Security rights under the EU Insolvency Regulation

A comparison of German and Dutch law and the paradigm of communication and coordination

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SUMMARY

The master's thesis covers the EU Insolvency Regulation which was founded with the objective of settling cross-border insolvency proceedings among the Member States more efficiently. The first question is how the Regulation deals with rights in rem vested on debtor's assets, and against who insolvency proceedings under the Regulation are opened. Article 5 answers this question, stating that these rights are not affected by the universal applicable insolvency law from 'Member State A' provided that the collateral security is located in 'Member State B' at the time proceedings commence. Whereas under the Regulation the administrator from 'Member State A' in principle has jurisdiction over all debtor's assets, encumbered assets are excluded by virtue of Article 5.

The provision's significance is clarified by a comparative analysis of German and Dutch law as it protects rights in rem from a surprise attack of the applicable insolvency law. Article 5's imaginary absence evidently harms security holders' (mostly banks) legitimate expectations, and such uncertainty of secured transactions results in an increase of interest on credit, which for its part even obstructs growth of wealth within the EU. Although Article 5 is drafted for just reasons, it yields one major concern as its application hampers the restructure of insolvent, but viable companies. With this in mind, the central questions addresses to what

extent communication and coordination in cross-border insolvencies is able to alleviate this latter concern.

But first, the study dissects Article 5's decisive criterion of the location of encumbered assets. Therefore, under the Regulation uniform rules of location exist, and yet give rise to a number of concerns. The relocation of the movable after its encumbrance, but prior to the opening of the insolvency proceeding causes two concerns. In the first place, the administrator is burdened with the difficult task to verify in retrospect the asset's physical location at the time the proceedings had commenced. Secondly, the relocation of the asset for tactical reasons out of 'Member State A', as a result of which Article 5 applies and thus protects the underlying security right raises questions, because the Regulation just oversees the annulment of legal acts instead of factual acts as such. Special attention is given to the assignment of claims, because of its complex legal nature. Under the Regulation the fictional location of claims is within the territory of the Member State of which the third-party debtor has its COMI, but as we all know the factual circumstances that constitute COMI remain uncertain.

In spite of the concerns with respect to the location of assets, some authors propose the applicable law on the right in rem rather than the location of the collateral security must form the decisive criterion in Article 5. However, finding the applicable law in particular on the international assignment of claims according to the PIL rules of each Member State proves to be a complicated venture, at least that is what German and Dutch rules on this point demonstrate. The latter clarifies that if harmonized rules that create rights in rem would exist in the EU, it would result in a more certain application of Article 5. In fact, such developments are already visible, as well as on a global scale. Besides, the financial crises nowadays inevitably lead to more economic integration, having an effect on the financing

practice. As a consequence, uniform standards in particular in systems of property and securities law are necessary in order to facilitate these developments.

Moreover, it is important to realize that the meaning of contemporary insolvency law has shifted from its traditional purpose for winding-up companies towards the notion that it should also aim at rescuing viable ones. Article 5 once applied however, lessens the chance of the scenario of a going concern. If the secured creditor consequently realizes the collateral security, the sale of debtor's estate as a whole, in principle needed for a successful restructuring, becomes impossible. That is to say, insofar as in 'Member State B' no territorial proceeding runs in which a stay of liquidation can prevent the secured creditor from separate settlement (Article 33). It is here where communication and coordination come into play. But then, such provisions seem absent in the event one insolvency proceeding is opened. Therefore, the study suggests that communication and coordination then also must take place, and in particular between the administrator and the secured creditor in order find an answer on the central question.

To take one example, the administrator can continue distributing (interest) payments to the secured creditor so as to avoid separate settlement. Both Dutch and German insolvency law provide for this, owing to the rules on lodging secured claims. The administrator is subsequently able to rely on the bank's expertise of specific market conditions, which information may either lead to a prudent liquidation or, to the secured creditor's benefit, refinancing a going concern. From the secured creditor's point of view, it is proposed that separate settlement must meet the general clause of good faith, the more so when he in a specific case is aware of the scenario of a going concern. The research proposes that exchanging vital information for that purpose may derive from Articles 40 and 41 Regulation, govern-

ing a mutual duty of notification of any relevant matter pertaining to the state of insolvency, respectively collateral security.

The above-mentioned practical notions certainly offer more room for the closure of the insolvency proceeding(s) by a composition plan. However, composition plans are a matter of the insolvency law of Member States. A comparison of the rules on composition plans according to German and Dutch law reveal that the *Insolvenzordnung* is better adjusted to contemporary insolvency law as secured creditors are mandatory involved in the creditor's meeting. Nonetheless, Article 5 protects the secured creditor, also from a compulsory reduction on his secured claim pursuant to a German composition plan.

This is the very reason why generally speaking, scholars consider Article 5 to be a conceptual failure. As a consequence, the Regulation as a whole functions inconsistently, and because the Regulation is part of more comprehensive Community law, from these EU principles may also derive further interpretative guidance so as to find an answer. In this regard, the study coins extrajudicial cooperation as Community goal (Article 65 EC Treaty). But also soft law instruments, based on best practice, may offer solutions. Given the frameworks drawn in this research, it concludes with a restatement with respect to Article 5: 'The secured creditor may as an ultimate remedy resort to separate settlement of the collateral security, provided that the applicable insolvency law threatens to affect the right in rem.'