

European Insolvency Regulation

11. Applicable law (rules on conflict of laws) Part 2

Dr Marek Porzycki



Payment systems and financial markets (Art.12 EIR)

- ▶ Role of payment systems and securities settlement systems in the financial system
- ▶ systemic risk – what happens if a participant in the system defaults or is declared insolvent?
- ▶ legal risk – are we aware of all legal implications of default or insolvency of a participant?
- ▶ Remedies:
 - legal risk – applicability of law applicable to the system or market
 - systemic risk – settlement finality (Directive 98/26/EC on settlement finality in payment and securities settlement systems)

Contracts of employment (Art. 13)

- ▶ extension of applicability of the law applicable to the contract for employment
- ▶ rationale: protection of employees from the application of (unknown) foreign insolvency law & protection of their expectations that local law would apply
- ▶ scope:
 - issues related to the contract itself (conditions of dismissal, notice periods, rules on salary) – Art. 13(1) EIR applies → (local) law applicable to the contract for employment
(as determined under Article 8 of the Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I))
 - but not issues related to general treatment of employees' claims (need to be lodged, any preferences in satisfaction etc.) – Art. 7 EIR applies → *lex fori concursus*

Contracts of employment (Art. 13)

- ▶ additional rule for secondary jurisdictions
(=Member State where an establishment of the debtor is located; even if no secondary proceedings have been opened):
 - if local courts or authorities are competent under local law to approve termination or modification of employment contracts in case of insolvency
 - those courts or authorities retain that competence even if only main proceedings are pending (=no secondary proceedings have been opened)

Contracts of employment (Art. 13)

Case: an Italian company Mancasoldi SpA has an establishment in Poland, where it employs Mr Józef K. Insolvency proceedings are opened in Italy against Mancasoldi. The Italian liquidator wants to liquidate the estate, including winding-up the establishment in Poland. He intends to dismiss Józef K. as soon as possible.

Mancasoldi owes Józef K. 3 months of unpaid salary.

Which law applies:

- to dismissal of Józef K. by the Italian liquidator?
- to satisfaction of Józef K.'s claim for unpaid wages?

Detrimental acts (Art. 16)

- ▶ concept of detrimental acts – acts by the debtor prior to the opening of proceedings (within the „suspect period”) which were detrimental to the creditors, by reducing the debtor’s assets (future insolvency estate)
- ▶ example:
 - the debtor donates his house to his brother
 - the debtor sells the wares in his warehouse below their value
- ▶ under most insolvency laws such acts are subject to transactions avoidance either by ineffectiveness *ex lege* or by a possibility of challenging them by avoidance actions

Detrimental acts (Art. 16)

- ▶ principle: *lex fori concursus* applies (Art. 7(2)(m) EIR)
- ▶ the beneficiary can raise the defence of Art. 16 EIR by demonstrating that:
 - the act is governed by the law of another Member State (*lex causae*)
 - under the *lex causae* the act in question cannot be challenged by any means in the relevant case
- ▶ burden of proof lies on the beneficiary of the act in question
- ▶ purpose: protection of legitimate expectations of beneficiaries of such acts

Detrimental acts (Art. 16)

- ▶ Practical results of Art. 16 EIR:
 - successful avoidance of a detrimental act requires a „double actionability test” – the act in question must be subject to challenge both under the *lex fori concursus* and the *lex causae*,
 - however, successfully raising the defence of Art. 16 EIR requires a negative proof that the act is not subject to challenge under the *lex causae*, not only under the provisions of insolvency law but also under general civil law

Detrimental acts – example

The debtor Jürgen Schuldner lives in Germany but frequently visits Gogolin (Poland) where part of his family lives. On one of his visits on 1.10.2023 he told his cousin Karolina Fikcyjna living in Gogolin that he is likely to go bankrupt and he needs to save his assets from the creditors. Subsequently he sold his Mercedes to Karolina for 10.000 PLN. The market value of the comparable car at the time was ca. 180.000 PLN. The parties chose to apply Polish law to the contract.

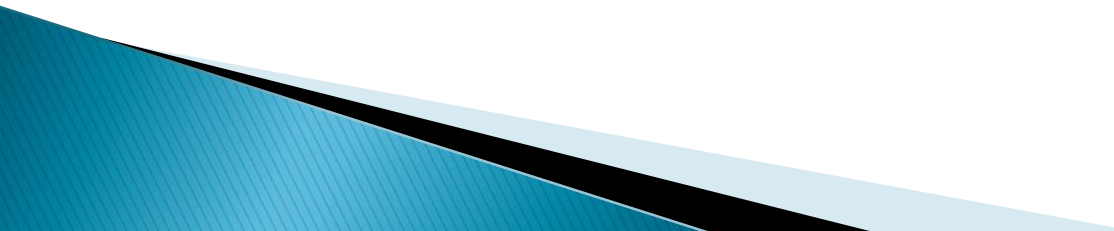
On 20.10.2023 insolvency request is lodged and on 26.11.2023 insolvency proceedings are opened in Germany against Jürgen Schuldner. German liquidator wants to claim the car back from Karolina Fikcyjna.

Detrimental acts – answer to the example

- ▶ In principle, German law applies to avoidance actions (Art. 7(2)(m) EIR)
- ▶ German law allows for avoidance of the sale, as the act was concluded less than 10 years before the insolvency petition, it is detrimental to the creditors and Karolina knew that it would be detrimental to the creditors (Section 133 (1) of the German InsO)
- ▶ Karolina may object by proving that Polish law does not allow any means of challenging the sale of the car
- ▶ This is not the case, as the sale would also be ineffective under Polish law as the car was sold flagrantly below its value (Art. 127(1) BL) and Karolina is a cousin of the debtor (Art. 128(1) BL)

RESULT: German law applies (Art. 7(2)(m) EIR), the German liquidator may claim the car back under Section 133 (1) of the German InsO

Detrimental acts – cases

- ▶ CJEU judgment of 16.04.2015, C-557/13, Lutz
 - ▶ CJEU judgment of 15.10.2015, C-310/14, Nike European Operations Netherlands
- 

Case C-557/13, Lutz

▶ Participants

- ECZ GmbH – a German company dealing in cars,
- ECZ Autohandel GmbH, ECZ's subsidiary established in Austria, subject to German insolvency proceedings,
- Mr Lutz – a creditor, with enforceable claim against the subsidiary.

▶ Facts:

- [AT] Mr Lutz obtained a valid payment order from an Austrian court against ECZ Autohandel GmbH for EUR 9566 plus interest on 17.3.2008;
- [DE] ECZ Autohandel GmbH filed an insolvency petition to a German court on 13.4.2008;
- [AT] three banking accounts of ECZ Autohandel GmbH at an Austrian bank are attached on 20/23.5.2008;
- [DE] German insolvency proceedings are opened against ECZ Autohandel GmbH on 4.8.2008
- [AT] acting on the basis of the attachment, the Austrian bank pays Mr Lutz EUR 11 778.48 from the account of ECZ Autohandel GmbH on 17.3.2009

Case C-557/13, Lutz

▶ Litigation:

- On 23.10.2009 the German liquidator of ECZ Autohandel GmbH challenged both the attachment and the payment to Mr Lutz seeking to have the transaction set aside and recovery of the total sum paid. She was successful in German courts.

Basis: § 88 of the German Insolvency Code (InsO) 'If a creditor, during the month preceding the lodging of an application to open the insolvency proceedings or thereafter, has acquired by virtue of enforcement a security over the debtor's assets forming part of the total assets, that security shall become legally invalid once the insolvency proceedings are opened.'

Mr Lutz claimed that under Austrian law (§ 43(2) of the IO) a limitation period of one year, from the date when the insolvency proceedings were opened, applied for commencing an action to set aside.

- Following appeals by Mr Lutz the case went to the German Supreme Court (BGH) which referred it to the CJEU.

Case C-557/13, Lutz

- ▶ Questions:
 - Does Art. 13 old EIR [Art. 16 EIR] apply when the payment of a sum attached before the opening of insolvency proceedings was actually made after the opening of proceedings?
 - Does the defence provided for in Art. 13 old EIR [Art. 16 EIR] also apply to limitation periods under the *lex causae*?
 - Are the relevant procedural requirements for asserting a claim for the purpose of Article 13 old EIR [Art. 16 EIR] also to be determined according to the *lex causae* or by the *lex fori concursus*?

Case C-557/13, Lutz

▶ Findings:

- The right resulting from the attachment of the bank accounts could constitute a 'right in rem' within the meaning of Art. 5(1) old EIR [Art. 8(1) EIR], provided that, under the national law concerned (here: Austrian law), that right was exclusive in relation to the other creditors of the debtor company → „exclusive right to have a claim met”.
- Art. 5(4) old EIR [Art. 8(4) EIR] excludes the application of Art. 5(1) [Art. 8(1)] in the case of an action for voidness, voidability or unenforceability as referred to in Art. 4(2)(m) old EIR [Art. 7(2)(m) EIR] → „action” should be understood broadly, as any rule relating to voidness, voidability or unenforceability under the *lex fori concursus*

Partial result: the attachment constitutes an Austrian right in rem under Art. 5 old EIR [Art. 8 EIR]. However, under Art. 4(2)(m) old EIR [Art. 7(2)(m) EIR] it is still subject to German rules on voidness, voidability or unenforceability.

Case C-557/13, Lutz

▶ Further issue:

- German law (§ 88 InsO) applied under Art. 4(2)(m) old EIR [Art. 7(2)(m) EIR] would lead to the payment to Mr Lutz being invalidated.
- Can he claim protection resulting from the limitation period of the Austrian law under Art. 13 old EIR [Art. 16 EIR]?

Answers:

- Art. 13 old EIR [Art. 16 EIR] is not, in principle, applicable to acts which take place after the opening of insolvency proceedings.
- In this case the payment was based on the right *in rem* established before the opening of proceedings → the issue is whether the establishment of the right *in rem* can be protected by Art. 13 [Art. 16] → Art. 13 [Art. 16] can extend to acts carried out after the opening of proceedings if they constitute exercising a right *in rem* falling within Art. 5(1) [Art. 8(1)]

Case C-557/13, Lutz

- ▶ Answers continued:
 - Art. 13 old EIR [Art. 16 EIR] must be interpreted as meaning that the defence which it establishes also applies to limitation periods or other time-bars relating to actions to set aside transactions under the *lex causae* → the limitation period of the Austrian law can be quoted as defence under Art. 13 [Art. 16].
 - nothing in the wording of Art. 13 old EIR [Art. 16 EIR] indicates that procedural requirements are excluded from the scope of that provision → procedural limits of the *lex causae* can also be used as defence under Art. 13 [Art. 16].

Case C-310/14, Nike European Operations Netherlands

- ▶ Background:

Sportland, a retailer operating in Finland, had a franchising contract with Nike (established in the Netherlands). Under this contract Sportland paid Nike outstanding debts in ten separate instalments made between 10 February 2009 and 20 May 2009, totalling EUR 195 108.15.

The contract was governed by Dutch law.

On 5 May 2009 an application for insolvency proceedings has been made against Sportland. On 26 May 2009 a Finnish court opened (main) insolvency proceedings.

Case C-310/14, Nike European Operations Netherlands

▶ Problem

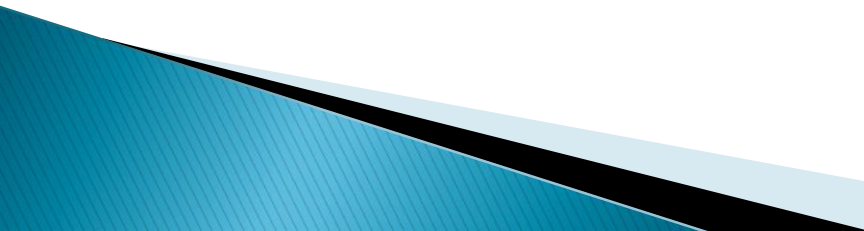
Under Finnish law (a specific legal act outside the scope of insolvency law), the payments made by Sportland to Nike prior to the opening of bankruptcy proceedings would be subject to challenge, with the result that Nike would need to return any amounts received plus interest to Sportland's insolvency estate → Sportland requested the annulment of payment under Finnish law.

Dutch law provides for grounds for challenging payments made prior to the opening of insolvency proceedings but those grounds are significantly narrower, resulting that payments made by Sportland would not be subject to challenge in this particular case → Nike sought dismissal of Sportland's action, quoting that the payments were governed by Dutch law.

The Finnish court examining the case referred questions to the CJEU.

Case C-310/14, Nike European Operations Netherlands

▶ Questions:

- what is the meaning of “the act in the relevant case” in Art. 13 old EIR [Art. 16 EIR]
 - does the reference to the law of the Member State in Art. 13 [Art. 16] include only its insolvency law or also other provisions?
 - who bears the burden of proof in relation to circumstances justifying the action to challenge the act?
- 

Case C-310/14, Nike European Operations Netherlands

▶ Answers:

- Art. 13 old EIR [Art. 16 EIR] provides an exception to the general rule of the application of the *lex fori concursus* which should not be extended beyond what is necessary to protect legitimate expectations.
- The act in question continues to be governed, even after insolvency proceedings have been opened, by the *lex causae*.
- All the circumstances of the case be taken into account when deciding whether Art. 13 [Art. 16] applies → Art. 13 [Art. 16] applies if, after taking account of all the circumstances of the case, the act at issue cannot be challenged on the basis of the law governing the act ('*lex causae*').
- The reference to the *lex causae* is not limited to the insolvency law of the Member State concerned → a person benefiting from a detrimental act must prove that the act at issue cannot be challenged on the basis of the insolvency provisions of the *lex causae* or on the basis of the *lex causae*, taken as a whole.

Case C-310/14, Nike European Operations Netherlands

- ▶ Answers:
 - It is for the defendant in an action relating to the voidness, voidability or unenforceability of an act to provide proof, on the basis of the *lex causae*, that the act cannot be challenged.
 - The applicant cannot be required to claim or prove provisions of the *lex causae* which would enable the act at issue to be challenged.
 - More detailed procedural rules are to be established under applicable national procedural law, provided that those rules are not less favourable than those governing similar domestic situations (principle of equivalence) and that they do not make it excessively difficult or impossible in practice to exercise the rights conferred by EU law (principle of effectiveness).