European Insolvency Regulation

10. Applicable law (rules on conflict of laws)
Part I

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Structure of provisions on applicable law

- Rule – Art. 7 – *lex fori concursus* – law of the State of the opening of proceedings
- Exceptions – Art. 8–18 – protection of local interests in other Member States
- Scope – conflict between laws of EU Member States. Application of the law of a non-EU state possible under private international law of the Member State in question (see par. 44 of the Virgos–Schmit Report)

Example: insolvency proceedings are opened in Germany. The debtor has real estate in the U.S. Any possible applicability of U.S. law in German proceedings results from the German private international law, not from the EIR.

- no *renvoi* – only substantive domestic law included, excluding private international law in force in the State of the opening of proceedings
substantial insolvency law supersedes general rules of private law → insolvency limits or excludes contractual liberty of the individual

correspondingly, provisions of the EIR on conflict of laws may displace common pre-insolvency conflict of laws rules (e.g. Regulation „Rome I”).

Example: a contract between the debtor and a third party is governed by German law under the Regulation No. 593/2008 on law applicable to contractual obligations (Rome I). Polish insolvency proceedings are opened against the debtor. The contract in question is detrimental to the creditors. Art. 7(2)(m) EIR supersedes Rome I and Polish law applies to determine the voidness of the contract (subject to Art. 16 EIR). See also par. 90 of Virgos–Schmit Report.
Lex fori concursus (Art. 7)

- Law of the Member State of the opening of proceedings
- Applicable to insolvency proceedings and their effects (Art. 7(1) EIR)
- Applicable to the conditions for the opening of proceedings, their conduct and closure – examples in a non-exhaustive list in Art. 7(2) EIR
- Applies in both main and territorial proceedings → the opening of secondary proceedings triggers application of local law of the state where those proceedings are started (see also Art. 35 EIR)
Third parties’ rights in rem (Art. 8) – scope

- Examples of rights in rem – pledge, mortgage, floating charge
- Flexible definition (no common concept within the EU). Main criteria: direct relation to a particular asset; enforceability against third parties, as opposed to enforceability only between the parties in contract law.
- Applicability of Art. 8 EIR to title transfer (transfer of full ownership to secure a claim) → in some legal orders (e.g. Germany, Poland) title transfer is treated in insolvency like pledge
- Rights on assets situated in another Member State at the time of the opening of proceedings (Art. 8(1) EIR) → see Art. 2(9) EIR
Third parties’ rights in rem (Art. 8) – rationale

- fundamental economic significance of rights in rem as a way of securing credit claims on assets
- expectation of the secured creditor: at least the level of protection provided for by the local law of the place where the assets are located
- way of protection of local interests preferred by the EU legislator → secondary proceedings (depending on existence of an establishment of the debtor, Art. 3(2) EIR, see also recital 68 to the EIR) → some protection of local interests needed also in cases with no secondary proceedings
Third parties’ rights in rem (Art. 8) – substantive law or conflict–of–laws provision?

Meaning of the wording of Art. 8(1) EIR: „The opening of insolvency proceedings shall not affect the rights in rem…” → two alternatives

1. The concept of „immunisation” of rights in rem („hard and fast rule”) – Art. 8 excludes any effect of insolvency proceedings on the right in rem → the right continues to exist (and may be exercised) as if insolvency proceedings were not opened → possibly better position than creditors secured on assets in the State of the opening of proceedings („internationality bonus”)

2. Art. 8 is a conflict–of–laws provision, providing for applicability (to a variable extent) of law of the state where the asset is situated (lex rei sitae)
Pleite GmbH, a German company, has real estate situated in Poland, encumbered by a mortgage (hipoteka) for the benefit of Kredytor Bank, a Polish bank. Insolvenzverfahren is opened against Pleite GmbH in Germany. What are the rights of Kredytor?

1. Kredytor’s mortgage is unaffected by German proceedings. Kredytor can be satisfied from the mortgage according to general (non-bankruptcy) rules of Polish law. The German liquidator of Pleite GmbH may keep the real estate by paying Kredytor’s claim (which would extinguish the mortgage).

2a. Kredytor is satisfied in German proceedings according to rules of Polish bankruptcy law applicable to claims secured by mortgage (Art. 336 and 345 of the Polish BL)

2b. Kredytor is satisfied according to the procedures of German law but the basic construction of right to separate satisfaction provided for by the Polish law is applied.

2c. Kredytor is satisfied according to German law but at least to the extent provided for by the Polish law.
Rights in rem (Art. 8) – less typical examples

- „an exclusive right to have a claim met” (Art. 8(2)(b) EIR) → may include attachment (seizure) of an asset in enforcement proceedings if such attachment is done for an exclusive benefit of a particular creditor. See CJEU in Case C–557/13, judgment of 16.4.2015 (Lutz): attachment order under Austrian law.

- a security created automatically (by force of law) by the national law, subjecting real estate to a public charge to secure payment of real property taxes. See CJEU in Case C–195/15, judgment of 26.10.2016, SCI Senior Home: claim for real property tax under German law.

- General conclusion: Art. 8 EIR also covers rights in rem granted outside the context of a commercial transaction.
Reservation of title (Art. 10)

- Economic and legal function – securing the claim of seller of an asset in a way similar to a right in rem
- The asset subject to sale with reservation of title is situated in another Member State than the state of the opening of proceedings.
- Insolvency proceedings against the buyer – the seller’s rights are not affected (Art. 10(1) EIR)
- Insolvency proceedings against the seller – no grounds for terminating the sale if the buyer continues to make payments → protection of the right of the buyer to acquire property according to the original contract for sale (Art. 10(2) EIR)
German Graphics, a German company, sold machines to Holland Binding, a Dutch company.

reservation of title clause in favor of the seller. Machines are situated in the Netherlands.

1.11.2006 – Dutch insolvency proceedings against the buyer (Holland Binding)

5.12.2006 – on request of German Graphics, German court issues an order for protective measures concerning the machines situated in the Netherlands

18.12.2006 – Dutch court declares the order of the German court enforceable in the Netherlands. Following subsequent appeals, the Hoge Raad (Dutch Supreme Court) refers the case to the ECJ.
applicability of Regulation 44/2001 (Brussels I) [currently Regulation 1215/2012 (Brussels Ia)] or of the EIR to the order for protective measures
- is an action to recover assets subject to reservation of title an action which relates to bankruptcy or the winding-up of an insolvent company (Art. 1(2)(b) of Brussels I[la]; Art. 25(1) old EIR [Art. 32(1) EIR])?
- does this action constitute a civil or commercial matter in the meaning of Brussels I[la]?
applicability of Dutch law under Art. 4(2)(b) old EIR [Art. 7(2)(b) EIR] to determine the assets included in the insolvency estate → are machines subject to reservation of title included in the estate? Is German creditor protected from the effects of Dutch proceedings by his reservation of title?
it is conceivable that there are some judgments which will come within the scope of application neither of the EIR nor of Brussels I[la] (par. 17) → it depends whether the judgment concerned applies to civil or commercial matters for Brussels I[la] to apply (par. 18 of the judgment)

the action against a debtor subject to insolvency proceedings to recover assets covered by reservation of title is an independent claim, neither derived from insolvency proceedings nor closely linked to it (par. 31–34) →

- the EIR does not apply (Art. 25 (1), 2nd subpara. old EIR [Art. 32 EIR])
- Brussels I applies (Art. 25 (2) old EIR [Art. 32(2) EIR]), as the matter is civil/commercial
Art. 7(1) old EIR [Art. 10(1) EIR] does not apply – assets subject to reservation of title are situated in the State of the opening of proceedings (i.e. the Netherlands), not in another Member State (par. 36)

Art. 7(1) old EIR [Art. 10(1) EIR] is a substantive rule protecting the rights of the seller.

Art. 4(2)(b) old EIR [Art. 7(2)(b) EIR] is a conflict of law rule specifying law applicable to determine the estate.

The existence of those rules does not imply that the matter concerning assets subject to reservation of title is a matter derived from insolvency proceedings or closely linked to them (Art. 25(1) old EIR [Art. 32(1) EIR]) → Brussels I applies.
the decision of the German court is subject to recognition and enforcement in the Netherlands pursuant to Brussels I[la]

however, the German court needs to take into account that the composition of the insolvency estate is determined according to Dutch law (Art. 4(2)(b) old EIR [Art. 7(2)(b) EIR]) → Dutch law determines whether assets subject to reservation of title are included in the estate. Dutch law determines whether the reservation of title is effective against the insolvency estate.
Contracts relating to real estate (Art. 11)

- scope: effects of insolvency proceedings on contracts relating to real estate, e.g. rent, usufructurary lease, leasing, preliminary contracts to acquire real estate (Polish: *umowa przedwstępna*), sale – existing (not yet fully performed) at the time of the opening of proceedings

- sole application of the law of the Member State where the immoveable property is situated (*lex rei sitae*)

- law of the Member State concerned is applied including its insolvency law (par. 118 of the Virgos–Schmit Report) → in some cases the liquidator may use the right to decide whether to terminate or to fulfill the contract (cf. Art. 98–99, Art. 109–110 of the Polish BL)

- the recast EIR has added a provision (Art. 11(2) EIR) specifying the powers of the court in main proceedings to approve termination or modification of a contract relating to real estate
Contracts relating to real estate – example

- A German company Pleite GmbH owns an office building in Poland. An office in this building is leased to a Polish company Najemca sp. z o.o. German *Insolvenzverfahren* is opened against Pleite GmbH. The German liquidator (*Insolvenzverwalter*) is charged with managing and liquidating the insolvency estate.
- No secondary proceedings opened in Poland
- What are the rights of the German liquidator in relation to the lease concluded with Najemca sp. z o.o.?
Contracts relating to real estate – example

- Polish law applies, including Polish bankruptcy law (Art. 11 EIR)

- according to Art. 109 of the Polish BL, the German liquidator may terminate the contract for lease, subject to a 3 months notice period.

- problem: under Polish law the judge–commissioner must allow for the termination, but there is no judge–commissioner in the German proceedings.

- solution under Art. 11(2) EIR – decision of the German insolvency court must be sought (definition of „court” under Art. 2(6)(ii) EIR allows for considering the Polish judge–commissioner to be „court” under Art. 11(2) EIR)
Additional reading


in Polish:
- M. Porzycki, Zabezpieczenia rzeczowe w transgranicznym postępowaniu upadłościowym w UE, Czasopismo Kwartalne „HUK” 2008, nr 3, s. 399–420