COMPARATIVE ANALYSIS OF GROUNDS FOR THE COMMENCEMENT OF INSOLVENCY PROCEEDINGS

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Otenko P. V. Comparative Analysis of Grounds for the Commencement of Insolvency Proceedings

This article is called comparative analysis of grounds for the commencement of Insolvency Proceedings. The problematic issue that was raised is the following one – is it necessary to harmonize grounds for the commencement of insolvency proceedings within the EU? Author outlines and examines two basic grounds for the commencement of insolvency proceedings: cash-flow and balance sheet insolvency tests, their interpretation and application under English, German and Lithuanian laws. Comparative analysis of these laws has showed that each country specifies and understands concepts of cash-flow and balance sheet insolvencies in the different manners, applying different indicators for their determination. Taking into account gained results, it is desirable and advisable to harmonize grounds for the commencement of insolvency proceedings within the EU in order to facilitate economic and investment climates in its Member States.

Keywords: *insolvency; European Union; insolvency proceedings; cash-flow insolvency; balance sheet insolvency; harmonization.*

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Отенко П. В. Порівняльний аналіз підстав для порушення провадження у справі про неплатоспроможність

Наведено результати аналізу умов для ініціювання процедур неспроможності. Ключовою ідеєю виступає обґрунтування необхідності для гармонізації підстав щодо ініціювання процедур неспроможності. Висвітлено дві основні підстави для ініціювання процедур неспроможності: готівковий та балансовий тести, як вони інтерпретуються та застосовуються в англійському, німецькому та литовському правових порядках. Порівняльний аналіз цих правопорядків показав, що кожна країна визначає та розуміє концепції готівкового та балансового тесту по-різному, застосовуючи різні індикатори для їх визначення. Беручи до уваги отриманий результат, гармонізація усередині ЄС підстав для ініціювання процедур неспроможності є бажаною, для того щоб покращити економічний та інвестиційний клімат у державах-членах ЄС.

Ключові слова: *неспроможність, Європейський Союз, процедури неспроможності, готівкова неспроможність, балансова неспроможність, гармонізація.*

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Отенко П. В. Сравнительный анализ оснований для возбуждения производства по делу о неплатежеспособности

Приведены результаты анализа условий для инициирования процедур несостоятельности. Ключевой идеей выступает обоснование необходимости для гармонизации оснований относительно инициирования процедур несостоятельности. Освещены два основных положения для инициирования процедур несостоятельности: наличный и балансовой тесты, как они интерпретируются и применяются в английском, немецком и литовском правовых порядках. Сравнительный анализ этих правопорядков показал, что каждая страна определяет и понимает концепции наличного и балансового теста по-разному, применяя различные индикаторы для их определения. Принимая во внимание полученный результат, гармонизация внутри ЕС оснований для инициирования процедур несостоятельности является желанной, для того чтобы улучшить экономический и инвестиционный климат в государствах-членах ЕС.

Ключевые слова: *несостоятельность, Европейский Союз, процедуры несостоятельности, наличная несостоятельность, балансовая несостоятельность, гармонизация.*

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The world economic crisis of 2008 emphasized the importance for countries of having effective, functional and proper regulatory framework for dealing with insolvency problems. Insolvency law plays an important role in the whole world. First of all, it provides a certain legal framework which serves as a step-by-step mechanism fro dealing with financial difficulties of an insolvent company. Also, it helps to maintain balance of interests of different stakeholders that are usually affected by an insolvent company. One of the most significant questions is grounds according to which particular insolvency proceedings can be initiated. Each country has its own national insolvency law, which stipulates different approaches regarding the grounds and types of available insolvency proceedings. For companies engaged in cross-border activities such a situation creates obstacles in interpreting grounds and is characterized by the lack of flexibility in choosing insolvency proceedings. It may lead to disbalance of interests in these companies. Moreover, within the EU these disparities are the factors that empower the phenomenon of forum shopping.

This problem has been examined by the following authors: Dennis Faber, Niels Vermunt, Jason Kilborn, Tomáš Richter, Ian F. Fletcher, M. Marinč, R. Vlahu, Paul J. Omar, and others. This topic is being hotly discussed nowadays.

The aim of the article is comparative analysis of national insolvency laws of England, Germany and Lithuania to identify peculiarities of grounds for the opening of insolvency proceedings in order to determine the necessity and possibility of harmonisation of grounds at the EU level.

Presentation of basic material of the research. Debates regarding the necessity and possibility of harmonisation of insolvency laws are taking place. According to **the Note on Harmonisation of Insolvency Law at EU level (2010)** of the European Parliament, one of the problems that might occur in the absence of common rules on insolvency are criteria for the opening of insolvency proceedings. It is desirable that the requirements relating to the opening of insolvency proceedings be harmonized. It can be achieved by standardisation of the test to be applied for the opening of the insolvency proceeding [1, pp. 8-11].

Later on, **the EU Commission adopted Recommendation of 12.3.2014 on a New Approach to Business Failure and Insolvency (2014)**. The main objective of this Recommendation is to ensure that viable enterprises in fi-

nancial 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 it also aims at giving honest bankrupt entrepreneurs a second chance across the Union. This Recommendation is a great example of a partial harmonisation of insolvency law at EU level [2].

Emilie Ghio (2015) says that a fully harmonised body of insolvency law would block negative externalities generated by the Member Statets' national legislations. It is further justified by the subsidiarity principle of the EU law. She adds that if certain issues are better dealt with at supranational level, the EU is given competence in the matter and harmonisation is justified by the need to internalise negative externalities [3, pp. 11-12].

Bob Wessels (2011) considers that harmonisation is a careful process. Harmonisation of certain topics is possible, but it has to be acknowledged that many of these topics will prove to be interconnected to larger (non insolvency law related) legal areas, such as employment law, property law, contract law or procedural law [4, p. 760]

On the other hand, **Alberto Núñez-Lagos (2016)** believes that it is very difficult to harmonise certain areas of insolvency legislation due to the old traditional insolvency roots of each of the local jurisdiction so that it would be difficult to obtain the necessary consensus for such harmonisation at EU level [5, p. 6].

Paul Omar (2012) stresses that it is difficult to see member states agreeing to proposals from the European institutions for substantive rapprochement of their internal insolvency laws unless there were overwhelming economic benefits for them to do so [6, p. 21].

However, later he changed his mind and states that whether "convergence" or "harmonisation", and to what fields, procedural and/or substantive, this should extend, is a token of how far down the road the European Union has travelled (2015) [7, p. 28].

Now we would like to make a brief comparison analysis of grounds for the commencement of insolvency proceedings in England, Germany and Lithuania. These countries have been chosen because each of them has its own unique legal regime and different legal roots.

In England, insolvency framework is mostly composed of two statutory acts: the Insolvecny Act of 1986 (IA 1986) and the Insolvency Rules (IR 1986). The first one plays the role of a substantive law, whereas the second one prescribes the procedural side of insolvency proceedings. Both acts are applied to individuals and legal entities. In the first case it is "bankruptcy proceedings" and in the second one – "insolvency proceedings". These two acts are additionally supplemented by the Companies Act 2006 and by the Company Directors' Disqualification Act 1986.

English insolvency regime can be characterized as "separate entry", i.e. for the commencement of a certain type of insolvency procedure particular threshold shall be meet. This means that two main requirements should be satisfied: the exact party, which is entitled to initiate particular insolvency procedure, and the existence of a particular ground.

Insolvency Act 1986 does not contain definition of what insolvency is. However, Insolvency Act 1986 enshrines 7 situations when a company may be wound up by the court. **One of the grounds is inability to pay its debts**. By this legal construction English insolvency law explains a situation when debtor is deemed to be insolvent. Statutory explanation of what should be understood as inability to pay debts can be found in Section 123 of the same instrument. According to this Section there are **four insolvency tests prescribed**.

According to Section 123 (1), a company is deemed unable to pay its debts 1) if a creditor (by assignment or otherwise) to whom the company is indebted in a sum exceeding £5,000 then due has served on the company, by leaving it at the company's registered office, a written demand (in the prescribed form) requiring the company to pay the sum so due and the company has for 3 weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor or 2) if execution or other process issued on a judgment, decree or order of any court in favor of a creditor of the company is returned unsatisfied in whole or in part or 3) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due (cash flow insolvency). Also, Section 123 (2) sets out the fourth insolvency test – if the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities (balance sheet insolvency). Additionally, Section 124 of the Insolvency Act 1986 prescribes persons who are entitled to file an application to the court for the winding up of a company.

Some time ago there was a unified doctrine of the three commercial insolvency tests, i.e. that all three commercial insolvency tests are based on single default, which is proof of the company's failure to meet a demand to pay an undisputed debt [8, p. 3]. This means that a creditor is free to choose any of three tests for filing a petition for winding up if the claim is undisputable. Under the first test, a creditor just should submit statutory demand, and, if the company fails to accomplish it, winding up is possible. Under the unsatisfied execution test, more should be done in the procedural sense – first of all, a creditor should obtain court judgment regarding the debt and then this judgment should be unsatisfied by the debtor. The last general commercial test (inability to pay debts as they fall due) considered being the most straightforward – a creditor is only required to demand to pay back the debts.

However, recent United Kingdom insolvency case law showed that perception of cash flow and balance sheet insolvency tests has been changed. The first case is Re Cheyne Finance Plc. (No 2) [9] and the second one is Eurosail case [10]. Now, a company may be wound up under cash flow test even if its debts has not fallen due yet but will fall in the future. If a creditor submits an insolvency petition on the ground of balance sheet insolvency, the court should take into consideration all the relevant facts and possibilities even if debtor's balance sheet shows negative net assets. Interpretation of both tests in such way also leaves enough space for consideration.

Another treatment of grounds for the commencement of insolvency proceedings is observed in **Germany**. Currently, insolvency framework in Germany is composed of the Insolvency Code (Insolvenzordnung), which was adopted in 1994 by the German Parliament and entered into force on the 1st of January 1999. It was amended in 2012 by the introduction of protection scheme proceedings to facilitate the restructuring of companies.

In Germany insolvency proceedings may be opened by and against legal and natural persons even if the last do not conduct any business activity. Thus, under German national insolvency law, insolvency proceedings may be invoked particularly for all types of private debtors. Only filing an insolvency petition to the court may commence any type of insolvency proceedings that are set out in the German Insolvency Statute. The insolvency regime in Germany is characterized as "single entry" – all types of the insolvency proceedings whether it is reorganization or liquidation shall be commenced in the same way. There is an absence of pre-insolvency proceedings and absence of pre-insolvency proceedings that may be initiated without a court order.

There is no definition of what insolvency is under the German Insolvency Statute. It only outlines that insolvency shall be the general reason to open insolvency proceedings. An insolvency petition for the commencement of insolvency proceedings may be made to the competent court by the debtor or by creditors. The submission of any petition for opening insolvency proceedings has to be founded on one of the three statutory grounds. **There are three grounds (tests)** that describe different situations when the debtor is deemed to be insolvent. The first one is illiquidity that is based on cash flow insolvency, the second one is overindebtedness, which reflects balance sheet insolvency, and the last one is imminent insolvency (pending illiquidity). However, not all of them may be invoked both by the debtor and its creditors.

One of the most frequently applied grounds for the commencement of insolvency proceedings by creditors is **illiquidity (cash flow)** insolvency. Under the Statute, the debtor shall be deemed illiquid if he is unable to meet his mature obligations to pay, and it is unclear whether any creditor who owns undisputable claim in any amount may submit an insolvency petition as long as the debtor has stopped payments.

In order to clarify this situation, the German Federal Supreme Court in its decision of 24.05.2005 interprets this ground more precisely. According to the decision, if it can be reasonably expected that the debtor will meet the payment obligations within no more than three weeks from their due date, the company is not considered illiquid; if the liquidity shortfall amounts to less than 10 % of all due payment obligations, the company is only considered illiquid if the shortfall is likely to increase to more than 10 % in the near future and; if the liquidity shortfall amounts to 10 % or more of the due payment obligations, illiquidity is assumed, unless there is a high likelihood that the shortfall will soon be covered completely, or almost completely, and the creditors can be reasonably expected to wait [11].

The second reason for the commencement of insolvency proceeding is **overindebtedness** (balance sheet insolvency). As in the case with illiquidity, this ground may be invoked either by the debtor or by creditors, but may be commenced only regarding legal entities. Under the German Insolvency Statue, overindebtedness shall exist if the debtor's assets no longer cover the existing obligations to pay. It is important to outline that until 17th October 2008, during the financial crisis, the evaluation of company' assets was permitted to be undertaken on a going concern basis in case of probability that the company's business could be continued, and if such evaluation resulted in a negative net asset value, the company was obliged to file for insolvency [12, p. 193].

Also, there is a third ground that may be exclusively invoked by the debtor. According to Section 18 (2) of the Insolvency Statute, the debtor shall be deemed to be faced with **imminent insolvency** if he is likely to be unable to meet the existing obligations to pay on the date of their maturity, i.e. the debtor will not be able to discharge the obligations in the future with a probability of more than 50%. This will require a prognosis of up to two years taking into account all currently existing claims and those future claims that will certainly come into existence [13, p. 257]. This ground was introduced in order to facilitate reorganization and increase chances for financially distressed corporate debtors to be rescued.

The third approach to grounds for the commencement of insolvency proceedings is characteristic for **Lithuania**. At the current moment, all insolvency issues are governed by three separate statutory laws: Enterprise Bankruptcy Law (2001), Law on Enterprise Restructuring (2001), and newly adopted Law on Natural Person Bankruptcy (2013). Thus, there is no unified insolvency law that would encompass all available insolvency proceedings.

Contrary to England and Germany, the Lithuanian legislation defines the concept of insolvency in Article 2 Paragraph 8 of Enterprise Bankruptcy law as follows: **Insolvency** of an enterprise means the state of an enterprise when it fails to discharge its obligations (pay debts, carry out works paid for in advance, etc.), and the overdue liabilities of the enterprise (debts, unperformed works, etc.) are in excess of half of the value of the assets entered on the enterprise's balance. In case of defining insolvency in such way, **cash flow and balance sheet insolvency tests are applied simultaneously**. Thus, sometimes it becomes very hard especially for creditors to prove that a particular company is in a stay of insolvency.

Enterprise Bankruptcy Act makes a clear distinction between **grounds for filing for initiation of enterprise bankruptcy proceedings** and **grounds for the commencement of bankruptcy proceedings by the court**.

Grounds for filing are mostly composed of failure of an enterprise to pay its debts when they fall due or a situation when an enterprise has publicly announced its inability or intent to discharge its obligations. Furthermore, there is a certain obligatory time limits (at least 30 days) specified for creditors before they will be entitled to file bankruptcy petition against an enterprise. Before filing bankruptcy petition, creditor shall notify the enterprise in writing about the intention to initiate bankruptcy proceedings in the court.

In the second case, law prescribes three **grounds on the basis of which the court shall commence formal**

bankruptcy proceedings. According to Article 9 Paragraph 5, the court shall initiate bankruptcy proceedings if at least one of the following grounds is met: (i) when the enterprise is insolvent; (ii) when the enterprise is late with payment of remuneration and amounts relating to employment relations to the employee (employees); or (iii) when the enterprise has publicly announced to or notified the creditor(s) in any other manner of its inability or lack of intent to discharge its obligations. Likewise in Germany, court refuses in opening bankruptcy proceedings if there is al lack of assets to cover legal and administration expenses.

The problem of the concept of insolvency has been described above and the place for argumentation is left regarding the second ground for the commencement of bankruptcy proceedings. There is no threshold regarding the minimum amounts of employee related payments. Also, there is unwritten precondition according to which employee's petitions must not be made in bad faith and sometimes even the need of supporting/submitting a petition by all employees of the enterprise is required [14, p. 291].

Contrary to formal bankruptcy proceedings, there is a possibility to conduct an out-of-court (extrajudicial) bankruptcy of the debtor. There is only one ground for their initiation that is pointed out in Article 12 Paragraph 2 – if the enterprise is unable and will not be able to settle with the creditor (creditors). Also, there are two obligatory conditions that shall be met in order to extrajudicial bankruptcy proceedings are commenced: if there is an absence of actions in court entered against the enterprise, and no recovery is made from the enterprise under the writs of execution issued by courts or other institutions. Only the owner(s) and the head of the enterprise may commence extrajudicial bankruptcy procedure if all the mentioned-above requirements are met. This is exclusive statutory insolvency procedure under the Lithuanian insolvency law that does not require court participation.

SUMMARY

On the basis of comparative analysis of national insolvency legislation and case law of England, Germany and Lithuania, there have been outlined piculiarities in application of grounds for the commencement of insolvency proceedings in these countries. In England the main ground for the commencement of insolvency proceedings is inability to pay debts. The stay of inability to pay debts is revealed through four main insolvency tests. In Germany, three main reasons (grounds) for the commencement of insolvency proceedings are enshrined in the German Insolvency Code. The German legislation specifies concepts of illiquidity, balance sheet and imminent insolvency. In its turn, Lithuania is one of three countries where the concept of insolvency is defined. Also, the Lithuanian legislation makes a clear distinction between grounds for filing for initiation of enterprise bankruptcy proceedings and grounds for the commencement of bankruptcy proceedings by the court.

The comparative analysis of grounds for the commencement of insolvency proceedings in England, Germany, and Lithuania has showed that companies conducting cross-border activities may face problems with their interpretation. Also, such situation makes it possible for companies to be considered insolvent under legislation of one country and at the same time non-insolvent under that of another one.

This empirical analysis proves that harmonization of grounds for the commencement of insolvency proceedings within the EU is desirable and necessary. ■

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ЄВРОПЕЙСЬКИЙ ДОСВІД РЕФОРМ МІСЦЕВОГО САМОВРЯДУВАННЯ

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УДК 352

Ватаманюк-Зелінська У. З., Фіковська М. Ю. Європейський досвід реформ місцевого самоврядування

Мета статті – дослідити та проаналізувати процес децентралізації та деконцентрації влади країн Європи, визначивши ефективно можливі напрямки його запровадження в Україні. Проаналізовано результати впровадження реформи адміністративно-територіального устрою в Україні. Зокрема, розглянуто динаміку утворення нових об'єднаних територіальних громад і наповнення місцевих бюджетів за рахунок власних надходжень. Обґрунтовано актуальність використання досвіду європейських країн, який передбачає два етапи децентралізації. Вони базуються, по-перше, на передачі всіх повноважень у сфері бюджетних послуг органам місцевого самоврядування; по-друге, на забезпеченні фінансової самостійності цих органів місцевої влади. Удосконалення процедури прийняття управлінських рішень на різних рівнях державної влади запропоновано здійснювати насамперед шляхом проведення консультацій з інститутами громадянського суспільства.

Ключові слова: *децентралізація, євроінтеграція, місцеве самоврядування.*

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Ватаманюк-Зелинская У. З., Фиковская М. Ю. Европейский опыт реформ местного самоуправления

Цель статьи – исследовать и проанализировать процесс децентрализации и деконцентрации власти стран Европы, определив эффективно возможные направления его применения в Украине. Проанализированы результаты внедрения реформы административно-территориального устройства в Украине. Рассмотрена динамика образования новых объединенных территориальных общин и наполнение местных бюджетов за счет собственных поступлений. Обоснована актуальность использования опыта европейских стран, который предусматривает два этапа децентрализации. Они базируются, во-первых, на передаче всех полномочий в сфере бюджетных услуг органам местного самоуправления; во-вторых, на обеспечении финансовой самостоятельности органов местной власти. Усовершенствование процедуры принятия управленческих решений на разных уровнях государственной власти должно осуществляться прежде всего путем проведения консультаций с институтами гражданского общества.

Ключевые слова: *децентрализация, евроинтеграция, местное самоуправление.*

Рис.: *2.* ***Библ.:*** *16.*

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Vatamaniuk-Zelinska U. Z., Fikovska M. Yu. The European Experience of Local Government Reforms

The article is aimed at researching and analyzing the process of decentralization and deconcentration of the European countries' authorities, determining the efficient possible directions of its application in Ukraine. The results of implementation of the reform of administrative-territorial structure in Ukraine were analyzed. The dynamics of formation of new joint territorial communities and filling of local budgets at the expense of own proceeds were considered. The relevance of the experience of European countries, which provides for two stages of decentralization, is substantiated. They are based, firstly, on the transfer of all powers in the sphere of budget services to local governments; secondly, on ensuring the financial independence of local authorities. Improvement of the managerial decision-making process at different levels of government should be carried out primarily through consultations with the civil society institutions.

Keywords: *decentralization, European integration, local self-government.*

Fig.: *2.* ***Bibl.:*** *16.*

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