Avoid the Choice or Choose to Avoid?

A quest to make sensible the choice of avoidance law under the European Insolvency Regulation

Juraj Alexander, 2009

Abstract

In this paper, I propose a novel interpretation of the rules for choice of law with respect to avoidance actions under the EC Regulation on Insolvency Proceedings. Further to an outline of the statutory framework and its interaction with the rules on jurisdiction I focus on the safe harbor rule, which protects a transaction from avoidance under the law of the main proceedings if the law governing such transaction does not enable avoidance. The traditional interpretation of „the law governing the transaction" in this provision designates the law chosen by the parties or the regular choice-of-law rules. Instead, I propose that it be interpreted as referring to the law „with the closest connection" to the transaction. I argue for a similar analysis in allocating avoidance actions among the main and the secondary insolvency proceedings.

The proposed interpretation leads to a proper framework for addressing the choice of avoidance law; it is practicable and is not trivial. On this basis, I propose three new rules related to the choice of avoidance law: a rule for choice of applicable fraudulent conveyance law out of insolvency proceedings, a rule giving the trustee in the main proceedings standing to bring non-insolvency fraudulent conveyance actions, and a rule expanding the safe harbor provision to laws of non-member states.

I. Introduction[1]

Being sued to return a hefty amount you obtained as a late repayment on a defaulted debt (a preference) or to return an asset you purchased just a few weeks ago in a fabulous deal (a fraudulent conveyance)[2] is an unpleasant experience. It can be even more troubling if the action is brought under a foreign law which you don't know and did not expect to apply, especially if such law allows avoidance whereas the law you expected to apply does not.[3] On the other hand, if the debtor and its counter party in a transaction removing assets from the reach of the creditors are able to select the law governing the avoidability of such transaction so as make it bulletproof in eventual insolvency proceedings, other creditors will be understandably upset and likely prejudiced. The rules of choice of the applicable law of preferences or fraudulent conveyances (avoidance law) tries to address these issues. This paper reviews such rules (and related jurisdiction issues)[4] under the European[5] Regulation on Insolvency Proceedings[6] (the *Regulation*).

The Regulation designates as applicable the avoidance law of the main or secondary[7] insolvency

1 I would like to thank Professor Susan Block-Lieb of Fordham Law School for comments and suggestions in writing this paper and to Peter Hodál of White&Case, Bratislava and to William Montalvo for their help in preparation of this paper.

2 The term "conveyance" is an anachronism and has been replaced even in the U.S. by "transfer", but is more distinctive for this particular use and is still widely used.

3 *See generally* Philip Wood, Principles of International Insolvency 458 - 548 (Sweet & Maxwell 2d ed. 2007) (1995) [hereinafter *Wood Principles*] (providing an overview of various avoidance laws).

4 Opinion of the ECJ Advocate General Colomer in Case C-339/07, Christopher Seagon v. Deko Marty Belgium NV (Oct. 16, 2008), para. 10, *available at* http://www.eurlex.eu (last visited Feb. 20, 2009) [hereinafter *Colomer, Deko Marty Opinion*] (issues of choice of law and of jurisdiction are intertwined).

5 The Regulation is a part of the law of the European Community (EC) and references to community law are therefore appropriate, even though the Regulation operates within the European Union (EU), of which the EC constitutes the first pillar.

6 Council Regulation No. 1346/2000, 2000 O.J. (L 160) 1 (EC) [hereinafter *Regulation*], the Regulation is directly enforceable in all the 27 member states of the European Union except Denmark.

7 Territorial proceedings under Regulation, art. 3(4), present issues similar to secondary proceedings and are not specifically referred to herein. However, the analysis should apply to remedies available in such proceedings as well.

proceedings, i.e. the law of the state, in which the debtor has its center of main interests (the *COMI*) or an establishment. The Regulation provides a safe harbor, which precludes avoidance, under such law, of transactions "subject" to another law, if such other law does not enable avoidance.[8] This is generally interpreted as a reference to the law governing the contract or the law of location of the transferred property[9] and has been severely criticized.[10] This paper argues that the safe harbor provision should be rather read as referring to the applicable avoidance law, this being the law with the closest connection to, or the greatest interest in defining the avoidability of, the act in question; as the latter will often correspond to the law of the main or secondary proceedings, the scope of the safe harbor will be severely reduced under the proposed reading. If a similar test is adopted for allocation of avoidance actions among the main and secondary proceedings in ambiguous situations, the framework established by the Regulation will properly designate the applicable avoidance law and limit the reach of avoiding powers in line with their purpose and the interests at stake.

The proposed analysis implies that the framework in its entirety, however, contains some gaps and leads to normative proposals to: (a) use a similar closest connection test for choice of the applicable non-insolvency fraudulent conveyance law, (b) development of an EC-law based rule giving the trustee[11] in the main insolvency proceedings standing to bring any non-insolvency fraudulent conveyance suit on behalf of the creditors and (c) open the safe harbor provision to laws of non-member states.

This subject might seem arcane given the paucity of court cases and literature. However, avoidable transactions occur in a significant proportion of insolvencies, despite the fact that lack of

8 Sebastian Zeeck, Das Internationale Anfechtungsrecht in der Insolnvenz, Die Anknüpfung der Insolvenzanfechtung 2, 126 (Mohr Siebeck 2003) (discussing a different proposal of alternative choice of law rule).

9 *See generally* Jan Peter Klumb, Kollisionsrecht der Insolvenzanfechtung 26 (Carl Heymanns Verlag 2005) [hereinafter *Klumb, Kollisionsrecht*].

10 Jay Lawrence Westbrook, A*voidance of Pre-bankruptcy Transactions in Multinational Bankruptcy Cases*, 42 Tex. Int'l L.J. 899, 903 n. 25 (2007) [hereinafter *Westbrook, Avoidance*] (approving of the predictability of the Regulation's rule but criticizing how easy it can be manipulated).

11 I use the term "trustee" despite the Regulation's use of "liquidator", as the term "trustee" does not imply the necessity of liquidation as much as the latter.

litigation funding often prevents successful prosecution and settlements are usual.[12] But litigation should not be the sole focus of the conflicts of law analysis. Such analysis is crucial also for transaction planners, in particular in distressed sales and work-outs, to enable structuring transactions so as to render them invulnerable to avoidance attack.[13]

This paper refers only to avoidance of suspect transactions occurring before the commencement of the insolvency proceedings (whatever the exact meaning of this term is[14]) and only to a narrow area of fraudulent conveyances and preferences in the traditional meaning.[15] My views are influenced by American scholarship and the interplay between the federal bankruptcy law and state non-bankruptcy law.[16] Therefore, although the terminology of the Regulation dominates this paper, for convenience purposes I use some terms based on U.S. concepts.

The paper proceeds as follows: after a rather obligatory review of the avoiding powers (part II) and of the EU framework for jurisdiction and choice of law in avoidance issues (part III), I disclose the proposed new interpretation of the safe harbor provision (Part IV). Subsequently, I subject the framework thus adapted to a strict scrutiny (Part V) and then present the three proposals for reform

12 *See generally* Gijs van Dijck, *Comparing Empirical Results of Transaction Avoidance Rules Studies*, 17 INT'L INSOLVENCY REV. 123 (2008).

13 *See* Wood Principles, at 461.

14 *E.g.* Thomas Bachner, *The Battle Over Jurisdiction in European Insolvency Law*, 3 EUR. COMP. AND FIN. L. REV. 315 (2006) (arguing that the meaning of this concept should be defined by member states, that provisional measures should not be given this meaning and criticizing the Eurofood decision) and the ECJ decision in Case C-341/04, *Eurofood,* 2004 E.C.R. I-03813, para. 54 (the appointment of a provisional liquidator under Irish law constituted "opening of proceedings").

15 *See* Jay Lawrence Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499, 502 n. 11 (1991) [hereinafter *Westbrook, Choice of Law*] (applying the concepts discussed for bankruptcy of legal entities to individuals is inappropriate, as individual insolvency triggers issues, which are more complex and difficult to decide). My discussion is limited to fraudulent conveyances and preferences and might not be applicable where specific remedies designed only for individual bankruptcy are in question, see e.g. Insolvency Act, 1986, s. 339(3)(b) (defining as transaction at undervalue a transaction entered in consideration of marriage) or s. 342A (allowing avoidance and recovery of excessive pension contribution).

16 *See* John T. Cross, S*tate Choice of Law Rules in Bankruptcy*, 42 OKLA. L. REV. 531 (1989).

mentioned above (Part VI).

II. Avoiding powers and non-insolvency law

The term "avoiding powers"[17] covers a broad range of legal remedies, which serve to unwind certain transactions that took place before the commencement of the insolvency proceedings.[18] This can mean (1) requiring the return of property transferred by the debtor, (2) canceling an obligation incurred by the debtor or (3) claiming monetary compensation from a beneficiary of the avoidable transaction in the amount of the benefit received.[19] The Regulation describes these remedies as "*voidness, voidability or unenforceability of legal acts detrimental to all the creditors*".[20]

For the purpose of analysis, it is useful to differentiate between two main groups of avoidance remedies: preferences and fraudulent conveyances (*actio pauliana*). Preference remedies serve to protect the collective nature of the insolvency proceedings and enable avoidance of transactions, by which one of the creditors gains an advantage over other creditors by being paid or granted a security interest, thus (at least partially) opting out of the impeding insolvency proceedings.[21] On the other hand, fraudulent conveyance law serves to police the debtor's behavior in the interest of all the creditors. It enables avoidance of transactions, whereby the debtor removes its assets or increases its liabilities to the detriment of its creditors, whether by a clearly fraudulent act or a panicked effort to raise cash resulting from its financial difficulties.[22] Fraudulent conveyance remedies are not particular to insolvency

17 Although this is a US term, it is used for convenience purpose, there being no suitable European equivalent.

18 Klumb, Kollisionsrecht, at 1.

19 *See* Westbrook, Choice of Law, at 499 n. 2.

20 *See* Article 4(2)(m) of the Regulation. The German term of art is "Insolvenzanfechtung"; the French term is "nullité" or „inopposabilité".

21 *See* Thomas Jackson, The Logic and Limits of Bankruptcy Law 136 (BeardBooks 1986) [hereinafter *Jackson, Logic*] (noting also that in certain instances, a pre-insolvency termination of an executory contract could be treated as a preference).

22 In the UK they are referred to as "transactions at undervalue" and "transactions defrauding creditors", in France as "actes en fraud des droits des créditeurs" and in Germany as „Vorsätzliche Benachteiligung der Gläubiger".

proceedings and exist both inside and outside of insolvency proceedings.[23]

The main difference between the insolvency avoiding powers and non-insolvency fraudulent conveyance remedies is that the insolvency remedies are exercised in the interest of all the creditors (i.e. the estate), whereas the non-insolvency remedy benefits only the creditor(s) bringing the action.[24] However, non-insolvency fraudulent conveyance remedies are often invoked within insolvency proceedings. In France, for example, there is no separate insolvency fraudulent conveyance remedy and a trustee may bring the fraudulent conveyance action (action paulienne) set forth under general civil law on behalf of all the creditors.[25]

In addition to preferences and fraudulent conveyances, some insolvency laws contain other similar remedies, such as avoidance of statutory or unperfected liens, of transfers of assets exempt for the benefit of an individual debtor, or subordinating shareholders' or even some creditors' claims.[26] Some of these remedies serve similar purposes as the preferences and fraudulent conveyances; some, however, serve different purposes, such as a protection of the individual debtor, establishment of relative values of claims, or definition of the property of the estate.[27] These remedies may require similar or different choice of law treatment as preferences and fraudulent conveyances; however, these questions are beyond the scope of this paper.

Differences between avoidance remedies under the laws of different member states may cause a particular transaction to be avoidable under the laws of one state and not avoidable under the laws of another state. These differences occur for example in:

General scope of the avoiding powers: Czech law does not enable a preference attack against

23 The German term of art for a non-insolvency avoidance is „Einzelgläubigeranfechtung", *see* Zeeck, *supra* note 8, at 3. An example of an exceptional non-insolvency preference remedy is U.S. Uniform Fraudulent Transfer Act, § 5(b), Anfechtungsgesetz [AnfG] [Fraudulent Transfer Act], Oct. 5, 1994, BGBl. I, at 2911, last amended by art. 11 of Gesetz, Oct. 23, 2008, BGBl. I, at 2026, § 6 (both enabling out-of-insolvency avoidance of a preferential payment to an insider (U.S.) or a shareholder (Germany)).

24 *See* Colomer, Deko Marty Opinion, para. 27, Wood Principles, at 461, para. 17-006.

25 Code de Commerce, Article L622-20, and Code Civil, Article 1167.

26 *See* 11 U.S.C. §§ 544(a), 545, 522, 510 (2008).

27 *See* Jackson, Logic, at 69, 129, 133.

pre-insolvency payment of a due debt,[28] while German or English law do, including if it was made within judicial enforcement procedure.[29] Most jurisdictions provide avoiding powers in each type of insolvency proceedings, but some do not in reorganization proceedings (Slovakia, Poland, Slovenia).[30]

Requirements of knowledge or intent: German law treats a payment of a due debt as an avoidable preference only if the beneficiary knows about the insolvency of the debtor (the debtor's intent is, though, irrelevant).[31] English law, on the contrary, requires (and in case of insiders presumes) that the debtor be influenced by a desire to give an advantage to the creditor, but does not require beneficiary's knowledge of debtor's insolvency.[32] The knowledge and intent requirements were reported to cause the most disputes in Dutch avoidance proceedings.[33]

Suspect periods: English law enables avoidance of preferential payments made to non-insiders within the six months preceding the filing of the insolvency petition,[34] German law applies various periods, but generally not more than three months before filing of the petition.[35]

Carve-outs: All EU member states provide for limited carve-outs for financial collateral transactions and payment systems.[36] However, German law protects a financial collateral arrangement from preference attack only if actually provided further to a margin call, whereas

28 Zákon č. 182/2006 Sb.,insolvenční zákon (Insolvency Act), last amended by zákon č. 458/2008 Sb., § 241 [hereinafter *Czech Insolvency Act*].

29 Insolvency Act, 1986, s. 239(7), Insolvenzordnung [InsO] [Insolvency Act], Oct. 10, 1994, BGBl. I, at 2866, last amended by Article 9 of Gesetz, Dec. 12, 2007, BGBl., I. at 2840 [hereinafter *Insolvenzordnung*], §§ 130, 141.

30 Wood Principles, at 517 and Zákon č. 7/2005 Z.z., o konkurze a reštrukturalizácii (Bankruptcy and Restructuring Act), last amended by zákon č. 447/2008 Z.z. [hereinafter *Slovak Bankruptcy Act*].

31 Insolvenzordnung, §§ 130, 131, Insolvency Act 1986, s. 239(5).

32 Insolvency Act 1986, s. 239(5).

33 van Dijcks, *supra* note 12, at 139.

34 Insolvency Act 1986, s. 240.

35 Insolvenzordnung, §§ 130, 131

36 Directive 2002/47/EC, on financial collateral arrangements, 2002 O.J. (L 168) 43, art. 8, and Directive 98/26/EC, on settlement finality in payment and securities settlement systems, 1998 O.J. (L166) 45.

Czech law protects any financial collateral arrangements without respect to any circumstances.[37] Another example: German and French laws contain special, but slightly differing, carve-outs for payments on promissory notes and checks.[38]

These differences have *ex ante* implications when transactions are structured and *ex post* implications when insolvency occurs and litigation is contemplated. A proper choice of law rule is therefore necessary, though not easy to devise.

III. Choice of law framework

Enforcement of choice of law rules is intertwined with the questions of jurisdiction, both for the non-insolvency fraudulent conveyance remedies and insolvency avoiding powers. The issues of jurisdiction being a background against which the choice of law rules operate, I address them first.

A. Jurisdiction out of Insolvency

The Brussels I Regulation, which sets forth uniform rules of jurisdiction for civil and commercial disputes within the EU, contains a carve-out for issues related to insolvency proceedings.[39] If a remedy "*derive[s] directly from the bankruptcy or winding-up and [is] closely connected with the proceedings for the"* liquidation or reorganization, it is out of scope of the Brussels I Regulation and subject to other rules of jurisdiction.[40]

37 Insolvenzordnung, § 130(1), and Czech Insolvency Act, § 366(1)(d).

38 Insolvenzordnung, § 137 and Code de Commerce, Article L632-3.

39 Council Regulation No 44/2001, on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, 2001 O.J. (L 12) 1, (EC) [hereinafter *Brussels I Regulation*], art. 1(2)(b).

40 *See* ECJ, Case 133/78, Henri Gourdain v. Franz Nadler*,* 1979 E.C.R. 733, para. 4, Colomer, Deko Marty Opinion, para. 35, Enriques, Geller, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law,* (Eur. Corp. Governance Inst. Law Working Paper No. 63, 2006), *available at* http://ssrn.com/abstract=887164, [hereinafter *Enriques, Geller, Encounters*] at 61 and for clear statement of this principle also Ulrich Mangus, Peter Mangovski, Brussels I Regulation 61 (Sellier 2007).

The European Court of Justice (ECJ) decided in *Reichert I*[41] and *Reichert II*[42] that a non-insolvency fraudulent conveyance action can be brought only in the courts of the member state where the defendant (the beneficiary) has its habitual residence. With respect to the purely non-insolvency fraudulent conveyance actions, this seems to be true even when insolvency proceedings are opened against the debtor, if the stay resulting from opening of the insolvency proceedings does not prevent the creditor from bringing the action.[43]

B. Jurisdiction in Insolvency

The Regulation prescribes uniform rules of jurisdiction and choice of law for insolvency proceedings within the EU (except for Denmark). There is always only one main insolvency proceeding, opened in the member state, where the debtor's center of main interests (the *COMI*) is located (the *home state*). There can be multiple secondary insolvency proceedings, opened in any member state where the debtor has an establishment.[44] The opening of the main insolvency proceeding has EU-wide effects and court decisions issued by any court having jurisdiction under the Regulation enjoy automatic recognition, subject only to a "manifestly contrary to the public order" exception.[45] The Regulation sets forth a presumption that COMI is located in the member state of the debtor's registered office.[46] However, courts tend to rebut this presumption and assume jurisdiction over large cases, often filed in the state where the group headquarters are located.[47]

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41 ECJ Case C-115/88, Mario Reichert v. Dresdner Bank AG, 1990 E.C.R. I-27 [hereinafter *Reichert I*].

42 ECJ Case C-261/90, Mario Reichert v. Dresdner Bank AG, 1992 E.C.R. I-02149 [hereinafter *Reichert II*].

43 Colomer, Deko Marty Opinion, para. 35, *see infra* Part VI.B – Trustee's standing.

44 Regulation, art. 3. On the notion of COMI, *see* Patrick Watelet, *Some Considerations on the Center of the Main Interests as Jurisdictional Test Under the European Insolvency Regulation* (July 3, 2007), *available at* http://ssrn.com/abstract=997983; Samuel L. Bufford, C*enter of Main Interests, International Insolvency Case Venue, and Equality of Arms: the Eurofood Decision of the European Court of Justice*, 27 Nw. J. Int'l L. & Bus. 351 (2007).

45 Regulation, art. 16, 25, 26. In particular, a court of a different member state requested to enforce a judgment cannot review the first court's determination of its jurisdiction.

46 Regulation, art. 3(1) *in fine.*

47 *See generally* Watelet, *supra* note 44; Wolf-Georg Ringe, *Forum Shopping Under the EU Insolvency Regulation*

The ECJ held, in its decision in *Deko Marty*,[48] that courts of the member state within which the main (or the secondary)[49] proceedings are pending have jurisdiction to adjudicate avoidance actions brought within the respective proceedings. The case arose when a German trustee sued a Belgian beneficiary in front of a German court, other than the (also German) court, in front of which the proceedings were pending. Lower courts dismissed the action on grounds of lack of jurisdiction and the case went up to the (German) Federal Court of Justice, which referred a preliminary question to the ECJ.[50] The ECJ decided that German courts had jurisdiction, whether or not the competent court was the same as the court in front of which the insolvency proceedings were pending.[51]

Besides the member state of the main or secondary proceedings, the trustee may file an avoidance action in another member state.[52] Whether a court of such state has jurisdiction will be most probably determined according to the Brussels I Regulation,[53] which designates generally the state of the

(Oxford University Legal Research Paper Series No. 33, 2008) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1209822*;* Gabriel Moss, Michael Haravon*, 'Building. Europe — the French Case Law on COMI'* Insolvency Intelligence (2007), *available at* http://www.milbank.com (last visited Mar. 8, 2009).

48 ECJ Case C-339/07, Christopher Seagon v. Deko Marty Belgium NV, 2009 E.C.R. (Feb. 12, 2009), *available at* http://eurlex.eu [hereinafter *Deko Marty Judgment*]. *See also* Laura Carballo, *ECJ Judgment on Deko-Marty Belgium, Case C-330/07* (Feb. 18, 2009) *available at* http://conflictoflaws.net.

49 This point was not explicitly stated in the ECJ's decision, but it is to be inferred from the court's adoption of the theory of *vis attractiva concursus*, a theory previously rejected by some commentators. *See* Klumb, Kollisionsrecht, at 192.

50 Bundesgerichtshof [BGH] [Federal Court of Justice] June 21, 2007, IX ZR 39/ 06, available at http://www.bundesgerichtshof.de (last visited March 6, 2009). *See also* Veronika Gaertner, *German Reference for a Preliminary Ruling - Delimitation between Brussels I Regulation and Insolvency Regulation* (Aug. 24, 2007), http://conflictoflaws.net.

51 *See generally* Deko Marty Judgment.

52 Miguel Virgos, Etienne Schmit: Report on the Convention of Insolvency Proceedings, DRS 8 (CFC), Brussels, May 3, 1996 (EC), *available at* http://aei.pitt.edu/952/ (visited Feb. 16, 2009), at 54 [hereinafter *Virgos Schmit Report*] (the Virgos Schmit Report accompanied the draft convention, which was converted into the Regulation, and is therefore an authoritative source for interpretation of the Regulation); Colomer, Deko Marty Opinion, para. 64 – 68.

53 *Cf.* Ian F. Fletcher, Insolvency in Private International Law: National and International Approaches 365 (Oxford University Press 2d ed. 2005) [hereinafter *Fletcher, Insolvency*]; Miguel Virgos, Francisco Garcimartin, The European Insolvency Regulation: Law and Practice 63, para. 97 (Kluver Law International 2004) [hereinafter *Virgos*

beneficiary's domicile.[54] However, as this analysis is not generally accepted, a judgment issued by a court so seized might not qualify for recognition and enforcement under the Brussels I Regulation.[55]

An alternative analysis is offered in a 2003 decision by a Vienna higher regional court.[56] The court accepted its jurisdiction in a preference case brought by the trustee of an insolvent German company against its Austrian sole shareholder and managing director.[57] The trustee was seeking to avoid repayment of a shareholder loan, which was voidable under a special provision of German insolvency law.[58] The Austrian court read the Regulation's choice of law provisions as referring also to procedural law and applied German rules determining venue; this analysis required the action to be heard by the courts of defendant's domicile, i.e. by the Austrian courts.[59] The court's analysis implied that German substantive law would be applicable to the merits.

The Regulation does not contain rules to prevent parallel litigation of the avoidance issues in different jurisdictions.[60] However, given that the jurisdiction in the main and secondary proceedings

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Garcimartin, Practice] (the jurisdiction under the Regulation in these issues is relatively exclusive).

54 *But see* 3 Hans-Peter Kirchhof, et al., Münchener Kommentar zur Insolvenzordnung 760, para. 144 (C.H. Beck. 2001) (expressing a view that the Regulation creates jurisdiction for courts of other member states). This view seems to have been rejected by ECJ's reaffirmation of the *Gourdain* decision in *Deko Marty, by* the decision by Vienna higher regional court discussed below (applying the venue rules of the law of the main proceedings) and also by Fletcher, Insolvency, at 428 (only decisions of the courts in the member state of opening enjoy recognition).

55 *See* Colomer, Deko Marty Opinion, para. 67; Klumb, Kollisionsrecht, at 190 (position preceding Deko Marty); Sup. Ct., decision No. 20 Cdo 2327/2006, Oct. 31, 2007, *available at* http://www.nsoud.cz (Czech Republic) (denying recognition of an Austrian judgment, where Brussels I Regulation did not apply, due to lack of reciprocity).

56 *See* Jennifer Marshall, European Cross Border Insolvency 2-163 (Sweet & Maxwell 2004); Oberlandesgericht Wien [OLG] [Higher Regional Court], Oct. 17, 2003, No. 3 R 151/03b, available at http://www.ris.bka.gv.at/jus/.

57 The trustee most probably brought the action in Austria knowing that German courts would refuse their jurisdiction, as they did in the *Deko Marty* case.

58 Insolvenzordnung, § 135 (*Kapitalersetzende Darlehen*).

59 The court's reasoning is wrong, as the Regulation's choice of law provision cannot refer to the rules of jurisdiction in the law of a member state, *see* Virgos Garcimartin, Practice, at 59, para. 84.

60 *See* Brussels I Regulation, arts. 27 – 30 (setting forth rules on *lis pendence* and resolution of concurrent claims of jurisdiction).

established by the Regulation is dominant and that the choice belongs to the trustee, there should be no risk of parallel litigation.[61]

C. Choice of Law out of Insolvency

Within the EU, there is no uniform choice-of-law rule for fraudulent conveyances, as this remedy is not recognized to be part of either the law of contractual or non-contractual obligations,[62] two areas of law for which uniform choice of law rules have been adopted.[63] Therefore, each member state applies its own choice-of-law rules. These rules may be unilateral, i.e. defining only the situations where such state's substantive law applies, or multilateral, i.e. defining the applicable law without differentiating whether it is the home state law or not.[64] The choice of law analysis is complicated by the fact that avoidance remedies are difficult to classify in the traditional scheme of a legal system and may belong to a state's contract,[65] insolvency[66] or civil procedure[67] law. Following the ECJ's case law on corporate mobility enabling regulatory competition in company law, member states may tend to recharacterize some creditor protection remedies traditionally enacted within company law as insolvency law avoidance powers.[68]

The German fraudulent conveyance act submits the fraudulent conveyance issues to the law

61 *See* Westbrook, Choice of Law, at 528 (discussing the risks of parallel litigation resulting from the grab rule).

62 ECJ in *Reichert II*, para. 20 and opinion of advocate general Gulmann in this case.

63 Regulation No. 593/2008 on the law applicable to contractual obligations (Rome I), 2008 O.J. (L 177) 6 (EC) [hereinafter *Rome I Regulation*], replacing as of December 17, 2009, the 1980 Convention on the Law Applicable to Contractual Obligations (80/934/EEC), and Regulation No 864/2007 on the law applicable to non-contractual obligations (Rome II), 2007 O.J. (L 199) 40 (EC) [hereinafter *Rome II Regulation*].

64 *See* Look Chan Ho, *Conflict of Laws in Insolvency Transaction Avoidance*, 20 SING. ACAD. L. J. 343, 369 (2008) (describing and criticizing the English unilateral approach).

65 French law, Article 1167 of Code Civil codifying the “action paulienne”.

66 English law and s. 423 of the Insolvency Act 1986.

67 Czech law, Czech Supreme Court, Decision No. 21 Cdo 4333/2007 dated July 12, 2008.

68 *See* Enriques, Geller, Encounters, at 62.

governing the challenged act.[69] Neither Czech, French nor English law have any clear choice-of-law rule for fraudulent conveyances,[70] although it seems that a Czech court will apply Czech law if it has jurisdiction over the defendant and the assets on the theory that fraudulent conveyance law is a part of the law of judicial execution.[71] In the U.S., the applicable state, i.e. non-insolvency, fraudulent conveyance remedies (as opposed to the federal remedies set forth in the bankruptcy code) are determined on the basis of a multilateral multi-factor analysis, searching for the law with the most significant relationship to the transaction.[72] The U.S. courts hold clearly that "a fraudulent conveyance suit is not a suit in contract",[73] but they have not decided, for this purpose, what is the proper qualification of the suit and whether the choice-of-law rule is federal or state law.[74]

Austria also does not have an explicit choice of law rule.[75] However, in 2006 the Austrian Supreme Court had to decide which law is applicable to a fraudulent conveyance claim by a German bank against a woman then residing and holding property in Austria.[76] The defendant, jointly with her husband, the plaintiff's debtor, sold in 2000 a jointly owned English property, wired the proceeds from

69 Anfechtungsgesetz, § 19. *See also* commentary to the statute available at http://www.recht-in.de/kommentare/ (last visited Feb. 16, 2009).

70 Zákon č. 97/1963 Sb., o mezinárodním právu soukromém a procesním (Act on International Private and Procedural Law) (Czech Republic); Ho, *supra* note 64; Bernard Audit, Droit International Privé 604 para. 761 (Economica 1991).

71 *See* Sup. Ct., Decision No. 21 Cdo 4333/2007 dated July 12, 2008 (Czech Republic), *available at* http://www.nsoud.cz. *But see* Klumb, Kollisionsrecht, at 119 n. 497 (referring to this theory as developped in 19th century and based on a concept of limited mobility of assets) and *Reichert II*, para. 28 and opinion of advocate general Gulmann (rejecting this qualification of *actio pauliana*).

72 See *Ferrari v. Barclays Business Credit, Inc. (In re Morse Tool, Inc.)*, 108 B.R. 384 (Bankr. D. Mass. 1989); *Murphy v. Meritor Savings Bank (In re O'Day Corp.)*, 126 B.R. 370 (Bankr. D. Mass. 1991); *Kaiser Steel Corporation v. Jacobs (In re Kaiser Steel Corp.)*, 87 B.R. 154 (Bankr. D. Colo. 1988). *See also* David W. Morse, *Legal Issues In Leveraged Acquisitions: From The Lender's Perspective*, 1713 PLI/Corp 251 (2009).

73 *In re Morse Tool*, 108 B.R. at 387.

74 *In re Morse Tool*, 108 B.R. at 385.

75 Gesetz über das internationale Privatrecht [IPRG] [Act on International Private Law], June 15, 1978, BGBl I 58, 2004, *available at* http://www.internet4jurists.at/gesetze/bg_iprg01.htm, § 1(1)

76 Oberste Gerichtshof [OGH] [Supreme Court] Apr. 4, 2006, docket No. 2Ob196/04v (Austria), *available at* http://www.ris.bka.gv.at.

the sale to the defendant's account in Germany and used it for acquisition of a property in Austria into defendant's exclusive ownership. The plaintiff had obtained a German judgment against the defendant's husband and sought from the defendant recovery of the net benefit she obtained from the sale. The court first concluded that the *lex rei sitae* should be the general rule of choice of applicable fraudulent conveyance law, as this usually corresponds to the law under which the transaction affects the creditor's chances of satisfaction.[77] However, as the choice of law analysis looks for the law with the strongest relationship to the case,[78] the court had to assess all factors causing another law to be applicable. Austrian law could generally apply, as the elements of the case were scattered between Austria, Germany and UK, but the case was remanded to the lower court to determine whether the case did not have closer relationship to English or German law,[79] which would be the case had the couple resided at the time of the sale in one of those states.[80] Interestingly, the court concluded that an eventual *renvoi* should be accepted.[81]

D. Choice of Law in Insolvency

The general choice-of-law rule of Article 4 of the Regulation declares that the law of the home state applies to avoidance of "*acts detrimental to all the creditors*".[82] This law applies also if a court of another member state has jurisdiction, as in the case decided by the Vienna higher regional court described above.[83] For purposes of this paper, this expression is deemed to cover all the relevant

77 Id., at 4, para. 3.3.

78 IPRG, § 1(1).

79 OGH, Apr. 4, 2006, at 4, para. 3.6.

80 It cannot be claimed that this approach does not resemble a backwards looking COMI analysis.

81 Id., at 4, para. 4, at 5, para. 5. *Renvoi* means application by the court of the choice of law rules of the applicable law (as compared to application of only substantive law), which can refer the court back to the use of its own substantive law or to the substantive law of a third country.

82 *See* Regulation, Art. 4(2)(m), French version says: "*actes préjudiciables à l'ensemble des créanciers*", German version: "*Rechtshandlungen[, die] die Gesamtheit der Gläubiger benachteiligen*".

83 *See above* Part III.B – Jurisdiction in insolvency.

avoidance remedies, including both fraudulent conveyances and preferences.[84]

If secondary proceedings are opened, the law of the state in which such proceedings are opened (the *law of secondary proceedings*) applies to avoidance actions brought by the trustee appointed there in respect of assets located within or removed, by an avoidable transaction, from the territory of such state.[85] The Regulation contains an elaborate definition of where an asset is deemed to be located: rights registered in a public register within the member state, where the register is kept, and other claims within the member state of the COMI of the obligor.[86] This definition is subject to nuances for assets such as bank accounts, which are deemed to be located with the respective branch.[87]

In case of liquidation, any proceeds realized within the secondary proceedings, including from avoidance actions, are distributed according to the priority scheme set forth by the law applicable to these proceedings; if there is a surplus, it will be transferred to the main proceedings.[88] If a reorganization plan is proposed in the main proceedings, creditors in the secondary proceedings can request that their rights recognized by the law of secondary proceedings be protected in any such plan.[89] Therefore, any recoveries from avoidance actions brought in the secondary proceedings will be distributed in line with the priority scheme established by the law of these proceedings. As the trustees shall cross-file the claims of the creditors so that all creditors participate in distribution in all proceedings, only the priority claimants in each proceedings will obtain a special benefit from the distribution of the proceeds of avoidance actions.[90]

The ability to use the avoiding powers of the law of the secondary proceedings may be one of the

84 *See* fn. 15 above.

85 Regulation, art. 18(2), 27, Virgos Schmit Report, at 137.

86 Regulation, art. 2(g), Virgos Schmit Report, at 48.

87 Virgos Garcimartin, Practice, at 168, para. 312 (noting also that the definition follows a "logic of enforcement", i.e. locating, for the purpose of the Regulation, assets in the member state, which can effectively exercise jurisdiction over them, but discussing a "separate entity theory" with respect to bank branches). I do not see why a special treatment under the definition should be reserved only to bank accounts.

88 Regulation, art. 28, 35.

89 Regulation, art. 33(1).

main grounds for parties to be in need of opening such proceedings.[91] Other areas where the laws of the main and secondary proceedings may materially differ seem to be amenable to negotiation, as seen in the Collins&Aikmans case where the English court authorized adjustment of English priority rules in order to prevent German creditors from opening secondary proceedings.[92]

The application of the avoidance law of the main or secondary proceedings is subject to a safe harbor under Article 13 of the Regulation – a defense available to the beneficiary of the transaction.[93] An act cannot be avoided if it is "subject to"[94] the law of another member state and if such law does not allow "any means" of challenging the act "in the relevant case".[95] The phrase "any means" is generally interpreted to refer to the fact that the safe harbor applies only if the challenged act could not be avoided under either insolvency or non-insolvency avoidance rules. "In the relevant case" requires that all the facts of the case be assessed when making this determination.[96]

The safe harbor provision raises at least two issues: (a) it does not apply if the law referred to is a law of a non-member state,[97] and (b) the meaning of "subject to a law" language may be unclear, in particular as to the choice of law rule used to determine the relevant law.[98] Most commentators suggest

90 Regulation, art. 32(2).

91 Gabriel S. Moss, et al., The EC Regulation on Insolvency Proceedings: A Commentary and Annotated Guide 50 (Oxford University Press 2002) [hereinafter *Moss, Commentary*].

92 See *Re Collins&Aikmans Europe SA and other matters*, [2006] EWHC 1343 (Ch). *See also* Marshall, *supra* note 56, at 2-165 (reporting a similar decision in MG Rover Benelux SA/NV, [2006] EWHC 1296).

93 See e.g., Virgos Garcimartin, Practice, at 134 .

94 In French: "*est soumis*", in German: "*daß für diese Handlung das Recht eines anderen Mitgliedstaats als des Staates der Verfahrenseröffnung maßgeblich ist*", which is slightly different from "*das Recht[,] dem die Wirkungen der Rechtshandlung unterliegen*", AnfG, § 19, but is interpreted in the same way as referring to what is referred to below as "plain reading". *See generally* Klumb, Kollisionsrecht.

95 Regulation, art. 13 and Virgos Schmit Report, at 87-90.

96 Virgos Schmit Report, at 88.

97 Fletcher, Insolvency, at 401.

98 *See* Marshall, *supra* note 56, at 1-48; Nick Segal, *The Choice of Law Provisions in the European Union Convention on Insolvency Proceedings*, 23 Brook. J. Int'l L. 57, 69 n. 56 (1997); Klumb, Kollisionsrecht, at 43, fn. 215 (stating that there is a general agreement that the choice of law rules of the state where the respective insolvency proceedings are

that the "subject to" language refers to the law governing the contract or, in case of transfer of property, the law of the state in which the transferred property is situated.[99] I refer to this interpretation as "plain reading" and propose an alternative reading, claiming that the safe harbor provision refers to the applicable avoidance law and embeds a choice of law rule for this purpose. If my interpretation is accepted, the benefits of the safe harbor should be offered whether or not the law to which a particular transaction is "subject" to the law of a member state.

There is no ECJ case law on these provisions so far. Only a few cases have been reported from national courts, all of them from the pre-Regulation era. In an older case, a Dutch appellate court authorized, within Dutch insolvency proceedings, a Dutch *actio pauliana* challenge against acts clearly governed by foreign law and executed abroad.[100] In a series of more recent cases, the Dutch courts applied the principle of the Regulation's safe harbor and denied recovery of payments avoidable as preferences under foreign law based on the fact that Dutch law did not allow avoidance.[101] The courts referred to principle of legal certainty and to the draft of Regulation;[102] it is, however, not clear, whether the choice amounted to more than just protection of the local defendant, especially compared to the

pending apply and referring to Virgos Schmit Report, at 30, para. 136, which, however, does not seem to address the issue).

99 *See* Segal, *supra* note 98, at 69, n. 57 (quoting 2 DICEY ON CONFLICT OF LAWS 1180 (Lawrence Collins ed., 12th ed. 1993)); Fletcher, Insolvency, at 402 (referring to the applicable law being chosen on the basis of the Rome Convention on the Law Applicable to Contractual Obligations (replaced by the Rome I Regulation)); ZEECK, *supra* note 8, at 119. For a defense of this rule, *see* WOLFRAM HENCKEL IN HANS STOLL, ET AL., STELLUNGNAHMEN UND GUTACHTEN ZUR REFORM DES DEUTSCHEN INTERNATIONALEN INSOLVENZRECHTS 158 (J.C.B.Mohr, Paul Siebeck 1992).

100 *See* MICHEL TROCHU, CONFLITS DE LOIS ET CONFLITS DE JURIDICTIONS EN MATIÈRE DE FAILLITE 167 (Sirey 1967) (reporting a decision by Amsterdam Court of Appeals dated June 11, 1954, appeal to Supreme Court rejected, Apr. 15, 1957).

101 MARSHALL, *supra* note 56, at 2-173. The cases referred to are Gustafen v. Mosk (NJ 1999, 316, Supreme Court, Oct. 24, 1997), CIKAM B.V. v. CIKAM GmbH (NJ 2003, 249, Supreme Court, Mar. 7, 2003) and Putizak Dolman International (District Court of Amsterdam, Jan. 26, 2005).

102 *See* Bob Wessels, *The European Union Insolvency Regulation: It's First Year in Dutch Court Cases.,* 2003 ANN. SURV. OF BANKR. LAW 481, 489*, available at* http://www.iiiglobal.org (quoting the Gustafen decision: "The principle of legal certainty however demands to take into account that a Dutch counter-party of the foreign insolvent debtor will not be prepared for the application of non-Dutch rules in a case where the legal act (of payment) is not subject to that foreign law and those foreign rules are less strict when granting a claim than the law applicable to the legal act itself...").

older case.[103] In Germany, pre-Regulation law based the choice of law on the question of which estate was diminished by the challenged act.[104] French courts enabled application of the law of the proceedings, subject to certain limitations effecting French policies.[105]

In *Re Paramount Airways Ltd. (No. 2)*,[106] the English court of appeal limited the application of English avoiding powers to transactions with "sufficient connection" to England,[107] clarifying this concept as follows:

> [I]n considering whether there is a sufficient connection with this country the court will look at all the circumstances, including the residence and place of business of the defendant, his connection with the insolvent, the nature and purpose of the transaction being impugned, the nature and locality of the property involved, the circumstances in which the defendant became involved in the transaction or received a benefit from it or acquired the property in question, whether the defendant acted in good faith, and whether under any relevant foreign law the defendant acquired an unimpeachable title free from any claims even if the insolvent had been adjudged bankrupt or wound up locally. The importance to be attached to these factors will vary from case to case.

It seems unlikely that an English court would feel authorized to apply foreign (insolvency) avoidance law given the clear language of the Insolvency Act.[108]

IV. Proposed Choice of Law Rules

As suggested above, the generally accepted reading of Article 13 does not seem acceptable and needs to be challenged (subsection A). This has, however, a direct implication for the Regulation's system of allocating the avoidance actions to main or secondary proceedings (subsection B).

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103 Wood Princiles, at 881.

104 *See* HANS-JURGEN LWOWSKI, HANS-PETER KIRCHHOF, MUNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG, BAND 3, 791, § 252. Ror a support to this rule as a proposal, *see* HENCKEL, *supra* note 99, at 166.

105 *See* TROCHU, *supra* note 100, at 164, 166, 171.

106 *In re Paramount Airways Ltd. (in Administration)*, [1993] Ch. 223 E.R. (C.A.).

107 Fletcher, Insolvency, at 92; *see also* Ho, *supra* note 64, at 371 (discussing Paramount Airways).

108 Fletcher, Insolvency, at 95.

A. Safe Harbor

Article 13 of the Regulation provides safe harbor to a detrimental act if "said act is subject to" a law that does not allow it to be avoided. In some cases, the challenged act is subject to only one law. However, with major cross-border transactions it might be difficult to identify the law to which an act is subject as a whole, the options comprising the *lex causae*, *lex rei sitae* or another law, such as the law governing the exchange, where the contract was entered into.[109] In addition, the governing law need not have any relationship to the interests at stake, especially in case of a contract where the parties use a foreign contract law only for its convenience, which is usual practice not only in many new member states.[110]

For example: consider a contract for sale of the shares in a Czech company governed by English law, but the transfer itself occurs under Czech law; a loan agreement governed by English law, but repaid in kind by French real estate under a settlement governed by German law; a security package consisting of multiple instruments governed by various laws. Although, it is possible to treat each instrument or portion of a transaction separately,[111] this approach does not make much sense, as what is inherently one transaction could be treated in a piecemeal manner. This would not lead to sensible results. The issue becomes even more complicated when more parties enter into the picture, such as when the beneficiary is not a party to the relevant transaction, e.g. a preference given to an insider by repayment of a loan he guaranteed[112] or action against a successor of the original beneficiary.[113]

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109 *See* Trochu, *supra* note 100, at 161.

110 Philip R. Wood, International Loans, Bonds and Securities Regulation 62, para. 5-2 (Sweet&Maxwell 1995).

111 *See* Klumb, Kollisionsrecht, at 107-109 (each portion of a transaction will benefit of the safe harbor according to the law governing such portion – i.e. the property effects may be avoided and the contract may remain valid).

112 *See e.g.* Insolvency Act, 1986, s. 421(1)(d), 421(2) (enabling recovery of benefits received by a person, who was not a party to the avoided transaction). *Cf. also In re Denochick*, 287 B.R. 632 (W.D. Penn. 2003) (repayment of a debt to a non-insider, if made within the longer suspect period for insiders, constitutes a preference given to the insider who guaranteed the debt).

113 *See* Zeeck, *supra* note 8, at 34; Klumb, Kollisionsrecht, at 97, 98 (second beneficiary can raise good faith defense under the law governing the challenged transaction, but not under the law governing second transfer). I do not see any reason

The "subject to the law" language can, however, be read also as referring to the applicable avoidance law. Such law would be selected by a choice of law rule embedded in the Regulation. This interpretation, rather than subverting the plain meaning of the safe harbor, makes the system established by the Regulation workable and sensible. Why this is so and how the concept should operate is the main topic of the rest of this paper.[114]

The first question is, obviously, how is the applicable avoidance law to be determined. It must be the law with the closest connection or most significant relationship to the challenged transaction. As most avoidance cases involve some degree of fraud or dishonest behavior by either the debtor or the beneficiary, a completely clear rule for selection of the safe harbor is simply not proper, as it would create incentives to engage in sophisticated structuring around the rules. Although this standard seems to be vague and empty, no simpler rule seems to be appropriate, other than a flat rule applying the home state law to all the transactions.[115] The latter would, however, fully ignore the text of the Regulation, and, as is suggested below, not properly address the interests at stake.

In the U.S. Case of *Maxwell Communications*,[116] an examiner appointed in a Chapter 11 case challenged, under U.S. preference law, a transfer of funds by the debtor, an English company, to its English creditor banks. The only connection of the transfer to the U.S. was the fact that the transferred funds came from the sale of the debtor's shares in certain U.S. subsidiaries. All the other connecting factors, i.e. debtor's principal business and headquarters, beneficiaries, accounts via which the transfer occurred and the law applicable to all the relevant contracts, were in England.[117] The court concluded

(other than plain reading), why the first beneficiary should be given higher protection than a subsequent beneficiary.

114 *See* David Costa Levenson, *Proposal for reform of choice of avoidance law in the context of international bankruptcies from a U.S. perspective*, 10 Am. Bankr. Inst. L. Rev. 291 (2002) (proposing an addition of a broad "closest connection" with an exemplary list of factors to be considered to the Chapter 15 of U.S. Bankruptcy Code).

115 *See* Westbrook, Choice of Law, at 530 („any system of counting contacts or weighing interests in each case will make the choice of law unpredictable and opaque").

116 See *Maxwell Communication Corp. Plc v. Societe Generale (In re Maxwell Communication Corp. Plc)*, 93 F.3d 1036, 1043 (2d Cir. 1996). *See also* Fletcher, Insolvency, at 94 (appreciating the Maxwell approach); *cf.* Westbrook, Avoidance, at 909 (criticizing the second circuit for confusing the analysis of comity with the choice of law).

117 *Maxwell Communications,* 93 F.3d at 1051.

that the U.S. had no significant interest in applying its avoidance law.[118] In another case, *French*, with facts not dissimilar from those in the *Reichert* cases,[119] a U.S. court applied U.S. bankruptcy fraudulent conveyance powers to avoid a transfer of real estate located in Bahamas between U.S. citizens in fraud of U.S. creditors.[120]

The approaches of the courts in *Maxwell, Paramount Airways, French* and the Austrian case quoted above provide good examples of courts' search for connecting factors within the "closest connection" analysis. This approach leads to a presumption in favor of the law of the debtor's COMI or establishment, if the debtor transacted through the establishment (whether or not secondary proceedings are opened and whether or not the transaction itself is governed by the law of the place of the establishment); the presumption might be rebutted if another law has stronger connection to the transaction.[121] The analysis may require some emphasis on the differing purposes of the law of preferences and of the law of fraudulent conveyances: the preference remedies are much more closely connected to the collective nature of the insolvency proceedings[122] and therefore, it should be slightly more difficult to find for a law of a state in which there is no reasonable chance of opening such proceedings. Further, if the defendant is not the a party to the transaction, circumstances might require an analysis of whether the defendant could suffer an extraordinary prejudice by being subject to a particular law, e.g. whether a later transfer of the asset between the party to the transaction and the defendant would not be subject to another avoidance law affording it with sufficient protection.[123]

118 *Maxwell Communications,* 93 F.3d at 1052 (the fact that the court analysed the issue within the prism of comity is not relevant for the present purpose, as comity is not applicable within the sphere of application of the Regulation).

119 In the Reichert case, the plaintiff bank argued that if the case was submitted to German courts, these would apply either German fraudulent conveyance law or require cumulatively satisfaction of both German and French requirements for avoidance of the transfer, *see* Opinion of Advocate General Gulmann in the *Reichert II* case, para. 14.

120 *French v. Liebmann (In re French)*, 440 F.3d 145 (4th Cir. 2006). For a description of the French case, *see* Westbrook, Avoidance, at 908 (approving the court's decision, but critical to the court's evaluation of comity). *But see* T. Brandon Welch, *The Territorial Avoidance Power of the Bankruptcy Code*, 24 Emory Bankr. Dev. J. 553, 580 (2008) (critical assessment of the French case due to excessive extraterritorial application of U.S. bankruptcy law).

121 *See* OGH, Apr. 4, 2006, *supra* note 76.

122 *See* Jackson, Logic, at 146.

123 *See e.g.* Insolvency Act, 1986, s. 240(2) (enabling avoidance against beneficiary's successor, subject to a good faith

B. Allocating Avoidance Actions

Acceptance of the closest connection analysis for the safe harbor leads to a further question: how to allocate avoidance actions between main and secondary proceedings. This might be relevant where (a) the assets in question are within the jurisdiction of the secondary proceedings, but the connection to the law of the main proceedings is much stronger (law of secondary proceedings should apply under literal reading of the Regulation),[124] or (b) where the assets are located out of the jurisdiction of the secondary proceedings, but the law of the secondary proceedings has a much closer connection to the transaction (law of main proceedings should apply under literal reading).[125] The Regulation's solution of the choice of law questions in such case depends on the location of the assets, which might not be the proper connecting factor.[126]

To make the framework functional, the closest connection should be applied in ambiguous situations also to the allocation of avoidance actions between the main and the secondary proceedings. However, the fact that secondary proceedings should properly stretch only to assets, which would be within such proceedings had the challenged act not taken place, should be taken into account to limit the breadth of such analysis.[127]

The allocation of jurisdiction over assets to secondary proceedings and the definition of location of an asset might be reasonable for the purpose of allocating jurisdiction over assets of the estate where the benefit of having a rule clearly outweighs the possible damages caused by the rule not being

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defense, if the later transfer was for value); Insolvenzordnung, § 145(2) (enabling avoidance against beneficiary's successor only if the latter had actual knowledge of the circumstances making the first transfer avoidable); Code de Commerce, art. L632-1 (which does not seem to enable recovery of a preferential (cash) payment from any other person than the direct beneficiary).

124 Regulation, arts. 3(2), 18(2) (or the assets have been removed from the jurisdiction by an avoidable act), Virgos Schmit Report, at 137, para. 224.

125 Regulation, art. 3(1); Virgos Schmit Report, at 5, para. 5.

126 Regulation, art. 2(g). *See above* Part III.B – Jurisdiction in insolvency.

127 *See* HENCKEL, *supra* note 99, at 166.

completely adequate.[128] However, whether such a clear rule is appropriate for allocation of avoidance actions is questionable. Allocating avoidance actions in a slightly different manner than the other assets will disrupt the general framework of the Regulation only minimally and the resulting benefits may be substantial.[129]

V. (E)valuation of the Rule

The appropriateness of a particular choice of law framework for avoidance actions needs to be assessed for its alignment with interests at stake, its ability to balance predictability with fairness of results, and its reaction to the fact of forum shopping.

In his article introducing the problem of choice of law in avoidance actions,[130] Professor Jay Lawrence Westbrook considers the European system of secondary proceedings to be equivalent to a system of a "grab rule" and therefore inferior to a system applying the avoidance law of the state where the main proceedings are pending to all suspect transactions (referred to further as the *flat home state rule*).[131] However, he admits that a reasonable system of application of local law to avoidance actions could be established under a system of modified universalism.[132] I argue that the Regulation, under the proposed interpretation, overcomes the main disadvantages suggested by Professor Westbrook and is superior to the flat home state rule.[133]

128 *See* Jackson, Logic, at 130 .

129 *See* Ho, *supra* note 64, at 372 (discussing only the question of choice of law within the framework of English international insolvency law other than the Regulation and suggesting similar treatment).

130 *See* Westbrook, Choice of Law, at 525 (discussing five possible choice of law rules for avoidance actions: (i) flat home state rule, (ii) only local law applies, (iii) closest connection analysis in each case, (iv) either law can be applied to avoid and (v) both laws need to avoid).

131 Westbrook, Choice of Law, at 516, 527. Professor's Westbrook's criticism of the model of secondary bankruptcies as enabling sophisticated creditors to extract more rent is inappropriate under the Regulation given the ability of the trustee's to cross-file claims, *see above* Part III.D – Choice of Law in Insolvency. A second criticism relating to risks of parallel litigation is also inappropriate – given the uniform assignment of jurisdiction and the wide recognition of judgments it is very limited..

132 *See* Westbrook, Choice of Law, at 533 n. 125.

133 *See* Zeeck, *supra* note 8, at 126 (arguing for an amendment of Article 13 to introduce a rule, which would enable

A. Avoidance and Distribution

As described in Part II above, avoiding powers serve two main objectives: protecting the collective nature of the insolvency proceedings and preventing the debtor from stripping off its assets in the pre-insolvency period.[134] The avoidance law often follows the same policies as the scheme of priorities in a country's insolvency law. Even when this is not true, the differing avoidance laws can be seen as protecting the countries' different priority schemes[135] and, as Professor Westbrook submits, these two regimes of a particular insolvency law should be therefore always applied together.

The Regulation's framework of the main and secondary proceedings satisfies this requirement.[136] The primary application of the avoidance law of the main proceedings corresponds to the assumption that the law of the debtor's COMI has closest connection to all debtor's transactions for the purpose of avoidance. The existence of an establishment might require the local interests related to the establishment (employees, suppliers) to be governed by local policies and the application of the avoidance law of the secondary proceedings within these proceedings is also sensible.[137] The proceeds of the avoidance action are distributed primarily according to the priority scheme set up by the law of the state that instituted the avoidance remedy. However, claims of all the creditors of the debtor are

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avoidance if either the law of the proceedings or the law governing the transaction allow it – the *alternative rule*); Westbrook, Choice of Law, at 532 (rejecting the alternative rule as not correspondingly protecting local interests and creating incentives for competitive pressure to deregulate). I guess that my analysis makes it clear why the alternative rule is unacceptable without the need to address it specifically.

134 *See* Jackson, Logic, at 146.

135 *See* Westbrook, Choice of Law, at 500.

136 *But see* HENCKEL, *supra* note 99, at 160, 167 (criticizing a similar framework proposed as a reform in Germany in 1992 and arguing for a rule applying exclusively the avoidance remedies of the law governing the transaction).

137 This point touches on a more general discussion in the international insolvency law scholarship, whether secondary proceedings are a proper solution, for which there is no space here. This implies argumentation by government willingness to accept foreign insolvency procedures – a very important issue given that the Regulation is directly applicable. *See e.g.* Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy,* 98 MICH. L. REV. 2216, 2238 (2000) (discussing problems of a purely universalist system and questions of national interest).

taken into account in all the pending proceedings, whether main or secondary.[138] Priority creditors, for whose protection an avoidance remedy might be established, will thus reap the benefit of the remedies, but all the other creditors will share equally after the priority creditors are paid in full. Therefore, a beneficiary of an avoided transfer cannot complain that its position was worsened by piecemeal application of different laws, as would be the case if a transaction were avoided according to a law different from the law governing the distribution where the beneficiary was entitled to a priority.[139]

On the other hand, these policy grounds do not support the plain reading of the safe harbor. If a beneficiary may avail itself of the law identified under the plain reading test, the priority scheme, as protected by the avoidance law of the forum, loses its effect. However, if the "closest connection" analysis applies, there is no reason to limit the application of the safe harbor. If a law does not have the closest connection to a transaction, application of its avoiding powers to protect the interests of its priority claimants would not be warranted, as it can be assumed that the transaction was sufficiently remote from the interests so protected.

A flat home state rule also does not seem to be optimal in the light of this analysis. First, it would not provide protection to some of the creditors, such as employees or public entities, who deserve such protection according to the government policy of the state, where their relationship with the debtor took place.[140] Second, it would fail to reach conduct considered inappropriate by the laws of the state, where such conduct had repercussions. These facts would not only make such a rule politically unfeasible, but would also undermine compliance once such a rule were adopted. Therefore, the structure of the Regulation with the "closest connection" analysis for the safe harbor is superior.

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138 Regulation, art. 32.

139 *See* Axona case, as reported in Westbrook, Choice of Law, at 521.

140 *See* Council Directive 76/308/EEC, on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures, 1976 O.J. (L 73) 18, art. 10 (providing that tax claims of authorities from other member states do not need to be accorded similar priority as tax claims of a home authority). Otherwise, the law is that states do not assist in recovery of other states' taxes and are even less willing to provide them the same priority as to their own tax claims, *see* Philip Baker QC, *Changing the Norm on Cross-border Enforcement of Tax Debts*, available at http://www.taxbar.com/documents/Cross-border_Enforcement_Philip_Baker_QC.pdf.

B. Predictability, fairness and manipulation

Each avoidance regime deals with the tension between the need to capture all the suspect transactions and the need to provide markets with a sufficient degree of certainty and predictability.[141] Jurisdictions differ in their approaches, from the very rule-based systems (such as U.S.)[142] to relatively broad standard-based systems (France,[143] Netherlands)[144] through a mixture of both (Germany, UK).[145]

The same tension applies in the choice-of-law analysis. Ideally, the parties should be able to identify which avoidance law will be applied to their transaction, whether in future insolvency proceedings or upon lawsuit by one party's unhappy creditor out of insolvency. On the other hand, the law chosen should always correspond to the interests involved. In addition, even if the applicable law can easily be predicted, a beneficiary should not be exposed to avoidance by a foreign law where he had no reason to engage in finding out that such law could apply and thus had legitimate expectations that no foreign law would apply.[146]

The Regulation accommodates these needs by application of the law of the main or secondary proceedings subject to the safe harbor. The beneficiary may easily assess whether a debtor has its COMI or at least an establishment in a particular member state and, hence, whether the avoidance law of such state could apply (the closest connection test generally applies only for the safe harbor).[147] Therefore, save for exceptional circumstances, the beneficiary will not be surprised by the application of this law. However, such exceptional circumstances arise for example where the challenged transaction has closest connections with, because it has been carried out from, the debtor's establishment and no secondary proceedings are opened, such as in the case where the establishment

141 *See* Jackson, Logic, at 130; Wood Principles, at 458; Westbrook Avoidance, at 901.

142 *See* 11 U.S.C. § 547 (regulating preference remedies, which are more rule-based than fraudulent conveyance remedies).

143 *See* Code de Commerce, Art. L632-1 through L632-4.

144 *See generally* van Dijcks, *supra* note 12, at 130.

145 *See* Insolvenzordnung, §§ 129 – 147; Insolvency Act 1986, s. 238 – 240.

146 Virgos Schmit Report, at 89; Regulation, preamble para. 24.

147 *Cf.* Westbrook, Choice of Law, at 530. Therefore, the closest connection interpretation of the safe harbor does not contradict Professor's Westbrook's argument that a pure "closest connection" rule would not be sufficiently predictable.

does not exist anymore[148] or if the debtor's COMI changes.[149] In such cases, it would be unfair to apply the law of the main proceedings; Article 13 under the closest connection reading sufficiently protects the beneficiary.[150] However, under the plain reading it does not provide such protection. A flat home state rule would fail to provide such protection and, despite its predictability, cannot be considered sufficiently fair.[151]

Where a (sophisticated) beneficiary could and should have expected the application of the avoidance law of the main or secondary proceedings, he has no legitimate expectations worthy of protection.[152] In fact, banks and other sophisticated parties are aware of the avoidance regime and structure transactions so as not to be caught by these rules.[153] They should apparently not be able to choose the applicable avoidance law.[154]

The plain reading of Article 13 fails also in this respect, unless a theory of fraudulent manipulation of the connecting factor is given substantial role.[155] Under such theory, the selection of governing law by the parties to the challenged transaction (whether by clause in contract or by location of other elements) would be disregarded. However, this route to the use of the proper avoidance law is

148 *See, e.g.,* MARSHALL, *supra* note 56, at 2-134 (quoting a Belgian decision, Ghent Commercial Court, Interstore NV v. Megapool BV, Feb. 21, 2006, docket No. A/05/02654, where the court refused to open secondary proceedings when the establishment – a shop – "had been vacated and all property removed").

149 *See above* Part III.B – Jurisdiction in Insolvency.

150 *See* Levenson, *supra* note 114, at 358.

151 *See* Westbrook, Choice of Law at 534 (admitting that small beneficiaries dealing with local branches could be unfairly prejudiced by application of the flat home state rule).

152 *See* Klumb, Kollisionsrecht, at 141-2 (noting that only legitimate reliance deserves protection and that proving sufficient reliance on a particular law is rather complicated).

153 *See* van Dijck, *supra* note 12, at 136. A particularly smart form would use judicial execution over a bank account located in a jurisdiction where such enforced payment would not be subject to preference attack – the question of applicable law under the plain reading seems extra-clear.

154 *See* Westbrook, Choice of Law, at 503 n. 18; Moss, Commentary, at 191, para. 8.127; LoPucki, *supra* note 137, at 2245 (discussing externalities resulting from the debtor having the possibility to choose the applicable bankruptcy law).

155 *See* Klumb, Kollisionsrecht, at 21 (criticizing suggestions for a broad use of the concept of fraudulent manipulation of the connecting factor in the choice of law rules for avoidance remedies).

too difficult. The ECJ recently provided a general definition of the concept of abuse of law within community law,[156] which would most likely apply also in this context:

> [F]irst, that the transactions concerned, notwithstanding formal application of the conditions . . ., result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.[157]

If the references to grant of tax advantage are replaced by "designation of applicable law", no abuse could be proved where the non-avoiding law selected by the parties was within the range of reasonably available laws. Therefore, it does not seem that the theory of abuse of right is a good tool to fix the problems caused by plain reading of Article 13, a reading which appears to select an inappropriate rule of choice of law in the first place.[158] The fact that most European legal orders do not enable discovery within collection of evidence is also relevant for this conclusion.

C. Forum shopping

Whether it is considered bad[159] or good,[160] forum shopping within European insolvency law is not

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156 *See* opinion of Advocate General Maduro in *Halifax,* Cases C-255/02, C-419/02 and C-223/02, 2005 E.C.R. I-01609, para. 60 through 72, and thereto relating judgment of the ECJ.

157 *See* ECJ Case *Halifax,* C-255/02 at holding point 2 (the case involved British bank, which could not properly claim VAT deductions on costs of construction, but set up an artificial scheme of subsidiaries so as to meet the formal requirements for deduction of the VAT at the level of subsidiary and to transfer the benefit to the parent through financing arrangement).

158 Klumb, Kollisionsrecht, at 109 – 111 (suggesting that a choice of law agreement or other displacement of connecting factor should be also subject to avoidance and that in such case, there should be no safe harbor to protect either the choice of law provision or the transaction itself from avoidance). This does not seem a viable strategy, as it operates without regard to the interests in question and basically removes the safe harbor for most transactions.

159 *See* Thomas Bachner, *The Battle over Jurisdiction in European Insolvency Law*, 3 Eur. Co. Fin. L. R. 310 (2006).

160 *See* Robert K. Rasmussen, *Where are All the Transnational Bankruptcies?: The Puzzling Case for Universalism*, 32 Brook. J. Int'l. Law 982, 1001 (2007); Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 Brook. J. Int'l L. 1019, 1040 (2007) (a dual, flexible COMI standard might be acceptable); John A. E. Pottow, *The Myth (and Realities) of Forum Shopping in Transnational Insolvency*, 32 Brook. J. Int'l L. 785 (2007) (questioning the

impossible[161] and occurs in a non-negligible number of cases.[162] Firms with substantial presence in more than one member state (or their creditors) are generally able to select the forum and the law of the main proceedings due to the fuzziness of the concept of COMI and the willingness of the courts to accept cases. Migration of companies in a pre-insolvency stage is also possible.[163]

In a world in which debtors and creditors manage to forum shop, the advantages of the flat home state rule are lost.[164] The rule stops being predictable and the necessary connection between the priority scheme, the avoidance law, and the interests so protected is completely displaced. Imagine a Czech company being put in administration under English law and its pre-insolvency transactions being assessed according to this law.[165] Given that no-one could predict whether English or Czech law would apply, there is no predictability and no reasonable relationship between the avoidance law, priority scheme and the interests involved – these being those of the Czech workers and government.

The system of main and secondary proceedings under the Regulation avoids such results. Even when the location of the debtor's COMI is really ambiguous, the debtor will either have a presence amounting to an establishment in each of the states possibly claiming jurisdiction. In the specific case where the main proceedings are opened in the state of debtor's registered office[166] or of the group

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maliciousness of forum shopping).

161 *See* Enriques, Geller, Encounters, at 40.

162 *See generally* Watelet, *supra* note 44.

163 *See* Westbrook, Choice of Law, at 536 ("...it is not likely that a company would relocate purely in anticipation of insolvency"). While it did not seem likely in 1991, it currently happens in a number of cases, such as *Schefenacker, Deutsche Nickel, Hans Brochier* and *PIN Group, see, e.g.,* Riaz K. Janjuah, *Court Allows Change of COMI to Bolster Cross-Border Group Restructuring,* Oct. 3, 2008, *available at* http://www.internationallawoffice.com/; Glen Flanery, Nicolaes Tollenaar, *European migration: The new forum shopping,* Financier Worldwide, Feb. 2008, *available at* http://www.nabarro.co.uk (last visited on Feb. 17, 2009).

164 *See* Westbrook, Choice of Law, at 529. However, it should be noted that the small size of the countries and resulting easiness of forum shopping within Europe differ considerably from the issues arising across Atlantic.

165 This would have been the case were there avoidance actions in the case of Collins&Aikmans Automotive, s.r.o. (the Czech subsidiary of the C&A group), *see* In the matter of Collins&Aikmans Automotive, s.r.o., [2005] NICh (Comp) (England) (July 15, 2005).

166 Regulation, art. 3(1). *See above* Part III.B – Jurisdiction in Insolvency.

headquarters[167] where the debtor does not do business, it will certainly have presence amounting to an establishment in the state, where it actually does business. The trustee in the main proceedings can thus challenge transactions which are not avoidable under the law of the main proceedings by opening secondary proceedings in the other state and requesting the trustee appointed in such proceedings to file an avoidance action.[168] The threat of secondary proceedings thus restricts the ability of the debtor or of the beneficiary to engage in forum shopping in order to avoid the application of unfavorable avoidance law.

The possibility of forum shopping requires that the avoidance actions be allocated between the main and secondary proceedings not according to the location of the assets test,[169] but according to the closest connection analysis. Otherwise, if the law of the main and secondary proceedings differ in relevant aspects, forum shopping could lead to a change of the resulting legal situation that is to the avoidability or not of a particular transaction.

The closest connection reading of the safe harbor (with the presumption in favor of COMI) jointly with the allocation of the avoidance actions on the basis of such test (with the presumption respecting the location of assets test) thus makes the framework intelligible and coherent.

VI. Implications

The above analysis has shown that the framework established by the Regulation properly addresses the basic issues arising with respect to choice of applicable avoidance law. However, this does not mean that the current framework of community and member states' law is perfect; three particular issues come to mind.

167 Fletcher, Insolvency, at 388, para. 7.68 (discussing Daisytek and Criss Cross cases, where entire group was put in insolvency by an English court) *and* at 396, para. 7.77 (noting that courts of other member states follow the same approach).

168 Regulation, art. 29(a).

169 *See* above Part IV.B – Allocation of avoidance actions.

A. Choice of law for non-insolvency fraudulent conveyance remedies

The non-insolvency fraudulent conveyance remedies provided by a legal system are, at least in England,[170] Germany,[171] Czech Republic,[172] U.S.[173] and France,[174] to a certain extent similar to those available within the insolvency law of the respective country.[175] These remedies often remain important even when insolvency proceedings are opened (France, England, U.S.).[176] A creditor may avail itself of these remedies enacted by a member state whether or not the insolvency law of such member state is applicable to the debtor and so whether or not the debtor has its COMI or establishment within such member state. Among the member states studied, only Germany appears to have a formulated choice of law rule for these remedies, which requires application of the fraudulent conveyance remedies of the law governing the transaction – the *governing law rule*.[177]

Given that the choice of law rules are being harmonized at European level ,[178] a uniform multilateral choice of law rule would be appropriate in this area, as it would reduce the risks in

170 Insolvency Act, 1986, s. 238(4), s. 423(2), (3) (the main difference being that out-of-insolvency the fraudulent conveyance remedy is available only upon showing of an actual fraudulent intent by the debtor and a slightly different construction of the good faith defense, other elements being largely similar).

171 Insolvenzordnung, §§ 133 – 135, 140, 143 – 145; Anfechtungsgesetz, §§ 3,4, 6, 6a, 8, 11, 15.

172 Czech Insolvency Act, § 242, Czech Civil Code, § 42a (main difference in availability of constructive fraudulent conveyance in insolvency, otherwise difference in the suspect period – three years out of insolvency, five years in insolvency).

173 11 U.S.C. § 548; UFTA (main difference in suspect period – two years in bankruptcy, four years out of bankruptcy).

174 No specific insolvency fraudulent conveyance action, *action paulienne* according to Code Civil, art. 1167 is used by trustees.

175 The analysis should apply also to non-insolvency preference remedies, where applicable. However, as these are new and exceptional and might warrant different qualification (e.g. as company law remedies), I put them aside for the present purpose. *See* Anfechtungsgesetz, § 6.

176 *See* van Dijck, *supra* note 12, at 131, whose data can be interpreted so that approximately one third of all fraudulent conveyance actions within English insolvency proceedings were conducted under s. 423 of the Insolvency Act 1986, a provision available in as well as out of insolvency proceedings.

177 *See above* – Part II.C – Choice of Law out of Insolvency.

178 *See supra* note 63.

transaction planning. The following considerations should inform its content:

The filing of an insolvency petition should not alter the (avoidance) law applicable to a transaction, even if an additional layer of the insolvency avoiding powers is put in place.[179] If the choice of law rule outside of insolvency differs from the one applicable inside, a creditor could attack a transaction which would be, within insolvency, protected by the Regulation's safe-harbor. On the other hand, proper transaction structuring could be used to avoid the application of some non-desirable non-insolvency avoidance laws. For example, if outside of insolvency a particular transaction would be subject to Czech fraudulent conveyance law, the possibility of applying German insolvency fraudulent conveyance law could induce filing of an insolvency petition or at least of filing it in Germany.

Therefore, the choice of law rule for non-insolvency fraudulent conveyance remedies should be the same as the rule argued for above for the definition of the law of the safe harbor.[180] It should follow the logic of closest connection analysis and should generally point to the debtor's COMI at the time of the relevant transaction, absent special circumstances, such as a transaction made from an establishment or a bundle of relationships fully located abroad. Particular attention should be given to the fact that the relationship of the debtor and plaintiff creditor might be only one of a number of debtor-creditor relationships relevant for the determination of the law with the closest connection to the case.[181]

The proposed rule reflects much better the interests at stake than the governing law rule – whether it is the location of the asset or a choice of law clause in the contract, the connecting factor need not have any relationship to the interests protected by the non-insolvency fraudulent conveyance law (i.e. the interest that a creditor enforcing its judgment is not harmed by the debtor concealing its assets).[182]

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179 See Jackson, Logic, at 83.

180 Klumb, Kollisionsrecht, at 19, 20 (similar argument, but given the differences vis-a-vis the insolvency avoidance he does not see a compelling case for identical connecting factor). *But cf.* Zeeck, *supra* note 8, at 95 (arguing that avoidance in and out of insolvency is principally different).

181 *See* OGH decision above in Part III.B – Jurisdiction in Insolvency.

182 See for *lex rei sitae* the *Reichert* case in Part III.A – Jurisdiction out of Insolvency and the *French* case in Part IV.A – Safe Harbor and for *lex causae* the discussion in Part IV.A.

This rule could be adopted by member states' courts without specific legislative intervention. To be sure, the benefits of such intervention would be far outweighed by the cost of the legislative process; however, in any future amendment to the Regulation, a provision to this effect could be included, despite the fact that it does not belong to the insolvency law proper.[183]

B. Trustee's standing

Insolvency statutes often give the trustee (and possibly, the debtor in possession) general standing to act on behalf of all the creditors (France)[184] or specifically to file non-insolvency avoidance claims (U.S., former Czech law).[185] The new Czech legislation does not contain this grant of standing, arguably on the theory that the insolvency avoiding powers are much broader than those provided under general law.[186] This might, however, not be true, especially if the applicable (non-insolvency) avoidance law is different than the applicable insolvency law.[187] German law likewise does not grant a similarly broad representative power to the trustee.[188]

The Regulation gives standing to bring any "action to set aside which is in the interest of the

183 This would not be an exceptional solution, *see* Insolvency Act, 1986, s. 423.

184 See Art. L622-20 of Code de Commerce and Cour de cassation [Cass. Com.], Oct. 8, 1996, Bull. civ. IV, No. 227 at 198, *available at* http://www.legifrance.gouv.fr (visited Feburary 20, 2009); Trochu, *supra* note 100, at 168 (setting forth an assumption that the trustee has the standing always, subject to recognition, which is not anymore an issue).

185 Zákon č. 328/1991 Sb., o konkurzu a vyrovnání [ZKV] [act on bankruptcy liquidation and composition], last amended by zákon č. 246/2006 Sb., repealed by the Czech Insolvency Act, § 16(1).

186 Neither of the reports on the two legislative proposals of the Czech Insolvency Act mentions the reasons for this, *see* Report on the Government Legislative Proposal No. 1122, 4th period (2005), at 213-215 and Report on the Legislative Proposal of MP Jiří Pospíšil No. 1044, 4th period (2005), at 128, *available at* http://www.psp.cz (last visited Feb. 19, 2009).

187 The differences are easiest to see in the duration of the suspect periods. Czech law enables avoidance of clearly fraudulent transaction in a three year period (five in insolvency), Czech Insolvency Act, § 242, whereas German law in a ten year period, Anfechtungsgesetz, § 3, Insolvenzordnung, § 133.

188 Insolvenzordnung, §§ 56-66, 130.

creditors" only to the trustee in the secondary proceedings.[189] For main proceedings, questions regarding whether, to what extent and with what consequences can a trustee bring such non-insolvency avoidance claims depend on both the applicable insolvency law and the respective non-insolvency avoidance law.[190]

Under U.S. bankruptcy law, the trustee is authorized to assert any state-law fraudulent conveyance claim as long as there is at least one creditor authorized to assert such claim.[191] However, the trustee may assert such a claim for the benefit of the entire estate, that is, for all the creditors and not just those having actual standing, and the transaction can be avoided fully, not only to the extent to which it could be avoided by the creditors under non-bankruptcy law.[192] This creates anomalies by allowing the trustee to distribute proceeds of a non bankruptcy avoidance action to all the creditors, even if, outside of bankruptcy, only certain creditors would be entitled to recover such proceeds and only to the extent of their unsatisfied claims.[193] These parameters have been criticized for creating incentives for initiating bankruptcy, even when it is not necessary or to avoid it where it is necessary. This critique fits squarely within Thomas Jackson's general argument that the opening of insolvency petition should alter the legal rights of the parties only to the extent necessary to protect the collective character of such proceedings.[194] Under this theory, the non-insolvency avoiding powers also should not be altered, although they may be subject to collectivization. Nevertheless, such powers are in many instances altered by the sole fact that creditors are barred by the automatic stay at least from reducing

189 Regulation, art. 18(2); Virgos Schmit Report, at 137, para. 224; Moss, Commentary, at169.

190 *See also* Klumb, Kollisionsrecht, at 36, 101, *but cf.* Colomer, Deko Marty Opinion, para. 66 (stating that the trustee has the power to bring an avoidance action without limiting the statement to a trustee in secondary proceedings) and *see* Virgos Garcimartin, Practice, at 135, para. 234 (non-insolvency fraudulent conveyance „actions are only admissible if and insofar as the *lex fori concursus* so permits"). The conditions of admissibility under the law of the respective actions need to be satisfied as well.

191 11 U.S.C. § 544(b) ("..the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable ...").

192 *Moore v. Bay*, 284 U.S. 4 (1931). *See also* Jackson, Logic, at 80.

193 Jackson, Logic, at 83.

194 Jackson, Logic, at 33.

their claim to a judgment, which is often a requirement for bringing a fraudulent conveyance action.[195] Some of the member states studied (Czech Republic, Germany) explicitly stay pending fraudulent conveyance actions upon the opening of insolvency proceedings.[196] This stay would not apply to a lawsuit already pending in another member state,[197] but might prevent a creditor from bringing such a fraudulent conveyance claim after the opening of the proceedings.[198]

As an example, consider a debtor with its COMI in Czech Republic who enters into a transaction with respect to German property with a German counter-party that prejudices German creditors, such as contractors working on the property. Under certain circumstances, such a transaction might be open to challenge under German non-insolvency fraudulent conveyance law, but by no means under Czech law.[199] The German fraudulent conveyance law is properly applicable under the closest connection standard, but at the time of insolvency, the debtor has no establishment in Germany and secondary proceedings are therefore not available.[200] As a result, the Czech trustee is not able to avoid the transfer and due to automatic stay and discharge, the creditors will also lose this right.[201]

195 *See* for Germany: Anfechtungsgesetz, § 2 (a creditor has standing to bring a fraudulent conveyance action, if the claim has been reduced to judgment and if execution did not or is not expected to lead to satisfaction of the claim), for Czech Republic: zákon č. 40/1964 Sb., občanský zákoník [Civil Code], as amended, § 42a (similar provision).

196 *See* Anfechtungsgesetz, § 16 (a fraudulent conveyance lawsuit is stayed upon opening of insolvency proceedings, the trustee can take over). For a similar rule in the Czech Insolvency Act, *see* § 239(1).

197 Regulation, art. 1. *See also* Fletcher, Insolvency, at 420, para. 7.118; Virgos Garcimartin, Practice, at 142 (whether this will be the case will depend on whether the fraudulent conveyance claim is considered to be an asset or a right of which the debtor was divested, i.e. belonging to the estate; this will be decided according to the law of the proceedings, Regulation, art. 4(2)(b)).

198 *But cf.* Klumb, Kollisionsrecht, at 81 (stating that it is not clear whether the exception of art. 15 of the Regulation applies to fraudulent conveyance defendants, as it applies only to lawsuits, where the debtor is a party). This seems to be incorrect reading of Regulation, art. 15 (referring to „lawsuits concerning an asset or a right of which the debtor has been divested“) and of Insolvenzordnung, § 352 (referring to „Rechtsstreit [] die Insolvenzmasse betrifft”) strongly influenced by legislative history, *see* Id., n. 363.

199 *See e.g.* Czech Insolvency Act, § 242 (suspect period of 5 years); Anfechtungsgesetz, § 3 (suspect periods of 10 years).

200 Regulation, art. 3(2).

201 This example might look too stretched given that it is based only on difference in suspect periods, *but see* Roger Ehrenberg, *The Madoff Saga: Perils of Fraudulent Conveyance*, Information Arbitrage, Dec. 18, 2008,

To preserve the collective nature of the proceedings and to enable recovery despite collective action problems within the creditor body, it would be useful if the trustee in the main proceedings had the power to assert such non-insolvency avoidance remedies.[202] Assertion of these remedies by the trustee might, however, be trumped by the conditions of standing – the plaintiff must be a creditor and sometimes have the claim reduced to judgment. I therefore propose that the Regulation be interpreted[203] or amended[204] so as to give the trustee standing to bring a fraudulent conveyance action.

The trustee should have the power to bring an avoidance action under any applicable non-insolvency law, which could be brought by a creditor, but only for the benefit of and to the extent available to the creditors authorized to bring such an action.[205] Unless all the creditors having the right to bring the action agree otherwise, bringing of the action by the trustee would enjoin the creditors from bringing it. In addition, no enforceable judgment on the claim would be required from the trustee. Such rule would be properly adopted on the community level, as it would alter the legal position under both the applicable insolvency law and the non-insolvency law of different member states.[206]

C. Safe harbor limitation to Member States' laws

The Regulation restricts the operation of the safe harbor to member states' law.[207] This does not

http://www.informationarbitrage.com/ (payments from a Ponzi scheme may be treated as fraudulent conveyances up to the limit of the suspect period, as a Ponzi scheme is fraudulent and insolvent by definition).

202 Jackson, Logic, at 80 (referring to trustee as "collection agent" and stating that "the notion that the trustee may assert the rights of an unsecured creditor is itself unobjectionable").

203 This can be achieved by argumentation *a minori ad maius* from art. 18(2), which gives such standing to the trustee in secondary proceedings. If the legislator has not explicitly granted standing to the trustee in the main proceedings, it was only because it did not doubt that the trustee would have such standing.

204 The amendment might be a more viable alternative given that European courts are not particularly inclined to develop statutory instruments by case law beyond the obvious.

205 *See* Fletcher, Insolvency, at 100 (appreciating 11 U.S.C. § 544(b)(1)).

206 Regulation, art. 46 (requiring the European Commission to prepare a report on the application of the Regulation by June 2012).

207 Virgos Schmit Report, at 69, para. 93 (explaining this limitation as follows: "The [] intention was simply to regulate

mean that where the law designated by the safe harbor is the law of a non-member state the transaction will be always avoided, if the home state law enables avoidance. Rather, it means that the choice of law rules of the state where the proceedings are pending determine whether the beneficiary can claim any safe harbor.[208] Although the Regulation does not regulate such cases substantively, it can create jurisdiction for their adjudication and require recognition of any judgment issued in such a dispute.[209] Such a situation may arise in particular where the assets and possibly the defendant in question are within a member state, but the transaction itself is more closely related to a non-member state (e.g., if insolvency proceedings are opened over a Danish company on the theory that its COMI is in a member state,[210] the respective assets are in another member state, but the dealings of the debtor with the beneficiary and debtor's general business took place in Denmark).

If the closest connection analysis (based on a presumption favoring COMI) within the safe harbor test designates a law of a non-member state (or Denmark), it means that this law has a (much) greater interest in deciding the issue of avoidability than the home state law. In such case, it does not make sense to avoid the transaction simply because the language of the Regulation enables that. Also, it does not make sense to restrict the safe harbor to the laws of member states based on an assumption that such laws have a closer conception of avoidability and the law of a non-member state could have virtually any kind of rules, thus providing unreasonably broad defense to the beneficiary. If the law of a non-member state trumps the presumptions inherent in the closest connection test as argued for above, there is simply no reason to extend application of the home state law.

Therefore, I suggest that the safe harbor be interpreted so as to apply also if the law designated is a law of a non-member state. This could be achieved as an interpretation of the Regulation, i.e. as a rule of community law, or as a solution particular to each member state's national law. As the Regulation

these cases in line with the general restriction of the Convention to the intra-Community effect of insolvency proceedings []. Contracting States are, therefore, free to decide which rules they deem most appropriate in other cases...").

208 Regulation, art. 13; Virgos Garcimartin, Practice, at 137, para. 243.

209 Regulation, art. 25.

210 *See* Watelet, *supra* note 44, at 75, para. 7 (reporting the Brac Rent-a-car decision opening insolvency proceedings under the Regulation over a Delaware corporation on this theory, [2003] EWHC (Ch.) 128).

contains a choice of law rule, to which this would be an exception,[211] I think that it would be more appropriate to consider this to be a interpretation of the Regulation applicable at the level of community law.

Among the member states studied[212] only Germany has adopted a rule similar to the Regulation's safe harbor for situations not covered by the Regulation, although it seems that this is uniformly interpreted as requiring the plain reading analysis.[213] Interpreting the safe harbor of the Regulation as suggested above would cause this German rule to be applicable only to fully non-community situations.

VII. Conclusion

No simple choice of law rule for avoidance actions is on the shelf. The closest connection reading of the safe harbor and the same analysis of the question of allocation of avoidance actions among the main and secondary proceedings are the best alternatives within the framework of the Regulation, making it coherent and corresponding to the policies at its heart. It forces the judge to choose the applicable law rather than to avoid the choice thereof by a mechanical plain reading rule. However, the tests are still quite burdensome and not completely predictable and it is arguable that some kind of harmonization of the avoidance remedies, at least in the context of business insolvency, might be advantageous to further integration and development of European common market.

This analysis leads me to propose three new rules, which can be adopted both by legislative or judicial action. The choice of law rule for non-insolvency fraudulent conveyance actions should be based on the same principles as the closest connection analysis for the safe harbor provision, that is presumingly referring to the debtor's COMI or establishment. This would be beneficial to legal certainty and would fit within the already undertaken effort to unify the choice of law rules for the law

211 Regulation, art. 4(2)(m), art. 28 (determining that the applicable law is the law of the main and secondary proceedings).

212 The U.K. has adopted the UNCITRAL Model Law on Cross-Border Insolvency, which, however, does not provide a rule for this case. *See* The Cross-Border Insolvency Regulations, 2006, art. 23 (giving a foreign representative standing to bring avoidance actions under the Insolvency Act, 1986). The Czech Republic and France do not have international insolvency rules.

213 Insolvenzordnung, § 339. *See generally* Klumb, Kollisionsrecht.

of obligations. Giving the trustee in the main proceedings standing to bring such non-insolvency actions by a rule of community law will bridge a mismatch between the laws of different member states identified in this paper. Finally, the safe harbor provision should be extended to all cases coming within the Regulation; it should not be limited to the laws of member states.

The Regulation addresses only the most basic issues arising in cross-border insolvencies.[214] It has thus allowed sufficient scope for experimentation, regulatory competition and arbitrage, and search for solutions reflecting the differences in the basic elements of member states' laws. At least in the context of avoidance actions, this is for now the appropriate approach. However, as we will gain more insight on the interaction of the Regulation with the insolvency and non-insolvency laws of various member states and on the differing policies underlying avoidance laws,[215] which is rather likely to happen in the current economy, we should consider whether the costs associated with diversity exceed the potential losses which would result from imposing a set of uniform substantive avoidance rules.

214 *See* Luca Enriques, *Silence Is Golden: The European Company Statute* As a Catalyst for Company Law Arbitrage (Eur. Corp. Governance Inst. Law Working Paper No. 7, 2003), *available at* http://ssrn.com/abstract=384801 (arguing that the gaps in the statute for a European company serve a useful role in enabling company law arbitrage).

215 *See* Westbrook, Choice of Law, at 512.