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THE CHOICE OF LAW PROVISIONS IN THE EUROPEAN UNION CONVENTION ON INSOLVENCY PROCEEDINGS

*Nick Segal**

I. INTRODUCTION

Professor Fletcher's paper provides a general review of and commentary on the provisions and status of the European Union Convention on Insolvency Proceedings (the Convention).¹ This paper, which is supplementary to Professor Fletcher's paper,² discusses the provisions in the Convention which identify the law governing particular proceedings or issues within proceedings.

One of the principal features of the Convention is the creation of certain uniform conflict-of-law rules for insolvency proceedings to which the Convention applies.³ The establishment of such a uniform approach plays an important part in the achievement of the Convention's overall objective. Because the Convention allocates many, but by no means all, matters to the law of the state in which proceedings have been opened,⁴ the Convention's choice-of-law rules are the means by which the main insolvency proceedings are given universal, Community-wide effect. Further, by allocating particular issues to a state other than that of the state of opening, they establish the limits on the extraterritorial effect of proceedings to which the Convention relates, and therefore enshrine a number of significant policy decisions regarding the balance to be maintained between the law of the forum and other potentially relevant

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1. European Union Convention on Insolvency Proceedings, Nov. 23, 1995, 35 I.L.M. 1223 [hereinafter EU Insolvency Convention]. The full text of the Convention is set forth in an appendix to this article at p. 75.

2. Professor Fletcher's paper and this paper were presented together at the Conference at Brooklyn Law School on 19th September, 1996.

3. See EU Insolvency Convention, *supra* note 1, preamble para. 4, 35 I.L.M. at 1225. Note that one of the objectives set out in the mandate given to the Working Group, established in 1989 by the EEC Council of Ministers to draft the Convention, was to "harmonize certain conflict rules that bear on the administration of bankruptcies" Manfred Balz, *The European Union Convention on Insolvency Proceedings*, 70 AM. BANKR. L.J. 485, 495 (1996).

4. See EU Insolvency Convention, *supra* note 1, art. 4, 35 I.L.M. at 1226-27.

and competing jurisdictions.⁵

In this paper, I review and comment on the provisions in the Convention dealing with choice-of-law issues.⁶

II. GENERAL RULE

A. *Article 4 of the Convention*

The general rule is set forth in article 4, which reads as follows:

1. Save as otherwise provided in this Convention, the law applicable to insolvency proceedings and their effects shall be that of the Contracting State within the territory of which such proceedings are opened, hereafter referred to as the "State of the opening of proceedings."
2. The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure. It shall determine, in particular:
 - (a) against which debtors insolvency proceedings may be brought on account of their capacity;
 - (b) the assets which form part of the estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings;
 - (c) the respective powers of the debtor and the liquidator;
 - (d) the conditions under which set-offs may be invoked;
 - (e) the effects of insolvency proceedings on current contracts to which the debtor is party;
 - (f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending;
 - (g) the claims which are to be lodged against the debtor's estate and the treatment of claims arising after the opening of insolvency proceedings;
 - (h) the rules governing the lodging, verification and admission of claims;

5. *See id.* arts. 5-15, 35 I.L.M. at 1227-29. "The purpose of these rules is to delineate the issues which are properly governed by insolvency law from those that should be treated as non-bankruptcy issues because non-bankruptcy policies should prevail, and then to determine the law applicable to such insolvency law situations." Balz, *supra* note 3, at 506.

6. *See* EU Insolvency Convention, *supra* note 1, arts. 4-15, 35 I.L.M. at 1226-29.

- (i) the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off;
- (j) the conditions for and the effects of closure of insolvency proceedings, in particular by composition;
- (k) creditors' rights after the closure of insolvency proceedings;
- (l) who is to bear the costs and expenses incurred in the insolvency proceedings;
- (m) the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors.⁷

A number of points are worth noting in relation to article 4. It lays down the Convention's basic rule on choice of laws. The approach of the Convention is to identify a general rule subject to limited exceptions. The general rule provides for the law of the state of the opening of the proceedings to govern "the conditions for the opening of those proceedings, their conduct and their closure."⁸ To facilitate the interpretation of article 4, it contains, in section 2, a non-exhaustive list of questions that are governed by the law of the state of opening. This approach applies both in the case of main proceedings and for local proceedings, whether secondary or independent territorial proceedings.

Thus, the general rule is to allocate to the state of the opening, as noted above, issues relating to the "conditions for the opening of [the] proceedings, their conduct and their closure."⁹ The Explanatory Report on the Convention on Insolvency Proceedings¹⁰ (Explanatory Report) notes that:

7. *Id.* art. 4, 35 I.L.M. at 1226-27.

8. *Id.* art. 4(2), 35 I.L.M. at 1226.

9. *Id.*

10. MIGUEL VIRGOS & ETIENNE SCHMIT, REPORT ON THE CONVENTION ON INSOLVENCY PROCEEDINGS, EU Council Doc. 6500/96, DRS 8 (CFC) (May 3, 1996) [hereinafter EXPLANATORY REPORT] (on file with the *Brooklyn Journal of International Law*). This is the report prepared by Professor Miguel Virgos of the Universidad Autonoma, Madrid, and Magistrate Etienne Schmit, Deputy Public Prosecutor, Luxembourg. Once the Convention is signed by all Member States, the Explanatory Report will be annexed to the text of the Convention and published in the *Official Journal*.

[T]he law of the State of the opening of proceedings determines all the effects of the insolvency proceedings, both procedural and substantive, on the persons and legal relations concerned.

This law governs all the conditions of the opening, conduct and closure of the insolvency proceedings. It stipulates, *inter alia*, who may be subject to insolvency proceedings, the requirements to open them and who may present the petition

The substantive effects referred to the competence of the law of the State of the opening by article 4 are those typical of insolvency law i.e. effects which are necessary for the insolvency proceedings to fulfil its aims. To this extent, the law of the State of the opening may displace (unless the Convention provides otherwise) the law normally applicable under the common pre-insolvency rules on conflicts of laws, to the act concerned. This happens for instance when article 4 makes applicable the law of the State of the opening of proceedings to invalidate any act (e.g. a contract) detrimental to all the creditors even if that Act is governed under the general rules of conflict of laws . . . by the law of a different State.¹¹

Thus, both procedural and substantive matters related to and deriving from the insolvency proceedings in question are allocated to the state of opening in the first instance. Any issue that arises in the insolvency proceedings and which is subject to the legal regime applicable to the relevant proceedings in the state of opening will, by virtue of article 4, be allocated, in the first instance, to that law.

It would therefore seem to follow, for example, that when the main proceeding in question is a voluntary arrangement under English law and the arrangement involves the variation or discharge of obligations of the debtor,¹² then it is the law of the opening which will govern the validity and effectiveness of the variation or discharge and not the proper law of the underlying obligation. If a main proceeding commenced in a state

11. *Id.* para. 90.

12. Under the Convention, a voluntary arrangement would be considered a main proceeding. See EU Insolvency Convention, *supra* note 1, Annex A, 35 I.L.M. at 1240-42 (establishing that voluntary arrangements under the Insolvency Act 1986 and the Insolvent Partnerships Order 1994 are to be considered "collective insolvency proceedings" pursuant to article 1(1) of the EU Insolvency Convention).

other than the United Kingdom makes provision for the variation or discharge of the obligations of the debtor, then the English courts likely will have to recognise and give effect to the discharge even in cases where the obligation is governed by English law. This would seem to overturn the basic English rule that only a variation or discharge under English law is effective to discharge obligations governed by English law.¹³ This interpretation has been consistently applied by the English courts.¹⁴

B. Exceptions to the General Rule

The application of national insolvency law by the courts in the state of the opening of proceedings, and the automatic extension of its effects to all the contracting states, may interfere with the rules under which transactions are carried out in these states. Therefore, to protect legitimate expectations and the certainty of transactions in states other than the one in which proceedings are opened, the Convention provides for a number of exceptions to the general rule.¹⁵

These exceptions can be broken down into two categories: (1) the Convention excludes some rights over assets located abroad from the effects of the insolvency proceedings;¹⁶ and (2) the Convention ensures that certain effects of the insolvency proceedings are governed not by the law of the state of the opening of proceedings but by the law of another state.¹⁷ These exceptions to the application of the law of the state of opening are dealt with in articles 5 to 15 of the Convention.

13. See 2 DICEY & MORRIS ON THE CONFLICT OF LAWS 1180-82 (Lawrence Collins ed., 12th ed. 1993). Note that the construction argued for above seems to be supported by the views of the Chairman of the EEC Working Group which was responsible for drafting the Convention:

[I]t has long been argued by some that the law governing the debtor's obligations (*lex contractus*) should be applied to the issue of discharge, at least cumulatively, *i.e.*, in addition to the law of the opening State. Article 4 now clarifies that only the law of the opening State will govern.

Balz, *supra* note 3, at 508 (footnote omitted).

14. See, *e.g.*, National Bank of Greece and Athens S.A. v. Metliss, 1958 App. Cas. 509, 513-15 (P.C. 1957) (appeal taken from Eng.). Query how many of the proceedings in other states included in Annex A of the Convention allow for a variation or discharge of the indebtedness of the debtor.

15. EU Insolvency Convention, *supra* note 1, arts. 5-15, 35 I.L.M. at 1227-29.

16. *Id.* arts. 5-7, 35 I.L.M. at 1227-28.

17. *Id.* arts. 8-11, 14-15, 35 I.L.M. at 1228-29.

It should be noted that these provisions, when referring to the jurisdiction that displaces the state of the opening as the governing law, refer to the law of another "contracting state." In certain cases, however, the jurisdiction to which the Convention will allocate a particular issue will be a non-contracting state. Since the Convention is limited to the intra-Community effect of insolvency proceedings, it will be left to contracting states in these cases to decide what choice-of-law rules to apply.¹⁸

I will now consider each of the exceptions to the general rule in turn.

III. THIRD PARTIES' RIGHTS IN REM

Article 5(1) states as follows:

The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, movable or immovable assets belonging to the debtor which are situated within the territory of another Contracting State at the time of the opening of proceedings.¹⁹

Several points may be noted in relation to this provision. First, the provision is designed to ensure respect for the proprietary rights of third parties in relation to assets located within a contracting state other than the state of the opening. The fundamental policies are to protect the integrity of transactions and trade in the state where assets are situated, and to avoid creating damaging legal uncertainty and risk.²⁰ These policy objectives are seen as particularly important in relation to rights in rem;²¹ such rights should not be affected to a greater extent by the opening of insolvency proceedings in other contracting states than by the commencement of insolvency proceedings in the state where the assets are located.²² Thus, article 5 excludes from the effects of the proceedings to which the Convention applies third-party rights in rem with respect to assets belonging to the debtor which, at the time of the

18. See EXPLANATORY REPORT, *supra* note 10, para. 93.

19. EU Insolvency Convention, *supra* note 1, art. 5(1), 35 I.L.M. at 1227.

20. See EXPLANATORY REPORT, *supra* note 10, para. 97.

21. See *id.*

22. See *id.*

opening of proceedings, are situated within the territory of another contracting state. The holder of a security interest in foreign situated collateral may therefore proceed as if there were no insolvency of the debtor. Where the assets in question are situated in a non-contracting state, article 5 does not govern the issue.

Second, in order to avoid the application of the law of the state of the opening of proceedings, it is necessary to establish (1) the existence of rights in rem in favour of creditors or other third parties; and (2) the fact that the assets in question are situated within the territory of another contracting state at the time of the opening of proceedings.

Third, "rights in rem" are not defined. The Convention does not impose its own definition of a right in rem, thus running the risk of describing as a right in rem something which would not be so regarded by the state where the assets are located. The Convention recognises the interests of each state in protecting the integrity of proprietary rights created in accordance with its own laws. For this reason, the characterisation of a right in rem is to be sought in the national law which, according to normal pre-insolvency conflict-of-law rules, governs rights in rem, and which is, in general, the *lex rei sitae* at the relevant time.²³

Article 5(2) provides a non-exhaustive list of the types of rights that are normally considered by national laws as rights in rem.²⁴ Article 5(2) states that:

The rights referred to in paragraph 1 [of this article] shall in particular mean:

- (a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;
- (b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;
- (c) the right to demand the assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;

23. See *id.* para. 100.

24. See EU Insolvency Convention, *supra* note 1, art. 5(2), 35 I.L.M. at 1226.

(d) a right in rem to the beneficial use of assets.²⁵

The Explanatory Report notes that this list is inspired by two main considerations.²⁶ The first is that a right that arises only after the commencement of insolvency proceedings is not covered or protected by article 5.²⁷ Second, a right in rem is regarded as having, essentially, two characteristics: (1) its direct and immediate relationship with the asset it covers, which remains linked to its satisfaction without depending on the asset belonging to a person's estate or on the relationship between the holder of the right in rem and another person;²⁸ and (2) the absolute nature of the allocation of the right to the holder.²⁹ This means that the person who holds the right in rem can enforce it against anyone who breaches or harms his right without his assent; that is, such rights are typically protected by actions to recover. Further, the right can resist the alienation of the asset to a third party; that is, it can be claimed *erga omnes*, with the restrictions characteristic of the protection of the bona fide purchaser. Thus, the right can resist individual enforcement by third parties and, in collective insolvency proceedings, by its separation or individual satisfaction.³⁰

In many cases, the issue of whether a particular right constitutes a right in rem will, as a matter of English law, be uncontroversial. There will, however, be cases on the borderline.³¹ For example, what about the floating charge? The Explanatory Report seeks to offer assistance here. It notes:

25. *Id.*

26. EXPLANATORY REPORT, *supra* note 10, para. 103. The Report also makes a cross-reference to the Schlosser Report on the revised 1968 Brussels Convention. See Peter Schlosser, Report on the Convention of 9 October 1978 on the Association of the Kingdom of Denmark, Ireland and the United Kingdom of Great Britain and Northern Ireland to the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters and to the Protocol on Its Interpretation by the Court of Justice, 1979 O.J. (C 59) 71, para. 166, at 120-21.

27. See EXPLANATORY REPORT, *supra* note 10, para. 103.

28. See *id.* para. 103(a).

29. See *id.* para. 103(b).

30. See *id.*

31. Consider, for instance, restitutionary proprietary remedies and rights under a constructive trust. See the distinction made between rights in rem and rights ad rem in Roy Goode, *Property and Unjust Enrichment*, in ESSAYS ON THE LAW OF RESTITUTION 215, 217 (Andrew Burrows ed., 1991).

A right in rem may not only be established with regard to specific assets but also with regard to assets as a whole. Security rights such as the "floating charge" recognised in the United Kingdom and Irish law can therefore be characterised as a right in rem for the purposes of the Convention.³²

Finally, the rule does not immunise rights in rem against the debtor's insolvency. If the law of the state where the assets are located allows these rights in rem to be affected in some way, the liquidator, or any other person empowered to do so, may request secondary insolvency proceedings to be opened in that state if the debtor has an establishment there.³³ (Query the position if there is no establishment?). The secondary proceedings are conducted according to national law,³⁴ and allow the liquidator to affect these rights under the same conditions as in purely domestic proceedings.

IV. SET-OFF

Under the general rule applicable by virtue of article 4, insolvency set-off is subject to the law of the state of the opening of the insolvency proceedings.³⁵ If insolvency proceedings are opened, it therefore falls to the law of the state of opening to govern the admissibility and the conditions under which set-off can be exercised against a claim of the debtor.

Article 6 of the Convention, however, provides additional rights of set-off by stating: "The opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim."³⁶ When the law of the state where proceedings open allows a set-off, article 4 governs and there is no

32. EXPLANATORY REPORT, *supra* note 10, para. 104.

33. See EU Insolvency Convention, *supra* note 1, arts. 3(2), 29, 35 I.L.M. at 1226, 1232. Note that the Working Group established to draft the Convention debated at length whether security holders with foreign situated collateral should be subjected to the insolvency law of the State in which the collateral is located, at least in cases where the law of the opening State provides for some effect of insolvency on the rights of secured creditors. But such an approach was thought to be too complex. See Balz, *supra* note 3, at 509.

34. See EU Insolvency Convention, *supra* note 1, art. 28, 35 I.L.M. at 1231.

35. See *id.* art. 4(2)(d), 35 I.L.M. at 1227.

36. *Id.* art. 6(1); see EXPLANATORY REPORT, *supra* note 10, paras. 107-11.

need to refer to article 6. However, if a set-off is not allowed by the law of the state where proceedings open, then a set-off may nonetheless be claimed if article 6 allows it. Claiming set-off requires consulting the law applicable to the insolvent debtor's claim, which is a safe haven.

For example, where English law is chosen as the governing law pursuant to an agreement regulating the parties' rights of set-off, then English law will still govern the availability of set-off rights, despite the insolvency under the Convention, of one of the contracting parties. Therefore, there is an override to protect contractual rights of set-off, provided that the contractual set-off is incorporated as a provision in the contract governing the insolvent debtor's claim. Such a provision will be of particular practical significance, although in practice—because it may be difficult to be certain which contract will generate the insolvent debtor's claim—prudence will dictate that the contractual set-off provision be contained within all contracts between the parties.

It is interesting to compare the approach of the Convention to the current position under English law. An English court recently considered a case in which a Luxembourg bank was subject to a proceeding in Luxembourg and a winding-up in England.³⁷ Because the bank was incorporated in Luxembourg, the winding-up in England was to be treated as ancillary to the Luxembourg proceedings;³⁸ a question arose as to what law should govern rights of set-off in the English proceedings.³⁹ This was a particularly acute problem because rights of set-off are very limited under Luxembourg law.⁴⁰ The English court held that the English rules applied so that full insolvency set-off was available and, indeed, was mandatory

37. *See Re Bank of Credit & Commerce Int'l S.A. (No. 10)*, [1997] 2 W.L.R. 172 (Ch. 1996). Admittedly a credit institution would not be subject to the Convention, *see* EU Insolvency Convention, *supra* note 1, art. 1(2), 35 I.L.M. at 1225, but the principles enunciated by the English court are not limited to credit institutions.

38. *See Re Bank of Credit & Commerce Int'l S.A. (No. 10)*, [1997] 2 W.L.R. at 190, 197. The proceeding was limited to assets in the United Kingdom, although the English court questioned the jurisdictional basis for ancillary liquidators. *See id.* Interestingly, since it was arguable that management of the Bank was conducted in and from London, *see id.* at 176-77, under the Convention the English proceeding might have been the main proceeding.

39. *See id.* at 190.

40. *See id.* at 187.

and self-executing.⁴¹ If the Convention had been in effect, the result would have been the same. English law, as the law of the state of the opening—whether the proceedings were main or territorial proceedings—would have, in the first instance, governed the availability of set-off rights.⁴² However, if the bank or entity in question had not had a branch or an establishment in England it could not, under the Convention, be wound up in England and creditors would therefore have lost their rights of set-off, unless the debtor's claim were governed by English law.⁴³

V. RESERVATION OF TITLE

Where a buyer becomes insolvent, the insolvency proceedings will not affect the rights of a seller based on a reservation of title clause where, at the time of the opening of the insolvency proceedings, the asset claimed is situated within the territory of a contracting state other than the state in which the proceedings are opened.⁴⁴

On the other hand, where the seller becomes insolvent after delivery of an asset to a buyer, the seller will not have grounds to rescind or terminate the sale.⁴⁵ The buyer, therefore, will not be prevented from acquiring title where at the time of the opening of proceedings the purchased asset is located within the territory of a contracting state other than the state of the opening of proceedings.⁴⁶

VI. CONTRACT RELATING TO IMMOVABLE PROPERTY

Article 8 stipulates: "The effects of insolvency proceedings on a contract conferring the right to acquire or make use of immovable property shall be governed solely by the law of the contracting state within the territory of which the immovable property is situated."⁴⁷

41. *See id.* at 197.

42. *See* EU Insolvency Convention, *supra* note 1, art. 4(2)(d), 35 I.L.M. at 1227.

43. *See id.* art. 3(2), 35 I.L.M. at 1226.

44. *See id.* art. 7(1), 35 I.L.M. at 1227-28.

45. *See id.* art. 7(2), 35 I.L.M. at 1228.

46. *See id.*

47. *Id.* art. 8.

VII. PAYMENT SYSTEMS AND FINANCIAL MARKETS

Article 9 states: "[T]he rights and obligations of parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Contracting State applicable to that system or market."⁴⁸

VIII. CONTRACTS OF EMPLOYMENT

Article 10 provides: "The effects of insolvency proceedings on employment contracts and relationships shall be governed solely by the law of the Contracting State applicable to the contract of employment."⁴⁹

IX. EFFECTS ON RIGHTS SUBJECT TO REGISTRATION

Article 11 provides: "The effects of insolvency proceedings on the rights of the debtor in immovable property, a ship or an aircraft subject to registration in a public register shall be determined by the law of the Contracting state under the authority of which the register is kept."⁵⁰

X. COMMUNITY PATENTS AND TRADEMARKS

Article 12 states: "For the purposes of this Convention a Community patent, a Community trade mark or any other similar right established by Community law may be included only in the proceedings referred to in Article 3(1) [main proceedings]."⁵¹

XI. DETRIMENTAL ACTS

Article 13 states:

Article 4(2)(m) shall not apply where the person who benefited from a legal act detrimental to all the creditors provides proof that:

- the said act is subject to the law of a Contracting State other than that of the State of the opening of proceedings; and
- that law does not allow any means of challenging that

48. *Id.* art. 9.

49. *Id.* art. 10.

50. *Id.* art. 11.

51. *Id.* art. 12.

act in the relevant case.⁵²

As with the exercise of rights of set-off, the Convention provides a two-tiered approach for dealing with the law governing the avoidance of pre-insolvency transactions. In general, the law of the contracting state where the proceedings open governs, subject to the availability of a safe haven.

The basic rule of the Convention is that under article 4, the law of the state of the opening governs any possible voidness, voidability, or unenforceability of acts that may be detrimental to all the creditors' interests.⁵³ This same law determines the conditions to be met, the manner in which the nullity and voidability function, and the legal consequences of nullity and voidability. Nullity and voidability function automatically, by allocating retrospective effects to the proceedings or pursuant to an action taken by the liquidator.

Article 13 represents a defence against, or safe haven in relation to, the application of the law of the contracting state of the opening. The defence must be pursued by the party who relies on it.⁵⁴ The aim of article 13 is to uphold the legitimate expectations of creditors or third parties regarding the validity of an act or transaction undertaken in accordance with the normally applicable national law.⁵⁵

In order for the defence to be available it is necessary for the party relying on it first to establish that the impugned act or transaction is "subject to"⁵⁶ the law of a contracting state other than the state where the proceedings open.⁵⁷ Second, the party must establish that the law of that other state does not allow a challenge by "any means" and "in the relevant case." "Any means" connotes that the act or transaction in question cannot be challenged using either rules applicable on

52. *Id.* art. 13.

53. *See id.* art. 4(2)(m), 35 I.L.M. at 1227.

54. *See id.* art. 13, 35 I.L.M. at 1228.

55. *See* EXPLANATORY REPORT, *supra* note 10, para. 138.

56. Query the meaning of "subject to" here?

57. Where the detrimental "act" arises out of a contract, then presumably reference has to be made to the governing law of that contract. *See* 2 DICEY & MORRIS ON THE CONFLICT OF LAWS, *supra* note 13, at 1180. Where there has been a disposition of property one would expect reference to be made to the law governing the proprietary aspects of the transfer (usually the *lex situs*) and not to (or at least not simply to) the proper law of the relevant contract.

an insolvency or other general rules of the applicable national law.⁵⁸ "In the relevant case" means that the act or transaction should not be capable of being challenged in the actual circumstances of the case.⁵⁹

One can compare the Convention's approach with English and U.S. approaches to the question of what law governs the application of avoidance provisions in cases with a foreign element.

A. England

An illustration of the English approach can be found in *In re Paramount Airways Ltd. (No. 2)*.⁶⁰ In that case, administrators made a claim for repayment of sums paid by an insolvent English company from its English bank account to Hambros Bank, Jersey (Hambros Jersey); the sum was to be credited to an account in the name of a Jersey company administration agent.⁶¹ The payment was made on the instructions of a person who was both a director and chairman of the English company. The money was ultimately paid to an account in Hambros Jersey; the account was held by a Panamanian company allegedly owned and controlled by that person.⁶² The payment received by the Panamanian company was used to reduce its overdraft with Hambros Jersey. The administrators of the English company alleged that the payments to the Panamanian company were transactions at an undervalue⁶³ made at a time when the English company was insolvent.⁶⁴ The claim against Hambros Jersey was based on the fact that it received a benefit from the repayment of the overdraft of the Panamanian company other than in good faith, for value, and without notice of the relevant circumstances.⁶⁵ The question was whether an order could be made against a defendant (i.e., Hambros Jersey) out of the jurisdiction (Jersey).⁶⁶

The Court of Appeal held that the statutory avoidance

58. See EXPLANATORY REPORT, *supra* note 10, para. 137.

59. See *id.*

60. [1992] 3 W.L.R. 690 (C.A. 1992).

61. See *id.* at 695.

62. See *id.*

63. See Insolvency Act, 1986, ch. 45, § 238 (Eng.).

64. See *Paramount Airways*, [1992] 3 W.L.R. at 695.

65. See *id.*

66. See *id.*

provisions⁶⁷ allow a claim to be made against "any person."⁶⁸ As a matter of jurisdiction, such provisions were not subject to any territorial limitation,⁶⁹ but even where the court had jurisdiction to set aside a transaction, it retained a discretion, under the applicable statutory provisions,⁷⁰ as to the order it would make.⁷¹ Where a foreign element was involved, the English court would have to be satisfied, with respect to the relief sought against him, that the defendant was sufficiently connected with England for the order to be just and proper.⁷² When considering "sufficient connection" the court would regard a number of factors, including

residence and place of business of the defendant, his connection with the insolvent, the nature and purpose of the transaction being impugned, the nature and locality of the property involved, the circumstances in which the defendant became involved in the transaction or received a benefit from it or acquired the property in question, whether the defendant acted in good faith and *whether under any relevant foreign law the defendant acquired an unimpeachable title free from any claims even if the insolvent had been adjudged bankrupt or wound up locally*. The importance to be attached to these factors will vary from case to case.⁷³

If the administration proceedings in this case had been subject to the Convention then it would have been necessary for the English court to determine what law the payment was "subject to." This may be a narrower test than the "sufficient connection" test that the English courts currently apply unless the "subject to" test allows the court to consider something other than the law which technically governs the effectiveness or validity of the payment or other act in question.

67. See Insolvency Act, 1986, ch. 45, § 423 (Eng.).

68. See *Paramount Airways*, [1992] 3 W.L.R. at 699.

69. See *id.*

70. See Insolvency Act, 1986, ch. 45, § 423(2) (Eng.).

71. See *Paramount Airways*, [1992] 3 W.L.R. at 702.

72. See *id.* at 702-03.

73. *Id.* at 703 (emphasis added).

B. United States

In the recent decision of the U.S. Court of Appeals for the Second Circuit, *Maxwell Communication Corp. v. Societe General plc (In re Maxwell Communication Corp.)*,⁷⁴ the court affirmed dismissals by the district court⁷⁵ and the bankruptcy court⁷⁶ of primary proceedings initiated by Maxwell in the United States. By the application of the comity doctrine, the Second Circuit has followed an approach close to that adopted by the English Court of Appeal in the *Paramount Airways* decision. The Second Circuit reviewed the connection between the subject matter of the disputes and the U.S. and English courts, and concluded that England had a much closer connection than the United States.⁷⁷ In doing so, the Court of Appeals noted:

[Maxwell] and most of its creditors—not only the beneficiaries of the pre-petition transfers—are British. Maxwell was incorporated under the laws of England, largely controlled by British nationals, governed by a British board of directors, and managed in London by British executives. These connecting factors indicated what the bankruptcy judge called the “Englishness” of the debtor These same factors, particularly the fact that most of Maxwell’s debt was incurred in England, show that England has the strongest connection to the present litigation.⁷⁸

Because of these relevant connections, the court concluded that comity precluded the application of U.S. avoidance laws to transfers in which England’s interest had primacy.⁷⁹

XII. PROTECTION OF THIRD-PARTY PURCHASERS

Article 14 of the Convention concerns acts of disposal that take place after the opening of the insolvency proceedings.⁸⁰ Protection is provided to purchasers who acquire an asset for

74. 93 F.3d 1036 (2d Cir. 1996).

75. 186 B.R. 807 (S.D.N.Y. 1995).

76. 170 B.R. 800 (Bankr. S.D.N.Y. 1994).

77. See *In re Maxwell*, 93 F.3d at 1051.

78. *Id.*

79. See *id.* at 1055.

80. EU Insolvency Convention, *supra* note 1, art. 14, 35 I.L.M. at 1229.

consideration (i.e., not gratuitously).⁸¹ The assets protected are immovable assets; ships or aircrafts subject to registration in a public register; and "securities whose existence pre-supposes registration in a register laid down by law."⁸²

The validity of any such disposal is to be governed by the law of the state where the immovable asset is situated or under the authority of which the register is kept.⁸³ Once again, this provision is designed to ensure the integrity of transactions by providing the same level of protection for bona fide purchasers for value in proceedings in another contracting state as would arise in domestic proceedings.⁸⁴

XIII. EFFECTS OF INSOLVENCY PROCEEDINGS ON PENDING LAWSUITS

Under article 15, "the effects of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested are to be governed solely by the law of the Contracting State on which that law suit is pending."⁸⁵ The effects, however, on individual enforcement action begun by creditors are governed by the law of the state of the opening⁸⁶ so that the collective insolvency proceedings may stay or prevent any individual enforcement action brought by creditors against the debtor's assets.

XIV. CONCLUSION

The operation of the choice-of-law rules, by virtue of the various exceptions to, and carve-outs from, the general rule providing for the application of the law of the state of the opening of proceedings, combined with the practicalities of conducting business across the Community, mean that the Community-wide effect of even a main proceeding will be limited. The fact that many groups incorporate and use local subsidiaries to conduct business in different contracting states means that the insolvent debtor often will have most of his assets in one con-

81. *See id.*

82. *Id.*

83. *See id.*

84. *See* EXPLANATORY REPORT, *supra* note 10, para. 147.

85. EU Insolvency Convention, *supra* note 1, art. 15, 35 I.L.M. at 1229.

86. *See id.* art. 4(2)(f), 35 I.L.M. at 1227.

tracting state.⁸⁷ Furthermore, the extraterritorial effect of a main proceeding is limited by virtue of the various carve-outs, for which provision is made in articles 5 through 15, particularly in relation to rights in rem over assets situated in another contracting state;⁸⁸ rights of set-off;⁸⁹ and the disapplication of the avoidance rules of the law of the state of opening where the act in question is subject to the law of another contracting state.⁹⁰ The Convention effectively provides for Community-wide recognition of main proceedings,⁹¹ the powers of officeholders appointed pursuant thereto,⁹² and the conduct of and mechanics for proving and participating in proceedings and a stay of creditors' rights granted thereunder. Nonetheless, in cases where there are assets outside the state of opening or transactions connected with other contracting states, then recourse to other local proceedings, if available,⁹³ will be necessary.

87. Nonetheless, a holding company that uses subsidiaries in a number of contracting states will have assets in those contracting states in the form of its shares in the subsidiaries.

88. See EU Insolvency Convention, *supra* note 1, art. 5, 35 I.L.M. at 1227.

89. See *id.* art. 6.

90. See *id.* art. 13, 35 I.L.M. at 1228.

91. See *id.* art. 16, 35 I.L.M. at 1229.

92. See *id.* art. 18.

93. Local proceedings will not be available unless the debtor possesses an establishment in the contracting state in question. See *id.* art. 3(2), 35 I.L.M. at 1226.