficiency of insolvency proceedings and ensure that they are dealt with in a more timely fashion.[127] Parties to impugned transactions might be less ready to fight proceedings to avoid when they know that they are unable to point to other rules which would defeat the application of avoidance provisions. The provision of harmonized rules could reduce transaction costs because liquidators would only need to be familiar with one set of avoidance rules. To a degree, it might mean that liquidators do not need to seek as much legal advice as in the past. Also law firms that advise on insolvency matters would not need to become conversant with more than one series of rules. Harmonization is able to reduce legal risk and as a consequence it enhances the stability and efficiency of the financial markets as a whole.[128]

Having the same avoidance rules might deter transactions that might be challenged on an insolvency under those rules as it will be known to all parties which rules would apply if the liquidator took proceedings to avoid.

Finally, harmonized avoidance rules might deter a person or company from moving his, her or its COMI as the same law would apply across the EU. A debtor might seek to change the COMI because a transaction that might come under the scrutiny of a liquidator benefits a person connected with the debtor, such as the spouse of an individual debtor or the relative of a director of a corporate debtor.

As with any harmonization project, there might well be some teething problems before a degree of uniformity in approach and practice across the EU is achieved. There will undoubtedly be an important role to be played by the CJEU, just as it has played a critical part in assisting the smoother

[124] COM(2012) 742 final at 3 and accessible at <http://ec.europa.eu/justice/civil/files/insolvency-comm_en.pdf>.

[125] H Micklitz, 'The Targeted Full Harmonization Approach: Looking Behind the Curtain' in G Howells and R Schultze (eds), *Modernising and Harmonizing Modern Consumer Contract Law* (Sellier European Law Publishers 2009) 51–2.

[126] Mucciarelli (n 30) 197.

[127] South Square/Grant Thornton, *From discord to harmony: the future of cross-border insolvency* (2015) 12, <http://www.southsquare.com/files/SouthSquare_GT_Report_From_discord_to_harmony.pdf>.

[128] Haentjens (n 91) 235.

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operation of the EIR, as the ultimate authority determining how the rules are to be interpreted and applied, and thus contributing to European integration.[129]

C. The Possible Drawbacks of Harmonization

Providing for total harmonization of the avoidance rules is a bold move and while there are arguments in favour of harmonization of avoidance rules there are patent potential problems. First, while many national legal systems of Member States cover some similar types of pre-insolvency transactions, there is significant divergence between the current avoidance provisions. While there are some similarities, no two avoidance regimes are identical. Most have several provisions dealing with avoidance as well as providing for differently structured avoidance regimes reflecting the large number of transactions susceptible to avoidance proceedings. A harmonized rule would be unlikely to reflect all aspects of the existing rules. So what would stay and what would go? Drafting harmonized rules is difficult since there is often controversy within Member States concerning their own avoidance rules. Furthermore, most States classify prejudicial transactions in different categories, which can cause difficulties,[130] as the categories employed will differ from country to country. The granting of security by an insolvent debtor to a creditor in relation to a pre-existing debt, which is a focus of the avoidance rules of many States, is a particular problem.[131]

Second, there are significant differences between States in how to address particular problems. For instance, there is significant divergence in Member States in relation to whether a rule imposes a subjective or an objective test in determining whether a transaction should be avoided or not.[132] Even where Member States apply the same kind of test, the content of the test differs or it is imposed on different people. Take for instance a comparison of German and English law concerning preferences. A preference, in general terms, involves the insolvent granting of some benefit to their creditor before the opening of insolvency proceedings, thus advantaging that creditor over others. Both German and English law include subjective tests but whilst German law provides[133] that, when determining whether or not a preference can be avoided, one has to consider the intention of the creditor/beneficiary of the preferential transfer, in England and Wales it is the insolvent debtor's intention that is critical.[134]

Third, in deciding upon the content of harmonized rules, there will need to be a common understanding concerning the goals of these rules and therefore there

[129] Del Duca (n 74) 647.
[130] See RJ de Weijs, 'Towards an objective European Rule on Transaction Avoidance in Insolvencies' (2011) 20 International Insolvency Review 219, 220–1.
[131] ibid n 7.
[132] Piñeiro (n 31) 212.
[133] Section 132 of the German Insolvency Code (Insolvenzordnung).
[134] Section 239(5) of the Insolvency Act 1986. But not in Scotland. The issue of desire is not so relevant in England and Wales where the creditor who received the benefit is a connected person.

is likely to be a need for some form of European debate on bankruptcy theory.[135] This could be lively.

Fourth, there are widely differing laws on security interests within the EU, both as regards the types of security that can be taken and when security interests can be avoided in an insolvency. Naturally, it would be necessary to determine what forms of security can be set aside and the conditions under which there is to be avoidance. The difficulty in harmonizing avoidance provisions in relation to security, and other issues such as preferential transfers, is that a large number of conditions usually are attached to them. But, of course, the significant variety of conditions that are applied in different Member States could itself be seen as a reason for their harmonization.

Fifth, creditors might protect themselves further either through the inclusion of (more) restrictive covenants in credit contracts or increasing the cost of credit by raising interest rates and costs associated with the granting of loans.

Sixth, total harmonization prevents national governments enacting fresh avoidance rules to deal with particular concerns or abuses, or amending any that are currently in place in order to address perceived problems. Thus, the harmonized approach might damage local interests which can be best catered for by domestic legislation.[136]

Seventh, the search for consensus in any negotiations is likely, according to one commentator, to benefit those powerful interest groups able to exert influence at the highest EU levels.[137]

Eighth, it is more difficult to amend rules if they are made at the EU level than at national level, so if certain rules appear to be functioning poorly or are not drafted effectively it could be some time before the problems can be remedied.

Ninth, it might be argued a harmonized law to avoid transactions produces a 'one size fits all' approach that is not appropriate for all national situations. In addition, the purpose of avoidance rules is to redistribute the insolvent's property according to statutory priorities and these will differ between jurisdictions.[138] It is true that there are differences between Member States concerning priority rules, although they are not generally that diverse. The main difference tends to be between those States like Germany and the UK which do not give priority to tax authorities and those, such as Spain and Italy that do.

It has been said that harmonization or unification of the law in the area of determining priority among creditors is extremely unlikely to happen.[139] This is not a compelling reason for refraining from harmonizing. The rules on priorities are far closer to matters of national policy than are the avoidance rules. The essential reasons for having avoidance rules were discussed earlier

[135] de Weijs (n 111) 1. [136] Mucciarelli (n 30) 198. [137] ibid.

[138] J Westbrook, 'Avoidance of Pre-Bankruptcy Transactions in Multinational Bankruptcy Cases' (2007) 42 TexIntlLJ 899, 903.

[139] J Garrido, 'Two Snowflakes the Same: The Distributional Question in International Bankruptcies' (2011) 46 TexIntlLJ 459, 460.

and they are generally seen across the EU as beneficial. What individual Member States do concerning prioritizing the payment of creditors might affect several areas of insolvency law but that does not really affect the avoidance rules. The only way that priority issues come into play is on distribution of recoveries. It is unlikely that a State will include a particular rule to ensure that its priority system benefits. Clearly those with priority debts will benefit as they will be paid first out of any recovery obtained by a liquidator, but that is not a reason for declining to harmonize. Successful use of avoidance rules will generally produce a greater amount of property available for distribution to creditors. There is going to be divergence across Member States concerning the likely beneficiaries. This might attract some criticism from those who believe that domestic laws should deal with domestic insolvencies because they take into account the specific needs of the local jurisdiction as well as its history, culture and politics,[140] but avoidance rules, may not really impinge on such matters as history or culture and, if there are agreed rationales for avoidance rules, this should not be an issue.

Tenth, when there is total harmonization of substantive, as opposed to procedural, rules there is more room for divergence of opinion and that could lead to uncertainty, as courts in different States take different approaches in interpreting and applying them. This occurred in the early days of the EIR, but the situation is now more balanced. As in some other areas concerning insolvency, such as the nature and application of the concept of the COMI, the CJEU may have a decisive role to play here.

Eleventh, there will be an initial start-up cost associated with the process of holding consultation meetings, studying the kinds of rules that already exist and analysing their appropriateness and effectiveness, and then with the demanding task of formulating harmonized avoidance rules. Though costly, this is a one-off cost and could lead, arguably, to dynamic and, overall, efficient change. Certainly the task is not easy, but there are commonalities in existing avoidance rules and approaches across Member States that can provide a fair foundation.

Twelfth, several different kinds of formal insolvency regimes apply across Member States. The predominant ones are liquidation/bankruptcy regimes and restructuring/ reorganization regimes. The concern is that the nature and effect of liquidation or restructuring regimes do differ. Given these differences, there might be opposition to having standard avoidance rules applicable to all forms of insolvency regimes. If, however, avoidance rules did not apply across the board, this could produce some uncertainty. Perhaps harmonized avoidance rules might only apply to liquidation/bankruptcy. But if that were the case what avoidance rules, if any, would apply to other

[140] D Mindel and S Harris, 'The pursuit of harmony can easily lead to discord – why local insolvency laws are best developed locally' Ernst and Young, April 2015, 1.

regimes? Some Member States might not have avoidance rules for some regimes, such as restructuring regimes, whilst others might.

Finally, it is likely that there would be some divergence in interpretation of any harmonized rules. This might be a result of the way that the rules are translated. In a recent decision of the CJEU[141] the Court noted that the Finnish version of Article 16 was different from the versions in other language versions and this had led to divergence.

Could the harmonization of avoidance rules be regarded as taking a piecemeal approach to insolvency? Certainly, it would involve a partial measure as far as insolvency as a field of law is concerned. But one has to start somewhere and the best that can be hoped for is gradual steps with partial measures, unless one were to harmonize all of insolvency, which is probably a step too far at the moment. Is there a danger in a partial step? Would it produce inconsistency, lack of coherence and uncertainty in the administering of insolvent estates? Arguably not, in the sense that, with total harmonization, the same rules would apply across the EU. If there was total harmonization then there would be greater certainty to the point where secured creditors, other creditors and others entering into transactions with debtors, and their advisers would know what avoidance rules would apply if the debtor entered insolvency proceedings. The same rules would apply no matter what the debtor's COMI is at the inception of any insolvency proceedings.

Would total harmonization work? Veronique Magnier opined that establishing detailed substantial rules applying to all Member States in relation to corporate law was not theoretically possible and was not practicable.[142] This conclusion might be drawn if the proposal was to harmonize all of insolvency law, but the issue currently under consideration, whilst important, is only one aspect of it.

What about the traditional points against harmonization?[143] First, that uniform rules are unstable and inefficient. This certainly might be a fair concern, but on the positive side uniform rules produce greater certainty. Second, there is always a cost to enforcing the rules, and a need for willingness to do so. The cost and willingness is likely to differ across the EU. Third, uniform rules might be weak. The danger is that the rules will embody the lowest common denominator and will not be thought to be fair in States currently taking a more rigorous approach. Harmonization may unsettle the domestic balancing of interests that has already taken place.[144]

[141] *Nike European Operations Netherlands BV v Sportland Oy* C-310/14; [2016] 1 BCLC 297, [17].

[142] Magnier (n 73) 107.

[143] See H Wagner, 'Is harmonization of legal rules an appropriate target? Lessons from the global financial crisis' (2012) 33 EJLE 541, 549–53.

[144] S Levmore, 'Harmonization, Preferences, and the Calculus of Consent in Commercial and Other Law' (2013) 50 CMLRev 243, 250.

VI. CONCLUSION

Insolvency law plays an important role within the financial system of any jurisdiction and what happens in one jurisdiction in the EU might well have an effect on others. The EIR has played an important part in the efficient resolution of the affairs of insolvents and this article has considered whether a significant aspect of insolvency law and practice, the avoidance of pre-insolvency transactions, should be harmonized. Avoidance rules are designed to ensure a fair distribution of the assets of insolvents among their creditors. There have been recommendations in the recent past that the avoidance rules should be harmonized and for some time there has been concern that the operation of the avoidance rules of the Member State where insolvency proceedings are opened can be thwarted by the operation of Article 16 of the EIR.

This article has considered the options that exist to address the problem with the present situation. It has focused on one of these options, namely the harmonization of avoidance rules and it has examined the various types of harmonization that are available. It has analysed the benefits and drawbacks in introducing a total harmonization scheme whereby the EU prescribes the avoidance rules in regulations and requires these to apply across the EU. There are clearly both merits and potential demerits of this approach. But overall, while there are not insignificant problems associated with total harmonization and undoubtedly there would be difficult technical and policy issues related to the introduction of an avoidance scheme, the advantages appear to outweigh the disadvantages. In particular, the advent of a harmonized scheme is likely to establish much greater certainty in an area where it has been lacking. All in all, the drafting of a coherent set of avoidance rules that will apply across the EU should be seen as highly beneficial.