

# **Insolvency in the European Union – The relevance of the balance sheet**

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## **ABSTRACT**

While the US have a Federal Bankruptcy Code, the harmonization of the insolvency rules within the EU is an ongoing process. It is however noteworthy that such ongoing process has been developing without establishing a common definition of the insolvency status. Said lack of harmonization is particularly clear in the recent “Proposal for a Directive of the European Parliament and of the Council harmonizing certain aspects of insolvency law”, dated of December 2022, and still in the legislative process. In fact, and while said proposal foresees, among other things, a legal duty to file for insolvency within a certain period, therefore harmonizing within the EU a duty to start insolvency proceedings under the threat of civil liability that does not exist in the US, it still fails to provide a common definition of what “insolvency” should be. It is, however, interesting that recital 37 of said Directive states that «The cessation of payments test and the balance sheet test are the two usual triggers among Member States for opening of standard insolvency proceedings. The balance sheet test may however be unfeasible for microenterprise debtors, particularly where the debtor is an individual entrepreneur, because of a possible lack of proper record and of a clear distinction between personal assets and liabilities and business assets and liabilities. Therefore, the inability to pay debts as they mature should be the criterion for the opening of simplified winding-up proceedings (...)». As a consequence, it seems clear to us that the European Commission recognizes that there are, within the EU, two different “main” reasons to open insolvency proceedings, but it decided not to harmonize this aspect. Under this light, we argue that it is impossible to have a meaningful harmonization on insolvency matters without a common definition of insolvency. Taking the next step, we suggest that the EU should move towards a common (and mandatory) definition of insolvency that comprises not only the cash flow insolvency but also the balance sheet insolvency. This last dimension, greatly inspired, in our proposal, by the German Insolvency notion of “Überschuldung” as it existed in the German law before the amendment of 2008, is justified by a comprehensive analysis that takes into consideration not only the insolvency law, but also the European Corporate Law rules, that still require the existence of a

minimum legal share capital in certain types of companies (also present in some US States) and impose a framework for the so called “serious loss of the subscribed capital”. It is our view that, in a comprehensive analysis, said minimum share capital requirements should be removed from the relevant EU Directive and replaced by a duty to file for insolvency when the net assets amount, in the balance sheet, reach the threshold of 0EUR or lower. We provide several arguments for such an amendment, of which we would like to highlight the fact that a balance sheet criterion is much more precise and objective, both being essential characteristics if one wants to move, as the EU apparently does – and in our opinion should –, towards a hard duty to file for insolvency imposed to the company’s Directors.