

TABLE OF CONTENTS

REGULATION 1346/2000 ON INSOLVENCY PROCEEDINGS: ITS APPLICATION IN FRANCE

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- I. Recognition and Enforcement of Foreign Judgments Outside the Context of Regulation 1346/2000:
 - (a) Universality of Bankruptcy
 - 1. Limited Effectiveness in Regard to the Undertaking's Assets
 - 2. Genuine Equality of French and Foreign Creditors
 - 3. Greater Expense of Coexistence of Concurrent Proceedings
 - (b) *Exequatur* of Foreign Judgments:
 - 1. Ineffectiveness of Judgments Not Covered by *Exequatur*
 - 2. Concerning the Strict Terms of *Exequatur*
 - 3. Some Extended Effects After the *Exequatur*

II. Implementation of Regulation 1346/2000:

(a) “De Jure” Recognition of Foreign Proceedings:

1. One Universal Main Proceeding and Some Territorial Secondary Proceedings
2. Extended Powers for the Foreign Liquidator
3. Coordination of the Rules of Recognition and the Regulation of December 22, 2000

(b) Co-operation of the Liquidators:

1. Recognition of the Priority of Objectives of the Main Proceeding
2. Duty of Mutual Exchange of Information Among Liquidators
3. Toward Judicial Co-operation

(c) Enhanced Rights of Foreign Creditors:

1. Toward Genuine Equality of Creditors
2. Facilitation of the Lodging of Claims
3. Interests of secured creditors

The Council regulation (EC) No 1346/2000 of May 29, 2000 on insolvency proceedings, which is soon to come into force, will significantly alter the circumstances in which collective proceedings in the countries of the European Union are recognized and enforced.

To assess the scope of the changes introduced by this Regulation, it is worth recalling the conditions applying to foreign judgments in collective proceedings prior to the coming into force of the Regulation.

These terms will continue to be applicable to decisions originating in non-member countries of the European Union, such as judgments rendered by U.S., Swiss or Japanese courts as well as those originating in Denmark, which exercised its right of opting out when the Regulation was adopted.

I. Recognition and Enforcement of Foreign Judgments Outside the Context of Regulation 1346/2000

French bankruptcy law is situated midway between a universalist conception of collective proceedings and a relatively territorial conception linked to the desire for effectiveness of enforcement measures in relation to a debtor's assets.

(a) Universality of Bankruptcy

The French courts consider themselves competent under French law to open a collective proceeding against any undertaking carrying on an activity within French territory.

The presence of an “undertaking” [*établissement*] or a mere agency is sufficient to empower a commercial court [*tribunal de commerce*] to order the restructuring or judicial winding-up of the undertaking even if its head office is outside the country. This is a territorialist conception of bankruptcy, of course.

But the idea that a collective proceeding addressed to a specific debtor must apply to all of his or its assets, to the whole of his or its estate, means that the French courts will open an insolvency proceeding against any foreign-owned undertaking in France once it has some connection with French territory, as in the case of a secondary undertaking or assets that are sufficiently stable to represent some asset value. So in this case the universality of the bankruptcy leads to extending the effects of the proceeding to assets that are not geographically limited to the national territory.

This universality of bankruptcy is not an abstract conception: it is behind not only the recent directives adopted by the European Union governing insolvency of banks and insurance companies (cf. the Directives 2001/17 of March 19, 2001 and 2001/24/CE of April 4) but also the applicable laws of Belgium and Germany; for example, the Act implementing the new insolvency code adopted by Germany on October 5, 1994 sanctions the recognition of foreign proceedings.

1. Limited Effectiveness in Regard to the Undertaking's Assets

But because the collective proceeding is primarily a set of divestment measures, the effectiveness of the decision rendered by a French court is limited, of course, to the property situated on French territory and cannot be extended to the assets situated abroad other than through an *exequatur* proceeding undertaken by the administrator or official receiver in accordance with the legal requirements under the foreign law. Hence the necessarily limited effectiveness both in fact and in law.

2. Genuine Equality of French and Foreign Creditors

However, the universality of bankruptcy means that the claims of both French and foreign creditors are admitted without discrimination to the liabilities of the proceeding opened by a French tribunal. As a result:

The receiver [*liquidateur*] must notify all known creditors of the applicable procedures without distinction as to domicile or nationality.

The creditors domiciled abroad may lodge their claims in a proceeding opened in France independently of the existence of any concurrent proceeding opened in another State and in which they have also lodged their claims against the debtor.

In return, these creditors are subject — as are the French creditors — to the applicable conditions as to form and deadlines under the local procedure, which results in a less favourable situation given the penalties for failing to lodge a claim within the period specified by law. However, it should be noted that French law gives creditors domiciled abroad additional time in which to lodge their claims: four months in place of two, commencing with the registration of the judgment opening proceedings. But there is no provision for foreign registration of the judgment.

Over and above the abstract equality among the creditors, this procedure also entails some inexorable differences in treatment. While a foreign creditor can obtain a more favourable payment owing to the lack of coordination among the various proceedings, he will have to pay special attention to the situation of his debtor, who may be restructured or judicially wound up by a French court.

3. Greater Expense of Coexistence of Concurrent Proceedings

The fact that a proceeding may be opened in France independently of the existence of a concurrent proceeding against the same debtor in another State is disadvantageous in a number of ways:

There is no assurance that the assets will be dealt with appropriately or that an overall economical solution will be sought.

The costs resulting from the collective proceeding are multiplied, to the disadvantage of all creditors.

The processing of claims (verification of claims and distribution of the proceeds of realization of the assets) is relatively complicated.

The risks of fraud by the debtor through concealment of assets or transfers of its business are greater.

Individual prosecutions are not stayed on the same conditions and at the same time.

The disadvantages of forum shopping are greater.

In this context, the international effectiveness of an insolvency proceeding necessitates either a treaty (see part II below) or an *exequatur* decision making a foreign judgment enforceable within the national territory.

(b) Exequatur of Foreign Judgments:

1. Ineffectiveness of Judgments Not Covered by Exequatur

Foreign judgments cannot be enforced in France without going through the *exequatur* procedure. This is a veritable “passport” that is needed to enforce any foreign judgment.

Until that procedure is completed, a judgment in bankruptcy issued by a foreign jurisdiction will continue to be disregarded.

The judgment is recognized (it is a proof of the capacity of the foreign liquidator or trustee), but it is not enforceable.

A debtor previously declared insolvent abroad is not divested of his or its property situated in France. Conversely, the debtor may be subject to a collective proceeding by a French court.

The foreign liquidator may not seize the debtor’s assets. His powers are confined to preservation measures. In the last analysis, the foreign liquidator can only be recognized in his capacity and apply for *exequatur* of the foreign judgment.

2. Concerning the Strict Terms of Exequatur

To be made enforceable in France, the foreign judgment must fulfill a number of conditions that the French court will verify:

The foreign court must have jurisdiction in accordance with the rules of French private international law: practically speaking, this condition is easy to verify since most laws

recognize the debtor's domicile or headquarters as a criterion of primary jurisdiction.

The procedure that is followed must be legitimate from the standpoint of the principles that are considered essential in French law: the *exequatur* judge will verify, for example, whether the proceeding was adversarial.

The third condition is the degree to which the foreign judgment corresponds to French public policy: this is a relatively flexible condition of public policy. Thus it is of little relevance that the debtor belongs to an occupational category that is unlikely to be declared bankrupt in France. *Exequatur* may be granted to a judgment declaring an individual or a self-employed professional person bankrupt.

The third [sic] condition is the absence of any collective proceeding already opened in France in regard to the same debtor: the principle of *res judicata* but also the practical incompatibility of simultaneous execution proceedings affecting the same property bar the coexistence of local and foreign proceedings over the same assets.

Finally, the French courts will sometimes verify the absence of fraud, which could result from the illegitimate seizing of a matter by a foreign court to obviate other statutory provisions applicable in the court that would normally have jurisdiction.

3. Some Extended Effects After the *Exequatur*

The foreign judgment is declared enforceable in France for the purposes stated by the foreign representative. It is enforceable against the assets identified or all of the debtor's property, as the case may be: through administration or closure of the secondary establishment, prosecution or termination of pending contracts, stay of proceedings by individual creditors, seizure of bank accounts, dismissals of employees, etc. The foreign representative may take any steps provided for by the foreign legislation. At the same time, the debtor is divested of his or its assets.

The French law on insolvency will not apply. In theory, the foreign judgment applies only from the date of the *exequatur* judgment but the French court may grant it retroactivity, and thus some actions taken between the foreign bankruptcy judgment and its *exequatur* may be challenged. This power is particularly useful since the *exequatur* proceeding may take about six months.

In return, the French rules in relation to sale such as seisin of immovable property (*saisie immobilière*) continue to be applicable to the foreign representative.

II. Implementation of Regulation 1346/2000:

The Regulation adopted by 14 of the 15 states of the European Union is primarily an attempt to facilitate the circulation of judgments in insolvency proceedings between member States without trying to reconcile the national statutes. To this effect, it establishes, predominantly, some rules of direct international jurisdiction for jurisdictions in which the debtor has his or its headquarters (“the centre of his main interests”), and secondarily some rules of statutory competence that favour the law of the State where the proceedings were opened.

To this effect, as well, it recognizes the coexistence of main and secondary proceedings, leaving States free to allow the opening of local proceedings if the interests of the local creditors or other, overriding economic or social interests are at issue.

(a) “De Jure” Recognition of Foreign Proceedings:

Insolvency proceedings opened in any one of the member States will be recognized, that is, they will be given the same legal standing as local decisions. *Res judicata* will apply in regard to third parties; they will have to demonstrate that the appointed liquidator has the requisite standing. But the important thing here, in so far as we are concerned, is the recognition and enforceability of the main proceedings.

1. One Universal Main Proceeding and Some Territorial Secondary Proceedings

While allowing the coexistence of one main proceeding in the centre of the debtor’s main interests, and a secondary proceeding where the debtor simply has an establishment, the Regulation sets down various rules to ensure priority for the objectives of the main proceeding: in this sense, it can be characterized as universal.

In the first place, it establishes some rules of direct international jurisdiction that will be imposed on the jurisdictions of the member States. In theory, the mandatory nature of the rules will not allow forum shopping, or the relocation of head offices in order to take advantage of national rules that are considered relatively favourable.

However, the debtor, its employees or some creditors may still request the opening of a proceeding on the basis of the supposed advantages associated with the law of the State of opening: where the guarantees granted the employees are more extensive, where the rights of the creditors holding security interests are preferable, it will still be possible to base a request for opening on the secondary criterion of the establishment as provided by the Regulation.

Only the main proceeding will be recognized and automatically apply in the other member States. However, the secondary proceeding, which will necessarily result in a liquidation, will apply only to the territory of the State in which it was opened.

It is necessary to mention this difference, for if a proceeding is opened in another member

State, the status in which it was opened will have to be specified in the judgment in order to enable the other jurisdictions to determine whether it applies locally or universally. In each case, once a main insolvency proceeding is opened abroad the French court will no longer be able to make the decision to open a restructuring or winding up proceeding that is intended to apply beyond the national territory.

2. Extended Powers for the Foreign Liquidator

The designated representative in a main insolvency proceeding abroad will have greater powers under the law of the State where the proceeding was opened and the decision that appointed him. He will have the benefit of the immediate effectiveness of the foreign proceeding within the territory of the other States: the main proceeding will be fully enforceable, without *exequatur*, against the (divested) debtor and the creditors (under the rule staying proceedings brought by individual creditors). Thus the representative will exercise the same prerogatives over the debtor's assets as in the State of opening. The only limitations under the Regulations are the need to comply with the substantive and procedural rules of the law of the State in which the foreign representative wishes to exercise his powers. The foreign representative is also barred from carrying out executions that are clearly in conflict with public policy or the fundamental principles or individual rights guaranteed by the Constitution.

3. Coordination of the Rules of Recognition and the Regulation of December 22, 2000: “a posteriori” Review of Foreign Judgments

Regulation 1346/2000 of May 29, 2000 formally recognized the enforceability of judgments opening an insolvency proceeding without further formality or *exequatur*.

In regard to the decisions made in the course of such proceedings, such as provisional or other decisions directly related to the proceeding, the Regulation of May 29, 2000 referred to the provisions of the Brussels Convention of September 27, 1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, more specifically to Articles 31 to 51 of that Convention with the exception of Article 34. In other words, the simplified *exequatur* procedure under that Convention is to apply to the decisions made in the context of insolvency proceedings. But in the meantime the Regulation of the Council of the European Union no. 44/2001, adopted December 22, 2000, has amended the rules for recognition and execution applicable to decisions made in civil and commercial matters.

Essentially, the latter Regulation substitutes *a posteriori* review of the foreign decisions for the *a priori* review under the Brussels Convention of September 27, 1968. On the basis of a certificate issued by the jurisdiction of origin, the judge of the requested State will recognize the enforceability of the decision without, of course, conducting a review on the merits (the 1968 Convention already excluded such a review), but also without reviewing its characteristics.

This Regulation takes the place of the 1968 Convention and this mechanism will apply to the decisions made in collective proceedings. This will produce some uncertainty in the

law since the decisions made by jurisdictions that have opened an insolvency proceeding may be enforced in the other member States without prior judicial review. The judge in the requested State will have jurisdiction over execution measures only if the decision is disputed.

However, the disadvantages of the system must be limited in so far as enforceability will apply only to decisions made in the framework of a main proceeding with universal scope (assuming that the secondary proceedings are territorial, limited to the State in which the proceeding is opened). Furthermore, public policy may always be cited as a reason for refusing to recognize the enforceability of a foreign decision that seriously conflicts with the public policy of the requested State, and this will impose some minimal review of the effects of the requested execution.

(b) Co-operation of the Liquidators:

1. Recognition of the Priority of Objectives of the Main Proceeding

To facilitate the administration of the main insolvency proceeding, the Regulation introduces a number of provisions that favour its management and subordinate any secondary proceeding to its objectives.

A number of examples can be cited, illustrating the changes introduced by the Regulation in this regard.

If a restructuring proceeding is opened in France on account of a secondary establishment operated by a foreign company, the representative designated in the context of an insolvency proceeding opened in the location of the company's head office may ask the French courts to convert the restructuring proceeding into a winding-up in order to promote the objectives of the foreign proceeding.

A foreign representative may take the initiative in requesting the opening of a local winding-up proceeding without having to demonstrate to the French court that the debtor is insolvent.

If a winding-up restructuring proceeding is under way in France, the foreign representative will be able to request a stay of the operations, their closure or, if applicable, the transfer of any surplus in the assets that might remain at the outcome of the local proceeding.

2. Duty of Mutual Exchange of Information Among Liquidators

Should there be more than one insolvency proceeding concerning the same undertaking, the official receivers and mandataries appointed by a French court, whether in a main or a secondary proceeding, will be bound by a duty of mutual exchange of information with a representative appointed in a foreign proceeding. For example, they shall inform their foreign colleagues of any necessary factors concerning the claims and the measures taken in the administration of the proceeding.

In addition, the various liquidators are duty bound to co-operate with each other.

However, the Regulation contains no provision as to how this information and co-operation will be implemented, leaving it to each State to determine the way in which this will be done. In particular, disclosure of information, conveyance of legal documents and transfers of property or funds cannot be envisaged without judicial review by the courts of the respective States.

3. Toward Judicial Co-operation

Without using the term judicial co-operation, the Regulation of May 29, 2000 establishes the preconditions of a genuine reconciliation of jurisdictions that will force a judge reviewing an insolvency proceeding to co-operate with the other courts of competent jurisdiction.

For example,

Once the proceeding is opened, the judge shall verify his jurisdiction in order to characterize it as a main or a secondary proceeding;

He shall facilitate the exercise of the powers assigned to the administrator or liquidator in regard to any property situated outside the country;

Conversely, he shall facilitate the action of the foreign representatives once they are able to justify their capacity;

He shall see to it that foreign creditors are provided with effective individual information;

He may order that the judgment opening the proceeding be published, in order to facilitate knowledge of the proceeding by creditors living in another State;

The judge will also have to take into account the conduct of any concurrent proceedings being carried on outside the country: if he is in charge of the main proceeding he will have to obtain the necessary co-operation from the foreign court to allow the objectives of the main proceeding to prevail; if he is in charge of a secondary proceeding, he will have to ensure that the interests of the local creditors are reconciled with the measures requested by the representative or the foreign court.

(c) Enhanced Rights of Foreign Creditors:

The Regulation of May 29, 2000 is designed to improve the material and legal status of creditors domiciled abroad. The latter are handicapped not only by differences of language but by their remoteness from the bodies engaged in the proceeding and their ignorance of the relevant rules of procedure. A number of provisions have been introduced, which will apply once the Regulation comes into force.

1. Toward genuine equality of creditors

The courts and the representatives appointed in a French restructuring or winding-up proceeding will have to guarantee that individual creditors domiciled abroad are adequately informed, using a form with the title prescribed by the Regulation: “Invitation to lodge a claim. Time limits to be observed” in all the official languages of the institutions of the European Union, and where applicable themselves convey to the representative appointed in a foreign proceeding the declared claims they have.

These formalities will help to improve the situation of the creditors who are domiciled abroad.

But other measures prescribed by the Regulation are also intended to guarantee to the degree possible, that local and foreign creditors are treated equally. In addition to the publication of the decisions opening the proceeding in any other State, at the request of the liquidators of the State of opening, the Regulation has set out a rule applicable to distributions: when a creditor who has obtained a dividend in one proceeding participates in another proceeding, he may not be compensated until the other creditors of the same ranking have obtained an equivalent dividend. This rule will be hard to implement without the loyal and effective co-operation of the courts and responsible representatives in each proceeding.

2. Facilitation of the Lodging of Claims

The Regulation of May 29, 2000 gives legal force to an essential right of creditors prejudiced by the insolvency of their debtor, the right to lodge their claims in the proceeding.

There is more than one aspect to this right:

Every creditor, including the tax authorities and social security agencies, is acknowledged to have the right to lodge a claim: while this right will not upset the applicable legal regime in France, some States will have to alter their conceptions in regard to this point, since it covers claims by government authorities. But — and this must be emphasized — the legal privileges accorded such claims will not be recognized (other than through a bilateral agreement) in the other States. This right to lodge one’s claim in writing, accompanied by supporting documents and indications of the nature of the claim and the potential guarantees relied on, takes the place of any more restrictive formality prescribed by local law. This will likely harmonize insolvency rights, over and above mere judicial co-operation. The right to lodge a claim in one’s own language (although the jurisdiction(s) reviewing the claim may demand a translation) is a recognition of Europe’s linguistic diversity, although in practice it will be in the interest of creditors to pre-empt a request for translation whenever they have cause to assume that the documents conveyed will not be easy to interpret.

3. Interests of Secured Creditors

The Regulation of May 29, 2000, as we know, adopted as a conflict of laws rule the application in principle of the law of the State of opening. Accordingly, that law will govern the conditions of opening and the conduct of the proceeding as well as the rights of the debtor, the powers of the insolvency representative and the rights of the creditors.

It will apply in particular to the methods for lodging claims, the payment of dividends, the methods for restructuring the undertaking or the liquidation of its assets and the distributions after realization of the assets. It will also apply to proceedings brought by individual creditors that are stayed by the opening of the proceeding and to actions tending to put in issue actions taken and improper payments made prior to the opening of the insolvency proceeding.

But the law of the State of opening is not the only applicable law. The rights of third parties have been taken into account, and the law of the State of opening will have to be combined with other concurrent laws: the *lex situs* where a proceeding impacts on a contract involving immovable property (rights in rem); employment law where the proceeding affects employees; the law applicable to payment systems and financial markets where it affects outstanding transactions; the law of the State in which the public registers are kept where the proceeding concerns the debtor's rights to property subject to such registration (buildings, ships or aircraft).

More generally, the Regulation formally reserves the rights *in rem* of third parties affecting property that is situated in another territory at the time of opening of the proceeding. Furthermore, by express derogation, the Regulation provides that the opening of the proceeding will not affect a seller's rights based on a reservation of title to an asset situated in a foreign State; thus, notwithstanding the immediate effectiveness of a foreign insolvency proceeding, the representative of the insolvency appointed therein may not disregard the rights of third parties and more particularly creditors holding properly registered security interests in property situated in another State.

The only limitation on this pro-creditor mechanism is a general reservation concerning actions for voidness: while in principle the various laws cited above may block the effects of the insolvency proceeding, the Regulation derogates in favour of the interests of the insolvency proceeding against the risk of fraud of the debtor or of payments and actions by individual creditors. In this sense, it expressly reserves the possibility of undertaking actions for voidness or unenforceability against improper acts and payments as provided by the law of the State of opening.

Accordingly, the Regulation of May 29, 2000 establishes a balance between the rights of the creditors, legal security, and the collective interest of the creditors, which is assumed to correspond to the objectives of the insolvency proceeding.

In conclusion, the coming into force of the Regulation of May 29, 2000 will have an impact on at least three levels:

1. Increased co-operation of the practitioners

To allow effective and rapid information concerning the assets of the undertakings;

To ensure execution of foreign judgments;

To coordinate concurrent proceedings;

To promote the search for out-of-court settlement whenever possible, to benefit from the flexible rules implemented in each law.

2. Some tangible aspects such as:

The effective publication of foreign judgments by all media (legal publications in local media, placing on computer media, etc.);

A system of legal advertising common to the countries of the European Union;

A system of speedy translation that is accessible to practitioners.

3. Increased vigilance in regard to the risks

The risk to practitioners and the boards of the parties of covering offences by corporate directors (transfers of assets);

The risk to professionals of conducting individual execution actions that would then be attacked and set aside (suspect period);

The risk to practitioners of being held individually liable for having acted improperly or for not having recovered some available assets.

The implementation of the Regulation on insolvency proceedings in France, as in the other countries of the European Union, thus involves a challenge to the way in which proceedings are administered and imposes closer coordination of the practitioners and the courts. In this sense, the work of Insol International and of the UNCITRAL in regard to the regulation of cross-border proceedings gives practitioners the tools for this revolution.