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THE DEVELOPMENT OF TRANSACTION AVOIDANCE IN EUROPEAN UNION INSOLVENCY LAW

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Abstract. Transaction avoidance is part of insolvency proceedings. The successful application of the rules on transaction avoidance allows the value of the debtor's assets to be maximised, and thus increases the satisfaction of creditors' claims. In the European Union, the substantive rules on insolvency law still are a matter of the national laws of Member States. However, trends in the policy-making actions of the European Union reveal that various initiatives have been proposed to establish certain rules on transaction avoidance which should increase recovery rates for creditors and contribute to the proper functioning of the domestic market. This article focuses on the general aims of transaction avoidance and provides a critical assessment of the proposed harmonisation of the rules on transaction avoidance in European Union law. The authors found that the proposed rules on the harmonisation of transaction avoidance rules in European Union insolvency law may actually discourage businesses regarding the exercise of the freedom of establishment, and may also intervene in the substantive insolvency and civil law regulations of Member States.

Keywords: transaction avoidance, insolvency law, European Union law.

Introduction

One of the main principles of insolvency proceedings is the maximisation of the value of the debtor's assets. This principle should facilitate higher distributions to creditors as a whole and reduce the burden of insolvency (UNCITRAL, 2004, p. 10). One of the means to accumulate (or recover) the debtor's assets in insolvency proceedings is setting aside unlawful transactions. The successful application of the rules on transaction avoidance allows creditors to be treated equally and increases the value of the debtors' assets. Though the application of the rules on transaction avoidance contributes to the attainment of these goals of insolvency proceedings, it also means direct intervention in pre-insolvency transactions concluded by a debtor and a third party before the opening of insolvency proceedings. Intervention in pre-insolvency contractual relations requires the careful assessment of whether setting aside a transaction is justified (Bork, 2020, p. 113). Striking a balance between the attainment of the goals of insolvency proceedings and the protection of legal certainty and stability in civil legal relations requires a well-crafted legal approach.

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This article focuses on transaction avoidance as a tool to increase the maximisation of the value of the debtors' assets and how it has been developed in EU insolvency law. There are no globally accepted definitions of the terms *transaction* and *avoidance*, but their broad interpretation seems to be suitable for the effectiveness of insolvency proceedings. *Transactions* (or, broadly speaking, legal acts) should cover all human acts which have legal consequences (Bork, 2020, p. 114). This term refers to the wide range of legal acts by which assets may be disposed of or obligations incurred, including by way of transfer, payment, encumbrance, set-off, guarantee, loan or release, and may include a composite series of such transactions. The term *avoidance* should refer to the court's power to declare a certain transaction invalid when the court applies the ground for invalidity of a transaction. Avoidance provisions permit transactions for the transfer of assets or the undertaking of obligations prior to the opening of insolvency proceedings to be cancelled or otherwise rendered ineffective and any assets transferred, or their value to be recovered, in the collective interest of creditors (UNCITRAL, 2004).

Insolvency law and the rules on transaction avoidance are part of national insolvency law. The grounds for transaction avoidance in insolvency law vary, but the three common grounds are preferential transactions, undervalue transactions and intentionally fraudulent transactions (Bork, 2020, pp. 120–132.). In some jurisdictions, there is a single set of avoiding powers that generally capture any transaction that is harmful to creditors. In others, particularly common law countries, these powers consist of a double set of avoiding powers, where some actions seek to avoid transactions in which the debtor received a lower (or even no) consideration, while other actions seek to avoid transactions in which the debtor put a particular creditor in a better position than other creditors (Martínez, 2018). However, despite the existence of different approaches, the aim of transaction avoidance is the same in all cases, namely to set aside unlawful transactions and maximise the value of the debtor's assets.

Currently, the two existing binding legal acts in EU insolvency law do not aim to harmonise the rules on transaction avoidance. The Regulation on Insolvency Proceedings (hereinafter – the EIR) harmonises only some of the rules of private international law when insolvency proceedings involve at least two different countries (cross-border insolvency proceedings) and does not seek to harmonise substantive insolvency law, except in a very limited way. Instead, it lays down the rules on jurisdiction, applicable law, and the recognition and enforcement of judgments in cross-border insolvency proceedings (Keay, 2018). However, the EIR establishes the rules on applicable law, which may be the *lex causae* law of the Member State in which the main insolvency proceedings are opened (Article 7(2)(m) of the EIR) as an exception (Article 16 of the EIR). The Directive on restructuring and insolvency (hereinafter – the Restructuring Directive) deals with the harmonisation of the rules on preventive restructuring mechanisms and the protection of transactions which provide new or interim financing (Article 18 of the Restructuring Directive); however, it does not establish any common rules for transaction avoidance.

The idea of the harmonisation of the substantive rules governing transaction avoidance has been looming in Europe for some time (European Parliament, 2010; European Commission, Directorate General Justice and Consumer Affairs 2016; Weijs, 2011; and others). The problems of transaction avoidance and asset recovery have attracted the attention of legal scholars in both the national and international insolvency contexts (CERIL, 2017; McCormack & Bork, 2017; Casasola, 2019; Keay, 2018; Bork & Veder, 2022). There are different positions in the legal literature regarding the harmonisation (to some extent) of transaction avoidance rules in EU insolvency law.

The suggestions and discussions regarding a harmonised approach to transaction avoidance in insolvency law resulted in the adoption of the Proposal for the Directive on harmonising certain aspects of insolvency Law (hereinafter – the Proposal), which was announced in December 2022. The Proposal proposes the rules harmonising transaction avoidance in Title II. These rules consist of general provisions regarding avoidance actions (Articles 4–5), specific conditions for avoidance actions (Articles 6–8) and the consequences of avoidance actions (Articles 9–12).

Before the Proposal was adopted, numerous methods of harmonising the rules on transaction avoidance were proposed in the legal doctrine. One proposal involved no harmonisation of transaction avoidance, suggesting that it should be left to the national laws of Member States. Another suggested that EU law should in essence substitute

transaction avoidance rules. Further, as a middle ground between full harmonisation and a complete absence, partial harmonisation was proposed, which could either involve the EU insolvency law regulating general aspects of avoidance and the national laws of the Member States regulating the questions not covered by EU law, or EU law regulating only cases which have a cross-border element with Member States maintaining their competence in domestic insolvency cases. Under partial harmonisation, a transaction is deemed to be cross-border when at least one of the parties involved have their habitual residence or centre of main interests in a Member State other than the one in which the proceedings are held, or the law applicable to the transaction is different from the law concerning the opening of the proceedings (Casasola, 2020). The partial harmonisation approach seems to be chosen in the Proposal.

The Proposal represents the first attempt to harmonise the national bankruptcy (liquidation) laws of the Member States. The proposed harmonisation of transaction avoidance seems to have a far-reaching aim, since it proposes to harmonise the grounds for three types of transactions and the legal consequences which arise when such unlawful transactions are declared void. Nevertheless, it raises a number of questions regarding whether such harmonisation is needed and whether it would really serve the goals which the rules on transaction avoidance seek to achieve. What type of transaction may be set aside? How should the grounds for transaction avoidance in the Proposal be applied in practice? How should the interests of the third party to a transaction be protected? Does the Proposal establish a fair balance between stability in civil relations and the market and the goals of insolvency proceedings?

This article aims to assess the application of transaction avoidance rules in EU insolvency law. It is structured as follows. First, it addresses the goal of transaction avoidance rules, which is to maximise the value of the debtor's assets. Second, it provides an analysis of the application of the *Actio Pauliana* rule as the main instrument for the recovery of assets and the rule of accumulation of claims (*vis attractiva concursus*) in EU insolvency law. Third, the new rules on transaction avoidance in EU insolvency law as set out in the Proposal are analysed. Fourth, the authors provide a critical assessment of the proposed harmonisation of transaction avoidance rules in EU insolvency law. The main sources used in the article are the relevant legal acts of EU insolvency law and the case law of the Court of Justice of the European Union (hereinafter – the CJEU) alongside articles and other sources of legal doctrine related to this subject. The authors rely on the scientific research methods which are common in such types of research, namely comparative and logical. The comparative analysis method is used for the assessment of the relevant rules which regulate the grounds for transaction avoidance in international soft law documents, EU insolvency law and national laws. The logical method is used to make conclusions and provide suggestions on the proposed rules on the harmonisation of transaction avoidance in EU insolvency law.

1. Transaction avoidance and the maximisation of the value of the debtor's assets

The maximisation of the value of the debtor's assets is closely linked with the application of the rules on transaction avoidance. The rules on transaction avoidance protect creditors and the insolvency estate from the debtor's unlawful transactions and contribute to the accumulation of the debtor's assets and the maximisation of their value (Commission Staff Working Document, 2022). For the effectiveness of insolvency proceedings, collective action is more efficient than creditors' individual remedies. Thus, the successful application of transaction avoidance rules results in the increase of the insolvency estate. After the tracing and identification of assets, an insolvency practitioner should consider whether pre-insolvency transactions are lawful or grounds may be raised to challenge them. By filing a claim for setting a transaction aside, an insolvency practitioner seeks to test the lawfulness of such a transaction, and if a transaction is found to be unlawful then this should result in the restitution of transferred assets and (or) compensation for the debtor (UNCITRAL, 2004, p. 136).

Avoidance actions might be seen as promoting collectivism and fairness among creditors, and the underlying purpose of avoidance provisions is usually seen as being to ensure that there is fairness. However, it is rightly pointed out that fairness does not translate into absolute equality between creditors, as the legislation in all Member States includes provisions embedding the right of priority to certain groups of creditors, such as employees, who usually receive priority in the satisfaction of their claims (Keay, 2018). The main policy arguments behind transaction avoidance rules in insolvency law are: protecting the general body of creditors from the unfair diminution of the insolvent's assets, stopping the dismemberment of the insolvent's estate, and deterring parties from entering into transactions with insolvents that could be avoided (Keay, 2018). Since the debtor's

property has to be distributed between creditors fairly, avoidance actions aim to recover property back to the insolvency estate and thus reflect the collective nature of insolvency proceedings and provide fairness among creditors. Avoidance actions also aim to prevent the dismemberment of the insolvency estate that occurs as a consequence of the insolvent's entry into a pre-insolvency transaction and deter entry into transactions that could be avoided if a company becomes subject to insolvency proceedings (Keay, 2017). One of the general tasks of the insolvency practitioner is to investigate the debtor's pre-insolvency transactions and evaluate whether they were detrimental to creditors or not (Casasola, 2020). The rules on transaction avoidance protect the general body of creditors from the unfair diminution of the insolvent's assets, which can be a consequence of a debtor giving an advantage to someone at some point before the opening of insolvency proceedings and therefore creating a distortion in the distribution of the property of the insolvent according to the statutory scheme (Keay, 2018).

A study on the harmonisation of transaction avoidance rules was published in 2011 (European Commission, Directorate General for Internal Policies, 2011). It was noted that though the national laws of the Member States do not essentially differ regarding the categories of contestable transactions, the rules on suspect period (the period preceding the opening of insolvency proceedings which defines whether transactions are contestable) differ. The issue is that, pursuant to the exception to the applicable law to detrimental acts, the legal system which least favours avoidance rights will take precedence, and in cross-border legal transactions the chances of successful avoidance actions are significantly reduced. The trust and foreseeability of the law applicable to transaction avoidance were also questioned, since in the area of avoidance actions in insolvency law so-called connected persons or stakeholders collaborating intentionally or fraudulently with the debtor should continue to enjoy such a protection of trust. A study on asset tracing and recovery by insolvency practitioners was presented in 2022 (European Commission, 2022b) which thoroughly analysed EU insolvency law and the national laws of the Member States related to the problems that insolvency practitioners encounter when searching for assets and recovering them for the insolvency estate. The importance of this topic is also confirmed by UNCITRAL Working Group V (2023), which has been working on the preparation of the guidelines on civil asset tracing and recovery in insolvency proceedings. Both studies acknowledged the importance of the effective application of the rules on transaction avoidance and the need to find a proper balance between the legitimate interests of the counterparty to the contract, the maximisation of the debtor's assets, and the protection of creditors' interests.

The recovery of assets may be also a challenging and expensive exercise which can incur financial and time costs. The importance of transaction avoidance in insolvency proceedings is recognised not only in national legal acts, but also in the international arena. For instance, Article 25 of the UNCITRAL Model Law on Cross-border Insolvency (1997) establishes that upon the recognition of a foreign proceeding, the foreign representative has the standing to initiate the types of actions to avoid or otherwise render ineffective acts detrimental to creditors that are available in this state to a person or body administering a reorganisation or liquidation. When the foreign proceeding is a non-main proceeding, the court must be satisfied that the action relates to assets that, under the law of this state, should be administered in the foreign non-main proceeding. Thus, an insolvency practitioner has the right to invoke local laws on transactional avoidance and submit a claim to the court. This does not grant the right to an insolvency practitioner to file a claim for transaction avoidance; it does not create such a right or solve conflict of law problems. Instead, this Article merely requires that an insolvency practitioner, upon recognition of insolvency proceedings, would not be placed in a less favourable position regarding their standing only because they are appointed in foreign insolvency proceedings. The standing of an insolvency practitioner under this Article is applicable only to actions that are available to the local insolvency representative in the context of an insolvency proceeding, and the Article does not equate the foreign representative with individual creditors who may have similar rights under a different set of conditions (UNCITRAL, 2014, p. 92).

In summary, transaction avoidance as a legal instrument is primarily designed to maximise the value of the debtor's assets. The application of these rules on transaction avoidance also provides for the examination of the lawfulness of civil market transactions, and may also serve as a means of deterrence for the conclusion of transactions which are detrimental to creditors.

2. *Actio Pauliana* and the accumulation of related actions in the EIR

One of the main tools for the recovery of assets is filing an action for transaction avoidance, and the main legal tool for the recovery of assets in insolvency proceedings is *Actio Pauliana*, which is deeply rooted in European civil law (Keay, 2017; Bork, 2020, p. 112). This is a legal defence mechanism for the preservation of a creditor's rights over a debtor's assets which is used against a third party which acquired the disputes assets, and thus '<...> constitutes an exception to the principle of privity of contract and is contrary to the rule that a person who is not party to a contract may not benefit from or suffer its legal consequences' (Opinion of AG Ruiz-Jarabo Colomer, 2008, para. 26). In essence, *Actio Pauliana* allows for interference into the transactions concluded by a debtor before the opening of insolvency proceedings which the debtor was not obliged to conclude. The successful application of this legal instrument allows the situation of the insolvency estate to be improved and creditors' claims to be satisfied. The aim of the successful application of *Actio Pauliana* is the recovery of assets which were transferred by an unlawful transaction directed against the debtor and the person who benefits from the act (*Mario Reichert, Hans-Heinz Reichert and Ingeborg Kockler v. Dresdner Bank AG*, 1992, para. 19). Thus, it aims to recover the debtor's assets from the third party which unlawfully received them from the debtor.

In the case of ordinary civil proceedings, the effects of the successful application of *Actio Pauliana* are confined to the individual creditors who have brought the action. When the property is returned to the debtor, a creditor can satisfy their claim from the returned property. However, in the case of insolvency proceedings, such effects apply to the entirety of the assets, and therefore benefit all creditors (Opinion of AG Ruiz-Jarabo Colomer, 2008, para. 27). Thus, an action for setting a transaction aside in insolvency proceedings aims to maximise the value of the debtor's assets and protect the common interests of all creditors. Even if *Actio Pauliana* is filed by a debtor's creditor and the action is satisfied, the asset is recovered not to that creditor, but to the creditors as a whole. After the successful challenge of an unlawful transaction, recovered assets should become part of the insolvency estate.

The rules on *Actio Pauliana*, as for all other grounds for transaction avoidance, are a matter of national law. A recent study on the tracing and recovery of assets suggests that a harmonised approach to *Actio Pauliana* is also needed in the EU. It has been suggested that the EIR should also have provisions '<…> concerning the creditor's power to use the *Actio Pauliana* during insolvency proceedings, as well as provide a tool for creditors to preserve assets which are in line with the freezing injunctions stipulated in common law jurisdictions' (European Commission, 2022b, p. 119). *Actio Pauliana* is often employed as a legal defence instrument in insolvency proceedings, and it contributes to the equal treatment of creditors. The proposed recommendation is that creditors should be allowed to bring this action forward only if the insolvency practitioner waives their right of action and is subject to the authorisation of the court opening the proceedings, and only if the result would be distribution for all creditors (European Commission, 2022b, p. 119).

The assessment of asset tracing also requires an analysis of the procedural aspects of the right of an insolvency practitioner to recover assets. In the *Seagon* case, the CJEU broadened the jurisdiction of the court which opened the main insolvency proceedings to also encompass the actions which directly derive from the insolvency proceedings and are closely related to them. This judgment acknowledged the *vis attractiva concursus* rule in EU insolvency law for *Actio Pauliana*, and similar actions for transaction avoidance. The main problem in this case was whether an insolvency court has jurisdiction to hear an action for transaction avoidance against a person located in another Member State. The court held that '<...> the courts of the Member State within the territory of which insolvency proceedings have been opened have jurisdiction to decide an Action to set a transaction aside by virtue of insolvency that is brought against a person whose registered office is in another Member State' (*Christopher Seagon v. Deko Marty Belgium NV*, 2009, para. 28).

The findings in the *Seagon* case were codified in Article 6(1) of the EIR, which establishes a European *vis attractiva concursus* rule pursuant to which the forum which opened insolvency proceedings shall hear a claim for transaction avoidance. The wording of this provision and the relevant case law raises an important procedural question as to whether *vis attractiva concursus* under the EIR is mandatory or not for an insolvency practitioner challenging the transactions of the debtor based on the transaction avoidance rules. Article 6(1) of the EIR establishes that the court which has jurisdiction under Article 3 of the EIR *shall have jurisdiction* to hear avoidance actions. The question then becomes whether the jurisdiction to hear an action for transaction avoidance by the court which has jurisdiction under Article 3 of the EIR is exclusive or optional. Does an insolvency practitioner

have a right to choose in which forum an action for transaction avoidance should be submitted, or is no discretion provided in such a case?

As a rule, an insolvency forum should hear avoidance actions such as *Actio Pauliana*. This is justified under general arguments such as legal foreseeability, the reduction of litigation costs, the simplified gathering of evidence and others. However, does this mean that the jurisdiction of an insolvency forum to hear an action for transaction avoidance by an insolvency practitioner or another competent person is exclusive, or an option? Do the parties with the right to institute such proceedings have the right to choose whether to avail themselves of the jurisdiction of the insolvency forum, or can they also choose to commence the case in another jurisdiction, relying on the general rules on jurisdiction in cross-border civil cases (the Brussels Ibis Regulation)?

The nature of the competence (exclusive or optional) to hear an action for transaction avoidance was the subject matter of the *Wiemer & Trachte* case. The question in this case was whether the international jurisdiction of the court hearing insolvency proceedings is exclusive or optional, thus enabling an insolvency practitioner to bring an action to set aside before a court of the Member State in which the defendant has their registered office or habitual residence. The CJEU found that the concentration of actions for transaction avoidance contributes to the effectiveness and efficiency of insolvency proceedings, having a cross-border effect (*Wiemer & Trachte GmbH v. Zhan Oved Tadzher*, 2018, para. 33) on the avoidance of abusive forum shopping (paras. 34–35). The court concluded that the courts of the Member State within the territory of which insolvency proceedings have been opened enjoy exclusive jurisdiction to hear related actions including actions to set a transaction aside based on insolvency (para. 36). Thus, the court established that the jurisdiction to hear an action for transaction avoidance by the court which has jurisdiction under Article 3 of the EIR is exclusive.

The rationale of the *Wiemer & Trachte* case – i.e., that the jurisdiction to hear an action for transaction avoidance is exclusive for the courts having jurisdiction under Article 3 of the EIR – has already raised debates. Some authors strongly argue that the *vis attractiva concursus* rule in cross-border insolvency proceedings should be interpreted as an option for insolvency practitioners, but not as a mandatory rule. The main arguments for the opposition to the rationale of this judgment are that it would limit the options of the insolvency practitioner and that it may contravene the objective of Article 6(1) of the EIR to improve the efficiency of insolvency proceedings (Bork, & Veder 2022, pp. 238–239). Both arguments reveal debates as to the approach to the interpretation of the *vis attractiva concursus* rule in the *Wiemer & Trachte* case. Though the court focused on the avoidance of abusive forum shopping and the general effectiveness of cross-border insolvency proceedings, the possibility for an insolvency practitioner to choose the forum for such related actions should be one of the main criteria in determining questions related to jurisdiction in such cases. An insolvency practitioner acting as a representative of the creditors and the debtor should be provided with the possibility to consider in which countries the case should be submitted.

It is also debatable whether the argument of avoiding abusive forum shopping plays a role in the interpretation of the nature of the *vis attractiva concursus* rule. Forum shopping is related to the jurisdiction for the opening of insolvency proceedings when a debtor seeks to take advantage of more favourable rules of insolvency proceedings in order to reduce the creditors' costs. When an insolvency practitioner considers submitting a related action, it is unclear whether the idea of avoiding abusive forum shopping plays a significant role in such a regard since it is unclear which transactions may be challenged by an insolvency practitioner before the commencement of insolvency proceedings. The option of an insolvency practitioner to choose the forum for a transaction avoidance action as a means to seek the most effective solution and reduce expenses for litigation costs seems not to have been analysed in the *Wiemer & Trachte* case. Depending on the national laws of (civil) insolvency proceedings, an insolvency practitioner may prefer to submit an action in the forum of the defendant's domicile. Thus, the highly restrictive approach of the CJEU in this case raises doubts as to whether it indeed represents the most effective way of dealing with insolvency problems.

3. The new rules on transaction avoidance in EU insolvency law

Since the rules on transaction avoidance and their application have great impact on the effectiveness of insolvency proceedings, it is not surprising that EU policymakers have also shifted the focus of proposals for the harmonisation of this matter at the EU level. A number of new initiatives for the harmonisation of the rules of substantive insolvency law were proposed in the Proposal. One of the main goals of the Proposal is to increase the recovery value of the insolvency estate, which would translate to lower costs to liquidate companies and higher recovery rates for creditors and investors. It was established that the average recovery time in insolvency proceedings in Member States ranges from 0.6 to 7 years, and judicial costs range between 0 and over 10%. As of 2018, the average recovery value of corporate loans in the EU was 40% of the amount outstanding at the time of the default, and this figure was just 34% for small and medium-sized enterprises (European Commission, 2022a). The proposed rule on transaction avoidance seeks to increase recovery values for all creditors, including cross-border creditors in the EU, and enhance the effectiveness of transaction avoidance rules and subsequent asset tracing for asset recovery (Commission Staff Working Document, 2022).

The effective application of the rules on transaction avoidance can indeed contribute to the effectiveness of insolvency proceedings and increase recovery rates. However, transaction avoidance is a legal instrument which is deeply embedded into the national laws of the Member States and derives from the general rules of civil law. The harmonisation of the rules on transaction avoidance in insolvency law would mean intervention in the legal traditions of the Member States, and requires careful consideration of whether a European instrument on transaction avoidance in purely national insolvency proceedings would exceed the limits of the competence of EU law. This article further deals with the main elements of transaction avoidance harmonised by the Proposal.

3.1. The general provisions

The general provisions of the Proposal regarding avoidance actions establish the requirements that transactions concluded prior to the opening of insolvency proceedings detrimental to the general body of creditors can be declared void under the condition of this act. These rules should be regarded as minimum standards for the protection of creditors' interests, and the national laws of the Member States may adopt provisions in this area which provide greater protection of creditors' interests.

Pursuant to Article 4 of the Proposal, Member States shall ensure that legal acts which have been concluded prior to the opening of insolvency proceedings to the detriment of the general body of creditors can be declared void under the conditions laid down in Chapter 2 of this Title. Article 5 of the Proposal establishes that the national laws of Member States may provide even greater protection of the general body of creditors than that proposed in this legal act. Thus, the Proposal provides only minimum standards of protection of creditors' interests, and leaves the competence to the Member States to provide stricter rules in this matter.

This general requirement means that national laws should provide remedies in insolvency proceedings to challenge transactions detrimental to all creditors which are concluded before the opening of insolvency proceedings. The notion of a transaction 'detrimental to the general body of creditors' is a qualification which may be challenged under this provision. The Proposal does not define the detrimental effect. This notion, however, is also used in the EIR, which establishes that the law on the opening of the main insolvency proceedings (*lex concursus*) determines which law is applicable to the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors (Article 7(2)(m) of the EIR). An exception to this rule on applicable law is established in Article 16 of the EIR. These rules concern actions to set aside based on the rules of insolvency proceedings, and not the rules of ordinary law (ordinary actions under civil and commercial law) (Opinion of AG Szpunar, 2014, para. 43). The indication that an act is detrimental to the general body of creditors means that the act should have a negative impact not on a certain creditor or a group of creditors, but all creditors. This negative impact is coupled with the decrease of the debtors' assets which would be used to satisfy creditors' claims.

One of the general problematic questions in the application of the rules on transaction avoidance is the time when a transaction was completed. This is important, since usually transactions may be challenged only when they were completed before a certain period prior to the opening of insolvency proceedings. The question of whether the relevant period of time in such a case should be calculated from the time when a transaction was concluded or

when it was executed then arises. Recital 5 of the Proposal solves this question by giving priority to the perfection of the legal act rather than to the execution of the performance, and provides an example of electronic money transfer, where the relevant point in time should not be when the debtor instructed the financial institution to transfer the money to a creditor (the performance of the legal act), but rather when the creditor's account was credited (the perfection of the legal act) (European Commission, 2022). Such a choice seems to be compatible with the requirement of legal foreseeability and legal certainty. In practice, it may also be complicated to determine exactly when a transaction was performed, especially when its performance depends on the actions of more than one party to the contract and/or the performance of the transaction may consist of several actions which may not be concluded at the same time.

A transaction may be defined as both an act or an omission. The Proposal suggests that transactions (actions) should be defined broadly in order to cover any human behaviour with legal effects. Pursuing the principle of equal treatment of creditors, legal acts should also include omissions, as it makes no significant difference whether creditors suffer a detriment as a consequence of an action or of the passivity of the party concerned. Such acts should also cover acts by the debtor, and should also include legal acts performed by the counterparty or by a third party (Recital 6 of the Proposal). The transaction avoidance rule should apply only to transactions which are detrimental to the general body of creditors (Recital 6 of the Proposal). Such an understanding of transactions is also broad, and should encompass how transactions are defined by Member States.

Attention is also paid to the interests of the third parties to the transaction. It is recognised that to secure the legitimate interests of the counterparty, transaction avoidance rules should be applied proportionately. Such circumstances should include the debtor's intent along with the knowledge of the counterparty or the time-span between the perfection of the legal act and the commencement of the insolvency proceedings. Therefore, it is necessary to distinguish between a variety of specific avoidance grounds that are based on common and typical fact patterns and that should complement the general prerequisites for avoidance actions. Any interference should also respect the fundamental rights enshrined in the Charter of Fundamental Rights of the European Union (Recital 6 of the Proposal). The rules on transaction avoidance in the Proposal do not indicate whether they are applicable to transactions with cross-border elements (for instance, when parties to the transaction are located in different Member States), nor do they specifically mention transactions without such elements. Thus, it seems that the proposed rules on transaction avoidance are deemed to be applicable to all transactions which fall under the scope of the Proposal, irrespective of whether they have a cross-border element or not.

The general rules on transaction avoidance, though mentioned mostly in the recitals of the Proposal, suggest that the broad notion of a transaction is established: it should cover all legal acts (acts and omissions) which lead to the creation of legal consequences. The relevant rules on the time when a transaction was concluded are also important in order to decide whether the special rules on transaction avoidance should be applicable.

3.2. Types of transactions which may be declared void

The Proposal establishes three types of contracts detrimental to creditors which are subject to transaction avoidance rules, namely preference transactions, transactions with no or a manifestly inadequate consideration, and transactions which intentionally harm. The consequences of all three actions would be the declaration of the voidness of the challenged transactions. The subjective element (parties' knowledge about the unlawfulness of the transaction) varies depending on the specific grounds, and serves the purpose of protecting the interests of the third party.

One type of unlawful action are preference transactions, where a debtor gives some *unjustified preference* (payment or the creation of security) to another person without a legal basis (Keay, 2017). Preference transactions may be declared void if they benefit a creditor or a group of creditors by satisfaction, collateralisation, or in any other way, and can be declared void if they were perfected: (a) within 3 months prior to the submission of the request for the opening of insolvency proceedings, under the condition that the debtor was unable to pay their mature debts; or (b) after the submission of a request for the opening of insolvency proceedings (Article 6(1) of the Proposal). The general rule on preference transactions actually does not establish what preference actually constitutes. It is also noted that 'since this avoidance ground is triggered by the mere perfection of the legal act,

the suspect period is the shortest compared to the suspect periods of the other avoidance grounds' (European Commission, 2022a).

A special rule is established for transactions for which performance is secured. Pursuant to Article 6(2) of the Proposal, if a due claim of a creditor was satisfied or secured in the owed manner, Member States shall ensure that the legal act can be declared void only if: (a) the conditions laid down in paragraph 1 are met; and (b) the creditor knew, or should have known, that the debtor was unable to pay their mature debts or that a request for the opening of insolvency proceedings has been submitted. The creditor's knowledge referred to in the first subparagraph, point (b), shall be presumed if the creditor was a party closely related to the debtor. This exception seeks to protect the counterparty to the contract which received a security. The intent of such a protection is to protect the interests of a creditor who has already received satisfaction, or if the performance of the obligation is secured. In such cases, creditors' knowledge of the unlawfulness of the transaction is also relevant, since the debtor had already encountered insolvency problems before insolvency proceedings were initiated.

Exceptions to preference actions are also established. Pursuant to Article 6(3) of the Proposal, by way of derogation from paragraphs 1 and 2, Member States shall ensure that the following legal acts cannot be declared void: (a) legal acts performed directly against fair consideration to the benefit of the insolvency estate; (b) payments on bills of exchange or cheques where the law that governs bills of exchange or cheques bars the recipient's claims arising from the bill or cheque against other bill or cheque debtors such as endorsers, the drawer, or drawee if it refuses the debtor's payment; and (c) legal acts that are not subject to avoidance actions in accordance with Directive 98/26/EC and Directive 2002/47/EC. The exceptions in Article 6(3)(a) seem to be the most complicated to prove since they require consideration of the impact of the transaction on the insolvency estate. Such an assessment would require individual considerations of what legal effects were established by the transaction and whether it contributed to the interests of the creditors.

The second group of unlawful actions are those with *no or a manifestly inadequate consideration*. A so-called undervalue transaction usually mean that a counterparty of the transaction receives some goods under a low or insignificant value which would normally would not occur in the market, and that is thus unreasonable (Keay, 2017). Such transactions are also detrimental to the interests of the debtor's creditors, since when a debtor enters insolvency creditors receive less since unjustified advantage was given to the counterparty to the transaction by the debtor.

Pursuant to Article 7(1) of the Proposal, Member States shall ensure that legal acts of the debtor against no or a manifestly inadequate consideration can be declared void where they were perfected within a time period of 1 year prior to the submission of the request for the opening of insolvency proceedings or after the submission of such a request. The exceptions to this transaction are gifts and donations of symbolic value. The assessment of what is a manifestly inadequate consideration depends on each case and requires the assessment of all relevant circumstances. Such cases would require comparing what considerations were provided by the debtor and what was provided to the debtor under the conditions of the transaction. Article 7(2) of the Proposal establishes that where several persons have submitted a request for the opening of insolvency proceedings against the same debtor, the point in time when the first admissible request is submitted shall be considered the beginning of the 1-year period referred to in paragraph 1.

The third group of unlawful transactions are those which are *intentionally detrimental to creditors*. Such transactions are those in which a debtor deliberately put assets beyond the reach of creditors and thus sought to defraud creditors (Keay, 2017). According to Article 8(1) of the Proposal, Member States shall ensure that legal acts by which the debtor has intentionally caused detriment to the general body of creditors can be declared void where both of the following conditions are met: (a) those acts were perfected either within a time period of 4 years prior to the submission of the request for the opening of insolvency proceedings or after the submission of such a request; (b) the other party to the legal act knew or should have known of the debtor's intent to cause a detriment to the general body of creditors. The knowledge referred to in the first subparagraph, point (b), shall be presumed if the other party to the legal act was a party closely related to the debtor. Article 8(2) of the Proposal establishes that where several persons have submitted a request for the opening of insolvency proceedings against the same debtor, the point in time when the first admissible request is submitted shall be considered the beginning of the 4-year period referred to in paragraph 1, first subparagraph, point (a).

The suspect period for intentionally detrimental transactions to creditors is longer than other suspect periods. This longer suspect period is justified by the fact that such a transaction was deliberately concluded to harm creditors and the counterparty to the transactions had knowledge (i.e., should have been aware) that such a transaction would be detrimental to all creditors. In such a case, the protection of the counterparty's interests is weaker since it is presumed that the counterparty knew that the transaction was unlawful and would harm the interests of all creditors.

3.3. The legal consequences of unlawful transactions

For the maximisation of the debtor's assets and increasing their recovery for creditors, the crucial aspect is not the application of the rules challenging the transaction, but the legal consequences when these rules are applied. The successful challenge of a transaction should lead to the return of the assets which were unlawfully transferred to another party (restitution), and thus increase the insolvency estate. The assets should be administered and (or) later sold, and the proceeds received should be distributed among the creditors to satisfy their claims. Other legal consequences in such a case can also involve the payment of damages to the insolvent company when restitution is not available. In such a case, the insolvency estate is increased not by the value of the returned assets, but by the award of damages.

The consequences of the successful application of the rules on avoidance actions are numerous. First, the claims, rights or obligations resulting from legal acts that have been declared void may not be invoked to obtain satisfaction from the insolvency estate concerned. Second, the party which benefitted from the legal act that has been declared void is obliged to compensate in full the insolvency estate concerned for the detriment caused to creditors by that legal act. A claim to obtain full compensation may also be assigned to a creditor or a third party. The limitation period for all claims resulting from the legal act that can be declared void against the other party is 3 years from the date of the opening of insolvency proceedings. Moreover, these rules should be enforceable against an heir or another universal successor of the party which benefitted from the legal act that has been declared void. Furthermore, the party which benefitted from the legal act that has been declared void has to compensate the insolvency estate for the detriment caused by that legal act, and any claim of that party which was satisfied with that legal act revives. The rules on the consequences on transaction avoidance are divided into four parts: general consequences, consequences for the party which benefitted from the legal act that has been declared void, liability of third parties, and relationship with the rules protecting new and interim financing under the Restructuring Directive.

The general rules on the consequences of transaction avoidance suggest that when legal acts are declared void, the rights and obligations deriving from them may not be invoked to obtain satisfaction from the insolvency estate concerned (Article 9(1) of the Proposal). The party which caused detriment to the creditors shall pay compensation (Article 9(2) of the Proposal), which may be assigned to a creditor or a third party (Article 9(4) of the Proposal). There is also a prohibition noting that the party that has been obliged to compensate the insolvency estate cannot offset this obligation with its claims against the insolvency estate (Article 9(5) of the Proposal). The limitation period for all claims resulting from the legal act that can be declared void against the other party is 3 years from the date of the opening of insolvency proceedings (Article 9(3) of the Proposal). The general rules on the consequences do not prohibit the filing of actions based on general civil and commercial law for the compensation of damages suffered by creditors as a result of a legal act that can be declared void (Article 9(9) of the Proposal).

The protection against void actions is even extended to the successors of the party which benefited from the void legal act. Article 11(1) of the Proposal establishes that Member States shall ensure that the rights laid down in Article 9 are enforceable against an heir or another universal successor of the party which benefitted from the legal act that has been declared void.

Article 11(2) of the Proposal establishes that Member States shall ensure that the rights laid down in Article 9 are also enforceable against any individual successor of the other party to the legal act that has been declared void if one of the following conditions is fulfilled: (a) the successor acquired the asset against no or a manifestly inadequate consideration; (b) the successor knew or should have known the circumstances on which the avoidance

action is based. The knowledge referred to in the first subparagraph, point (b), shall be presumed if the individual successor is a party closely related to the party which benefitted from the legal act that has been declared void.

The special rules are proposed in relation to the party which benefited from the legal act. Member States shall ensure that if and to the extent that the party which benefitted from the legal act that has been declared void compensates the insolvency estate for the detriment caused by that legal act, any claim of that party which was satisfied with that legal act revives (Article 10(1) of the Proposal).

Article 10(2) of the Proposal establishes that Member States shall ensure that any counter-performance of the party which benefitted from the legal act that has been declared void performed after or in an instant exchange for the performance of the debtor under that legal act shall be refunded from the insolvency estate to the extent that the counter-performance is still available in the estate in a form that can be distinguished from the rest of the insolvency estate or the insolvency estate is still enriched by its value. In all cases not covered by the first subparagraph, the party which benefitted from the legal act that has been declared void may file claims for the compensation of the counter-performance. For the purposes of the ranking of claims in insolvency proceedings, this claim shall be deemed to have arisen before the opening of insolvency proceedings.

4. Criticism of the proposed harmonisation of transaction avoidance in the Proposal

The harmonisation of the rules on transaction avoidance in the Proposal first requires consideration of the harmonisation of the substantive laws on transaction avoidance under EU law, and can then be assessed from the view of the merits of these questions. First, insolvency law is part of national law, and thus part of policy regarding how insolvency proceedings should be governed. The different rules on the distribution of assets reflect different policy goals pursued by governments (Keay, 2017). The application of transaction avoidance rules often requires subjective and objective assessments of the factual circumstances surrounding the transaction and parties' will regarding it. Both subjective and objective tests have shortcomings which it would be even more difficult to address at the EU level. The application of transaction avoidance is also often based on rebuttable presumptions which reflect the peculiarities of the particular transaction (Keay, 2017).

The divergence of national rules on transaction avoidance, however, means a lack of harmonised solutions to insolvency problems and enables businesses to choose where their commercial interests are best served (i.e., the Member State of incorporation). The business regime and the national laws regulating business relations (of which insolvency law is a part) have a significant impact on how a business evolves. The peculiarities of the national laws applicable to insolvency proceedings may also be part of such considerations when deciding in which country a business should be incorporated. The principal idea of the harmonisation of the transaction avoidance rules may actually diminish the effective exercise of fundamental freedoms of EU law such as free movement and establishment, which are basic fundamentals for the proper functioning of the internal market.

The choice of establishment, and thus the rules applicable to business relations, are encouraged or prohibited only when they result in abuses of EU law. EU law cannot be invoked for abusive or fraudulent aims (*SICES and Others v. Agenzia Dogane Ufficio delle Dogane di Venezia*, 2014, para. 29.)

The development of EU insolvency law is also linked with the evolution of company law. It was established in the *Centros* case that a company's corporate laws will be determined by its domicile, even if most or all of its assets and operations are located elsewhere. The freedom of establishment allows companies established in one Member State to pursue activities in other Member States through an agency, branch or subsidiary (*Centros Ltd v. Erhvervs- og Selskabsstyrelsen*, 1999, para. 26). Moreover, the mere fact that a person seeks to establish a company according to the rules of company law that seem to them the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment (para. 27). Thus, looking for a better regime for taxes or other corporate governance reasons should not itself constitute an abuse of EU law. The enjoyment of freedom of establishment opens the door for companies and traders to search for more favourable legal regulation. When forum shopping is employed for the optimisation of procedural possibilities, it should not be regarded as an abuse of the law. However, unlawfulness may arise when such a transfer of business leads to unjustified inequality between the parties to a dispute (Opinion of AG Ruiz-Jarabo Colomer, 2005, paras. 72–73.)

The longstanding approach in EU law has been that transfer of business is a lawful action and may be treated differently when the transfer of business from one Member State to another results in fraudulent forum shopping. Thus, the EIR only prohibits fraudulent forum shopping (Recital 29 of the EIR) and establishes the rules of jurisdiction based on the centre of main interests (Recital 31, Article 3 of the EIR), which should discourage abuse of EU law and protect the interests of creditors. The mere fact that a person chooses to move to the jurisdiction which best suits their business interests in the light of the procedural or substantive advantages it offers is not unlawful. Forum shopping is negative only when it turns into abuse of law (Opinion of AG Saugmandsgaard Øe, 2020, para. 87). Thus, even looking for a more favourable insolvency regime is not itself an example of fraudulent forum shopping in EU law.

Another important element related to transaction avoidance are safe harbour rules. Though the Proposal refers to special transactions in restructuring proceedings which provide new or interim financing which later enjoy immunity from the application of transaction avoidance rules, the national laws of the Member State provide other safe harbour rules for certain transactions in insolvency proceedings. For instance, German insolvency law provides 'restructuring privilege' when a transaction was concluded during the 3 months prior to the insolvency application where the legal prerequisites are met, but that these performances are not deemed to be made with the intention of disadvantaging creditors if they have been fulfilled on the basis of a serious restructuring attempt (European Law Institute, 2017, p. 279).

The safe harbour rules are justifiable exceptions to the general rules on transaction avoidance which recognise that in certain cases the advantage of the transaction to the debtor and even the whole body of creditors outweighs setting aside a transaction which would be void under the general rule. The special safe harbour rules are particularly relevant for the effectiveness of workouts and in pre-insolvency proceedings when a creditor already takes a risk by concluding a contract with a debtor encountering solvency problems. It is thus suggested that avoidance rules under insolvency law should not apply in subsequent formal proceedings if a transaction is objectively fair ex post, or justified ex ante (under the given circumstances) by serving the goal of restructuring a business which is at its core viable. The criteria for the lawfulness of the transaction may be the assessment of the value provided by the transaction. Another important assessment may be the comparison of the value of the transaction and the market price (European Law Institute, 2017, p. 282). There is also no indication of who has the right (*locus standi*) to apply to the court to challenge transactions. Normally, this right is designated to an insolvency practitioner. In some Member States, it is only an insolvency practitioner who has the right to file a claim for transaction avoidance, such as in Germany (Article 129 of Insolvency Law of Germany), while in other countries, such as Lithuania, this right is provided to both an insolvency practitioner and creditors. The question of who has the right to submit an action for transaction avoidance is not regulated in the Proposal.

Furthermore, the question of whether the proposed harmonisation of transaction avoidance is compatible with the special rules on the law applicable to acts detrimental to creditors arises. As a general rule, such actions fall under the scope of *lex concursus*, but to protect the legitimate interests of a counterparty, there is the possibility to demand the application of *lex causae* which would not establish the grounds for transaction avoidance. Pursuant to Article 16 of the EIR, Article 7(2)(m) 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. The application of this exception to *lex concursus* seems to suggest that the harmonisation of the transaction avoidance rules in the Proposal may not be applicable in a cross-border scenario when a counterparty proves that a transaction is lawful under *lex causae* (i.e.., there are no grounds for the challenge). Thus, the questions of the (in)compatibility of the rules on transaction avoidance in the Proposal and the rules of applicable law in the EIR may arise.

Conclusions

Transaction avoidance serves as an effective legal instrument to recover assets unlawfully transferred by a debtor and thus maximise the value of the debtor's assets in insolvency proceedings. However, the application of transaction avoidance rules should also not diminish legal certainty in the market and the legal expectations of the counterparty to the transaction regarding whether the effects created by the transaction would remain valid.

Though *Actio Pauliana* is one of the main grounds for transaction avoidance and the filing of related transactions in insolvency law, such *Actio Pauliana* in EU law raises the question of whether in cross-border insolvency proceedings an insolvency practitioner should have the right to choose whether to file such an action in the insolvency forum under Article 6(1) of the EIR, or should rely on the general rules on jurisdiction under the Brussels Ibis Regulation.

The Proposal establishes certain rules on the harmonisation of the rules on transaction avoidance in EU insolvency law. In essence, it establishes three grounds for transaction avoidance and the consequences of the declaration of the voidness of transactions which should substitute the relevant rules of the national insolvency law of Member States. The Proposal not only seeks to harmonise the grounds for such transaction avoidance, but also provides exceptions to their application and cases in which they are not applicable. The proposed rules reflect the common approach to understanding these transactions in general in insolvency law. However, the main question asked in this article is whether such harmonisation is indeed necessary, since the divergence of the national laws of Member States may actually provide more flexibility and a more beneficial approach to regulating how business activities should be pursued. The harmonisation of transaction avoidance rules in bankruptcy (liquidation) proceedings, together with the other rules proposed in the Proposal, may actually discourage businesses regarding the exercise of the freedom of establishment, and may also intervene substantially in the substantive insolvency and civil law regulations of Member States.

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