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Security rights, the European Insolvency Regulation and concerns about the non-application of avoidance rules

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*E.L. Rev. 72 Abstract

This article addresses debtors who have entered insolvency proceedings in a Member State of the EU so that the European Regulation on Insolvency Proceedings applies, and before the opening of insolvency proceedings they granted some form of security to another party. The article analyses the issues that are relevant to determining whether the granting of security prior to the advent of insolvency proceedings under the Regulation can be avoided, and it examines the extent to which pre-insolvency transactions involving security would be protected by arts 5 and 13 of the Regulation . It then analyses the concerns that might be articulated in relation to the application of art.13 and what options are available to the EC to address these concerns.

Introduction

The EC Regulation on Insolvency Proceedings 2000 (the Regulation)[1] came into force on 31 May 2002. The Regulation seeks to foster co-operation between countries in the EU as far as insolvency proceedings are concerned. The Regulation was the result of a significant amount of discussion and debate over several years, and took shape following the failure to implement a European Bankruptcy Convention in 1996.[2] The Regulation furnishes us with a framework that provides rules that are common in all insolvencies, of both companies and individuals, opened in EU Member States (apart from Denmark), but it does not provide for any common substantive law outside of recognition of jurisdiction and laying down which law would be applied to any given insolvency proceeding. The Regulation has been subject to review in recent years and now a recast version of it has been drafted [3] and recently approved by the European Council, and is likely to come into effect in 2017.[4] One critical element of the Regulation is that it provides, ***E.L. Rev. 73*** in art.4, that where insolvency proceedings have been opened against an insolvent debtor, for the most part the law of the place where the proceedings were opened (the *lex concursus*) will apply to matters that have to be addressed during the course of the administration of the affairs of the insolvent. Proceedings must be opened in the Member State where the debtor's centre of main interests is to be found.[5]

Article 4 enumerates examples of matters that are determined by the *lex concursus*. One of these is the rules relating to the avoidance of transactions that were entered into by the insolvent before the opening of insolvency proceedings and which are detrimental to all of the creditors of the insolvent.[6] The examination of transactions that were entered into prior to the commencement of insolvency proceedings is a very important task that will be undertaken, in most cases, by the person appointed to administer the affairs and property of an insolvent debtor (in this article referred to as the liquidator[7]) as an aspect of his or her duty to investigate the insolvent's circumstances and dealings. Of particular interest is to determine whether any of these dealings might be avoided, invalidated or adjusted in some way in order to swell the funds that will be available to boost the amount to be paid to the general creditors. It has been said that the existence of avoidance actions against transactions entered into by the insolvent prior to the opening of insolvency proceedings (referred to in this article as pre-insolvency transactions) is undoubtedly among the basic principles of every insolvency law regime.[8]

An important element of the liquidator's investigations in relation to pre-insolvency transactions will be to examine any security that had been granted by the insolvent debtor prior to the opening of

insolvency proceedings and see if it can be set aside, thereby freeing the property secured and producing a greater dividend for all creditors. Thus, Member States of the EU, like most states around the world, have provision for the avoidance of pre-insolvency transactions, including those that involve the granting of security, that have occurred in defined periods prior to an insolvent's entry into insolvency proceedings, this period being variously referred to as "the suspect period", "the twilight zone" or "the risk period". However, it should be added that not all transactions in this period will be attacked by a liquidator, and, if they are, not all actions are necessarily going to provide the liquidator with success.

This article considers the position where a debtor has entered insolvency proceedings in a Member State of the EU so that the Regulation applies and before the opening of insolvency proceedings the debtor granted some form of security to another party, often a creditor—but, according to the terms of the Regulation, not all pre-insolvency transactions involving the giving of security are able to be avoided under the law of the *lex concursus*, as some transactions are effectively protected. The aim of the article is to examine the issues that are relevant to determining whether the granting of security prior to the advent of insolvency proceedings under the Regulation can be avoided (set aside) in those proceedings. More specifically the article examines the invalidation of security interests and the extent to which pre-insolvency transactions involving the granting of security interests would be protected by arts 5 and 13 of the Regulation. It analyses the concerns that might be articulated in relation to the application of art.13 and what options are available to the EC to address these concerns. ***E.L. Rev. 74**

The article is structured as follows. First, it sketches the principles that relate to the giving of security and the policy behind seeking security. Secondly, there is a brief consideration of avoidance rules, and the policy that underpins them. Thirdly, the article engages in an examination of how the Regulation addresses the avoidance of transactions made before the opening of formal insolvency proceedings, with an emphasis on arts 5 and 13. Next, the analysis examines the concerns that might be articulated in relation to the use of art.13 to prevent the avoidance of pre-insolvency transactions. This is followed by an exploration of the options that might be available to the EU to address these concerns about the non-application of the avoidance rules. Finally, there are some concluding remarks.

Security

The focus of the article is on security rights bestowed on a party by a debtor before the debtor enters insolvency proceedings that are governed by the Regulation. Initially it is to be noted that there is no exhaustive definition of security (rights in rem) in the Regulation, although some provision is made in this regard in art.5. Article 5.3 provides that:

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

The reasons for the lack of a definition are probably threefold. First, if there were a definition then it could conflict with the various definitions of the term used in jurisdictions where assets are located.[9] Secondly, and related to the first, there is a deliberate policy that the law of the state where the property is located should determine whether a right is a right in rem.[10] Thirdly, refraining from including a definition reflects the fact that there is no universal definition of security rights.[11] The *Report on the Convention of Insolvency Proceedings*, commonly referred to as the Virgos-Schmit Report (a report of the European Bankruptcy Convention in 1996), is regarded as an aid to interpretation,[12] is influential[13] and is of persuasive authority,[14] having been amended following the comments of Member States after it was disseminated.[15] It stated that refraining from providing a definition was intended to enable the law of the state where the assets that are allegedly subject to security were located to decide the issue of whether a right was in fact a right in rem.[16]

Security is taken, giving rights to a party against particular property, in order to secure the payment of a debt or other obligation. This is usually designed to protect a lender or other creditor, at least to the extent that the value of the secured property covers the debt owed. The granting of security rights is seen as an essential element in the lending of money or the giving of credit.[17] Security permits credit to be obtained by debtors where, but for the right to take security and the concomitant benefits in a subsequent insolvency proceeding which security gives, they would not be granted credit.[18] Importantly for the secured creditor, he or she is granted a right, by taking security, which is additional to a contractual right, namely ***E.L. Rev. 75** a proprietary right. Security will provide, usually, the

security holder with a right to payment of any debt owed from the sale of the secured property before all or most other creditors[19] are satisfied from the sale proceeds. This is particularly important when a debtor is insolvent as the debtor will not be able to pay out all of its creditors in full. The great benefit for security holders is that they are protected from the worst risks of the insolvency of a debtor and the interference of third parties.[20]

Bargains between a debtor and its creditors involving the granting of entitlements to creditors are generally respected when insolvency procedures are commenced, so that secured creditors enjoy priority over those creditors who are unsecured.[21] This is reflected in the Regulation. It provides in art.5.1 that:

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

Further understanding of the Regulation's approach to security is demonstrated in Recital 25, which states that there is a particular need to diverge from the law of the state where proceedings were opened in relation to rights in rem, as they are of considerable importance for the granting of credit. It adds 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. The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security." [22]

Berends refers to the approach taken by art.5 as "a hard and fast rule" in that, inter alia, the article provides that rights in rem can never be affected by the opening of insolvency proceedings even if both the *lex concursus* and the *lex situs* provide for such a rule.[23]

There are other benefits, besides priority ranking, enjoyed by secured creditors. A security holder usually has the right to enforce the security, and the mechanisms that exist to allow this are generally speedier than those available to unsecured creditors.[24] Furthermore, as a result of the secured creditor's power to enforce security by way of sale or other action, debtors will generally discharge liabilities owed to secured creditors because they cannot afford to lose the types of assets that are often subject to security as they are key to the continuation of the debtor's business.

The social benefits of security are often said to be that it enables debtors to obtain more credit and at a reduced rate of interest than would normally be the case,[25] and this will have the knock-on effect of benefiting others in society. Importantly, it is asserted that security reduces the cost of creditors in monitoring debtors, for secured creditors know that they have a priority interest in the property which is the subject of the security. ***E.L. Rev. 76***

The fact that security rights are protected in insolvency proceedings is a matter that has been subject to extensive debate. Security is regarded as playing a very important function with regard to credit and the mobilisation of wealth, and so those holding security should retain their interests in property even in insolvency proceedings. Clearly, secured creditors have a great advantage where security is permitted. In most jurisdictions security remains in place and is respected after the initiation of formal insolvency proceedings. If the security does not cover the amount that it is owed to the creditor then the creditor becomes an unsecured creditor for the balance owed and shares on an equal basis with the general unsecured creditors. This is something that a creditor wishes to avoid as it means he or she will not be paid in full.

The fact that there are widely differing laws on security interests in the various Member States of the EU is one example given in the Recitals to the Regulation for the view that it is not practicable to produce regulations with universal scope as far as substantive law goes.[26]

Avoidance or invalidation of security

For many years, and certainly since Roman times, there have been provisions in legislation around the world that enable liquidators to challenge transactions that were entered into before the commencement of insolvency proceedings. Avoidance or invalidation is employed retrospectively in insolvency law, with the consequence that an act which was permitted when it was done can be held

to be invalid following the subsequent entry of a debtor into insolvency proceedings. This approach is put in place for several reasons, and in order to implement certain critical policies. There does not appear to be any standard theory which has been developed in Europe as to the reason for the existence of avoidance provisions, but there are clear policies that underpin the provisions. It is outside the scope of the article to enter into a detailed discussion of the policies, but a brief consideration is appropriate.[27]

There are two main policies that arguably underpin avoidance rules. First, the property of an insolvent is to be distributed fairly and rateably among its creditors,[28] subject to any statutory exceptions. The underlying aim of the inclusion of avoidance provisions for reasons of equality is to ensure that this distribution occurs. Avoidance provisions exist in order to protect the general body of creditors from the unfair diminution of the insolvent's estate which can result from the fact that a debtor has given an advantage to one party prior to the opening of insolvency proceedings. In this respect, provisions are designed to prevent the unjustified enrichment of one individual party to the detriment of all creditors. They aim to counter both the possibility that insolvents may sell some of their assets, prior to entry into insolvency proceedings, at below value market, in order to benefit some third party, often an associate or connected party, and that one or two creditors are paid while other creditors are not. Both of these scenarios will usually be detrimental for the general body of creditors. ***E.L. Rev. 77** [29]

The second policy is prevention of the dismemberment of the insolvent's estate[30] that occurs as part of pre-insolvency transactions, for a loss of assets might reduce the chances of the insolvent being able to continue doing business efficiently or at all, and reduces the possibility of the insolvent being able to be restructured effectively, or at all.[31] The value of the assets of the debtor might be greater when employed in a business that is a going concern than when disposed of separately.[32] Transaction avoidance might be regarded as having a significant role in an insolvency law framework developed to act as a preventative measure and a critical element in protecting creditors and the estate, as well as exacerbating the debtor's insolvency problems.[33]

While the term "avoidance" is most frequently used in this area, the rules that are usually subsumed under "avoidance rules" not only provide for the setting aside of a transaction but will include rules that provide for the return of any property that was transferred under the impugned transaction or the ordering of monetary compensation from a person who benefited from the transaction.[34] That is, courts often have the power to adjust transactions that are successfully challenged by liquidators, for pure avoidance might not be possible or optimal in any given situation. Avoidance as far as security is concerned will usually mean that the security interest is invalidated and the property that was subject to the security is henceforth regarded as being unencumbered. The liquidator will then usually realise the property and distribute the resulting funds among all of the creditors who make claims on the estate of the insolvent, including the formerly secured creditor.

While all sorts of transactions might be affected by avoidance rules, security transactions are focused on in this article. An example of a case where security is often sought to be avoided is where the security was granted in order to secure a pre-existing debt or obligation owed to the creditor who is granted the security.[35] Security is usually granted as part of the extension of credit or given to an existing creditor who might seek some sort of assurance that he or she will be paid in the long run. If security is granted to a person who has extended fresh finance to the debtor then the security is not, usually, avoided unless there has been some failure to adhere to non-insolvency law rules, such as failing to register the creation of the security on the appropriate public register. The benefit of successfully challenging security and having it invalidated is that the creditor affected by it will become an unsecured creditor and rank with all the other unsecured creditors when it comes to paying out the funds of the insolvent, and the amount realised from the sale of the security will be added to those that are to be distributed to the unsecured creditors and according to the statutory scheme that is in operation.

Article 1 of the Regulation provides that the Regulation only applies to collective insolvency proceedings and where there is the appointment of a liquidator, a catch-all term used in the Regulation to cover insolvency practitioners who take office to administer the affairs of an insolvent. Thus the avoidance or ***E.L. Rev. 78** invalidation of a security interest is only considered in the context of a collective proceeding, thus ruling out proceedings such as administrative receivership, which is applicable in the UK.[36]

The approach of the European Insolvency Regulation to avoidance of security interests

It is probably fair to say that the Regulation seeks to address, as far as its approach to avoidance goes, the tension that exists between the need to cover all suspect transactions and the need to provide a reasonable degree of certainty and predictability.[37] In considering how the Regulation deals with avoidance, the starting point for us is art.4.2(m), which provides that the law of the place where insolvency proceedings are opened will determine the rules relating to the voidness of legal acts that are detrimental to all of the creditors.[38] This is included because the basic rule of the Regulation is that the law of the Member State where proceedings are opened governs the administration of the insolvency. Under art.4.2(m) this law determines the rules relating to the voidness, voidability or uneforceability of legal acts detrimental to all of the creditors. The *Report on the Convention of Insolvency Proceedings* stated that the,

"same law determines the conditions to be met, the manner in which the nullity and voidability function (automatically, by allocating retrospective effects to the proceedings or pursuant to an action taken by the liquidator, etc.) and the legal consequences of nullity and voidability." [39]

The recent case of *Lutz v Bauerle* [40] provides that the scope of art.4.2(m) is not limited to actions commenced in court, because the provision refers to avoidance rules and not avoidance actions. It has also been held by the European Court of Justice (CJEU) in *Seagon v Deko Marty Belgium NV* [41] that courts in the place where insolvency proceedings were opened are able to make a decision in relation to an action to avoid because of insolvency that is taken against a company whose registered office is in another Member State.

Exceptions to article 4

While art.4 provides that the law of the place where insolvency proceedings are opened will determine matters in the insolvency, art.5 provides the most significant exception to this rule.[42] In doing this it acts to strengthen in a substantial way the position of the secured creditor. The article is regarded by some as a "negative conflict rule"[43] as its operation means that the *lex concursus* will not apply to affect security. Vigos and Gilmartin have said that: ***E.L. Rev. 79***

"Article 5 functions more as a rule of substantive law than as a simple conflict rule and 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." [44]

In addition art.5 provides for an exception to the general principle that the main proceedings are to have universal scope in that they govern all of the property of the insolvent wherever that is located. The exception in art.5 is included to address the concern that was noted in Recital 24 to the Regulation, that is, but for exceptions the application of law of the place where proceedings were opened could interfere with the rules applying in other Member States. Exceptions are included in order to protect legitimate expectations and certainty of transactions in other Member States.

While it is not intended to provide an exegesis of art.5, where the article fits and its operation need to be examined. For a right to be covered by art.5, the *lex concursus* must have first determined that the assets under review are assets of the insolvent estate. Furthermore, the assets, according to art.5.1 must belong to the debtor,[45] and the assets must have been "situated within the territory of another Member State [not the one in which proceedings have been opened] at the time of the opening of proceedings". This phrase is not defined in the Regulation, but art.2(g), which provides localising rules, informs us what "The Member State in which assets are situated", a roughly equivalent phrase, means in relation to three kinds of property, namely tangible property, property whose ownership must be entered on a public register, and claims. That is, art.2(g) provides some guidance as to where specific classes of assets are located for the purposes of the Regulation. Once the place where the assets are located is resolved then that tells us what law will apply to them, namely the domestic law of that place, the *lex situs*. Where property is not situated in a Member State then art.5 will not apply and what law applies will be left to the *lex concursus* and its private international law rules to determine.[46]

Article 5.1 provides that the opening of insolvency proceedings is not to affect rights in rem (created before the opening of insolvency proceedings) of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets belonging to the debtor which are situated within another Member State at the time of the opening of proceedings. The substantive and procedural rights of the secured creditor remain such that the security rights remain intact and also the secured creditor can enforce the security, such as realising the property secured,[47] but what is meant by "not affect the

rights in rem"? The meaning is very much a moot point. The main issue is whether the article only refers to the right in rem itself or whether it also covers the debt that relates to the right in rem. It is submitted that it must be the latter as the whole purpose of introducing art.5 was to protect secured creditors, and if the debt underlying the security were not covered it could potentially impact significantly on creditors.[48]

Rights in rem are not defined save for the fact that para.(2) of the article adumbrates the types of rights that are normally considered by domestic laws as rights in rem. For instance, the paragraph provides that rights in rem cover the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of, or income from, those assets by virtue of a lien or a mortgage. In *Lutz*,[49] the CJEU accepted the fact that the right to attach the credit balance on a bank account was a right in rem, as it allowed for an exclusive right to have a claim met and thus the rights of the holder of the power to obtain an ***E.L. Rev. 80*** attachment.[50] Article 5.3 goes on to provide, somewhat inelegantly, that a right recorded in a public register and enforceable against third parties, under which a right in rem within art.5.1 may be obtained, is considered to be a right in rem. So, there is no exhaustive definition of rights in rem in the Regulation. It is submitted that an unreasonably broad definition of rights in rem will not be employed, as to do so would be to strike at the essential principle that underpins the Regulation to an inappropriate degree, namely to allow the *lex concursus* to have universal application.[51] In determining what is a right in rem it is possible that a court might expect it to have the following two characteristics mentioned in the *Report on the Convention of Insolvency Proceedings*.[52] The first is a,

"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."

The second is "the absolute nature of the allocation of the right to the holder".

The relevant domestic law, the *lex situs*, will determine what is a right in rem. As we have seen, art.2(g) determines where assets are located for specific forms of property and, consequently, what will be the *lex situs* applying to the property—but there is no certainty as to whether art.2(g) purports to encompass all kinds of property.[53] If it does not, what determines the *lex situs* of property that does not fall within the three kinds of property particularised in the article? It is possible that what the *lex situs* is will depend on the conflict of law rules of the *lex concursus*.[54]

While art.5 is an important exception to art.4, it does not protect rights in rem totally. Article 5.4 provides that what is said in para.(1) can be overridden as far as avoidance actions referred to in art.4.2(m) are concerned.[55] As noted earlier, art.4.2(m) lays down the principle that avoidance of transactions entered into before the opening of insolvency proceedings and detrimental to all the creditors[56] would be determined by the law that applied in the Member State where those proceedings were opened. Thus, art.5 will not prohibit the effectiveness of avoidance actions. Also, if the law where the assets are situated allows the relevant rights in rem to be affected in some way, the liquidator could seek the opening of secondary proceedings in the Member State where the security was held, and the law of the *lex situs* would apply to affect the rights in rem just as any domestic legal proceedings would.[57]

More specifically, and more importantly for the purposes of this article, art.13 of the Regulation takes things further than art.5, for while para.4 of art.5 means that a right in rem is not precluded from being set aside as a result of an avoidance action permitted by the *lex concursus*, art.13 provides that an avoidance action permitted by the law of the place of the opening of insolvency proceedings is not able to be taken, in certain situations, in relation to the giving of security or the making of other transactions. Thus art.13 effectively nullifies the impact of art.5.4, and restores the position that is established in art.5.1 in that the opening of proceedings will not affect rights in rem as far as the question of avoidance is concerned. It means that the defence for any secured creditor to any avoidance claim under art.4.2(m) is to invoke art.13. The rationale for the inclusion of art.13 is found in Recital 24, namely to protect legitimate expectations and certainty of transactions in other Member States. In particular there is a desire to protect the expectations ***E.L. Rev. 81*** of creditors or third parties as far as the validity of transactions is concerned from being prejudiced by the rules of a different *lex concursus*,[58] one that was not envisaged when the transactions were entered into.

Effectively, art.13 provides a defence against the application of the avoidance rules in the law of the Member State where insolvency proceedings were opened. The Virgos-Schmit Report referred to the article as acting as a "veto" against the invalidity of the act decreed by the law of the Member State in

which proceedings were opened,[59] and to uphold the legitimate expectations of creditors and others concerning the validity of the security.[60] It means that if a creditor entered into a transaction involving the granting of security to a debtor and the law of a particular country has been nominated, in a relevant contract, as the one that governs the transaction it can be expected that this law will apply even if the debtor enters insolvency proceedings, and it will prevent the avoidance of the security if it does not permit avoidance.

Article 13 states that:

"Article 4.2(m) shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that—

- the said act is subject to the law of a Member State other than that of the State of the opening of proceedings, and
- that law does not allow any means of challenging that act in the relevant case."

In the light of the above, a person seeking to rely on the article must meet two conditions.

The rule provided for in the article relates to both the main proceedings and any secondary proceedings commenced, with the result being that the law of the Member State in which main or secondary proceedings were opened will be affected.[61]

For art.13 to apply, the transaction under challenge must be "subject to a law" of a Member State (X) other than the State where proceedings were opened and this is usually regarded as a reference to the law that is said to govern the transaction or, particularly with security, the law of the place where the property is located.[62] For art.13 to operate, the law of X must not permit the transaction to be challenged by "any means," and this is normally construed as referring to the fact that the defence is only permissible if the act being attacked is not able to be avoided under any part of the insolvency and non-insolvency law of X whose law applies.[63] The reference to "relevant case" in the second limb of the article is taken to mean consideration of avoidance given the specific facts that are before the court.[64] As one would expect, the party who seeks to rely on art.13 as a defence to an avoidance action brought in the Member State where main proceedings were opened has the onus of proving that the article applies.[65]

Lutz was the first case in which the CJEU had the opportunity to give judgment in a matter involving art.13, and its importance is reflected in the fact that several non-parties made submissions to the Court including the EC and several Member State governments. The case deals with the same issue that was before the European Free Trade Association Court in ***E.L. Rev. 82** *LBI hf v Merrill Lynch International Ltd (E-28/13) 17 October 2014 EFTA Court*.[66] The latter case involved consideration of Directive 2001/24 on the reorganisation and winding up of credit institutions [67] as incorporated into Annex IX to the EEA Agreement. Articles 10(2)(l) and 30(1) of the Directive are broadly equivalent to arts 4.2(m) and 13 respectively of the Insolvency Regulation, although art.10 of the Directive refers to the law of the home state of the credit institution being applied in the winding up.

For our purposes *Lutz* is doubly interesting as it involved the attempted setting aside of a security interest. The judgment was delivered in April 2015. The facts were that ECZ, a company that was registered in Germany, was in the business of selling cars and it operated in Austria through a subsidiary, X, that was registered in Austria. Lutz purchased a car from X. X failed to deliver the car and so Lutz initiated legal proceedings against X in Austria, seeking the return of the amount that he had paid. On 17 March 2008 the court hearing the proceedings handed down an enforceable payment order against X and in favour of Lutz. On 13 April 2008 X filed an application in a German court seeking the opening of insolvency proceedings. Proceedings were opened on 4 August 2008. Meanwhile on 20 May 2008 the Austrian court had granted leave to Lutz to enforce the payment order and three bank accounts of X at an Austrian bank were attached. The bank was notified of the attachment on 23 May 2008. On 17 March 2009 the bank paid Lutz the sum of €11,778 from X's accounts. Earlier the liquidator of X, had in a letter of 10 March 2009, notified the bank that he

reserved the right to challenge any payment made in favour of X's creditors. On 3 June 2009 the liquidator informed Lutz that he was going to attack the enforcement of Lutz's rights which had been authorised on 20 May 2008 by the Austrian court as well as the payment that had been made to him on 17 March 2009. On 23 October 2009, a new liquidator of X instigated proceedings against Lutz in Germany. She sought to have the transaction (the payment of the money) set aside and to recover the amount paid. At first instance and on appeal, the courts found for the liquidator. Lutz then asked the German Federal Court to determine a matter of law in relation to the interpretation of art.13. German law, the *lex concursus*, provided that the right to attach the credit balance on X's bank accounts became invalid on the date when the insolvency proceedings against that company were opened. This was because the attachment was not authorised and put into effect until after the application to open the insolvency proceedings, and so the payment made to Lutz was invalid. Austrian law provided that a liquidator only has a period of one year, from the date when the insolvency proceedings were opened, to commence an action to set aside a transaction. The period in Germany was three years. While the liquidator met the German requirement, she had not met the Austrian one as the action to set aside was not instituted within one year of the opening of the insolvency proceedings. So, under Article art.4(2)(m), German law would permit the transaction to be avoided. However, Lutz argued that art.13 applied as Austrian law did not permit the transaction to be avoided on the basis that proceedings to avoid had not been instituted within a year of the opening of insolvency proceedings. The matter was referred to the CJEU (First Chamber). The upshot of the Court's response to the questions posed to it was that Lutz succeeded. The Court took the same approach as the EFTA Court in *LBI v Merrill Lynch*. While the actual decision is interesting, the comments that the Court made about art.13 in general are far more informative.

It was made clear by the Court that art.13 is not, in principle, applicable to acts which take place after the opening of insolvency proceedings,[68] although in the case before the Court it was said that a creditor who was paid after the opening of insolvency proceedings was able to rely on art.13 where, as in the case before it, the rights in rem were obtained before the opening of proceedings.[69] According to the Court, the ***E.L. Rev. 83*** article makes no distinction between substantive and procedural provisions,[70] and thus the article applies to limitation periods or other time-bars relating to actions to set aside transactions pursuant to the law governing the transactions.[71] Thus in this case the Austrian time-bar was applicable and art.13 prevented the operation of the German avoidance rule.

Behind the existence of the article is a respect for the national laws where security is created and to protect legitimate expectations of the parties as far as the legal regime which is expected to be applicable to their legal relationship.[72] Creditors or third parties will generally expect that the transaction will be valid if entered into in accordance with the normally applicable national law of the relevant Member State, and it will prevent interference from the law of a different Member State.[73] In order to protect the legitimate expectations of parties to the creation of security, the operation of art.13 is justified as it covers actions that were carried out prior to the opening of the insolvency proceedings, and which are threatened by the retrospective nature of insolvency law applying because of the opening of insolvency proceedings in another country.[74] There is a tension that exists with the implementation of avoidance rules, namely the need to retain the statutory scheme of distribution of assets as against certainty that goes with binding transactions, and the article comes down on the certainty side of the tension.

The problem that art.13 creates, as far as liquidators and the general creditors of an insolvent are concerned, can be illustrated in the following way. Say liquidation proceedings are opened against a company, X, in Spain on the basis that Spain is the company's centre of main interests (COMI) for the purposes of the Regulation. Under the Regulation insolvency proceedings may only be opened in the Member State where the debtors' COMI is to be found. X owed, before the insolvency proceedings were opened, a debt to Y. Again, before the opening of proceedings, X granted to Y a fixed charge over its property for no consideration. This occurred seven months before the opening of proceedings. The charge was created in favour of Y because Y had threatened to take proceedings to liquidate X. The granting of security related to property held in England and the charge was arranged and created in England. If proceedings were brought in Spain to challenge the charge on the basis that it was a preferential transaction and they would ordinarily be successful,[75] Y could rely on art.13 to defend the claim as in England the claim would not succeed on two grounds. First, assuming Y is not a person connected to X (usually this would involve being a director or a relative of a director of the company), the creation of the charge was more than six months before the commencement of liquidation[76] and, secondly, it is likely that it could not be said that the transaction (the granting of the charge) was influenced by a desire to produce an advantage for Y over and above other creditors.

Under English and Welsh law it is likely that the granting of security for commercial reasons, namely to convince a creditor not to take proceedings against the debtor, would not constitute being influenced by a desire to produce an advantage for a creditor. ***E.L. Rev. 84** [77]

Concerns over the application of article 13

There have been a number of concerns voiced about both the presence of art.13 in the Regulation and the drafting of the article, and the fact that it is likely to diminish the effectiveness of avoidance provisions and undercut the rationales for them. The leading ones are now considered.

The first concern in relation to art.13 is that its effect may produce the undesirable consequence that the parties to the transaction that is detrimental to the general body of creditors are able to succeed in protecting it from being impugned by including in the contract establishing security a choice-of-law clause in favour of a legal system that would not allow any challenge in the event of the debtor's insolvency. It is possible to choose the law of any EU jurisdiction, and there is no requirement that there be any natural or factual link between the law chosen and the transaction.[78] Pfeiffer has said: "A contractual choice of law cannot be considered to be fraudulent or invalid just because it refers to a law that may impede avoidance claims."[79] So, where a law, other than the law of the Member State where insolvency proceedings were opened, applies, either on the basis of the substantive determination of the law applicable to the relevant transaction or founded on a choice of law clause in the contractual provisions, one can end up with the operation of a legal regime which does not favour an avoidance action.[80] Pfeiffer has said that this is not likely to occur as generally in international contract law the terms of transactions are not predicated on possible avoidance claims brought on the basis that one party to the contract becomes insolvent.[81] Nevertheless, the fact of the matter is that financiers (or at least their lawyers), when providing finance to most parties, will take into account the insolvency scenario and include provisions that might, for instance, address any loss of security for the secured creditor. Avoidance rules can be of critical importance and it is likely that they will feature as important elements in lawyers' advice to lenders.

Secondly, there is some doubt whether the ambit of the article only covers specific means or remedies relating to avoidance or voidness which are based on insolvency law, or whether it covers all cases of avoidance or voidness including those based on general private law, e.g. in cases of illegality, immorality or mistake.[82] The use of the words "any means" in art.13 appear to indicate that besides the transaction not being able to be challenged because the insolvency rules of another Member State to which the transaction is subject do not permit a challenge, the article will also not allow the transaction to be avoided if the general rules contained in the national law of the State that is applicable to the transaction do not permit it. However, it is not as clear as one would like.

Thirdly, because art.13 leaves open the possibility that creditors might object that any avoidance action has also to be judged by the law that was applicable to the transaction, in accordance with the contract, this creates great uncertainty among liquidators. As one might expect, liquidators are generally in favour of abolishing art.13 so that only the law of the place where insolvency proceedings were opened is applicable to the avoidance issue. ***E.L. Rev. 85** [83]

Fourthly, the article attenuates the general policy of the Regulation, namely that the law of the Member State in which proceedings are opened is supposed to be paramount, as it undermines the universalist philosophy that underpins the Regulation.[84]

Fifthly, the avoidance of pre-liquidation transactions is designed, inter alia, to provide for fairness between creditors, distribution according to statutory priorities and to foster the collective nature of proceedings, and art.13 hinders the achievement of these aims.[85]

Finally, art.13 's drafting is far from precise, and is in fact ambiguous. There is, as we have seen, some uncertainty over the interpretation of "any means" and similar uncertainty exists in relation to other phrases in art.13, such as "subject to the law" and "the relevant case". The recast version of the Regulation takes us no further as it repeats the phrases mentioned here without resolving any possible uncertainty.

Options for change

Given the criticism of the present state of play with the Regulation as far as the avoidance rules are concerned, and the possible application of art.13, what options exist to change the situation? There

appear to be five leading contenders.

First, provision for the exclusive application of the law of the Member State where proceedings have been opened—that is, regardless of where the rights to security are located and any choice of law clause in the contract, this law will apply.[86] This appeared to be favoured by the *Report on the Convention of Insolvency Proceedings* [87] on the basis that the main proceedings are only able to be opened if the debtor's COMI is in the Member State where proceedings are opened and,

"it seems logical that the decision of the law of that State to allow collective insolvency proceedings against that debtor should be respected by the other Member States, whose connection with the debtor is restricted to the existence of an establishment or assets." [88]

Such an approach would necessarily involve the abolition of art.13. This action might be said to be attractive as it would be easier for liquidators to pursue avoidance proceedings as only the *lex concursus* would have to be taken into account, and there would not have to be an interpretation of the laws of other Member States, such as the *lex situs*, to assess whether they do in fact prevent the challenging of transactions creating security interests (or other transactions). It is also said that in taking this action certainty is still retained as the insolvency law that is to be applied under art.4 is determined by the COMI and that is a foreseeable and certain standard. Furthermore, it might be argued that this approach is fairer to most stakeholders as they are likely to be domiciled in the COMI.

The adoption of this approach has been criticised on the basis that this would mean that conduct that is regarded as inappropriate under the law of the Member State where the conduct had its effect would ***E.L. Rev. 86*** not be relevant to whether or not there was avoidance.[89] In defence of art.13, it has been submitted that while the present law has its complications, it is not uncommon in international cases for more than one national law to have to be considered in dealing with an issue, and so the present situation is not overly burdensome.[90] Further, it is argued that it is better to permit a contractual choice of law and have that law operating when it comes to consideration of avoidance, rather than simply having the law of the COMI of the insolvent applying because a party can change its COMI subsequent to any agreement being made between the insolvent and a lender and before the proceedings are commenced, thus there cannot be certainty even if the law of the COMI is applied exclusively in any avoidance action.[91] The final point is that this option might lead to creditors protecting themselves further, either through the inclusion of (more) restrictive covenants or increasing the cost of credit.

The second option is to provide in art.13 that not only can a defendant to an avoidance action rely on that part of the *lex causae* which is able to be invoked to prevent any avoidance that is permitted under the *lex concursus*, a liquidator could rely on any part of the *lex causae* that might justify avoidance where the *lex concursus* did not.[92] This would mean that neither the *lex concursus* nor the *lex situs* would be able to be relied on in order to veto the avoidance action. If that were the case then it would not affect any expectations of the parties with regard to the nature of the parties' legal relationship.[93] The difficulty with this is that it would potentially result in the application of a great number of different avoidance laws, which would render avoidance a more complicated issue for a liquidator.[94] Liquidators already have this onus with the existing law, because insolvency proceedings could be opened in any one of the Member States and thus the avoidance rules of any one of these states could be applicable under art.4.2(m). This second option might in effect already be available. That is, if the jurisdiction where the assets subject to security are located does permit the avoidance of the security in the circumstances that relate to the insolvent debtor, but the jurisdiction where proceedings were opened did not allow avoidance, then provided that the insolvent had an establishment in the former jurisdiction secondary proceedings could always be commenced and the law of the location of the assets would apply.

Thirdly, the avoidance rules of the *lex situs* are to apply.[95] The potential drawback with this approach is that liquidators would still have to deal with a significant number of different avoidance rules. It is also vulnerable to the argument that the secured creditor might well have done all he or she could do to ensure that the security interests did not fall foul of the avoidance rules where the security was created. It also derogates from the idea that runs throughout the Regulation, namely that the law that applies to the insolvency proceedings should be that of the Member State where proceedings were opened. The advantage, in applying the *lex situs*, might be that it brings greater certainty, for when the security is granted the parties know which avoidance rules will apply in the event of the opening of insolvency proceedings at some later date in a different Member State. ***E.L. Rev. 87***

Fourthly, the *lex concursus* should not determine what the effects of insolvency are as far as rights in

rem in property located in a Member State other than the place where proceedings are opened. In other words, only where property is situated in the Member State where proceedings are opened should avoidance rules of the *lex concursus* apply.[96] Article 5 adopts this approach in that it provides for a kind of immunity rule in favour of third-party security rights on the basis that this diminishes the complexity of the proceedings, and leads to cost savings.[97]

Fifthly, the most radical, and possibly the most permanent answer to the problems raised here, is for there to be a complete harmonisation of the avoidance provisions applying across the EU. It would involve the EU composing a set of avoidance rules that would apply to insolvencies in all Member States (except, presumably, for Denmark). This option entails what some have called the total harmonisation of avoidance rules.[98] It would seem to avoid many of the issues identified above, but it conceivably leads to others.

The last option would have the clear advantage of producing greater certainty (especially for liquidators) and would contribute to the prevention of forum shopping. It would also induce a feeling of fairness in that one rule would apply to all insolvencies no matter where the security was created, where the assets were located, what law is said to govern the contract and where the insolvency proceedings were opened. And, as discussed below, the idea of having harmonised laws is not unrealistic in today's climate. Finally, harmonisation would provide for greater transparency so that all parties are able to know what will happen on the insolvency of a debtor.[99] For the foregoing reasons it is submitted that total harmonisation is probably the most preferable way to proceed,[100] even though it is not without its problems that cannot be evaluated in this article, given space constraints.

It will be recalled that the Regulation was not introduced to harmonise the substantive insolvency rules that apply across the EU, but to harmonise rules on the recognition of insolvency proceedings and conflict of laws. However, in the past five years there have been moves to consider the possible introduction of some harmonisation as far as insolvencies are concerned.[101] In 2010, following a request from the European Parliament, INSOL Europe[102] prepared a report which examined the need for, and the feasibility of, harmonisation of European insolvency law. The report concluded that a number of areas of insolvency law were apt for harmonisation and that harmonisation in relation to these areas was desirable and achievable.[103] The report indicated that the divergence in rules across Member States provides incentives for the implementation of forum shopping, namely searching for the most favourable courts notwithstanding ***E.L. Rev. 88*** where the activities and property of parties were situated.[104] According to this report, it did not endeavour to provide any possible rules that might be applied as far as harmonised avoidance rules were concerned, but it was felt that the issue of avoidance actions was one of the most appropriate matters for harmonisation.[105]

Following the INSOL Europe report, the European Parliament in a Resolution of 15 November 2011 suggested partial harmonisation, focusing on specific types of acts that are detrimental to creditors. It said that even if the creation of a body of substantive insolvency law at EU level is not possible, there are certain areas of insolvency law where harmonisation is worthwhile and achievable.[106] It resolved that there should be harmonisation of aspects of avoidance actions and should cover: "transactions in a situation of imminent insolvency, *the creation of security rights*, transactions with connected parties and transactions carried out with the intention of defrauding creditors"[107] (emphasis added).

While the harmonising of avoidance rules and other aspects of insolvency law that INSOL Europe identified as constituting possible areas for harmonisation has not occurred, there has been some movement on the harmonisation of insolvency laws generally. The European Parliament Resolution of 5 February 2014[108] amended Recital 11 to the Regulation so as to refer to harmonisation and it stated that "further harmonization measures should also introduce preferential rights of employees". Subsequently there was an EC Recommendation of 12 March 2014,[109] entitled "on a new approach to business failure and insolvency", which referred to the European Parliament Resolution of 15 November 2011[110] and made mention of,

"common principles for national preventive restructuring frame-works, which intends a bottom-up harmonization with a view to enhancing coherence among them and thus promoting the rescue and recovery culture." [111]

The EC Recommendation of 12 March 2014 provided that new financing for a struggling company which is agreed upon in a "restructuring plan and confirmed by a court should not be declared void, voidable or unenforceable as an act detrimental to the general body of creditors".[112] The recast version of the Regulation ***E.L. Rev. 89*** includes Recital 22, which indicates a desire to harmonise the priority rights of employees in an insolvency.[113] Clearly there appears to be an appetite in the EC

for some degree of the harmonisation of some, at least, of the insolvency laws.

It has been said that the tests on avoidance remain burdensome and not completely predictable,

"and it is arguable that some kind of harmonisation of the avoidance remedies, at least in the context of business insolvency, might be advantageous to further integration and development of European common market." [114]

Creditors might be more ready to extend loans to companies if they know which law will apply if a company becomes subject to insolvency proceedings. If there was total harmonisation then there would be greater certainty to the point where secured creditors and their advisers would know what avoidance rules would apply if the debtor entered insolvency proceedings as the debtor's COMI could, theoretically, change on several occasions between the time of granting the security and the inception of insolvency proceedings. As far as security interests are concerned, we must note that there are widely differing laws on security interests within the EU, and in particular in relation to the types of security that can be taken, the ranking of secured creditors in relation to other creditors, when security interests can be avoided in insolvency proceedings, and restrictions on rights to self-enforcement of security. Also, some States require a portion of the secured benefit to go towards the unsecured pool. Naturally, it would be necessary to determine what forms of security can be set aside and the conditions that will be prescribed for avoidance.

Conclusion

The avoidance of certain transactions entered into prior to the opening of insolvency proceedings is clearly regarded as an important element of insolvency law. Among other things, it prevents the general creditors being prejudiced for if a transaction is set aside the benefit given to one person is then able to be shared among all creditors. This can be particularly beneficial if a security right can be invalidated as the property that is subject to the security is sold and the resulting funds, rather than being given to the secured creditor alone (unless the sale produced a surplus over and above the amount secured), are distributed among the creditors in general and according to the statutory rules that apply in the jurisdiction in which the insolvent's affairs are being administered.

At the present moment there is no little disquiet with the situation that exists when an insolvent's property is subject to security that was created in a different Member State of the EU to the one in which insolvency proceedings have been opened under the European Insolvency Regulation. In such circumstances the security cannot be set aside even if the law of the latter would allow it to be, where the transaction is subject to the law of another Member State and that law does not allow any means of challenging the transaction. The article has addressed the concerns with this state of affairs and recognised the fact that these concerns have merit and should be addressed. Hence the article considered several options that appear to be available to overcome or, at least, ameliorate the position. These options range from merely abolishing art.13 so that the law of a Member State other than the one where insolvency proceedings have been opened cannot prevent avoidance, to total harmonisation of the avoidance rules. The article has identified drawbacks with all of the options, which means that care must be taken in determining which is the best way to proceed, if indeed the EC decides that the concerns over the non-application of avoidance rules that can result from the operation of art.13 justify a change to the present position, but total ***E.L. Rev. 90*** harmonisation, where harmonised avoidance rules apply to all insolvencies, appears to be the most attractive way to proceed.

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1. Council Regulation on Insolvency Regulations 1346/2000, 29 May 2000.

2. For a detailed discussion of the background to the Regulation, see *G. Moss, I. Fletcher and S. Isaacs (eds), The EC Regulation on Insolvency Proceedings, 2nd edn (Oxford, Oxford University Press, 2009), pp.1–16*.

3. Described by Horst Eidenmuller as making overly modest changes: H. Eidenmuller, "A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond" (2013) 20 Maastricht Journal of European and Comparative Law 133, 150. For a recent discussion of the recast regulation, see M. Weiss, "Bridge over Troubled Water: The Revised Insolvency Regulation" (2015) 24 International Insolvency Review 192, and first published online on 18 August 2015, http://onlinelibrary.wiley.com/doi/10.1002/iir.1241/full [Accessed 14 December 2015].

4. See Regulation 2015/848 on insolvency proceedings (recast) [2015] OJ L141/19 art.16.

5. Regulation 2015/848 art.3.1.

6. Regulation 2015/848 art.4.2(m).

7. This is not meant to refer only to those who wind up companies in liquidation but to all those qualified to oversee the affairs of an insolvent company. The use of "liquidator" as in the EC Regulation on Insolvency Proceedings is adopted. The Regulation provides in art.2(b) that a liquidator is a person or body whose function is to administer or liquidate assets of which a debtor has been divested or to supervise the administration of the debtor's affairs. In Annex C "liquidator" covers a host of roles that are played by those who administer the estates of insolvents. The recast of the Regulation omits reference to "liquidator" and substitutes the more neutral term "insolvency practitioner". See Regulation 2015/848 art.2(5).

8. *DG for Internal Policies, "Harmonisation of Insolvency Law at EU Level: Avoidance Actions and Rules on Contracts", Briefing Note (2011), p.11*. See *I. Fletcher, Insolvency in Private International Law, 2nd edn (Oxford: Oxford University Press, 2005), p.400*.

9. *Report on the Convention of Insolvency Proceedings (Virgos-Schmit Report) (1996), para.100*.

10. *Moss et al. (eds), The EC Regulation on Insolvency Proceedings (2009), p.135*.

11. *G. McCormack, Secured Credit and the Harmonisation of Law (Cheltenham: Edward Elgar, 2011), p.54*.

12. I. Fletcher, "Effect on Arbitration Proceedings of the EU Regulation" (2009) 22 Insolvency Intelligence 60, 61.

13. P. Smart, "Rights in Rem, Article 5 and the EC" (2006) 15 International Insolvency Review 18, 20.

14. *G. McCormack "Article 2" in L. Doyle and A. Keay (eds), Insolvency Legislation: Annotations and Commentary, 3rd edn (Bristol: Jordans, 2009), p.1383*.

15. The EC Insolvency Proceedings Regulation and the provisions of the 1995 Convention are close in terms of substance.

16. *Virgos-Schmit Report (1996), para.100*.

17. EC Regulation on Insolvency Proceedings, Recital 25. For a comprehensive discussion of the essence and importance of security, see *G. McCormack, Secured Credit under English and American Law (Cambridge: Cambridge University Press, 2004), pp.1–38*.

18. *Virgos-Schmit Report (1996), para.97*.

19. In some Member States, such as France, Hungary and Italy, employee claims can take priority over secured rights.

20. EC Regulation on Insolvency Proceedings, Recital 25; *Virgos-Schmit Report (1996), para.97*. See *H. Eidenmüller, "Secured Creditors in Insolvency Proceedings" in H. Eidenmüller and E.-M. Kieninger (eds), The Future of Secured Credit in Europe (Berlin: De Gruyter, 2008), p.273*.

21. F. Mucciarelli, "Not Just Efficiency: Insolvency Law in the EU and Its Political Dimension" (2013) 14 E.B.O.R. 175, 180.

22. The Regulation as recast also provides for this: Regulation 2015/848 on insolvency proceedings (recast), Recital 68.

23. A. Berends, "The EU Insolvency Regulation: Some Capita Selecta" (2010) 57 Netherlands International Law Review 423, 430–431.

24. *McCormack, Secured Credit and the Harmonisation of Law (2011), p.54*.

25. *McCormack, Secured Credit and the Harmonisation of Law (2011), p.55*.

26. Regulation 2015/848, Recital 11.

27. For a detailed discussion, see, for example, *A. Keay, Avoidance Provisions in Insolvency Law (Sydney: Law Book Co, 1997), Ch.3*; *R. Parry, "The Rationale of the Transaction Avoidance Provisions of the Insolvency Act 1986" in R. Parry, J. Ayliffe and S. Shivji (eds), Transaction Avoidance in Insolvencies, 2nd edn (Oxford: Oxford University Press, 2011), Ch.2*; *A. Boraine, Avoidance Provisions in a Local and Cross-border Context (London: INSOL International, 2014)*; R. de Weijs, "Towards an Objective European Rule on Transaction Avoidance in Insolvencies" (2011) 20 International Insolvency Review 219; *INSOL International, Avoidance of Antecedent Transactions and Cross-Border Insolvency (London: INSOL International, 2014)*.

28. E. Warren, "Bankruptcy Policymaking in an Imperfect World" (1993) 92 Michigan Law Review 336, 353; J. McCoid, "Bankruptcy Preferences and Efficiency: An Expression of Doubt" (1981) 67 Virginia Law Review 249, 260; A. Keay, "In Pursuit of the Rationale behind the Avoidance of Pre-Liquidation Transactions" (1996) 18 Sydney Law Review 56; M. Frigessi, "Avoidance Actions under Article 13 EC Insolvency Regulation: An Italian View" (2009) 6 European Company Law 27, 28; L. Carballo Pineiro, "Vis attactiva concursus in the European Union: its development by the European Court of Justice" (2010) 3 InDret 1, 19.

29. *DG for Internal Policies, "Harmonisation of Insolvency Law at EU Level" (2011), p.11*.

30. J. Westbrook, "Two Thoughts about Insider Preferences" (1991) 76 Minnesota Law Review 73, 77; Keay, "In Pursuit of the Rationale behind the Avoidance of Pre-Liquidation Transactions" (1996) 18 Sydney Law Review 56.

31. *DG for Internal Policies, "Harmonisation of Insolvency Law at EU Level" (2011), p.11*.

32. If this is the case then the outcome is clearly inefficient: Mucciarelli, "Not Just Efficiency" (2013) 14 E.B.O.R. 175, 179.

33. L. Carballo Pineiro, "Towards the Reform of the European Insolvency Regulation: Codification rather than Modification" (2014) 2 Nederland Internationaal Privaatrecht 207, 212.

34. *J. Alexander, "Avoid the Choice or Choose to Avoid? The European Framework for Choice of Avoidance Law and the Quest to Make it Sensible" (15 March 2009), p.5, SSRN*, http://ssrn.com/abstract=1410157 [Accessed 14 December 2015].

35. Avoidance is provided for specifically in legislation in relation to this type of situation in many Member States. An example is art.67 of the Italian Bankruptcy Law (*Legge Fallimentare*). Other Member States do not provide a specific rule to cover this kind of transaction, but it would be covered by a general provision, an example being s.129 of the German Insolvency Code (*Insolvenzordnung*).

36. See Insolvency Act 1986 Pt III.

37. *Alexander, "Avoid the Choice or Choose to Avoid?" (15 March 2009), p.5, SSRN*, http://ssrn.com/abstract=1410157 [Accessed 14 December 2015], and referring to J. Westbrook, "Avoidance of Pre-Bankruptcy Transactions in Multinational Bankruptcy Cases" (2007) 42 Texas International Law Journal 899, 901.

38. *Fletcher, Insolvency in Private International Law (2005), p.400*.

39. *Virgos-Schmit Report (1996), para.135*.

40. *Lutz v Bauerle (C-557/13) EU:C:2015:227; [2015] Bus. L.R. 855* at [30].

41. *Seagon v Deko Marty Belgium NV (C-339/07) [2009] E.C.R. 1-767; [2009] B.C.C. 347*. This approach has been affirmed recently in *Schmid v Hertel (C-328/12) EU:C:2014:6; [2014] B.P.I.R. 504*, insofar as the defendant is an individual residing in another Member State. This is also made clear in the recast Regulation: Regulation 2015/848, Recital 35.

42. *I. Fletcher, Insolvency in Private International Law (2005), p.402*.

43. *M. Virgos and F. Garcimartin, The European Insolvency Regulation: Law and Practice (Amsterdam: Kluwer Law International, 2004), p.104*.

44. *Virgos and Garcimartin, The European Insolvency Regulation (2004), pp.103–104*.

45. See the discussion in *M. Veder, "Applicable law, in particular security rights", presented at the Conference on the Future of the European Insolvency Regulation, Amsterdam (28 April 2011)*, http://www.eir-reform.eu/ [Accessed 14 December 2015].

46. *Fletcher, Insolvency in Private International Law (2005), p.405*.

47. P. Smart, "Rights in Rem, Article 5 and the EC" (2006) 15 International Insolvency Review 18, 23.

48. For a discussion of the issue in relation to some specific situations, see *Moss et al. (eds), The EC Regulation on Insolvency Proceedings (2009), pp.140–141*.

49. *Lutz (C-557/13) EU:C:2015:227* at [30].

50. *Lutz (C-557/13) EU:C:2015:227* at [27]–[28].

51. *Moss et al. (eds), The EC Regulation on Insolvency Proceedings (2009), p.287*.

52. *Virgos-Schmit Report (1996), para.103*.

53. *Moss et al. (eds), The EC Regulation on Insolvency Proceedings (2009), p.138*.

54. *J. Marshall, "Article 5 (rights in rem)"*, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf [Accessed 14

December 2015].

55. See Lutz (C-557/13) EU:C:2015:227 at [26].

56. The Regulation, as recast, omits "all" from the article and replaces it with "general body": Regulation 2015/848 art.4.2(m).

57. *Virgos-Schmit Report (1996), para.98*.

58. *Virgos-Schmit Report (1996), para.138*.

59. *Virgos-Schmit Report (1996), para.136*.

60. *Fletcher, Insolvency in Private International Law (2005), p.401*.

61. *Virgos-Schmit Report (1996)*.

62. *Alexander, "Avoid the Choice or Choose to Avoid?" (15 March 2009), p.16, SSRN*, http://ssrn.com/abstract=1410157 [Accessed 14 December 2015].

63. *Alexander, "Avoid the Choice or Choose to Avoid?" (15 March 2009), pp.16–17, SSRN*, http://ssrn.com/abstract=1410157 [Accessed 14 December 2015].

64. *Virgos-Schmit Report (1996), para.137*.

65. See *Nike European Operations Netherlands BV v Sportland Oy (C-310/14) EU:C:2015:690; [2015] Bus. L.R. 1547* at [25],[31],[38], [42].

66. *LBI hf v Merrill Lynch International Ltd (E-28/13) 17 October 2014 EFTA Court*, http://www.eftacourt.int/fileadmin/user_upload/Files/Cases/2013/28_13/28_13_Judgment_EN.pdf [Accessed 14 December 2015].

67. Directive 2001/24 [2001] OJ L125.

68. *Lutz (C-557/13) EU:C:2015:227* at [36].

69. *Lutz (C-557/13) EU:C:2015:227* at [43].

70. *Lutz (C-557/13) EU:C:2015:227* at [47], [53].

71. *Lutz (C-557/13) EU:C:2015:227* at [49].

72. *P. Pfeiffer, "Article 13 EIR: Avoidance, Avoidability and Voidness" in Commission, External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings, JUST/2011/JVC/PR/0049/A4 (2013), para.6.10.2.1*.

73. *Virgos-Schmit Report (1996), para.138*.

74. *Virgos-Schmit Report (1996), para.138*.

75. *Clifford Chance, European Insolvency Procedures (London: Clifford Chance, 2012), p.54*.

76. Insolvency Act 1986 s.240(1)(b).

77. See *Re MC Bacon Ltd (No.1) [1990] B.C.L.C. 324 Ch D*. For an explanation and criticism of the law, see A. Keay, "Preferences in Liquidation Law: A Time for a Change" (1998) 2 Company, Financial and Insolvency Law Review 198; A. Keay, *McPherson's Law of Company Liquidation, 3rd edn (London: Sweet and Maxwell, 2013), pp.697–707*.

78. *DG for Internal Policies, "Harmonisation of Insolvency Law at EU Level" (2011), pp.13–14*.

79. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.2.3*.

80. *DG for Internal Policies, "Harmonisation of Insolvency Law at EU Level" (2011), p.14*.

81. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.2.3*.

82. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.2.1*.

83. *INSOL Europe, "Harmonisation of Insolvency Law at EU Level" (April 2010), p.19*, http://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/empl_study_insolvencyproceedings_/empl_study_insolvencyproce [Accessed 14 December 2015].

84. *G. McCormack, "European and International Insolvency" in Gore Browne on Companies, edited by A. Alcock (Bristol: Jordans, looseleaf), para.53[11C]*.

85. *McCormack, "European and International Insolvency" in Gore Browne on Companies (looseleaf), para.53[11C]*. See also S. Paterson and M. Blaak, "Conflict of Laws and the EC Insolvency Regulation: Difficult Issues of Interpretation" (2008) 1 Corporate Rescue and Insolvency 10, 10.

86. Carballo Pineiro, "Towards the Reform of the European Insolvency Regulation" (2014) 2 Nederland Internationaal Privaatrecht 207, 212.

87. It has also been supported more recently by the *Group for International and European Studies at the University of Barcelona, "Proposals on the reform of the Council Regulation No 1346/2000 of 29 May 2000 on insolvency proceedings", p.160*; and in *S. Kolmann, "Thoughts on the governing [sic] insolvency law", both presented at the Conference on the Future of the European Insolvency Regulation, Amsterdam (28 April 2011)*, http://www.eir-reform.eu/ [Accessed 14 December 2015].

88. *Virgos-Schmit Report (1996), para.148*.

89. *Alexander, "Avoid the Choice or Choose to Avoid?" (15 March 2009), p.25, SSRN*, http://ssrn.com/abstract=1410157 [Accessed 14 December 2015].

90. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.2*.

91. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.2.1*.

92. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.3*.

93. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.3*.

94. *Pfeiffer, "Article 13 EIR" in External Evaluations of Regulation No 1346/2000/EC on Insolvency Proceedings (2013), para.6.10.3*.

95. Carballo Pineiro, "Towards the Reform of the European Insolvency Regulation" (2014) 2 Nederland Internationaal Privaatrecht 207, 212.

96. Carballo Pineiro, "Towards the Reform of the European Insolvency Regulation" (2014) 2 Nederland Internationaal Privaatrecht 207, 212.

97. Carballo Pineiro, "Towards the Reform of the European Insolvency Regulation" (2014) 2 Nederland Internationaal Privaatrecht 207, 212.

98. For example, P. Slot, "Harmonisation" (1996) 21 E.L. Rev. 378, 382–383; M. Dougan, "Minimum Harmonization and the Internal Market" (2000) 37 C.M.L. Rev. 853, 866; W. van Gerven, "Harmonization of Private Law: Do We Need It?" (2004) 41 C.M.L. Rev. 505, 508.

99. B. Wessels, "Harmonization of Insolvency Law in Europe" (2011) 8 European Company Law 27, 30.

100. Although Horst Eidenmuller takes the view that the EC is too cautious in relation to harmonisation of substantive insolvency law: Eidenmuller, "A New Framework for Business Restructuring in Europe" (2013) 20 Maastricht Journal of European and Comparative Law 133, 150. For a view that harmonisation is a possibility in particular areas of insolvency, see R. Liddy-Murphy, "Reformation of the European Insolvency Regulation to Act as a Legislative Tool to Assist in Europe's growth Agenda" (2015) 26 European Business Law Review 283, 302.

101. Interestingly, UNCITRAL had proposed harmonisation of the law of secured credit: *UNCITRAL, "Draft legislative guide on secured transactions—Report of the Secretary-General", A/CN 9/WG viwp 2 (2002), para.2* and referred to by *McCormack, Secured Credit and the Harmonisation of Law (2011), p.56*.

102. European Association of Insolvency Practitioners and Scholars.

103. *INSOL Europe, "Harmonisation of Insolvency Law at EU Level" (April 2010), p.20*, http://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/empl_study_insolvencyproceedings_/empl_study_insolvencyproce [Accessed 14 December 2015].

104. *INSOL Europe, "Harmonisation of Insolvency Law at EU Level" (April 2010), pp.26–27*, http://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/empl_study_insolvencyproceedings_/empl_study_insolvencyproce [Accessed 14 December 2015].

105. *INSOL Europe, "Harmonisation of Insolvency Law at EU Level" (April 2010), p.27*, http://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/empl_study_insolvencyproceedings_/empl_study_insolvencyproce [Accessed 14 December 2015].

106. European Parliament Resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)), Recital C, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0484+0+DOC+XML+V0//EN [Accessed 14 December 2015].

107. Annex to European Parliament Resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)), para.1.3, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0484+0+DOC+XML+V0//EN [Accessed 14 December 2015].

108. See http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2014-0093+0+DOC+XML+V0//EN [Accessed 14 December 2015].

109. EC Recommendation C(2014) 1500 final (12 March 2014), http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf [Accessed 14 December 2015].

110. European Parliament Resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)), p.3, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0484+0+DOC+XML+V0//EN [Accessed 14 December 2015].

111. Carballo Pineiro, "Towards the Reform of the European Insolvency Regulation" (2014) 2 Nederland Internationaal Privaatrecht 207, 212–213, but the EC argued in 2014 against full harmonisation as far as preventative measures are concerned: *Commission Staff Working Document, SWD(2014) 61 final*.

112. EC Recommendation C(2014) 1500 final (12 March 2014), para.27, http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf [Accessed 14 December 2015].

113. Regulation 2015/848, Recital 22.

114. *Alexander, "Avoid the Choice or Choose to Avoid?" (15 March 2009), p.38, SSRN*, http://ssrn.com/abstract=1410157 [Accessed 14 December 2015].