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SECURITY RIGHTS IN CROSS-BORDER INSOLVENCY PROCEEDINGS WITHIN THE EUROPEAN UNION

Master Thesis

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ABBREVIATIONS

CJEU – the Court of Justice of the European Union

COMI – Centre of main interests

EU - European Union

European Insolvency Regulation, Insolvency Regulation – Council Regulation (EC) No. 1346/2000 of 29 May 2000 on Insolvency Proceedings. Official Journal L 160, 30.6.2000.

European Insolvency Regulation (Recast), Insolvency Regulation (Recast) - Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive][accessed: 13/04/2015, 19:33]. Article 2(9). <http://bobwessels.nl/wp/wp-content/uploads/2015/04/2015-03-12-EIR-Recast-Council-first-reading.pdf>

Insolvency Convention - Convention on Insolvency Proceedings of 23 November 1995 [interactive]. CONV/INSOL/en 1. <http://aei.pitt.edu/2840/1/2840.pdf>

INTRODUCTION

Statement of topic. Third millennium and rapid development of all life spheres, including business, means that law has to advance and meet the changes, novelties and arising issues. Business depends on the regulation of possible business forms, schemes of legal persons, assets, taxation, labour law and insolvency too. Insolvency regulation has played an important role in law since ancient times. Means of securing one party against the other's failure to fulfil their obligations have existed since roman times.[1] In business environment various property rights may be held as the mover of business. Business transactions can be complicated to proceed and securing them can help ease the process and help the business develop at a faster pace. There are situations when paying for a transaction in full amount at once is hard or even impossible. Payment extension in time helps in this case but in exchange of that transactions become more expensive because of interest rate. Moreover, hardly anyone is keen on extending payments for transactions of large sums, just on promise to repay the money, even when expecting to receive interest. Therefore protection of creditor rights is relevant[2] and it is common practice for creditors to *"take a security interest in either the item purchased or some other property of the debtor"*[3]. This works in favour of both, creditor and debtor. The former faces lower risk due to security and claim against debtor's property in case of his default. This reduction in risk increases the creditor's willingness to extend credit and lowers the interest charged. On the other side, the debtor gets a credit at lower costs without undertaking extra risk. The main task of security rights is to enhance the possibility of creditor being repaid for the credit.[4] Therefore, well-designed regulation of security rights is an incentive for low-cost transactions and it becomes impetus for all business to develop, as well.

Understanding of security rights is the first step towards ascertaining their operation in various instances. Thus, the notion and concept of security rights in European Union law will be presented in order to make a background for the topic.

Easier ways of getting investments provides new possibilities for businesses as does the single market of the European Union consisting of 28 European Economic Area states, it forms the biggest single market in the world. Therefore, business becomes international as it gets involved with more than one country in search of the best place and the most favourable rules for development. More possibilities and broader market means higher competition, which can result in the business collapsing and cause cross-border insolvency proceedings. International

[1] Tamm, D. *Roman Law And European Legal History.* Kopenhagen: DJØF Publishing, 1997, p. 92.
[2] Nekrošius, I. Nekrošius, V. Vėlyvis, S. *Romėnų teisė.*Vilnius: Justitia, 2007, p.141.
[3] Cheeseman, H.R. *Business Law. Legal Environment, Online Commerce, Business Ethics, And International Issues. Sixth edition*. Upper Saddle River, New Jersey: Pearson Education, 2007, p. 401.
[4] Bradgate, R. *Commercial Law. Third edition.* London: Butterworths: Lexis Nexis™, 2000, p. 488.

jurisdiction and applicable law are typical legal issues arising in the aforementioned cases. Insolvency rules differ accross countries, due to various legal traditions and approaches regarding economic interests. These differences in national laws lead to distinct treatment of creditors' participation and their rights in insolvency proceedings. Answers to questions of jurisdiction and applicable law direct insolvency process from commencement to termination and control protection of security rights. National insolvency rules and their developments are of high value to other member states, especially neighbouring ones, within the European Union.

However, purely national provisions regulating insolvency are not sufficient to solve all issues arising in cross-border insolvency cases. A wide variety of states' laws had consequences and the different effects on cross-border insolvency procedures can be minimized by unification of significant angles of cross-border insolvency. Several decades of efforts to adopt unanimous rules on cross-border insolvency proceedings[5] resulted in the enactment of the Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings, which came into force on 31 May 2002[6]. National substantive laws in the field of insolvency are not harmonized by this Regulation. As specified in recital 11 of the Regulation *"This Regulation acknowledges the fact that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening of proceedings would, against this background, frequently lead to difficulties."* This Regulation determines three aspects of cross-border insolvency proceedings: jurisdiction, applicable law and recognition of insolvency proceedings. European Insolvency Regulation's goal of effective and efficient cross-border insolvency proceedings can be reached if provisions are interpreted and applied in the same way by national courts of member states within the European Union. National laws on security rights differ significantly. As a result, this gives incentive for inevitable issues related to protection of security rights when insolvency proceedings cross borders of one European Union member state.

In the insolvency proceedings various legal rights and procedures are modified, restricted or prohibited. Due to that, security rights and their correlation with insolvency proceedings that have cross-border effects will be analysed and suggestions for improvement of existing regulation will be made.

The scientific research problem results from the relationship between security rights and insolvency proceedings that contain the cross-border element, and is formulated as a question: What practical problems of operation of security rights in cross-border insolvency

[5] Attempts to regulate insolvency proceedings in the level of EU law started in the seventh decade by putting aim of Insolvency Convention on the program of the European Union (then - Community).
[6] Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings. Official Journal L 160, 30.6.2000.

proceedings should be solved and/or legal regulation improved in order to increase the effectiveness of secured creditors' rights?

Relevance. During more than a decade when the main instrument regulating insolvency proceedings that have cross-border effects in the EU - Insolvency Regulation - is in force, issues arose regarding application and interpretation of it. Further, the 2007 global economic crisis continues to have effect on economic growth and the development of enterprises. In 2009 the EU economy suffered from its worst recession so far and after a brief recovery it went to a mild recession again in early 2012. EU has taken measures for economic recovery, boost investment and protect employment, as seen, for example, from Europe 2020[7] and recent European Council Conclusions[8]. Retention of business entities having difficulties is one of the main objectives in the strategy and attempts to improve regulation of cross-border insolvency proceedings are imperative in order to reach it. The European Commission indicated a revision of the European Insolvency Regulation in its Work Programme for 2012 and it is one of the measures in the field of 'Justice for Growth' set out in the Commission's Action Plan implementing the Stockholm Programme[9]. As can be seen from the recent Green Paper by the European Comission (2015), an improvement of insolvency regulation is still among the future goals. Commissioner Jourova has stated that *"every year in the EU, 50 000 companies are faced with cross-border insolvencies – meaning one in four of all insolvency proceedings in the EU"*.[10] Furthermore, after the Commission's Proposal for amendments of Insolvency Regulation[11], Heidelberg-Luxembourg-Vienna Report[12], Council position on recast version of European Insolvency Regulation[13], and an evaluation of all the aforesaid facts, the regulation of security rights in European Union is relevant to analyse currently.

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[7] This aim can be seen in, for example, Communication From The Commission of 3 March 2010. Europe 2020. A Strategy For Smart, Sustainable And Inclusive Growth. COM(2010) 2020 [interactive] [accessed: 12/04/2015, 17:48]. <http://ec.europa.eu/eu2020/pdf/COMPLET%20EN%20BARROSO%20%20%20007%20-%20Europe%202020%20-%20EN%20version.pdf>.

[8] European Council Conclusions of 28 June 2013. EUCO 104/2/13 REV 2 [interactive] [accessed: 11/04/2015, 15:54]. <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/137634.pdf>

[9] The Stockholm Program – An Open And Secure Europe Serving And Protecting Citizens. Official Journal C 115, 4.5.2010. It determined guidelines for European Union work for the period 2010 – 2014 in three areas: justice, freedom and security.

[10] Commissioner Jourova's statement at the Justice and Home Affairs Council (press conference) 13 March 2015 [interactive]. [accessed: 21/04/2015, 00:45]. < http://ec.europa.eu/commission/2014-2019/jourova/announcements/commissioner-jourovas-statement-justice-and-home-affairs-council-press-conference-13-march-2015_en>.

[11] European Commission Proposal For A Regulation Of The European Parliament And Of The Council Amending Council Regulation (EC) No 1346/2000 On Insolvency Proceedings of 12 December 2012. COM(2012) 477 [interactive] [accessed: 10/04/2015, 12:13]. <http://ec.europa.eu/justice/civil/files/insolvency-regulation_en.pdf>.

[12] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceeding.* JUST/2011/JCIV/0049/A4 [interactive]. 2011 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

[13] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive][accessed: 13/04/2015, 19:33]. <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2015:141:FULL&from=EN>.

Scientific novelty of this Master thesis lies in the fact that it is dedicated to notion of security rights, notion of cross-border insolvency proceedings within the EU and correlation of these two concepts. Moreover, the analysis is made with reference to the recent proposals to amend Insolvency Regulation and bearing in mind the project of Insolvency Regulation Recast.

Review of the literature shows that protection of security rights in cross-border insolvency proceedings within the European Union is not analysed sufficiently at a scientific level.

There is a limited amount of works published considering all aspects of the topic of security rights in cross-border insolvency proceedings. Relevant is a scientific essay of P.M. Veder[14]. This is the work that includes comparison of security rights in Dutch and German law and also analyses European Insolvency Regulation and UNCITRAL Model Law on Cross-Border Insolvency. However, it was published a decade ago. As topic of this research is analysed only marginally, works that consider parts of it are also relevant. Such studies discuss either security rights, or cross-border insolvency in the European Union.

E.M. Kieninger's work[15] concerns security rights (in movable property) in European Private Law. Usually only part of a study is dedicated to analysis of Security rights. Duo of authors - A. Clarke and Paul Kohler[16] - incorporated a chapter in a book about property law, analysing security rights, but mainly in the United Kingdom, similarly to the study of R.J. Mokal[17]. There are works that review 45 or 33 national jurisdictions of insolvency in various world countries in one publication: respectively series "Getting The Deal Through"[18] and "Commercial Dispute Resolution"[19] where among other aspects security rights are analysed briefly.

Insolvency when crossing borders of one particular country is analysed in a dissertation of R. Čiricaitė[20] and in a book of I.F. Fletcher[21]. J. Israel's book[22] and Annotated Guide of L.

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[14] Veder, P. M. *Cross-Border Insolvency Proceedings And Security Rights. A Comparison of Dutch And German Law, The EC Insolvency Regulation and the UNCITRAL Model Law on Cross-border Insolvenc.* Kluwer Legal Publishers, 2004.

[15] Kieninger, E.M. (ed.) *Security Rights In Movable Property in European Private Law.* Cambridge: Cambridge University Press, 2004.

[16] Clarke, A., Kohler, P. *Property Law: Commentary and Materials.* Cambridge: Cambridge University Press, 2005.

[17] Mokal, R.J. *Corporate Insolvency Law. Theory And Applicatio,.* Oxford University Press, 2005.

[18] Leonard, B. (ed.) *Restructuring & Insolvency in 45 jurisdictions worldwide.* London: Law Business Research, 2014.

[19] Peterson, S. (ed.) *The International Comparative Legal Guide To: Corporate Recovery & Insolvency. 8th Edition. A Practical Cross-Border Insight Into Corporate Recovery And Insolvency Work* [interactive]. London: Global Legal Group, 2014, [accessed 11/04/2015, 22:08]. <http://www.iclg.co.uk/practice-areas/corporate-recovery-and-insolvency/corporate-recovery-&-insolvency-2014>.

[20] Čiricaitė, R. *Legal Regulation Of The Aspects Of Cross-Bordder Insolvency Proceedings In European Union and Lithuanian Law:Summury of Doctoral Dissertation.* Social sciences, law (01 S). Vilnius: Vilnius University, 2012.

[21] Fletcher, I. F. *Insolvency In Private International Law: National And International Approaches. Second edition*. Oxford, New York: Oxford University Press. 2007; Fletcher, I. F. *Insolvency In Private International Law. Supplement To Second Edition*, Oxford, New York: Oxford University Press, 2007.

Sealy and D. Milman[23] deal specifically with European cross-border Insolvency Regulation. R.M. Goode[24], dedicated a part of a study to cross-border insolvency, as well as a group of Lithuanian authors in their manuals consisting of two books[25].

In addition, modern technology implies an evolution of platforms where researchers can share ideas; for instance, internet blogs have become reliable sources of academic thought. Therefore, a blog by B. Wessels[26], professor of International Insolvency Law at the University of Leiden will also be taken into consideration.

Significance. Firstly, this Master thesis incentivises future research on the correlation of security rights and EU insolvency proceedings. Secondly, evaluation of proposals for amendments of European Insolvency Regulation may become an objective of analysis of the historical evolution of the European Insolvency Regulation.

The aim of this Master thesis is to analyze the concepts of security rights, cross-border insolvency proceedings and regulation of the relationship between these two matters within the EU, so as to identify problems arising in the application of existing regulation. In doing so, it seeks to establish if this regulation is appropriate to effectively protect security rights of creditors.

In order to achieve such a goal the following **research objectives** are formulated:

1. To reveal the concept of security rights in the context of European Union insolvency law and indicate the main features of security rights;
2. To review the concept of cross-border insolvency, disclose main principles and approaches of jurisdiction and applicable law to proceedings in such cases;
3. To explore the regulation of the European Union regarding insolvency and ways to protect security rights when situation relates to more than one country;
4. To assess recent proposals for amendments of European Insolvency Regulation;
5. In light of systematised research results, confirm or deny the raised defended statement and give suggestions for improvement of regulation on security rights in cross-border insolvency within European Union.

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[22] Israel, J. *European Cross-Border Insolvency Regulation.* Antwerpen- Oxford: Intersentia, 2005.
[23] Sealy, L.S., Milman, D. *Sealy & Milman: Annotated Guide to the Insolvency Legislation. Fourteenth Edition. Volume 2.* London: Sweet & Maxwell, 2011.
[24] Goode, R.M. *Principles Of Corporate Insolvency Law.*London: Thomson/ Sweet & Maxwell, 2005.
[25] Kavalnė, S., Mikuckienė, V., Norkus, R., Velička, R. *Bankroto teisė. Pirmoji knyga. Manual,* Vilnius: Justitia, 2009.
[26] Wessels, B. Blog [interactive]. [accessed 13/04/2015, 19:51]. <http://bobwessels.nl/>.

Defended statement. Current EU regulation of insolvency proceedings is not appropriate to protect security rights in cross-border insolvency proceedings.

Methods which will be used to reach the goals of this Master thesis: analysis, linguistic, historical, comparative, systematisation among others.

The Structure of the Master thesis corresponds to its title. Security rights, cross-border insolvency and security rights in cross-border insolvency proceedings are investigated in succession. The research starts with (Chapter I) definition of what security rights are and presentation of main features as well as a disclosure of concept of security rights in European Union insolvency law. Second part of Chapter I copes with the cross-border insolvency proceedings generally and the basic principles attributed to the main approaches of cross-border insolvency effects are studied briefly. Thesis moves on to the international instruments of unification and harmonization relevant to the EU, protection of security rights in these instruments and amendment proposals regarding security rights. Proposals for improvements are presented and evaluation by Researcher is given.

CHAPTER I. NOTION OF SECURITY RIGHTS AND CROSS-BORDER INSOLVENCY PROCEEDINGS

The core of this research topic – security rights in cross-border insolvency proceedings within the EU – comprises two concepts: security rights and cross-border insolvency proceedings. These notions are very important for understanding of the topic and further analysis of correlation between them. Thus, concepts of security rights and cross-border insolvency proceedings will be analysed in this chapter dividing it in two parts accordingly.

1.1.Security Rights

In this research security rights are understood as part of the property rights. Due to the fact that property law is mainly national law, its development was influenced by laws of other countries only trivially. Thus, great diversity between countries regarding regulation of property law, and security rights, exists. Considered rights became important as of the creditors' desire to protect their rights and preserve their assets in cases when debtor is solvent and cases of insolvency, too. In short, meaning of security rights could be explained as a derivative of the debtor's property right and granted by debtor to creditor in order to secure refund of the debt.[27] This is an objective in every country and in matters crossing borders of one single state. As the topic of this research considers operation of security rights in insolvencies it is necessary to define what security rights are and their main features as well as the definition of security rights in the EU insolvency law.

1.1.1. General Features Of Security Rights

A security right may be a mean that helps to overcome the issue of asymmetric information concerning relations of debtor and creditor as E.M. Kieninger indicates.[28] It is believed that another case of asymmetric information could be indicated between creditors who secured their credit and unsecured creditors (in this case, for example, such a vulnerable category of unsecured creditors as employees are relevant). Although usually enjoying priority ensured by the state, this category of unsecured creditors is not aware of the number of secured creditors, value of securities and the debtor‘s (employer‘s) ability to fulfil their obligations under security and then pay unsecured debt (to the employee). However, this case is not relevant to the topic of

[27] Clarke, A., Kohler, P. *Property Law: Commentary and Materials.* Cambridge: Cambridge University Press, 2005. p. 657.
[28] Kieninger, E.M. (ed.) *Security Rights In Movable Property in European Private Law.* Cambridge: Cambridge University Press, 2004, p. 8.

this research and, thus, more analysis is not needed. Ordinarily, debtors are better informed about their willingness and ability to fulfil their obligations than creditors. As interest rate is not capable of showing that, assets with which the security right is linked may prove debtor‘s ability to pay debt. A security right helps getting credit with a lower interest rate and increases the amount of possible credit, as it proves creditworthiness as opposed to the debtor‘s willingness to risk, according to E.M. Kieninger. A. Clarke and P. Kohler also express opinions that offering asset as security signals the debtor’s ability to repay and creditworthiness. Moreover, security right may also be used by creditors to monitor debtor’s activities (in some cases, intervene, too).[29] However, there are different opinions regarding the question of when debtors are riskier. According to a study of „The Future Of Secured Credit In Europe“, both, debtors willingness to pay higher interest rate and determination to render proprietorial interest in his property to creditor, signal risky borrowers[30]. Further, this study provides H.B. Schafer‘s opinion that „*debtor‘s advantage from offering a pledge increases with the probability of insolvency*“[31]. However, security rights definitely protect creditors in case of debtor‘s insolvency and intervention of third persons. Although, it is not clear whether security right represents the debtor‘s riskiness or willingness to repay debt, it is an information providing instrument to the creditor about the debtor and protecting creditor.

The question of whether security rights are beneficial is under debate. E.M. Kieninger remarks that *“secured transaction either benefits the two contracting parties or at least does not harm their interests”.* Author also notes that the situation changes when unsecured creditors are taken into account. As the main aim of the security right is to ensure the priority of secured creditor regarding all other creditors, these other creditors may react in order to reduce the effect caused by secured creditors. [32] Author recalls A. Schwartz’s idea that *“Secured creditors will charge lower interest rates because security reduces their risks, but unsecured creditors will raise their rates because security reduces the assets on which they can levy, and so increases their risks”*.[33] Security rights are beneficial for getting debts of larger amount with lower interest rate, but when all unsecured obligations are taken into account, these become more expensive as compared to beneficial secured debts.

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[29] Clarke, A., Kohler, P. *Property Law. Commentary And Materials.* Oxford: Oxford University Press, 2005, p. 661. When creditor intervenes in debtro‘s business and controls it - the case of outside management. This could happen when security is taken over all the assets of business (floating charge).

[30] Armour, J. The Law And Economics Debate About Secured Lending: Lessons For European Lawmaking? *The Future Of Secured Credit In Europe.* De Gruyter Rechtswissenschaften Verlags, 2008, p. 10-11.

[31] Schafer, H.B. Commentary. *The Future Of Secured Credit In Europe.* De Gruyter Rechtswissenschaften Verlags, 2008, *p. 30.*

[32] Kieninger, E.M. (ed.) *Security Rights In Movable Property in European Private Law.* Cambridge: Cambridge University Press, 2004, p. 8.

[33] Schwartz, *Vanderbilt Law Review 37* (1984)1051. (Cited from: Editor: Kieninger, E.M. *Security Rights In Movable Property in European Private Law.* Cambridge: Cambridge University Press, 2004, p. 9.).

Different names are used in various sources to refer to security rights. Expressions like „security interest“[34], „secured credit“[35], „real security“[36], „legal security“[37] or „security“ refer to security rights when the concept that is being named means that debtor renders some kind of proprietary interest in his property to the creditor in order to strengthen fulfilment of his obligation. According to recital 25 of European Insolvency Regulation security rights are *„of considerable importance for the granting of credit“*. This type of guarantee permits the possibility of getting credit under conditions, where it would not be possible otherwise.[38] Three reasons encourage the desire to secure debt. Firstly, if debt is unsecured, the debtor can lose (sell or spend) all the assets from time of granting debt until the due time to repay it. Secondly, after the granting of unsecured debt, debtor can become owing money to more other debtors who may get repayment first and there can be not enough assets left. Thirdly, the debtor may provide security rights in all of his assets before receiving unsecured debt. In this case, the secured creditors would get repayments from the assets, in which security rights are granted, leaving nothing for unsecured creditor. Thus, security rights are usually used for debt transactions, even though they can be supporting fulfilment of any kind of obligations.

Generally, certain aspects can be attributed to the security rights:

1. Contains two entitlements to lender. This firstly means that a security right provides priority to get payment, and also ensures the right to control the collateral (the right is dependent on the debtor‘s willingness to repay money). Controlling right means creditor‘s possibility to interdict sales contract of the collateral. In case of the debtor‘s failure to fulfil obligations, a creditor with security rights is able to control the sale of collateral and be repaid the debt from it on priority basis; this also forms the essential purpose of security.[39]
2. When an obligation ceases to exist, a security right does, too. A security right, as accessory right, is dependent on obligation.
3. Secure particular and clearly defined obligations (security right can only exist when there is an obligation existing). Usually secured are pecuniary obligations, but other obligations can be secured, too (depending on the regulation in different states regarding what obligations can be secured).

[34] Clarke, A., Kohler, P. *Property Law. Commentary And Materials.* Oxford: Oxford University Press, 2005, p. 657.
[35] Drobnig, U. *Secured Credit in International Insolvency Proceedings* [interactive]. 33 Tex. Int‘l L. J. 53 1998. [accessed: 17/03/2015, 11:37]. <http://heinonline.org>.
[36] Bradgate, R., White, F. *Commercial Law.* Oxford: Oxford University Press, 2008, p. 323.
[37] Gullifer L., Vogenauer S. (ed.) *English And European Perspectives On Contract And Commercial Law: Essays In Honour Of Hugh Beale.* Oxford and Portland, Oregon: Hart Publishing, 2014, p. 418.
[38] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 97. [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.
[39] Eidenmüller, H. (ed.), Kieninger E.M. (ed.) *The Future Of Secured Credit In Europe.* De Gruyter Rechtswissenschaften Verlags, 2008, p. 4.

For example, the Scotland law regulating floating charge states that it can secure *"any debt or other obligation"*.[40]

4. Are created by properly authorised parties. This means not only corresponding all legal requirements for creating obligation, under which security is needful, but also for creation of security also (for example, the debtor has to possess some property in order to be able to secure an obligation with it).
5. Are directly linked to assets. This link remains until the obligation is ceased. *"The grant of security interest does not diminish the value of the secured asset to the grantor"*[41], it just allocates assets in which security right is vested for the repayment of secured creditor's debt, and not any other debt. This also means that the debtor cannot sell obligation securing property without having first fullfiled the obligation.
6. Have effect *erga omnes*. This effect means that "the right in question can be invoked against posterior acquirers of (rights in) the asset, subject of course to protection of bona fide acquirers"[42]. This also implies that security right is not affected by individual enforcement.
7. Are perfected by legal requirements that can vary in different states.
8. Have to be regarded in insolvency (otherwise, it does not constitute a security right).

According to these features security rights can be separated from other objects named by the same or similar expressions. However, specific requirements depend on a country's regulation, which is used to evaluate if the object is a security right.

In addition, security rights have to be distinguished from the rights ensured to preferential creditors. In case of a preferential creditor, the relevant state *„imposed a discriminatory regime of administering the debtor's property for the benefit of certain categories of claimant so as to create an exception to the principle of* pari passu *treatment of the claims of all creditors as a single body"*[43]. Thus, certain categories of unsecured creditors against the remainder, the less favoured, enjoy preference in sequence of getting payment ensured by the regulation of a particular state. Due to that, two aspects can be assigned to preferential creditors:

[40] Drobnig, U., Snijders, H.J., Zippro, E.J. *Divergences Of Property Law- An Obstacle To The Internal Market?*. München : Sellier. European Law Publishers, 2006, p. 50.
[41] Clarke, A., Kohler, P. *Property Law. Commentary And Materials.* Oxford: Oxford University Press, 2005, p. 657.
[42] Veder, P. M. *Cross-Border Insolvency Proceedings And Security Rights: A Comparison Of Dutch And German Law, The EC Insolvency Regulation And The UNCITRAL Model Law On Cross-Border Insolvency*. Nijmegen: Kluwer Legal Publishers. 2004, p. 336.
[43] McGrath v. Riddell (In re HIH Cas. & Gen, Ins. Ltd), [2008] UKHL 21,1 W.L.R. 852 (H.L.) (Lord Hoffmann) (appeal taken from Eng.). (Cited from: Fletcher, I. „L'enfer, c'est les autres": Evolving Approaches To The Treatment Of Security Rights In Cross-Border Insolvency. *Texas International Law Journal* [interactive] Vol. 46, Issue 3 (Summer 2011) [accessed 22/03/2015, 14:09]. <http://heinonline.org>.).

(1) their priority is established by law of certain country, and (2) there is a particular rank of creditors in sequence to get payment within the category of unsecured creditors. Another difference between priority in distribution and security right derives from one of the aforesaid features of security rights: a direct link to definite assets is typical for security rights. Therefore, entitlement to priority of payment to preferential creditors by the relevant state and connection of security rights in assets help to distinguish preferential and secured creditors.

There are various types of security rights that exist in different groups of assets: immovable, movables, claims and others. Rules regulating these rights differ on two levels: firstly, between different groups of assets, and, secondly, between the European Union countries[44]. Pursuant to this, the definition of security rights in European Insolvency Regulation will be presented in the following part of this chapter.

1.1.2. Notion Of Security Rights Under Article 5 Of European Insolvency Regulation

There is one more expression used regarding security rights, in addition to the several that were indicated earlier. In part 1 of Article 5 of European Insolvency Regulation, which is the main instrument establishing regulation for security rights in insolvency proceedings at the level of the European Union, security rights are named as "rights *in rem*". However, there is no clear determination of what they are.

Only Article 5 (3) of European Insolvency Regulation constitutes an exception to no definition of rights *in rem.* It establishes that a "*right, recorded in a public register and enforceable against third parties, under which a right* in rem *within the meaning of paragraph 1 may be obtained, shall be considered as right* in rem*".* According to I.F. Fletcher, all Member States recognize these rights as rights *in rem*, despite the fact that by national law of state the contrary would be established[45]. The Article 5 (3) is *"opaquely drafted"* and its meaning is not easy to find, pursuant to R. Goode. The author agrees with the effect expressed by I.F. Fletcher and notes that *"registered right as itself"* is a right *in rem.* Further, he states that *"it is not easy to think of a case of registered right under which a right* in rem *may be obtained where registered right is not itself right* in rem*".*[46]

[44] Drobnig, U., Snijders, H.J., Zippro, E.J. *Divergences Of Property Law, an obstacle to the Internal Market?* München: Sellier European Law Publishers, 2006, p. 17.
[45] Fletcher, I. F. *Insolvency In Private International Law: National And International Approaches. Second edition.* Oxford University Press. 2007, p. 406.
[46] Goode, R. *Principles of corporate insolvency law. Fourth Edition.* Sweet & Maxwell, 2011, p. 763.

Regardless of the exception and because provision of Article 5 was transposed almost unchanged from Draft Insolvency Convention[47], Virgos-Schmit Report[48] is relevant to the interpretation of this Article and understanding the essence of rights *in rem*, as well as many other provisions. *"Although this report does not refer directly to the Regulation and has never been officially adopted, it contains useful background material and has been referred to in a number of judgments"*.[49] Only words *"both specific assets and collections of indefinite assets as a whole which change from time to time"* have been added to the provision. With reference to Article 5 (1) of European Insolvency Regulation, it intentionally "*does not intend to impose its own definition of a right* in rem, *running the risk of describing as rights* in rem *legal positions which the law of the Member State where the assets are located does not consider to be rights* in rem, *or not encompassing rights* in rem *which do not fulfil the conditions of that definition"*, according to Virgos-Schmit Report.[50] There are several expressions in the provision of rights *in rem* in European Insolvency Regulation that need a more profound analysis in order to be able to separate which of the rights are rights *in rem.* A wider explanation is required regarding certain parts of the is of the provision in Article 5, such as: what rights can be regarded as rights *in rem* and by law of which state it is established, how to localize particular assets and what is the right moment to do that. These uncertainties will be analysed further.

1.1.2.1.Concept Of Rights *In Rem*

European Insolvency Regulation does not provide a definition of rights *in rem*, but the Article 5 (2) of European Insolvency Regulation establishes the types of rights generally included into category of rights *in rem* by national laws, in order to assist with the interpretation and application of Insolvency Regulation. This list works as a guide to attributing certain rights to rights *in rem*, exercised by the state where the assets in question are located. As R. Goode stated *"Article 5 (2) is sufficiently flexible to accommodate significant differences in national laws of Member States"*. For instance, a lessee who has goods in possession has a right *in rem* under English law and it is encompassed by Insolvency Regulation, contrary to *détenteur* who has sheer personal right.[51] Virgos-Schmit Report puts some limits on the interpretation of Article 5 of European Insolvency Regulation and rights in rem. This commentary states that a national

[47] Convention on Insolvency Proceedings of 23 November 1995 [interactive]. CONV/INSOL/en 1. <http://aei.pitt.edu/2840/1/2840.pdf>.
[48] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996 [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.
[49] Sealy, L.S., Milman, D. *Sealy & Milman: Annotated Guide to the Insolvency Legislation. Fourteenth Edition. Volume 2.* London: Sweet & Maxwell, 2011, p. 128.
[50] Virgos M., Schmit E., *op. cit.*, para. 100.
[51] Goode, R. *Principles of corporate insolvency law. Fourth Edition.* Sweet & Maxwell, 2011, p. 762.

definition of a right *in rem* cannot be unreasonably wide, for example, by including rights simply reinforced by a right to claim a preferential claim, as this would make specific treatment of rights *in rem* established by this provision meaningless. A right *in rem* can also be established with regard to assets as a whole, not only specific, and by that security rights like floating charge of the United Kingdom and Irish laws are falling into the concept of a right *in rem*.[52] Later, when creating the European Insolvency Regulation, words added to provision of Article 5 (1) – *"both specific assets and collections of indefinite assets as a whole which change from time to time"* – clearly eliminated all doubts whether floating charge that has no equivalent is a right *in rem.* Virgos-Schmit Report is valuable source when interpreting whether rights can be regarded as rights *in rem*.

As in European Insolvency Regulation there is no definition of a right *in rem* it is important to note that, according to Virgos-Schmit Report, in case of some unclear concept, the regulation can demand to derive that concept from the relevant national law – this means that *lege causae* characterization is adopted.[53] The relevant law is determining whether the right in question can be regarded as a proprietary right and then enjoy protection of Article 5 or as a personal right. A personal right falls outside the range of the application of Article 5. Thus, provision of Article 5 (1) of European Insolvency Regulation entitles the privilege to determine whether the right is a right *in rem* to the law of the state where the assets are located at a specific time – opening of insolvency proceedings[54]. But thereof the question of how the law according to two factors – state where assets are located and time of the opening of the proceedings – should be determined arises.

1.1.2.2.Assets

Article 5 (1) of Insolvency Regulation establishes a rule relating to third parties' rights *in rem* in respect to the assets belonging to the debtor, which are situated within the territory of another Member State at the time of the opening of proceedings. This rule causes a few uncertainties: whose assets, how to determine that location of various assets is in other Member State and the correct time to determine the location.

1.1.2.2.1. Location of Assets

[52]Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 102-104. [accessed 2015-03-19, 12:40].
<http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.
[53] *Ibid.*, para. 43.
[54]*Ibid.*, para. 100.

According to the *Schmid* judgement of the Court of Justice of The European Union[55], application of this Article *"requires the presence of connecting factors with the territory or the legal system of at least two Member States"*. Article 5 (1) of Insolvency Regulation establishes that provision applies to rights *in rem* with respect of the various types of assets that are situated within the territory of the other Member State. Thus, determination of location of certain assets is important for application of Insolvency Regulation. There is a definition of the expression *"the Member State in which assets are situated"* in Article 2 (g). Rules on tangible property, property that requires to be entered in a public register and claims are established. In the first case, location of tangible property is established according to *situs*. Location of second property group – property that needs to be registered – is determined by the register keeping Member State. Regarding the third group – claims – they are situated in the Member State in which the obligor's centre of main interests (hereinafter COMI) is located. Article 2 (g) that help to determine the location of assets in cases of three categories of property.

J.A.V.D. Weide and B. Wessels are in the project of drafting Localization rules[56]. Most of these rules are consonant with the provision of the European Insolvency Regulation (Article 2 (g)). For example, they propose a Localization rule for non-registrable movable property, as it *"and rights vested in or attached to them, are located at the place where the non-registrable movable is situated"* usually (not including a chance holiday country and country of transit).[57] Regarding movables that are in transit or rights in them, they are presumed to be located in a state of destination, according to the mentioned localisation rules. Authors of Localization rules note that a longer-term connection must be established between the movable and the location, but this forms uncertainty, thus, physical location of the movable is important. Also, the Localization rule regarding claims corresponds to Article 2 (g) of the Regulation, stating that "a claim with a known creditor must be asserted at the place where the debtor has his seat or his domicile"[58].

There are different opinions on how to establish the location of intangible assets. Current European Insolvency Regulation as indicated in the Heidelberg-Luxembourg-Vienna

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[55] Case C-328/12, *Ralph Schmid v Lilly Hertel*, Application: OJ C 303 from 06.10.2012, p.14, Judgment: OJ C 85 from 22.03.2014, p.5, paragraph 22.

[56] Weide, J.A.V.D., Wessels, B. Where to locate assets, subject to certain security rights. [interactive]. 2011 [accessed 15/04/2015, 16:17]. < http://bobwessels.nl/wordpress/wp-content/uploads/2011/04/2011-04-14-JIBLR-final.pdf>.
Localization rule – "rule that indicates where a debtor's assets must be deemed to be located so that it is possible to determine the scope of operation of (cross-border) insolvency proceedings".
The aim of the project is providing non-binding assistance as best practice for various persons in cases where legislation gap exists.

[57] *Ibid.*

[58] *Ibid.*

Report *"does not provide for any criteria as to the localisation of intangible assets"*.[59] This Report also indicates that protection of Article 5 could be beneficial to Community trademarks and patents, as they cannot be included in secondary insolvency proceedings.[60] But a lack of clarity regarding the location of patents may be resolved by Regulation on Insolvency Proceedings (Recast). [61] Provision that European patents are situated in the Member State for which it is granted, is designed as a part of amendments. It should be noted that Localization rules of J.A.V.D. Weide and B. Wessels propose a different approach regarding patent rights, stating that patent rights, trademark rights, copyrights, and rights vested in them are located *"at the place where the patent holder, the trademark proprietor or the copyright holder has his seat or his domicile"*[62]. According to authors of Localization Rules, registration of some intellectual property cannot be the basis for determining the location of these property rights. In case of copyright, rules of European Insolvency Regulation (Recast) and Localization Rules are consistent.

In addition, J. Marshall indicates that Regulation is not clear on the point whether all types of property will definitely fall into one of the three categories of Article 2 (g), how cases when some property can be regarded under more than one category should be treated and whether parts of Article 2 (g) are made in hierarchy. [63] As examples J. Marshall uses private company shares (not clear if they fall under the scope of Article 2 (g)), bank account and, a ship (may fall into category of tangible property and also in the registrable, too). The first unclear situation is also mentioned by R. Goode stating that *"it would have been helpful if Art. 2 (g) had made it clear that the first indent does not apply to tangible assets within the second indent. There is a similar overlap between the third indent [...] and the first and second indents"*.[64]

European Insolvency Regulation (Recast)[65] may be able to remove the problem of hierarchy of indents in Article 2 (g) (or 2 (9) in Recast) by indicating in the indent that location of a property is established by that indent if the property does not fall under the regulation of

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[59] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceeding.* JUST/2011/JCIV/0049/A4 [interactive]. 2011 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

[60] *Ibid.*, p. 260.

[61] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive]. [accessed: 13/04/2015, 19:33]. Article 2(9). <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2015:141:FULL&from=EN>.

[62] Weide, J.A.V.D., Wessels, B., *op. cit.*

[63] Marshall, J. Article 5 (rights in rem), *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 12/04/2015, 19:29]. <http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf>.

[64] Goode, R.M. *Principles Of Corporate Insolvency Law.*London: Thomson/ Sweet & Maxwell, 2005, p. 607.

[65] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive]. [accessed: 13/04/2015, 19:33]. Article 2 (9). <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2015:141:FULL&from=EN>.

some other indent in Article 2 (9). This new version of Insolvency Regulation is trying to solve other mentioned problems, too. The solution of adding additional categories of assets to Article 2 (g) – registered shares in companies, financial instruments and cash in accounts of credit institutions, in addition to aforesaid patents and copyright - is chosen.

Regarding shares in companies, rule of the registered office of issuing company in Regulation on Insolvency Regulation (Recast) differs from the proposed Localization rule. According to Localization rules, location is determined by different rules applicable to bearer shares, registered shares and book-entry shares. For the group of bearer shares, the place where the bearer share certificate is situated is the decisive factor. In case of registered shares, locations of the ones that are entered in a register of shareholders kept by company are deemed to be where the rights are recorded. In the absence of such a registration, shares are situated where the company has the centre of its main interest – a presumption of the registered office. Considering the third group, book-entry shares, the *"registered office of the intermediary with which the securities account is kept in which the book-entry shares are administered. Location of all securities, when they are administered and traded via book-entry system, can be established by this rule"*.[66]

Insolvency Regulation (Recast) is trying to solve problems arising in determining the location of a property by adding new categories of assets and indicating relations between these categories, however, these prospective provisions are different from Localization rules proposed by J.A.V.D. Weide and B. Wessels, as best practice for that matter.

Provision of Article 5 (1) is limited to cases when property, under which security is taken, is situated in the territory of a Member State other than the one that opened insolvency proceedings and also at the time of opening of these proceedings. Thus, when the location of a property involves some third country, the effect of opening of insolvency proceedings, regarding security rights, is not regulated by Article 5 (1).

1.1.2.2.2. Time and "belonging to the debtor" factors

It is not clear how should be interpreted that provision refers to assets "belonging to the debtor". P.M. Veder raises question whether the broad view – when Article 5 encompasses all proprietary security rights in assets irrespective of whether assets in question belongs to the

[66] Weide, J.A.V.D., Wessels, B. Where to locate assets, subject to certain security rights. [interactive]. 2011 [accessed 15/04/2015, 16:17]. <http://bobwessels.nl/wordpress/wp-content/uploads/2011/04/2011-04-14-JIBLR-final.pdf>.

debtor (and forms part of debtor's estate) or not - is correct. [67] In that view the forms of ownership of third parties serving security purpose would be included in the scope of Article 5.

Although, A. Clarke and P.Kohler indicate that *"security acts as a hostage, providing an incentive for the borrower to comply with the loan agreement"*[68] it could look like the narrower approach is appropriate. Obvious but it should be noted that the more valuable particular asset is to the debtor, the more efforts he is going to make to fulfil obligation and retain that asset. According to these arguments and keeping in mind the purpose to ensure repayment of debt or secure creditor in case of failure of getting repayment, in order to establish that assets are belonging to debtor the most important aspect is debtor's interest in that asset. That interest has to form the ground for debtor's willingness to fulfil obligation and retain the security forming asset in which debtor has interest. Thus, most likely debtor's ownership of some asset in which security right is provided would ensure performance of obligation most.

However, any debtor's proprietary rights should be encompassed by the expression "belonging to the debtor". This is endorsed by R. Goode, as he expresses similar opinion and states that not only ownership of the debtor suits, but *"entitlement to a limited interest, for example, a security interest or a right of possession under a lease, suffices"*.[69] In addition, P.M. Veder remarks that a broad view of Article 5 should prevail and *"it must be understood to include any proprietary right in assets, regardless of the question whether under the* lex concursus *they form part of the debtor's estate or not"* but adds that this could be clarified.[70] Yet, these two authors are contradicting to each other in aspect whether assets in which security rights is provided should be included in debtor's estate. R. Goode notes that some kind of debtor's interest in asset has to be established and asset should be brought into the estate.[71]

In order to determine the location of assets correctly, time factor is important, too. Under the rule of Article 5 (1) of European Insolvency Regulation at the time of the opening of insolvency proceedings it is. This can result in complications, and in inequalities, in case when location of a movable property was changed after the creation of a right *in rem*, but before the opening of proceedings.[72] In some cases security rights that have been granted by the debtor after the moment indicated – the time of the opening of the proceedings – also can fall under the

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[67] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.
[68] Clarke, A., Kohler, P. *Property Law. Commentary And Materials.* Oxford: Oxford University Press, 2005, p. 660.
[69] Goode, R. *Principles of corporate insolvency law. Fourth Edition.* Sweet & Maxwell, 2011, p. 759, 762.
[70] Veder, P. M. *Cross-Border Insolvency Proceedings And Security Rights: A Comparison Of Dutch And German Law, The EC Insolvency Regulation And The UNCITRAL Model Law On Cross-Border Insolvency*. Nijmegen: Kluwer Legal Publishers. 2004, p. 337.
[71] Goode, R., *op. cit.*, p. 759, 762.
[72] Fletcher, I. F. *Insolvency In Private International Law: National And International Approaches. Second edition*. Oxford University Press. 2007, p. 404.

special regime established by Article 5.[73] According to P.M. Veder, these are the situations when rights, created after the debtor's lost of his rights because of insolvency proceedings, are valid and enforceable because acquirer of the right is honest and therefore protected against effect of the opening of the proceedings.[74] However, P.M. Veder notes that security rights that were established by way of anticipation in future assets are not protected by Article 5. The location of assets has to be established at the time of the opening of proceedings, with the exception stated in Article 14.

1.2.Cross-Border Insolvency Proceedings

Cross-border insolvency can be caused by a numerous reasons, either by one at a time or by several concurrently. According to I.F. Fletcher, ground for that can be debtor's relations to one or few parties from foreign countries, debtor's property or interests in property which is not situated in home state of debtor, liabilities or obligations for persons who are connected to different than debtor's state, or these obligations are governed by foreign law, or they may have been originated in other state, or they are planned to be performed in foreign state.[75] All these situations may cause the existence of cross-border insolvency proceedings.

The instrument that regulates cross-border insolvency cases in the European Union is European Insolvency regulation. In recital 1 of European Insolvency Regulation EU has set the goal of *"establishing an area of freedom, security and justice"*. As activities are getting more international, when matters cross borders of more than one state, significance of European Union level Regulation on insolvency proceedings increases. It states that only regulation in the level of EU, regarding cross-border insolvency proceedings, can help achieve objectives of *"proper functioning of the internal market"*. Laws on these matters in national level would not be as efficient as it is needed because of the development and globalization of activities[76].

In this subchapter the main features and concepts of European Insolvency Regulation will be analyzed.

1.2.1. Core of the European Insolvency Regulation

[73] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 96. [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.
[74] Veder, P. M. *Cross-Border Insolvency Proceedings And Security Rights: A Comparison Of Dutch And German Law, The EC Insolvency Regulation And The UNCITRAL Model Law On Cross-Border Insolvency*. Nijmegen: Kluwer Legal Publishers. 2004.
[75] Fletcher, I. F., *op. cit.*, p. 3-4.
[76] Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings. Official Journal L 160, 30.6.2000, Recitals 2-5.

The fundamental things of Insolvency Regulation may be, firstly, the ambit of this regulation as to know what situations are encompassed by its provisions and, secondly, underlying principles that guide application and interpretation of the Regulation. These aspects are analysed further.

1.2.1.1.Ambit

Scope of European Insolvency regulation can be defined by four autonomous criterions: in territory, in time, for types of cases and for persons.[77]

Insolvency Regulation is applicable to insolvency proceedings when they are **cross-border cases within the European Union** (except Denmark, as established by Recital 33). Recital 1 of the Regulation establishes that it is adopted to achieve the aim of efficient internal market, which can be reached through effective operation of cross-border insolvency proceedings. Referring to Manual of Insolvency Law, there are different opinions on the question, whether Insolvency Regulation applies to cases when two or more EU Member states are involved or also to cases when at least two countries are involved and at least one of them is Member State.[78] B. Wessels states that it is not established whether it has to be qualified foreign connection or simple foreign connection (foreign connection to the country outside the EU) is enough. But according to his opinion, *"it would be advisable to refrain from broadening the scope of applicability of the Regulation to non-Member States"*.[79]

However, the Court of Justice of the European Union in decision of *Schmid* case stated different opinion. Although the Court indicated that in particular cases Insolvency Regulation requires connecting factors with at least two Member States (e.g. Article 5 (1), provisions of Chapter III), general principle is that provisions not containing express restriction (e.g. Article 6 and 14) should not be interpreted in a narrow manner.[80] Therefore, the Court ruling that *„the provisions of the Regulation which do not expressly prescribe a cross-border element involving at least two Member States, it must be stated that the objectives pursued by the Regulation, as resulting in particular from the recitals in its preamble, likewise do not support a narrow interpretation of the Regulation's scope, requiring the presence of such an element"* must be followed.

[77] Kavalnė, S., Mikuckienė, V., Norkus, R., Velička, R. *Bankroto teisė. Pirmoji knyga. Manual,* Vilnius: Justitia, 2009, p. 314; Pennen, K. *European Insolvency Regulation – Commentary.* Berlin: De Gruyter, 2007, p. 22.
[78] *Ibid.*, p. 315.
[79] Pennen, K. *European Insolvency Regulation – Commentary.* Berlin: De Gruyter, 2007, p. 47.
[80] Case C-328/12, *Ralph Schmid v Lilly Hertel,* Application: OJ C 303 from 06.10.2012, p.14, Judgment: OJ C 85 from 22.03.2014, para. 22-24.

Insolvency Regulation is applicable only to situations when insolvency proceedings are opened after Regulation's entry into force (Article 43). This means that insolvency proceedings of which the **time** of opening is on 31 May 2002 or later are regulated by European Insolvency Regulation.

Insolvency Regulation is applicable to proceedings in both situations; either subject is natural person or legal person, as can be seen from the recital 9. National legislation establishes for which **persons** insolvency proceedings can be opened in that Member State. Annexes enumerate these proceedings for which the Regulation applies.

European Insolvency Regulation applies to particular **types of cases** - *"collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator"*, according to Article 1 (1). Four cumulative conditions presuppose that European Insolvency Regulation will be applicable. Proceedings are collective, meaning that all concerned creditors use these proceedings in order to get repayments instead of individual actions, has to be established. Second, the proceedings have to be caused by the *"debtor's insolvency"*. Third, the proceedings have to be the reason for the total or partial divestment of the debtor. Fourth, the proceedings also cause the appointment of *"liquidator"*.[81]

1. Concept of collective proceedings is not defined in Insolvency Regulation. Contrary, European Insolvency Regulation (Recast) establishes the definition of collective proceedings in Article 2 (1) by indicating that it *"means proceedings which include all or a significant part of a debtor's creditors provided that, in the latter case, the proceedings do not affect the claims of creditors which are not involved in them"*. National proceedings, which can be found in Annexes A and B, are encompassed by the application of Insolvency Regulation. Only the proceedings stated in these annexes are governed by the Insolvency Regulation and may enjoy ensured benefits. According to Article 1 (2) insurance undertakings, credit institutions, investment undertakings, which provide services involving the holding of funds or securities for third parties, and collective investment undertakings, are excluded from the ambit of the Insolvency Regulation and are subject of special regulation.
2. There is no definition of "insolvency" provided by Insolvency Regulation and this fact is left to establish for the regulation of *lex concursus*.

[81] Wessels, B. *European Union Regulation On Insolvency Proceedings. An Introductory Analysis (October 2006)* [interactive]. [accessed:19/04/2015, 12:28]. <www.bobwessels.nl>; Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

3. Current Insolvency Regulation indicates that outcome of the proceedings is partial or total divestment. However, Heidelberg-Luxembourg-Vienna Report indicates that this definition of "insolvency proceedings" is not relevant in current situation, now, when *"major objectives of insolvency laws are the restructuring of businesses and the discharge of insolvent individuals"* to ensure fresh start, definition of insolvency proceedings becomes inappropriate.[82] This problem is solved by Insolvency Regulation (Recast) as of establishing the definition of insolvency proceedings that refers to Annex A, where all proceedings are enumerated, including pre-insolvency proceedings. Also, Article 1 (1) establishes that *"Regulation shall apply to public collective proceedings, including interim proceedings"*. Further, additional definition, particularly of "collective proceedings", is added to Article 2 and it is more relevant as encompassing pre-insolvency proceedings. In addition, Insolvency Regulation (Recast) adds provision to Article 1 establishing that in case of imminent insolvency purpose of proceedings *"shall be to avoid the debtor's insolvency or the cessation of the debtor's business activities"*. Also, Heidelberg-Luxembourg-Vienna Report proposes to improve coordination between Article 1 (1) and Annex A by providing clear hierarchy in order to know if proceedings not enumerated in Annex A, even though corresponding to requirements of Article 1 are encompassed by Insolvency Regulation.[83] But this proposal cannot be seen embodied in the Insolvency Regulation Recast.
4. Persons acting as "liquidators" may be found in the Annex C. In the European Insolvency Regulation (Recast) the naming is changed to "insolvency practitioner" Recital 21 and these persons are stated in Annex B.[84] In the Insolvency Regulation Recast the definition of these persons is different in the way that more functions are enumerated, in Article 2 (5). Further in this Thesis when referring to liquidator it means that the same can be said regarding insolvency practitioner under Insolvency Regulation (Recast).

[82] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 10-11. [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.
[83] *Ibid.*, p. 13.
[84] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive]. [accessed: 13/04/2015, 19:33]. <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2015:141:FULL&from=EN>. Article 2(9).

In view of prospective regulation on insolvency proceedings within the EU, conclusion that these conditions not necessarily have to be established all together can be derived due to formulation of Article 1.[85]

R. Goode adds additional condition to already mentioned: debtor has its centre of main interests in a Member State.[86] Recital 14 of the Insolvency Regulation determines that *"this regulation applies only to proceedings where the centre of the debtor's main interests is located in the Community"*. This presupposes that situation of debtor's centre of main interest in the territory of European Union is essential condition for Insolvency Regulation to be applicable.

However, Article 3 (1) indicates that *"the courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have the jurisdiction to open insolvency proceedings"*. According to I.F. Fletcher, facts that former rule is placed in recital, but not as the substantive provision, and that the provision of Article 3 on jurisdiction does not provide such a clear and definite rule as recital 14 may cause uncertainties when interpreting the Regulation.[87]

Pursuant to I.F. Fletcher, recitals of European Insolvency Regulation were extracted from Virgos-Schmit Report. It was done in order to equip the Regulation with help while interpreting it. They can be used by European Union Court of Justice and national courts.[88] Moreover, *"it has been accepted by the European Court of Justice that a Preamble may be referred to where the text in the body of a Regulation is unclear or imprecise"*.[89] Due to that, it may seem like unclear provision in the body of Regulation and certainly definite rule in recital should be interpreted as supplementing each other and forming one rule. Furthermore, it is hard to imagine that EU legislator intended to establish not definite rule in the body of legally binding document – Regulation – considering the fact that "shall" is used in entire Insolvency Regulation.

However, prevailing is opposite opinion. According to I.F. Fletcher, *"due to their highly condensed and heavily selective nature, the Recitals will in many instances fail to provide sufficiently clear information about the intended meaning and effect of a given provision within*

[85] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive]. [accessed: 13/04/2015, 19:33]. <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2015:141:FULL&from=EN>.
[86] Goode, R.M. *Principles Of Corporate Insolvency Law.*London: Thomson/ Sweet & Maxwell, 2005, p. 571.
[87] Fletcher, I. F. *Insolvency In Private International Law: National And International Approaches.* Second edition. Oxford University Press, 2007, p. 365.
[88] *Ibid.*, p. 357.
[89] Sealy, L.S., Milman, D. *Sealy & Milman: Annotated Guide to the Insolvency Legislation. Fourteenth Edition. Volume 2.* London: Sweet & Maxwell, 2011, p. 133.

the main body of the Regulation itself".[90] In addition, referring to opinion of R. Goode, *"all too often they are made to carry the burden of answering questions which are not addressed in the text"*. Due to that, concepts and rules found only in recitals, but not body of the Regulation, can be of limited aid only.[91] Also, A.J. Berends in article regarding Eurofood case indicates that *"A recital is not a decisive text. A recital may be of great help, but we should not forget that in the making of legislation – whether it is Brussels or not – the words of recitals are chosen less carefully than the words of the corpus itself*".[92] Due to stated opinions, can be seen that Recital 14 *„plainly have legislative effect"*[93] and provision of Article 3 (1) is not definite enough.

Despite that, Article 3 (1) and Recital 14 in some instances causes that one of EU Member States has jurisdiction to open insolvency proceedings for person whose centre of main interest is within the EU territory, even though the registered office is in the country outside the EU. It appears from this that European Insolvency Regulation applies to situations when debtor's centre of main interests is located within the EU, nevertheless other factors.[94] The essence of concept of COMI will be analysed later.

1.2.1.2.Principle of mitigated universalism

Cross-border insolvency situations presupposes that debtor in some way is related to more than one country. In such cases many questions arise considering that national laws of states differs widely. Therefore, issues on appropriate court appointment, determination of applicable law, establishing the location of assets and others have to be solved.

"Traditionally, most of these questions have been addressed by reference to the dogmatic principles of universality and its conceptual counter-part, territoriality". Strictly the universality means that effect of insolvency proceedings opened in one state is universal – *"covering all assets and liabilities of the debtor wherever they are located".* Meanwhile, the principle of territoriality creates effect only within the state of proceedings.[95]

Pure form of universality has its advantages and disadvantages. One of the advantages can be mentioned that universalism is *"in fullest harmony with the principal of collectivity and*

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[90] Fletcher, I. F. *Insolvency In Private International Law: National And International Approaches.* Second edition. Oxford University Press, 2007, p. 357.
[91] Goode, R.M. *Principles Of Corporate Insolvency Law.*London: Thomson/ Sweet & Maxwell, 2005, p. 567.
[92] Berends, A.J. The Eurofood Case: One Company, Two Main Insolvency Proceedings: Which One Is The Real One?. *Netherlands International Law Review*, 2006, Volume 53, Issue 02, August 2006: 331-361. <http://journals.cambridge.org/abstract_S0165070X06003317>.
[93] Sealy, L.S., Milman, D. *Sealy & Milman: Annotated Guide to the Insolvency Legislation. Fourteenth Edition. Volume 2.* London: Sweet & Maxwell, 2011, p. 133.
[94] *Ibid.*, p. 135.
[95] Israel, J. *European Cross-Border Insolvency Regulation.* Antwerpen- Oxford: Intersentia, 2005, p. 11.

the equal treatment of all creditors on a global basis" [96] and predictability[97]. According to McCormack, universalism is less costly for debtor and creditors to deal with one, not few, insolvency representatives. In addition, due to approach that debtor's assets are one unit, reorganisation or sale of business is easier to perform. However, there are disadvantages. For instance, participation in proceedings may cause difficulties due to language, ignorance of law in foreign state. Further, realization in full of universality can be achieved only when all states recognize it in their legislation, rather than when prevailing principle differs in states. Same rules on jurisdiction in states are another prerequisite to realize universality principle in full.[98] Disadvantages of universality principle are used by supporters of opposite in order to defend principle of territoriality.

Looking to Article 4 of European Insolvency Regulation the impression is of prevailing universality principle, but it changes when looking to exceptions established in Article 5 – 15. Moreover, *"another modification to the universalist philosophy in the Regulation comes from the fact that secondary insolvency proceedings may be opened in respect of a debtor and these proceedings do not serve simply as mechanisms for the more convenient collection of assets and their remission to the liquidator in the principal proceedings"*.[99] As *"neither pure universalism nor pure territorialism is practical"*[100], European Insolvency Regulation *"adopts combined method (or: mixed model), which introduces main insolvency proceedings, reflecting the principle of universality, but permits local proceedings, necessary to protect local interests"* [101]. This model of modified universalism (or mitigated universalism, or limited universalism, or co-ordinated universality[102]), *"recognizes the problems of a global system where debtors can easily*

[96] Fletcher, I.F. Insolvency Law in Private International Law. 2005 (Cited from: Clark, L.M., Goldstein, K. Sacred Cows: How to Care for Secured Creditors' Rights in Cross-Border Bankruptcies. *Texas International Law Journal* [interactive]. Vol. 46, Issue 3 (Summer 2011): 513-558 [accessed: 22/03/2015, 08:40]. <http://heinonline.org>.)

[97] Clark, L.M., Goldstein, K. Sacred Cows: How to Care for Secured Creditors' Rights in Cross-Border Bankruptcies. *Texas International Law Journal* [interactive]. Vol. 46, Issue 3 (Summer 2011): 513-558 [accessed: 22/03/2015, 08:40]. <http://heinonline.org>.

[98] McCormack, G. Universalism in Insolvency Proceedings and the Common Law. *Oxford Journal of Legal Studies* [interactive]. 2012, Vol. 32, No. 2: 1-23 [accessed: 19/04/2015, 19:23]. <http://ojls.oxfordjournals.org>.

[99] McCormack, G. Reforming the European Insolvency Regulation: a Legal Policy Perspective. *Journal Of Private international Law* [interactive]. 2014, Vol. 10 No. 1: 41-67 [accessed: 16/04/2015, 14:05]. < https://www.insol.org/_files/Fellowship%20Class%20of%202014%20-%202015/Literature/Session%20Four/McCormack%20JPIL%202014.pdf>.

[100] Clark, L.M., Goldstein, K., *op. cit.*

[101] Wessels, B. *European Union Regulation On Insolvency Proceedings. An Introductory Analysis (October 2006)* [interactive]. [accessed:19/04/2015, 12:28]. <http://www.insol.org/INSOLfaculty/pdfs/BasicReading/Session%205/European%20Union%20Regulation%20on%20Insolvency%20Proceedings%20An%20Introductory%20analysis,%20Bob%20Wessels.pdf>.

[102] Wessels, B. The *Changing Landscape of Cross-Border Insolvency Law in Europe.* Paper presented during the conference „Developments in Cross-Border Insolvencies: The Changing Landscape of U.S and Foreign Law [interactive]. New York City, 2006 [accessed: 13/03/2015, 23:34]. <http://bobwessels.nl/download/changing_landscape.pdf>.

choose a substantive law that will govern their insolvency and that is contrary to the expectations and interests of creditors".[103]

1.2.2. Two Main Decisions In The Beginning Of Insolvency Proceedings

When cross-border insolvency situation arises, primary task is to determine court of which state will has jurisdiction to decide certain case and then, law of which state will be applied by court having jurisdiction. Articles 3 and 4 of European Insolvency Regulation establish rule on international jurisdiction and general rule of law applicable, respectively.

1.2.2.1.Jurisdiction

Article 3 of Insolvency Regulation establishes rules on international **jurisdiction**. Based on this provision jurisdiction is determined for proceedings, which are encompassed in the ambit of the Regulation. I.F. Fletcher stated that *"contrary to the initial impression generated by the use of the words 'shall have jurisdiction to open insolvency proceedings', the jurisdictional scheme of Article 3 actually operates in an exclusive manner, and does not merely create an additional basis of jurisdiction to operate in parallel with national rules"*.[104] Thus, court of the Member State in which centre of debtor's main interests is situated has priority to open insolvency proceedings. These proceedings are main insolvency proceedings and have universal effect (encompass all debtor's assets and affect all creditors worldwide[105]).

"*It is important to keep in mind that the principle of subordination between primary and secondary proceedings is set forth by Articles 3 (2) – 4"*.[106] As Article 3 (2) establishes *"where the centre of a debtor's main interests is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Member State"*. These proceedings are called secondary or territorial proceedings, referring to its territorial effect (restricted to the assets of the debtor situated in the Member State which opened

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[103] Adams, E.S., Fincke, J.K. *Coordinating Cross-Border Bankruptcy: How* Territorialism Saves Universalism, 15 COLUM. J. EUR. L. 43, 46 (2009) (cited from: Clark, L.M., Goldstein, K. Sacred Cows: How to Care for Secured Creditors' Rights in Cross-Border Bankruptcies. *Texas International Law Journal* [interactive]. Vol. 46, Issue 3 (Summer 2011): 513-558 [accessed: 22/03/2015, 08:40]. <http://heinonline.org>.

[104] Fletcher, I. F. *Insolvency In Private International Law: National And International Approaches.* Second edition. Oxford University Press, 2007, p. 365.

[105] Torremmans, P. Coming To Terms With The COMI Concept In The European Insolvency Regulation. *International Insolvency Law. Themes And Perspectives.* Ashgate, 2008, p. 173-185.

[106] Wessels, B. *European Union Regulation On Insolvency Proceedings. An Introductory Analysis (October 2006)* [interactive] [accessed:19/04/2015, 12:28]. <http://www.insol.org/INSOLfaculty/pdfs/BasicReading/Session%205/European%20Union%20Regulation%20on%20Insolvency%20Proceedings%20An%20Introductory%20analysis,%20Bob%20Wessels.pdf>.

secondary proceedings) It should be noted that there can only be one main proceedings opened, while secondary proceedings can be opened in one or several Member States, when in these states debtor possesses establishments. Furthermore, according to current Insolvency Regulation secondary proceedings *"must be winding-up proceedings"*[107] but in Insolvency Regulation (Recast) this rule is not included[108], therefore, now encompassing all proceedings that are in the scope of the Regulation (Recast).

In addition, Insolvency Regulation does not contain any provisions establishing rules how to solve cases when courts of two Member States simultaneously open insolvency proceedings under Article 3 (1). Such cases are seen as exceptional as jurisdictional rules are uniform and any dispute should be solved according to principle of mutual trust of courts of two Member States.[109] But Insolvency Regulation (Recast) intend to establish rules on *"examination as to jurisdiction"* imposing to courts duty of examining on its own motion whether it has jurisdiction to open insolvency proceedings and providing grounds for jurisdiction, in particular whether it is Article 3 (1) or (2). Further, *"judicial review of the decision to open main insolvency proceedings"* is also provided in Insolvency Regulation (Recast) allowing debtor or any creditor to challenge the decision opening main insolvency proceedings and for parties other than already mentioned if national law allows that.[110] These amendments allow avoiding situations when insolvency proceedings are started in Member State which actually does not have jurisdiction. Pursuant to, E. Aasaru, such situations were able to exist due to "first in time" rule and recognition of judgement to open insolvency proceedings by courts of other Member States. [111]

Regulation establishes only international jurisdiction rules, but *"territorial jurisdiction within the Member State must be established by the national law of Member State concerned"* (Recital 15 (26 in Regulation (Recast)).

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[107] Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings. Article 3(3).

[108] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive]. [accessed: 13/04/2015, 19:33]. <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2015:141:FULL&from=EN>.

[109] Wessels, B. *European Union Regulation On Insolvency Proceedings. An Introductory Analysis (October 2006)* [interactive]. [accessed:19/04/2015, 12:28]. <www.bobwessels.nl>.

[110] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive]. [accessed: 13/04/2015, 19:33]. <http://bobwessels.nl/wp/wp-content/uploads/2015/04/2015-03-12-EIR-Recast-Council-first-reading.pdf>. Articles 4-5, Recital 27.

[111] According to this rule the court of the Member State that chronologically was the first one to open main insolvency proceedings based on Article 3(1) of the Regulation was authorized to do so.
Aasaru, E. The Desirability of ‚Centre of Main Interests' as a Mechanism for Allocating Jurisdiction And Applicable Law in Cross-Border Insolvency Law. *European Business Law Review* [interactive]. 2011, Vol. 22, Issue 3, p. 349-380 [accessed: 22/03/2015, 08:27]. <http://heinonline.org>.

The crucial element to decide court of which state has jurisdiction to open main insolvency proceedings and for Insolvency Regulation to be applicable to proceedings is situation of debtor's centre of main interests in the Member State. Thus, its concept is important to analyse in order to understand basis for jurisdiction.

1.2.2.1.1. Debtor's Centre Of Main Interests

Although Article 3 (1) indicates that jurisdiction belongs to courts of Member State where centre of debtor's main interest is situated, it does not provide the definition what place should be regarded as corresponding to this concept. COMI is decisive factor in order to establish the jurisdiction and applicable law.

Definition of centre of main interests is provided by Recital 13 of Insolvency Regulation and denotes *"place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties".* In European Insolvency Regulation (Recast) this definition is transposed to Article 3 (1). Thus, the same aspects are relevant regarding both, current Regulation and Regulation (Recast).

According to P. Torremans, firstly, COMI *"concept can only work in conjunction with the unity and universality principle with which it is supposed to work if it points to a single place"*. And the purpose of this concept is *"to have one court that is competent to open a single set of insolvency proceedings, leading to a single worldwide insolvency case"*.[112] Every debtor can have only one centre of main interests and only economic interests count when establishing COMI.[113] In cases when debtor has establishments in several states and exercises his activities there, it does not mean that several main insolvency proceedings may be opened, but that single one centre have to be determined.

The very term "main" refers that basic, fundamental place of activities must be determined and this also must be done from the point of view of third parties[114]. Court of Justice of the European Union in *Eurofood* judgment stated that *"the centre of main interests must be identified by reference to criteria that are both objective and ascertainable by third parties"* and

[112] Torremmans, P. Coming To Terms With The COMI Concept In The European Insolvency Regulation. *International Insolvency Law. Themes And Perspectives.* Ashgate, 2008, p. 173-185.
[113] Bogdan, M. The EU Bankruptcy Convention. *International Insolvency Review*[interactive]. 1997, Vol. 6: 114-126 [accessed: 25/04/2015, 19:26]. < http://onlinelibrary.wiley.com/journal/10.1002/%28ISSN%291099-1107>.
[114] Szydlo, M. The Notion of COMI in European Insolvency Law. *European Business Law Review.* Kluwer Law International, 2009, Vol. 20: 747-766. (Cited from: Aasaru, E. The Desirability of ‚Centre of Main Interests' as a Mechanism for Allocating Jurisdiction And Applicable Law in Cross-Border Insolvency Law. *European Business Law Review* [interactive]. 2011, Vol. 22, Issue 3, p. 349-380 [accessed: 22/03/2015, 08:27]. <http://heinonline.org>.)

that is *"necessary in order to ensure legal certainty and foreseeability concerning the determination of the court with jurisdiction to open main insolvency proceedings"*[115].

There is only one rule, that forms exception to no definition of COMI, and it is given as a presumption. It establishes that registered office is presumed to be centre of main interests of companies or legal persons. Regarding that, the Court of Justice of the European Union indicated that aforesaid presumption *"can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect"*[116]. As relevant factors should be considered places where debtor exercise economic activities and places where his assets are located[117]. As the third parties are creditors from court's perspective[118]. Additionally it should be noted that *"where the bodies responsible for the management and supervision of a company are in the same place as its registered office and the management decisions of the company are taken, in a manner that is ascertainable by third parties [...] is not possible that the centre of the debtor company's main interests is located elsewhere"* as the Court explained.[119] Also, Regulation (Recast) to registered office presumption adds requirement of *"a specific period of time to pass in order to make it possible to establish that COMI is effective in a new location"*[120]. It is necessary that *"the registered office has not been moved to another Member State within the three-month period prior to the request for the opening of insolvency proceedings"*. According to F. Garcimartin, this rule of minimum period of the situation of centre of main interests was established as one of the means preventing forum shopping. However, this solution is problematic because it will cause *"practical problems and more litigation since it is not always easy to fix the exact day when the COMI is moved"*, especially referring to that transfer of COMI – *"set of facts and activities"* – cannot be performed all at once. [121]

Moreover, Insolvency Regulation (Recast) establishes similar rules regarding *"individual exercising an independent business or professional activity"* and *"any other individual"*. COMI is presumed to be *"individual's principal place of business"* and "*habitual*

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[115] Case C-341/04, *Eurofood IFSC Ltd* [2006] ECR I-03813.
[116] *Ibid.*
[117] Case C-396/09, *Interedil Srl, in liquidation v Fallimento Interedil Srl and Intesa Gestione Crediti Sp.* [2011] ECR I-09915.
[118] Torremmans, P. Coming To Terms With The COMI Concept In The European Insolvency Regulation. *International Insolvency Law. Themes And Perspectives*. Ashgate, 2008, p. 173-185.
[119] Case C-396/09, *Interedil Srl, in liquidation v Fallimento Interedil Srl and Intesa Gestione Crediti Sp.* [2011] ECR I-09915.
[120] Aasaru, E. The Desirability of ‚Centre of Main Interests' as a Mechanism for Allocating Jurisdiction And Applicable Law in Cross-Border Insolvency Law. *European Business Law Review* [interactive]. 2011, Vol. 22, Issue 3, p. 349-380 [accessed: 22/03/2015, 08:27]. <http://heinonline.org>.)
[121] Garcimartin, F. *The EU Insolvency Regulation: Rules On Jurisdiction* [interactive] 2013 [accessed: 26/04/2015, 02:16]. <http://www.ejtn.eu/PageFiles/6333/Rules_on_jurisdiction.pdf>.

residence" if place of these factors were not changed in the period of three-month and six-month, respectively. Also, the same rule of rebuttable presumption in case of existing evidence to the contrary appears.

Moreover, the correct time to establish the centre of debtor's main interests is important. This time is at the moment when the request to open insolvency proceedings is lodged. This is confirmed by the Court of Justice of the European Union in *Staubitz-Schreiber* judgement as it was stated that *"Article 3 (1) of the Regulation must be interpreted as meaning that the court of the Member State within the territory of which the centre of the debtor's main interests is situated at the time when the debtor lodges the request to open insolvency proceedings retains jurisdiction to open those proceedings if the debtor moves the centre of his main interests to the territory of another Member State after lodging the request but before the proceedings are opened"*[122].

While interpreting concept of centre of debtor's main interests the Court was able to establish a *"balance between the two main objectives of the COMI concept: predictability for the creditors and enabling insolvency proceedings to be opened in the Member State that has the closest ties with the debtor company"*.[123] Text of the Regulation (Recast) includes a definition of centre of debtor's main interests, former presumption of registered office, rule on its applicability, as well as provisions regarding natural persons.

1.2.2.1.2. Secondary Proceedings

European Insolvency Regulation allows opening of proceedings other than that in Member State where centre of debtor's main interests is located. There is a *"hierarchical scheme of main (primary) and secondary (subsidiary) jurisdictional competence in relation to a debtor"*[124]. Regulation (Recast) states that it *"permits secondary insolvency proceedings to be opened to run in parallel with the main insolvency proceedings"* in order to secure various interests (Recital 23). In addition, unity in the EU is established by the rules of coordination between main and secondary proceedings (Recital 23 of Regulation (Recast)).

Secondary, proceedings can be opened in a state where the debtor possesses establishment, and they have territorial effect as mentioned earlier. Opening of secondary

[122] Case C-1/04 *Susanne Staubitz-Schreiber* [2006] ECR I-701.
[123] Case C-396/09 *Interedil Sri*, Judgment of the Court of 20 October 2011, not yet reported. Court guidance as to the COMI concept in cross-border insolvency proceedings. *Maastricht Journal of European and Comparative Law* [interactive]. 2011, Vol. 18, Issue 4 [accessed: 22/03/2015, 08:14].
[124] Wessels, B. *European Union Regulation On Insolvency Proceedings. An Introductory Analysis (October 2006)* [interactive] [accessed:19/04/2015, 12:28].
<http://www.insol.org/INSOLfaculty/pdfs/BasicReading/Session%205/European%20Union%20Regulation%20on%20Insolvency%20Proceedings%20An%20Introductory%20analysis,%20Bob%20Wessels.pdf>.

insolvency proceedings is easier comparing to the main. As establishes Article 27, court can open these, secondary, proceedings *"without the debtor's insolvency being examined"*. Definition of what is regarded as establishment can be found in Article 2 of Insolvency Regulation. According to the provision, establishment is *"any place of operations where the debtor carries out a non-transitory economic activity with human means and goods"*. Insolvency Regulation (Recast) establishes three months period of exercise of defined economic activity[125] and only *"presence of an asset or bank account is not enough to create this establishment"*[126].

Referring to authors' opinion expressed in "Annotated Guide to the Insolvency Legislation", the wording of Article 3 (2) (which remains unchanged in Regulation (Recast) – *Researcher's remark*), causes obscurities. As provision states "possesses an establishment" it refers to current situation. "*It may well have been intended that if a debtor has ceased to possess an establishment in a particular jurisdiction, everything is to be administered in the main proceedings; but this would prevent any ring-fencing of the local assets for the benefit of local creditors and could cost preferential creditors their priority"*.[127]

Territorial proceedings can be opened prior main insolvency proceedings in two situations (Article 3 (4)): when main proceedings cannot be opened due to the legislation of Member State in territory of which debtor's COMI is situated or when creditor having his domicile, habitual residence or registered office in the State where debtor's establishment is situated, or when creditor's claim arises from the operation of that establishment. These proceedings are independent and becomes secondary once the proceedings in the state where debtor's centre of main interests is located.

Generally, secondary proceedings are capable of filling the blank *"between the principles of universality and unity on the one hand and those of territoriality and plurality on the other hand"*.[128]

1.2.2.2.Applicable Law

General rule of determination of applicable law is in Article 4 of European Insolvency Regulation. *Lex concursus* rule is established and reads as *"the law applicable to insolvency*

[125] Position Of Council At First Reading With A View To The Adoption Of A Regulation Of The European Parliament And Of The Council On Insolvency Proceedings (Recast) of 12 March 2015, 16636/5/14 REV 5 [interactive]. [accessed: 13/04/2015, 19:33]. <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2015:141:FULL&from=EN>. Article 2 (10).

[126] Wessels, B. *European Union Regulation On Insolvency Proceedings. An Introductory Analysis (October 2006)* [interactive]. [accessed:19/04/2015, 12:28]. <http://www.insol.org/INSOLfaculty/pdfs/BasicReading/Session%205/European%20Union%20Regulation%20on%20Insolvency%20Proceedings%20An%20Introductory%20analysis,%20Bob%20Wessels.pdf>.

[127] Sealy, L.S., Milman, D. *Sealy & Milman: Annotated Guide to the Insolvency Legislation. Fourteenth Edition. Volume 2*. London: Sweet & Maxwell, 2011, p. 143.

[128] Israel, J. *European Cross-Border Insolvency Regulation.* Antwerpen- Oxford: Intersentia, 2005, p. 236.

proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened". It is applied when the Regulation does not establish otherwise. Similar rule is provided regarding secondary proceedings (Article 28) – applicable law is of the Member State in which secondary proceedings were opened.

When law applicable is established according to the state of the opening of the proceedings, it destines all *"effects of the insolvency proceedings, both procedural and substantive, on the persons and legal relations concerned"* Rule of *lex concursus "governs all the conditions for the opening, conduct and closure of the insolvency proceedings, the admissibility of claims and the rules on distribution and preferences, etc."*.[129] Article 4 (2) enumerates matters that have to be determined according to *lex concursus* rule provided in Article 4 (1).

To sum up, two notions – security rights and cross-border insolvency proceedings – are important in order to analyse the topic of correlation between these two concepts. Security right is a proprietary right, which can work as a mean to secure the fulfilment of obligation by providing priority to get it for secured creditor, especially in insolvency due to regard for such a right. In European Union Insolvency law security rights are named as rights *in rem* and there is no definition of them. Therefore, Insolvency Regulation imposes a duty to answer the question whether particular right is right *in rem* to the state of location of assets and at the moment of opening of insolvency proceedings. Several problems arise regarding the determination of rights *in rem* – establishing the location of assets, time to do that and question whose assets it should be. Insolvency Regulation (Recast) may be able to solve few of these issues. In Regulation (Recast) provisions on determination of location of assets differs from Localization rules, introduced by J.A.V.D. Weide and B. Wessels. Another important concept is cross-border insolvency proceedings. These situations arise when debtor has assets, creditor or obligations in other state than the state of his centre of main interests. Debtor‘s COMI is decisive factor for jurisdiction and applicable law. Regulation (Recast) contains the definition of COMI in its body. Thus, it solves uncertainties regarding the concept of centre of main interests, which arise due to only supporting significance of Recitals, which contains definite rule on COMI and imprecise rule in Article 3.

[129] Wessels, B. *Current Topics of International Insolvency Law.* Deventer: Kluwer, 2004, p. 122.

CHAPTER II. CORRELATION BETWEEN CROSS-BORDER INSOLVENCY AND SECURITY RIGHTS

On the international level, the growth of multinational businesses was one of the reasons, which influenced the importance of security rights in cross-border matters and demand that security rights obtained in one country would be recognized and enforceable in other countries. In addition, status of secured creditors in insolvency proceedings is important factor for development of lending relationships and investment desirability of the state.[130] Therefore, protection of security rights, treatment of them in various instances and predictability capacitate well-being of economics in the states. As topic of this Thesis relates to cases within the EU, protection of security rights and effects established by the European Insolvency Regulation, taking into account prospective changes in the Regulation, will be analysed in the following chapter. Moreover, few initiatives will be presented regarding security rights in insolvency law of European Union.

2.1. Protection Of Security Rights Under The European Insolvency Regulation

Security rights in cases of insolvency in European Union are protected by giving applicable law regime other than the general rule. Recital 24 of Insolvency Regulation states that general rule provided in Article 4 has several exceptions formulated in order to achieve the aim of protection of legitimate expectations and certainty of transactions in cross-border situations. More than one situation is established as exception to Article 4 of European Insolvency Regulation, but *„the most significant exception to the* lex concursus *rule of Article 4 is provided by Article 5"*[131] of European Insolvency Regulation. In addition, this provision appears to be limiting the universal effect (encompassing all debtor's assets despite their location) of main insolvency proceedings.

Article 5 designating specific rule of applicable law in case of security rights - rights *in rem*, as referred in the Regulation - establishes that *"the opening of insolvency proceedings shall not affect the rights* in rem *of creditors or third parties".* Protection of security rights was regarded as important matter since the debates on Insolvency Convention[132] (the wording of the provision on security rights remained almost unchanged, as this was mentioned before). Further, definite rule on applicable law of the state where proceedings were opened for rights *in rem*,

[130] Lietuvos apeliacinio teismo Civilinių bylų skyriaus teisėjo 2014 m. Gegužės 27 d. Nutartis civilinėje byloje *Fabrika Glinice "Birač" AD Zvornik* (bylos Nr. 2T-69/2014), p. 13.
[131] Fletcher, I. F. *Insolvency In Private International Law: National And International Approaches.* 2nd Edition. Oxford University Press. 2007, p. 402.
[132] Convention on Insolvency Proceedings of 23 November 1995 [interactive]. CONV/INSOL/en 1. <http://aei.pitt.edu/2840/1/2840.pdf>.

situated in other than opening Member State, was not an option due to wide variety of treatment of secured creditors in states (for instance, United Kingdom has traditionally been "pro-secured creditor" jurisdiction, while France – emphasising employee rights[133]). As explained one of the courts of European Union – Court of Appeal of Lithuania - *"Considering the importance of lending relationships for economics of states and influence of secured creditors for state's system of lending relations as well as principles of equity, rationality and fairness, modification of status of secured creditors would not be reasonable and rational"*.[134] Due to that, exception from general rule of applicable law was dedicated to "Third parties' rights *in rem*".

Moreover, recitals of Insolvency Regulation provide that special regime may be established for rights *in rem* because of their importance for the granting of credit and widely differing national legislations on this matter, as it was mentioned earlier. The implication of significance of security rights in order to achieve intended goals of Insolvency Regulation can be made notwithstanding the only function of assistance of recitals mentioned when analysing the ambit of European Insolvency Regulation. This becomes evident after the ruling of the CJEU that in its *"approach to the aims and objectives of the Insolvency Regulation the recitals in the preamble are pivotal. Furthermore, emphasis is laid on the interests and the protection of creditors, which seems to function as a forerunner of the ECJ decision in the Eurofood case"*.[135]

2.1.1. Effect Of Article 5 Of The Regulation

Heidelberg-Luxembourg-Vienna Report recommends abandoning the idea that Article 5 of Insolvency Regulation establishes something else than a conflict of laws rule.[136] However, majority of authors considers it as different rule than usual conflict of laws rules because of its formulation. For example, M. Veder expresses different position stating that it is more like rule limiting *"the effects of the recognition of the main insolvency proceedings opened in another Member State and, in that sense, are uniform provisions of substantive law for international cases"*[137] and INSOL Europe noting that *"it operates rather as a negative conflict rule: the*

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[133] Marshall, J. Article 5 (rights in rem), *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 12/04/2015, 19:29]. <http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf>.

[134] Lietuvos apeliacinio teismo Civilinių bylų skyriaus teisėjo 2014 m. Gegužės 27 d. Nutartis civilinėje byloje *Fabrika Glinice "Birač" AD Zvornik* (bylos Nr. 2T-69/2014), p. 13.

[135] Wessels, B. Cross-Border Insolvency Law in Europe: Present Status and Future Prospects [interactive]. 11 Potchefstroom Elec. L.J. 1 (2008) [accessed: 22/03/2015, 08:05]. <http://heinonline.org.skaitykla.mruni.eu/HOL/Page?handle=hein.journals/per2008&id=174>.

[136] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 72 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

[137] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.

opening of insolvency proceedings will not impinge upon those rights in rem"[138]. Moreover, according to Heidelberg-Luxembourg-Vienna Report, currently Article 5 (1) establishing exceptional regime for rights *in rem* is interpreted as *"substantive restriction rule"* in most Member States. Pursuant to this understanding, rights *in rem* situated in one Member State are affected by no means because of opening of the insolvency proceedings in other State. Situation changes only if secondary insolvency proceedings are opened in State of situation of considered right *in rem*.[139] Such a uniform substantive law means *"complete isolation of security rights from the effects of main insolvency proceedings"*.[140] Also, this provision is called "hard and fast rule".

According to Heidelberg-Luxembourg-Vienna Report, such *"interpretation may (in certain cases) lead to results which are not in line with the policy goals pursued by Article 5 (1)"*.[141] When considering the ways to achieve policy goals of Article 5 of Insolvency Regulation, Virgos-Schmit Report states that there were several alternative solutions discussed by working group. However, the Report does not provide what are these alternatives, it only states that choice was made in order *"to facilitate the administration of the estate"*. Thus, simple formula that *"insolvency proceedings do not affect rights in rem on assets located in other Contracting States"* preferred by majority of group is in current Insolvency Regulation.[142]

Pursuant to the opinion of A.J. Berends, prevention of rights *in rem* situated in one Member State from effects of other State law where insolvency proceedings were opened was primary aim of the drafters of Insolvency Regulation. The desire was to create provision containing the regulation that "*if the* lex concursus *contains a rule which states that the opening of the insolvency proceeding affects rights in rem, that rule does not apply to rights in rem vested in goods which are located in a Member State where the insolvency proceeding has been opened"*. It should be noted that this rule does not direct to any certain law other than law of the state of opening of insolvency proceedings it just establishes that rule of *lex concursus* is not applicable. However, in Article 5 rule of some other state law is not indicated to change the excluded *lex concursus*. Drafters of the Regulation have chosen 'hard and fast rule' and the

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[138] INSOL Europe *Revision Of The European Insolvency Regulation* [interactive]. 2012 [accessed 22/04/2015, 16:45]. <http://www.nautadutilh.com/Documents/Publications%20to%20profiles/Revision_of_the_European_Insolvency_Regulation.pdf>.

[139] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 24 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

[140] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.

[141] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C., *op. cit.* p. 24.

[142] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 97. [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.

primary intention was achieving that rights *in rem* would never be affected by the law of state where insolvency proceedings were opened.[143]

In Article 5 simple formula is chosen, however, as stated in legal doctrine it causes few uncertainties that need further consideration, despite the already analysed – aspects of definition of rights *in rem* in Chapter I. It is, especially, the questions of what is meant by wording "shall not affect" and what is the scope of protection provided.

2.1.1.1. „Shall Not Affect"

In Article 5 (1) it is clear immediately from what can be read that provision does not contain a rule directing towards the law of some state, it is only establishing that opening of insolvency proceedings has no effect to rights *in rem.*[144] In this provision used wording "shall not affect" causes obscurities and precise interpretation becomes complicated. First of all, such a wording differs from other provisions which provide exceptions to general applicable law rule of Article 4(1). For instance, in Articles 8, 9, 10, 14 and 15 wording *"shall be governed (solely) by the law"* is used and in Article 11 - *"shall be determined by the law"*. These provisions establish definite rules that certain matters are governed by law of concrete state. Due to that, according to M. Virgos and F. Garcimartin, rule of Article 5 *"does not operate as a normal conflict of laws rule [...] rather as a negative conflict rule"* – opening of insolvency proceedings is not influencing rights *in rem.*[145] As the formation of provision on rights *in rem* is unlike usual conflict of law rules interpretation differs from these conflict of laws rules, too.

In addition to the different formulation from other conflict of laws rules, the meaning and influence of expression "shall not affect" is not clear and unambiguous in Article 5. M. Virgos, F. Garcimartin and P. Smart agree on the fact that protection of rights *in rem* provided by Article 5 (1) has procedural and substantive aspects. According to P. Smart, "shall not affect" wording implies that secured creditor's substantive rights are not reducible and also that if law of the state where right *in rem* is situated allows, secured creditor can realize asset under right *in rem* despite the fact that the law of the state where proceedings were opened set a stay.[146] And two authors of "The European Insolvency Regulation: Law and Practice" note the impossibility

[143] Berends, A.J. The EU Insolvency Regulation: Some Capita Selecta. *Netherlands International Law Review* [interactive]. 2010, 57: 423-442 [accessed: 07/05/2015, 15:04]. <http://journals.cambridge.org/abstract_S0165070X10300039>.

[144] Čiricaitė, R. 2000 m. Gegužės 29 d. Europos Tarybos Reglamentas (EB) Nr. 1346/2000 Dėl bankroto bylų: taikytinos teisės nustatymo ypatumai. *Teisė.* 2008, 67: 65-75.

[145] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 104.

[146] Smart, P. Rights in rem, article 5 and the EC insolvency regulation: and english perspective. *Int. Insolv. Rev.* [interactive]. 2006, Vol. 15: 17-55 [accessed 06/03/2015, 15:32]. <http://onlinelibrary.wiley.com/doi/10.1002/iir.135/pdf>.

of procedural and substantive restraints of insolvency on rights *in rem*. This is the case even when both, law of State of the opening of proceedings and law of State where right *in rem* is situated, provide such restrictions. Due to that, Article 5 is more rule of substantive law than conflict of laws rule.[147] According to P. Smart, *"quite simply, 'the opening of insolvency proceedings shall not affect...' can properly be interpreted as meaning 'the law of the opening State shall not affect..."*.[148] In addition, Recital 25 of the Regulation (68 in Recast) provides some assistance when interpreting the expression "shall not affect". It establishes that *"the basis, validity and extent of such a right in rem should therefore normally be determined according to the lex situs and not be affected by the opening of insolvency proceedings"*. Moreover, the Court of Justice of European Union in judgement of *German Graphics* case stated that Article 7 (1) *"constitutes a substantive rule intended to protect the seller with respect to assets which are situated outside the Member State of opening of insolvency proceedings"*.[149] As the wording („the opening of insolvency proceedings ([...]) shall not affect") of Articles 5 (1) and 7 (1) are identical this ruling is relevant in interpretation of Article 5 as well. Thus, Article 5 (1) should be interpreted as substantive rule aiming to secure the creditor who has right *in rem* in debtor's assets situated in another Member State than the one in which insolvency proceedings were opened.

Pursuant to Virgos-Schmit Report, rule of Article 5 *"does not "immunize" rights in rem against the debtor's insolvency"*. [150] When the legislation of the state in which assets are situated permits possibility of affecting rights *in rem* in particular manner, the opening of secondary proceedings by request of the liquidator (or other entitled person) cannot be precluded if the condition of presence of establishment in state of right *in rem* is met. M. Virgos and F. Garcimartin express identical opinion and propose that Article 5 can be called rule of immunity, but they note that it is only relative.[151] Moreover, Virgos-Schmit Report indicates that *"the secondary proceedings are conducted according to national law and allow the liquidator to affect these rights under the same conditions as in purely domestic proceedings"*.[152] As well, authors of Heidelberg-Luxembourg-Vienna Report approve that the effects on rights *in rem* under insolvency law of the Member State where rights *in rem* are located can only be caused by the opening of secondary proceedings in that state, but not by main insolvency proceedings.

[147] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 104.
[148] Smart, P. Rights in rem, article 5 and the EC insolvency regulation: and english perspective. *Int. Insolv. Rev.* [interactive]. 2006, Vol. 15: 17-55 [accessed 06/03/2015, 15:32]. <http://onlinelibrary.wiley.com/doi/10.1002/iir.135/pdf>.
[149] Case C-292/08 *German Graphics* [2009] ECR I-8421, para. 35.
[150] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 98. [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.
[151] Virgos, M., Garcimartin, F., *op. cit.*, p. 94.
[152] Virgos M., Schmit E., *op. cit.* Para. 100.

These authors also note that according to Virgos-Schmit Report, protection of rights *in rem* is not full due to the fact that "*liquidator can file for the opening of secondary proceedings if the debtor has an establishment in the Member State in which the assets are situated"*.[153] In addition, *"Art 5 (4) of the EIR makes it clear that the creditor's secured rights in rem do not enjoy unlimited protection"*.[154]

As note M. Virgos and F. Garcimartin, Article 5 establishes rule of immunity if debtor does not have establishment in the state where right *in rem* is situated. This immunity means that secured creditor's situation is *"as if the insolvency had not occurred"*[155]. Situation changes only when debtor has establishment and secondary insolvency proceedings can be opened.

In accordance with the opinion of M. Virgos and F. Garcimartin, Article 5 (1) *"when compared with the national laws concerned, it may afford a stronger level of protection against the insolvency of the debtor than that which these national laws demand; in this sense, the rule may overprotect secured creditor"*.[156] For instance, such a situation of over protection of secured creditor can be imagined in case when legislation of Member State where security right is located allows some effects on such rights, but when secondary proceedings cannot be opened. It should be presumed that creditor taking security right knows the location of asset in which right *in rem* is vested and, thus, law of the Member State of location. Such a situation implies that creditor is protected more than he would be if secondary proceedings were opened. In addition, this can cause different status of secured creditors in insolvency proceedings. This can be evident in cases when right *in rem* of one creditor is situated in the State of opening of main proceedings and right *in rem* of another creditor is in other State than the State of opening of proceedings where no debtor's establishment is. As M. Virgo and F. Garcimartin noted, by such overprotection of secured creditors, authors justify the attempts to limit the influence of the "shall not affect" rule in various ways. One of the ways is limiting the ambit of Article 5.[157]

Rights in rem can only properly fulfil their function insofar as they are not more affected by the opening of insolvency proceedings in other Contracting States than they would be by the opening of national insolvency proceedings in the state where these rights *in rem* are located.[158] In addition to that, *"Article 5 cannot be used to confer more powers on the holder of a*

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[153] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 258 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.
[154] Ingelmann, T. *European Insolvency Regulation – Commentary.* Berlin: De Gruyter, 2007, p. 252 (para. 26).
[155] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 105.
[156] *Ibid.*, p. 104,106.
[157] *Ibid.*
[158] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 100. [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.

right in rem than those which he would enjoy in a non- insolvency situation".[159] Therefore, the balance could be found in the provision that allows opening of secondary insolvency proceedings not only in the State where establishment is situated, but also in the State in which asset forming the base for right *in rem* is situated (this is the proposal of M. Bogdan and will be discussed later).

2.1.1.2. Scope Of Article 5

As it was noted some authors are trying to limit the scope of Article 5 by interpreting it in a narrow manner. Some say that only mere right *in rem* is protected or only the ones created after Regulation entered into force, some that protection is guaranteed only in liquidation proceedings.

There is an opinion of I. Bach that Article 5 of Insolvency Regulation *"only protects the existence of the right in rem itself, and not the existence of the secured claim".*[160] But the contrary opinion is prevailing. M. Virgos and F. Garcimartin opposes aforesaid narrow approach to protection of rights *in rem* by stating that such understanding is contradictory to the intention of Article 5 *"because it would render the security function of rights in rem worthless".*[161] M. Arnold[162] and J. Marshall[163] also argue that both, security right and secured debt are protected. Furthermore, M. Veder supports such understanding by disagreeing to the opinion that only security right is protected and reduction of claims is possible.[164] Thus, the view that Article 5 protects not only the right *in rem* is supported by the majority of proficients. As usually the obligation secured by right *in rem* is closely coherent with the asset in which right *in rem* is vested, it is hard to imagine the case when by infringing the protection established by Article 5 regarding the asset, right *in rem* would remain unaffected.

As well J. Marshall states that provision of Article 5 refers to rights *in rem* between creditor and debtor, but not between creditors reasoning by the fact that right *in rem* is obtained

[159] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 99.
[160] Bach, I. Fachanwaltskommentar Insolvenzrecht, Annex I, Artcile 5 EuInsVO, para. 36. (cited from: Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 282 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.)
[161] Virgos, M., Garcimartin, F., o*p. cit.*, p. 104.
[162] Wessels, B. 2015-04-doc3 Review: Sheldon (ed.), Cross-Border Insolvency [interactive]. 2015 [accessed: 18/04/2015, 21:17]. <http://bobwessels.nl/2015/04/2015-04-doc3-review-sheldon-ed-cross-border-insolvency>.
[163] Marshall, J. Article 5 (rights in rem), *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 12/04/2015, 19:29]. <http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf>.
[164] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.

over the assets of debtor.[165] This is evident from the wording of the provision and the fact that the Regulation is applicable to insolvency proceedings. The latter reason means that proprietary rights of debtor's creditor vested in assets of other creditor are not relevant in insolvency proceedings and, thus, they are not protected by the provision of Article 5.

Moreover, Article 43 of Insolvency Regulation establishes that *"Regulation shall apply only to insolvency proceedings opened after its entry into force. Acts done by a debtor before the entry into force of this Regulation shall continue to be governed by the law which was applicable to them at the time they were done"*. The latter sentence is subject to some debate. According to the view of J. Marshall, 'acts done' referred in provision should be understood as *"actions undertaken to place a debtor into insolvency proceedings and not other 'acts' more generally"*.[166] The decision opening insolvency proceedings is important, but not the moment of creation of right *in rem* for the Regulation to be applicable regarding Article 43. Thus, protection ensured by Article 5 is guaranteed to rights *in rem* even created prior the Regulation entry into force.

Regarding the applicability in time of European Insolvency Regulation and considering rights *in rem ERSTE Bank* case should be mentioned. The considered situation was that company, registered in Austria, a letter of credit assigned in 1998, issued by Hungarian creditor, to several banks and when creditor refused to pay this Austrian company gave shares, held in Hungarian creditor, as a guarantee (a security deposit). Insolvency proceedings against Austrian company were opened in 2003. Shares that formed security deposit were purchased under the court order in 2005. In 2006 ERSTE Bank, having registered office in Hungary, was the legal successor of Hungarian creditor and brought an action before court, which issued aforesaid order *"against the defendants in the main proceedings seeking a declaratory judgment to the effect that it had a right over the security deposit paid into court"*. Also, ERSTE Bank requested the opening of secondary insolvency proceedings in Hungary. Hungarian court of appeal ruled that Austrian insolvency law was the law applicable and it was decisive if *„ERSTE Bank may obtain a declaratory judgement that it has right over the security deposit paid into court"*, thus, the claim was refused. ERSTE Bank then appealed arguing that Insolvency *„Regulation was not applicable in this case because the judgement opening insolvency proceedings against BCL Trading (Austrian company* – researcher's remark*) had been handed down before the Republic of Hungary's accession to the European Union, which therefore made it impossible, pursuant to the Regulation, to regard that company as being in liquidation in Hungary*". The Court of cassation addressed the Court of Justice for a preliminary ruling with the question whether Article 5 (1) of

[165] Marshall, J. Article 5 (rights in rem), *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 12/04/2015, 19:29]. <http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf>.
[166] *Ibid.*

Insolvency Regulation is applicable in situation when at the moment the insolvency proceedings were opened in a Member State (Austria) assets in which concerned right *in rem* was vested were located in another State (Hungary) – not yet a Member State at that time. Court of Justice ruled that *„in order to maintain the cohesion of the system established by the Regulation and the effectiveness of insolvency proceedings, Article 5(1) thereof must be interpreted as meaning that that provision is applicable even to insolvency proceedings opened before the accession of the Republic of Hungary to the European Union in a case, such as that in the main proceedings, when, on 1 May 2004, the debtor's assets on which the right in rem concerned was based were situated in that State, which is for the referring court to ascertain"*. Court justified such a decision by the fact that *„the provisions of the Regulation are applicable in Hungary from the date of accession of that State to the European Union, that is 1 May 2004, and therefore, from that date, the Hungarian courts were required to recognise the decision to open insolvency proceedings handed down by the Austrian courts"*.[167]

Regarding the scope of Article 5 two more uncertainties arise. It is not clear what effect has expression "opening of insolvency proceedings" to scope of the provision and whether protection of rights *in rem* is possible in reorganization proceedings. These issues are discussed further.

2.1.1.2.1. "Opening Of Insolvency Proceedings"

In legal doctrine exists the view that rights *in rem* are only protected from the influence arising due to the mere decision opening of insolvency proceedings. According to this view judicial orders and plans of insolvency are excluded from subjects able to affecting security rights. *"Logically, the secured creditor should redeem his secured rights (or have them redeemed) before the court has a chance to make an order that could lower the value of his security"*.[168] Virgos-Schmit Report by stating that *"the liquidator, even if he is in possession of the asset, cannot take any decision on that asset which might affect the right in rem created on it, without the consent of its holder"* intended to tell that rights *in rem* are protected not only against 'opening of insolvency proceedings' but from other decisions as P. Smart also notes.[169] *"So*

[167] Case C-527/10 *ERSTE Bank*, Judgement: 5 July 2012, published in the elctronic Reports of cases.
[168] Ingelmann, T. *European Insolvency Regulation – Commentary.* Berlin: De Gruyter, 2007, p. 252 (para. 28).
[169] Smart, P. Rights in rem, article 5 and the EC insolvency regulation: and english perspective. *Int. Insolv. Rev.* [interactive]. 2006, Vol. 15: 17-55 [accessed 06/03/2015, 15:32]. <http://onlinelibrary.wiley.com/doi/10.1002/iir.135/pdf>.

reduction or compromise of debt only is possible with the consent of the holder of the right in rem".[170]

According to Heidelberg-Luxembourg-Vienna Report, large number of authors *"state that Article 5 (1) EIR does not protect secured creditors against a reduction or even the discharge of the secured claim during insolvency proceedings, e.g. by payment of the secured claim, by means of avoidance or by court decision"*. These authors *"argue that Article 5 EIR solely protects rights in rem against restrictions resulting from the 'opening of insolvency proceedings'. Article 5 EIR does not expressly exclude a restriction of the accessory right in rem during insolvency proceedings.* [171] Such understanding can be attributed to articles using wording "the effects of the insolvency proceedings" (articles 8, 9, 10, 11, and 15).[172] *Furthermore, the Regulation distinguishes the recognition of the 'judgement opening insolvency proceedings' (Article 16, 17 EIR) from the recognition of 'judgements [...] which concern the course and closure of insolvency proceedings' (Article 25 EIR). A reorganisation plan is not recognised pursuant to Article 16 EIR, but rather falls into the scope of Article 25 EIR. It therefore does not result from the 'opening of insolvency proceedings', expression used by Article 5 (1) EIR as well as by Article 16 and 17 EIR".*[173]

However, the essence of the rule provided by the Article 5 presupposes that security rights locating in other Member State than the state of the opening of proceedings are relieved from any influence of main proceedings. M. Veder while supporting such approach states that Article 5 *"must be understood to protect secured creditors from the effects of the main proceeding as such, whether (by operation of law) attached to the opening of the proceeding itself or resulting from a subsequent court decision".*[174] Furthermore, analysing wording of Article 5 (1) protection against "the opening of insolvency proceedings" stated can be seen. There is no hint about the mere decision of opening of insolvency proceedings in this provision. That is confirmed not only by Insolvency Regulation in English ("the opening of insolvency proceedings"), but French (*"l'ouverture de la procédure d'insolvabilité*) and Lithuanian ("bankroto bylos iškėlimas") also. Further, as the Court of Justice of the European Union ruled in *Lutz* case, Article 5 (1) aims to ensure the rights of secured creditors even after the opening of insolvency proceedings. Moreover, *"the special feature of Article 5 of Regulation No 1346/2000*

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[170] Wessels, B. 2015-04-doc3 Review: Sheldon (ed.), Cross-Border Insolvency [interactive]. 2015 [accessed: 18/04/2015, 21:17]. <http://bobwessels.nl/2015/04/2015-04-doc3-review-sheldon-ed-cross-border-insolvency>.

[171] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 281-282 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

[172] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 107.

[173] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C., *op. cit.*, p. 282.

[174] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.

is thus that it seeks to protect not only acts completed before the opening of the insolvability proceedings but also, and above all, acts taking place after the opening of those proceedings".[175]

The approach that Article 5 secures rights *in rem* from decision to open insolvency proceedings and other decisions in proceedings, as well, should be assumed as established by the Insolvency Regulation. According to report on Insolvency Regulation by Lithuanian scholars, independence from opening of insolvency proceedings, established in provision on third parties' rights *in rem*, should not be understood as providing independence from all insolvency rules, but only insolvency rules of the State of opening of proceedings.[176]

2.1.1.2.2. Reorganisation Proceedings

There is some debate on the question whether the rights *in rem* are secured in both types of mechanisms dealing with insolvency cases – liquidation and restructuring.

Some scholars support the view that rights *in rem* are protected against the effects of one type of insolvency proceedings, in particular, liquidation only. M. Virgos and F. Garcimartin provide possible argument to justify the opinion of the ones supporting the view that the rule of Article 5 excludes reorganisation from its scope. This justification is that the removal of assets in interest of secured creditors can be detrimental to all other creditors and to continuation of business - the aim of restructuring. But this can happen only when assets are of such significance as indispensible to continue business. To this M. Virgos and F. Garcimartin respond stating that *"it is unlikely that this will be the case of those assets to which Article 5 applies: assets not integrated either in the debtor's main centre or in the debtor's establishments (because in the latter case local insolvency proceedings may be opened)".* Therefore they oppose narrow view – that Article 5 is applicable only to liquidation proceedings.[177]

More authors agree with the applicability of Article 5 to all insolvency proceedings (apparently, referring to those falling under the scope of the Insolvency Regulation). They also state that rights *in rem* meeting requirements of Article 5 shall not be affected by restructuring plans. But they find another argument to justify their position. Their opinion is that *"secured creditor's responsibility to participate in reorganisation proceedings is already an "affection"*

[175] Case C-557/13, *Lutz,* Application: OJ C 15 from 18.01.2014, p. 9, Judgement: 16.04.2015, para. 39, 40.
[176] Kavalnė, S. Norkus, R. Mokslinio tyrimo Pasiūlymo dėl Europos Parlament ir Tarybos reglamento, pakeičiančio 2000 m. Gegužės 29 d. Tarybos reglamentą (EB) Nr. 1346/2000 dėl bankroto bylų nuostatų galima įtaka bankroto prcesams Lietuvoje ir galimas pveikis Lietuvos ekonominiams interesams bankroto srityje Galutinė ataskaita [interactive]. Vilnius: Mykolo Romerio universitetas, 2013, p. 79 [accessed: 17/04/2015, 10:43]. <http://www.ukmin.lt/uploads/documents/reglamentas%20MRU%20galutine%20ataskaita_1.pdf>.
[177] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 106.

of the creditor's right in rem".[178] Further, referring to the view of M. Veder, any measures applied in main proceedings affecting rights *in rem "cannot affect security rights in assets situated in other Member States"*. This includes means influencing security rights indirectly.[179] Authors of Heidelberg-Luxembourg-Vienna Report favour protection applicable to liquidation and reorganization proceedings reasoning by the fact that this approach is in conformity with policy of Article 5 – protection of creditors' rights *in rem*, ease of proceedings - and understanding of Article 5 as substantive restriction rule.[180]

As the Insolvency Regulation is applicable to the proceedings listed in Annexes A and B, it presupposes that protection provided for rights *in rem* is guaranteed in those proceedings. It seems reasonable that rule naming some particular situations for which it is designed is applicable to them all, not excluding some part of the situations. In the case of Article 5 this means that it is applicable to insolvency proceedings if it meets all the conditions in order to fall in the ambit of the Regulation. Moreover, reference that protection of rights *in rem* can only exist in the course of liquidation proceedings may be seen neither in the body, nor recitals of the Regulation.

2.1.2 Operation Of Security Rights After The Decision Opening Insolvency Proceedings

As it was ascertained Article 5 of European Insolvency Regulation protects rights *in rem* not only from mere decision, which opens insolvency proceedings, but subsequent decisions also. In such approach understanding how security rights operate in insolvency proceedings after the opening of them is important.

2.1.2.1. Relations between Article 5 and Other Provisions of Insolvency Regulation

One of the important provisions regarding rights *in rem* is in Article 5 (4). It provides exception to rule establishing protection of rights *in rem* (Article 5 (1)). It states that *"Paragraph 1 shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4 (2) (m)"*. According to T. Ingelmann, it is an *"appropriate abuse-control"*.[181] Article 4 (2) (m) establishes that *"the rules relating to the voidness, voidability or unenforceability or legal acts detrimental to all creditors"* are determined by the law of the State of the opening of

[178] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 282-283 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.
[179] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.
[180] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C., *op. cit.* p. 283.
[181] Ingelmann, T. *European Insolvency Regulation – Commentary.* Berlin: De Gruyter, 2007, p. 252 (para. 26).

proceedings. Furthermore, as INSOL Europe noted, even though Article 5 (4) establishes exception in Article 5 (1) to general rule of applicable law in Article 4 (1), it does not intend to prevent actions of Article 4 (2) (m). *"This means that the act by which the right in rem is created might be subject to a challenge in the form of an action which would be governed by the law of the State of the opening of the proceedings"*.[182] As well, CJEU in *Lutz* case stated that protection for secured creditors ensured by Article 5 (1) *"may however be overridden, pursuant to Article 5(4) [...]in the situations and in accordance with the procedures laid down by the* lex fori concursus*"*. This means that the Court explained Article 5 (4) as exclusion from the Article 5 (1) in situation of an *„action for voidness, voidability or enforceability as referred to in Article 4 (2) (m)"* of European Insolvency Regulation. In addition, the Court ruling clarified that word „action" not necessarily mean court actions, but all rules as referred in Article 4 (2) (m). *„Consequently, in order to determine whether the voidness, voidability or unenforceability of an act may result from legal action, from another legal measure or even from the effect of law, reference should be made to the competent lex fori concursus for determining, in accordance with Article 4(2)(m) of Regulation No 1346/2000, the rules relating to voidness, voidability or unenforceability."*[183]

Therefore, rule, provided by Article 5 (4) could be regarded as exception from the exception. Questions pursuant to the expression "all the creditors" may arise. But R.M. Goode answers it stating that it *"should not be taken literally, for there are always likely to be creditors unaffected by the acts in question, including secured creditors"*. And he indicates reference of this expression *"to acts detrimental to the creditors collectively, that is, the general body of creditors"*.[184]

Moreover, according to Heidelberg-Luxembourg-Vienna Report, scope of application of Article 5 of EIR *"has to be distinguished from Article 4 (1) EIR and, in particular, from Article 4 (2) (i) EIR"*. Referring to the Recital 25 and to the nature – granting privilege in distribution process – of collateral, in most cases the law applicable to rights *in rem*, must govern the distribution of the proceeds.[185]

Article 18 (1) of Insolvency Regulation establishes that in main proceedings appointed liquidator can exercise all the powers, he is entitled to under the law of the state of opening of

[182] INSOL Europe *Revision Of The European Insolvency Regulation* [interactive]. 2012 [accessed 22/04/2015, 16:45]. <http://www.nautadutilh.com/Documents/Publications%20to%20profiles/Revision_of_the_European_Insolvency_Regulation.pdf>.
[183] Case C-557/13, *Lutz*, Application: OJ C 15 from 18.01.2014, p. 9, Judgement: 16.04.2015, para. 26, 29, 30.
[184] Goode, R.M. *Principles Of Corporate Insolvency Law*.London: Thomson/ Sweet & Maxwell, 2005, p. 600.
[185] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceeding*. JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 259 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

proceedings (and of law, by which he was appointed), in another Member State, if no other insolvency proceedings are opened or there are no preservation measures taken in order to avoid them after the request to open insolvency proceedings. Further, provision establishes right of liquidator to remove assets from the State in which they are situated, except rights *in rem* (Article 5, and reservation of title, too) have to be respected *"since the proceedings cannot affect rights in rem of creditors or third parties over assets, situated at the time of the opening in a Member State other than the State of the opening of proceedings. The creditors can prevent such a transfer by requesting the opening of secondary proceedings concerning those assets, provided that the conditions laid down in Article 3(2) or Article 3(3) are fulfilled".*[186] This means that rights *in rem* have to be regarded and assets under them cannot be transferred from the State where they are situated.

According to B. Wessels, *"the aim of Article 20 is to guarantee the equal treatment of all the creditors of a single debtor"*. According to this author, universalist approach of main insolvency proceedings leads to the first part of provision where is established that *"a creditor who, after the opening of the proceedings referred to in Article 3(1) obtains by any means, in particular through enforcement, total or partial satisfaction of his claim on the assets belonging to the debtor situated within the territory of another Member State, shall return what he has obtained to the liquidator"*. If that is not done it means the breach of one of fundamental insolvency principles. *"The liquidator may demand either the return of the assets received or the equivalent in money"*. However, provision states that such a rule is *"subject to Article 5 and 7"*. This means that rights *in rem* situated in another Member State than the State where main insolvency proceedings are opened are excluded from the scope of main insolvency proceedings. *"As long as these articles apply, a creditor who obtains satisfaction of claims guaranteed by rights in rem by realization of the security does not enrich himself to the detriment of the estate and does not breach the principle of collective satisfaction".*[187]

Notably, relation between Article 5 and *pari passu* principle is important. It is deemed to be one of the fundamental principles in insolvency law. However, there is some debate on the significance of this principle and due to the fact that Article 5 is exception to the aforesaid provision of equal treatment of creditors also. Further, according to R.M. Goode, *pari passu* principle does not apply to the rights of secured creditors. As he states, this is not because Article 5 is an exception to the rule but because such assets do not belong to the company and thus do

[186] Wessels, B. *European Union Regulation On Insolvency Proceedings. An Introductory Analysis (October 2006)* [interactive] [accessed:19/04/2015, 12:28]. <http://www.insol.org/INSOLfaculty/pdfs/BasicReading/Session%205/European%20Union%20Regulation%20on%20Insolvency%20Proceedings%20An%20Introductory%20analysis,%20Bob%20Wessels.pdf>.
[187] *Ibid.*

not fall to be distributed among creditors on any basis.[188] But Virgos-Schmit Report notes that Insolvency Regulation *"does not make it obligatory for these assets to be included in or excluded from the estate in the main proceedings".* There is only a responsibility to regard rights *in rem* vested in assets located in other State than the State of opening of proceedings established.[189] R.J. Mokal, assenting to the opinion of R.M. Goode, suggests abandoning such principle as unhelpful and paradoxical.[190] However, despite the fact that there is certain ranking of creditors in every Member State, absolute denial of *pari passu* principle should be reconsidered. It is still useful, but this principle should be interpreted in a way that all the creditors falling in the same category should be treated equally and none within that category can get priority to the payment.

2.1.2.2. Pay-Off

Another effect of Article 5 of Insolvency Regulation is guiding to *"the possible advantage of the secured creditor (never to his disadvantage!)"* when distributing what has been got of realization of assets under which rights *in rem* were granted. Moreover, placing secured creditor in the rank for getting distribution is not consistent with the aim of Article 5, as *"the ranking of claims under the lex concursus cannot influence the distribution of realisation proceeds of encumbered assets that are situated in other Member States"*.[191]

Article 5 ensures right to the secured creditor to get direct recourse from the asset in which right *in rem* was vested. Referring to M. Virgos and F. Garcimartin, *"Although only the right in rem, and not the collateral as such, is excluded by Article 5 from the effects of the opening, the exercise thereof will mean, in the majority of cases, that the separate enforcement of the asset and/or payment to the secured creditor will exhaust its economic value".*[192]

As rights *in rem* cannot be affected by the opening of main insolvency proceedings, point requiring some analysis arise. It is „*whether Article 5 would prevent a liquidator in the main proceedings from "paying off" the bank, thereby gaining control of the secured asset".*[193]

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[188] Goode, R.M. *Principles Of Corporate Insolvency Law*.London: Thomson/ Sweet & Maxwell, 2005, p. 189. In the case of assets subject to a security interest, the assets do not belong to the company to the extent of the security interest but the company does, of course, have an equity of redemption.

[189] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 95. [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.

[190] Mokal, R.J. Priority As Pathology: The Pari Passu Myth. *The Cambridge Law Journal* [interactive]. 2001, Vol. 60, Issue 3: 581-621 [accessed: 22/03/2015, 12:40]. <http://journals.cambridge.org/abstract_S0008197301001246>.

[191] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.

[192] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 97.

[193] Marshall, J. Article 5 (rights in rem), *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 12/04/2015, 19:29]. <http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf>.

„The liquidator, even if he is in possession of the asset, cannot take any decision on that asset which might affect the rights in rem *created on it, without the consent of its holder"* as Virgos-Schmit Report indicated. Pursuant to this Report[194] and Recital 25 of Insolvency Regulation, secured creditor when getting payment from sale of the asset has to pay to liquidator everything what is over the amount of his security right. However, there is a contrary opinion that the rule is too beneficial for the banks and *„it is difficult to understand why pledged assets in another Member State should not be subject to the same rules as pledged assets in the Member State where the proceedings have been opened."*[195]

Virgos-Schmit Report (paragraph 99) states that in order to *„avoid the loss in value that certain assets could suffer when they are realized separately"* liquidator is entitled to make immediate payment to secured creditor. But in contrary situation this can cause issues. As J. Marshall indicated, *„for example, if the secured debt is 100 but the secured asset (at the current time) is only worth 50, the secured creditor would be deprived of its chance to wait and see if the value of the secured asset might increase in the future if the liquidator in the main proceedings were able to discharge the security by paying the secured creditor 50".*[196]

In accordance with aforesaid, it appears that pay-off to secured creditor can be. However, it should be in interest of such creditor and if it reduces the value of receivable, the consent of the holder of right *in rem* should be needed.

2.2. Future of protection of security rights in cases of insolvency within the EU

Considering the development of protection of security rights few factors are relevant. Proposals for potential changes of Article 5 are important and other initiatives possibly improving protection of security rights are discussed in doctrine.

2.2.1. Suggestions for the rule of rights *in rem* in Article 5 of European Insolvency Regulation

Rule established in Article 5 of European Insolvency Regulation is highly criticized. Although Insolvency Regulation (Recast) is not intended to make any substantial changes to Article 5 or to aforesaid related provisions, there is a great discussion on the changes provision of third parties' rights *in rem* requires.

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[194] Virgos M., Schmit E. Report on the Convention on Insolvency Proceedings [interactive]. DRS 8 (CFC), Brussels, 1996, para. 95, 99. [accessed 2015-03-19, 12:40]. <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf>.

[195] Directorate-General for internal policies, policy department, Citizens' rights and constitutional affairs Note „The Revision of the EU Insolvency Regulation" [interactive]. 2011 [accessed: 29/04/2015, 13:51]. <http://www.europarl.europa.eu/RegData/etudes/note/join/2011/432770/IPOL-JURI_NT%282011%29432770_EN.pdf>.

[196] Marshall, J. Article 5 (rights in rem), *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 12/04/2015, 19:29]. <http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf>.

The majority of legal scholars agree on the view that "hard and fast rule" established in Article 5 of current Insolvency Regulation (and it should be noted remaining the same in Insolvency Regulation (Recast)) entail overprotection of secured creditors.[197] *"The overprotection offered by the current text of Article 5 can only be understood if one realizes that the main aim of this text is to facilitate the administration of the insolvency proceedings"*[198] and that aim was incentive for implementation of simple formula discussed earlier. *„The conflict of law rules reflect the policy choices of a large majority of Member States at a certain moment in time. Such policies may have changed in recent years, e.g. the choice for Article 5 as a 'hard and fast rule"*[199] and should be reconsidered. Therefore, suggestions to this rule will be analysed.

Heidelberg-Luxembourg-Vienna Report indicates that European Union can act in three ways regarding the text of Article 5 (1) of Insolvency Regulation:

1) Leave substantive restriction rule as it is now. In this case opening of insolvency proceedings in one state would have no effect on rights *in rem* situated in another Member State.
2) Change it into the choice of law rule (as it is in articles 8 and 10, for example).
3) Change it to opposition rule (like in Article 13). It enables *"secured creditor to oppose more favourable substantive rules of the* lex rei sitae*"*.[200]

Authors of this Report propose the choice of opposition rule as the best by indicating that it has two implications. Firstly, assets in all Member States can be affected by *"restrictions of foreclosure by creditors and third parties and to the powers granted to the insolvency organs (liquidator, courts, debtor in possession etc) under the insolvency law of the State of the opening of proceedings"*. Secondly, secured creditors and third parties can seek that the law of the situation of rights *in rem* would be applied. Argument of different treatment of rights *in rem* by national legislation is significant – consequences of opening of insolvency proceedings in one Member State are not present in the Member State within territory of which right *in rem* is

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[197] B. Wessels in Twenty Suggestions For a Makeover Of the EU Insolvency Regulation [interactive]. 2006, 2006-09-doc4 [accessed: 22/03/2015, 18:40]. <www.bobwessels.nl>.
M. Veder in Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.
P. Smart in Rights in rem, article 5 and the EC insolvency regulation: and english perspective. *Int. Insolv. Rev.* [interactive]. 2006, Vol. 15: 17-55 [accessed 06/03/2015, 15:32].
<http://onlinelibrary.wiley.com/doi/10.1002/iir.135/pdf>.

[198] INSOL Europe *Revision Of The European Insolvency Regulation* [interactive]. 2012 [accessed 22/04/2015, 16:45].
<http://www.nautadutilh.com/Documents/Publications%20to%20profiles/Revision_of_the_European_Insolvency_Regulation.pdf>.

[199] Wessels, B., *op. cit.*

[200] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 24, 270-271 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

situated. Further, Report notes that this solution is in conformity with Article 4 (1) and Article 17 of Insolvency Regulation, protects rights of creditors as it is needful and avoids issues arising in adaptation.[201]

INSOL Europe has different opinion. *"The discrepancy of the treatment of security rights depending on whether insolvency proceedings have actually been opened in the Member State where the assets are located has been the cause of much debate"* admits INSOL Europe. Furthermore, it states that such a distinction can be reasoned historically. INSOL Europe proposes amend text of Article 5 to make it similar to wording of Article 8 and 10. Their proposed amended provision is the following:

> *"The effects of insolvency proceedings on the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets – both specific assets and collections of unidentified or mixed assets as a whole which change from time to time – belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings shall be governed solely by the law of the Member State within which the assets are situated."*[202]

Thus, INSOL Europe proposed to change the rule of Article 5 to choice of law rule.

In addition, some scholars also indicate the latter solution as most appropriate to situation of security rights. For instance, M. Virgos and F. Garcimartin are of the opinion that more sufficient choice would have been to establish rule similar to the one in Article 8 of Insolvency Regulation – rule stating that *"the effects of insolvency proceedings will be determined by the law of the State where the asset is located"*. They state that current form of rule was chosen because it precludes issues arising due to *"interplay of institutions and effects of one Member State with the lex concursus of another, which would arise from the rule of subjecting the effects of the insolvency proceedings to the provisions of the law which governs the right in rem itself (normally, the lex rei sitae)"*.[203]

M. Veder noted that from the drafting the Insolvency Convention existing complete isolation of rights *in rem* need to be reassessed to evaluate the necessity of it. He agrees to mentioned authors' point. Firstly, he states that rule established in Article 5 requires rethinking as it *"entails that secured creditors in a cross-border context acquire a position that they have*

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[201] Hess, B., Oberhammer, P., Pfeiffer, T., Piekenbrock, A., Seagon, C. *External Evaluation Of Regulation No. 1346/2000/EC On Insolvency Proceedings.* JUST/2011/JCIV/0049/A4 [interactive]. 2011, p. 270-279 [accessed: 22/03/2015, 08:08]. <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>.

[202] INSOL Europe *Revision Of The European Insolvency Regulation* [interactive]. 2012 [accessed 22/04/2015, 16:45]. <http://www.nautadutilh.com/Documents/Publications%20to%20profiles/Revision_of_the_European_Insolvency_Regulation.pdf>.

[203] Virgos, M., Garcimartin, F. *The European Insolvency Regulation: Law and Practice.* Netherlands: Kluwer Law International, 2004, p. 105-106.

under no existing insolvency law". M. Veder states that *"article 5 leads to unjustifiable bonus for secured creditors in cross-border insolvencies"* and *"gives secured creditors a hold out position that can only be avoided by opening secondary proceedings, if possible".* But this causes disadvantages of parallel proceedings, for instance increased costs. Therefore, application of the law of the Member State where is the location of assets seems better option.[204]

In addition, N.W.A. Tollenar agrees on the view regarding such an amendment. Despite the mentioned reasons demonstrating the need of amendments, he indicates the threat for possible rescue of business. As he noted, insolvency laws usually have rules affecting security rights to facilitate the rescue. For example, there are measures like: stay, which precludes creditor from enforcing his security right, compositions or rules that entitles liquidator to sell assets notwithstanding encumbrances. Article 5 allows no effect on security rights, *"even if the insolvency proceedings in the State where the assets are situated would affect the security rights". "Main proceedings, for example, cannot prevent lenders from enforcing security rights over the assets of an establishment"*. In such a case only secondary proceedings may have some help. However, these proceedings are not available in case when assets are situated neither in the State of debtor's COMI location nor where establishment is situated. *"The rule that foreign security rights are entirely immune to insolvency proceedings requires reconsideration. It can frustrate restructuring processes and provide out of the money creditors with hold-out value. It also does not seem justified: it puts the holders of foreign security interests in a better position than holders of local security interests and it also puts them in a better position than they would have been if insolvency proceedings could have been opened in the State where the foreign assets are located. Clause 5 EIR should be changed to provide that the effects of insolvency proceedings on foreign security rights are determined by the insolvency law of the State where the assets are located (lex rei sitae), which would probably best match the law applicable to the (enforcement of) the relevant security right"*.[205]

Similar opinion is expressed by S. Kolmann, who contradicts to favour granted for secured creditors reasoned by mere location of assets in State other than the State of opening of insolvency proceedings. He indicates that *"the effects of the insolvency proceeding, the manner and the conditions under which the right in rem is involved in the insolvency should be determined"* by the rule of *lex rei sitae.* In addition, this author opposes the idea of particular insolvency proceedings opened in the Member State within territory of which assets are located as unnecessary. However, author indicates that such solution would cause some issues in

[204] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.
[205] Tollenaar, N.W.A. Proposals for reform: improving the ability under the European Insolvency Regulation to rescue multinational enterprises. *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 06/05/2015, 19:43]. <http://www.eir-reform.eu/uploads/papers/Paper%203.3.pdf>.

adjustment also. *"In particular, the insolvency administrator/liquidator must enquire about the relevant powers according to the foreign law. In practice, local advisors are consulted"*.[206]

There is a suggestion not to deny the idea of secondary proceedings, but give new approach to it. M. Bogdan proposed *"that there should be jurisdiction to open territorially limited proceedings in any contracting state where there are substantial assets, even if the debtor has no establishment there"*. This author argues the need of precondition for establishment to exist in Member State where opening of proceedings is intended. *"On the other hand, if there is no establishment, but there are substantial assets, these assets can be moved abroad and distributed without any regard to legitimate interests of local creditors, who have no possibility of preventing it by applying for a secondary bankruptcy. Some restrictive form of assets jurisdiction would, therefore, be preferable"*.[207]

Provision of Article 5 remains unchanged in the European Insolvency Regulation (Recast). As legislator tend to leave substantive restriction rule as it is currently, the best option to overcome arising cases of absolute immunity seems introducing the possibility of initiating secondary proceedings not only in the State where establishment of the debtor is, but where substantial asset is located also. This would allow avoiding cases when right *in rem* is not affected by main insolvency proceedings and secondary insolvency proceedings cannot be opened in the State of right *in rem* because no establishment of debtor is there. In addition, such a solution would require less explanations and assistance in interpretation than the completely changed rule of the exception of applicable law of rights *in rem*. In order to avoid additional costs caused by secondary insolvency proceedings, option of the rule establishing that in main insolvency proceedings rights *in rem* should be treated as if secondary insolvency proceedings were opened can be chosen. However, this solution would require the court of the main insolvency proceedings apply the law of another Member State. Both options have drawback but would be helpful avoiding absolute immunity of rights *in rem* and, thus, different status of creditors.

2.2.2. Initiatives Related To Protection Of Security Rights Within The EU

While reviewing authors analysing security rights proposals regarding not only amendments of Article 5 of European Insolvency Regulation can be seen. These namely are

[206] Kolmann, S. Thoughts on the governing insolvency. *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 06/05/2015, 21:25]. <http://www.eir-reform.eu/uploads/PDF/AMMEND_Kolmann.pdf>.

[207] Bogdan, M. The EU Bankruptcy Convention. *International Insolvency Review*[interactive]. 1997, Vol. 6: 114-126 [accessed: 25/04/2015, 19:26]. < http://onlinelibrary.wiley.com/journal/10.1002/%28ISSN%291099-1107>.

proposal for facilitation of interpretation of provision on third parties' rights *in rem* and proposal to create unified hypothec for the European Union.

2.2.2.1. Assistance for Interpretation

As it was ascertained, the wording of rule established in Article 5 is not fully clear and it causes difficulties in application. Due to that, various methods of interpreting it becomes relevant.

Question whether the amendment of Article 5 of Insolvency Regulation or it is the concern of proper interpretation of this provision was raised. Further, it is proposed to interpret this provision as establishing the protection of legitimate expectations of the creditor secured by right *in rem* and due to that right *in rem* has to be evaluated under the law of the State where such a right is situated and cannot be evaluated under the law of other State only because proceedings are opened there. Thus, the amendments of Article 5 are not necessary, unless there is aspiration to concur all possible obscurities, and then this is an option.[208]

As B. Wessels noted, *„With the entry into force of the Lisbon Treaty, the slow process of having references to the Court of Justice of the EU (only allowed by the court of the highest instance of a Member State) has been abolished. The method of interpreting the Regulation is still under development. Traditional sources for interpretation, such as the historical genesis of the Regulation, are very hard to find and court cases (until now at least some 500) are not published in a central source, which is easily accessible. Therefore, in daytoday practice, there is no opportunity to develop a shared approach to certain topics. For this reason nearly all possible explanations are possible (and defended) with regard to the meaning of Article 5(1) (providing that the lex concursus of the main proceedings shall not affect a party's right in rem on an asset located in another Member State)".*[209]

The need of some explanatory guidelines regarding European Insolvency Regulation is expressed by M. Veder. As there is only preamble of assistance in interpretation and Virgos-Schmit Report (fortunately the text of Insolvency Regulation is almost identical to Insolvency Convention), he proposes the idea that *„European regulations and directives should be*

[208] Kavalnė, S. Norkus, R. Mokslinio tyrimo Pasiūlymo dėl Europos Parlament ir Tarybos reglamento, pakeičiančio 2000 m. Gegužės 29 d. Tarybos reglamentą (EB) Nr. 1346/2000 dėl bankroto bylų nuostatų galima įtaka bankroto prcesams Lietuvoje ir galimas pveikis Lietuvos ekonominiams interesams bankroto srityje Galutinė ataskaita [interactive]. Vilnius: Mykolo Romerio universitetas, 2013, p. 79 [accessed: 17/04/2015, 10:43]. <http://www.ukmin.lt/uploads/documents/reglamentas%20MRU%20galutine%20ataskaita_1.pdf>.

[209] Wessels, B. Revision of the EU Insolvency Regulation: What type of facelift? *The Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed: 07/05/2015, 11:15]. <http://www.eir-reform.eu/uploads/papers/PAPER%205-1.pdf>.

accompanied by explanatory reports, similar to the reports in respect of, for example, the Brussels Convention".[210]

Problems when interpreting European Insolvency Regulation mainly arise due to diverse national legislation and legal traditions. Moreover, mere text of the Regulation can be an incentive of uncertainties as it is published in 28 languages of European Union. Due to that, in some cases interpretation can become dependent on the translation. Therefore, assistance for interpretation of Insolvency Regulation provided by European Union is welcome. However, the preamble of the Insolvency Regulation and already existing case-law of the CJEU is a base when interpreting rule of rights *in rem* while no additional assistance is provided.

2.2.2.2. Unification Of Security Rights

Almost since the beginning of third millennium, idea to create unified instrument as proprietary security right was discussed. Such proposal was raised due to widely differing established security rights in national legislations and aimed to ease the application and interpretation of security rights and their effects in cross-border cases. It was based on previous similar initiatives. *„In 1966, the "Segré Report" on "The Development of a European Capital Market" held: An approximation or harmonisation of the laws on security rights within the individual Member States should be considered a priority".*[211] In addition, *„In 1987, a commission of the International Union of Latin Notaries (UINL) proposed that along with the existing security rights over real property in the individual Member States (such as mortgages, land charges etc), a pan-European mortgage should be introduced in all Member States and made available to lending institutions*".[212]

The proposal is not to replace distinctions in national laws by uniform instrument. But rather it is suggested to introduce Eurohypothec (or Euromortgage) as „*an additional security instrument existing alongside national instruments"*. The essence of Eurohypothec *„may be used to secure a claim to repayment of a debt, but can nevertheless exist independently of any secured claim"*. Eurohypothec is of non-accessory nature and it *„creates a gap between the collateral security and the claim secured by it"*[213] which is filled by security agreement.

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[210] Veder, M. Applicable Law, In Particular Security Rights. *Future Of The European Insolvency Regulation* [interactive]. 2011 [accessed 19/04/2015, 11:50]. <www.eir-reform.euuploadspapersPAPER/204-3.pdf>.

[211] Basic Guidelines for a Eurohypothec. Outcome of the Eurohypothec Workshop. November 2004/April 2005 (Ed. A. Drewicz-Tulodziecka) [interactive]. 2005, Warsaw [accessed: 10/05/2015, 11:03]. <https://www.pfandbrief.de/cms/_internet.nsf/0/6B4B095D2EE0FA70C1257B98004F1FEF/$FILE/Eurohypothek%20-%20Basic%20Guidelines.pdf>.

[212] *Ibid.* p. 6.

[213] Watt, G. The Eurohypthec and the English Mortgage. *Maasticht Journal of European and Comparative Law.* [interactive]. 13 MJ 2, 2006 [accessed: 17/03/2015, 16:55]. <http://www.maastrichtjournal.eu>.

According to Guidelines for Eurohypothec, in case of insolvency Eurohypothec provides the holder of it a right to get full repayment. *„The order of ranking must not be changed in enforcement proceedings to the detriment of the Eurohypothec, with the exception of the expenses of the insolvency administrator related to the property which may be accorded a higher rank."* Moreover, there is no need for additional time and the asset can be realized separately from other assets, thus, assets of Eurohypothec are treated separately from insolvency estate. Any measures can be taken against Eurohypothec in order to stop enforcement or interrupt it. Enforcement can be initiated by the holder in two ways: first, enforcement proceedings separately from insolvency proceedings or, second, sale exercised by insolvency administrator.[214] Furthermore, the idea of Eurotrust was introduced as it *„is a needed complement to the Eurohypothec in order to facilitate all types of fiduciary mortgage operations"*.[215]

According to what was said, initiative of Eurohypothec seems idea worth considering. Regarding the treatment and protection of security rights it would be helpful as creating certainty. In such a case legislation of States where debtor and holder are situated or have their main interests located is not important, as well as of the State where assets are situated. Thus, the interpretation of security rights becomes unambiguous as debtor and holder of Eurohypothec agrees on such an instrument.

To sum up, the protection guaranteed to rights *in rem* under European Insolvency Regulation was analysed, wording and interpretation of it taking as the starting point. Expression "shall not affect" has decisive significance in interpretation of Article 5 and should be understandable in that way as security rights cannot be affected by the law of the State of opening of insolvency proceedings if such a right is situated in another State. Rights *in rem* are protected not against mere decision to open insolvency proceedings, but decision in the course of proceedings if it is taken under the legislation of the State of opening main proceedings. Moreover, protection is guaranteed in all proceedings falling under the scope of Insolvency Regulation, thus reorganisation is not an exception. Due to the fact that in interpretation of protection of rights *in rem* arise uncertainties, proposals to amend the text and make it similar to the wording of Articles 8 and 10 is highly discussed. There is also contradicting opinion, that

[214] Basic Guidelines for a Eurohypothec. Outcome of the Eurohypothec Workshop. November 2004/April 2005 (Ed. A. Drewicz-Tulodziecka) [interactive]. 2005, Warsaw, p. 6 [accessed: 10/05/2015, 11:03]. <https://www.pfandbrief.de/cms/_internet.nsf/0/6B4B095D2EE0FA70C1257B98004F1FEF/$FILE/Eurohypothek%20-%20Basic%20Guidelines.pdf>.

[215] Nasarre-Aznar, S Response to european commission green paper on the mortgage market 19-7-2005 [interactive]. 2005 [accessed: 10/05/2015, 10:51]. <http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/comments/priv-es_nasarreaznar-en.pdf>.

amendments are not necessary as proper interpretation is able to facilitate application of Article 5. Assistance regarding application of Insolvency proceedings provided by European Union is welcomed. In addition, model of Eurohypothec has been presented and considered for a long time now. However, this is the supplementary instrument and negotiated by the parties of it. Thus, issues arising in application of Insolvency Regulation to cases of rights *in rem* remains.

CONCLUSIONS

1. Security rights (part of proprietary rights) are the instruments helping creditor to ease the access to debt with lower interest rate, or of bigger amount *ceteris paribus* (other things being equal). These instruments may be called in different names, and the understanding of security right depends on the state, but generally, instrument falls under the concept of security rights when it contains 8 features: first, entitles creditor to priority getting payment and control the collateral, second, it is accessory right and only supplements underlying obligation, thus, it exists as long as exists the obligation, third, it is linked to the obligation and the latter has to be clearly defined, fourth, it must be created by parties capable to do that, fifth, it is directly linked to the asset in which it is vested, sixth, it has *erga omnes* effect, seventh, it must be created and perfected according to legal requirements of relevant state, eighth, it is regarded in insolvency cases.
2. Rights *in rem* is the name of security rights used in the European Insolvency Regulation (Article 5), which does not provide definition of such rights, but leaves this to be determined by the legislation of Member State where assets in which right *in rem* is granted. This provision establishes that rights *in rem* granted by the assets *"belonging to the debtor"* are protected and this should be understood in a way that debtor has some kind of interest in that asset and it motivates to repay. At the time of opening of proceedings asset must be situated in another Member State and localisation rules of Article 2 (g) to determine that helps. Insolvency Regulation (Recast) establishing rules on how to determine location of new categories of assets and establishing hierarchy between these categories should solve issues arising when interpreting current Regulation.
3. Cases of cross-border insolvency proceedings arise when insolvency in some way relates to more than one state (or more than one Member State strictly when so is indicated in the Insolvency Regulation). In such cross-border insolvency cases European Insolvency Regulation is applicable when insolvency proceedings were opened after Regulation entered into force in (31 May 2002) to natural or legal persons (according to legislation of relevant Member State) and for certain types of cases. Features of such cases that have been cumulative in became alternative Insolvency Regulation (Recast). European Insolvency Regulation adopts the model of mitigated universalism – main insolvency proceedings are introduced, but along territorial proceedings can be opened.
4. Jurisdiction is established in the Member State where debtor's COMI is situated. Definition of COMI transposed from Recital 13 to the main body of Insolvency Regulation (Recast) and introduced definitions of COMI of other persons than company should be

able to overcome currently arising uncertainties. Secondary proceedings may be opened in the State where debtor's establishment is located. The law applicable for insolvency proceedings, both main and secondary, is of the State where these proceedings were opened. These are general rules applied if the Insolvency Regulation does not provide otherwise.

5. Rights *in rem* are protected in cross-border insolvency cases by establishing different regime than general rule of applicable law in the Insolvency Regulation and, thus, making an exception to universal scope of proceedings (Article 5). This provision constitutes a substantive rule aiming to protect the creditor having right *in rem* vested in debtor's assets situated within the territory of another Member State. Article 5 (1) should be interpreted as providing rights *in rem* the immunity from the law of the State where insolvency proceedings were opened. This can cause overprotection of secured creditor due to the fact that in order to open secondary insolvency proceedings establishment in the State of the location of right *in rem is* required. Possibility to open territorial proceedings in the State where right *in rem* is located could be a solution to the arising issue when opening of secondary proceedings depends on whether establishment exists in the same State or not.
6. The scope of provision provided by the Article 5 should be interpreted as protecting the asset granting right *in rem* and obligation secured by it as these three elements are closely related. As well, Insolvency Regulation is applicable to cases when rights *in rem* were created before it entered into force if only the condition of the opening of insolvency proceedings after 31 May 2002 is met. Rights i*n rem* are secured in regard of the decision opening insolvency proceedings and other decisions later particularly under the legislation of the State where proceedings are opened. Article 5 should be interpreted as encompassing the proceedings which fall under the scope of the Insolvency Regulation, thus, liquidation and reorganization. One exception to protection of rights *in rem* is established – actions for voidness, voidability or unenforceability under the rules of *lex concursus* cannot be precluded.
7. There are authors who suggest abandoning the *pari passu* principle as Article 5 forms an exception to it. However, the recommendation is to leave this principle existing in insolvency cases as it always has been the fundamental principle. *Pari passu* principle should be interpreted as establishing equal treatment of creditors who are in the same category and equally protecting rights of creditors provided by the relevant law.
8. Three possible solutions are presented in legal doctrine regarding the rule of Article 5 (1): first, leaving substantive restriction rule as is currently, second, changing into the choice of law rule and, third, changing into opposition rule. The most suitable and recommended is

leaving the rule of applicable law for rights *in rem* as it is formulated now. In addition, possibility to open insolvency proceedings in the Member State where right *in rem* is situated regardless of the existence of debtor's establishment is recommended to introduce or possibility to treat right *in rem* in main insolvency proceedings so as secondary insolvency proceedings would have been opened.

9. Widely differing national laws and lack of assistance when interpreting Article 5 presupposes the desirability of some guidelines for its interpretation in any way. While waiting for such assistance case-law as well as recitals should be invoked abandoning all doubts of their significance in order to interpret provision on rights *in rem.*
10. The idea of unified instrument of security rights – Eurohypothec – is the idea recommended to consider. It is an additional instrument not replacing existing national laws. It would provide more certain and extensive rules on the instrument and right deriving from it. This would allow avoiding the vagueness of possible interpretations.
11. Despite the fact that several uncertainties in application may arise due to the chosen approach to the interpretation of the provisions relevant to rights *in rem*, another issue is that the scope of protection of secured creditors is dependent on the question of whether the secondary proceedings can be opened in the state where right *in rem* is situated. Whereas, existence of debtor‘s establishment presupposes if these proceedings are available.
12. After the analysis the defended statement, which was raised in the beginning, is denied. European Insolvency Regulation protects creditors‘ rights *in rem* situated in one Member State from the rules under the law of the other Member State where main insolvency proceedings were opened. This protection is granted for right *in rem*, obligation secured and asset in which it is vested, no matter the right is created before or after the Insolvency Regulation came into force, in reorganisation and liquidation proceedings. Therefore, current Insolvency Regulation is sufficient to protect creditors' security rights in cross-border insolvency proceedings.

ANNOTATION

Topic of the Master Thesis: Security Rights in Cross-Border Insolvency Proceedings within the European Union.

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Supervisor: Prof. Dr. Rimvydas Norkus.

The Master's Thesis is dedicated to correlation between creditor's security rights and cross-border insolvency cases in the European Union. The aim of this research is to reveal the concept of security rights, both general and established in Article 5 of the European Insolvency Regulation, features and problematic aspects of it and concept of cross-border insolvency proceedings, as well as effects of insolvency on security rights.

This research analyses arising problems in distinguishing security rights from other proprietary rights, protection of security rights in insolvency cases established in the European Union law and issues caused by formulation of relevant provisions, their interpretation and effects. Examining all aspects of the research current European Insolvency Regulation was invoked, as well as prospective Insolvency Regulation (Recast).

SUMMARY

SECURITY RIGHTS IN CROSS-BORDER INSOLVENCY PROCEEDINGS WITHIN THE EUROPEAN UNION

Lina Taujanskytė

Keywords: creditor's security rights, rights *in rem*, cross-border insolvency proceedings, European Insolvency Regulation.

Security rights (or rights *in rem,* as referred in the European Insolvency Regulation) are instruments providing possibility of getting credit on better conditions and in that way being incentives for development of business, especially, in international level. In cross-border insolvency cases within the European Union interpretation and application of special regime – exception from general rule of applicable law – of rights *in rem* provided by Article 5 still causes uncertainties after 13 years the Insolvency Regulation has been in force.

Main unambiguous aspects of Article 5 are analysed in this Master thesis. The scope of right *in rem* should be interpreted in the way as encompassing the ones vested in assets the location of which is determined by localization rules at the moment of the opening of insolvency proceedings and in which debtor has interest. Rule on rights *in rem* should be interpreted as meaning that such rights have immunity from the law of the State where insolvency proceedings were opened. Also, the scope of the provision established in Article 5 is understood as providing the protection for right *in rem,* created at any time as long as proceedings are opened after the Regulation entered into force, and underlying obligation against decisions under the rules of the State of the opening of insolvency proceedings, both, liquidation and reorganization leaving exception to affect right *in rem* to actions for voidness, voidability or unenforceability.

Article 5 forms exception to universal effect of main insolvency proceedings and *pari passu* principle. But the latter does not lose the significance in insolvency proceedings and remains one of fundamentals despite the fact of the exception. It should be interpreted as guaranteeing equal treatment of creditors falling in the same category of creditors. In order to overcome issues that may be not eliminated by Insolvency Regulation (Recast) most suitable and recommended solution is leaving the rule as it is now and introducing secondary insolvency proceedings in the State where right *in rem* is located or in main insolvency proceedings treating right *in rem* as it would be treated in secondary insolvency proceedings. These may be the

solutions for different treatment of secured creditors depending on the location of their rights *in rem.*

Moreover, means providing the assistance in interpretation of provision established in Article 5 are welcomed. As well, unified instrument establishing rules of security rights should be considered as introducing the possibility for parties to choose these rules applicable on their right *in rem* created.

SANTRAUKA

KREDITORIŲ DAIKTINĖS TEISĖS TARPTAUTINIAME NEMOKUMO PROCESE EUROPOS SĄJUNGOJE

Lina Taujanskytė

Reikšminiai žodžiai: kreditorių daiktinės teisės, tarptautinis nemokumo procesas, Europos Sąjungos nemokumo reglamentas.

Kreditorių daiktinės teisės yra priemonės, suteikiančios galimybę gauti kreditą geresnėmis sąlygomis ir dėl to skatina verslo vystymąsi, ypač tarptautiniame lygmenyje. Po 13 metų, kai Europos Sąjungos Nemokumo reglamentas yra įsigaliojęs, kreditorių daiktinių teisių apsauga, nustatyta 5 straipsnyje, vis dar sukelia neaiškumų interpretuojant ir taikant jį tarptautinio nemokumo proceso situacijose Europos Sąjungoje.

Pagrindiniai neaiškumai sukeliami 5 straipsnio yra analizuojami šiame Magistro baigiamajame darbe. Kreditorių daiktinių teisių apimtis turėtų būti interpretuojama kaip apimanti teises, suteiktas į nuosavybę, kurios vieta yra nustatoma pagal vietos nustatymo taisykles tiksliai nemokumo proceso iškėlimo metu ir į kurią skolininkas turi interesą. Kreditorių daiktinių teisių apsaugos taisylė turėtų būti interpretuojama kaip reiškianti, kad tokios teisės turi imunitetą valstybės, kurioje nemokumo procesas iškeltas, nemokumo taisyklėms. Nemokumo reglamento 5 straipsnis suteikia apsaugą kreditorių daiktinėms teisėms, sukurtoms bet kuriuo metu, jei tik nemokumo procesas buvo iškeltas po Nemokumo reglamento įsigaliojimo. Be to, šis straipsnis suteikia apsaugą ir įsipareigojimui, kuris yra garantuotas daiktine teise, bei likvidavimo ir reorganizavimo procesuose nuo galimo sprendimo iškelti nemokumą procesą poveikio, bei kitų sprendimų, galinčių turėti poveikį. Reglamento 5 straipsnio taisyklė negali užkirsti kelio byloms dėl teisės aktų paskelbimo niekiniais, ginčytinais ar dėl negalimumo užtikrinti jų vykdymą.

Nuostatos įtvirtintos 5 straipsnyje yra išimtis iš universalaus nemokumo proceso poveikio ir išimtis iš kreditorių lygiateisiškumo principo. Tačiau pastarasis nepraranda savo reikšmės ir lieka vienu iš pagrindinių, nepaisant 5 straipsnio įtvirtintos išimties. Šis principas turėtų būti interpretuojamas kaip garantuojantis kreditorių, kurie patenką į tą pačią kreditorių kategoriją, lygiateisiškumą. Geriausias būdas įveikti problemas, kurios greičiausiai nebus išspręstos Nemokumo reglamento nauja redakcija, atrodytų palikti 5 straipsnio taisyklę tokią, kokia ji yra, ir įvesti galimybę iškelti šalutinę bylą ir toje Valstybėje narėje, kurioje yra kredotoriaus daiktinė teisė arba įvedant taisyklę pagrindinėje nemokumo byloje traktuoti

kreditorių daiktines teises taip, lyg būtų iškelta šalutinė nemokumo byla. Tai galėtų būti sprendimas skirtingo kreditorių traktavimo, priklausomai nuo daiktinės teisės buvimo vietos, problemai.

Priemonės, suteikiančios pagalbą interpretuojant 5 straipsnio taisyklę, yra laukiamos. Taip pat ir unifikuotas instrumentas, numatantis vieningas taisykles kreditorių daiktinėms teisėms, turėtų būti laikomas priemone suteikiančia galimybę sutarties šalims pasirinkti šio instrumento taisykles kaip taikytiną teisę jų sukurtai daiktinei teisei.

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CONFIRMATION OF INDEPENDENCE OF THE WRITTEN WORK

2015-05-20

Vilnius

I, Mykolas Romeris University (hereinafter referred to as the University), Faculty of Law, European and International Business Law study program student Lina Taujanskytė, hereby confirm that this Master's final thesis "Security Rights in Cross-Border Insolvency Proceedings within the European Union":

1. Has been accomplished independently by me and in good faith;
2. Has never been submitted and defended in any other educational institution in Lithuania or abroad;
3. Is written in accordance with principles of academic writing and being familiar with methodological guidelines for academic papers.

I am aware of the fact that in case of breaching the principle of fair competition – plagiarism – a student can be expelled from the University for the gross breach of academic discipline.

Lina Taujanskytė