European Insolvency Law: Sleeping Beauty Has Woken Up

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13

Once upon a time … insolvency was rare: "…After all our complaints of the frequency of bankruptcies, the unhappy men who fall into this misfortune make but a very small part of the whole number engaged in trade, and all other sorts of business; not much more perhaps than one in a thousand. Bankruptcy is perhaps the greatest and most humiliating calamity which can befall an innocent man. The greater part of men, therefore, are sufficiently careful to avoid it. Some, indeed, do not avoid it; as some do not avoid the gallows". These are the words of Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations (1779; par. II.3.29). In those days regulation of insolvency was rare too and sometimes contained criminal sanctions. Only a few bilateral treaties (within what now is the Netherlands and in Italy) existed. Nowadays, the number of one in a thousand has become obsolete. During the calendar year 2003 the total of bankruptcies filed in the USA resulted in over 1.6 million, most of these non-business (personal) filings. Business filings then were around 35,000. In Western Europe in 2002 in the (then) fifteen Member States these filings were around a quarter of a million; around 150,000 businesses went into bankruptcy. Sanctions today are not of a criminal nature. Legislation in general contains mechanisms for the orderly treatment of claims and liquidation of the assets of the company and the company itself. In Europe furthermore, from the 80s of the last century, mechanisms to rescue businesses form a part of many Member States' legislation. In the USA the Chapter 11 proceeding – in European eyes – has become a strategic business device, sheltering e.g. local airlines from the inevitable. After the downgrading at the beginning of May of General Motors and Ford to junk status, affecting a record high $450 billion in debt, this week's The Economist's predicts that companies like these only can seek refuge in Chapter 11 bankruptcy if their burden becomes too great.

The numbers have gone up. Insolvency may form part of the strategy of a business. The volume of legislation with regard to international insolvency law has grown tremendously. For European insolvency law the 21st century got off to a merry start. In 2000 the EU Insolvency Regulation No. 1346/2000 was born, which entered into force on 31 May 2002. For several financial institutions, falling outside the scope of the Regulation, 2001 produced Directive 2001/17 and Directive 2001/24 on the reorganization and winding-up of insurance undertakings and of credit institutions. Where a Regulation is a European Community law measure binding fully the EU Member States (except for Denmark), both Directives have to go through a legislative implementation process in each individual EEA (European Economic Area) Member State. The implementation date for Directive 2001/24 is 20 April 2003 and for Directive 2001/24 it is 5 May 2004 and the drafting process in all countries is nearing its final phase.

The Regulation is not limited to Europe though. With a focus on harmonization and basically containing "soft law", drafters of insolvency legislation may be strongly assisted by a tool provided by the United Nations Commission on International Trade Law (UNCITRAL). UNCITRAL, sometimes known as the commercial arm of the UN, has in several legal fields contributed to the harmonization of international commercial law, e.g. the Vienna Convention on International Sales of Goods (CISG) of 1980 and the Model Law on International Commercial Arbitration of 1985. A Model Law may be viewed as a (strong) recommendation to individual States to incorporate the literary text of the Model into national legislation. In 1997 the UNCITRAL Model Law on Cross-Border Insolvency was approved. It sets a world standard for national legislative provisions with regard to international insolvency, which Model was quite closely followed in drafting a new Chapter 15 to the US Bankruptcy Code. The Model Law has been followed in countries like Mexico, Japan, South Africa, Spain and Rumania. Other countries have followed their own approach to provide for rules on international insolvency law, e.g. Germany in 2003 and Belgium in 2004. In April 2005 in the USA Chapter 15, as a part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (S 256) was passed by the House and was signed by President Bush. It will enter into force on 17 October 2005. The introduction of legislation based on said Model Law is to be expected in the UK in 2006.

The legal community has witnessed an explosion of regulations and legislation with regard to international insolvency. In the USA this year the regulation of cross-border insolvency cases evolves into a chapter containing 32 articles of provisions. In Europe rules with regard to cross-border insolvency came into effect three years ago. The Insolvency Regulation is being tested in courts, it may bring improvements, and European insolvency law and European company law should better align. That is what this issue of ECL is about.

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