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PROTECTION OF THE INTERESTS OF SECURED CREDITORS IN CROSS-BORDER INSOLVENCY PROCEEDINGS IN EUROPEAN UNION INSOLVENCY LAW

Master thesis

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LIST OF ABREVIATIONS

APR – Absolute Priority Rule

Art. – Article

CoC – Committee of Creditors

COMI – Center of main interest

CJEU – Court of Justice of European Union

Directive on restructuring and insolvency – Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132

EIR – Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings

EU – European Union

IA – Insolvency administrator

IP – insolvency proceedings

Legislative guide – UNCITRAL legislative guide on insolvency law

Lex concursus – Law of the place where insolvency proceedings are initiated

Lex Fori – Law of the forum / law of the court in which a proceeding is brought.

Lex rei sitae / Lex situs – Law of the place where assets are situated

MS – Member State

Para. – Paragraph

Pari passu – Equal treatment of the creditors

Rec. – Recital

RPR – Relative Priority Rule

UK – United Kingdoms

UNCITRAL – United Nations Commission on International Trade Law

US – United States

U.S. Chapter 11 – Chapter 11 of the United States Bankruptcy Code

INTRODUCTION

Relevance of the final thesis. The thesis analyses the protection of secured creditors in cross-border insolvency proceedings in EU insolvency law. The relevance of the examination of legal characteristics of protection of the interests of secured creditors in European Union cross-border insolvency law and the need for scientific analysis of the application of the rules on the rights of secured creditors under Article 8 of the EIR stems from several factors. Firstly, the EIR is silent on the definition of right in rem creating significant doubts what property rights fall under this concept. Secondly, when it comes to the ranking of the creditors, the priority of the claims can also be an issue since EU law is silent on this matter and this question is differently addressed in the national laws of the Member States. Third and most importantly the treatment of the secured assets of the creditors has become more debatable with the adoption of the Directive on restructuring and insolvency which may establishes the rules on stay of individual enforcement actions against the insolvency estate.

The EIR establishes a *European* framework for cross-border insolvency proceedings, including the protection of the interests of secured creditors and treatment of third-party assets. The proper functioning of the internal market requires that cross-border insolvency proceedings should operate efficiently and effectively.[1] One of the underlying purposes of the recast EIR is to prevent forum shopping. It is necessary for the proper functioning of the internal market to avoid incentives for parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favorable legal position to the detriment of the general body of creditors.[2]

The EIR was designed to ensure that the insolvency laws of EU Member States could operate 'efficiently and effectively' in cross-border cases.[3] In May 2015, after a scheduled review of the operation of the EIR 2000,[4] a recast version of the European Insolvency Regulation was passed. The EIR incorporated developments in the interpretation and application of the provisions of the EIR 2000, widened the scope of the regulation's potential application to encompass a broader range of insolvency procedures and introduced some new features designed to fill perceived gaps in the original instrument. Thus, the core provisions of the EIR 2000 relating to jurisdiction to open insolvency proceedings, the law governing such proceedings, and the recognition of such proceedings and extension of their effects across the Union were essentially retained, while its provisions on coordination were expanded.[5]

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[1] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) [2015] OJ L 141, EUR-Lex, Recital 3
[2] *Ibid*, Recital 5
[3] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2rd ed. (New Yourk: Oxford University Press, 2002), 1.
[4] Required by Art. 46 of the EIR 2000.
[5] R. Bork, K. van Zwieten, *supra note,* 3; 2.

The EIR determines which court has jurisdiction to open insolvency proceedings, establishes the uniform rules on the applicable law and provides the rules on the recognition and enforcement of the ensuing decision throughout the Union.[6] Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction shall be recognized in all other Member States from the moment that it becomes effective in the State of the opening of proceedings.[7] The same rule applies to the judgments handed down by a court whose judgment concerning the opening of proceedings is recognized and which concern the course and closure of insolvency proceedings.[8] Consequently, the declaration of insolvency in one Member State becomes effective in other Member States from the moment the judgment opening insolvency proceedings is rendered.

The rules on the position of the secured creditors and third parties and protection of the interest of the holders of secured assets is related to the complexities of applicable law, that are provided in the EIR and its predecessor. In cross border insolvency proceedings creditors should have a chance to monitor the actions of the insolvency representative, providing a check against possible abuse of insolvency proceedings and excessive administrative costs, as well as a means of processing and distributing information. The desirability of facilitating high levels of creditor participation must be balanced against the need to ensure that the creditor representation mechanism remains efficient and cost-effective and avoids creditors involving themselves in matters that will not have an impact on their interests.[9]

With reference to the ranking of the creditors and its statutory priorities within EU insolvency law, this question bears no easy answer. Recital 22 of the EIR acknowledges that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope throughout the Union. The application without exception of the law of the State of the opening of proceedings would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing national laws on security interests to be found in the Member States. Furthermore, the preferential rights enjoyed by some creditors in insolvency proceedings are, in some cases, completely different.

[6] K. Ochocinska, *Creditors' and third parties' rights in rem under European Union Regulations and The UNCITRAL Legislative Guide on Insolvency Law*, Comparative law review, Vol. 27 (Nicolaus Copernicus University in Torun, Poland, 2021), 354.
[7] Article 19(1) Recast EIR and article 16(1) EIR.
[8] Article 32(1) Recast EIR and article 25(1) EIR
[9] UNCITRAL, *Legislative Guide on Insolvency Law*, (United Nations, New York, 2005), 190.

The relevant case law provided by CJEU Including, but not limited the ERSTE Bank Hungary Nyrt case,[10] Herman Lutz case,[11] SCI Senior Home case[12] and overall legal practice reveals the practical problems of the application of the EIR to secured creditors and their rights in rem in cross-border insolvency cases and the issues concerning incomparability between EIR and the Directive on restructuring and insolvency. Besides the case law from CJEU, legal practice on international insolvency law reveals the relevance of the topic, particularly recent case on restructuring proceedings of SAS Airlines highlights how major business incorporated in EU used Chapter 11 of U.S Bankruptcy code to restructure its debts and continue business operation to gain profit. This case demonstrates the importance of coexistence of Secured interests and the stay as the protective mechanism for the debtor.

Scientific researched problem. Analysis of the literature, legal acts and case law that are relevant to the master thesis topic indicate that there is no clear definition of rights in rem, lack of clarity can create challenges in the interpretation and application of the regulation in EU insolvency law. Without the specific definitions, the process of interpretation and application of these rights may significantly differ between the Member States resulting in litigation based on the unharmonized framework, potentially undermining the principle of legal certainty that the EIR aims to uphold.

Moreover, a problem occurs when it comes to the treatment of the secured assets of the creditors due to the different, contrasting approaches of EIR and Directive on restructuring and insolvency. Article 8 of the EIR creates a separation between rights in rem and the insolvency estate in order to protect secured creditors' interests under the EIR, by which their rights over certain assets may be preserved even in cases of cross-border insolvency. This method promotes legal certainty and minimizes risks for secured creditors with respect to transnational financial stability. However, the Directive on restructuring and insolvency is broader in scope as it may include rights in rem in the insolvency estate. This approach is intended to facilitate full reorganization plans, which take into account all debtor's assets and obligations thus providing for efficient preventive measures at an early-stage equitable treatment of creditors alike.

[10] "ERSTE Bank Hungary Nyrt v Magyar Állam, BCL Trading GmbH, ERSTE Befektetési Zrt, Case C-527/10." CJEU, Curia. 5 July 2012. ECLI:EU:C:2012:417. https://curia.europa.eu/juris/document/document.jsf?text=&docid=124745&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619130

[11] "Hermann Lutz v Elke Bäuerle, Case C-557/13." CJEU, Curia, 16 April 2015. ECLI:EU:C:2015:227. https://curia.europa.eu/juris/document/document.jsf?text=&docid=163721&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619207

[12] SCI Senior Home v Gemeinde Wedemark, Hannoversche Volksbank eG, Case C-195/15." CJEU, Curia. 26 October 2016. ECLI:EU:C:2016:804. https://curia.europa.eu/juris/document/document.jsf?text=&docid=184857&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619258 .

Besides, taking into consideration the principle of equal treatment of creditors, the questions concerning the priority of the claim and ranking of the creditors are crucial, since in insolvency proceedings the priority of claims comes to determining the order in which creditors are entitled to receive payment from the assets of the bankrupt debtor. It becomes particularly complex when secured creditors, having a legal interest, such as a mortgage or a lien in specific assets of the debtor, compete with other unsecured creditors or preferential creditors such as employees or tax authorities.

In the light of the European Insolvency Regulation, the important question arises: **does the existing framework of EU insolvency law effectively protect the interests of secured creditors in cross-border insolvency proceedings?** The current research is aimed at answering this question.

Scientific novelty of the master thesis. The chosen topic is a step forward to deeply identify the challenges in the EU legal framework concerning the relation between the EIR and the Directive on restructuring and insolvency, furthermore, the protection of the interests of secured creditors in European Union Insolvency law, in particular the nature of secured creditors and treatment of rights in rem. The issue has not received enough attention so far, therefore the topic is considered insufficiently researched and new.

Level of analysis of the researched problem. The issue of creditors secured interests and third parties rights in rem under EU insolvency law has been addressed by authors such as Stanley D. Longhofer from Wichita State University and Stephen R. Peters from University of Illinois (1999),[13] Tom Smith from Academy of European Law (2015),[14] Karolina Ochocinska (2017),[15] Vladimir Kozar and Ivana Maraš (2021)[16], Dr Horst Eidenmüller from University of Oxford (2023).[17] In addition to that, questions concerning the rescue of business in insolvency law, Creditors privileged by secured claims, secured creditors and ranking of creditors has been widely analyzed by Prof Em Bob Wessels from University of Leiden, Prof Stephan Madaus from Martin-Luther-University of Halle-Wittenberg and Gert-Jan Boon from University of Leiden (2017).[18] However, these researches were related to the analysis of certain aspects of the rights of secured

[13] Stanley D. Lonhofer, Stephen R. Peters, *Protection from whom? Creditor Conflicts in Bankruptcy*, (Wichita State University; University of Illinois, 1999).
[14] Tom Smith, *Applicable law and carve outs: Cross-border security and rights in rem*, (Academy of European law, 2015)
[15] Karolina Ochocinska, *creditors' and third parties' rights in rem under European Union Regulations and The UNCITRAL legislative guide on Insolvency law*, Comparative law review (Nicolaus Copernicus University, 2021).
[16] Ivana Maraš, Vladimir Kozar, *Protection of the rights of secured creditors in the bankruptcy debtor assets sales procedure*, (University Business Academy in Novi Sad, 2021)
[17] Horst Eidenmüller, *Comparative Corporate Insolvency Law*, 2nd Ed. (University of Oxford and ECGI, 2023)
[18] Em Bob Wessels, Stephan Madaus, Gert-Jan Boon, *Instrument Of The European Law Institute Rescue of Business in Insolvency law*, (European Law Institute, 2017).

creditors in cross-border insolvency proceedings, but did not thoroughly address the challenges of the application of the EIR and the Directive.

Significance of the final thesis. Previously many scholars paid attention to the problem of rights in rem and protection of the interests of secured creditors in insolvency law and the EIR. Nevertheless, the issues related to rights of rem, ranking of creditors and secured interests still constitute certain concerns and existing case law demonstrates that the Member State's national judicial time by time faces problems in regard to treatment and applicable substantive law in cross-border insolvency proceedings. It is especially relevant when it comes to the definition of rights of rem. In this regard, the necessity for additional research on the current issue seems to be useful.

Aim of research. Research aims to analyze the effectiveness of the protection of the interests of the secured creditors in cross-border insolvency proceedings and provide the solutions to ensure effective treatment of the rights in rem in EU insolvency law.

Objectives of research. In order to achieve an established goal of this master thesis the following steps have to be carried out:

1) To analyze the scope of the protection of the interest of the secured creditors within the EU insolvency law framework;

2) To evaluate the core problems that may arise in connection with the different approaches towards the conflict of interests between secured and unsecured assets as part of insolvency estate;

3) To identify the core problems that may arise in the case to provide a sufficient definition of rights in rem under EIR, measures of treatment and applicable substantive law in the cross-border cases in insolvency proceedings.

Research methodology. The following methods will be used during the current scientific research:

1) Data Collection and Analysis – will be used to collect and evaluate the information from multiple sources to find the relevant answers to the research problems, evaluate outcomes and forecast the probabilities;

2) Comparative analysis and historical method – that allows us to understand the dynamic changes in legislation through analyzing legal acts on national and EU levels. It gives the possibility to compare different legislative approaches of different jurisdictions within the European Union or internationally.

3) Interdisciplinary approach – due to the nature of the research topic it is important to use this method to evaluate issues within the relevant disciplines and analyze the legal, economical, social and policy implications of a secured interest in cross-border insolvency.

4) Logical methodology – including induction, deduction and generalization this method addresses a systematic approach to reasoning that relies on logical principles driving conclusions from premises.

The structure of the thesis. A two-part separation system was chosen for this research. It means that the issues provided in the master thesis are divided into two separate analytical fields. The first stage is designed to explore the theoretical and legal aspects of the thesis, on the basis of the researched doctrinal, legal and normative studies. The main issues and related grounds of protection of interests of secured creditors in EU cross-border insolvency law, priority of claims, rights in rem, nature of secured assets and ranking of creditors. after examining the theoretical meaning of the research topic, it moves to the second stage, dealing with the practical examination of Article 8 of EIR and linked issues. Attention is drawn to the case law established by the CJEU, which is a significant source for interpreting cross-border insolvency law issues. The results obtained during the research from both of the mentioned stages are correlated, thus are designed to answered questions raised in the master thesis.

Defense statements. Master thesis defends the following statements:

1. The lack of definition of clear elements constituting the rights in rem in EU insolvency law lead to the lack of legal foreseeability and diminishes the protection of the interests of secured creditors;

2. The application of the stay of individual enforcement proceedings in the Directive on restructuring and insolvency may violate the interests of secured creditors in cross-border insolvency proceedings.

CHAPTER 1: Lack of harmonious approach to rights in rem under EU Insolvency Law

The concept of rights in rem poses a significant importance in insolvency law, especially in in cross-border cases where legal certainty is vital. Despite the significance they possess, rights in rem are not clearly and uniformly defined in the European Insolvency Regulation, giving rise to divergences in how they are interpreted and applied across EU Member States. As for creditors, debtors, and insolvency professionals coping with cross-border insolvency proceedings, this lack of harmonization leads to practical and legal obstacles. The question arises who rights in rem should be perceived? How to distinct rights in rem from other property rights? What are the elements of the concept of rights in rem in cross-border insolvency proceedings?

This chapter examines the legal definition along with the significance of rights in rem, establishing the challenges brought on by the EIR's lack of definition. It evaluates the judicial interpretation of the regulatory framework, with a focus on Article 8 of the EIR. Additionally, a comparison of national strategies and case law delivered by CJEU.

1.1. Concept and legal nature of rights in rem

This chapter is dedicated to the analysis of the concept and legal nature of rights in rem in cross-border insolvency proceedings including the analysis of the role of rights in rem in insolvency proceedings and distinction between secured rights of third parties and other property rights. It focuses on the distinction between rights in rem and rights in personam, demonstrating the protective nature of secured interest and its main difference from other rights covered under insolvency proceedings.

1.1.1. Role of rights in rem in insolvency proceedings

Rights in rem is the concept of property law which is also recognized in insolvency proceedings. The purpose of rights in rem is to grant the creditor with ability to have and exercise the control and recourse to the property covered by the security priory of the claims of other unsecured or lower ranking creditors with the intention of achieving the repayment of his debt.[19]

Such priority of the holders of rights in rem is also recognized in EU insolvency law. Art. 8 of the EIR is designed to establish protective treatment for rights in rem of third parties under the law of assets location known as *lex situs* from effect of *lex concursus*. It is a compound provision,

[19] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2rd ed. (New Your: Oxford University Press, 2002), para. 8.02, p. 269

which has been the subject of extensive debate in the literature and analyzed by the CJEU. It is likely to be the broadest out of all of the exceptions.[20]

The first exception to the general rule of applying the *lex concursus* to the matters arising in the insolvency is to be found in Article 8, which addresses the impact of insolvency proceedings on rights in rem. The reason behind the concept of rights in rem is to provide the creditor with some kind of guarantee, to be secured for the repayment of debt. Rights in rem can also arise by operation of law.[21]

Recitals of EU legal acts serve as the source of interpretation of the provisions. The policy behind Articl 8 is provided in Recital 64 of the EIR stating that the basis, validity and extent of rights 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 a right in rem should therefore be able to continue to assert its right to segregation or separate settlement of the collateral security.[22] Thus rights in rem are worthy of protection 'since these are of considerable importance for the granting of credit'.[23]

Rights in rem create the protection for 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.[24] The fundamental point is that allowing creditors to be secured by rights in rem is necessary for the smooth functioning of credit systems.[25] Thus, for secured creditors to be truly secure, their right must be legally certain, and this is not (or is less) possible if those rights can be affected by the opening of insolvency proceedings in other States.[26]

However, why secured creditors should be given such privileges, not just having priority in distribution of the assets, but also by having their rights protected from restrictions that would apply within their own Member State as a matter of insolvency law?[27] After all, unsecured creditors relying merely on the law of contracts would expect their contracts to be subject to their

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[20] Bork, Reinhard. "Procedural Principles." Chapter. In Principles of Cross-Border Insolvency Law, para. 4.48, p.136. Intersentia, 2017.
[21] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2rd ed. (New Your: Oxford University Press, 2002), para. 8.01, p. 269.
[22] European Parliament and Council. *Regulation (EU) 2015/848 of 20 May 2015 on Insolvency Proceedings (Recast)*, recital 68. Official Journal of the European Union OJ L 141, June 5, 2015.
[23] Bork, Reinhard. "Procedural Principles." Chapter. In Principles of Cross-Border Insolvency Law, para. 4.48, p.136. Intersentia, 2017.
[24] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 97.
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf
[25] V. Finch, Corporate Insolvency Law: Perspectives and Principles, 2nd ed. (Cambridge: Cambridge University Press, 2009), 93–120.
[26] Bork, Reinhard. "Procedural Principles." Chapter. In Principles of Cross-Border Insolvency Law, para. 4.48, p.136. Intersentia, 2017.
[27] *Ibid*, para. 4.49, p.136. Intersentia, 2017.

own laws and not to the law of the debtor's COMI, and they may actually be surprised by the application of the general rule in Art. 7 of the EIR. If legal certainty of creditors is privileged above the advantages of universality, then a whole scheme of the EIR itself is undermined. However, this position is debatable for a few arguments. First, (enhanced) legal certainty is a specific function of rights in rem, therefore rights in rem must have their legal certainty protected, even when this is to the detriment of other rights.[28] Second, rights in rem may take different legal forms, in contrast to the universally recognized concept of a contract. This makes it difficult to identify analogous concepts under *lex fori concursus*. Legal certainty may be hampered, if lex fori concursus were applicable to rights in rem, since a secured creditor will believe that he possesses one type of right, while actually suffering the burdens of possessing another type of right.[29]

In any case, there is the risk that special treatment stablished under Article 8 of the EIR could overcome the effect of general rule stated in Article 7 of the EIR, especially when most of the creditors are aiming to secure their interest. Therefore, the Virgós–Schmit Report suggests limiting or simply speaking balance the concept of a right in rem, in order to maintain stability between unsecured and secured creditors, otherwise there could be majority of security holders leaving general principle of *lex concursus* set out in Article 7 of the EIR ineffective. However, this limitation is not immediately evident on the face of the text.[30] Whichever way the practical effect of Article 8 is interpreted, it certainly gives rise to considerable inconsistency concerning the Regulation's objective of universality.[31]

One of the main challenges in a cross-border insolvency proceedings is that the secured interest or right in rem might have been established over an asset or assets that are situated in a Member State different from the State of the opening of main insolvency proceedings. Together with that it can also be the case that the law governing the creation of the right over the assets differs from the law of the State of the opening of the insolvency proceedings.[32] How should in such case the principle of universality be applied? Should the treatment of the rights in rem be regulated by *lex concursus* or another legal system?

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[28] Bork, Reinhard. "Procedural Principles." Chapter. In Principles of Cross-Border Insolvency Law, para. 4.49, p.136. Intersentia, 2017. / Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para 97.
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf

[29] Bob Wessels, International Insolvency Law, 5th ed. Nov. 2, 2022), para. 10640a.

[30] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. para. 102.
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf

[31] Bork, Reinhard. "Procedural Principles." Chapter. In Principles of Cross-Border Insolvency Law, para. 4.49, p.136. Intersentia, 2017.

[32] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2rd ed. (New Yourk: Oxford University Press, 2002), para. 8.02, p. 269.

Recital 64 of the EIR explicitly sets the commercial significance of secured lending for the awarding of credit and other financial assistance to companies and individuals. Secured creditors may claim that if they provide funding based on security that is consider valid according to domestic law, that security right shall be enforceable in the event of insolvency of the debtor and should not unexpectedly be rendered unenforceable or otherwise affected if the debtor happens to go into insolvency proceedings in a different jurisdiction.[33] It also implicitly recognizes that commercial certainty in this respect will have paramount importance for lenders, who are unlikely to lend unless assured that rights properly granted over assets in one jurisdiction will remain enforceable in the circumstance when the debtor becomes insolvent-irrespective of where the debtor may enter insolvency proceedings and whether or not such security would be equally valid and effective under the foreign law applicable to the insolvency proceedings in question.[34]

It has to be pointed out that, the same ideas were expressed by judicial authorities. The CJEU has found that "the legislature intended to provide for a special reference diverging from the *lex fori concursus* in the case of rights in rem, since these rights are of considerable importance for the granting of credit. According to the same recital, the proprietor of a right in rem accrued before the opening of the insolvency proceedings should therefore be able to continue to assert, after that opening, his right to segregation or separate settlement of the collateral security".[35]

Consequently, this exception to the general rule is created for purpose that the law of the state of opening insolvency proceedings knowns as *lex fori concursus*, governs insolvency related matters, including rights in rem. Exception permits creditors with security interests that are established before the opening of insolvency proceedings to keep enforcing their right to treat their collateral separated from the insolvency estate, even after the proceedings are initiated.

To sum up, the opening of insolvency proceedings in general does not affect secured creditors of their rights in rem over collateral, they can still enforce their secured claims, despite the general rule that would otherwise subject all debtor assets to the law of the state of opening proceedings. Correspondingly, the purpose of rights in rem is to protect secured claims from effect of lex concursus providing the guarantee to the assets of security holders to be governed by *lex situs*.

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[33] *Ibid*, para. 8.03, p. 269.
[34] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 97.
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf
[35] "Hermann Lutz v Elke Bäuerle, Case C-557/13." CJEU, Curia, 16 April 2015. ECLI:EU:C:2015:227.
https://curia.europa.eu/juris/document/document.jsf?text=&docid=163721&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619207, para. 38.

1.1.2. Distinction between rights in rem and rights in personam

Rights in rem are not the only rights that creditors can claim from insolvent debtor to satisfy their own interests. Insolvency proceedings often cover other property rights, that can be exercised in parallel with rights in persons. The concepts "Right in Rem" and "Right in Personam" demonstrate the differences between types of legal rights and their enforcement.[36] However, how these rights of the creditor be established? Does it mean that the mere fact that creditors' claim is somehow related to the property means that it is a right in rem?

A right is a legally recognized freedom granted upon individuals or entities, it is a legal or moral recognition of choices or interests to which particular weight is attached.[37] Some authors define a right as "a prerogative granted by a specific statute, enabling its holder to enforce it against another person or persons."[38] Some of them "describes a legal right as the capacity to control the actions of others with the approval and aid of the state."[39]

Right in rem also referred as Jus in Rem is an intangible right owned by an individual or legal entity. It is considered to be a negative right, that primarily serves to protect its owner by securing the interest with under mutual agreement of the parties involving certain type of guarantee. It acts to prevent the violation of interest of the secured creditor in case if party fails to fulfil its obligation. Stating that right in rem is a negative right leads me to discuss its characteristics. Jus in rem are considered as negative right since it allows the holder of the right to remain unaffected by the interference of others. "It obliges everyone to refrain from interfering with the right holder's property or rights."[40]

Universality is another characteristics of right in rem, that means that it is enforceable against all individuals, on another words, these rights have an absolute and *erga omnes* nature. Due to the universality, secured creditors are granted with more certainty and welfare in insolvency proceedings. Since rights in rem refers to the to the claims "against the thing", on opposite, right in personam is directed to the claims "against the person". It can be a legal actions or proceedings

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[36] Aishwarya Agrawal, "Right in Rem and Right in Personam." LawBhoomi, Jurisprudence blogs, 27 June 2024. https://lawbhoomi.com/right-in-rem-and-right-in-personam/#:~:text=Right%20in%20Rem%3A%20Ownership%20of,tenant%2C%20enforceable%20against%20specific%20individuals .

[37] Dictionary of Law, 10th ed. Oxford University Press, 2022, ISBN-13: 9780192897497

[38] Aishwarya Agrawal, "Right in Rem and Right in Personam." LawBhoomi, Jurisprudence blogs, 27 June 2024. https://lawbhoomi.com/right-in-rem-and-right-in-personam/#:~:text=Right%20in%20Rem%3A%20Ownership%20of,tenant%2C%20enforceable%20against%20specific%20individuals .

[39] *ibid.*

[40] *Ibid.*

targeted against specific person or group, aiming legal matters allied to liabilities of individual or an entity.[41]

Right in personam, also known as *Jus in Personam* usually arises out of contractual relationships and is considered as a positive right. Positive character means that right obliges the party to perform in a specific way to fulfill a duty.[42] Specify is also a characteristic meaning that such rights are enforceable against a particular person or entity. Together with that such right has a special applicability referring to special character and arise out of specific relationship, like contracts, that is in contrast with general applicability of right in rem.[43]

Right in rem was well established in basics of civil law, in Roman law such right was one brought in order to vindicate a jus in rem i.e. right such as ownership available against all the individuals. Judicial practice recognized jus in rem as a right against the whole world.[44]

Discussions regarding distinction between tights in rem and other property rights raise the question when right in personam give rise to right in rem? Jus in personam and jus in rem have been defined as respectively contract rights and tort rights. Then it would seem to follow that right in personam give rise to right in rem so far as torts are founded on contract.[45] However, not all the torts are arising out of the contractual relationships, non-contractual torts should be taken into consideration as well. A breach of contract does not always give rise to the tort right unless there is negligence, the probable and natural reason of which causes damage.[46] Therefore rights in personam can potentially give rise to right in rem, if the secured interest directed to the property is rooted to the contract.

Thus, the distinction between rights in rem and rights in personam is rooted to their scope. On one hand rights in rem are considered as absolute, universal rights directed to specific assets and are enforceable against the world at large. These rights guarantees that holders can claim control over property without interference from third parties. On another hand, rights in personam are considered as personal obligations directed against specific individuals or entities, typically arising from contractual agreements. Although rights in rem prioritize stability and predictability, rights in personam aims duties and remedies for individuals.

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[41] UOLLB Law Notes, in Rem vs In Personam, 14 july, 2024. https://uollb.com/blogs/uol/in-rem-vs-in-personam?srsltid=AfmBOorGGZi7l7uQjGQ13fNqL-am3sn5so_VHmY75TH1gY9zuXqzie8M

[42] Aishwarya Agrawal, "Right in Rem and Right in Personam." LawBhoomi, Jurisprudence blogs, 27 June 2024. https://lawbhoomi.com/right-in-rem-and-right-in-personam/#:~:text=Right%20in%20Rem%3A%20Ownership%20of,tenant%2C%20enforceable%20against%20specific%20individuals

[43] *Ibid*.

[44] Case R. Viswanathan v. Rukn-Ul-Mulk Syed Abdul Wajid, Supreme court of India, 4 May, 1962, judgement para. 17.

[45] Raymond M. Hudson, When Rights in Personam Give Rise to Rights in Rem, Vol. 5, No. 1, May, 1899, p. 13

[46] *Ibid*.

In conclusion, the examination of rights in rem within the EU insolvency law reveals a legal uncertainty, precisely while Article 8 of the EIR creates protections for secured creditors, the Regulation itself fails to provide an autonomous definition of what constitutes a right in rem and what falls under jus in rem. Instead, the Court of Justice has adopted approach where firstly refers to national law, based on principle *lex rei sitae*, to determine whether existing right qualifies as a right in rem, and only then considers the application of Art. 8. This approach reflects a legal uncertainty of harmonization on EU level and domestic laws of Member States. Unlike rights in personam, rights in rem provides secured creditors with protection to be treated differently from unsecured creditors. Such protection is also reflected in the idea of Art. 8, where secured interest not governed by the lex concursus principle under Art. 7 of EIR.

1.2. The absence of a unified definition of rights in rem under Article 8 of the EIR

The difficulties in delineating rights in rem in the EU legal order are caused by the absence of a unified definition of rights in rem in the EIR. These difficulties stem from the uncertainties that surround the definition and the terminology relating to this subject-matter both in the normative instruments and in the case law of the EU.[47] This subchapter examines the structure of art.8 or EIR to demonstrate what are the elements of the rights in rem in cross-border insolvency proceedings.

1.2.1. The structure of Article 8 of EIR

The technique adopted by the EIR is not about to specify any particular law that should be applicable to rights in rem in the event of the opening of insolvency proceedings.[48] Instead, Article 8 of the EIR makes two assumptions and then contains an express negative provision rather than an express choice of law. It has thus been described, rather than a conflict of laws rule, as a negative substantive rule.[49]

Article 8(1) of the EIR presumes that the right in rem to which it refers already exists and is held by its rightful owner at the time main insolvency proceedings are open. In other words, when creditors have the secured interest that was created before the opening the insolvency proceedings, security holders remain the priority rights after the proceedings are initiated. In this regard Article 8 aims to protect secured status by stating that secured rights that already existed before the

[47] The EAPIL blog, Rights in Rem in the European Union: General Aspects and International Jurisdiction, 10 February 2023, https://eapil.org/2023/02/10/rights-in-rem-in-the-european-union-general-aspects-and-international-jurisdiction/

[48] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.05, p. 270

[49] opinion of advocate general Szpunar, SCI Senior Home v Gemeinde Wedemark, Hannoversche Volksbank eG, Case C-195/15." CJEU, Curia. 26 October 2016. ECLI:EU:C:2016:804. https://curia.europa.eu/juris/document/document.jsf?text=&docid=184857&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619258

proceedings will remain after the debtors insolvency. As a general rule in cross-border insolvency proceedings, the effect of the opening of main proceedings on any rights created or purporting to become effective at a later time will be governed by the lex concursus.[50]

Furthermore, Article 8(1) of the EIR supposes that "Article 7 will apply the lex concursus to determine the effects of the opening of proceedings on rights in rem over assets situated in the Member State of the opening of main proceedings. In simpler terms, Article 8 does not apply to assets situated within the State of the opening of main insolvency proceedings. That assumption is entirely sensible and in accordance with business expectations because it should be easy to predict the effects of insolvency proceedings in the Member State in which the debtor's COMI is located and in which the debtor owns the assets that are to be provided by way of security. No foreign law is involved."[51]

The proprietor of a right in rem should therefore be able to continue to assert its right to segregation or separate settlement of the collateral security, meaning that secured creditors are able to enforce their rights after opening of insolvency proceedings. Lastly, recital talks how regulation allows insolvency practitioner to request opening of insolvency proceedings in the jurisdiction of another member state where assets protected under rights in rem are located.[52]

Thus, this exception to the application of *lex concursus* represents the idea that if insolvency proceedings are initiated in one Member state but secured assets are situated in another secured claims remain governed by the law of assets location.

Art. 8(1) of the EIR sets out a specific rule that protects rights in rem when at the time of opening insolvency proceedings the assets are situated in the territory of another Member State. The article provides that opening insolvency proceedings 'shall not affect' the validity and extend of secured creditor's rights in rem on such assets. Therefore, it does not directly impose the application of law of the state the assets location, as for lex situs, however in normal circumstances it is predictable that the law of the state where the assets are situated will be applied to examine whether a secured creditor exercises rights in rem over the specific assets.[53]

The wording 'shall not affect' has become the object for a discussion between practitioners, particularly the matter was about interpretation of such wording expressed in Art. 8 of the EIR. Does it establish that the property which falls under the scope of this article is excluded from the

[50] Council of the European Union, Report on the Convention of Insolvency Proceedings, by Miguel Virgós and Etienne Schmit, 6500/96 DRS 8 (CFC), para. 96, 3 May 1996
[51] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.07, p. 270
[52] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), OJ L 141, Rec. 68
[53] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.08, p. 271

insolvency estate of the debtor? Does it prohibit an insolvency practitioner of realization of these assets?

Following the logic of 'maximalist' view, "rights in rem over the assets located in a state other than the state of opening of main proceedings should be entirely insulated from the effect of the opening of insolvency proceedings in another member state than the state in which they are situated."[54] This underlines the specific nature of secured interest requiring treatment different from the one established under Art. 7 of EIR.

Corresponding this approach, even if the conditions of Recital 68 of the EIR regarding lex situs prioritizing the law of the assets location are met, the opening the main insolvency proceedings would have an effect on assets under rights in rem. Consequently, opening the insolvency proceedings in any other member state will not have an impact on rights in rem. Nevertheless, there is a possibility that rights in rem in can be affected only when local or secondary insolvency proceedings will be initiated in the Member State in which assets are situated, therefore will be governed by domestic law. [55]

It is interesting to observe how 'maximalist' view covers the insolvent debtor and its center of main interest. Following this approach secured assets under rights in rem will not be affected if this assets are situated in the territory of member state, other than the state of opening proceedings.[56] The reason is that insolvency proceedings cannot be opened in that member state. Thus, even under this approach secured assets situated in member state other than COMI of debtor will remain unaffected.

The authors consider that such approach might be used by the creditors to affect debtor during the insolvency proceedings. There can be another scenario where a secured creditor might demand the debtor in the event of insolvency to move the assets in the specific member state in prior to the opening insolvency proceedings.[57] "It is far from clear or obvious that any doctrine of the 'fraudulent location of assets' or application of the rules of the lex concursus relating to legal acts detrimental to the general body of creditors under Article 7(2)(m) as permitted by Article 8(4) would be sufficient to discourage such conduct in moving the assets or prevent such prejudice to the general body of creditors."[58]

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[54] B. Wessels, S. Madaus, International Insolvency law: Part II European insolvency law, 30 Nov, 2022, para. 10635(iii) / Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 164
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf

[55] *Ibid*, para. 98

[56] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.10, p. 271

[57] *Ibid*, para. 8.11, p. 271

[58] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 105.
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf

The question can arise whether there is any justification for 'maximalist' view and everything discussed above, why secured interest shall be based on lex situs and not governed by lex concursus?

The answer seems to be proper administration and protection of the interest of secured creditors. From authors point of view the simple rule behind this concept is that the law of state of opening insolvency proceedings per se do not affect the third parties rights in rem over the assets situated in any Member State. The same idea is shared in Virgos-Schmit report, proving that secured interest of creditor remaining unaffected by the location of the assets that are covered by rights in rem are the whole truth behind the concept.[59]

To simply summaries the idea behind the 'maximalist' approach is to consider whether it is possible to examine rights in rem under the domestic law of the state where assets are situated. I can also assume that this instrument can be to determine effective way to initiate secondary insolvency proceedings in the Member State of assets location following the principle of territoriality. Correspondingly, EIR introduced possibility of application of Lex situs, principle that act like a tool to overcome rule on Lex concursus and stablish different treatment of secured assets that will be governed by the law of the assets location. This approach of EU policy makers is important since it would be unfair if creditors that managed to secure their interest before the debtors insolvency would be treated same as unsecured creditors under lex concursus. In such case what would be the idea of owning secured interest if you are treated like other creditors not having priority in distribution. Exactly answer on this question was provided by EIR to give priority to secured creditors by granting them different treatment such as possibility for application of law of MS where secured assets are situated.

I see it reasonable to discuss the opposite opinion of the scientists on 'maximalist' approach that is called 'pure and simple' view. Prof. dr. Bob Wessels examines this view and "suggests that Art. 8(1) merely protects rights in rem against the effects of the opening of insolvency proceedings, but not against any other decision or orders made during such proceedings."[60] Judicial practice of CJEU develops the view as "that very limited and literal approach, which would, however, not be consistent with the obvious commercial purpose of Article 8, which is to ensure that rights in rem are capable of being effectively asserted when it matters most—namely after the opening of the insolvency proceedings. It is only then that the proprietor of the right in rem will wish to take enforcement steps and receive the monies to which his right entitles him."[61] It is in contrast with

[59] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 164.
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf
[60] B. Wessels, S. Madaus, International Insolvency law: Part II European insolvency law, 30 Nov, 2022, para. 10634
[61] "Hermann Lutz v Elke Bäuerle, Case C-557/13." CJEU, Curia, 16 April 2015. ECLI:EU:C:2015:227. Para. 21.

the Virgós-Schmit Report, which twice describes the approach adopted in Article 8 as excluding rights in rem over assets located abroad 'from the effects of the (insolvency) proceedings' without any reference to any limitation implied by the use of the word 'opening".[62]

Therefore, the priority established under Art. 8(1) should be interpreted to mean that an existing right in rem shall not be affected by the initiation of insolvency proceedings in any Member State other than the State where assets are situated accordingly to principle lex situs, or by any decisions driving from lex concursus during those proceedings. That follows the view expressed in the Virgós-Schmit Report standing for privileging national law of MS of assets location over right in rem rather than to affected by the opening of insolvency proceedings in another Member State under lex concursus.[63]

To sum up, right in rem will not be affected by the opening of insolvency proceedings, however, In case there will be remaining assets after satisfaction of secured claims from insolvency estate and they will fall within the scope of the relevant insolvency proceedings.[64] The secured creditor gets according to the preexisting secured rights, but any remaining assets after distribution goes back to the insolvency estate for satisfaction of other creditors claims in insolvency proceedings.

1.2.2. The scope of Article 8 of EIR

To identify and analyze the scope of art. 8 and how it applies to the rights in rem of third parties we need to dive into deep discussion of EIR's understanding of rights in rem and further practical implementations by local or international juridical authorities.

A few questions arise from the concept of rights in rem enclosed in Art. 8 of EIR. What is the notion of right in rem? How it should be interpreted in regards of secured creditors? How it shall be defined in relationship of Arts. 8(2) and 8(3)? How it should be determined whether the right of the creditor in respect of an assets is a rights in rem? How to determine whether an assets, tangible or intangible one, is 'situated within the territory of another Member State' and how do we separate that the secured assets from other assets included in insolvency estate that belonged to the debtor 'at the time of the opening of proceedings'?[65]

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https://curia.europa.eu/juris/document/document.jsf?text=&docid=163721&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619207 / Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 101. https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf

[62] *Ibid*, paras. 92 and 94.

[63] *Ibid*, para. 97,

[64] *Ibid* para. 99. / R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.20, p. 275

[65] Bork, Reinhard. "Procedural Principles." Chapter. In Principles of Cross-Border Insolvency Law, para. 4.50, p.136. Intersentia, 2017

Rights in rem are the rights against property and it is different from other property rights that are directed to individuals, however Art. 8 of the EIR does not provide independent and exact definition of the term itself and what is more important what does it cover, on other words what falls under rights in rem.

There are discussions regarding the absence of the unified definition of the rights in rem, especially when we are talking about the regulation harmonizing the insolvency proceedings in 27 Member States. Is it correct decision by lawmakers to live such gap or an additional space for legal uncertainty when it comes to the protection of the interests of the secured creditors, holding rights in rem toward insolvent debtors assets?

There is an opinion that „the characterization of a right as a right in rem must be sought in the national law which, according to the normal pre-insolvency conflict of law rules, governs rights in rem (in general, the lex rei sitae at the relevant time).“[66] However, the problem with this is that some systems may have a very broad concept of rights in rem.[67] Thus, „the modern approach is to leave it to the lex rei sitae to define the prerequisites and effects of the right in question, and to decide on an autonomous construction of Art. 8 whether the so-defined right is a right in rem within the meaning of Art. 8.“[68]

Question is how does Art. 8(2) address issue of having list of rights, which are particularly to be regarded as rights in rem. This list contains ‘parameters’ within which national concepts of rights in rem may exist.”[69] However, “the use of the phrase ‘in particular’ suggests that those rights are a subset, rather than the only rights that may be countenanced.”[70] Consequently, “this is further supported by the contents of the rights listed in Art. 8(2), which clarifies, for the benefit of practitioners and the courts, that the there-mentioned common security rights definitely fall within the scope of Art. 8. Art. 8(2) can also be said to draw attention to the fact that the major beneficiary of Art. 8 is intended to be secured creditors. What Art. 8(2) does not do in and of itself is limit the scope of the term ‘right in rem’.”[71]

When it has to be decided whether a right is considered as rights in rem, the court has to pay attention to two things, first if right is directly rooted to a specific asset, second if it is directed

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[66] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 100
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf
[67] *Ibid*, para.102.
[68] Bork, Reinhard. “Procedural Principles.” Chapter. In Principles of Cross-Border Insolvency Law, para. 4.51, p.138. Intersentia, 2017.
[69] Goode, Principles of Corporate Insolvency Law, para. 15-76
[70] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 103.
https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf
[71] Bork, Reinhard. “Procedural Principles.” Chapter. In Principles of Cross-Border Insolvency Law, para. 4.52, p.138. Intersentia, 2017.

against "everyone" but not to just one person. Domestic court in Belgium applied this test when deciding whether creditors claim to seize the ship meets this criteria's.[72]

While the classification of a right as a right in rem is left up to the law of the Member State, Article 8.3 of the EIR provides additional requirements, particularly whether a right is officially recorded in register and is the subject to enforcement against others.[73] Article 8 does not impose any substantive restrictions on what kind of assets are linked to the right in rem. Basically, any kind of assets falls under the scope of Art. 8, thus there is no need to identify the nature of the asset to apply protection of rights in rem.[74] Furthermore, in Senior Home v Gemeinde Wedemark the CJEU confirmed that how or for what reason rights in rem were created does not matter, the question is whether specific right can truly be considered as right in rem. The CJEU made it clear that there is not limitation on Art. 8 to specific type of assets.[75] Along with that limitation of the assets falling under the scope of Art. 8 is not provided in recitals 66 and 67.[76]

Also, Article 8.2 of the EIR does not give any definition of what rights in rem is and how it has to be interpreted, instead it gives the list of the rights that are characteristics of a rights in rem.[77] By authors point of view the major idea behind is that, according to principle lex situs, to decide if specific assets falls under the concept of rights in rem it is up to domestic laws of member states where the assets are situated.

This has been confirmed by CJEU in two major cases. First, in Lutz v Bäuerle[78] it was held that, to decide whether there is rights in rem lex situs principle must apply instead of law of the

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[72] Bork, Reinhard. "Procedural Principles." Chapter. In Principles of Cross-Border Insolvency Law, para. 4.53, p.139. Intersentia, 2017.
[73] *Ibid*, para. 4.54, p.139. Intersentia, 2017.
[74] *Ibid*, para. 4.56, p.139. Intersentia, 2017.
[75] SCI Senior Home v Gemeinde Wedemark, Hannoversche Volksbank eG, Case C-195/15." CJEU, Curia. 26 October 2016. ECLI:EU:C:2016:804. https://curia.europa.eu/juris/document/document.jsf?text=&docid=184857&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619258 / R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.21, p. 275
[76] SCI Senior Home v Gemeinde Wedemark, Hannoversche Volksbank eG, Case C-195/15." CJEU, Curia. 26 October 2016. ECLI:EU:C:2016:804. https://curia.europa.eu/juris/document/document.jsf?text=&docid=184857&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619258
[77] Virgos, Miguel and Etienne Schmit. Report on the Convention on Insolvency Proceedings. Brussels: The council of European Union, 1996. Para. 100 https://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf / SCI Senior Home v Gemeinde Wedemark, Hannoversche Volksbank eG, Case C-195/15." CJEU, Curia. 26 October 2016. ECLI:EU:C:2016:804. https://curia.europa.eu/juris/document/document.jsf?text=&docid=184857&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619258
[78] "Hermann Lutz v Elke Bäuerle, Case C-557/13." CJEU, Curia, 16 April 2015. ECLI:EU:C:2015:227. https://curia.europa.eu/juris/document/document.jsf?text=&docid=163721&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619207 ,

state of opening insolvency proceedings.[79] Second, in Senior Home v Gemeinde Wedemark[80] it was held that, although the lex concursus was French law, German law as law of the state where assets are located applied to consider if there was rights in rem or not.[81]

Also, Article 8(3), it adds a specific type of right by providing that rights recorded in a public register and can be enforced against third parties and considered as rights in rem.[82]

To sum up, Article 8 of the EIR does not apply to rights that simply grants some priority to particular creditors such as priority creditors to be paid out before other creditors.[83] There should be a clear agreement between partis of granting the secured rights to the creditor, simply speaking it is not an agreement to grant the priority on distribution on assets, but it is an agreement when creditor is exchanging with the debtor assets with value and receives the guarantee that in case of non-performance creditor will have the security to enforce the claim. Alongside, it is important to state that if the law of the state of opening insolvency proceedings grants to some creditors priority over some assets it does not constitute that these creditors will enjoy the same priority under the law of the assets location. The concept of lex situs serves to in prior the interests of secured creditors.

[79] *Ibid*, Para 26. / R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.24, p. 276 - 277

[80] SCI Senior Home v Gemeinde Wedemark, Hannoversche Volksbank eG, Case C-195/15." CJEU, Curia. 26 October 2016. ECLI:EU:C:2016:804. https://curia.europa.eu/juris/document/document.jsf?text=&docid=184857&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619258

[81] R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.24, p. 276 - 277

[82] Council of the European Union, Report on the Convention of Insolvency Proceedings, by Miguel Virgós and Etienne Schmit, 6500/96 DRS 8 (CFC), para.101, 3 May 1996 / R. Bork, K. van Zwieten, *Commentary on the European Insolvency Regulation*, 2nd ed. (Oxford, UK, 2022), para. 8.26, p. 277-278

[83] *Ibid*, para.102, 3 May 1996

CHAPTER 2: Exercise of creditors rights: challenges of ranking of creditors in insolvency proceedings

Since insolvency proceedings are designed to address the collective financial interests of all creditors, the fundamental question arises how insolvency proceedings should maximize creditors' returns. For this aims it is necessary to consider which creditors will be paid, in what order, and to what extent. This chapter examines the complex landscape of creditor rights in EU cross-border insolvency proceedings, with particular emphasis on the challenges arising from divergent approaches to creditor ranking across Member States.

This chapter explores the existing framework governing ranking of creditors in insolvency proceedings within the European Union law, focusing particularly on the position of security (*rights in rem*) holders. The analysis is based on two major issues, namely the priority nature of secured interest of the creditors and principle of equal treatment, followed by divergent approaches of ranking of creditors in Member States.

2.1. Principles of priority and equal treatment of creditors in Insolvency Law

This subchapter is dedicated to the analysis of the concept of secured creditors in cross-border insolvency proceedings including the consideration of the ranking of the creditors and collision of secured and unsecured interests. It covers the issues of ranking of the creditors and comparison of legal status of interest holders from different classes.

2.1.1 Reasoning behind the ranking of the creditors

Upon the initiation of insolvency proceedings, creditors acquire a substantial financial interest in the debtor's operational and asset distribution processes. Insolvency law seeks to protect these interests through the designation of an insolvency administrator, who assumes responsibility for managing the debtor's estate in accordance with statutory priorities. Correspondingly, national laws establish mechanisms to engage creditors in insolvency proceedings, enabling active participation in decision-making processes. This structural approach reflects policy objectives balancing efficient asset liquidation with accountability to financial stakeholders, while addressing various scenarios requiring creditor engagement on restructuring plans or asset distribution strategies.[84]

However, of insolvency proceedings have to cope with the common pool problem meaning that the insolvency estate is enough to satisfy the financial interests of all the creditors. The inherent problem of the lack of assets to satisfy all creditors' claims and address the social and

[84] UNCITRAL. Legislative Guide on Insolvency Law. New York, 2005. P. 190, para 75 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf.

economic peculiarities of their claims raises the question whether all creditors' claims should be satisfied in a single or separate rankings. How should the proceeds received from the sale of insolvency estate be distributed and who has the priority right among other creditors? Why certain creditors enjoy more favorable treatment regarding the satisfaction of their claim than the other? Since a debtor's assets will likely fall short of meeting all financial obligations in full, insolvency regimes must determine how to distribute these limited resources among competing claims. The inherent nature of insolvency, where asset realization cannot fully satisfy outstanding liabilities, triggers three distributive approaches. First, all the creditors are paid equally *pro rata*, regardless of their positioning in creditors classes. Second, some creditors according to their class are paid first, before others. And third, both option may be combined.[85] Majority of jurisdictions[86] preferably use third option, and for this reason they provide the list of the ranking of the creditors, clearly indicating the positions of each class of the creditors and prioritizing them accordingly.

There is the possibility that all de claims of creditors involved in insolvency proceedings will not be fully satisfied. To address this inherent problem of insolvency proceedings, the author believes that the equal treatment of creditors (*pari passu*) is the most effective response to this challenge. Under the principle of *pari passu*, „<....> similarly situated creditors are treated and satisfied proportionately to their claim out of the assets of the estate available for distribution to creditors of their rank".[87] However, it has to be outlined that idea behind this principle is not to place all the creditors in the same line, but to ensure that all the creditors in the same class are treated the same way.

Does *pari passu* principle resolve the questions raised in the beginning? Unfortunately, no. Some of the creditors have the special legal bond with debtor, having secured interest like a financial collateral or mortgage, some creditors may have particular social needs like employees, while others may perform specific public functions such as tax authorities.[88] In such scenario *pari passu* principle would not resolve the issue in full, it just reveal the importance of existence of hierarchy of creditors, that will set the order according to which the assets will be distributed to creditors. Simply speaking, this principle in not the universal solutions to the challenges concerning ranking of the creditors but addresses the importance of having equality between certain classes.

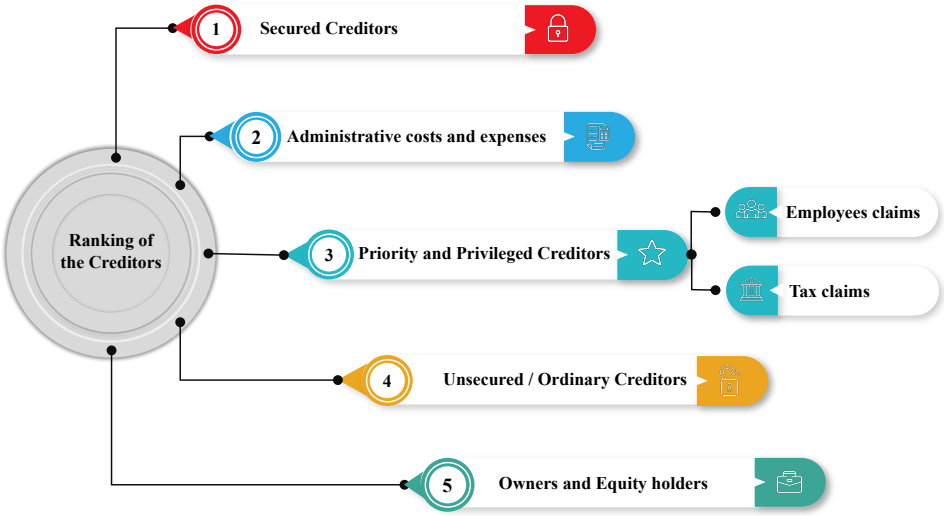
[85] Rescue of business in insolvency law, B. Wessels, S. Madaus, G. J. Boon, European Law Institute, 2017, p. 240, para. 400
[86] *Ibid*
[87] UNCITRAL Legislation guide on insolvency, New York, 2005, P. 6, para (cc).
[88] Rescue of business in insolvency law, B. Wessels, S. Madaus, G. J. Boon, European Law Institute, 2017, p. 240, para. 402

Correspondingly, necessity of having clear, legally binding rule harmonizing ranking of creditors is important to answer in what order assets shall be distributed. Indeed, there is no legally binding, harmonized international approach of ranking of creditors and national policymakers may adopt different approaches, both with respect to priorities between different ranks and the treatment of creditors within the same class, for example different sub-ranks may be created among unsecured creditors.[89]

Dealing with priorities between different ranks of creditors, most national insolvency laws recognize the rights of secured creditors to have a first priority to satisfy their claims, either from general funds or the proceeds of sale of the specific burdened assets.[90] Difference between national laws mostly occurs when it comes to the administrative expenses of the insolvency proceeding, that are often ranked below secured claims but above unsecured claims.[91] However, in some jurisdictions secured claims are ranked below the costs of administration and other claims, such as unpaid employment claims, tax claims, environmental claims and personal injury claims.[92] Once the priority and secured claims have been satisfied, the balance of the insolvency estate would generally be distributed to next tire of creditors in the hirerachy, to ordinary unsecured creditors on a pro rata basis before being distributed to any equity holders.[93]

Even though UNCITRAL legislative guide is not a legally binding source it has significant effect on jurisdictions to harmonize the common understanding of the ranking of creditors. The UNCITRAL legislative guide on insolvency law provides the following priority order of the creditors' claims:

Figure 1. Ranking of the creditors



[89] UNCITRAL. Legislative Guide on Insolvency Law. New York, 2005. Recommendation 267. https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf .
[90] *Ibid*, Recommendation 269.
[91] *Ibid*, Recommendation 270.
[92] *Ibid*, Recommendation 269.
[93] *Ibid*, Recommendation 273.

In different national jurisdictions the ranking of creditors may differ from the one established in the UNCITRAL legislative guide on insolvency law but these differences are not very significant, national law may adopt an individual approach but in most of the cases the order of the claims remains identical to the one admitted by UNCITRAL.

There are two main ways to distribute the assets of the debtor to satisfy the creditors claims. First is *pro rata* distribution, used for proportionate allocation of assets, simply speaking allocated assets are distributed in equal proportions to all the creditors.[94] Second is waterfall payment, stating that higher-tiered creditors receive payment for their claims, while the lower-tiered creditors receive principal payments after the higher-tiered creditors are paid back in full.[95]

Thus, the legislative choices behind the ranking of the creditors in insolvency proceedings is to determine in what order creditors debts will be satisfied, how the debtors assets in insolvency estate will be allocated in correlation with the existing debts and which claims has the priority. According to this priority ladder it is possible to foresee and predict the order of the claims, and most importantly how the interest of the secured creditors will be protected.

2.1.2. Secured creditors: legal standing and priority over others

Secured creditors enjoy the privileged position during the insolvency proceedings, characterized by legal entitlement of secured interest to the specific assets of the debtor as collateral for their claims. This subchapter explores the legal standing of the creditors having secured interests, examining how their rights to enforce security interests and priority in payment set them apart from other creditors.

While most of the creditors will be situated in the same ranking like the others, certain groups of creditors, such as secured creditors enjoy a privileged position, having priority for the satisfaction of their claims in contrast to other creditors. Insolvency law ranks creditors for the purposes of distribution the debtor's property according to the creditors' claims. it is well noted above that ranking creditors helps to understand the order of satisfaction of claims. The question is what if conflict of interest will arise between the creditors situated in the same class? Indeed *pari passu* principle is the answer here, but will the principle of the equal treatment of the creditors be enough to resolve the conflict of the secured interests when the property right of the creditor is ensured by securing the particular assets of the debtor?

[94] W. Kenton, Pro Rata: What It Means and Formula to Calculate It, Investopedia, 14 Apr, 2025. [https://www.investopedia.com/terms/p/pro-rata.asp]
[95] Investopedia, Waterfall Payment: Definition, Benefits, How It Works and Example, 28 Nov 2020 [https://www.investopedia.com/terms/w/waterfallpayment.asp]

To understand why secured creditors have the priority in the ranking of creditors the author analyses the specific of the creditors' classes for each of the creditors and afterwards discuss the privileged position of those holding the secured interest.

(a) Secured creditors

A secured creditor is has a legally recognized right over specific assets or collateral provided by the debtor as security for a loan or debt or by the law such as tax provisions. This arrangement grants the creditor a direct claim to certain assets, serving as a protection if the borrower fails to perform their repayment obligations. In this way, the creditor's interests are safeguarded in case of default since a creditor would maintain the right to satisfy the claim from the pledged asset.[96] The most common example of secured creditors are banks holding the mortgages or other securities, financial companies, factoring companies, public authorities such as revenue and tax authorities, individuals or entities holding the pledges and etc.

Secured creditors enjoy priority among other creditors in insolvency proceedings and if the debtor fails to perform its obligation, or will open the insolvency proceedings secured creditors are entitled to seize and sell the collateral to recover the existing debt. The preferential status increases the likelihood that such creditors will have their interest satisfied, although the practice shows that outcome depends on many other circumstances.[97]

Insolvency laws generally prioritize secured creditors, but the way their interest is satisfied depends on how their security interests are protected during the proceedings. If the value of the collateral is preserved throughout the insolvency proceedings, secured creditors are entitled to receive payment first by selling that specific asset, accordingly their claim. Alternatively, if the value of the secured claim is determined at the beginning of the proceedings, secured creditors usually have a priority right to receive that amount from the insolvency estate. Any portion of the claim that exceeds the value of the collateral is treated as an unsecured claim and is paid out according to the rules for unsecured creditors.[98]

In some jurisdictions, secured creditors are subordinated to administrative costs and prioritized claims like unpaid wages, taxes, environmental liabilities, or tort claims. Some systems limit the percentage of a secured claim that can be recovered from collateral, with variations based on the type of security interest. For example, policies may distinguish between broad security interests covering nearly all business assets and narrower collateral arrangements, applying

[96] Inquesta, Four Types of Creditors in Insolvency, 13 Nov, 2023 [https://inquesta.co.uk/blog/four-types-of-creditors-in-insolvency/]
[97] Inquesta, Four Types of Creditors in Insolvency, 13 Nov, 2023 [https://inquesta.co.uk/blog/four-types-of-creditors-in-insolvency/]
[98] UNCITRAL. Legislative Guide on Insolvency Law. New York, 2005. P. 269, para 62. https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf

recovery caps or exceptions only to the former. These approaches reflect policy choices to balance creditor rights with social or administrative priorities, ensuring critical claims are addressed before secured creditors receive full repayment.[99]

When a part of a secured creditor's claim is set aside often referred to as a „carve-out" that amount is typically used to satisfy the claims of other creditors, such as lower classes creditors, or to cover the costs and expenses of the insolvency proceedings itself when the assets from insolvency estate are insufficient. This approach is based on the idea that secured creditors should, in fairness, share some of the losses or costs that arise during liquidation or restructuration, rather than being paid in full at the expense of others. Without reserving part of the debtor's assets for these purposes, other creditors might receive nothing in the distribution. However, introducing such exceptions to the general rule of secured creditors' first priority can create uncertainty about how much secured creditors will actually recover, potentially discouraging secured lending and increasing its costs. Therefore, in my opinion it is generally recommended that such carve-outs and exceptions be used sparingly in insolvency law to maintain predictability and confidence in secured credit.[100]

When secured creditors are paid directly from the profits of their collateral, in some jurisdictions, they typically do not have to share in the general costs of insolvency proceedings, unlike unsecured creditors unless specific legal provisions require it, but there are EU member states such as Lithuania, Estonia, Latvia, France[101], The Netherlands[102], Belgium[103], Spain[104] and Slovakia, where secured creditors must contribute to the cost of administration of insolvency proceedings. However, secured creditors may still be responsible for costs that are directly related to preserving the value of their collateral. For example, if the insolvency representative incurs expenses to maintain or protect the asset, those costs can reasonably be deducted from the amount payable to the secured creditor. Additionally, exceptions to the secured creditors priority can arise when new financing is obtained after the insolvency has begun. in such cases, any impact on secured creditors rights should be transparent and, agreed upon in advance, since secured creditors may have approved the arrangement.[105]

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[99] UNCITRAL. Legislative Guide on Insolvency Law. New York, 2005. P. 269, para 63. https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf
[100] *Ibid*, para 64
[101] https://www.legal500.com/guides/chapter/france-restructuring-insolvency/
[102] https://iclg.com/practice-areas/restructuring-and-insolvency-laws-and-regulations/netherlands
[103] https://www.loyensloeff.com/belgium---lexology-panoramic--insolvency-litigation-2024.pdf
[104] https://restructuring.bakermckenzie.com/wp-content/uploads/sites/23/2017/01/Global-Restructuring-Insolvency-Guide-New-Logo-Spain.pdf
[105] UNCITRAL. Legislative Guide on Insolvency Law. New York, 2005. P. 269, para 65. https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf

National laws of the EU Member States often prioritize secured creditors in insolvency proceedings, provided their security rights comply with national laws and avoid deceptive asset transfers. These rights whether consensual (e.g., mortgages, pledges) or statutory grant creditors preferential access to specific assets.[106] While statutory liens protect vulnerable creditors who lack bargaining power, consensual security arrangements dominate, enabling creditors to mitigate insolvency risks by securing claims against movable or immovable assets. consequently, secured creditors typically rank first in repayment order, either by reclaiming collateral directly or receiving priority distributions from asset sales. This system reflects a legal consensus that security rights safeguard creditors financial interests, though their enforcement varies: some jurisdictions permit secured creditors to claim asset ownership outright, while others restrict them to post-liquidation monetary claims.[107]

A few jurisdictions have introduced mechanisms to balance secured creditor rights with restructuring needs. In France, financial agreements in a ratified conciliation agreement enjoy a conciliation privilege in a subsequent insolvency by being paid ahead of secured creditors from the proceeds of asset sales. Similarly, some regimes grant courts authority to approve "super-priority" security rights on already encumbered assets, ensuring interim financing while protecting existing secured creditors' interests. These innovations aim to resolve the tension between preserving secured creditor priorities and allowing debtor's recovery. However, such reforms remain rare, and their effectiveness depends on strict safeguards to prevent abuse. [108]

(b) Administrative costs and expenses

Administrative costs in insolvency proceedings are typically given priority over unsecured claims to guarantee that those administrating the insolvency estate are duly compensated. These expenses usually cover the fees and salaries of the insolvency practitioners or administrators and any professionals they or, in certain cases, the debtor engage. They also include debts occurred through ongoing costs from existing contracts such as employment or lease agreements, court costs, and in some jurisdictions, the fees of professionals hired by a creditors committee. This prioritization ensures that the necessary costs of running the insolvency proceedings are met before distributing assets to unsecured creditors.[109]

(c) Priority or privileged creditors

Insolvency laws frequently grant certain unsecured claims priority status, meaning these claims are paid ahead of other unsecured creditors. These priorities are often rooted in social or

[106] Rescue of business in insolvency law, B. Wessels, S. Madaus, G. J. Boon, European Law Institute, 2017, p. 240, para. 409
[107] *Ibid*, para. 411
[108] *Ibid*, para. 414
[109] UNCITRAL Legislation guide on insolvency, New York, 2005, P. 269, para 66.

political considerations, or in contractual relations, which can conflict with the pari passu principle of equal distribution among creditors. As a result, ordinary unsecured creditors may receive less from the debtor's estate. The existence of such priority rights can also lead to considerations about which creditors deserve preferential treatment and why. Moreover, the more priority claims there are, the less money remains for other creditors, which can cause the insufficiency in insolvency estate to repay low class creditors.[110]

Some priorities in insolvency law are designed to address social issues, such as employee protection and welfare. When insolvency laws do include these priorities, it is important that they are clearly defined and ranked to maintain transparency and predictability for all parties involved. This clarity helps lenders better assess their risks and ensures the insolvency process remains fair and efficient. However, if too many claims are given priority, the insolvency process can become way too complex, potentially leading to inefficiencies and complications in developing restructuring plans.[111]

Existing practice in insolvency reform show a diverse approach: some countries have reduced the number of priority claims such as removing tax claim priorities, while others have expanded them. Increasing the categories of priority creditors can weaken the effectiveness of insolvency proceedings, as each new category reduces the benefit for others and may prompt further demands for special treatment. Eventually, changing the order of distribution does not increase the total assets available to creditors, it merely shifts the advantage from one group to another. When considering whether to grant privileged status to certain debts, lawmakers must weigh factors such as international obligations, the balance between public and private interests, the impact on lending costs, and the risk of unfairly burdening particular creditor groups. Approaches to priority claims vary widely, with employee and tax claims being the most common, and cross-border cases raising additional complexities regarding the recognition and ranking of foreign claims.[112]

In most jurisdictions, employees claims such as unpaid wages, holiday pay, and leaves are treated as priority claims in insolvency proceedings, often ranking above tax and social security claims and in rare cases in jurisdictions like France, Austria, Germany, Finland, Portugal[113], even above secured creditors. This prioritization aligns with broader legal protections for workers and

[110] UNCITRAL Legislation guide on insolvency, New York, 2005, P. 269, para 67-68
[111] *Ibid*, P. 271, para 68-69
[112] *Ibid*, P. 271, para 70-71
[113] Federico M. Mucciarelli, Employee Insolvency Priorities and Employment Protection in France, Germany and the United Kingdom: An Essay on the Use of the 'Varieties of Capitalism Theory' in Comparative Law, Oxford, 29 Jun 2017. [https://blogs.law.ox.ac.uk/business-law-blog/blog/2017/06/employee-insolvency-priorities-and-employment-protection-france] / ILO, Protection of workers' wage claims in enterprise insolvency, 18 May, 2020. [https://www.ilo.org/sites/default/files/wcmsp5/groups/public/@ed_protect/@protrav/@travail/documents/publication/wcms_745455.pdf]

reflects international standards aimed at safeguarding employees rights. However, in some jurisdictions like UK, Canada, Ireland, U.S, Luxembourg, Malta[114], employee claims share equal priority with tax and social security claims and are paid proportionally if funds are insufficient. In others, employees receive no special priority and are treated as ordinary unsecured creditors. To address this, some countries have established wage guarantee funds or insurance schemes that cover certain employee claims, especially those accrued shortly before insolvency. These funds may then claim reimbursement from the insolvent estate, often enjoying the same priority status as the original employee claims, at least up to a specified limit.[115]

Preferential creditors also cover tax authorities, granting priority to tax claims in insolvency is commonly intended to safeguard public finances. The reasoning is that tax authorities may be more willing to postpone tax collection from struggling businesses if they know their claims will be prioritized in insolvency, and because governments, unlike commercial creditors, often lack access to typical debt recovery tools. However, this approach can lead to negative consequences. Prioritizing tax claims may reduce consistent tax enforcement and act as a hidden subsidy, weakening the financial discipline that insolvency laws are meant to uphold. It might also lead tax authorities to be less attentive in monitoring and collecting debts, which could contribute to increased insolvency risks and further asset depletion.[116]

(d) Ordinary unsecured creditors

Unsecured creditors could be a individuals or entities that have lent another party money without any specific assets or collateral being pledged as security as part of the deal. Where secured creditors have a direct claim on specific assets under their secured interest, an unsecured creditor will rely on the debtors' word to repay the debt and perform its obligation as per the terms of their agreement. Unsecured creditors could be suppliers, service providers, lenders and etc.[117]

After all claims of secured and priority creditors have been paid, the remaining assets of the insolvency estate are typically shared among ordinary unsecured creditors on a proportional pro

[114] J. Sarra, A Brief Overview of the Treatment of Employee Claims and Collective Agreements in Canadian Insolvency Law, International Insolvency Institute, New York, 15 May, 2006. [https://insolvencylawacademy.com/wp-content/uploads/2022/09/A-Brief-overview-of-the-Treatment-of-Employee-Claims-Janis-Sarra.pdf] / ILO, Protection of workers' wage claims in enterprise insolvency, 18 May, 2020. [https://www.ilo.org/sites/default/files/wcmsp5/groups/public/@ed_protect/@protrav/@travail/documents/publication/wcms_745455.pdf] / J.W. Eastby, The Law of Unintended Consequences: The 2015 E.U. Insolvency Regulation and Employee Claims in Cross-Border Insolvencies, Chicago journal of international law. [https://cjil.uchicago.edu/print-archive/law-unintended-consequences-2015-eu-insolvency-regulation-and-employee-claims-cross]

[115] UNCITRAL Legislation guide on insolvency, New York, 2005, P. 272, para 72-73

[116] *Ibid*, P. 273, para 74

[117] Inquesta, Four Types of Creditors in Insolvency, 13 Nov, 2023 [https://inquesta.co.uk/blog/four-types-of-creditors-in-insolvency/]

rata basis. Within this same group of creditors, there may be further distinctions, with certain claims ranked as subordinate or granted specific priority.[118]

(e) Owners and equity holders

Equity holders, or shareholders, are individuals or entities with a direct ownership in an insolvent company, usually through owned shares. In insolvency proceedings, equity holders are generally last in line in ranking among other creditors, since secured, preferential, and unsecured creditors all have superior claims, shareholders rarely recover their investment once the company's assets are distributed.[119]

Owners and shareholders may have claims against the debtor based on loans they have provided or from their ownership. Insolvency legislations often treat these two types of claims differently. Generally, for claims tied to equity interests, the rule is that owners and shareholders are only entitled to receive a share of any remaining assets after the claims of all higher-ranking creditors have been fully satisfied. As a result, it is rare for equity holders to receive any payout during insolvency. If a distribution does occur, it follows the order of share classes outlined in company law and the firm's corporate documents. In contrast, ownership claims based on loans are not always automatically subordinated and may be treated differently depending on the circumstances.[120]

To sum up, secured creditors are privileged in insolvency proceedings due to their legally enforceable right to specific assets of the debtor, which serves as guarantee for their claims. This security interest, typically established through contractual agreements, granting them a direct and immediate claim to the debtor's assets, bypassing the general pool of unsecured creditors. The purpose of securing a debt to mitigate lender risk ensures that, upon default, secured creditors can enforce their rights, either by seizing and liquidating the collateral or claiming priority to its realization proceedings. This enforceability is not contingent on the insolvency process's outcome, as their claims are tied to identifiable assets rather than the debtor's residual estate. By contrast, unsecured creditors must rely on the insolvency administrators distribution of remaining assets, which are often insufficient. This advantage reduces risk of dismissal of claim and reflects a legal prioritization of pre-negotiated property rights over unsecured interests, reinforcing their privileged position in creditor hierarchies.

[118] UNCITRAL Legislation guide on insolvency, New York, 2005, P. 273, para 75
[119] Inquesta, Four Types of Creditors in Insolvency, 13 Nov, 2023 [https://inquesta.co.uk/blog/four-types-of-creditors-in-insolvency/]
[120] UNCITRAL Legislation guide on insolvency, New York, 2005, P. 273, para 76

2.1.3. Protection of secured creditors through the absolute priority rule in insolvency proceedings

Another important element related to the treatment of secured creditors is the absolute priority rule (APR), a principle of insolvency law that ensures a structured order of creditor repayments during bankruptcy or restructuring proceedings. Under APR, secured creditors are placed the highest priority, followed by unsecured creditors and, lastly, equity holders. This rule states that priority creditors like creditors with secured interest must be paid in full before stakeholders receive any distribution, thereby safeguarding secured creditors contractual rights to collateral.[121]

According to principle that secured claims are satisfied first, APR ensures that secured interest will not be violated. For example, in U.S. Chapter 11 cases (§ 1129(b)(2))[122], APR prevents equity holders from retaining value unless all creditor classes are fully compensated, ensuring a "fair and equitable" outcome. This predictability is important for secured creditors, as it guarantees their claims are prioritized over unsecured obligations.

Under EU law, during insolvency proceedings, application absolute priority rule is not mentioned in EIR, regulation does not harmonize application of the rule among Member States. Nevertheless the Directive recognizes this rule. Recital 55 of the Directive establishes that APR as an option available to Member States for protecting creditors holding security who oppose a restructuring plan.[123] In essence, this implementation of the APR examines that Member States can safeguard the interests of secured creditors as the class that has voted against a restructuring plan by requiring priority for secured creditors as they must receive complete payment of their claims before any below class creditors.[124]

This APR rule acts like a waterfall payment (order of payment where distribution flows down according to ranking order from high ranked to lower situated creditors) discussed above, where cost must fully satisfy claims at each level before flowing down to the following class.[125] The rule prevents charge transfers from highly ranked class to lower class and ensures that the established ranking of claims is maintained during proceedings.[126] The APR performs as one of two options

[121] D. G. Baird, Priority matters: absolute priority, relative priority, and the costs of bankruptcy, University of Pennsylvania Law Review, 2017, Vol. 165, No.4 p. --
[122] U.S. Chapter 11 cases (§ 1129(b)(2))
[123] 2019 European Restructuring Directive, rec. 55
[124] The New European "Relative Priority": An Analysis of its Impact in the EU Restructuring Directive and Dutch Insolvency Regime [https://www.clearygottlieb.com/-/media/files/emrj-materials/issue-9-2018/the-new-european-pdf.pdf] / Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive [https://www.elibrary.imf.org/view/journals/001/2021/152/article-A001-en.xml]
[125] CORPORATE RESTRUCTURING UNDER RELATIVE AND ABSOLUTE PRIORITY DEFAULT RULES: A COMPARATIVE ASSESSMENT
[https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=6817&context=faculty_scholarship]
[126] Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive [https://www.elibrary.imf.org/view/journals/001/2021/152/article-A001-en.xml]

the Directive provides to Member States for cross-class cram-down situations, with the alternative being the more flexible Relative Priority Rule, which only sets a requirement that high ranked classes be treated "more favorably" than lower ranked classes without mandating full payment.[127]

Followed by Recital 56, directive brought a contrast to the APR by permitting Member States to make exceptions in some scenarios where application of APR could affect and cause delays in restructuring proceedings. In this regards the Directive allows two options: first, Member States may let shareholders maintain partial ownership interest even when secured creditors must accept less than full satisfaction of their claims, if such an arrangement is considered fair in the circumstances. Second, they may prioritize payment to parties necessary for business continuity over technically higher placed creditors to prevent operational failure. This provision grants Member States flexibility to balance creditor ranking principles with practical business rescue means, granting the possibility to choose which protection mechanisms fits best their national insolvency laws and economic priorities.

Recital 57 of the Directive addresses APR application in two ways specifically for equity holders' influence in restructuring proceedings by limiting their rights in favor of secured creditors. On one hand, it states that Member States who exclude shareholders from voting on restructuring plans aren't required to apply the Absolute Priority Rule in relationships between creditors and equity holders. This creates a kind of flexibility in jurisdictions where by law shareholders lack voting rights, as strict devotion to priority payment order becomes less effective when shareholders can not directly influence the restructuring process.

On another hand, it creates an alternative chance to limit shareholders' ability to interfere restructuring plans, firstly by ensuring that when shareholder’s approval is legally requested for measures directly influencing their rights, the voting thresholds are not granted with unreasonably high permissions, and secondly, restricting shareholders from having authority to make decisions over restructuring matters that do not directly affect their ownership interests. Such balanced approach prevents shareholders from unreasonable delays of restructuring while still respecting their rights when genuinely affected. Correspondingly it facilitates efficient and successful corporate rescues without unnecessary delays.

While the restructuring directive encourages Member States flexibility in adopting APR or the more lenient Relative Priority Rule (RPR) in national restructuring proceedings, APR remains a major instrument for secured creditors seeking consistent enforcement of their claims across different jurisdictions. For instance, German and French courts typically maintains APR to protect

[127] The New European “Relative Priority”: An Analysis of its Impact in the EU Restructuring Directive and Dutch Insolvency Regime [https://www.clearygottlieb.com/-/media/files/emrj-materials/issue-9-2018/the-new-european-pdf.pdf]

secured creditors interests, alternatively states that adopts APR like the Netherlands prioritize restructuring flexibility, potentially undermining secured recoveries. At some point lack of full harmonization of APR framework on EU level creates uncertainties, such as forum shopping and issues with asset distribution, which can go across the secured creditors interests. Nonetheless, APR major point to ensure secured creditors priority over lower ranked claimants remains a main point of creditor guarantee, promoting cross-border stability while potential competing interests of the creditors.[128]

2.2. Diversity of national laws and the challenges of harmonization

This subchapter examines the existing diversity of ranking of creditors' claims across EU Member States and the resulting challenges of harmonization for cross-border insolvency proceedings. Despite efforts to harmonize insolvency law at the European level, major differences remains how national laws prioritize creditor claims, leading to issues of predictability and legal certainty for cross-border cases.

The discussion will cover the problems of harmonization in EU insolvency law, highlighting how the absence of legally binding, uniform ranking rules creates fragmentation within the internal market. It will then analyze the impact of these national differences, focusing on how varying frameworks affect cross-border cases and interests of secured creditors. Finally, the subchapter will present illustrative case law by CJEU and domestic courts, demonstrating the inconsistencies in creditor treatment.

2.2.1. Differences of ranking of creditors' claims on national level of Member States

While the principle of supremacy of EU law stands as a basis of Union's legal system, it does not prevent Member States from introduction in their own national approaches on ranking of creditors' claims in insolvency proceedings, respecting their sovereignty and reflecting it in internal policies. Although no legally binding EU instrument explicitly establishes a unified order of creditor claims, both the EIR and the Directive contains provisions that recognize preferential nature of certain creditors.

The UNCITRAL Legislative Guide on Insolvency Law may have influenced Member States towards adopting similar principles of ranking in their domestic policies, such as the recognition of privileged nature of secured creditors and preferential treatment for employees and tax authorities. However, examination of national insolvency regimes demonstrates differences in

[128] D. G. Baird, Priority matters: absolute priority, relative priority, and the costs of bankruptcy, University of Pennsylvania Law Review, 2017, Vol. 165, No.4 p. --

order of creditor's claims across the EU, despite procedural harmonization efforts from EU's side, it comes clear that ranking of creditors remains basically within the authority of domestic policies.

The clear example of adopting individual national approach on ranking of the claims is the rules found in the insolvency law of the Netherlands. Claims against the estate known as „*boedelvordeningen"* are ranked first and given priority over other creditors. This include the obligations occurred during the bankruptcy such as the fees of the insolvency administrator and employee wages which are categorized as estate debts. Preferential claims are ranked second, once the estate debts have been settled. These preferred creditors include the Dutch Tax Authority, the Employee Insurance Agency (UWV), and employees with unpaid wages from before the bankruptcy. The priority of these creditors is determined by the nature of the claim and the circumstances under which it arose. Non-preferential claims are ranked third, after claims discussed above next in order unsecured claims „*concurrente vorderingen"* will be paid. These claims typically stem from unpaid debts for goods or services that have already been delivered, such as outstanding invoices from suppliers, utility providers, or health insurers.

In cases where the estate lacks sufficient funds, these creditors will only receive a partial payout relative to the amount they are unpaid. Ordinary creditors and subordinated creditors come last, post-competitive creditors such as shareholders get their money back last. They will only get their deposited money back when other debts are paid and there is still money.[129]

Dutch law also treats security holders differently from other creditors, particularly a creditor who holds security *„borgtocht"* has an agreement with another party to claim the debt if the bankrupt company cannot pay. The other party is then the guarantor. This security is also called surety in legal terms. In practice, the bankrupt entrepreneur has often put up their private assets as security. But it can also be someone in the family or friends. With security, the creditor has more certainty of being (partially) repaid.[130]

Germany adopted approach by establishing separation between different types of secured creditors. German law introduced preferred creditors with collateral rights *„Absonderungsgläubiger"* and creditors entitled to asset recovery *„Aussonderungsgläubiger"*.[131] In contrast, French law in certain circumstances places claims from tax authorities above secured creditors through so called „super priority" status.[132] This demonstrates more interfering approach

[129] Netherlands Chamber of Commerce, KVK, Ranking of creditors https://business.gov.nl/ending-or-transferring-your-business/bankruptcy/ranking-of-creditors/
[130] *Ibid*
[131] LDR - Annex on Insolvency ranking 2021 - Annex 3 - Insolvency Ranking in the jurisdictions of the Banking Union https://www.srb.europa.eu/system/files/media/document/LDR%20%20Annex%20on%20Insolvency%20ranking%202021%20v1.6_1.pdf
[132] *Ibid*

of internal policy of France, where public interests frequently overrides private agreement of the parties, that in my opinion questions the idea of security itself, since the creditor is getting security in order to have a guarantee if debtor fails to perform its obligations, basically under certain conditions public interest can overcome the private agreement of secured asset.

Similarly to France, Belgium also established the rules that requires an existence of certain circumstances in order to justify the privileged status of secured interest. Precisely, policy makers created the system where statutory liens are based on the Mortgage Act that create a web of conflicting priorities, on other words such rule creates an ability to claim different priority status by multiple creditors. This complexity leads to frequent conflicts of ranking between creditors and demands case-by-case determinations of creditor order.[133]

For the lower-class creditors such as priority holders, unlike security holders internal policies of Member States sharing the similar approach. For example, French and Austrian laws are considering employees as priority creditors but not considering the exceptional cases they grant employees wage claims super-priority status, ranking them higher than secured creditors in insolvency proceedings, referring to labor protections in these legal systems.[134]

Quite opposite approach is observed in Spain and former MS United Kingdoms, where both systems consider employee claims as preferential unsecured claims that are placed below secured creditors but above general unsecured creditors. This approach is incorporation with ranking established by UNCITRAL, these jurisdictions balances employee protection and its social interest with respect for security claims.[135]

Therefore, different jurisdictions across the EU are recognizing the privileged nature of secured creditors, indeed local approaches may differ from one to another and sometimes social and tax claims could be prioritized over secured creditors under certain conditions, still secured creditors enjoy the fact that they are placed highest in the raking order.

2.2.2. Challenges of court practice concerning the order of creditor's claims

View of policymakers further created as legally binding rules are not always performed in practice as it was designed. In the EU, the Member States maintain sovereignty to develop their national policies in insolvency law. The national courts deal with the cases according to domestic laws, Therefore establishing the local court practice that may very from the state to state.

[133] LDR - Annex on Insolvency ranking 2021 - Annex 3 - Insolvency Ranking in the jurisdictions of the Banking Union
https://www.srb.europa.eu/system/files/media/document/LDR%20%20Annex%20on%20Insolvency%20ranking%202021%20v1.6_1.pdf
[134] Cross-border insolvency law in the EU
https://epthinktank.eu/2013/02/27/cross-border-insolvency-law-in-the-eu/
[135] Creditor Priority in European Bank Insolvency Law
https://blogs.law.ox.ac.uk/oblb/blogpost/2023/03/creditor-priority-european-bank-insolvency-law

Correspondingly, supreme authority of CJEU to rule on the matters of EU law that affects national courts is important. But if the mechanism is designed in such a way that everything is in connected, Member States are able to maintain the domestic individuality at the same time comply with the international custom then what could be an issue?

Practice showed that rulings of the national courts or CJEU sometimes are different from the classic ranking of the creditors author discussed above, on a case to case basis sometimes courts changed the order of creditors priority of claims and granted the preferential status to the lower ranked creditors based on public or social interests. This subchapter aims to analyze the how court practice prioritized lower class creditors over higher situated creditors and its impact on insolvency proceedings.

Last year Munich higher regional court ruled on the matter of insolvency law concerning claims for damages by shareholders as third-party creditors, particularly subject matter of the case concerned the legal uncertainty of classification of stakeholders claims for damages arising from capital market violations. Question before the court was to determine whether such claims should be treated as standard insolvency claims under Sec. 38 of the German Insolvency Code allowing shareholders to participate in distribution of assets or allied to lower-ranking status under Sec. 39.[136]

The Munich Higher Regional Court was called upon to determine whether claims for damages could be registered as insolvency claims, giving the shareholders chance to satisfy their interest, after the lower instance court had previously held that such claims were subordinated and not entitled for registration.[137] In contrast, the Higher Regional Court of Munich changed the judgement of lower instance court, ruling that shareholders claims qualify as standard claims under Section 38. The court discarded the automatic subordination of shareholder claims under Section 39, pointing that the claims arose not from the shareholders equity ownership but from torts caused by Wirecard's management actions violating of capital markets laws. The court followed the existing practice of German Federal Court of Justice on EMTV case,[138] which established that shareholders can perform as external creditors if their claims arise from management failure independent of their shareholder status. The court mentioned that the damage like nonsufficient

[136] Higher Regional Court of Munich, partial and interim judgment of 17 September 2024 – 5 U 7318/22 e Claims for damages by a deceived shareholder against the stock corporation as insolvency claims ("Wirecard") (OLG München, Teil- und Zwischenurteil v. 17.09.2024 – 5 U 7318/22 e - Schadensersatzansprüche eines getäuschten Aktienerwerbers gegen die Aktiengesellschaft als Insolvenzforderungen ("Wirecard")) [https://www.gesetze-bayern.de/Content/Document/Y-300-Z-BECKRS-B-2024-N-24286?hl=true]

[137] *Ibid*.

[138] *EMTV decision*, Federal Court of Justice, judgment of 9 May 2005 - II ZR 287/02

financial statements occurred not because of shareholders involvement but from board of managements decisions, making subordination unjustified.[139]

This judgement demonstrates domestic approach of Member State towards the ranking of the creditors. Practical relevance of this judgement is obvious since court simply explained that Shareholders in respect of their property rights are entitled to submit their tort claims in order not to be excluded from asset distribution and be considered as external creditors expecting potential satisfaction of their interests. Such justification is based on the idea that shareholders were not responsible for the decisions of the management that lead to the bankruptcy of the company, therefore it would be unfair to put the burden of management's mistake on shareholders.

It is also relevant to discuss the CJEU practice where court granted the privilege to public and social claims over privileged class of creditors. This reveals that status of secured creditors as the ones placed higher than others are not absolute and sometimes can be changed under specific circumstances. The CJEU dealt with the questions of the application of Article 23(4) of Directive and its relation with Portuguese law, primarily excluding tax and social security debts from discharge in insolvency proceedings.[140]

The Court had to answer whether Member States are allowed to exclude non-listed debts such as tax and social security from discharge if duly justified and does such exclusion grants privilege status to public creditors over others? In this case a Portuguese debtor initiated discharge of debts in insolvency, but tax and social security debts were excluded under national law. CJEU allowed to declare tax claims as non-dischargeable claims.[141]

Thus, Article 23(4) of the Directive allows Member States to exclude tax and social security debts if duly justified under national law. Justification may derive from domestic legal acts, constitutional principles, or legislative intent.[142] The court supported the privileged status of claims submitted by tax authorities or social security agencies. Permitting such priority court stated that excluding public debts is lawful if justified by objectives like social equity or public interest of tax authorities.[143] The directive does not restrict Member States discretion to prioritize public creditors in case there will sufficient grounds.[144]

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[139] Higher Regional Court of Munich, partial and interim judgment of 17 September 2024 – 5 U 7318/22 e Claims for damages by a deceived shareholder against the stock corporation as insolvency claims ("Wirecard") (OLG München, Teil- und Zwischenurteil v. 17.09.2024 – 5 U 7318/22 e - Schadensersatzansprüche eines getäuschten Aktienerwerbers gegen die Aktiengesellschaft als Insolvenzforderungen ("Wirecard")) [https://www.gesetze-bayern.de/Content/Document/Y-300-Z-BECKRS-B-2024-N-24286?hl=true]

[140] C-20/23 - Instituto da Segurança Social and Others, para. 16-22

[141] *Ibid*, para. 16-19

[142] *Ibid*, para. 33-39, 54

[143] *Ibid*, para. 41-45

[144] *Ibid*, para. 26-27

Such position of the CJEU allows national rankings favoring public creditors like tax authorities and social debt holders over private ones, even the secured creditors in insolvency proceedings, according to the judgement such exclusions are grounded in domestic policy of Member State. By allowing Portugal to exclude tax and social security debts, the CJEU admits that public revenue protection can override the scope of directive for harmonization and interests of security holders. This demonstrates divergent practice of creditor rankings across the EU, as Member States may now can prioritize the public interests over privet relying on the practice of the CJEU.[145]

The judgement grants privilege to national sovereignty over creditor equality, permitting distribution of the assets not in the order of priority ranking. While the Directive aims for harmonization, the approach adopted by the court to duly justified exclusions strengthens the risks of legal certainty and predictability in cross-border insolvency proceedings. Public creditors privileged status may decrease the recoveries for commercial lenders and mislead capital allocation between creditors. The court's reliance on national justifications creates gap for misuse, potentially requiring judicial review to prevent violation of creditors rights.

Interesting approach we observe in another case by CJEU which concerned the interpretation of Directive 2008/94/EC on employee protection in insolvency, specifically whether national French national law may exclude employees' claims from asset distribution if the employment contract is terminated by the employee due to employers insolvency.[146] Along with that, question before the court was whether or not such exclusion is compatible with the Directive's objectives and the principle of equal treatment.[147]

In this case employees of insolvent company terminated their contracts due to serious employer breaches connecter with unpaid wages. Under French labor code employees claims were excluded from the guarantee institution AGS because termination was initiated by employees. The referring court questioned whether this exclusion violates EU law or not.[148]

Following the ruling of the CJEU, Directive on restructuring and insolvency precludes the national laws of the Member States to exclude coverage for terminations made by employees due to employer breaches. Court of justice stated that such terminations are not voluntary or based on consensual will of the parties but a consequence of employer misconduct, making affected employees comparable to those terminated by insolvency officials. Excluding such claims violates the principle of equal treatment.[149] The Court held that the scope of Directive is to ensure minimum

[145] C-20/23 - Instituto da Segurança Social and Others, para. 41-45
[146] C-125/23 - Association Unedic délégation AGS de Marseille, para. 22-28
[147] *Ibid*, para. 28-30
[148] *Ibid*, para. 18-27
[149] *Ibid*, para. 47-49, 52

protection standard for all employees during the insolvency proceedings. Cort ruled that severance pay claims must be covered regardless of who initiated termination of agreement if it is tied with the equal treatment and rights of the employees.[150]

The importance of this case is justified by its idea regarding ranking of the creditors, this judgement reinforces of status employees as privileged creditors in insolvency proceedings. By securing the obligation of coverage for severance claims regardless of initiated of contract termination, it prevents Member States from neglecting protection of employees interests through procedural distinctions.[151] Alongside with that, judgment limits national discretion to lower employee claims based on termination procedure, ensuring alignment with the scope of Directive on uniform protection across the EU.[152]

As a result, the CJEU grants privileges status to the employees claims based on the social interest behind them, guaranteeing that ranking of the creditor in insolvency proceedings do not neglect employees interest based on procedural matters. Judgement demonstrates the court practice towards employees as priority creditors, shielded by social interest, restricting national laws of Member States to override the principles of EU law ensuring predictability in cross-border insolvencies held in other Member States.

To sum up, the divergent approach of Member States on ranking of the creditors exist, even though in most of jurisdictions secured creditors are placed higher in the order of the asset distribution and hierarchy of the claims, practice shows that on a case to case basis, under some circumstances lower ranked creditors like tax authorities and employees or insolvency administration costs may overcome the secured interest if public or social policy will be duly justified. Correspondingly, such diversity of court practices are risky in regards of legal certainty and predictability of cross-border insolvency proceedings, demonstrating the lack of harmonization on international level, challenging the unification aims of EU law.

[150] *Ibid*, para. 51
[151] C-125/23 - Association Unedic délégation AGS de Marseille, para. 51-52
[152] *Ibid*, para. 46-48

CHAPTER 3: Risk of potential contradictions in the exercise of the rights in rem in EU Insolvency Law

This chapter examines possible contradiction between the scope of the EIR and the Directive on restructuring and insolvency, analysing their conflicting approaches to secured creditors' rights. While the EIR prioritizes the absolute protection of rights in rem to ensure legal certainty in cross-border insolvency, the Restructuring Directive adopts a rescue-oriented framework that subordinates secured claims to collective restructuring mechanisms. The approach in the EIR regarding the protection of secured creditors' rights is coupled with idea that such creditors enjoy the right to decide over the treatment of secured assets. The Directive, however, aiming to rescue the business first, is linked to address primarily the interests of the debtor and the treatment of all assets (including the collateral) should be directed towards effective rescue of viable business. The different approach towards the treatment of the collateral and the exercise of the rights of secured creditors in cross-border restructuring cases then raise question whether two EU binding legal acts are (in)compatible and provide a coherent way to ensure the effectiveness of restructuring proceedings.

This Chapter is dedicated to the analysis of two major mechanism of protection of parties involved in insolvency proceedings, namely the rights in rem established under Art. 8 of the EIR that serves as protective provision for the creditors granting secured status and the stay of individual enforcement actions (moratoria), the instrument established under the Restructuring Directive that shields a debtor from secured creditors' claims against the insolvency estate. The objective of the chapter is to understand the potential legal contradiction of two EU legal acts regulating insolvency proceedings and assess whether the proposed legislative solutions provide the balance between the interests of a debtor and secured creditors in restructuring proceedings.

3.1 Debatable positions of the treatment of secured creditors in EU law

Art. 8 of the EIR establishes an absolute protection for rights in rem, ensuring that secured creditors' claims over assets in other Member States usually remain unaffected by insolvency proceedings. This provision reflects a territorial logic that prioritizes the *lex situs* also known as law of the asset's location over the *lex concursus* (the law governing main insolvency). By contrast, the Restructuring Directive mandates the inclusion of secured creditors in preventive restructuring plans, subjecting their claims to moratoria, class voting, and potential cram-downs.

The possible contradiction between two different approaches towards the treatment of the collateral arises from the EIR's preservation of secured rights as inviolable property interests, while the Restructuring Directive treats them as negotiable components of a broader rescue

strategy. For instance, Article 6(2) of the Directive permits stays on enforcement actions against secured assets during restructuring, directly conflicting with Article 8 EIR's guarantee that such rights "shall not be affected". Such dilemma may be also found in the relevant case law of the CJEU. In the Senior home case, the CJEU found that public creditors' rights in rem fall under EIR protection, underlines the complexities of the coexistence of these regimes when national courts must apply both instruments meaning that the security rights created in any legal relation (from public or private law) shall enjoy the special treatment in cross-border insolvency proceedings.

3.1.1 International comparison of moratoria

Due to the aims to the EU policymakers to harmonise insolvency law in the EIR, the national laws of the Member States provide similar approaches of protections towards the treatment of debtors in restructuring proceedings. The Directive is a legislative act that sets out a goal that EU countries must achieve, and it applies to all Member States. However, it is up to each Member State to devise their own laws on how to reach these goals.[153] Because of that member states can have differences in the legislative policies but in the end they serve the same purpose.

UNICITRAL legislative Guide on Insolvency Law serve as an important soft law document in insolvency law., Even though it is not legally binding, it provides the guidance and best practices for the national legislators and policymakers. UNCITRAL Legislative Guide on Insolvency admits that letting creditors directly enforce the claims during restructuring could interrupt the efficiency of restructuring proceedings. In case a business continues to operate, it might increase the value of the assets comparing to asset distribution proceedings. According to Legislative guide, restructuring seeks to keep the business operating to keep and increase the value. However, if creditors are allowed to take important assets during ongoing proceedings, the business might not survive. Thus, it upholds the idea that moratoria serve to protection of debtors to rescue the business, rather than distribute its assets accordingly to creditors' claims.[154]

Under UNCITRAL Legislative Guide a secured creditor is permitted to request the separation of their claims from moratoria if the asset they are holding secured interest isn't required or necessary for the planned restructuring or sale of the debtor's business. Additionally, while the stay is in place, the creditor has the right to ensure that the value of the asset securing their claim is preserved.[155] Basically, the tires to be fair, on one hand they don't want to obstruct creditors

[153] „Types of legislation." An official EU Website. https://european-union.europa.eu/institutions-law-budget/law/types-legislation_en#:~:text=A%20%22directive%22%20is%20a%20legislative,straws%20and%20cups%20for%20beverages

[154] Gerard McCormack, *The European Restructuring Directive* (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.08.

[155] *Ibid*, para. 4.09.

from satisfaction of their claims if it's not contributing the company recover, in contrast, they also make sure debtors restructuring is possible to be carried effectively.

The moratorium is an important feature of the Chapter 11 of US Bankruptcy Code. Under Chapter 11 of the US Bankruptcy Code a debtor usually offers a plan of reorganization to maintain its business alive and pay creditors over time. Similarly to the underlying ideas in the Directive, a case filed under Chapter 11 of the United States Bankruptcy Code is referred to as a restructuring bankruptcy, during which the debtor remains in possession, has right to continue business operation, and may, with court approval, borrow new money. A reorganization plan is revealed, creditors whose rights are affected can vote for the plan, and the plan can be confirmed by the court under condition of satisfactory number of votes and certain legal requirements.[156] Thus, the fundamental ideas of restructuring in the US Bankruptcy Code are also related to the ones found in the Directive.

Chapter 11 also establishes the automatic stay which creates possibility to freeze enforcement in order to evaluate the reorganization plan and discuss the possibility of business rescue. Nevertheless, secured creditors can apply for "adequate protection" under specific requirements. Concept of adequate protection is not defined[157] and there are relevant case law where the court rejected the view that the preservation of a certain "collateral-to-debt" ratio was part of the creditor's property interest that warranted protection.[158] However, the US Supreme Court also ruled that the adequate protection provision did not entitle an non secured creditors to compensation for the delay caused by the stay in enforcing the security.[159] It should be stated that secured rights arising out of collateral are intitled to have the adequate protection.

Another relevant element of the application of the rules on a stay is the application of moratorium in liquidation proceedings. US Bankruptcy code permits the application of a stay in both liquidation proceedings under Chapter 7 and reorganization proceedings under above stated Chapter 11. In contrast UK Insolvency Act 1986[160] provides a clear separation for application of a stay between liquidation and restructuring proceedings called administration order.[161] Under UK Insolvency Act, the liquidation stay is established to prevent unnecessary expenditure of debtor's assets, which should be used to repay creditors claims and does not affect the enforcement of

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[156] https://www.uscourts.gov/court-programs/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics
[157] Gerard McCormack, The European Restructuring Directive (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.11.
[158] In re Alyucan Interstate Corp. Case, n re ALYUCAN INTERSTATE CORP., Debtor. BANKERS LIFE INSURANCE COMPANY OF NEBRASKA, Plaintiff, v. ALYUCAN INTERSTATE CORP. and Stewart L. Grow, Jr., Defendants, U.S. Bankruptcy Court — District of Utah, 12 BR 803, 16 July 1981 [https://case-law.vlex.com/vid/in-re-alyucan-interstate-893779174]
[159] United Savings Association of Texas v Timbers of Inwood Forest Associates Ltd (1988) 484 US 365
[160] https://www.legislation.gov.uk/ukpga/1986/45/contents
[161] Gerard McCormack, The European Restructuring Directive (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.12.

secured rights. It is designed to replace the creditor's need to prove their claim through a court judgment with a simpler version of lodging a proof of debt in the insolvency proceedings.[162] However, a stay in restructuring is broader concept and applies to the enforcement of the secured claims.[163]

To sum up, various international instruments, both binding and non-binding provide rules on restructuring and moratorium. Their approach appears to be similar in some regards such as granting secured creditors with the right to request separation of some assets from moratoria in case if it is not contributing to the process of restructuring. Under EU law, through the Directive on restructuring and insolvency member states have the common goal of harmonization but the way they will achieve this goal is left to the domestic lawmakers. Rules on restructuring under US Bankruptcy code and UK Insolvency Act are demonstrating familiar approach. All the mentioned law including UNCITRAL legislative guide admits the importance to recover debts and promote the idea of business rescue.

3.1.2 Effect of moratoria on the enforcement of rights against debtors assets

To understand possible contradictions between the EIR and the Directive, it is important to explain the aims of the rules found in the Art. 6 of Directive on restructuring and insolvency . This subsection is dedicated to the discussion on moratoria or otherwise called stay on actions brought by creditors against debtor and its assets during the restructuring proceedings.

Under the Directive, the moratoria is one of the instruments to provide effective restructuring proceedings and protect debtor's assets (insolvency estate). It is one of the main legal instruments found in the Directive to ensure effective restructuring proceedings. One of the main policy aims in the Directive regarding preventive restructuring proceedings is to restructure effectively at an early stage and to avoid insolvency and avoid the unnecessary liquidation of viable enterprises (Recital 2 of the Directive). Under Recital 32 of the Directive, "a debtor should be able to benefit from a temporary stay of individual enforcement actions, whether granted by a judicial or administrative authority or by operation of law, with the aim of supporting the negotiations on a restructuring plan, in order to be able to continue operating or at least to preserve the value of its estate during the negotiations".

The moratoria found in Art. 6 of the Directive acts like a temporary shield for debtors facing likelihood of insolvency and trying to rescue the business from financial trouble. Simply a struggling business is getting a chance to suspend creditors' claims of individual enforcement

[162] Gardner v Lemma Europe Insurance Co Ltd [2016] EWCA Civ 484 at 2, England and Wales court. [https://www.casemine.com/judgement/uk/5b2897cd2c94e06b9e19b529]
[163] Gerard McCormack, The European Restructuring Directive (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.13

actions. Moratoria provides protection to the debtors to protect their assets from distribution to the creditors according to their claims meaning that temporarily no creditor is entitled to exercise the contractual and/or property rights against the debtor's assets. Stay is not the automatic or necessarily comprehensive measure, but it provides the protection, even from secured and preferential creditors.[164] However, it is does not guarantee the absolute protection, in particular the exception can be the claims of employees, even though Member States can impose the specific measures on this regards to somehow grant debtors the protection from this particular claims, still workers claims could be separately treated when it comes to the stay. [165]

One of the main elements of a stay is its temporal character. The initial duration of the moratoria is limited by the EU policy makers and it is limited of maximum period of 4 months.[166] Nevertheless, total duration can be extended to 12 months including extensions and renewals.[167] In any case the stay should perceived as a temporal solution which should not alter the legal relations between a debtor and creditors.

However, why the EU policy makers found that a stay is necessary for the effective treatment of assets and contributes to the effectiveness of restructuring proceedings? Why did they create such rule and what are the reasons behind the rules of a stay under the Directive? The answer is quite promising for the debtors but becomes the problem when creditors seek the enforcement of their claims from the debtor's assets. The stay is intended to permit a debtor to have the chance for the effective negotiation of restructuring plan without the concern that during the negotiations a debtor may be deprived of the assets is the creditors' exercise their rights against them. It is logical, since unlike creditors, debtors in the first order seek to find the solutions how to maintain the business on the market to continue the operation and generate the profit. Namely, the support to the debtor regarding the negotiations of the restructuring plan is one of the main policy and legal considerations in the Directive. Such interpretation is also related to the text of the Directive itself, stating that "the aim of stay is to support the negotiations on a restructuring plan, in order to be able to continue operating or at least to preserve the value of its estate during the negotiations."[168]

Moratoria is designed to grant the debtor some kind of protection by giving the time for proper negotiation over the restructuring plan in order to maximize the value of its assets and promote the restructuring plan for the interest of the business. As for my understanding, if there would not be the stay creditors could have the possibility to seize or enforce the debtors' assets,

[164] Gerard McCormack, *The European Restructuring Directive* (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.02.
[165] EU Directive on restructuring and insolvency, art. 6(5)
[166] *Ibid*, art. 6(6)
[167] *Ibid*, art. 6(8)
[168] *Ibid*, Rec. 32

that are important for maintaining business operation on the market, that would make successful restructuring impossible.

Ones may reasonably assert that this is exactly why we have the risks of legal contradiction between EIR and Directive. Obviously, it becomes very hard when regulation creates the protective mechanism for secured creditors and directive establishes the protection for debtors. Under circumstances of such collision satisfaction competing interests could be ineffective in terms or legal certainty and predictability, especially when cross-border element appears and some assets are covered by laws of multiple states.

While this position may be valid, however, insolvency (bankruptcy) and restructuring proceedings are not simple in terms of satisfaction of all the interests of parties, and from authors point of view it requires individual evaluation of every single case. simply revealing authors position, insolvency estate can be considered as "common pool"[169], if creditors with their protection will "overfish"[170] in the pool, meaning that they will use all the existing assets to satisfy their claims, then nothing will remain and the idea of restructuring will be unreasonable, since without the assets restructuring of the business is not possible.

Such interpretation is also based on the recent examples of cross-border restructuring proceedings. In July 2022, the Swedish airline company SAS filed for Chapter 11 bankruptcy protection in the court of United States to put into action company's restructuring plan called "SAS Forward". This filling for the opening of restructuring proceedings aimed to reduce costs, restructure debt and attract new investment of the company. SAS achieved the fleet optimization approval, when court allowed airlines to continue operating on the market and to use already existing assets to maximize the value. By exploitation the aircrafts company maintained flight operation for customers and SAS restructured over $2 billion in debt. By August 2024, SAS successfully emerged from Chapter 11 proceedings with an improved financial position and new ownership structure.[171] This case demonstrates importance of moratorium in cross-border restructuring proceedings. In such case because of the moratorium to against the creditors to seize the company's assets, SAS continued to operate on the market with existing aircrafts and increased financial solvency of the company in order to successfully complete the restructuring proceedings.

[169] Gerard McCormack, *The European Restructuring Directive* (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.06.
[170] *Ibid.*
[171] „SAS initiates court-supervised process in the United States by a Chapter 11 filing to implement key elements of SAS FORWARD Plan and will continue to serve its customers throughout the process" SAS AB. 5 July 2022. https://www.sasgroup.net/newsroom/press-releases/2022/sas-initiates-court-supervised-process-in-the-united-states-by-a-chapter-11-filing-to-implement-key-elements-of-sas-forward-plan-and-will-continue-to-serve-its-customers-throughout-the-process?

It would not be possible if the creditors' claims had been satisfied, as SAS would had remained without any asset to maximize its value and continue operations.

Such practical example reveals that the moratoria is intended to increase the overall value of the common pool of debtor's assets that form the insolvency estate and are available to all creditors. At the same time, it helps to prevent creditor interaction caused when individual secured creditors act on their own to block or disturb the restructuring process, even if plan has the support of most creditors.[172]

Moratoria carries the identical meaning not only in EU but other legal systems as well. In the US, the mechanism of stay is considered as one of the most important measures designed for debtors' protection established by bankruptcy legislation. Having the same effect described above it gives the debtors whose assets are regulated by US law to have protection from collective efforts of creditors. Alongside, it allows debtor to promote restructuring plan and repayment in reorganisation, simply not to be pressured by creditors willing to enforce their claims.[173]

Thus, a stay serves as the shield for the debtor to be temporarily protected from the creditors' claims. It helps a debtor to proceed with the restructuring plan and maintain business operations on the market in order to increase the assets value. Without the application of the stay debtors would be alone against the creditors seeking enforcement of their interest and with no assets remained restructuring would become ineffective. The risks of the depletion of the assets may lead to the situation when a debtor not only has little chances to effectively negotiate over the restructuring plan but also the possibilities to rescue the business may be significantly diminished.

Due to the aims to the EU policymakers to harmonise insolvency law in the EUR, the national laws of the Member States provide similar approaches of protections towards the treatment of debtors in restructuring proceedings. The Directive is a legislative act that sets out a goal that EU countries must achieve and it applies to all Member States. However, it is up to each Member State to devise their own laws on how to reach these goals.[174] Because of that member states can have differences in the legislative policies but in the end they serve the same purpose.

UNICITRAL legislative Guide on Insolvency Law serve as an important soft law document in insolvency law. Even though it is not legally binding, it provides the guidance and best practices for the national legislators and policymakers. UNCITRAL Legislative Guide on Insolvency admits

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[172] D Baird and R Rasmussen, 'Anti-Bankruptcy' (2010) 119 Yale L J 648; R de Weijs, 'Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool and Anticommons' (2012) 21 International Insolvency Review 67; MA Heller, 'The Tragedy of the Anticommons: Property in the Transition from Marx to Markets' (1998) 111 Harvard Law Review 622.

[173] https://www.uscourts.gov/court-programs/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics

[174] „Types of legislation." An official EU Website. https://european-union.europa.eu/institutions-law-budget/law/types-legislation_en#:~:text=A%20%22directive%22%20is%20a%20legislative,straws%20and%20cups%20for%20beverages

that letting creditors directly enforce the claims during restructuring could interrupt the efficiency of restructuring proceedings. In case a business continues to operate, it might increase the value of the assets comparing to asset distribution proceedings. According to Legislative guide, restructuring seeks to keep the business operating to keep and increase the value. However, if creditors are allowed to take important assets during ongoing proceedings, the business might not survive. Thus, it upholds the idea that moratoria serves to protection of debtors to rescue the business, rather than distribute its assets accordingly to creditors' claims.[175]

Under Legislative Guide a secured creditor is permitted to request the separation of their claims from moratoria if the asset they are holding secured interest isn't required or necessary for the planned restructuring or sale of the debtor's business. Additionally, while the stay is in place, the creditor has the right to ensure that the value of the asset securing their claim is preserved.[176] Basically, they tired to be fair, on one hand they don't want to obstruct creditors from satisfaction of their claims if it's not contributing the company recover, in contrast, they also make sure debtors restructuring is possible to be carried effectively.

To conclude all the discussed arguments, the stay serves as the protection for the debtors and aims to help them save the business, giving the space for restructuring to recover the debt, continue operation and maintain business on the market. The main objective is to rescue the business and during the restructuring proceedings maximize the existing assets in order to have the successful restructuring proceedings.

3.1.3 Effect of stay on collateral and treatment of assets not necessary for the restructuring

Another question that arises when discussing the stay is whether secured interest can freely coexist with the measure of debtors' protection, without experiencing the negative economic effect on its value. Apparently, secured creditors are concerned since they can fail to benefit if the assets backing their loans will be cut in value while they're limited from taking action during the stay. This rise concerns especially if the restructuring is not successful and the business doesn't recover.[177] Correspondingly, "Directive does not cover provisions on compensation or guarantees for creditors of which the collateral is likely to decrease in value during the stay."[178] The question arises whether a stay may cause damage to the interests of the holder of the rights in rem and such creditor is entitled to the compensation? Should be court when considering the imposition of the

[175] Gerard McCormack, *The European Restructuring Directive* (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.08.
[176] *Ibid*, para. 4.09.
[177] *Ibid*, para. 4.30
[178] EU Directive on restructuring and insolvency, rec. 37

stay also consider the interests of a secured creditor? What relevant circumstances may be assessed in such scenario?

The UNCITRAL Legislative Guide on Insolvency suggests that providing the protection to the secured creditors and the assets under collateral while a stay is applied. According to Legislative guide, it can be done or by providing additional security, cash payment or let the court to determine the protection measure.[179] Similarly to UNCITRAL, US bankruptcy code under section 362(d) upholds the importance to protect the interest of the secured creditors stating that safeguard of interest has to be priority and the stay during the restructuring should not became the bargain of the secured interest holders.[180] The main idea behind it is to ensure the value of secured assets will not decrease during the restructuring proceedings.

In Re Bermec[181] case before the US court question before the court was to rule on the issue whether the assets covered by rights in rem has to maintain the value or it could be affected by the restructuring proceedings. Secured creditors were concerned with the value loss of their collateral and inability to recover it. Nevertheless, the court reinforced the need to balance of the interests. The purpose of having "adequate protection" discussed in the subsection above is to ensure that secured creditors will receive the payment in value to what they were originally promised under collateral agreement. This idea was supported and argued that under the “adequate protection” criterion secured creditors are entitled to have the protection from losing value of their secured interest, otherwise it is unfair to the security holder when their priority can be adjusted according to the interest of debtor.[182]

Such approach seems well founded and reflects the idea of security. When a creditor is entering into the agreement with a debtor on the collateral as security for the performance of debtor’s obligations, a creditor is relying on legal certainty that in case a debtor fails to perform its obligation to repay back to the creditors, it will be possible to enforce the secured interest to satisfy the obligation. Indeed, the author of the thesis supports the view of EU policy makers that there should be the balance of the interests between creditors and debtors in order to grant both of them mechanism of protection like rights in rem and moratoria. However, it becomes hard to understand why protection of the debtors' interest has to be placed on the shoulders of secured creditors. The

[179] Gerard McCormack, The European Restructuring Directive (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.31 / Recommendation 50 of the UNCITRAL Legislative Guide on Insolvency, accessed 27 January 2021 https://uncitral.un.org/en/texts/insolvency/legislativeguides/insolvency_law.

[180] Gerard McCormack, The European Restructuring Directive (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.32

[181] In re BERMEC CORPORATION case (1971) 445 F2d 367. United States Court of Appeals, Second Circuit [https://law.resource.org/pub/us/case/reporter/F2/445/445.F2d.367.71-1667.71-1642.71-1597.1089.1090_1.html]

[182] J White, ‘Death and Resurrection of Secured Credit’ (2004) 12 American Bankruptcy Institute Law Review 139 at p 146

author believes that it is a reasonable approach when balance that is achieved by granting both of them with specific protection is logical, secured creditors can wait maximum of 12 months in order to let debtor try to rescue its business and overcome the insolvency, but it becomes hard to understand the logic when in addition to this creditors are risking to sacrifice the value of their secured interest.

Under the Directive, "everything is subsumed within the concept of unfair prejudice. Instead of seeking compensation for a decline in the value, a secured creditor could apply for the stay to be lifted."[183] Art. 6 does not provide distinction between different classes of creditors including security holders. Nevertheless, it is relevant that employees claims are treated separately from others, meaning that Member States must make sure that employees claims are sufficiently protected. Simply speaking, even during early restructuring, these claims must be granted priority that is similar to what they would get during insolvency proceedings. This approach is similar to the one discussed to in pervious chapter, where employees claims are placed after secured creditors and considered lower class, however in certain circumstances employee claims were granted priority over secured claims.

Other question connected to the stay is how directive treats the creditors assets that are the subject of secured claims and do not have value in debtors recovery? Art. 6(1) refers to "the refusal stay of individual enforcement actions where such a stay is not necessary"[184]. Alongside the Directive also states the in case if stay do not achieve the goal of supporting the negotiations on the restructuring plan can be relieved and became the subject of enforcement according to creditors claims.[185]

To sum up, the stay is designed to protect the interest of the debtor, serving as the shield from the enforcement claims and give the chance to maintain business and recover from the financial crisis due to effective restructuring proceedings. A different treatment of the stay may be found in the EU insolvency law and other jurisdiction (US bankruptcy law) and international soft-law insolvency documents. The Directive does not guarantee the fixed value of secured asset and if it will be deceased, in case of successful restructuring secured creditors will receive the decreased value. The UNCITRAL legislative Guide on Insolvency and US Bankruptcy Code uphold the idea where a secured claims has to be granted with the priority to maintain stability during reorganization. Also, the assets that no longer serves the objectives of restructuring and do not contribute to the rescue of the business can be relieved and creditors are able to claim its enforcement.

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[183] Gerard McCormack, The European Restructuring Directive (Cheltenham, UK: Edward Elgar Publishing) 2021, p. 108, para. 4.39 / EU Directive on restructuring and insolvency , Art. 6(9)c
[184] EU Directive on restructuring and insolvency , para. 6(1)
[185] *Ibid* , para. 6(9)a

3.2 Conflict of policy objectives in cross-border insolvency proceedings

The conflict between legal certainty and business rescue rooted to the different objectives of the EIR and the Directive. Art. 8 of EIR stands for the principle of legal certainty by protecting pre-insolvency rights in rem from foreign proceedings, ensuring creditors can rely on the lex situs to enforce claims against assets in other Member States. This approach prioritizes predictability and legal certainty for secured creditors, particularly regarding the creation and enforceability of rights in rem. Alternatively, the Directive stands for the collective restructuring mechanisms, permitting moratorium. This conflict outlines major questions about whether the protection of pre-insolvency property rights under EIR such as the time of their creation, the types of assets eligible for pledge, and the applicable law under *lex rei sitae* can coexist with the Directive purpose to save the business.

This subchapter examines the conflict of legal objectives under EU law and analysis the practical issues related to the applicable law and timing of creation of secured interest.

3.2.1 Conflict of legal objectives: legal certainty or rescue of business

Art. 8 of the EIR grants creditors with priority to satisfy their claims in insolvency proceedings and aims to protect the secured interest of creditors. Article 6 of the Directive establishes the protective mechanism for debtor for application of moratorium that will temporarily suspend the enforcement. Art.8 of the EIR is governed by principle of legal certainty for secured creditors to be sure that their secured claims will be enforced in case of opening insolvency proceedings. In contrast Art. 6 of Directive aims to maintain business operating in the market and for purpose of business rescue requests to include secured assets in insolvency estate then to administrate is for restructuring proceedings.

Legal certainty ensures that creditors rights in rem remain protected from the effects of foreign insolvency proceedings, provided those rights were validly established under the lex situs before initiating the proceedings. This principle guarantees creditors ability to rely on the domestic law of the Member State where assets are situated, preventing unexpected application of such law for their secured claims. Principle of legal certainty and predictability under Art.8 of the EIR is rooted to the principle of *lex rei sitae* referring to the law of the place where assets are located. This rule allows creditors to foresee how secured assets will be treated in foreign jurisdiction.

The author of this thesis believes that the principle of legal certainty and predictability is main reason why rights in rem are not governed by the *lex concursus* but by *lex situs*. Secured creditor has to be sure that the assets on which he is holding the protection will be governed by the law of state where it is located and not by the place where debtor has COMI, that time to time can be switched from one member state to another. Same approach was adopted by the CJEU in

ERSTE Bank Hungary[186] case where court of justice prioritized the lex situs over the lex concursus and applied law of Hungary as the place of assets location. By prioritizing *lex situs*, the EIR ensures that creditors can be confident knowing which law will govern the proceedings over their secured assets.

EIR by stating that "to protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened, provision should be made for a number of exceptions to the general rule."[187] Such exception is *lex situs* that promotes legitimate expectations under Art.8 of the EIR to protect creditors reliance on the stability of property rights under the law of assets location. The principle of legitimate expectations prevents member states from application of lex concursus to protect pre-existing secured rights, ensuring that creditors have protection from collective restructuring mechanism under the Directive.

Even though these principles and Art. 8 of the EIR itself can not guarantee absolute protection and secured assets fall under the moratoria pursuant to Art. 6 of the Directive still we can find certain balance of competing objectives. This balance can be identified by admitting that even in collective restructuring proceedings secured creditors maintain the priority comparing to creditors from other classes of creditors. The objective of Art. 6 of Directive is to save the business by effective restructuring, where priority is given to debtor and it aims to maximize the debtors assets in order to rescue business.

3.2.2 Problems of exercise of the rights in rem

The exercise of the rights in rem triggers various practical questions especially in cross-border insolvency proceedings. Some of the relevant questions related to the exercise of the rights in rem are not covered by the EIR. For instance, when rights in rem are created? Can rights in rem be created after opening of insolvency proceedings? What property can be pledged under Art. 8 of EIR and how to determine law applicable to rights in rem?

Rights in rem are directed towards property and its validity depends on the validity of the agreement between the parties. Rights in rem are usually considered as pre-insolvency created rights that were constituted before opening of insolvency proceedings.[188] Art. 8 of the EIR establishes the rule of relative immunization which protects pre existing rights in rem from the effects of insolvency proceedings.[189] Therefore, rights in rem usually are considered as pre existing

[186] "ERSTE Bank Hungary Nyrt v Magyar Állam, BCL Trading GmbH, ERSTE Befektetési Zrt, Case C-527/10." CJEU, Curia. 5 July 2012. ECLI:EU:C:2012:417. https://curia.europa.eu/juris/document/document.jsf?text=&docid=124745&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619130

[187] European Insolvency Regulation, rec. 67

[188] European insolvency regulation applicable law, cross border insolvency law in the EU, Sonia Pereira, 2020 Para. 4.4.2 [https://portal.ejtn.eu/Documents/Applicable%20law.pdf]

[189] *Ibid* Para. 4.1 [https://portal.ejtn.eu/Documents/Applicable%20law.pdf]

rights and created before opening insolvency proceedings, even though there is not exact prohibition established under Art. 8 of the EIR that it is impossible to have post created rights in rem still it is not common to conclude agreement after opening insolvency proceedings. Along with that it can contradict with the restructuring objectives and rise the concerns about pari passu principle. Indeed, some jurisdictions may allow to have post existing rights in rem, nevertheless, Art. 8 of the EIR states that "The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties <…> at the time of the opening of proceedings."[190]

The EIR, however, does not provide the list of the property that falls under the rights in rem or any exception of what property does not fall under protection of Art. 8. Correspondingly, rights in rem covers all kind of property including tangible and intangible assets regardless of their nature.[191] This was confirmed by the judgement of CJEU in case SCI Senior Home[192]. However, it the EIR provides the rights that particularly has to be regarded as rights in rem in Art. 8(2). Thus, instead of providing the definition of the rights in rem, EU insolvency law rather establishes the list of rights of the rightsholder of rights in rem.

Turning to the question of determining law applicable to the rights in rem, it was addressed partially in the discussion above, where author discussed that lex concursus would not be the perfect fit for secured assets and in order to determine the law governing such assets. The principle of lex rei sitae also called lex situs have to be prioritized. This corresponds to the application of the law of the member state where assets are located. Same was proved by CJEU in the case ERSTE Bank Hungary[193] where court of justice determined applicable law according to the place of assets location.

This matter was addressed by the CJEU in the SCI Senior Home case. In the case the French real estate company SCI Senior Home that owned immovable property in Wedemark, Germany. After opening of insolvency proceedings under French law in May 2013 German municipality of Gemeinde Wedemark sought to enforce a public charge against Senior Home's property to recover unpaid real estate taxes. Under German law, real property tax constitutes a public charge on immovable property, However, French insolvency law generally prohibits

[190] EU Directive on restructuring and insolvency , Art. 8(1)
[191] European insolvency regulation applicable law, cross border insolvency law in the EU, Sonia Pereira, 2020 Para. 4.4.1 [https://portal.ejtn.eu/Documents/Applicable%20law.pdf]
[192] Case C-196/15, SCI Senior Home, CJEU 26 oct 2026 [https://curia.europa.eu/juris/document/document.jsf?text=SCI%2Bsenior%2Bhome&docid=184857&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=1132176#ctx1]
[193] "ERSTE Bank Hungary Nyrt v Magyar Állam, BCL Trading GmbH, ERSTE Befektetési Zrt, Case C-527/10." CJEU, Curia. 5 July 2012. ECLI:EU:C:2012:417. https://curia.europa.eu/juris/document/document.jsf?text=&docid=124745&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=2619130

individual creditor enforcement actions after the opening of proceedings. The CJEU was asked to determine whether the tax claim qualified as a protected "right in rem" under Article 8 of EIR.

The CJEU admitted the importance of lex situs and prioritized the concept of location of assets in order to determine applicable law, since assets were located in Germany, secured assets owned by tax authorities were governed by Dutch law. The CJEU dismissed the request to apply French law as law governing the insolvency proceedings under Art. 7 of the EIR and prioritized the law of assets location as applicable law related to the secured claims.

Tu sump up, Art. 8 of the EIR prioritizes the protection of rights in rem created before the opening of insolvency proceedings, therefore, ensuring legal certainty, predictability, and the legitimate expectations of secured creditors in cross-border insolvency proceedings. This principle is followed by the exception form the general rule of applicable law, where law governing the secured interests should be the law of assets location as it is under lex situs, confirmed by the CJEU in SCI Senior Home and ERSTE Bank Hungary cases. While this approach safeguards the position of secured creditors and promotes transactional stability, it also creates contradiction with objectives of business rescue expressed in the EU Restructuring Directive.

CONCLUSIONS

1. Rights in rem is the protection mechanism for secured creditors established in the national and EU insolvency law. Article 8 of the EIR is based on principle *lex situs* meaning that secured assets are governed by the law of the state where assets are situated and the third parties rights in rem are excluded from exercising their rights to that property when insolvency proceedings of a debtor are opened. The dominant approach of modern insolvecny law suggests that the rights in rem are not affected by the opening of main insolvency proceedings and the assers which constitute this right are governed by the law of the state where assets are located. In case after the satisfaction of the secured claims, the claim of the secured creditor remains unsatisfied, the remaining amount of the claims is satisfied according to the genereal ranking of creditors under the law of the state of opening of insolvency proceedings.

2. The concept of right in rem is different from the concept of rights in personam and this distinction is based on their scope. Rights in rem are considered as absolute, universal right directed to the specific assets owned by security holders and are enforceable against the world at large. Right in personam is considered as personal obligation directed against specific individuals or entities, typically arising from contractual agreements.

3. In case the questions arise regarding the validity of rights in rem (the lagal basis constituting these rights), the law of the state of assets location has to be applied to determine the existence of such rights. preferred creditors holding the priority on some assets does not constitute to their protection like secured creditors. if creditors are granted some priority under the law of the state of opening insolvency proceedings it does not mean that they will enjoy the same priority in the state where assets are located.

4. Secured creditors may be regarded as privileged creditors in insolvency proceedings due to their legally enforceable right to specific assets of the debtor, which serves as the guarantee for their claims. Secured creditors are often ranked highest in the hierarchy of the creditors and they enjoy the privilege to be satisfied the first during the asset's distribution. However, the legal status of secured creditors is not absolute and in some cases tax and social claims can overcome the secured class in the process of assets distribution. Absolute Priority Rule also upholds the idea of structured order of creditors repayments during the bankruptcy and restructuring and supports the idea that secured claims have to be satisfied first.

5. There are no binding rules of international insolvency harmonizing the ranking of the creditors. Only UNCITRAL legislative guide on insolvency law provide the structure of ranking of secured creditors. Similarly the EIR also lack the definition of the rights in rem leaving the discretion for the Member States to adopt local approaches concern the ranking of the creditors

and in general they are very similar to each other, nevertheless in some jurisdictions there are specific differences in the order of the creditors classes, rising concerns regarding legal uncertainty as some classes may not be recognized in another jurisdiction as separate class of creditors.

6. A Stay (moratoria) is the instrument which temporarily protects the interests of. a debtor from the enforcement of creditors' claims. Under moratoria a debtor has the possibility for certain time period to initiate the restructuring proceedings to continue business operation on the market and as a result maximize its assets and successfully rescue the business by restructuring its debts. There are several approaches regarding the value of assets owned by secured creditors. Under the Directive on restructuring and insolvency there is the risk of fall of value during the say and debtor will not be responsible to compensate the difference. Consequently, secured creditors will receive the lower value of the assets they are claiming. UNCITRAL legislative guide along with the US bankruptcy code and UK insolvency act uphold the importance of the balance mechanism to maintain the stability of secured assets value.

7. There is a possible incompatibility between EIR and Directive on restructuring and insolvency regarding application of stay. Article 8 of the EIR establishes the measure for protection of rights in rem of third parties, in contrast Article 6 of the Directive on restructuring and insolvency provides the possibility of moratoria, that serves as protection for debtors interests. Article 8 of the EIR shields preexisting secured rights from foreign proceedings ensuring legal certainty and predictability and enforceability of secured rights as confirmed in SCI senior home case by the CJEU.

RECCOMENDATIONS

The study revealed that there is no clear definition of the right in rem for harmonization of insolvency proceedings. Along with that, there is not any information in the EU law legislative acts providing the information regarding what kind of assets falls under the concept of rights in rem, what kind of assets could be protected under rights in rem. The presented recommendations address two major gaps in EU cross-border insolvency law, the absence of a harmonized definition of rights in rem and clarity on the assets falling under the concept, particularly regarding digital such as crypto assets and NFT (non-fungible token) and the lack of harmonized rules on clear order of ranking of creditors claims. These purpose of the proposal is to resolve high risk of contradictions between the EIR and the Directive on restructuring and insolvency.

1. EU officials and policy makers should adopt a harmonized definition of rights in rem. Approach demonstrated in Art. 8 of EIR on the principle of lex situs to define the rights in rem according to the national law of the state of assets location creates segmentation and lack of harmonization. To provide legal certainty and predictability, the EU policy makers should consider introducing the autonomous EU definition of rights in rem in the next revision of the EIR.

2. Also, the lack of clarity which assets fall under the concept of rights in rem established by Art. 8, the criteria which allow to determine such assets may be also established in the EIR. Also, due to the absence of clear rules on the EIR, it remains unclear whether digital assets fall under the definition of the rights in rem. Furthermore, after adopting the MiCA regulation in 2023 digital assets like Crypto and NFT were recognized as assets with transferable value. Thus, it is advisable for the EU policy makers to consider the need of clear list of assets falling under the protection of rights in rem.

Providing clear definition of tights in rem and the list of the assets that are falling under the scope of the Art. 8 of the EIR will contribute to harmonization of insolvency law framework across the EU and will make its practical application and protection of interests of secured creditors easier and more effective.

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ABSTRACT

The research of masters thesis was focused on the protection of the interest of secured creditors in insolvency proceedings under cross-border insolvency law dedicated to the analysis of the concept of rights in in rem, ranking of the creditors, conflicting approach of measures for protection of secured creditors and interests of debtors in restructuring proceedings and its practical application of EU law, especially in the field of cross-border insolvency proceedings, which mainly operate through the European Insolvency Regulation and Directive on restructuring and insolvency proceedings.

Therefore, with the help of existing International and European cross-border insolvency framework developed by authors, insolvency practitioners and lawmakers, it was explained from both the theoretical and practical point of view – what is rights in rem, what falls under the concept of rights in rem, concept of ranking of creditors and coexistence of two competing measures of protection for creditors and debtors. One of the major processes analyzed in the study was unionization and harmonization of insolvency laws. Study examined the practice developed by the CJEU regarding Insolvency law cases, as the clear link between the existing legal framework and its application in practice. The research revealed that under EU law there is no clear definition of rights in rem and what assets fall under the concept, also revealed the importance of having the harmonized order of ranking of creditors.

Keywords: *cross-border insolvency law, restructuring, rights in rem, ranking of creditors, moratoria, harmonization, treatment of secured assets.*

SUMMARY

One of the primary objectives of the EU is to simplify the matters for its Member States, including the cross-border cases and agreements. Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings known as European Insolvency Regulation and Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 referred as Directive on restructuring and insolvency aims to harmonize the cross-border insolvency issues between member states.

Protection of the secured creditors and itself the concept of rights in rem established under the Art. 8 of the EIR is plays important role in insolvency proceedings. EIR regulates the rights in rem of third parties but do not provide not definition nor the information about the assets that falls under the scope of the article. Practice of CJEU helped to understand the concept of secured creditors and protection established under rights in rem but still it is up to member states to consider whether certain agreement between parties can be coalified as rights in rem, according to lex situs law of the state where assets are situated governs the rights in rem but only reliance on domestic law demonstrates the lack of unified definition of rights in rem and harmonization in this regard.

Another challenge is the ranking of the creditors, EU law does not provide the clear order of ranking of creditors claims as an autonomous legal concept, thus it is also left to member states to regulate. From one perspective the approach of member states are more or less similar to each other and in all of them secured creditors are highest situated creditor in the hierarchy, but later court practice revealed that in some cases under specific circumstances claims by tax authorities or employees and social agencies were prioritized over secured creditors. Later on, the judgements by CJEU also reflected the similar approach where tax claims were prioritized and placed first in the list for assets distribution. This creates the issues for legal certainty and predictability and legitimate expectations of secured creditors since the main idea of being the secured creditor is to have privilege over any other creditors in the proceedings.

Followed by the existing mechanism of protection for debtors during the restructuring proceedings established under the Art. 6 of Directive on restructuring and insolvency “absolute” right of secured creditors are suspended during the moratoria when debtor is granted with the possibility to restructure its debts and save the business. During the stay there is the high risk that value of the secured assets in the insolvency estate of the debtor can be decreased and secured

creditors claim will be satisfied accordingly. The coexistence of two competing protection mechanism is discussed in the presented masters thesis.

To conclude all the arguments stated above, there is the clear need for unified definition of rights in rem to harmonize the insolvency proceedings in the EU, together with the importance of establishing the common rule on ranking of the creditors to ensure the legal certainty and predictability for security holders. The EU has the important role to contribute the harmonization of the Law across the member states, creating the common system of values for its members. Creating the unified framework will increase the efficiency for protection of the interests of secured creditors in insolvency proceedings under cross-border insolvency law.