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The Treatment of Secured Rights in Cross-border Insolvency

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The Treatment of Secured Rights in Cross-Border Insolvency

Contents

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Acknowledgement

INSOL International is pleased to present the 19th Technical Paper under its Technical Papers Series titled " The Treatment of Secured Rights in Cross-border Insolvency" written by Prof. Bob Wessels, Independent legal counsel, Dordrecht, the Netherlands; Professor of International Insolvency Law, University of Leiden; Deputy Justice at the Court of Appeal, The Hague, INSOL Scholar for Europe, Africa and Middle East region 2010/2011.

This paper examines the position of a secured creditor in the event its debtor's assets are located in a country other than where the insolvency proceedings have commenced. The focus is more on European countries and in particular UK, Germany, Austria, Netherlands, Belgium, Spain and France. It examines the EU Insolvency Regulation and the applicability of Article 5 paragraph 1 and the conflicting views that have been expressed in interpreting the provision. It further explores how Article 5(1) has been tested in practice.

In the concluding part of the paper, Prof. Wessels takes the view that Europe lacks clear rules to interpret the EU Regulation and recommends that - future research should provide more clear rules for interpretation, not only in relation to Article 5 but several other provisions too. The relevance of the UNCITRAL Legislative Guide and ALI-III Draft proposals are also covered under the section "Towards a global rule"?

INSOL thanks Prof. Wessels for writing this informative and well-researched paper and we hope our members will find the paper useful.

September 2011

Secured Rights of Banks in International Insolvency

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1. Introduction

Article 5 paragraph 1 of the EU Insolvency Regulation (InsReg) reads:

1. *The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets - both specific assets and collections of indefinite assets as a whole which change from time to time - belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings.*

   In this Technical paper I will focus on the position of a secured creditor in an insolvency case which has international dimensions. The general question is: what is the position of a secured creditor in an insolvency proceeding opened against its debtor if the encumbered asset is located abroad, i.e. in another country other than the one in which these proceedings have been opened? Central in my observations will be Article 5 paragraph 1 of the EU Insolvency Regulation, cited above. Although nearly any party can be a secured creditor (for instance a parent company, a bank or a third party). I will frequently use a bank as an example. I will also make some remarks with regard to the other three paragraphs of Article 5.

2. *The rights referred to in paragraph 1 shall in particular mean:*

   (a) *the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;*

   (b) *the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;*

   (c) *the right to demand the assets from, and / or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;*

   (d) *a right in rem to the beneficial use of assets.*

3. *The right, recorded in a public register and enforceable against third parties, under which a right in rem within the meaning of paragraph 1 may be obtained, shall be considered a right in rem.*

4. *Paragraph 1 shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m).*[1]

This Technical paper will have a European focus, though acknowledging that secured rights in international insolvencies is globally a topic with great complexities.[2] It uses court cases and literature from the UK, Germany, Austria, Netherlands, Belgium, Spain and France. In analyzing this provision I will cross swords with several respected authors and finally conclude that a clear system of interpreting the EU Insolvency Regulation is still lacking. The other theme of this

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* The views expressed in this article are of the author and not of INSOL International, London.

1 See Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160 of 30 June 2000. It should be mentioned that the Insolvency Regulation (InsReg) itself and its accompanying Annexes have been changed or amended six times. The present consolidated version is available via www.bobwessels.nl, weblog, document 2010-08-doc2.

2 See for instance Steven L. Harris, Choosing the Law Governing Security Interests in International Bankruptcies, in: 32 Brooklyn Journal of International Law 905 (2007) (symposium); Daniela Rossmaier, *Besitzlose Mobilarsicherkeiten in grensüberschreitenden Insolvenzverfahren. Eine rechtsvergleichende Untersuchung des deutschen und des U.S.-amerikanischen Internationalen insolvenzrechts sowie der Europäischen Verordnung über Insolvenzverfahren*, Frankfurt am Main, 2003.

essay relates to the question whether the 'European' approach in Article 5(1) is to be recommended for adoption on an international (global) level. Here it will be noted that presently two rather conflicting lines of reasoning are developing. Within the framework of this paper it is evident that only a few problems can be tackled. For other topics I refer to the literature which is included in the footnotes.[3]

A general characterization for a security interest is that its holder is a creditor, who in case of the insolvency of its debtor in general receives his monetary claim in part or in full, dependent on the amount received by selling the attached asset. Generally (again) such a creditor is not influenced by the insolvency of its debtor.[4]

To understand the meaning of Article 5 it is important to realize the system of international jurisdiction of the courts of the Member States of the Europe Union (except Denmark) in cross-border insolvency cases that has been set up. The court where the 'centre of the debtor's main interests' (COMI) of a debtor is situated, so within the territory of a Member State, will have the primacy to open the proceedings against any debtor, be it a natural person or a company.[5] Article 3(1) 2nd sentence, assumes that the registered office is the centre of main interests, in the absence of proof to the contrary. Such a proceeding is called a main (insolvency) proceeding. In cases where the debtor's centre of main interests is located in a Member State, the courts of other Member States have no power to open main insolvency proceedings. However, any of those States may open territorial proceedings, if the debtor has an 'establishment' in the territory of that State. This is called a secondary proceeding. An establishment results from a rather vague description and means any place of operation where the debtor carries out a non-transitory economic activity with human means and goods according to Article 2(h) InsReg. COMI is a prerequisite for international jurisdictions of the courts in one of the Member States. The COMI decision is of utmost importance as the judgment must be recognized automatically in the other Member States (Article 16) and in principle the law of the State the court that has opened insolvency proceedings will apply in the rest of the EU (principle of universality, see Articles 4 and 17).[6] This brings me to the starting point of my observations.

2. Applicable law according to the EU Insolvency Regulation

Contrary to the Brussels Regulation 2002 (or: Judgment Regulation), which regulates the international jurisdiction of courts regarding general civil and commercial judgments and their enforcement within the EU (except for Denmark)[7] the Insolvency Regulation contains – in addition to rules for determining international jurisdiction of courts and provisions for recognition – its own conflict of law rules. Recital (23) provides: 'This Regulation should set out, for the matters covered by it, uniform rules on conflict of laws which replace, within their scope of application, national rules of private international law.'

The imperative text does however not provide a compelling argument to include such rules in the Insolvency Regulation. Nevertheless I think that the combination of the nature of an international insolvency case and the system chosen for recognition of judgments is a decisive reason to take these rules on board. In general insolvency leads to a situation of a common forum where competing claims of creditors should be dealt with in an orderly fashion. The individual creditor's aim to recover the largest part of his claim as possible is – after insolvency of its debtor – halted to be replaced by a collective proceeding, which either is a liquidation or a reorganization. The mirror of the exercise of an individual right is the piecemeal dismantling of the group of assets of the debtor, which assets by themselves form the necessary ingredients of the debtor's business. During insolvency several solutions may be offered that may rescue the business and provide for a better value than a piecemeal liquidation of assets. The individual creditors' rights however may be determined by different substantial rules, e.g. based on

[3] Literature is copious. For Germany I will refer in the footnotes to Ph.D studies of e.g. Liersch (2001), Rossmaier (2003), Naumann (2004), Plappert (2008) and Schmitz (2010). See for the Netherlands Veder (2004), Berends (2005) and Van der Weide (2006). As an aside: German authors should be encouraged to write in English or to include a sound summary of their research results into their publication.

[4] In the Netherlands it is a popular saying that a secured creditor has a legal position 'as if there were no insolvency' of its debtor. However, a more detailed analysis results in at least eight ways in which his position is being influenced by the insolvency of its debtor, see (in Dutch) Wessels Insolventierecht III, 3rd. ed., 2010, para. 3224. In this way for several European countries, William W. McBryde and Axel Flessner, Principles of European Insolvency and General Commentary, in: W.W. McBryde, A. Flessner, S.C.J.J. Kortmann (eds.), Principles of European Insolvency Law, Law of Business and Finance, Vol. 4, Deventer: Kluwer Legal Publishers, 2003, 57ff, submitting that a bank, unaffected by a pari passu rule, receives ultimately the payment of its claim, but the realization of the enforcement may be subject to special rules.

[5] Excluded several financial institutions, among which credit institutions, see Article 1(2) InsReg.

[6] The COMI judgment for instance also establishes the power of the main liquidator in the rest of Europe (Article 18), whilst he has several duties to inform creditors abroad (Article 40). I refer to legal literature regarding the EU Insolvency Regulation, which in the meanwhile is abundant

[7] Council Regulation (EC) 44/2001 of 22 December 2000, OJ L 12 of 16 January 2001.

different legal systems according to which these rights are created, different choices of law in contracts to which the (now insolvent) debtor is a party, different rules regarding set-off of claims and / or different rules regarding preferential rights. To bring this all together in an orderly way, especially in a case where the judgment opening the insolvency proceedings against the debtor is to be recognized automatically (such as the system in the Insolvency Regulation, see Article 16) rules are necessary to steer the traffic on the road of insolvency, as national insolvency rules as such ordinarily do not govern this situation. As a matter of fact, as has been recognized in the history of the Insolvency Regulation ' … international insolvency proceedings can be effectively conducted only if the States concerned recognize the jurisdiction of the courts of the State of the opening of the proceedings, the powers of their liquidators and the effects of their judgments. They may accept it only if the rules on conflict of laws are also harmonized, because harmonized conflict of law rules prove a degree of certainty that, in the event of insolvency, rights created or granted in their jurisdictions will be recognized throughout the … States.'[8] In this way the rules on cross-border insolvency contribute to a better functioning of the internal market, which is one of the aims of the Regulation (see recital 2).[9]

A conflict of law rule relates – broadly – to three topics: jurisdiction, recognition of a foreign judgment and choice of law. The latter is a legal rule that points to a certain specific law, which is the 'applicable' law for (an element in) a certain question or case.[10] Given the nature of a Regulation as an EU measure,[11] the uniform conflict of law rules in the Insolvency Regulation substitute, by operation of law, national rules of Member States dealing with private international law. A reference to the 'applicable law' of a Member State should therefore be taken to mean a reference to that State's internal law, designated by the respective conflict of law rules and without reference to the latter State's private international law. Therefore, the rather complicated method of '*renvoi*' (the reference to 'applicable law' of a State, which also includes a reference to rules of private international law of that State) is avoided.[12]

2.1 General rule of applicable law in insolvency proceedings

Article 5(1) InsReg, referred to above, is to be seen as an exclusion to the general rule of applicable law in cross-border insolvency proceedings within the EU. Recital (23) to the Insolvency Regulation introduces this general rule: '…. Unless otherwise stated, the law of the Member State of the opening of the proceedings should be applicable (lex concursus). This rule on conflict of laws should be valid both for the main proceedings and for local proceedings; the lex concursus determines all the effects of the insolvency proceedings, both procedural and substantive, on the persons and legal relations concerned. It governs all the conditions for the opening, conduct and closure of the insolvency proceedings.' This general rule is laid down in Article 4(1) InsReg and contains the guiding principle that, aside from as otherwise provided in the Regulation, the law applicable to 'insolvency proceedings and their effects' shall be that of the Member State within the territory of which such proceedings are opened. As indicated, the law of such Member State is known as the '*lex concursus*' or the '*lex fori concursus*'. The law of the State of the opening of proceedings shall, in particular, determine the conditions for the opening, conduct and closure of those proceedings and Article 4(2) contains an enunciatively list of thirteen subjects which are determined by the lex concursus. As examples I mention here that the lex concursus shall determine against which type of debtors insolvency proceedings may be brought on account of their capacity (Article 4(2)(a)), the respective powers of the debtor and the liquidator appointed (Article 4(2)(c)), the effects of insolvency proceedings on current contracts to which the debtor is a party (Article 4(2)(c)), the rules governing the lodging, verification and admission of claims and those governing the distribution of proceeds from the realization of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off (Article 4(2)(h) and (i)), or the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors (Article 4(2)(m)).

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8 See Report of May 1996, containing the Report on the Convention of Insolvency Proceedings, designated for the delegation of the Member States, delivered by Miguel Virgós en Etienne Schmit (referred to as Virgós / Schmit Report (1996)) , nr. 8.

9 See Gunnar Lennart Schmüser, *Das Zusammenspiel zwischen Haupt- und Sekundärinsolvenzverfahren nach der EuInsVO*, Internationalrechtliche Studien, Band 55, Frankfurt am Main: Peter Lang, 2009, 23ff. This aim will also be reached by providing a clear and predictable system that facilitates cross-border finance of business investments or trade.

10 Peter Stone, EU Private International Law, 2nd ed., Cheltenham: Edward Elgar 2010, 3.

11 A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States', thus Article 288, second line Treaty on the Functioning of the European Union (TFEU; formerly Article 249, second line EC Treaty).

12 See Bob Wessels, International Insolvency Law, Deventer: Kluwer, 2nd ed., 2006, para. 10624.

Article 4(2)(b) InsReg determines which assets of the estate of the debtor form a part of the insolvent estate. Article 4 however does not determine whether these assets belong to the debtor (are owned by the debtor) as this is not a question of international insolvency law, but one of international property law; see Court of Appeal Leeuwarden 3 March 2009.[13]

The choice in the Regulation for the lex concursus rule as a general rule is, justified or at least remains undisputed by the majority of legal commentators, but its acceptance should be considered in the light of the applicable exceptions, see Article 4(1), the first words being: 'Save as otherwise provided in this Regulation.' As indicated, the Article 4(1) conflict of law rule applies to both main insolvency proceedings and territorial (independent territorial and secondary) proceedings, which is repeated – for secondary insolvency proceedings – in Article 28 InsReg.

2.2 Which 'law' applies?

In respect of 'insolvency proceedings and their effects', Article 4(1) InsReg of the English, French and Dutch texts use the wording 'the law applicable' ('*la loi applicable'*, '*het recht van de lidstaat*') respectively, whereas the German and the Austrian text refer to the applicability for the insolvency proceedings and their effects of '*das Insolvenzrecht des Mitgliedstaats*', meaning: the applicability of (only) the insolvency laws of the Member State (of the opening of proceedings).[14] The wording in the German and Austrian texts certainly indicate a narrower meaning of the lex concursus than the wording in other texts as certain legal rules of 'the law applicable to insolvency proceedings' may fall outside a Member States' 'insolvency law' falling instead under general civil law or general company law but of interest to insolvency proceedings. The following example may serve as an illustration.

In the Netherlands a form of protection is given to the purchaser of goods (A), if the seller (B) claims these goods back when A becomes insolvent (right to claim back goods which are not paid for, generally within six weeks; *recht van reclame*). If the seller himself is insolvent, the question arises as to whether this rule applies against a foreign debtor, who is also insolvent. In this case a rule of general civil law (Article 7:40 Netherlands Civil Code) comes into play, providing the purchaser with a certain portion of protection. Under the German / Austrian approach these rules could probably not be regarded as 'insolvency law' rules. According to the Dutch approach these types of rules would most probably fall under the 'law applicable to insolvency proceedings and their effects' and therefore would be part of the applicable lex concursus. For Germany and Austria I indicated a formal criterion: decisive is the form in which a rule is laid down. If this form is not an Insolvency Act, but a Commercial Code or a Company Act, then the substance of these Codes and Acts do not fall within 'the insolvency law of the member State.' As most German authors, I am in favor of a substantial approach. Whatever the formal (legalistic) place of a rule may be in domestic legislation, it has to be decided whether the rule is functional within the mechanics of the efficient application of insolvency law in any given State. Therefore it could be argued that rules relating to director's liability in insolvency (for instance laid down in a national Corporate Law Act) or rules concerning fraudulent transactions (encompassed in a national Criminal Code) indeed should be seen as rules related or flowing from the body of insolvency law. I leave aside the possibility that the chosen German words (or even the non German texts) reflect a mistake in translation. Certainly recital 23, referring to 'the law of the Member State of the opening of the proceedings should be applicable (lex concursus)' cited above in par. 2.1, indicates a broad meaning.

2.3 Rationale of the exclusion in Article 5 InsReg

Application of the general rule of the lex concursus results in the application of the internal law of the Member State, in which main insolvency proceedings have been opened, in other Member States and the automatic extension of this law (and therefore the legal – procedural and substantial – consequences of the proceedings) to other Member States (Article 16 and Article 25(1) InsReg; Article 17 InsReg), thus thwarting the legal rules which would otherwise apply to legal acts. The Regulation however aims to provide a counter-balance, see recital (24): 'To protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened, provisions should be made for a number of exceptions to the general rule.' The Insolvency Regulation therefore provides a number of exceptions.

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[13] Court of Appeal Leeuwarden 3 March 2009, LJN: BH5277; RI 2009, 38. See for instance in this way too Stephan Kolmann, in: Peter Gottwald (ed.), *Insolvenz-Handbuch*, Verlag C.H. Beck, München, 2010, § 132, nr. 20.

[14] Consequently in German literature it is questioned whether certain topics belong to the domain of (German internal) insolvency law, e.g. the issue of whether a certain specific form of director's liability is an 'insolvency' question of a matter of 'corporate' law. For an overview Kolmann (2010), § 132, nr. 4ff.

Protecting legitimate expectations is an alternative method of stating that certain creditors will be protected from a surprise attack by the lex concursus. The recitals to the Regulation here again are useful, see recital (25): 'There is a particular need for a special reference diverging from the law of the opening State in the case of rights in rem, since these are of considerable importance for the granting of credit. The basis, validity and extent of such a right in rem should therefore normally be determined according to the lex situs and not be affected by the opening of insolvency proceedings. The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security…'. The exclusion of Article 5 is built on the policy of acknowledgment of the interest of each Member State 'in protecting its market's trade, in the form of respect of rights in rem acquired over assets of the debtor located in that country under the law that is applicable before the opening of the insolvency proceedings.'[15]

The other exceptions (to the general rule of Article 4) in Articles 6-15 I will leave aside. Articles 4-15 InsReg form, in the words of Fletcher '…. a miniature code of uniform conflict rules', which offer, in practice '… the essential requirement of predictability for parties who need to calculate the legal consequences of their actions within an intra-Union context.'[16]

2.4 Justification of the exclusion in Article 5 InsReg

Is goes without saying that the most important function of a right in rem for its holder is its function of providing certainty, especially in a situation of financial distress of the debtor. As the Virgós / Schmit Report puts it: 'Rights in rem have a very important function with regard to credit and the mobilization of wealth. They insulate their holders against the risk of insolvency of the debtor and the interference of third parties. They allow credit to be obtained under conditions that would not be possible without this type of guarantee.'[17] The last sentence of course expresses the right in rem's value for the debtor. On the other hand a general underlying policy in matters of insolvency is to try to fix the assets, including the results of transaction avoidance actions, to be available in the pool to distribute on an equal basis to creditors. Is it possible to find a balance between providing security / protecting certainty in financial transactions and increasing the estate / equal treatment of creditors?

Until two decades ago, two approaches to the treatment of rights in rem, situated in another country than the country in which insolvency proceedings had been opened, were considered. These two approaches echo the most well-known dogmatic treatment of matters of insolvency in cross-border matters: universality and territoriality. Universality would mean that the lex concursus of the country in which insolvency proceedings are opened would be applied on a global level. The limitations to a 'foreign' right in rem would therefore be fully determined by the lex concursus. The advantage of this model is that in general all existing rights in rem, on assets wherever located on the globe, exclusively would be treated according to the lex concursus, so the administration of these rights would be dealt with according to one existing policy, which in addition would favor a global equal treatment of creditors. Another advantage would be that any form of reorganization or restructuring would stand better chances, as foreign rights in rem would loose its 'foreign' peculiarities, as they are to be treated as if they were domestic rights. Here too, the disadvantage becomes clear, as it will not always be possible to 'translate' the foreign right in rem into an existing category of (domestic) rights in rem. Forms of 'translation' or 'conversion' may be possible for mortgage or pledge, but many difficulties will arise in characterizing into domestic categories certain rights such as a 'floating charge', a 'trust', a '*Vormerkung*' or a '*Vorzugsrecht*'. This uncertainty then would hamper the availability of finance based on rights in rem related to assets located abroad. The opposite on the scale (territoriality) would mean that all legal effects of the right in rem would be determined by the law according to which the right is created, including its effects in insolvency proceedings (in general: lex rei sitae, being the law of the country where the asset is situated). This approach means for the holder of the right in rem that his certainty in protection and enforcement is on the top of the list. The obvious disadvantage is the complexity of the insolvency proceeding, necessitating the administrator to do research in all the aspects of rights in rem in, say, Norway, Tanzania or Germany, to be able to co-ordinate their treatment.[18] In legal doctrine both approaches have led

[15] Virgós / Schmit Report (1996), nr. 100.
[16] Ian F. Fletcher, Insolvency in Private International Law. National and International Approaches, Oxford Private International Law Series, Oxford University Press, 2nd ed. 2005, nr. 7.78.
[17] Virgós / Schmit Report (1996), nr. 97.
[18] See e.g. J. Taupitz, *Das (Zukünftige) europäische Internationale Insolvenzrecht – insbesondere aus international-privatrechtlicher Sicht*, in: 111 Zeitschrift für Zivilprocess (ZZP) 1998, 315 e.v. See also Alexander Plappert, *Dingliche Sicherungsrechte in der Insolvenz, Schriften zum Insolvenzrecht*, Band 21, Baden-Baden 2008, 249ff, describing several variations.

to suggested models for treatment with a mixed character, either in forms of combination or cumulation.[19]

The question therefore rises which of the alternatives, developed in legal doctrine, was found to be the most convincing or at least the most useful in the context of the of the Insolvency Regulation (its predecessor, namely the Convention). The Report Virgós / Schmit raises a tip of the veil: 'Rights in rem can only properly fulfill their function insofar as they are not more affected by the opening of insolvency proceeding in other … States than they would be by the opening of national insolvency proceedings. This aim could be achieved through alternative solutions which were in fact discussed in the working party. However, to facilitate the administration of the estate the simplicity of the formula laid down in the current Article 5 was preferred by the majority: insolvency proceedings do not affect rights in rem on assets located in other … States.'[20]

Because a solid publication on the very history of the Regulation (going back to the sixties of last century) still lacks, it is hardly possible to learn more about the very background of the deliberations, the pros and cons and the alleged (policy) choices which underpin the Regulation. Interesting, however, are the remarks of the person who was very close to the chefs in the kitchen. In a publication in 1998 professor Virgós explains that the final draft (contrary to an earlier draft) of the Convention requires the presence of an 'establishment' for the possibility of opening a secondary proceeding: 'For this reason, the impact of this rule on the legal position of secured creditors was also different.' Which elements or effects are different is, however, not explained. The citation continues: 'However, a balance between the simplicity of application and the legal certainty provided for by this rule (i.e., Article 5(1); Wess.) against competing alternatives convinced the Working Group in favour of maintaining the solution', being 'the rule adopted … exempts rights in rem from the effect of foreign bankruptcies. It only permits their being affected by way of the opening of domestic insolvency proceedings. The reason for this is clear: to avoid complex forms of regulation which may work well within individual cases, but which require a high level of expertise and are difficult to administer'. This pragmatic point of simplifying insolvency proceedings by isolating rights in rem on foreign assets from the effects of the main insolvency proceedings is valuable, however, it is not reflected in the text, nor in the recitals to the Regulation.

As far as can be assessed, the opinions differ as to the awareness of the final solution adopted by the Working Group mentioned. There are strong views expressed by people involved in the discussions, that the option chosen was clear and deliberately approved[21], for others however, the result came as a surprise. According to an Austrian author, the Working Group did not agree with one of the existing solutions chosen in legal theory, but (in my translation) 'entered a new own road', 'a fully new road'.[22] In the words of German professor Von Wilmowsky (in my translation): 'They found instead a rule, which prior to that moment nearly no one had even considered and which creates for the foreign security rights a peculiar separate status'.[23] In literature indeed this pragmatic argument is stressed, see e.g. the Spanish authors Virgós and Garcimartín. They defend that the exclusions respond to the need to reduce the overall complexity of the insolvency proceedings, referring to recital 11, which opens with the acknowledgment that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community, as '(T)he application without exception of the law of the State of opening of proceedings would, against this background, frequently lead to difficulties.'[24] The reason given by Virgós for the choice of the rule as laid down in Article 5 is that it is based on an idea of law and economics: 'In evaluating the alternatives, not only policy considerations but also arguments based on the relative procedural costs were taken into account: both administration (= those necessary for the application of the rules) and error (= those derived from wrong applications of the law) were compared for this purpose…. (…) …..the idea of facilitating the administration of the estate and the purpose of achieving a PIL text (PIL stands for Private International Law, Wess.) of simple application was decisive: better but more difficult to administer PIL solutions would require constant recourse to legal services, added costs and time-delays'.[25]

[19] See Taupitz, op. cit., 322 e.v.; P. Huber, *Internationales Insolvenzrecht in Europe*, in: 114 Zeitschrift für Zivilprocess (ZZP) 2001, 133 e.v.
[20] Virgós / Schmit Report (1996), nr. 97.
[21] See Manfred Balz, The European Convention on Insolvency Proceedings, in: 70 American Bankruptcy Law Journal 1996, 485ff.
[22] P. von Wilmowsky, *Sicherungsrechte im Europäischen Insolvenzübereinkommen*, in: Europäisches Wirtschafts- und Steuerrecht (EWS) 1997, 295
[23] P. von Wilmowsky, *Sicherungsrechte im Europäischen Insolvenzübereinkommen*, in: Europäisches Wirtschafts- und Steuerrecht (EWS) 1997, 295.
[24] See M. Virgós and F. Garcimartín, The EC Regulation on Insolvency Proceedings: A Practical Commentary, Kluwer Law International, 2004, nr. 135.
[25] M. Virgós, The 1995 European Community Convention on Insolvency Proceedings: an Insider's View, in: Forum Internationale, no. 25, March 1998, 20.

I agree with those authors that argue that this reasoning in itself is flawed.[26] It goes without saying that the complete isolation of rights in rem related to assets, situated abroad, of the influence of main proceedings (also know as: hard and fast rule, see below) results in the non-application of those provisions in the lex concursus which relate to forms of postponement or dissolution of rights and of the provision that certain holders of rights in rem should contribute to the costs of the estate.[27] Some authors describe this situation in terms of the secured creditors gaining an unexpected advantage.[28] The 'bonus' connected to the 'European dimension' of the case allows a secured creditor to execute the collateral pending an insolvency proceeding in a case where the national law would not allow such execution. Although Article 5 in general by the majority of scholars is indeed interpreted as a hard and fast rule, I adhere to the general opinion that the result of this interpretation is the over-protection of secured creditors.[29] According to Virgós and Garcimartín this principle only can be understood by resorting to the main reason: the simplification of the administration of insolvency proceedings.[30]

2.5 Secondary proceeding

It follows from the Preamble to the Insolvency Regulation and from the Virgós / Schmit Report[31], that a certain right in rem shall not be affected by the opening of the main proceedings. Under the system of the Regulation the liquidator in the latter proceedings is able to influence the rights of the holder of the right in rem by initiating, in the other Member State (when the debtor possesses an establishment there) a secondary proceeding: 'Where assets are subject to rights in rem under the lex situs in one Member State but the main proceedings are being carried out in another Member State, the liquidator in the main proceedings should be able to request the opening of secondary proceedings in the jurisdiction where the rights in rem arise if the debtor has an establishment there', see recital 25, fourth line. The Virgós / Schmit Report demonstrates that the term 'not affected' does not immunize rights in rem against the debtor: 'If the law of the State where the assets are located allows these rights in rem to be affected in some way, the liquidator (or any other person empowered to do so) may request secondary insolvency proceedings be opened in that State if the debtor has an establishment there.'[32] These secondary proceedings are conducted according to national law and will allow the liquidator to affect these rights under the same conditions provided for purely domestic proceedings. It also follows from the preamble and the Report that the liquidator in the main proceedings can only affect rights in rem which are in existence elsewhere by initiating secondary proceedings in that other country. It is then necessary for the debtor to possess an establishment, pursuant to Article 2(h), in that Member State. It should be noted that if there is no establishment in the other Member States the applicability in Europe of the lex concursus is halted by Article 5 in a situation in which secondary proceedings cannot be opened. The assets will be beyond the reach of the liquidator and the secured creditor may exercise his right as if there was no insolvency.[33]

The opening of the insolvency proceedings does not affect certain rights in rem, but this does not mean that the assets involved are also fully unaffected. If the value of the assets exceeds the value of the related claim, the creditor is obliged to hand over any surplus to the main liquidator: 'If a secondary proceeding is not opened, the surplus on sale of the asset covered by rights in rem must be paid to the liquidator in the main proceedings', see recital 25, fifth line.[34] This appears to be a logical consequence of the principle which dictates that main proceedings have universal effect. Article 5 introduces an exception to the application of the lex concursus with regard to certain rights in rem, but not with regard to the actual assets which are subject to

[26] The given reason of 'facilitating administration' is not self-evident, see Paul Michael Veder, Cross-Border Insolvency Proceedings and Security Rights. A comparison of Dutch and German law, the EC Insolvency regulation and the UNCITRAL Model Law on Cross-Border Insolvency, Ph.D. Nijmegen 2004, in: Series Law of Business and Finance, Vol. 8, Kluwer, Legal Publishers, 2004, p. 104. According to Jona Israël, European Cross-Border Insolvency Regulation. A Study of Regulation 1346 / 2000 on Insolvency proceedings in the Light of a Paradigm of Cooperation and a Comitas Europaea, Doctoral Thesis, European University Institute, Florence, 2004, Intersentia, Antwerp-Oxford, 2005, 168, the argument 'is, quite simply, unconvincing', as the system of the Regulation itself is complex in nature, particularly with reference to coordination between parallel proceedings, several differences in applicable law and the vagueness of central terms, such as COMI and 'establishment', etc.

[27] See e.g. Vincent Sagaert, *Internationale faillissementen*, in: H. Cousy and E. Dirix (eds.), Cahier / Themis, vormingsonderdeel 20, academiejaar 2003-2004, Brugge, Die Keure, 2003, nr. 42.

[28] See M. Balz, M., *Das neue Europäische Insolvenzübereinkommen*, in: Zeitschrift für Wirtschaftsrecht (ZIP) 1996, 948 (an 'internationality-bonus') and Virgós / Garcimartín, o.c., ('overprotection').

[29] See the former footnote and e.g. O. Liersch, Sicherungsrechte im internationalen Insolvenzrecht: unter besonderer Berücksichtigung der Vereinbarkeit vor Art. 5 und 7 der EG-Verordnung über Insolvenzverfahren (EUInsVo) mit dem deutschen Insolvenzrecht, Europäische Hochschulschriften, Band 3141, Frankfurt am Main: Peter Lang, 2001, 39.

[30] Virgós / Garcimartín, op. cit., 105.

[31] Virgós / Schmit Report (1996), nr. 97ff,

[32] Virgós / Schmit Report (1996), nr. 98,

[33] See Jan Schmitz, *Dingliche Mobilarsicherheiten im internationalen Insolvenzrecht. Internationales und euräisches Privat- und Verfahrensrecht*, Band 11, Nomos, 2010, 114ff. See in a similar context Germany's Federal Court of Justice (BGH) 21 December 2010, NZI 2011, 120, deciding that a secondary proceeding requires the existence of an 'establishment' and that Articles 354 or 356 German Insolvency Act (international insolvency law provisions in relation to non-EU member States) are not applicable.

[34] So too Virgós / Schmit Report (1996), nr. 99; Virgós / Garcimartín (2004), nr. 166(b).

these rights. The asset itself (the ownership of it) belongs to the estate and the size of the estate is determined by the lex concursus of the main proceedings.[35]

Here, I further leave aside the situation that opening of a secondary proceeding in another member State may have its influences on a right in rem and the possibility for the liquidator in the main insolvency proceedings to gain a form of control over the execution of the right in rem.[36]

3. Article 5(1) InsReg further explored

3.1 Basis of a right *in rem*

Article 5(1) InsReg refers to 'rights in rem', but it does not define what these rights are. The starting point should be the understanding that the basis, validity and extent of a right in rem, pursuant to Article 5, will normally be determined according to the law of the Member State within the territory of which the property is situated.[37] This right in rem shall not be affected by the opening of the main proceedings. The question as to which law is decisive with regard to the basis, validity and consequences of the said right in rem will be determined by the applicable rules of international private law, which will in many cases come down to the lex rei sitae at the relevant time. In principle, the consequence will be that the holder of the assets, although it is a part of the insolvent estate, will retain all his rights in respect of the assets in question. He may therefore exercise the right to separate the security from the estate and, where necessary, realize the asset individually to satisfy his claim.[38] The InsReg acknowledges, the interest for each State protecting trade, in the form of respecting those rights *in rem* acquired over assets of the debtor located in that country under the law that is applicable before the opening of the insolvency proceedings.[39]

3.2 Nature of the rule laid down in Article 5

In Article 5(1) – see the text above – the opening words provide that the judgment concerning the 'opening of insolvency proceedings' shall not affect certain rights.[40] As a matter of fact Article 5 only provides a certain limitation to the principle conflict of law rule (lex concursus) and leaves open which law (when the asset is located in another State than the one in which main proceedings have been opened) applies. Several authors have characterized the rule of Article 5(1) as a 'negative' conflict of law rule[41], as it only provides that a right in rem is not affected by a certain law, but is silent on what law applies to them.[42] This reading is confusing, as Article 5(1) can not be seen as a (true) conflict of law rule, as the rule of Article 5 itself does not refer to or points at a certain law. It simply provides for a limitation to the general principle that the lex concursus, with no further formalities, shall produce the same effects in any Member States as under the law of the State of the opening of main proceedings, unless the Regulation provides otherwise and as long as no secondary proceedings are opened in the other member States (Articles 4(1) jo. Article 17(1) InsReg).[43] The exclusion of affecting a right in rem from the 'opening' raises the question whether such rights will be affected by other decisions during the conduct of the proceedings and what the precise meaning is of the words 'shall not affect'. Several of the terms contained in Article 5(1) will be analyzed below.

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[35] See Article 4(2)(b) and for instance Virgós (1998), 20; Flessner, o.c. (1998), 284; E. Dirix and V. Sagaert, *Zekerheidsrechten in de Europese Insolventieverordening*, in: Tijdschrift voor Insolventierecht (Tvl) 2002/Special – Insolventieverordening, 113; Claudia Naumann, *Die Behandlung dinglicher Kreditsicherheiten und Eigentumsvorbehalte nach den Artikelen 5 und 7 EuInsVo sowie nach autonomem deutschen Insolvenzkollisionsrecht*, Europäische Hochschulschriften, Reihe II, Rechtswissenschaft, Vol. 4011, 2004, 359; Stefan Stehle, *Die Stellung des Vollstreckungsgläugigers bei grenzüberschreitenden Insolvenzen in der EU*, KTS Schriften zum Insolvenzrecht, Band 33, Carl Heymans Verlag, 2006, 326; Gabriel Moss and Tom Smith, Commentary on Council Regulation 1346/ 2000 on Insolvency Proceedings, in: Moss, Gabriel, Ian F. Fletcher, Stuart Isaacs (eds.), The EC Regulation on Insolvency Proceedings – A Commentary and Annotated Guide, Oxford University Press, 2nd 2009, 8.90; Kolmann (2010), § 132, nr. 20.

[36] I should also point at Article 5(4) InsReg, providing that Article 5(1) does not preclude actions for voidness, voidability or unenforceability of legal acts detrimental to the body of creditors. See Wessels, op. cit. (2006), para. 10659ff.

[37] For a debate in literature, see Stehle, op. cit. (2006), 119ff; J.A. van der Weide, *Mobiliteit van goederen in het IPR*, Ph.D. Vrije University, Amsterdam, 2006, 197; Schmitz, o.c. (2010), 71ff.; Moritz Brinkmann, *Kreditsicherheiten an beweglichen Sachen und Forderungen*, Jus Privatum 156, Mohr Siebeck, 2011, 339; R. Dammann, *Le droit des sûretés à l'épreuve des procédures collectives*, no. 152, in: Crise du crédit et enterprises, les réponses du droit, oct. 2010, 130ff, submitting – with e.g. Kolmann (2010), § 132, nr. 25 – a minority point of view that 'rights in rem' should be interpreted autonomously, unconnected to the respective Member State's law according to which laws the right has been established.

[38] See Virgós / Schmit Report (1996), nr. 95.

[39] See Virgós / Schmit Report (1996), nr. 100.

[40] It should be noted that similar language as in Article 5 InsReg is used in Article 21 of the Directive 2001/24 of the European Parliament and of the Council of 4 April 2001 on the reorganization and winding up of credit institutions (see Bob Wessels, Commentary on the Directive 2001/24/EC on the Reorganisation and Winding-up of Credit Institutions, in: Gabriel Moss and Bob Wessels (eds.), EU Banking and Insurance Insolvency, Oxford University Press, 2006, 2.111ff.) and its equal in Article 212u Dutch Bankruptcy Act (see Wessels Insolventierecht I, 2nd ed., 2009, para. 1571ff.).

[41] In this way e.g. Virgós / Garcimartín, o.c. (2004), 163; François Melin, Le règlement communautaire du 29 mai 2000 relatif aux procédures d'insolvabilité, Bruylant, Bruxelles, 2008, 234; and Moss / Smith, op. cit. (2009), 8.185.

[42] See N. Watté, *L'opposabilité des sûretés dans le nouveau règlement européen des procedures d'insolvabilité*, in: Revue du droit Université Libre Bruxelles, Vers l'harmonisation en Europe du droit de l'insolvabilité et des garanties, Bruxelles: Bruylant, 2001-2, 7, nr. 13; François Mélin, *Le règlement communautaire du 29 mai 2000 relatif aux procédures d'insolvabilité*, Bruylant, Bruxelles, 2008, 234.

[43] The nature of the rule of Article 5(1) is hotly debated in German language literature, see Stehle, op. cit. (2006), 228ff.; Schmitz, op. cit. (2010), 74ff.

3.3 What is a 'right in rem'?

Article 5(1) merely states that the opening of (main) insolvency proceedings 'shall not affect the rights in rem of creditors …..'. The provision precludes the enforcement of the (universal effect of the) lex concursus, it does not specifically provide when a 'right' is a 'right in rem'. Nevertheless, the opinion in the Report[44], which is also mentioned in the preamble (see recital 25) appears to be logical. It should be noted, however, that the reporters defend a restrictive interpretation of a 'right in rem' by analyzing the following steps: (i) Article 5 is itself an exclusion to the general rule of applying the lex concursus of the 'main' Member State, (ii) secondary proceedings may only be opened when the debtor possesses an establishment in the specific country, and (iii): 'An unreasonably wide interpretation of the national concept of a right in rem to include, for instance, rights simply reinforced by a right to claim preferential payment, as is the case for a certain number of privileges, would make the [Regulation] meaningless, and such a wide interpretation is not to be attributed to Article 5.' In the opinion of the reporters[45] a right in rem (i) is directly and immediately related to assets covered, (ii) the absolute nature of which right can be enforced against all third parties.

The criterion to be applied to qualify a right as a right in rem in the meaning of Article 5(1) InsReg requires that the 'assets' 'belong' to the debtor and are 'situated' within the territory of another Member State at the time of the opening of proceedings. Therefore, there must be an 'asset' 'situated' in a Member State. See below. Future assets, e.g. future installments of a lease, must exist at the time at which the main proceedings are opened abroad, which rule can only be the result of an interpretation of the national law of the other Member State.[46] The same is true for the question of whether such an asset 'belongs' to the debtor, an additional criterion being that this asset must be capable of being 'situated' in another Member State. It is not the national law which is decisive with regard to this latter question but the location rules of Article 2(g) InsReg. Which specific assets are covered by Article 5(1) depends on the provisions and conditions the internal law of the Member State (not being the one where the proceedings are opened) dictates as being subject to certain rights in rem, e.g. – as the provision recognizes – tangible and intangible goods. In addition to establishing rights in rem towards certain specific goods a right may exist in respect of 'collections of indefinite assets as a whole which change from time to time', see Article 5(1). For the purposes of the Regulation, rights which exist in the UK and Ireland known as 'floating charges' are characterized as 'rights in rem'.[47] Likewise for a German type of retention of title (with a broad and lengthier scope)[48], the French form of a pledge of an assembly of assets within a business-undertaking (*fonds de commerce*) or the Spanish form of mortgage on all machinery in such an undertaking (*establicimiento mercantile*).[49]

Article 5(2), cited above, provides an enunciative list of the characteristics of such rights. The Insolvency Regulation deliberately abstains from providing its own definition of a right in rem, as this may differ from the definition given to 'rights in rem' by the specific country in which the assets are located. Article 5(2) states that rights in rem 'in particular' mean a concentrated group of legal powers; the characterization of a right as a right in rem shall be determined by the national law which, according to the normal pre-insolvency conflict of law rules, governs these rights in rem, which in general will be the lex rei sitae at the relevant time.[50] According to the Report, op. cit., the characterization of a right as a right in rem should be sought within the national law which governs rights in rem as according to the normal pre-insolvency conflict of law rules. The Insolvency Regulation adopts, what the reporters call, a 'lege causae' characterization. It appears however that this observation is not reflected in the text of Article 5(1) and 5(2).

It is observed that the most well known rights in rem are mortgage and pledge, though their legal form will vary on a per country basis.[51] In countries where a fiduciary transfer of title (resulting in 'legal ownership' for the creditor) is possible, such ownership is to be regarded as a right in rem.

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[44] Op. cit., nr. 102.
[45] Op. cit., nr. 103.
[46] See Fletcher, op. cit. (2005), 7.88.
[47] See Ian F. Fletcher, Choice of Law Rules, in: Gabriel Moss, Ian F. Fletcher, Stuart Isaacs (eds.), The EC Regulation on Insolvency Proceedings – A Commentary and Annotated Guide, Oxford University Press, 2nd ed. 2009, 4.18ff.
[48] Kolmann (2010), § 132, nr. 25.
[49] Reinhart, book review of Plappert, op. cit. (2008), in: Zeitschrift für Zivilprozess (ZZP) 2010, 386. 'Good faith' in the existence of a certain right in rem is not protected, see Kolmann (2010), § 132, nr. 40.
[50] See Virgós / Schmit Report (1996), nr. 100. See Court of Appeal Leeuwarden 3 March 2009, LJN: BH5277; RI 2009, 38, deciding that Article 5(2)(b) and 5(2)(c) only apply to secured rights on assets located in another Member State on the moment of opening of main proceedings.
[51] See N. Watté, op. cit. (2001), nr. 12; Vincent Sagaert, *Internationaal insolventierecht: enkele actuele ontwikkelingen*, in: Braeckmans et al. (eds.), Curatoren en Vereffenaars: Actuele Ontwikkelingen II, Antwerpen-Oxford: intersentia 2010, 277.

The (Dutch) right of retention should not be characterized as a right in rem.[52] Case law starts to provide its examples. The Court of Appeal Antwerp 4 March 2009 is deciding in a case in which in Germany main insolvency proceedings have been opened, but the applicable German law, according to the court, does not affect a prejudgment attachment (*bewarend beslag*) on a sea-going vessel located in Belgium. Where the lex rei sitae is decisive in qualifying a certain right as a right in rem, the court applies Belgian law.[53]

Another decision comes from a court in Arnhem, the Netherlands, in 2008.[54] At hand is a claim for damages, made by the claimant ('Reederei') against the defendant ('F.L.B') resulting from a collision between an inland navigation ship owned by F.B.L and a tow boat (*duwboot*), owned by Reederei, on the river Waal in the Netherlands. The latter claims damages. Reederei has invoked Article 5 InsReg, but the court denies its applicability, stating that it may be the case that a claim for damages will create a right of priority on the ship, but that there are no indications that such a priority is a right in rem as required by Article 5, nor that its holder is allowed to recover his claim outside of the insolvency proceedings and execute the ship without the liquidator's involvement.

In order for Article 5 InsReg to apply, the rights in rem, which remain unaffected by the opening of the main insolvency proceeding, exist '….. in respect of tangible or intangible, moveable or immoveable assets - both specific assets and collections of indefinite assets as a whole which change from time to time - belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings', see Article 5(1). The quotation carries a substantive component (in terms of which particular assets fall within the ambit of the exception) and a territorial component (in terms of where such assets are situated). For the latter question, see the next paragraph.

By virtue of Article 5(3) the right, recorded in a public register and enforceable against third parties, under which a right in rem pursuant to Article 5(1) may be obtained, shall be considered a right in rem. The provision deviates from the conflict of law rule of the lex rei sitae and determines that for the application of Article 5 the said right is a right in rem directly, without referring to a particular national law.[55] Such a recorded right should also exist prior to the opening of the main proceedings.[56] An example of such a right is the German '*Vormerkung*' or '*Vorkaufsrecht*'[57] and its Dutch equivalent in Article 7:3 of the Netherlands Civil Code.

3.4 Localisation of a right *in rem*

In the context of the Insolvency Regulation, the definition in Article 2(g) encompasses the only localisation rule. The Regulation provides on this point uniform rules regarding the determination of the territorial location of the assets and is therefore decisive in respect of (i) the question of whether assets belong to the main insolvency proceedings and whether or not rights in rem – on assets located abroad – are affected or (ii) the question of whether these assets belong to the territorial proceedings, as such proceedings can only affect the assets located in the State in which the proceedings are opened. Article 2(g) InsReg distinguishes three rules for locating assets. The relevant point in time to determine the location of assets is the time at which the proceedings are opened.[58] In case an asset is located in a third state in general decisive is the law of this location, including its conflict of law rules.[59]

Article 2(g) provides that 'the Member State in which assets are situated' shall mean, in the case of:

- tangible property, the Member State within the territory of which the property is situated,

- property and rights ownership of or entitlement to which must be entered in a public register, the Member State under the authority of which the register is kept,

[52] See Dirix / Sagaert, op. cit. (2002), 111.
[53] Court of Appeal Antwerp 4 March 2009, Europees Vervoer 2009, 256. According to Sagaert, op. cit. (2010), 277, also specific privileged creditors (in as far as their form of execution is similar to the execution of a pledge), fall within the scope of a 'right in rem'.
[54] District Court Arnhem 3 December 2008, LJN: BG6986 (*X Reederei GmbH v. F.L.B. SPRL*).
[55] See Report Virgós / Schmit (1996), nr. 101.
[56] see Report, op. cit., nr. 96 and nr. 103.
[57] Kolmann (2010), § 132, nr. 18.
[58] See Virgós / Schmidt Report (1996), nr. 224; Virgós / Garcimartín, op. cit. (2004), nr. 307
[59] See Mélin, op. cit. (2008), 236ff, explaining the rather uncertain rules in France.

- claims, the Member State within the territory of which the third party required to meet them has the centre of his main interests, as determined in Article 3(1) InsReg.

Tangible property situated in the territory of a Member State is considered to be located in the place in which it is physically situated. This is the situs naturalis, which confirms the lex rei sitae rule for furniture, laptops and computers, large equipment, stock, etc. In the event that main proceedings are opened at a time in which certain tangible goods are in transit, the rules of the State within which main proceedings are opened are decisive to determine the location of these goods for the purposes of the Regulation.[60]

Pursuant to Article 2(g), third point, Article 3(1) InsReg, claims are located in the Member State within the territory of which the third party required to meet them has the centre of his main interests. The location of the Member State in which the centre of main interest of the third party – i.e. the debtor of the insolvent debtor – is decisive. Sometimes this point of departure is referred to as lex debitoris or "account debtor."[61]

For certain types of assets, such as shares in a company or IP-rights, the Regulation is silent about the way these rights should be located. Here, I would like to point to a project reflecting 'law in development'. I am referring to a set of Global Principles for Co-operation in International Insolvency Cases, the preliminary draft of which was published in April 2010, by professor Ian Fletcher (University College London) and myself. These Principles reflect a non-binding statement, drafted in a manner to be used both in civil-law as well as common-law jurisdictions, and aim to cover all jurisdictions in the world. To a large extent these Global Principles for Co-operation in International Insolvency Cases build further on the Principles of Co-operation among the member-states of the North American Free Trade Association, developed by the American Law Institute. These Principles in turn have evolved from the American Law Institute's Transnational Insolvency Project, conducted between 1995 and 2000. For their work for the Global Principles project Fletcher and I, having been appointed by the American Law Institute and the International Insolvency Institute, have produced texts – in draft, dated April 2010 – of, respectively, 41 Global Principles for Co-operation in Global Insolvency Cases, 18 Global Guidelines for Court-to-Court Communication in International Insolvency Cases, and 23 Global Rules on Conflict of Laws Matters in International Insolvency Cases.[62]

We also have been developing so-called 'localization rules'. I limit myself here by only providing the 'rule' we suggest to apply on a global level.

For 'Non-registered movables' the general rule is followed, presently numbered 7.1, providing 'Non-registered movables, and rights vested in or attached to them, are located at the place where the non-registered movable is situated', but a distinction has been made:

7.2 For the purposes of paragraph 1 the following legal presumptions apply:

a. Movables recorded in a vehicle license register, and rights vested in or attached to them are presumed to be located at the place where the movable is recorded in the vehicle license register.

b. Goods in transit as well as rights vested in or attached to them are presumed to be located in the state of destination.

Two other rules suggested are:

Rule 10 Shares in joint-stock companies

10.1 Bearer shares and rights vested in or attached to them are located at the place where the bearer share certificate is situated.

[60] See Virgós / Garcimartín, op. cit. (2004), nr. 310. .
[61] For an application, see Higher Regional Court Vienna 9 November 2004 (Stojevic), NZI 2005, 56, in which it was considered that the location of a claim is determined according to the third point laid out in Article 2(g) InsReg.
[62] These texts are at this stage provisional, pending approval and formal adoption by the ALI and III respectively. The text, including commentaries and Reporters' Notes, is available via http://bobwessels.nl/wordpress/?p=996.

10.2 Registered shares and rights vested in them are located at the place where the registered share or the right vested in it is recorded in a register of shareholders kept by the company.

10.3 If a registered share or a right vested in it is not recorded in a register of shareholders, the registered share or the right vested in it is located at the place where the company has the centre of its main interests. The centre of the main interests of the company is presumed to be the place of its registered office.

10.4 Book-entry shares and rights vested in them are located at the place of the registered office of the intermediary with which the securities account is kept in which the book-entry shares are administered.

Rule 11 Intellectual property rights

Patent rights, trademark rights and copyrights and rights vested in them are located at the place where the patent holder, trademark proprietor or copyright holder has his seat or his domicile.[63]

3.5 Opening of insolvency proceedings

The 'opening' of the main insolvency proceedings and the consequential effects of automatic recognition (and the universal effect of the lex concursus within the EU) 'shall not affect' certain rights. Given the prominence of the term 'opening' the obvious question is: are these rights only free from the influence of the judgment 'opening' main insolvency proceedings and therefore, will such rights be affected by other decisions or judgments made during the course of the main insolvency proceedings? Or should '(T)he opening of insolvency proceedings', be read to mean: shall not be affected by '(T)he Insolvency Regulation'.[64] Berends refers to the effect of the text as being clear (as it simply says: 'opening') with the designation that it is a: '*règle pure et simple'* (the 'pure and simple' rule).[65] The consequence of this view is that only the effects of the opening judgment are halted, not any later effects of other decisions or orders during these proceedings. Berends argues[66] that Article 5(1) can be interpreted in terms of the 'pure and simple rule'. He admits that this explanation is not contained in the Virgós / Schmit Report (1996), but, it is also not rejected or impossible.[67] Anyway, other authors as well submit that Article 5(1) can be interpreted in terms of the pure and simple rule. This particular rule has followers in the Netherlands and both Germany and Austria.[68] The text is certainly confusing, however, it is my contention that the pure and simple rule does not contribute to the achievement of the purpose of the Regulation. Its application would lead to interference with legitimate expectations and would cross the continuation of common credit lines. It furthermore can hardly be seen as simplifying the administration of the proceedings. The genesis and the teleology of the Regulation point to the interpretation that the rights mentioned in Article 5 (and 6 and 7) are immune from the main insolvency proceedings.[69]

3.6 Shall not affect

The exception to the central principle of applicability of the lex concursus in Articles 5(1) is worded thus: the 'opening' of insolvency proceedings 'shall not affect' ('*onverlet' laat; 'nicht berührt', 'n'affecte pas*') the rights which fall under the scope of this article. The text itself is not clear. Here a reference can be made to the German author Naumann. She provides a detailed analysis of Articles 5(1) (and Article 7, containing the same language) in an aim to shed some light on the 'interpretation chaos' in legal literature (not including English and Dutch literature).[70]

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[63] Rule 11 follows § 101 (4) juncto § 102(1) of the American Law Institute's Intellectual Property Principles of 2007. The suggested rule is nearly similar to Recommendation 248(c) of the UNCITRAL Legislative Guide on Secured Transactions. Supplement on Security Rights in Intellectual Property (published early 2011), which provides that a national law should provide that the law applicable to the enforcement of a security right in intellectual property is the law of the State in which the grantor is located. A 'grantor' means a person that creates a security right to secure either its own obligation or that of another person.

[64] For discussion of this question see Axel Flessner, *Dingliche Sicherungsrechte nach dem Europäischen Insolvenzübereinkommen*, in: Festschrift für Ulrich Drobnig, Jürgen Basedow et al., Tübingen 1998, 277ff.; Schmitz, op. cit. (2010), 73ff.

[65] A.J. Berends, *Insolventie in het internationaal privaatrecht*, Ph.D. Vrije University, Amsterdam, 2005, 388.

[66] Berends, op. cit. (Ph.D. 2005), 399.

[67] Berends is of the opinion that draftsmen are inclined to deliberately include terms of a vague nature in respect of certain topics in EU Regulations and Directives. The adoption of ambiguous text occurs, in Berends' opinion, where issues are, on the one hand, of a sensitive nature, but on the other hand not sufficiently significant to warrant the inclusion of a separate EU measure (such as the Insolvency Regulation). In Berends' opinion the chosen words in this instance could have been the result of such 'intentional and creative ambiguity.' This is of course a serious qualification, coming from someone who was closely (as civil servant representing the Netherlands) involved in the 'Brussels negotiations'.

[68] Israël, op. cit. (2005), 280; Klaus Pannen / Tina Kühnle, *Zur Stellung der Insolvenzgläubiger nach der Europäischen Verordnung über Insolvenzverfahren (EuInsVO)*, in: Neue Zeitschrift für das Recht der Insolvenz und Sanierung (NZI) 2002, 305; Duursma-Kepplinger, op. cit. (2002), Art. 5, nr. 37 and nr. 49; Plappert, op. cit. (2008), 268.

[69] In this way too Virgós / Garcimartín, op. cit., nr. 166.

[70] Naumann, op. cit. (2004), 133.

Naumann considers a textual interpretation in fourteen languages with regard to the wording 'shall not affect' ('*onverlet' laat; 'nicht berührt', 'n'affecte pas'*, etc). The outcome of the study is that in nearly all languages the term may be read to mean either 'no affect whatsoever on the right in rem' or 'not to be influenced to the detriment of the holder of the right in rem.'[71]
With regard to Article 5(1), the majority of scholars explain the wording 'shall not affect' largely in three ways. The first proposition is that the holder of a right in rem will not be affected by foreign law (i.e. the universal reach of the lex concursus of the main proceedings), but he will be bound by any limitation of the lex rei sitae, meaning the limitations which are contained in the law of the Member State in which the asset is situated. The limitation is made to the applicability of the lex concursus, but not to the insolvency law of the Member State in which the asset is situated. A creditor who has taken security over moveable property located in Italy will not be affected by the consequences of the opening of main proceedings in Poland, but he will be subject to any limitations imposed by Italian law for this type of creditor (and this type of right). The rationale for this approach is that it is unfair to place this creditor in a better position than he would have been if the property had been located in the Member State in which the proceedings were opened. The strongest advocate for this approach is Flessner.[72] The second proposition is derived from the first one and can be summarized thus, that the secured creditor is limited in its actions only to the extent that the limitations of the lex rei sitae (in the given case: Italy) match the limitations of the lex concursus (i.e. Poland). Therefore, in principle the right in rem is not affected by the opening of foreign main proceedings, but the secured creditor will be bound by those limitations of the lex rei sitae to the extent that such limitations reflect the limitations of the lex concursus. Authors in favour of this opinion state that the protection which Article 5(1) aims to provide is not frustrated as rights in rem are not limited as severely as they would have been in a domestic proceeding.[73] The desire to uphold legal certainty is presented as central to this proposition as the creditors' rights in rem will not be affected as they would have been following the opening of national insolvency proceedings. This approach has been called the 'cumulative solution' ('*Kumulationslösung*') by Liersch.[74] Recently this line of reasoning has been defended again by Plappert.[75]

For both views either the text, nor the history (as far as can be reconstructed) provides any basis. Furthermore both models do not seem logical as they introduce elements, derived from the lex concursus (of the other Member State), whereas Article 5(1) InsReg intentionally serves as an exception to the lex concursus (of the Member State in which the main proceedings are opened). It may be the case that the German text of recital 11 has prompted the position taken. Having noted the differences in the laws on security interests to be found in the Community and those regarding the preferential rights enjoyed by some creditors in the insolvency proceedings, the Regulation should take account of this in two different ways: 'On the one hand, provision should be made for special rules on applicable law in the case of particularly significant rights and legal relationships (e.g. rights in rem and contracts of employment). On the other hand, national proceedings covering only assets situated in the State of opening should also be allowed alongside main insolvency proceedings with universal scope.' The English text uses the rather neutral words 'special rules on applicable law' (Dutch: '*specifieke voorschriften betreffende het toepasselijke recht*'; French: '*des règles spéciales relatives à la loi appicable*'), where the German text says: '*Sonderanknuepfungen*' for certain rights, which seems to indicate that Article 5(1) indeed provides a connecting factor.

The third proposition, however, finds the strongest support in legal literature. It plainly contains the rule that a secured creditor may exercise all his rights, fully, unconditionally, unlimited and undisturbed.[76] The wording 'shall not affect' in this approach is to be read as to mean that said secured creditor does not encounter any limitation. It is clear from the Regulation's preparatory working documents that this is the approach that should be followed. As said, this view is referred to as the 'hard and fast rule' or the 'maximalist view'[77] and it is clear from the Virgós /

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[71] Naumann, op. cit. (2004), 214. That the text in itself is clear, as submitted by Lars Westpfahl, Uwe Götker and Jochen Wilkens, Grensüberschreitende Insolvenzen, Köln: RWS Skript 347, 2008, 91, is therefore incorrect (as in many instances a legal texts seems clear, but after analysis it isn't).

[72] See Flessner, o.c. (1998), 285.

[73] See S.C.J.J. Kortmann / P.M. Veder, *De Europese Insolventieverordening*, in: Weekblad voor Privaatrecht, Notariaat en Registratie (WPNR) 6421 (2000). These authors contend that the proposition that the limitations of the lex rei sitae should be aligned with the lex concursus only can be defended if, and to the extent that, such limitations are reflected by similar such limitations in the lex concursus.

[74] Olivier Liersch, *Sicherungsrechte im Internationalen Insolvenzrecht*, in: Neue Zeitschrift für das Recht der Insolvenz und Sanierung (NZI) 2002, 17

[75] Plappert, op. cit. (2008), 284. For critique, see the book review of Reinhart, op. cit. (2010), 385ff. Recently André Berends, The EU Insolvency Regulation: Some Capita Selecta, Netherlands International Law Review, LVII, 2010, 423ff, has submitted that in the theory that indeed the lex rei sitae applies (what he calls: 'soft and slow rule') a distinction could be made in (i) indeed the lex rei sitae is decisive, or (ii) the lex rei sitae allows the opening of insolvency proceedings to affect the right in rem, in which case, the lex concursus is decisive.

[76] District Court Rotterdam 29 April 2009, S&S 2009, 122, indeed follows this approach, by considering that the court agrees with the parties (a German bank with a right in rem on a ship versus a German liquidator of an insolvent GmbH) that the insolvency of the GmbH in Germany will not stand in the way of the bank selling the ship, situated in the Rotterdam harbour.

[77] See e.g. Virgós, op. cit. (1998), 20; Dirix / Sagaert, op. cit. (2002), 112.

Schmit Report[78] that despite the existence of several possibilities, it is the latter approach which should prevail. As explained above, it is recorded from the history of the Insolvency Regulation that during the final discussions regarding facilitation of estate administration the majority preferred the simplicity of the formula laid down in the current Article 5: the 'simplification of the administration of insolvency proceedings.'[79] According to Virgós and Garcimartín this principle only can be understood by resorting to the main reason: the simplification of the administration of insolvency proceedings. Support for the hard and fast rule is found in France[80], the Netherlands[81], Belgium[82], Germany[83] and the United Kingdom.[84]

4. Article 5(1) tested in practice

As previously explained, the meaning of 'shall not affect' according to the prevailing view in legal commentary is the hard and fast rule: the holder of a right in rem (secured creditor), when he exercises his rights, will be able to do so, fully undisturbed by the lex concursus. This will also be the case in the event that the applicable national law (lex rei sitae) imposes restrictions on secured creditors in the context of national insolvency proceedings. The approach laid out in the explanatory report[85] and the notes related to Article 5's history by Virgós prevent creditors from being hampered in connection with property located in a Member State and subject to a right in rem. The consequences of the universal effect of the lex concursus of the main proceedings apply throughout the Community, but rights in rem of third parties (and the rights as laid down in Article 6 and 7) in other Member States remain unaffected. An individual attachment to an asset which is subject to a right in rem contradicts the general principle of the universal effect of the lex concursus. Under the system of the Regulation, if a liquidator in the main proceedings desires to prevent execution of goods, which are situated in another Member State and are subject to a right in rem, he should initiate secondary proceedings in that other Member State (under the presumption that the debtor has an establishment there and that the national law of the latter Member State indeed contains limitations with regard to secured creditors and individual attachments).

The hard and fast rule ('shall not affect') appears to be clear-cut. However, it raises the question of precisely which elements of a right in rem will not be affected. Recital 25, second and third line, provide: 'The basis, validity and extent of such a right in rem should therefore normally be determined according to the lex situs and not be affected by the opening of insolvency proceedings. The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security.' The central question therefore is: does the hard and fast rule protect the right in rem itself or does it also protect all the powers that are, according to the lex situs, attached to it. For instance, will the holder of the right be protected against all those rules which may not interfere with the right in rem, but do interfere with the exercising of this right? For example, the lex concursus contains certain forms of postponement or dissolution of rights, e.g. the power of the liquidator to redeem the right in rem. The Dutch cooling-off period can be used as an example of a form of postponement. A related question is: will the right in rem be affected, when the right itself remains untouched, but the debt to which the right relates is affected by a certain rules of the lex concursus? A clear 'no' to this question has been given by Veder.[86] The rights in rem on assets located abroad can not be affected by provisions in the lex concursus of the main proceedings concerning for instance an exclusive power of the liquidator to execute assets which are subject of a right in rem, the power to set a time period to the secured creditor to realize his right, a form of a cooling off period or any temporary limitation to execute the right in rem or the duty to pay a certain amount of costs to the estate. His argument is based on the recitals preceding the Insolvency Regulation, the Virgós / Schmit report and the personal account of Virgós' adventures of the

[78] Virgós / Schmit Report (1996), nr. 97.
[79] Virgós / Garcimartín, op. cit. (2004), nr. 136 and nr. 164.
[80] Mélin, op. cit. (2008), 242ff.; R. Dammann, op. cit. (2010), 134. In a 'Circulaire' of 2006, issued by the French Minister of Justice, and providing guidance in interpreting the Regulation indeed it is provided that a right in rem can be execised without any restriction ('*sans aucune restriction*'). See: www.textes.justice.gouv.fr/art_pix/boj_20070001_0000_0001.pdf.
[81] P.M. Veder, *Goederenrechtelijke zekerheidsrechten in de internationale handels- en financieringspraktijk*, in: R.W. Clumpkens et al., Zekerhedenrecht in ontwikkeling. Preadvies voor de Koninklijke Notariële Broederschap 2009, 307ff; A.J. Berends 2010, Sdu Commentaar Insolventierecht, 497, Art. 5, C.3 ('Most likely the hard and fast rule applies'); Berends, Netherlands International Law Review 2010, 433: 'Whether we like it or not, Article 5 contains a hard and fast rule.'
[82] Sagaert, op. cit. (2010), 277ff.
[83] Thomas Ingelmann, in: Klaus Pannen (ed.), European Insolvency Regulation, Berlin: Walter de Gruyter, 2007, Art. 5, nr. 8 (with further references); Schmitz, op. cit. (2010), 79ff.; Brinkmann, op. cit. (2011), 339ff.
[84] It follows from the treatment of the system of conflict of law rules by Fletcher, op. cit (2009). In this way too Moss / Smith, o.c. (2009), 8.187. Some doubts are expressed by Stuart Isaacs, Felicity Toube, Nick Segal and Jennifer Marshall, The Effect of th Regulation on Cross-Border Security and Quasi-security, in: Gabriel Moss, Ian F. Fletcher, Stuart Isaacs (eds.), The EC Regulation on Insolvency Proceedings – A Commentary and Annotated Guide, Oxford University Press, 2009, Chapter 6, 79ff.
[85] Virgós / Schmit Report (1996), nr 96ff.
[86] Veder, op. cit. (2009), 306ff.

drafting history of Article 5, therefore the clear pragmatic rule not to make the liquidator's life difficult. Several authors, from several countries, have nevertheless expressed some doubts.

4.1 Right to redeem

It has been submitted that – without affecting the economic value of the right or its immediate realization – Article 5 gives the liquidator the power to decide on the immediate payment of a guaranteed claim, thus avoiding the loss in value that certain assets could suffer if realized separately.[87] Full payment of the claim will in general have the consequence of the termination of the right in rem. I agree with Berends that the 'right to pay the debt' by the liquidator is not a 'natural' right, but should have its basis in the applicable law, as the powers of the main liquidator to pay the claim, in full, to which the right in rem relates, are determined by the lex concursus.[88] In the Netherlands the main liquidator indeed possesses such a power ('The liquidator may, ….. redeem the pledged or mortgaged property against payment of the amount for which the pledge or mortgage serves as security and the foreclosure costs already incurred,' Article 58(2) Netherlands Bankruptcy Act). The next question raised is whether, when a right to redeem exists, and such a right is exercised by the main liquidator, the right in rem is affected when the claim, on which the right in rem is based, is fully paid up, with the consequence that the right in rem lapses. Several authors are of the opinion that a liquidator's right to redeem indeed does not affect the rights of the holder of a right in rem.[89] In his approach to Article 5 as a *règle pur et simple* Berends opines that the main liquidator's right to redeem is not a direct consequence of the opening of the insolvency proceedings and therefore Article 5 does not protect the holder of the right against the use of it by the liquidator.[90]

4.2 Cooling-off period

In several countries, a cooling-off period or moratorium is set in place, either by operation of law or based on a request. For instance, in the Netherlands on the application of each interested party or on his own motion, the supervisory judge may issue a written order stipulating that, for a period of two months (with one possibility to extend for a maximum of two months), '…. each right of third parties to recourse against property belonging to the estate or to claim property under the control of the bankrupt or the liquidator may only be exercised with his authorization'.[91] Does such a moratorium 'affect' a right in rem within the meaning of Article 5(1) InsReg? Berends has submitted that a temporary postponement of the enforcement of a right in rem can be defended as leaving the right in rem itself unaffected.[92] The reasoning is that the right may be used to its full extent, albeit that the enforcement is postponed to make way for the realization of another, more important interest (in the Netherlands to provide some breathing space for the liquidator to assess the estate and to consider his position). The order itself is a judgment deriving directly from the insolvency proceedings and which is closely linked with it, as pursuant to Article 25(1), third sentence InsReg. Not every influence on the exercise of a right in rem has an inherent affect on the right itself. It was previously noted that the text 'shall not affect' may be interpreted to mean – in 14 languages – either 'no affect whatsoever on the right in rem' or 'not to be influenced to the detriment of the holder of the right in rem' and that a systematic analysis of Article 5 InsReg and related, nearly similar texts of EU Directives, such as Directives 2001/17 and 2001/24 on the winding-up and reorganization of insurance undertakings and credit institutions, results in the interpretation that 'in its core Article 5 dealt with the protection against substantial impediments. Rights in rem must be realizable without hindrances and without noticeable devaluation'.[93] However, I agree that (temporary) 'postponement of some sort' contradicts, to a certain extent, Recital 25, third line: 'The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security,' particularly with respect to the word 'continue.'[94] Other authors have

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87 Virgós / Schmit Report (1996), nr. 99.

88 A.J. Berends, *Grensoverschrijdende insolventie*, Amsterdam: Nederlands Instituut voor het Bank- en Effectenbedrijf, 1999 (NIBE Bankjuridische Reeks, nr. 57), 131. In this way too Plappert, o.c. (2008), 265.

89 Dirix / Sagaert, op. cit. (2002), 113; Jens Haubold, *Europäische Insolvenzverordnung, Kapitel 32*, in: M. Gebauer / T. Wiedmann (Eds.), Zivilrecht unter europäischem Einfluss. Die richtlinienkonforme Auslegung des BGB und andere Gesetze – Kommentierung der wichtigsten EU-Verordnungen, Richard Boorberg Verlag, 2nd ed., 2010, nr. 120; S. Reinhart, *EuInsVO*, in: Münchener Kommentar Insolvenzordnung, Band 3, 2. Auflage, München: Verlag C.H. Beck, 2008, Art. 5, nr. 3; Kolmann (2010), § 132, 32; Schmitz, op. cit. (2010), 78.

90 Berends, op. cit. (PhD, 2005), 411.

91 Article 63a (bankruptcy liquidation), Article 241a (suspension of payment) and Article 309 (debt rescheduling natural persons) Netherlands Bankruptcy Act.

92 Berends, op. cit. (PhD, 2005), 402. In a recent publication however (Berends, Netherlands International Law Review 2010, 434), Berends seems to nuance his earlier position by submitting that the right in rem should not be adversely affected by the opening of an insolvency proceeding: 'The loss suffered by the suspension of the exercise of the right in rem is as relevant as the loss suffered by the infringement of the right itself, but where Article 63(2) of the Dutch Bankruptcy Act allows the court to compensate the loss caused, the result is that the right in rem is not affected.'

93 See Naumann, o.c. (2004), 238

94 See Balz, op. cit. (1996), 509, submitting that a stay affects a right in rem. Expressing some doubts: Isaacs et al., op. cit. (2009), 6.81.

proposed an alternative view, generally based on the argument that a moratorium is an inherent limitation of the right in rem itself.[95]

4.3 Lodging the claim

Another question is whether the right in rem is 'affected' when the lex concursus in the main proceeding prescribes that all claims of creditors, therefore including claims of secured creditors, must be lodged. Based on Article 4(2)(g) and (h) such a secured creditor will have a duty indeed to lodge his claim. The notice the main liquidator must send to known creditors contains specific information, prescribed in Article 40(2), including an indication of whether creditors whose claims are preferential or secured in rem need to lodge claims. The secured creditor is therefore not fully 'free' as a result of the Article 5 hard and fast rule.

4.4 Paying certain costs

In case the lex concursus contains a rule prescribing that secured creditors must also pay towards the costs of the insolvency administration (such as Article 170-172 of the German Insolvency Act), it must be questioned whether this affects the secured creditor's right. According to Berends[96] this rule results ipso iure from the opening of the insolvency proceedings and affects the creditor's rights. Other authors have a different view, expressing that such a rule indeed affects a right in rem.[97]

4.5 Realization of the asset

In literature it has been discussed whether the main liquidator (in the context of the main insolvency proceedings) may realize the asset, if the lex concursus so allows. The majority of authors answer in the affirmative rightly submitting that the Article 5 rule of 'non-alteration' protects the right in rem, but not the asset.[98] The prevailing view is that the liquidator in the main proceedings has to pay the secured creditor the amount which is derived from the lex rei sitae. Article 18 InsReg serves as an indication here. In case the holder of the right in rem executes this right and any amount remains after having satisfied his claim, that amount should be transferred to the main proceedings.[99]

4.6 Affected by a rescue plan?

As a last example of the question whether a certain legal topic may have its influence on a right in rem serves the possibility that in the State where the main insolvency proceeding is pending a rescue plan or a similar proposal evidently will affect the underlying claim. With a simple example: in the plan all creditors will receive 65 percent on their claim. In such a situation, is the foreign holder of a right in rem bound by the plan, as it will probably influence his claim, but leaves his right in rem untouched? Already early after the introduction of the Insolvency Regulation in 2002, this possibility has been defended. The Austrian author Duursma-Kepplinger has, under the heading 'limitations of unaffectedness', defended the proposition that Article 5 does not protect against any legal effects of the proceedings, which occur during the insolvency proceedings, e.g. a rebate of claims or the influence of a rescue plan, including its domestic 'cram-down' rules.[100] In the same way the Dutch author Van Galen[101] and the German authors Paulus[102] and Westphal et al.[103] Other authors defend the hard and fast rule to the limit: secured creditors may not be impaired by a plan.[104] Duursma-Kepplinger contends that her interpretation follows from Article 4(2)(j) and Article 34 InsReg, which places the rescue plan at the close of the insolvency proceedings rather than at the opening of the proceedings. This is, I believe, an expression of the *règle pur et simple* (a la Berends) and not so much the idea that influencing the underlying debt is not automatically also influencing the right in rem. Other

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[95] Veder, op. cit. (PhD 2004), 249. See also Dirix / Sagaert, op. cit. (2002), 113, and possibly Virgós, op. cit. (1998), 20, who, very generally states, between brackets '(….. no bankruptcy stay may be imposed').

[96] Berends, op. cit. (PhD, 2005), 412ff.

[97] Kolja von Bismarck / Kirsten Schümann-Kleber, Insolvenz eines ausländischen Sicherungsgebers – Anwendung deutscher Vorschriften auf die Verwertung in Deutschland belegener Kreditsicherheiten, Neue Zeitschrift für das Recht der Insolvenz und Sanierung (NZI) 2005, 149. The German liquidator can not invoke said rules rules abroad, see Kolmann (2010), § 132, 30.

[98] See Virgós / Garcimartín, op. cit. (2004), nr. 166(a); Moss / Smith, op. cit. (2009), 8.86; Plappert, op. cit. (2008), 264, referring to other German and Austrian authors.

[99] See Moss / Smith, op. cit. (2009), 8.86; Reinhart, op. cit. (2008), Art. 5, nr. 3.

[100] Duursma-Kepplinger, op. cit. (2002), Art. 5, nr. 37. Effects will result from applying the lex concursus from the main proceedings, see Article 4(i), 4(j) and 4(k) InsReg.

[101] R.J. van Galen, Praktische opmerkingen over de werking van de Europese Insolventieverordening en de belangen die daarbij betrokken zijn, Tijdschrift voor Insolventierecht (TvI) 2002, 140.

[102] Christoph Paulus, *Europäische Insolvenzverordnung. Kommentar*, Frankfurt am Main: Verlag Recht und Wirtschaft, 2006, Art. 5, nr. 18.

[103] Lars Westpfahl, Uwe Götker, Jochen Wilkens, op. cit., 94.

[104] See Balz, op. cit. (1996), 509; Smart, Rights In Rem, Article 5 and the EC Insolvency Regulation: An English Perspective, International Insolvency Review 2006, 17ff, 33; Veder, op. cit. (2009), 314; Schmitz, op. cit. (2010), 113.

authors suggest that it can not be excluded that Article 5(1) does not protect the underlying secured debt[105], although they also state that this submission would seem to rob article 5 of any purpose if the secured debt could be compromised to a lesser percentage of its face value.[106] Another obstacle seems to come from the Court of Justice of the European Union. It has observed that after the main insolvency proceedings have been opened in a Member State, the competent authorities of another Member State, in which no secondary insolvency proceedings have been opened, are required, subject to the grounds for refusal derived from Articles 25(3) and 26 InsReg, to recognize and enforce all judgments relating to the main insolvency proceedings and, therefore, 'are not entitled to order, pursuant to the legislation of that other Member State, enforcement measures relating to the assets of the debtor declared insolvent that are situated in its territory when the legislation of the State of the opening of proceedings does not so permit and the conditions to which application of Articles 5 and 10 of the regulation is subject are not met.' The Court explains that from the system of Article 3 and 18 it follows that only the opening of secondary insolvency proceedings is capable of restricting the universal effect of the main insolvency proceedings.[107] The result seems to be that a rescue plan can include the claims, which are subject to a right in rem, but that the plan can not be enforced because the conditions of Article 5 are not met.

5. Europe lacks clear rules for interpreting the EU Insolvency Regulation

It follows from the forgoing that in the more practical, detailed queries concerning the application of Article 5(1) InsReg many answers, going into different directions, have been given. The hard and fast rule clearly finds its strongest defenders in Balz, Virgós, Smart, Veder and Kolmann, although they understand the objections raised in literature and do view the treatment to holders of rights in rem, given in Article 5(1), as leading to 'excessive' overprotection.[108] It is submitted that the 'simplicity' of the administration of any insolvency, as a decisive argument for the hard and fast rule, comes from personal notes of one of the persons close to the drafting process. The argument has however not been expressed in the recitals, not in the text of the Regulation. The strong defense only based on a historical note in itself is not very convincing. In recital 4 of the Insolvency Regulation it is mentioned that one of the main goals is, that it is necessary for the proper functioning of the internal market to avoid incentives for the parties 'to transfer assets ….. from one Member State to another, seeking to obtain a more favourable legal position (forum shopping).' For a debtor in financial trouble it seems clear that transferring certain assets to another Member State, would certainly open the door for forum shopping, a phenomenon the Regulation tries to prevent.[109] The hard and fast rules has as a principle objection – acknowledged also by its defenders – that certain holders of these rights receive a favoured treatment, which only purely is based on the location of the secured assets.[110] In terms of insolvency policies – in short: the dramatic rise in Europe of reorganisation methods and proceedings during the last decade – the hard and fast rule can be seen as a 'conceptional failure'[111], which lead to a territorial split of the assets, which is detrimental to its value[112], and to the sheer impossibility for the liquidator in main insolvency proceedings to administer the estate[113] or to implement a European wide rescue plan.[114]

Where in itself the reasoning in favor of the hard and fast rule is not without objections derived from other considerations, it should be noted to that a 'pure' historic defense also may overlook the fact that the Insolvency Regulation as an instrument of EU law. Although other authors will be much more equipped to disclose the specific methods of interpreting EU instruments[115] in general it is to be understood that the absolute binding force of a historic argumentation in general in European law plays a limited role.[116]

Taking into consideration the context of the Insolvency Regulation as a measure of EU law and the historical background of its content, an interpretation (furthermore) should be based on principles of respect for the international character of the Regulation (and of the cases it seeks

[105] Isaacs et al., op. cit. (2009), 6.56 and 6.129
[106] Isaacs et al., op. cit. (2009), 6.138.
[107] Court of the European Union 21 January 2010, C-444/07 (MG Probud Gdynia sp. z o.o.).
[108] Thus Veder, op. cit. (2009), 309.
[109] See Westphal et al., op. cit. (2008), 91.
[110] See Plappert, op. cit. (2009), 263, and Sagaert, book review of Veder, op. cit. (2009), Weekblad voor Privaatrecht, Notariaat en Registratie (WPNR) 6812 (2009).
[111] '…ein konzeptioneller Fehler der Verordnung', thus Reinhart, op. cit. (2008), Art. 5, nr. 14. In this way too Kolmann (2010), § 132, 31.
[112] See Nina Scherber, *Europäische Grundpfandrechte in der nationalen und internationalen Insolvenz im Rechtsvergleich*, Europäische Hochschulschriften, Vol. 3865, Frankfurt am Main: Peter Lang, 2004, 147ff.
[113] Reinhart, op. cit. (2008), Art. 5, nr. 14; Sagaert, review of Veder, op. cit. (2009), in WPNR 6812 (2009).
[114] Plappert, op. cit. (2008), 264.
[115] See e.g. Stuart Isaac and Richard Brent, The Insolvency Regulation as a Community Legal Instrument, in: Moss, Gabriel, Ian F. Fletcher, Stuart Isaacs (eds.), The EC Regulation on Insolvency Proceedings – A Commentary and Annotated Guide, Oxford University Press, 2nd. ed., 2009, Chapter 2.
[116] See in this way too Plappert, op. cit. (2008), 280.

to provide with efficient and effective solutions), the desire to achieve uniformity within the Community (territorial scope) and the disallowing of departures (mandatory and fully binding nature) within the spirit of intra-community cooperation, as the Insolvency Regulation is one of the instruments related to the progressive establishment of 'an area of freedom, security and justice' (see recital 1, preceding the Insolvency Regulation).[117] Further interpretative guidance may be derived from the general principles of Community law, e.g. (i) the principle of equal treatment or non-discrimination, (ii) the principle of respect for fundamental rights, (iii) the principle of legal certainty, and (iv) the principle of proportionality.
Another question, which further influences an outcome of an interpretation process, is whether the argumentation, (mainly) based on the history of a Convention (as it then was) is compatible with the method of interpretation of a Regulation, in which principles of subsidiarity and proportionality play a manifest role (see also recital 6).

Finally, the place of the rules regarding conflict of laws and therefore Article 5 too, must be assessed within Europe's developing system of rules of private international law.[118]

In all, future research should provide more clear rules for interpretation, not only for the topic of this article – of course several provisions of the Insolvency Regulation can be clarified – but also for a more certain application of the Regulation on all the themes it covers. It would even be preferred that during the process of evaluating the Insolvency Regulation – of the meaning of Article 46 of the Insolvency Regulation – the Commission will also in this context propose rules for adaptation of the Regulation.

6. Towards a global rule?

As explained, in general Article 5 InsReg is regarded as serving two puposes: (i) to protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened and (ii) to prevent a situation in which an administrator has to cope with the overall complexity of the insolvency proceedings, as a result of widely differing substantive laws. Does its rationale resonate on a global level?

6.1 Germany, Spain and The Netherlands in relation to third states

In the Netherlands, the legal system which deals with insolvency is formed by the Netherlands Bankruptcy Act 1896 and, to a lesser extent, case law, especially case law from the Netherlands Supreme Court. The Act contains three proceedings: '*faillissement*' (bankruptcy liquidation), '*surseance van betaling'* (postponement of payment, a moratorium/reorganization proceeding), and, since 1998, '*schuldsanering natuurlijke personen*' (debt rescheduling natural persons, generally after three years resulting in a "clean sheet").[119] In the last thirty years, several efforts have been made to amend and renew the Act, but these have only led to limited, partial results. In 2003, the '*Commissie Insolventierecht*' (Insolvency Law Committee) was appointed by the Ministry of Justice. The Committee served till 2008.[120] In November 2007 the Committee published a pre-draft for a new Insolvency Act, with around 350 legal provisions and an explanatory memorandum of over 200 pages. One of the most interesting renewals the Committee has presented is Title 10, which contains provisions concerning 'International Insolvency Law'. Its provisions will, once accepted, apply in all relations between the Netherlands and third States, not being those States to which the EU Insolvency Regulation applies. Title 10 contains 35 articles, divided over five chapters, one of which is Chapter 10.4 ('Applicable law'). Article 10.4.1 of the draft pays tribute to the general rule of applicability of the lex concursus ('Save as otherwise provided in this Act, the law applicable to insolvency proceedings in respect of the debtor and their effects shall be the law of the state within whose territory such proceedings are opened'). The draft also provides for a special rule, in Article 10.4.2, for 'Third Parties' Rights in rem'.

Paragraph 1 reads: 'The insolvency of the debtor shall not affect the rights in rem of creditors or third parties in respect of assets, both specific assets and whole collections of undefined assets changing from time to time, belonging to the debtor which are situated within the territory of

[117] See Fernando Paulino Pereira, *La cooperation judiciaire en matière civile dans l'Union européenne: bilan et perspectives*, Revue Critique de droit international privé, 99 (1) janvier-mars 2010, 1ff.

[118] See Kirsty Jane Barnes, The role of the European Union in the harmonization of international private law: a theoretical perspective, in: Cambridge Student Law Review 2009, p. 124ff.

[119] See P.J.M. Declercq, Netherlands Insolvency Law: The Netherlands Bankruptcy Act and the Most Important Legal Concepts, The Hague: T.M.C. Asser Press 2002.

[120] Chaired by Professor Sebastian Kortmann of Radboud University, Nijmegen. I was a member of the Committee.

another state at the time of the opening of proceedings'. It is clear, and it is expressed in the Explanatory Notes, that in this respect the Committee has followed the EU Insolvency Regulation, although recognizing that it contains several uncertainties and gaps. The well know opening words of Article 5(1) ('opening of insolvency proceedings') therefore have not been used, to make clear that rights in rem are not affected by any kind of decision or order taken during the course of the insolvency proceedings either. The Committee explains that 'shall not affect' means that the exercise of these rights will be 'fully undisturbed'. The Committee deliberately adopts the 'hard and fast rule', which is based on the rationale that the administration of the estate will be facilitated: 'Although the chosen rule is not without criticism, it is not necessary to deviate [from its meaning in Article 5(1) InsReg; Wess.] in the pre-draft.'[121]

The method of 'extending' a provision of the EU Insolvency Regulation to relationships with non-EU Member States has not been dealt with in the draft Act in the Netherlands. Both Spain ('Art. 201 – *Ley 22/2003, de 9. de Julio, Concursal*, Rights in rem and reservation of title: '1. The effects of the insolvency on creditors' or third parties' rights in rem which fall into the estate or rights of any category belonging to the debtor, including the joint assets whose composition can change over time, and which at the moment of the declaration of insolvency are located in the territory of another State, shall be governed solely by the laws of that State. The same rule shall apply to the rights of the seller in relation to the assets sold to the insolvent under reservation of title', as well as Germany ('Section 351 German *Insolvenzordnung* - Rights in Rem: (1) The right of a third party in an object of the assets involved in the insolvency proceedings which at the time of opening of the foreign insolvency proceedings was situated on domestic territory, and which in accordance with domestic law grants a right to separation or to separate satisfaction shall remain unaffected by the opening of the foreign insolvency proceedings….') have chosen to do so. In both countries this rule has been applied since 2003.

It should be mentioned that in November 2009, the legislative process for a new Insolvency Act in the Netherlands has been put on hold and the Rutte-Verhagen administration, active since autumn 2010, only very recently (January 2011) has given the sign that in its present form the Pre-draft will not be enacted. The proposals were seen as too harsh on the position of banks and the tax agency. Title 10 on International Insolvency Law (probably) did not create political controversy. In the meantime, international insolvency practice, touching the Netherlands (Lehman Treasury, KPNQuest, Yukos Oil) makes many demands, but as long as specific rules are lacking in this area some guidance may be found in the results of the many soft law examples which are available in the field.

6.2 UNCITRAL Legislative Guide

In 2000 UNCITRAL gave a mandate to one of its six Working Groups (Working Group on Insolvency Law, sometimes referred to as Working Group V)) '…. to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including considerations of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches'.

The Guide presents a comprehensive description of the core objectives and the structure of an effective and efficient commercial insolvency system. Every key provision which is recommended to be included in a national law is discussed and the possible treatment is evaluated. Furthermore the Guide provides comments on controversial issues such as automatic stays, post-filing finances, treatment of financial market transactions and the overriding of contract terms for termination. In the field of international insolvency law the Guide provides several recommendations. In its suggestions, the Guide recognizes the importance of certainty with regard to the applicable law in insolvency proceedings (i) to facilitate commerce by recognizing, in insolvency proceedings, the rights and claims that arise before commencement of insolvency proceedings and the law that will apply to the validity and effectiveness of those rights and claims, (ii) to establish the law applicable in insolvency proceedings and exceptions, if any, to the application of that law. A national insolvency law should recognize rights and claims arising before commencement of insolvency proceedings (Recommendation 30), and the law

[121] Although some criticism has been made regarding the conflict of law rules proposed, these remarks did not relate to Article 10.4.1(1), see Jeroen van der Weide, Conflict of Law Rules: Section 10.4, in: Bob Wessels and Paul Omar (eds.), Crossing (Dutch) Borders in Insolvency, Nottingham, Paris: INSOL Europe, Nottingham-Paris, 2009, 87ff, and Ian Fletcher, Commentary on Section 10.4, in: Bob Wessels and Paul Omar (eds.), Crossing (Dutch) Borders in Insolvency, Nottingham-Paris: INSOL Europe 2009, 95ff.

applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced (Recommendation 31). The recommended law applicable to insolvency proceedings should be the lex concursus applied to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects (Recommendation 32). Notwithstanding recommendation (30), the effects of insolvency proceedings on the rights and obligations of the participants in a payment or settlement system or in a regulated financial market shall be governed solely by the law applicable to that system or market (Recommendation 33), and the effects of insolvency proceedings on rejection, continuation and modification of labor contracts may be governed by the law applicable to the contract (Recommendation 34).[122] Remarkably, rights in rem are not excluded.

6.3 ALI-III Draft proposals

In its relations to third states, as explained in para. 6.1, the Netherlands intends to apply in future a rule which is rather similar as the one contained in Article 5 InsReg, whilst a similar rule applies to all third countries that have relationships with Spain and Germany. In the light of these developments the question is whether in principle, it is currently appropriate, or acceptable, to suggest a rather similar rule for global application. The overall justification for an exception for rights in rem is that it operates to protect legitimate expectations founded upon provisions of law that are not replicated in the state in which insolvency proceedings are subsequently opened. In this way such an exception supports commercial predictability and certainty and to ensure a less complicated application of the rules of applicable law. Such an exception would reflect the rationale to protect courts and insolvency office holders against the sometimes overwhelming complexities, added costs and time delays of solving to every last detail of the more complex issues of conflicts of law. As long as specific rules are lacking in this area some guidance may be found in the results of a set of Global Principles for Co-operation in International Insolvency Cases, the preliminary draft which was published in April 2010, by professor Ian Fletcher (University College London) and myself. I referred to this project in para 3.4 above.

For the purposes of these Global Rules, which are designed for application under the currently prevailing conditions of global diversity of national laws and policies, it is considered appropriate to maintain a certain number of specific exceptions to the general rule (laid down in Global Rule 12) of the applicability of the lex concursus. Included in the proposals is an exception for rights of secured creditors ('third parties' rights in rem'). In its present form draft Global Rule, Rule 15(1) ('Rights of secured creditors') reads:

'15.1 Insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets - both specific assets and collections of indefinite assets as a whole which change from time to time - belonging to the debtor which are situated within the territory of another state at the time of the opening of proceedings.'

The main purpose of this arrangement for granting some form of real security to a creditor is to provide the creditor with an alternative form of recourse in the event of the debtor's failure to perform his obligation. This includes a situation where non performance is due to the insolvency of the obligated party. Real security therefore offers a means of protecting a creditor against risks associated with the extending of credit. The extent to which the rights of a secured creditor are capable of being affected by the debtor's insolvency is an essential aspect of the creditor's assessment of the net risk to which he is exposed, and can have a significant bearing upon the decision whether to extend credit, and if so on what terms. The rationale of the exception created by Article 5 InsReg has been adopted as the basis for Global Rule 15. In a European context Fletcher and I acknowledge that a less clear cut approach than the one the hard and fast rule offers is defensible, but on a global scale however, covering some 200+ countries and unrelated to such objectives as creating an 'internal market', a pragmatic view has led to the proposal of the application of a hard and fast rule in every case.

[122] These two categories of exception generally correspond to those embodied in Articles 9 and 10 of the EU Insolvency Regulation.