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The European Union approach to cross border insolvencies. The European Insolvency Regulation:

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1. Introduction

On 31 May 2002, the European Insolvency Regulation (“EUIR”) came into force. This regulation is the result of more than 30 years of discussions on the European approach to cross border insolvency issues. This paper is intended to provide some background of the EUIR and information on its applicability, its system and its structure.

2. Practical information

The official name of the EUIR is Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings. Its full text can be found at www.europa.eu.int/eur-lex. Once on that web-site click the purple “en” button. On the next page go to “Legislation” and click again. Then go to the “search by document number” area and at “year” fill in “2000” and at number fill in “1346”. Click on “search”. On the next page go to “Council regulation (EC) 1346/2000” and finally click “html”. This will provide you with the text of the EUIR in English.

Please note that for a proper understanding of the EUIR it is important to read its 33 preambles and for explanatory notes see the Report on the Treaty on Insolvency Proceedings, written by Virgos and Schmit, and published in 1996 (see below).

3. History and background of the EUIR

For the non-European reader it is important to realise that Europe has for many ages consisted of a varying number of more or less independent Empires, Kingdoms, States, Duchesses, city-states and other forms of local or territorial power, and that many countries as we know them today have only existed in their present form for often less than two ages. Wars and revolutions have played an important role in Europe and certainly asked their toll. Sovereignty and territoriality were key factors in the political and legal thinking of that time. It is only after the two major wars of the last century, that Europe started with serious efforts for co-operation and harmonisation, efforts that have by now lead to the European Union.

In the legal field, the first important step ahead was made in 1968 when the European Execution Treaty (“EEX”) came into force. Under this treaty important rules, often overriding national rules, were accepted in the areas of jurisdiction (competent court) and execution (enforcement in other EU countries of civil judgements). The EEX exempted all legal issues that were insolvency law related. The view was that as insolvency laws in the various European jurisdictions were too different, it would take more time to prepare a treaty on European insolvency law issues. After many years, and some failing tries, in 1995 a Treaty on European Insolvency Proceedings has been drafted. It is in relation to this treaty that the Virgos/Schmit report was written. For political reasons, unrelated to any insolvency issue, this treaty never came into force. But its contents are now almost fully and identically reflected in the EUIR.

The EUIR is a direct binding regulation for all EU-countries as from 31 May 2002, with the exception of Denmark, where the EUIR is not applicable for the time being.

Note: the EEX has been replaced by the EEV (European Execution Regulation (“EER”) as per 1 March 2002, also except for Denmark (EEX applicable). Further note that for some non-EU-countries similar rules related to the recognition and execution of foreign judgements apply under the EVEX (Fe. Norway, Poland, Switzerland, Iceland).

4. Scope of the EUIR

The EUIR has limited applicability. It will only be applicable if the centre of main interests of the insolvent debtor is located within the EU. If that centre of main interests is located outside the EU the EUIR is not directly applicable and each Member country of the EU may apply its own rules of private international law or international insolvency law on cross border issues. If no bilateral or other treaty applies, it is likely that most EU-jurisdictions will seek guidance from the EUIR when addressing non-EU cross border insolvency issues.

The scope of the EUIR is also limited to certain types of insolvency proceedings. The EUIR is applicable to all EU collective insolvency proceedings, which entail the partial or total divestment of the debtor and the appointment of a liquidator (art 1). The insolvency proceedings on which the EUIR is applicable are all listed in Annex A to the Regulation.

Further, the EUIR is not applicable on insolvency proceedings of insurance companies, credit institutions and (collective) investment undertakings. For these types of insolvencies see EC Directives 2001/24/EG and 2001/17/EG.

The EUIR is only applicable on insolvency proceedings opened as from 31 May 2002 and insolvency related issues arisen thereafter.

5. The system of the EUIR; universality vs. territoriality; harmonisation

In an increasingly internationally operating business world, where from the commercial point of view, borders are just a nuisance and not very relevant, and an “open market approach” is often economically necessary, one would be inclined to ultimately aim at harmonisation of insolvency laws and the universal effect of insolvency proceedings. The tremendously increased speed of transport, travel, information and the interdependence of economies would certainly justify such harmonisation and such universal effect. But the European Union is not ready for such change, due to social, cultural, legal and political differences within the EU. This is reflected in Preamble 11 of the EUIR:

“This regulation acknowledges the fact that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening of proceedings would, against that background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors in the insolvency proceedings are, in some cases, completely different.”

As a consequence, the EUIR does NOT harmonise the national insolvency laws. The insolvency law of France will remain quite different from the insolvency law of Germany,

which again differs substantially from the Dutch insolvency law. This is not changed by the EUIR.

Also, the EUIR does not impose an unlimited universal effect of insolvency proceedings. The system allows for a limitation on the universality principle.

What is the systematic view of the EUIR?

- a. First principle is that “Main Insolvency Proceedings” (see art. 3.1. EUIR) can (only) be opened in the Member State where the debtor has his centre of main interests. Once opened in the EU, these Main Insolvency Proceedings have universal scope (of course: within the EU) and aim at encompassing all of the debtors assets.
The second principle is that Main Insolvency Proceedings have a direct and immediate effect all over the EU.
The third principle is that the insolvency law of the Member State where the Main Insolvency Proceedings have been opened is applicable all over the EU.
- b. But to protect local/national interests, Secondary Insolvency Proceedings can be opened in any Member State where the debtor has an Establishment (as defined in art. 2h EUIR). Secondary Insolvency Proceedings are limited to the assets located in that Member State where these Secondary Proceedings are opened. The insolvency law of that Member State is applicable on the Secondary Proceedings.
The universal effect of the Main Insolvency Proceedings is therefore basically frustrated in the jurisdiction where Secondary Proceedings are opened. But some effects of the first principle remain (see: art. 33. 1 EUIR).
- c. If Main Insolvency Proceedings have been opened in a Member State and assets of the debtor are located in another Member State, but in that Member State no Secondary Proceedings can be opened due to the fact that these assets do not create an “Establishment” as defined in the EUIR, the Main Proceedings are effective in that Member State. The insolvency law of the Main Proceedings is applicable in such Member State. But to protect certain interests (rights in rem, set off, retention of title, real estate, labour agreements, patents, nullity actions) the EUIR provides for specific rules: art. 5-15 EUIR. These specific rules limit the application of or consequences of the insolvency law of the State of opening of the Main Proceedings.

In brief, Main Proceedings are directly effective all over the EU, and the insolvency law of the State where the Main Proceedings have been opened are applicable all over the EU, but Secondary Proceedings limit this universal approach in case of an Establishment in another Member State, and for quite some legal relations/rights the EUIR has specific rules limiting the consequences of the applicability of the insolvency law of the Main Proceedings.

6. No consolidation

To avoid any misunderstanding, one should realise that the EUIR is applicable on the insolvency proceedings of just a debtor. The EUIR does not create or promote the principle of consolidated insolvencies. In brief, if a company is declared bankrupt in France (Main Proceedings) and that company has a subsidiary in Italy, that subsidiary is not (directly) affected by the French proceedings. If that subsidiary is insolvent under Italian law and has its centre of main interest in Italy, it is the Italian court that may open Main Proceedings of the Italian company.

7. Main, Secondary and “Secondary without Main”.

As described above, the starting point of the EUIR is that, in case of insolvency of a debtor, Main Insolvency Proceedings are to be opened in the Member State where that debtor has his centre of main interests. Only to protect local/national expectations, Secondary Insolvency Proceedings can be opened in a Member State where the debtor has an Establishment.

There is a third type of proceedings though. Only under very limited circumstances Secondary Proceedings can be opened if no Main Proceedings have been opened. If so, these “Secondary without Main”-proceedings have again territorial effect only.

Finally, the issues referred to above are all to be found in Chapter I of the EUIR: “General Provisions”.

8. Chapter II Recognition and Fair Treatment

The principle of recognition of insolvency proceedings is laid down in article 16-26: without further formalities the judgement opening the Main Proceedings shall have effect all over the EU (unless Secondary Proceedings are opened). The court appointed liquidator may exercise his powers all over the EU. Decisions of the court that has opened Main Insolvency Proceedings and which concern the course and closure of the proceedings, including compositions, are also directly recognised all over the EU without further formalities. Clearly, the EUIR aims to have as much direct recognition, without time consuming formalities, in order to allow for effective Main Insolvency Proceedings.

In order to achieve, within the framework of Main and Secondary Proceedings fair treatment of creditors, some rules were needed. One of these rules is the Imputation rule of art. 20.2 EUIR.

A creditor who has, in the course of insolvency proceedings, obtained a dividend on his claim shall share in distributions in other proceedings only where creditors of the same ranking have, in those other proceedings, obtained an equivalent dividend.

9. Chapter III Secondary Proceedings.

The opening and conduct of Secondary Proceedings is further described in this chapter. These proceedings are territorial and have limited scope. The liquidators in the Main and Secondary Proceedings are duty bound to co-operate, but the liquidator in the Main Proceedings has more power in some respects (see art. 33 and 37).

10. Chapter IV Information and the filing of claims.

First principle: any creditor may file his claim in any insolvency proceedings, whether main or secondary. This includes filings of claims of tax authorities and social security authorities. These type of claims were often not recognised on the basis of the sovereignty principle, but this view has now been overruled.

Second principle: also the liquidators may, and shall file, the known claims of creditors in other insolvency proceedings of the same debtor, in order to achieve, as much as possible, equal treatment of creditors.

Third principle: in order to alert creditors so that they can file, the competent court or the competent liquidator shall inform all known creditors in the EU (this is slightly discriminating) of the opening of the proceedings.

11. Conclusions.

The harmonisation of insolvency laws within Europe is still a dream. The EU IR only has limited provisions of substantive law. Also, the universal approach (within the EU) of the EU IR can be limited in case of secondary proceedings (if there is an establishment in another Member State).

Nevertheless, the EU IR is a first step in the right direction. It aims at effective insolvency proceedings under one insolvency law, or a limited number of insolvency laws (secondary proceedings), it creates direct recognition within the EU, it urges for co-operation and it implies that a certain amount of trust between the jurisdiction of the EU.

Far from perfect, but far better than the former territorial, sovereign approach.

S.H. de Ranitz, 8 Dec. 2002