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in Insolvency Proceedings
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APPLICABLE LAW FOR AVOIDANCE ACTIONS IN CROSS-BORDER INSOLVENCY

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INTRODUCTION

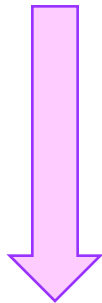
Company with
registered office
and COMI
in the State A



Company with
registered office and
COMI
the State B

Sales contract: 1st October 2020
subject to the law of the State B

buyer



seller

*the market value of the machine:
50.000,00 EUR

*payment: **100.000,00 EUR**

Opening of main insolvency proceedings
against the buyer
on 1st December 2020 in the State A

What avoidance law will apply to this sales contract?

PURPOSE OF AVOIDANCE CLAIMS IN CASE OF INSOLVENCY PROCEEDINGS

In the suspect period **prior to the commencement i.e. opening of insolvency proceedings** debtor may hide assets from his creditors, undertake obligations for inadequate value, make gifts, donations to relatives, friends, certain business partners or pay certain creditors to the exclusion of others, etc.

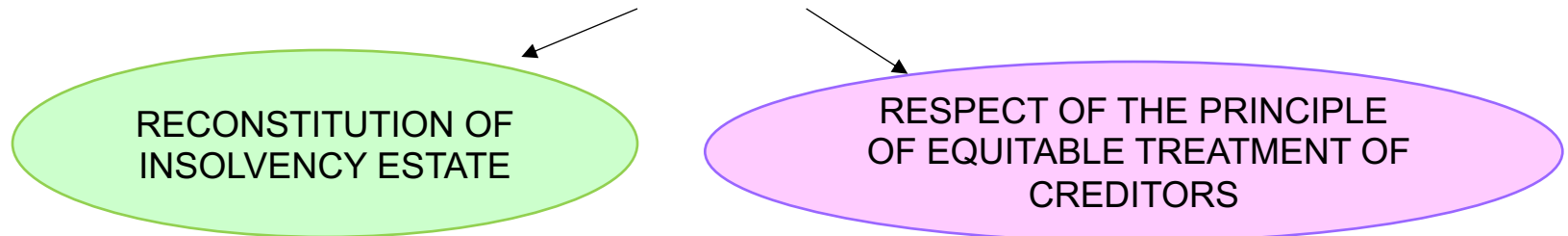
**different legal acts of disposal of assets or of undertaking obligations – by way of transfer, payment, encumbrance, guarantee, loan, release, etc.; also omissions*

There is a need to overturn such detrimental debtor's transactions that

*reduce the value of the insolvency estate and/or

*disturb the principle of equitable treatment of creditors.

(Insolvency proceedings are collective proceedings.)



Necessary balance between

INTERESTS OF THE ENTIRETY
OF THE DEBTOR'S CREDITORS



INTERESTS OF A THIRD PARTY
(COUNTERPARTY TO THE
CONTESTED, AVOIDED
TRANSACTION)

IMPORTANCE OF DETERMINATION OF THE APPLICABLE LAW REGARDING AVOIDANCE CLAIMS IN CROSS-BORDER INSOLVENCY PROCEEDINGS

Insolvency proceedings
opened at home and
their recognition abroad

or

Recognition of foreign
insolvency proceedings
at home

- *a part of debtor's assets involved in detrimental transactions is located abroad*
- *a third party involved in a detrimental transaction has its registered office, seat, principle place of business or habitual residence abroad*

Different legal systems have different rules concerning following issues:

What types of transactions and under which circumstances are subject to avoidance?
**different subjective and objective criteria*

Which types of transactions are exempt from avoidance actions?
**especially financial contracts concluded within pre-insolvency/pre-emptive proceedings*

May security rights be subject to avoidance and if so, under which circumstances?

How long are suspect periods for different types of transactions?

Which categories of persons with sufficient connection to the debtor may be treated as so called “related persons”
(*longer suspect periods, presumptions and shifts in the burden of proof that facilitate the conduct of avoidance proceedings)

Who has authority and responsibility to commence avoidance proceedings?
**insolvency practitioner (administrator), creditors*

Which court has international jurisdiction and territorial competence for avoidance actions?

What is the time period within which an avoidance proceeding may be commenced?

Which party is responsible for proving the necessary elements in order to avoid a particular transaction?

How to fund avoidance proceedings, who bears costs of proceedings?

What are legal consequences of the successful avoidance and rights of a counterparty to avoided transaction?

Are avoidance actions allowed against legal successors of the party to a detrimental transaction?

Importance of **LEGAL FORESEEABILITY** and **LEGAL CERTAINTY** for proper functioning of each legal system.

**SOME MOST KNOWN PROPOSALS FOR APPLICABLE LAW SOLUTION
REGARDING INSOLVENCY LAW AVOIDANCE**

LEX CAUSAE

COMBINATION OF THE LEX FORI CONCURSUS
AND LEX CAUSAE

ALTERNATIVE APPLICATION
OF THE LEX FORI CONCURSUS
OR THE LEX CAUSAE DEPENDING ON
WHICH LAW IS MORE FAVOURABLE TO
THE INSOLVENCY ESTATE

LEX FORI CONCURSUS

APPLICABILITY OF THE LEX CAUSAE

The applicability of the law of the State that governs a particular transaction.

PRO:

Protection of interests of the party to the transaction:

“trust in the fact that the validity of the transaction will continue to be governed by the law of the same State, even if insolvency proceedings would be opened against the other party to this transaction in some other State”.

CONS:

The voidability of transactions is a specific consequence of the opening of insolvency proceedings which were unchallengeable until then and the basis for the ineffectiveness of such transactions does not lie in themselves.

Therefore, no reason for the applicability of the lex causae.

In the case of absence of parties' choice of law, the law applicable to the contract, transaction shall be determined by the use of accidental elements: habitual residence, place of performance, situs (property) – no connection with later insolvency proceedings.

By use of choice of law clause parties could manipulate the voidability of their transaction.

Why should the interests of the party to the transaction be more important than the interests of the entirety of the debtor's creditors?

Applicability of the lex causae is not in accordance with the basic principle of the insolvency law – principle of equal treatment of debtor's creditors.

Principle of territorialism?

COMBINATION OF THE LEX FORI CONCURSUS AND THE LEX CAUSE

Art. 7(2)point (m) **European Insolvency Regulation 2015** (EIR)

(Art. 4(2)(m) EIR 2000)

...it (*lex fori concursus*) shall determine the following:

....(m) the rules relating to the **voidness, voidability or unenforceability** of legal acts detrimental to general body of creditors.

Art. 16 EIR 2015 (Art. 13 EIR 2000)

Point (m) of Article 7(2) shall not apply where **the person who benefited** from an act detrimental to all the creditors **provides proof** that:

- (a) the act is subject to the **law of a Member State other than that of the State of the opening of proceedings**; and
- (b) the law of that Member State does **not allow any means of challenging that act** in the relevant case.

PRO:

Virgós/Schmit, **Report on the Convention of Insolvency Proceedings**, No. 138:
“to uphold **legitimate expectations of creditors or third parties of the validity of the act** in accordance to the normally applicable national law, against interference from a different *lex concursus*“

See very similar, but not identical solution in **§ 339 German Insolvency Code**.

CONS:

Is this additional protection of the parties really necessary?

*The parties could assess the voidability of the act under **lex fori concursus**, when they concluded their contract.*

*Do parties, **who acted fraudulently**, deserve protection through the applicability of the **lex cause**?*

*Parties may **circumvent the insolvency avoidance rules** of the **lex fori concursus** by choosing a less strict law as the **lex causae**.*

*Sometimes it **is not so easy to determine** which law is **the lex cause** for a certain transaction.
(shareholder loans, security rights):*

expensive and complicated legal opinions, long avoidance proceedings



costs of insolvency proceedings → a smaller insolvency estate → a lower pro rata share of the debtor's assets for a creditor



*Combination of the **lex fori concursus** and the **lex causae** complicates and **makes more difficult the successful avoidance of detrimental acts**.*

Are *all procedural and substantive requirements of the lex causae* included?

Yes, CJEU, Case C-557/13 *Hermann Lutz v Elke Bäuerle*

Art. 12 EIR 2015 (Art. 9 EIR 2000):

Without prejudice to Article 8, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Member State applicable to that system or market.

Paragraph 1 shall not preclude any action for voidness, voidability or unenforceability which may be taken to set aside payments or transactions **under the law applicable to the relevant payment system or financial market.**

See Art. 340 para 1 of the German Insolvency Code

Harmonisation of national law of the Member States regarding avoidance rules

**especially avoidance actions in pre-insolvency proceedings,
restructuring proceeding*

ALTERNATIVE APPLICATION OF THE LEX FORI CONCURSUS OR THE LEX CAUSAE DEPENDING ON WHICH LAW IS MORE FAVOURABLE TO THE INSOLVENCY ESTATE

focus



PRO:

*to support the **purpose of the insolvency law avoidance:**
reconstitution of the integrity of the insolvency estate and equitable treatment of creditors

No need to open parallel non-main secondary insolvency proceedings,
in order to apply a more strict law, favourable to the insolvency estate

CONS:

**against the legal certainty and legal foreseeability*

*in the case of the application of the lex causa, *the violation of the basic principle of the private international law, the principle of the “closest connection”*

**violation of the principle of the equal treatment all debtor’s creditors*

**insolvency practitioner should have to know avoidance rules of many legal systems*

**secondary insolvency proceedings may have not only a supporting function, but also so called a protective function as well as an auxiliary function*

APPLICABILITY OF THE LEX FOR CONCURSUS

PRO:

The lex fori concursus as the dominant conflict of law rule.

It represents **the law of the closest connection**.

*There should be very strong arguments for any deviation from the applicability of the lex fori concursus.

It is about **reconstitution the integrity of the insolvency estate** and **respect of the equitable treatment of creditors**.

Reasons for the insolvency law avoidance are closely connected with the law of the state of the opening of insolvency proceedings.

A counterparty to a transaction that has been avoided must return the assets obtained or make a cash payment to the estate for the value of the transaction.

Place of fulfilment – as a rule in the state of the opening of insolvency proceedings.

There is **a close connection** between the insolvency avoidance rules and limitations **regarding disposal of the assets** belonging to the insolvency estate after opening of insolvency proceedings.

The **purpose of the insolvency law** avoidance is identical with the **purpose of the conduct of insolvency proceedings**.

Issues regarding **avoidance actions and avoidance proceedings** as well as **conditions for the avoidance** and **legal consequences** of successful avoidance should be subject to the same law.

The applicability of the lex fori concursus provides for **equal treatment of all debtor's creditors**.

Application of only one law, the lex fori concursus is **simple solution for insolvency practitioners**:

*contributions to the speed and efficiency of insolvency proceedings,

If we have a firm criteria for international jurisdiction (COMI), applicability of the lex fori concursus **prevents the parties from manipulation with the applicable law**.

Unacceptable results of the application of the lex fori concursus in a concrete case – **application of the ordre public clause**

CONS:

*Insufficient protection of the **trust of a third party, counterparty to a transaction***

Is the additional protection of the trust of a third party really necessary?

The substantive law governing the transaction in question (lex causae) must be determined by the court having jurisdiction and venue
It applies its own conflict of law rules.

States have very different rules regarding vis attractiva concursus.

***It is very difficult for the parties to know in advance which court will have jurisdiction in avoidance proceedings and how it will determine which law is lex causae in the concrete case.**

Protection of parties who acted fraudulently?

Insolvency law of each state makes a certain balance between interests of the entirety of the debtor' creditors and interests of a counterparty to a transaction.

Possibility of **special rules** regarding avoidability of transactions connected with **a payment or settlement system and financial market.**

Legislative Guide on Insolvency Law, Part Two, I Recommendation 31(g)

Law applicable in insolvency proceedings: lex fori concursus:

(g) avoidance of certain transactions that could be prejudicial to certain parties

Croatian Bankruptcy Act, Arts 395, 411, 417:

*applicability of the lex fori concursus regarding insolvency avoidance

CONCLUDING WORDS

When looking for the best solution regarding applicable law for insolvency avoidance:

INTERESTS OF THE ENTIRETY
OF THE DEBTOR'S CREDITORS



INTERESTS OF A THIRD PARTY
(COUNTERPARTY TO THE CONTESTED,
AVOIDED TRANSACTION)

Equally important?

Taking into account all pro and cons.

Personal view:

applicability of the *lex fori concursus as the best solution
(with possible rare exceptions)

THANK YOU
FOR YOUR ATTENTION!