

**The Inclusion of Security Rights
in Insolvency Proceedings under European Law**

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I. Statement of the Problem

In today's world, economic life is unimaginable without security rights. Economic action means taking risks in order to tap opportunities. Frequently, however, investments in products and services cannot be financed through proprietary capital alone. In granting a loan, the lender assumes part of the investor's economic risk without participating in the opportunities and the earnings generated by the product. The lender ensures that it is compensated for the disparity between the risk assumed and the lack of this opportunity by charging interest and creating security rights to guard against total loss. In general, this applies equally to monetary and commodity credits

Security rights gain their real importance when the debtor becomes insolvent. It is in insolvency that the risk, which security rights seek to mitigate, first materializes. It is, therefore, natural that security rights should be recognized in insolvency proceedings. The restriction or disallowance of security rights in insolvency proceedings would be contrary to the economic objective of security rights.¹ It would, at the same time, be an encroachment on the market position of the secured creditor, which obtained the security right through its market position.

It is not the purpose of insolvency proceedings to redistribute wealth, so that secured creditors are satisfied in insolvency proceedings to a lesser extent than they would be by liquidating their collateral outside of insolvency proceedings. Insolvency proceedings have another purpose. They are an orderly procedure for satisfying the body of creditors. This reflects the experience that, on the whole, the uncoordinated seizure of a debtor's assets by creditors leads to less satisfaction of the body of creditors than does an orderly winding up procedure.² Therefore, in insolvency proceedings, it is generally the sole responsibility of the insolvency administrator to dispose of the debtor's assets. The laws of individual countries restrict this principle to a greater or lesser degree when it comes to disposing of security rights.

¹ Obermüller/Hess, *InsO, Eine systematische Darstellung des neuen Insolvenzrechts*, 3rd ed., 1999; Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 102.

² Jackson, *The Logic and Limits of Bankruptcy Law*, 1986, p. 57 et seq.; Eidenmüller, *Unternehmenssanierung zwischen Markt und Gesetz*, 1999, p. 17 et seq..

Under German law, §§ 165 et seq. of the Insolvency Code [InsO] differentiates between immovable assets, on one hand, and movable assets and receivables, on the other.³ After the reform instituted by the Enterprise Act of 2002 and the concomitant restriction of administrative receivership, English law also guarantees that security rights will be included in administration proceedings.⁴

There is a certain tension between security rights and insolvency proceedings. On one hand, the value of the security right should not be encroached upon, even in insolvency proceedings. Security is furnished to deal with the possibility of insolvency. On the other hand, in the interests of satisfying the body of creditors, the disposition of all assets, including those subject to security rights, should be the province of the insolvency administrator. The latter must decide, in agreement with the debtor's creditors, which disposition actions are suitable and comport with the interests of the body of creditors. Such actions can include reorganization as well as liquidation of the debtor company.⁵

The aforementioned tension between security rights and insolvency proceedings becomes even more complex in the international context. In addition to the differing interests of secured creditors and unsecured creditors, the various legal systems to which security rights or insolvency proceedings are subject must also be complied with. Depending on which country's laws are applied in insolvency proceedings or which country's laws govern a security rights, very different results may occur in insolvency with respect to the disposition of assets and the satisfaction of security rights. It is the task of international insolvency law to provide answers that take this tension into account and meet the challenges described above.

II. The European Regulation on Insolvency Proceedings (EIR)

1. Legal Situation

Due to its various restrictions and prerequisites, it is impossible to understand Art. 5 of the EIR at first glance. However, if one sets aside certain restrictions in its text (to be discussed later), Article 5 says that the opening of insolvency proceedings shall not affect the in rem

³ Cf. Braun/Gerbers, *InsO*, 2002, §§ 165 et seq.

⁴ Ehricke/Köster/Müller-Seils, *NZI* 2003, 409, 411.

⁵ Braun/Uhlenbruck, *Unternehmensinsolvenz*, 1997, p. 432. et seq.

rights of a creditor or a third party in a debtor's assets situated on the territory of another Member State. It should first be stressed that there is no choice-of-law provision. Art. 5 of the EIR does not address which legal system to apply to security rights. Instead, it merely stipulates that insolvency proceedings shall not affect security rights in certain cases. This is a property law provision. In terms of choice of law, the basic norm set forth in Art. 4 of the EIR controls. Thus, the *lex fori concursus* applies.

There is still some dispute over what "not affect" means. At least in Germany, the prevailing opinion is that security rights remain completely unaffected by the opening of insolvency proceedings.⁶ This coincides with the opinions expressed in the literature of other countries where the EIR applies.⁷ Therefore, to the extent security rights come within the purview of Art. 5 of the EIR, they can be fully enforced in insolvency proceedings. This also applies to the disposition of security rights in insolvency proceedings. In the first place, the insolvency administrator has no ability to prohibit secured creditors from disposing of assets in which they hold security rights. This applies equally to receivables, movable assets and real estate subject to security rights. There are no restrictions, such as those embodied in German law under §§ 166 et seq. of the InsO or in the English law governing administration proceedings.

Thus, Art. 5 of the EIR does not, by its terms, subject security rights to the restrictions (if any) contained in the laws of the country in which the insolvency proceedings were opened or the laws of the country in which the secured assets are situated or the insolvency laws of the country where the security rights were created.

At this point, it should be mentioned that, whether or not security rights exist, is not a matter for international insolvency law to decide. Accordingly, the EIR contains no provisions on this matter. The extent to which a security rights has been effectively established is a question of international private law. The opening of insolvency proceedings cannot invalidate a

⁶ Balz, *ZIP* 1996, 948, 950; v. Wilmsky, *EWS* 1997, 295; Wimmer, *ZInsO* 2001, 97; Eidenmüller, *IPRax* 2001, 2, 6; Paulus, *ZIP* 2002, 729, 735; Liersch, *Sicherungsrechte im Internationalen Insolvenzrecht*, 2001, p. 42 et seq.; *ibid.*, *NZI* 2002, 15, 16; to the contrary: Flessner, *IPRax* 1997, 1, 7; Fritz/Bähr, *DZWIR* 2001, 221, 227.

⁷ Johnson, *IIR* 1996, 80, 86; Garrido, *IIR* 1998, 79, 87; Kayser, *IIR* 1998, 95, 125; Goode, 33 *Texas Int. Law Journal* 51 (1998); Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 50 et seq. (Fletcher), p. 103 et seq. (Isaacs/Toube/Segal/Marshall) and p. 181 (Moss); Duursma-Kepplinger/Duursma/Chalupsky, *Europäische Insolvenzverordnung*, 2002, Art. 5 margin no. 19 et seq. (Austria).

security rights that has been effectively established.⁸ International insolvency law only determines the extent to which security rights may be restricted in insolvency proceedings.

Before examining the problems inherent in the current legal situation, let me once again consider the current state of the law. Art. 5 of the EIR states that the opening of insolvency proceedings “shall not affect” security rights. This does not mean the asset itself may not be affected by insolvency proceedings. The consequences of this distinction manifests themselves when the secured creditor disposes of the asset and there are excess proceeds, i.e., the secured creditor has been fully satisfied.⁹ The excess proceeds must be handed over to the insolvency administrator, since the asset itself is included in the insolvency proceedings and, after the secured creditor has been satisfied, there is no secured right to justify restricting this principle.

Art. 5 of the EIR defines “security right” very broadly.¹⁰ It includes security right in receivables and movable and immovable assets. The insert in Paragraph 1 of the provision – which was not added until late in the legislative process – further includes the “floating charge” recognized under Anglo-American law. A non-exclusive definition of in rem rights follows in Art. 5 (2) of the EIR. There is a separate provision on reservation of title in Art. 7 of the EIR. In content, however, it is equivalent to Art. 5 (1) of the EIR. Thus, reservation of title is also treated as a security right.

The time term in Art. 5 of the EIR is significant. It states that the restriction covers assets situated within the territory of another Member State at the time of the opening of insolvency proceedings. Here, the time of the opening of insolvency proceedings is controlling. This is of particular importance if the country’s insolvency law recognizes insolvency petition proceedings. In this event – which is the case under German law – a distinction must be made between the date the insolvency petition was filed and the date insolvency proceedings were opened. As a consequence of Art. 5 (1) of the EIR, the date on which the insolvency petition was filed has no significance. Therefore, transfers of movable assets during insolvency petition proceedings may have a significant effect on the legal consequences of Art. 5 of the

⁸ Liersch, *Sicherungsrechte im Internationalen Insolvenzrecht*, 2001, p. 45 et seq.; Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 103.

⁹ Liersch, *NZI* 2002, 15, 16.

¹⁰ Cf. Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 54 et seq.

EIR. Only those assets that are still abroad on the date insolvency proceedings are opened are covered by Article 5 of the EIR and, therefore, are not affected by the opening of insolvency proceedings.

Security rights not created until after the opening of insolvency proceedings are also not covered by the provisions of Art. 5 of the EIR. These security rights are covered by Art. 4 of the EIR and are treated in accordance with the *lex fori concursus*.¹¹

As already mentioned, Article 5 of the EIR covers only those assets that are situated in a Member State other than the one in which insolvency proceedings are opened. Assets situated in the country in which insolvency proceedings are opened are subject to the general provisions of that country's laws. European law does not make an exception for security rights. The reason is that there is no cross-border aspect to these security rights.

2. Problems

I feel obliged to characterize Art. 5 of the EIR as failed provision. Secured creditors can dispose of assets that come under the purview of Art. 5 of the EIR without restriction – even during insolvency proceedings. The insolvency administrator has no ability to prevent secured creditors from disposing of essential assets needed to carry on the business. Secured creditors can carry out the same types of forced sales that would be available to them outside of insolvency proceedings.

The aforementioned tension between security rights and the goal of insolvency administration – namely, to maximize the satisfaction of creditors' claims – is here shifted one-sidedly in favor of secured creditors. They have the unrestricted ability to dispose of secured assets and use the proceeds to cover their risks. To be sure, European law rightly refrains from interfering with the economic value of the collateral. However, it does not in any way promote the maximum satisfaction of creditors' claims. The disposition of individual assets without any coordination with the insolvency administrator one-sidedly disadvantages unsecured creditors, who only participate in the disposition of unsecured assets and are often prevented from continuing the business so it can later be sold as a whole.

¹¹ Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 103.

3. Approaches to reaching a solution under existing law

Even where Art. 5 of the EIR applies, the worst consequences of this provision can be avoided through proper structuring. Three options, in particular, should be mentioned:

As already stated earlier, a distinction must be made between security rights and assets as a whole with respect to the effect of insolvency proceedings. Art. 5 of the EIR clearly states that only security rights remain unaffected. Therefore, the insolvency administrator has the ability to discharge security rights in individual cases. If the insolvency administrator satisfies the secured creditor's claim in full, the security right is discharged. The asset is subject to the insolvency estate under insolvency proceedings and is thus subject to the insolvency administrator's decisions with respect to its disposition. By paying off secured claims, the insolvency administrator can hold onto assets urgently needed to continue business operations in the interests of the insolvency estate. The disadvantage of this option is, of course, that he must raise the cash to satisfy the secured creditors. As a rule, the insolvency administrator will be able to take this option only when the ratio between the secured claim to be satisfied and the resulting benefit from the ability to carry on the business or transfer it as a whole is very great.

Another structuring possibility under European law is provided by the wording of Art. 5 of the EIR itself, which states that Art. 5 only covers assets situated on the territory of another Member State on the date insolvency proceedings are opened. Where the petition for insolvency and the opening of insolvency proceedings are fragmented, as is the case with insolvency petition proceedings under German law, structuring possibilities result. To the extent the debtor or the interim insolvency administrator can influence the location of the secured assets during insolvency petition proceedings, the legal consequences of Art. 5 of the EIR can be circumvented by transferring the assets to the country in which insolvency proceedings are being opened. It can be assumed that such an action would not constitute an abuse of the law if it were done to maintain business operations in the interests of continuing the business. On the other hand, it must be pointed out that the same circumstance also provides secured creditors with an opportunity to remove assets from the country where insolvency proceedings will be opened during insolvency petition proceedings – to take advantage of the legal consequences of Art. 5 of the EIR with respect to the assets in which they hold security rights.

The third structuring possibility is to open secondary insolvency proceedings. Art. 3 (2) in conjunction with Art. 27 of the EIR permits the opening of secondary insolvency proceedings against the debtor's assets. This option is restricted in that secondary insolvency proceedings may be opened only in countries in which the debtor has an "establishment." The term "establishment" is defined at Art. 2 (h) of the EIR as a place of operations where a debtor carries out non-transitory economic activity with human resources and material assets. The definition of an establishment is very broad.¹² Despite this, the opening of secondary insolvency proceedings is restricted to places where the debtor has an establishment, and such proceedings may not be opened wherever the debtor has assets.

The opening of secondary insolvency proceedings has an advantage with respect to the inclusion of secured assets [in insolvency proceedings] in that assets situated in a country in which secondary insolvency proceedings are opened are not covered by Art. 5 of the EIR, since such assets are not "situated within the territory of another Member State."¹³ Of course, the administrator in the main proceedings, who has the right to petition for the opening of secondary insolvency proceedings under Art. 29 of the EIR, still has no authority to dispose of assets situated in the country in which secondary insolvency proceedings have been opened. However, under the provisions of Art. 31 through 34 of the EIR, he may influence the disposition of assets in the secondary insolvency proceedings, including those subject to security rights. Under Art. 33 of the EIR, the insolvency administrator in the main proceedings can even obtain a stay of liquidation in the secondary insolvency proceedings to protect secured assets against seizure by secured creditors – in the interest of continuing business operations.

With respect to the administrator's latter option – namely, petitioning for secondary insolvency proceedings – let me take this opportunity to discuss two peculiarities of the new German International Insolvency Law. A new International Insolvency Law took effect in Germany on March 20, 2003, which applies, in particular, to countries outside the purview of the EIR. In addition, several provisions address the application and implementation of the EIR

¹² Duursma-Kepplinger/Kepplinger/Chalupsky, *Europäische Insolvenzverordnung*, 2002, Art. 2 margin no. 20 et seq.; Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 165 et seq.

¹³ Liersch, *NZI* 2002, 15, 16; Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 103.

in Germany. A significant difference between the EIR and the German International Insolvency Law is that, under the German International Insolvency Law (§ 354 in conjunction with § 356 of the Insolvency code [InsO]), secondary insolvency proceedings may be opened in countries in which the debtor has assets but no “establishment.”¹⁴ Therefore, the opening of secondary insolvency proceedings can be used as a means of including secured assets in insolvency proceedings to a greater degree, since assets can be reached that are situated in countries where the debtor has no establishment.

With respect to the stay of liquidation under Art. 33 of the EIR, briefly mentioned above, German law (Art. 102 § 10 of the EGInsO) provides that, when liquidation of an asset subject to a right of separate satisfaction is stayed, a creditor who is entitled to separate satisfaction shall be paid the current interest due out of insolvency estate funds. This provision is meant to compensate for the fact that the secured creditor is not permitted to seize the asset immediately.¹⁵ The insolvency administrator, who petitions for a stay of liquidation under Art. 33 of the EIR, must, therefore, determine whether the advantage provided by the stay, namely, holding onto assets in the interests of continuing the business or selling it as a whole and thus maximizing the proceeds from the liquidation, justify the payment of interest to the secured creditor.

In summary, let me say that there are approaches under European law that permit the administrator to somewhat minimize the negative consequences of Art. 5 of the EIR in the interests of satisfying the body of creditors. However, this is just the second-best approach, which is attempted here only to mitigate the negative consequences of a failed provision. In many situations, there will be no way to structure matters, and the provisions of Art. 5 of the EIR will prevail. Therefore, in what follows, I will consider what alternative provisions can be formulated to deal with the tension between the interests of secured creditors and the interest of the insolvency proceedings in maximizing the satisfaction of the body of creditors.

¹⁴ Liersch, *NZI* 2003, 302, 309.

¹⁵ Liersch, *NZI* 2003, 302, 310.

III. Reflections on the Proper Balance of Interests with respect to the Inclusion of Security Rights in Insolvency Proceedings

1. Alternative solutions and interest groups

The solution reached by Art. 5 of the EIR favors the interests of secured creditors in a one-sided manner without taking the interests of the insolvency proceedings into account. This is the result of the exclusion of security rights from insolvency proceedings under Art. 5 of the EIR. If one wishes to include secured rights in insolvency proceedings, one must make them subject to a choice-of-law provision that determines what law to apply to security rights in insolvency. In the ongoing discussion on the proper treatment of security rights in insolvency proceedings, which is, in part, conducted in the literature, reference is regularly made to various legal systems that should be taken into consideration from the viewpoint of various commentators.

These include the laws of the country in which insolvency proceedings have been opened (*lex fori concursus*)¹⁶, the laws of the country in which the secured asset is located (*lex rei sitae*)¹⁷, the law to which the security interest itself is subject outside of insolvency proceedings (*lex causae*)¹⁸, and protective statutes by which national law favors certain groups or claims.¹⁹ In addition, there are proposals that advocate applying some of these laws cumulatively.²⁰ For years there has been a protracted dispute in the German literature over the extent to which security rights should be made subject to the *lex fori concursus* or the *lex rei sitae*. The dispute reflects the interests of the supporters of these proposed solutions.

¹⁶ Uhlenbruck-Lüer, *Insolvenzordnung*, 12th ed., 2003, Art. 102, *EGInsO*, margin no. 80; Favoccia, *Vertragliche Mobiliarsicherungsrechte im internationalen Insolvenzrecht*, 1991; Summ, *Anerkennung ausländischer Konkurse in der Bundesrepublik Deutschland*, 1992, p. 30 et seq.

¹⁷ Nerlich/Römermann-Mincke, *Insolvenzordnung*, as revised, March 2003, Art. 102, *EGInsO* margin nos. 120 and 185.

¹⁸ At least for receivables: *Münchener Kommentar zur Insolvenzordnung-Reinhart*, Art. 102, *EGInsO*, margin no. 154 et seq.

¹⁹ v. Wilmsky, *Europäisches Kreditsicherungsrecht*, 1996, p. 280 et seq.; *ibid.*, *WM* 1997, 1461.

²⁰ Drobnig, 33 *Texas Int. Law Journal* 53 (1998); Flessner, *IPRax* 1997, 1.

If the *lex fori concursus* is applied, the law of the country in which insolvency proceedings have been opened decides the extent to which security rights will be taken into consideration in insolvency proceedings. This has the advantage that the administrator can include all secured rights in the insolvency proceedings solely according to the *lex fori concursus*, i.e., the law of the country in which insolvency proceedings were opened. He need not take the peculiarities of any other legal system into account. One set of laws alone, namely the *lex fori concursus*, governs the inclusion of security rights in the insolvency proceedings.

On the other hand, it should be taken into account that, if only the *lex fori concursus* applies, this legal system also decides to what extent insolvency proceedings can encroach on the economic value of security rights. Under this scenario, the secured creditor cannot plan with any degree of predictability. At the time the security right is created – which is long before any subsequent insolvency – the secured creditor does not know in what country insolvency proceedings will be opened and what *lex fori concursus* will apply. Accordingly, mere chance governs whether insolvency proceedings will be opened in a country with laws that do not attack the economic value of security rights or whether they will be opened in a country with laws that significantly impair security rights in insolvency proceedings. This uncertainty increases the secured creditor's risk of loss and thereby increases the capital costs of companies that need to borrow.²¹ Therefore, applying only the *lex fori concursus* serves the interests of the body of creditors and the insolvency administrator, but is contrary to the interests of secured creditors, who need to make reliable plans.

The opposite situation occurs if one applies only the *lex rei sitae* or the *lex causae*. If either the *lex rei sitae* or the *lex causae* is applied, a separate examination must be made of each asset in the estate to determine what law applies. Each asset will have its own *lex rei sitae* or *lex causae*. If these laws were to determine to what extent the administrator could include these assets in insolvency proceedings, the administrator would have to deal with a hopeless variety of legal systems. At the start of insolvency proceedings, just when the administrator needed to quickly review his options for disposing of the assets, he would have to investigate

²¹ Moss/Fletcher/Isaacs, *The EC Regulation on Insolvency Proceedings*, 2002, p. 50 et seq.

all the legal systems that might be applicable. In addition, it should be taken into account that this diversity of legal systems presents an obstacle, if the goal is to sell these assets together or transfer the entire business operation to a new legal entity or reorganize the business, since legal institutions in various countries are differently constituted.²² By contrast, application of the *lex rei sitae* or the *lex causae* benefits the secured creditor. If the *lex causae* applies, the secured creditor knows which legal system the security right will be subject to at the time it is created and can easily determine what legal consequences insolvency would have on its security rights. This is true only to a limited extent if the *lex rei sitae* is applied. The location of a piece of real estate is not subject to change and, therefore, the law to which it would be subject in insolvency proceedings can be clearly determined. However, this is not the case with movable assets. If the *lex rei sitae* is applied, the secured creditor must plan for the risk that an asset will be sent abroad where it will be at the mercy of the insolvency laws of another country. Therefore, in general, referral to the *lex rei sitae* should be avoided.

2. Proposal for a solution that takes all interests into account

For the above reasons, applying the *lex fori concursus*, or the *lex rei sitae*, or the *lex causae* alone cannot provide a solution that takes all interests into account. This results from the tension between security rights and insolvency administration in the interests of the body of creditors. To balance the interests, the various areas relating to security rights and insolvency proceedings have to be defined and made subject to separate legal systems.

The goal of insolvency proceedings is to include assets encumbered with security rights in the proceedings so the various options for disposing of assets can be realized. The focus is on disposing of assets that are qualified under insolvency law. Secured creditors, on the other hand, have an interest in hedging the risks associated with the lending of capital. They are not concerned with the procedure by which they receive satisfaction, but with safeguarding the value of their secured assets.²³ In this regard, the focus is on distribution. This is why there is tension between security rights and the interests of insolvency administrators.

²² For cross-border insolvency reorganization plans, cf. Liersch, *NZI* 2003, 302, 309.

²³ A.A. Münchener, *Kommentar zur Insolvenzordnung-Reinhart*, Art. 102, *EGInsO*, margin no. 153. However, he disregards the purpose of insolvency proceedings: to safeguard the debtor's assets from the threat of individual enforcement actions – in the interests of creditors in general. This principle is recognized in the

If one differentiates between disposition matters and distribution matters, one can do justice to the differing interests of the insolvency administrator and the body of creditors, on one hand, and the interests of the secured creditors, on the other, by subjecting them each to different legal systems.²⁴

In the interests of disposition, it makes sense to apply a single legal system to decide how the debtor's assets should be disposed of. Which legal system one applies is of secondary importance. However, it makes sense to apply the *lex fori concursus* because of its proximity to the insolvency proceedings. This guarantees that the secured assets are disposed of uniformly under one legal system, without having to take separate rules into account for certain assets. The interests of the insolvency proceedings are thereby satisfied.

Revising the distribution of proceeds is not a goal of insolvency proceedings. Insolvency law must not interfere with the existing rights of creditors, particularly with their security interests. Accordingly, distribution should be handled differently with respect to different assets and differing rights in individual assets. Any solution that seeks to distribute all the proceeds [of the disposition of assets] without taking the different security rights in the various countries into account will result in unequal treatment. This must be avoided. Therefore, in making a choice-of-law decision, a legal system that takes this diversity into account must be selected. This eliminates the *lex fori concursus*. The legal system that has the closest connection to the security interest is the *lex causae*. It determines the law that governs the security right. Thus, it makes sense to subject the question of restricting distribution of the proceeds of secured assets in insolvency proceedings to the *lex causae*.

By making the disposition of security rights subject to the *lex fori concursus* and the distribution of proceeds subject to the *lex causae*, the differing interests in insolvency proceedings are taken into account for the most part.

national legislation of many countries (and includes security rights). Therefore, there is no reason for treatment to differ under international insolvency law.

²⁴ v. Wilmowsky, *Europäisches Kreditsicherungsrecht*, 1996, p. 280 et seq.; *ibid.*, *WM* 1997, 1461; Liersch, *Sicherungsrechte im Internationalen Insolvenzrecht*, 2001, p. 33 et seq.; *ibid.*, *NZI* 2002, 15, 17 et seq.

3. Excursus: Protected rights

So far we have not taken into account provisions of national legislation intended to give particular interest groups preference in insolvency proceedings. Various insolvency laws contain such provisions in favor of employees. The question is to what extent such an encroachment on the right of distribution should be applied in cross-border insolvency proceedings.²⁵ In purely national insolvency proceedings, national laws may interfere with distribution rights. If only the *lex causae* were applied to distribution rights in cross-border insolvency proceedings, the applicability of any protective statute in cross-border proceedings would depend on whether the legal system that applies to the security right has such a protective statute. Whether this is the case, is, in turn, pure chance. Therefore, consideration should be given to adopting a restriction in the choice-of-law standard for distribution rights that justifies encroachments on the *lex causae* to the extent individual insolvency creditors rely on protective statutes under the laws applicable to their legal relationships.²⁶

To simplify, the question of whether protective statutes should be taken into account will not be addressed here. Even without taking protected rights into account, the choice-of-law proposal made here will do far better justice to the interests of the various groups in insolvency proceedings than does Art. 5 of the EIR.

IV. Summary and Theses

1. Summary

Secured rights are first called into effect in insolvency proceedings. Therefore, they must be recognized in insolvency proceedings. There is tension between the interests of secured creditors and those of unsecured creditors. This is reflected in any discussion of the proper law to be applied to the treatment of security rights in insolvency proceedings. The solution embodied in Art. 5 of the EIR favors the interests of secured creditors in a one-sided manner, while presenting an obstacle to corporate reorganization. The discussion of a choice-of-law solution is largely driven by vested interests. Whereas, application of the *lex fori concursus* is in the interests of creditors in general, application of the *lex rei sitae* or the *lex causae* favors

²⁵ In favor: v. Wilmowsky, *Europäisches Kreditsicherungsrecht*, 1996, p. 326; critical: Eidenmüller, *Jahrbuch für Neue Politische Ökonomie*, 1999, p. 90.

²⁶ Cf. on the proper consideration of protected rights in choice of law, Liersch, *NZI* 2002, 15, 18 et seq.

secured creditors to the detriment of other creditors. This tension can only be resolved by making distinctions based on the purposes of insolvency proceedings and security rights. Insolvency proceedings are intended to facilitate the decision whether to liquidate or reorganize the business and should not redistribute the wealth. Security rights are intended to mitigate the risk assumed by lenders, and the method of satisfaction is secondary. If one separates disposition and distribution questions and adopts different choice-of-law rules for each, a solution can be developed that does justice to the interests of both secured and unsecured creditors.

2. Theses

- a) Art. 5 of the EIR has missed the mark. It prevents reasonable reorganizations.
- b) Choice-of-law rules are needed to guarantee that security rights are included in insolvency proceedings.
- c) The interests of both secured creditors and creditors in general can be protected only if there are different choice-of-law decisions for disposition questions and distribution questions.
- d) The extent to which insolvency law encroaches on the right of a secured creditor to dispose of the assets in which it holds a security right is to be determined by the law of the country in which insolvency proceedings have been opened.
- e) The extent to which insolvency law encroaches on the right of a secured creditor to receive distributions of the proceeds of liquidated secured assets is to be determined by the law of the country that otherwise determines the creditor's rights under security rights.