International Insolvency Institute

The Inter-Relationship Between Main and Secondary Bankruptcies

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1. <u>Introduction</u>

Cross Border bankruptcy (I am using the terms bankruptcy and insolvency inter-changeably as having the same meaning) is largely about the search for co-operation between two or more jurisdictions in which assets and potential assets belonging to a bankrupt are situated. The bankruptcy will often give rise to conflicts which will need to be resolved. So one issue – where we are dealing with two or more jurisdictions - is where should they be resolved (the issue of "jurisdiction"). A second issue is, in accordance with whose principles of law, should these disputes be resolved (the "choice of law" issue). These disputes are inevitable, and, if protracted, destructive of what remains in the bankrupt estate. By contrast, the shorter the time and the smaller the expense spent in resolving such disputes, the better the return for those, especially the creditors, directly interested in the bankruptcy.

This is not a new problem and there are many examples of the few methods there are to secure this agreement between jurisdictions. Before the world knew about international and regional and multilateral treaties, we had bilateral treaties between states. As far as bankruptcy, or at least debt enforcement is concerned, the earliest or one of the earliest, bilateral treaty can be traced back to 1715.[1]

[1] See *Lipstein*, "Early Treaties for the Recognition and Enforcement of Foreign Bankruptcies" in Fletcher (ed) *Cross Border Insolvency: Comparative Dimensions* (United Kingdom Comparative Law Series, volume 12, 1990) 223.

Although the earliest treaty catalogued by Lipstein – that between France and the Catholic Swiss Cantons and Valois of 1715 – was clearly concerned with judgment debt enforcement, rather than cross border bankruptcy as such, the connection between debt enforcement and bankruptcy was specifically recognised in the first amendment to this treaty, effected in 1727. This particular amending provision reads:

> "A fraudulent bankrupt national of France cannot find asylum in Switzerland in order to evade his creditors; instead he can be pursued and seized, and the judgment is directly executory as to its civil law effects; the same principle applies in similar circumstances against a Swiss citizen in France."

This amended treaty was also among the first to recognise the importance of seeking to extend the recognition of the judgment of the court which had rendered it, not only to the courts of the country where the debtor lived (this was effected in the original treaty of 1715), but also to any third countries where any assets of the debtor might be situated. Simple treaties such as these - and there are many examples today – oblige the party states to ensure that their courts and other enforcement agencies recognise and enforce judgments of the courts of the other party states. Where there is no treaty the enforcement process of a judgment of a different country will necessarily be a longer and more complicated business. Most often this will mean starting a fresh action on the foreign judgment, in the country where the judgment is to be enforced.[2] General principles of private international law - goodwill between the states, sometimes called comity, for example – will be invoked.

Probably the first modern type of cross border bankruptcy treaty comes with the Convention in 1826 between the nineteen Swiss Cantons and Wűrtemburg, which first, proclaimed the equality of treatment of all creditors in accordance with the law of the country exercising jurisdiction in the bankruptcy, and secondly, recognised the universality and unity of the bankruptcy. The Convention precluded any seizure of the bankrupt's property, except in favour of the estate, but all the bankrupt's movable and

[2] A recent example can be seen in *Adams* v. *Cape Industries Ltd*. [1990] Ch 433, [1990] BCLC 479

immovable property, which constituted collateral for secured claims, was excluded from the bankruptcy so as to be available for enforcement by the appropriate (secured) creditor in accordance with the appropriate law.

Thus, two important distinctions have emerged so far. The first is the distinction between there being a treaty which is binding on appropriate countries and where there is not. The second distinction is that between the enforcement of debt as opposed to the establishment of a bankruptcy regime.

Without a treaty, the clarity of the principle directing enforcement disappears. The basis on which the request is made for the enforcement of the judgment shifts to the messier and more complex issue of principles of private international law, questions of comity and even the principles of the law among nations. We will find that there will be many instances which the EC's Regulation on Insolvency Proceedings does not cover and where the parties to a cross border insolvency in the EC are thrown back on to these general principles.

So, in principle, it is better to establish a treaty to direct the courts, even where this is to deal with the politically uncontroversial matter of enforcement of judgments. Here the benefit of the treaty is largely to free the court from the complexity of the legal sources and principles and the machinations of the lawyers.

Let us now consider how much more complex is the establishment and administration of insolvency than is the enforcement of judgments. Now we no longer have the simple matter of procedural assistance being given by state A to state B. Instead, we now have the attempt to establish a regime in one country which must command the respect and recognition of other countries, and within which, a range – quite possibly a wide and extensive range – of disputes are to be settled, many of which, by definition will have implications for citizens and residents of those other states. The need for a treaty may look a lot more compelling because of the much greater complexity; on the other hand it is this greater complexity which makes the treaty much more difficult to achieve –

especially when this is designed to cover not two but quite possibly tens or even hundreds of member states. In the regime of bankruptcy, there will often fall to be settled disputes of a commercial and industrial nature which lie very close to the heart of any domestic legal system. A cross border bankruptcy treaty – to be significant and effective – will need to achieve some degree of uniformity on both jurisdiction and choice of law and will, therefore, be asking member states to cede the resolution of these disputes to the courts of one only of their number and in accordance with that country's laws.[3] We will see when we come in a moment to consider relevant provisions of the EC regulation, that various compromises had to be made in this regard.

Whereas a treaty which provides solely for the enforcement of judgments is relatively straightforward and uncontroversial, at least among states at similar stages of economic development,[4] a full blown cross border bankruptcy treaty seeks a surrender of sovereignty on what might be contentious domestic political issues. The matter is further complicated by the fact that, domestically, the member states are likely to have insolvency systems which are based on the principle of the equal treatment of creditors. Whereas few would dispute the appropriateness of this principle for domestic bankruptcy, this principle may produce politically difficult circumstances at the cross border level. An insolvent debtor may have solvent as well as insolvent operations, and hundreds, maybe thousands of employees at a successful operation may find unacceptable the idea that their salaries are to be exchanged for a claim in a large bankrupt estate where the equal treatment of creditors principle will yield a small percentage of what they are owed. Judges having to adjudicate on a claim by the administrator of the bankruptcy, to remove from the jurisdiction, the debtor's substantial assets so that they can be added to the single estate, will need very clear authority to enable them to act in the interests of all, and not just the local, creditors.

[3] Note Preambles 4 and 5 of the EC Regulation on Insolvency Proceedings, which sums up very effectively the need for a treaty rather than relying on domestic legal principles

[4] The case of the European Community's Convention on Jurisdiction and the Enforcement of Judgments (the Brussels Convention) is instructive. Initially, this was negotiated on the basis of including agreement as to cross border bankruptcy but when the latter continued to raise irresolvable issues, it was abandoned for fear of jeopardising the less contentious issue of the Convention, namely enforcement of judgments, see art. 1(2) excluding from the remit of the Convention "bankruptcy proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings."

Again, it should be stressed that while there are many shining examples of judges having acted in this way under general principles of private international law, there are at least as many examples where the temptation to appease local creditors, to act according to a territorial rather than a universalist principle, was irresistible.

The EU now has a Regulation,[5] (significantly, not a Convention, which had been the favoured form of agreement for almost the entire 40 year history of the search for EC cross border bankruptcy accord). This Regulation was enacted on 29 May 2000 and declared to enter into force on 31 May 2002.[6] It has the powerful centralising forces of direct effect in the member states and the interpretive power and authority of the European Court of Justice. It provides, among other things, for what are described as "Secondary Insolvency Proceedings",[7] creating, in effect, the possibility of several simultaneous insolvency processes in relation to the same debtor. So what I propose to do in this paper is, first to describe and analyse the different types of bankruptcy and bankruptcy procedures which come within the provisions of the Regulation. Then I shall move on to examine the provisions of the chapter on secondary insolvency proceedings. This should give us some grasp of how the different insolvency procedures are expected to relate to each other. Questions of jurisdiction and choice of law in cross border bankruptcy in the EU will inevitably come within our discussion.

2. The Different Insolvency Proceedings

Chapter III, which sets out the provisions relating to Secondary Insolvency Proceedings, refers back to article 3 which distinguishes between a bankruptcy of a debtor established where the centre of the debtor's main interest are located (a "main bankruptcy")[8] and other bankruptcies of the same debtor, initiated where the debtor has an "establishment"[9] (a "secondary bankruptcy" or "secondary bankruptcies"). This article is complemented

[5] Council Regulation (EC) No 1346/2000 (Official Journal L160, 30/06/2000, pp 1 – 18)
[6] See art. 47
[7] Chapter III, arts. 27ff.
[8] art. 3(1).
[9] art. 3(2).

by Appendixes A and B, which, respectively set out the domestic insolvency regimes which may constitute either the main or the secondary bankruptcy. At this stage it is sufficient to pint out that Appendix A is wider than Appendix B, the chief difference being that the business rescue regimes of the Member States are permitted in the case of a main, but not a secondary bankruptcy.

It is a relatively simple matter to understand the nature of a main bankruptcy under the treaty. This can only ever arise where the centre of the debtor's main interests is within the territory of one of the member states. In fact, if the centre of the debtor's main interests is located in a country outside the EU, the entire Regulation has no effect whatsoever.[10] As we shall soon see, the significance of a bankruptcy being a main bankruptcy under the Regulation is that all issues and disputes, except in the case of certain specifically described claims ("the excepted claims"), will be decided in accordance with the domestic law of the country of the main bankruptcy.

We will need to return to these excepted claims shortly, but before we do, let us briefly consider the nature of the secondary bankruptcy, created under the provisions of art. 3(2) of the Regulation. Here, the Regulation authorises the opening of a limited bankruptcy in one member state in the case of a debtor whose centre of main interests is in another member state (if the debtor's centre of main interests is not in any of the member states, you will recall, the Regulation is a dead letter). It is likely that the limited bankruptcy (the secondary bankruptcy, also called a "territorial bankruptcy") will be opened after the main bankruptcy has been opened, but the opening of the latter is not a pre-requisite for the opening of the former. Indeed, it is even contemplated that a bankruptcy might never be opened at the debtor's centre of main interests.[11] Certain conditions apply in connection with the opening of the limited bankruptcy. First, the debtor must have an "establishment" in the country of the limited bankruptcy. Secondly, that bankruptcy can only be concerned with the debtor's property located in that country, hence the description by the Regulation for these as "territorial insolvency proceedings". We will

[10] Preamble 14, EC Regulation on Insolvency Proceedings
[11] art. 3(4).

deal shortly with the provisions which deal with the inter-relationship between the main and any territorial bankruptcies.

Main and territorial are the only insolvency procedures provided for by the Regulation. However, it is also pertinent to refer at this stage to what was referred to above as the "excepted claims". These are set out in Articles 5 – 15 and consist of a variety of rights and claims asserted against the bankrupt estate by creditors and third parties. There are some common substantive characteristics to many of these claims. Several are secured against specific property either owned by, or in the possession of, the debtor.[12] Others, like reservation of title claims[13] and setoff claims[14] are indirectly secured against specific property in the debtor's possession. Some, on the other hand, like claims arising out of contracts of employment,[15] and rights and obligations to a payments or settlement system,[16] lack any meaningful property connection. They do, however, all share one important procedural attribute afforded to them by the Regulation - none will fall, automatically, to be judged in accordance with the legal principles of the country where the debtor's centre of main interests are located, that is to say the country where the main bankruptcy has been opened.

In some instances the Regulation effects this exclusion from legal system governing the bankruptcy by implication. "The opening of insolvency proceedings", the Regulation records, "shall not affect the rights in rem of creditors or third parties, … the rights of creditors to demand the setoff of their claims against the claims of the debtor … [and] the seller's rights based on a reservation of title … ."[17] In other instances, the Regulation explicitly lays down the choice of law rule to be applied. Thus, it is declared that the effect of the debtor's insolvency on pending law suits will be decided in accordance with the country in which that suit is pending.[18] Likewise the effects of insolvency proceedings on a contract conferring the right to acquire or make use of immoveable

[12] art. 5.
[13] art. 7.
[14] art. 6.
[15] art. 10.
[16] art. 9.
[17] arts. 5 – 7.
[18] art. 15

property, is to be governed by the law of the members state within whose territory the immoveable property is located.[19] And in the case of contracts of employment, "the effects of insolvency proceedings on employment contracts and relationships shall be governed solely by the law of the Member State applicable to the contract of employment."[20] I am not a private international lawyer, but I would guess that in each of these cases, these are overwhelmingly the choice of law principles adopted by most countries.

These excepted claims all relate to what are, clearly, significant commercial, industrial and financial events, where the participants have established powerful public positions from which to bargain for the protection of their own interests in a bankruptcy as opposed to the general interests of creditors. It was always anticipated that one of the really contentious issues for a cross border bankruptcy treaty would be the secured claim, the claim arising out of a contract in which the creditor stipulated for security in specifically described property, or a category of property, belonging to the debtor, out of the realization of which, the creditor's claim would be met in the event of the debtor being unable to pay the debt. We all know of the concerns and sensitivity of secured debt, contracts of employment, payment and settlement systems and so forth. Indeed, the case is well presented in the preamble to the Regulation

> "There is a particular need for a special reference diverging from the law of the opening State in the case of rights in rem, since these are of considerable importance for the granting of credit. The basis, validity and extent of such a right in rem should therefore normally be determined according to the lex situs and not be affected by the opening of insolvency proceedings. The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security."[21]

[19] art. 8 (expressing a very widespread principle of private international law).
[20] Art. 10
[21] Preamble 25.

Succeeding preamble provisions make the case for special treatment of set-off,[22] payment systems and financial markets,[23] and the protection of employees and jobs.[24]

We can, therefore, identify three possible separate focuses of a bankruptcy process under the Regulation. First there will be the main bankruptcy, opened in the country where the debtor has the centre of his or her or its main interests and carried out under the law of that country; secondly there may be one or more territorial bankruptcies limited to dealing with the debtor's assets located in the country or countries where the territorial bankruptcy or bankruptcies have been opened and carried out in accordance with the law of the appropriate territory; finally, there may be one or more adjudications taking place to resolve disputes arising out of any of the rights or claims for each of which the Regulation has prescribed a different choice of law. A big cross border bankruptcy may, therefore, be before several courts in many different EU countries, simultaneously.

In separating the various choice of law possibilities, it should be mentioned that certain coincidences are bound to arise. The contracts of employment of some or even all of the employees of the debtor, for example, may have been negotiated and concluded in the country where the main insolvency proceeding has been opened. It is highly likely, therefore, that the law governing the contracts of employment will be the same as that under which the main insolvency proceeding is conducted.

Other, similar coincidences can readily be envisaged. A specific form of such a coincidence may be said to have been envisaged by the treaty itself in relation to rights in rem. The protection to be afforded to rights in rem includes, according to the preamble provision quoted above, the right of the proprietor "to assert his right to segregation or separate settlement of the collateral security." Article 5 does this by a comprehensive description in 5(2) of the various rights which the proprietor may wish to assert, but it should be noted that these rights are, according to 5(1) to be unaffected by the opening of insolvency proceedings "in respect of tangible or intangible, moveable or immoveable

[22] Preamble 26.
[23] Preamble 27.
[24] Preamble 28.

assets … belonging to the debtor *which are situated within the territory of another Member State at the opening of proceedings*”.[25] If the assets in question are, indeed, located in the country where the main insolvency process has been opened, the special regime of article 5 would seem to be inapplicable. However, that part of the preamble which enjoins that the “basis, validity and extent of such a right in rem should … normally be determined according to the lex situs and not be affected by the opening of insolvency proceedings” will have been satisfied through the coincidence of the law governing the insolvency process and the lex situs.

What, it may be asked, happens where the principles of the lex situs do not provide for “segregation or separate settlement” at the behest of the proprietor? Where, to put the point in a more colloquial fashion, there is less respect for secured creditors? There may be said here to be a specific and a general point. The specific point is that the creditor should have anticipated that any dispute arising in connection with the attempted enforcement of his or her or its right in rem, would be resolved in accordance with the principles of the lex situs. Thus, the due diligence which might be expected of one entering into a “significant” contract should have revealed any obstacles or limitations in the enforcement of the rights contracted for.

The general point relates to the main insolvency proceedings and the fact that they are conducted in accordance with the principles of the country where the debtor’s centre of main interests is located. As we will see, much hinges on where the main insolvency proceedings are to be conducted (despite the fact that a substantial slice of asset disputation might be hived off to the law of any territorial insolvency proceedings and special treatment claims), possibly to the disgruntlement of some of the interested parties. To any such, the following passage from the Virgos and Schmidt report on the ill-fated Convention on Insolvency Proceedings, may be of interest:

> “The concept of ‘centre of main interests’ must be interpreted as the place where the debtor conducts the administration of his interests on a regular

[25] My emphasis.

> basis and is therefore ascertainable by third parties. The rationale of this rule is not difficult to explain. Insolvency is a foreseeable risk. It is therefore important that international jurisdiction (which as we shall see, entails the application of the insolvency laws of that Contracting State) be based on a place known to the debtor's potential creditors. This enables the legal risks which would have to be assumed in the case of insolvency to be calculated."[26]

3. The Scope of the Jurisdiction of the Main Insolvency Proceedings

The legal principles of the Member State where the main insolvency is opened will resolve the legal issues in the insolvency apart from issues in relation to those assets which have been hived off to territorial insolvency proceedings and the excepted claims. Although this might remove much of the meat from the skeleton, much is bound to remain for what is known as the *lex concursus*, the law of the place where the insolvency is being conducted. Much of the conduct of an insolvency is procedural and so this principle enshrined in the Regulation, to a large extent follows another widely accepted principle of private international law, namely that matters of procedure are dealt with according to the lex fori – the law of the country where the litigation is conducted. This aside, as we shall see, certain significant substantive issues will remain for resolution in the main insolvency proceeding.

We have a good idea of the excepted claims as well as the function and content of territorial insolvencies. It is now time to look briefly at the specified coverage of the main insolvency. Article 4 deals extensively with this. First it states:

> "Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, …"

[26] Miguel Virgos and Etienne Schmit, Report on the Convention on Insolvency Proceedings, para. 75. This Report was circulated as an EU Council document 6500/1/96; see further Fletcher, *Insolvency in Private International Law*, (Oxford, 1999), 249 (footnote 10)

Article 4(2) gets down to particulars. After stating that "[t]he law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure", all decidedly matters of procedure, it enumerates thirteen categories of insolvency administration related activities. Many of them are detailed matters of procedure – for example "the respective powers of the debtor and the liquidator"[27] and "the rules governing the lodging, verification and admission of claims".[28] But there are also the essential substantive issues which are included in any comprehensive insolvency code, such as determining "the assets which form part of the estate",[29] "the effects of insolvency proceedings on current contracts to which the debtor is a party"[30] and "the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors".[31]

This list is long and detailed but will be subject to interpretation, both as to its perimeter and its internal substance. To take the latter first, would the power of the state of the opening of proceedings to determine "the assets which form part of the estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings" include that state's legal provisions (if it has any) to empower the liquidator to bring proceedings against the debtor's former executives whose negligent or fraudulent conduct contributed to the debtor's downfall? If it doesn't (or if it does, but the state in question has no such provision) we will, surely, have identified one matter for the reform of the Regulation agenda.

[27] art. 4(2)(c).
[28] art. 4(2)(h).
[29] art. 4(2)(b) – here, in England, we might look forward to riveting litigation analysing the various factoring and similar arrangements designed to ensure that not even for a scintilla temporis do the payments by the debtor's creditors touch the debtor's estate before being routed to the factor. See for example *Welsh Development Agency* v. *Export Finance Co*. [1992] BCLC 148. The doctrine of the resulting trust may also come in for scrutiny, see *Barclays Bank Ltd*. v. *Quistclose Ltd*. [1970] A.C. 567, as well as the relationship between netting out arrangements and the onset of insolvency, see British *Eagle International Airlines Ltd*. v. *Compagnie Internationale Air France* [1975] 2 WLR 758, [1975] 2 All ER 390.
[30] art. 4(2)(e). There may be much fun to be had in the U.K. here on the distinction between Administration and Administrative Receivership (the latter is under sentence of severe curtailment, but may last a while yet), see *Astor Chemicals Ltd*. v. *Synthetic Technology Ltd*. [199] BCLC 1, as just the merest tip of the iceberg
[31] art. 4(2)(m).

On the issue of the perimeter of the powers identified in article 4(2), we might ask what is encompassed by the phrase "insolvency proceedings"? This is the encompassing phrase at the beginning of article 4 and is susceptible of both a wide and a narrow construction.

This has been the subject of litigation before the ECJ, in *Gourdain* v. *Nadler*,[32] a case arising under the Convention on Jurisdiction and the Enforcement of Judgments (the "Brussels Convention"), where the issue was whether the judgment of a French court ordering the manager of a bankrupt company to pay compensation, was a judgment of a civil and commercial nature or was a bankruptcy matter. If the latter, it would have been excluded from the scope of the Convention.[33] In the event the ECJ held that this was a bankruptcy matter because it would not have arisen but for the bankruptcy. There the court was dealing with a provision which excluded bankruptcy related issues and set a high threshold to the exception (the test applied was whether the litigation would have arisen but for the bankruptcy and, given that the proceedings were brought under a provision whose only operation was the raising of a compensation claim against directors of a bankrupt company, the test was held to have been satisfied). Had the action been brought under ordinary tort or delict principles, it would seem that the court would have ruled it not to be within "bankruptcy proceedings" and, therefore, within the jurisdiction of the Convention.

Under the Insolvency Regulation, a strict interpretation of insolvency proceedings might be broadly, inclusively interpreted to encompass any action undertaken by the liquidator – even for example, an action against an alleged tortfeasor for damage caused to the debtor while the latter, if a business, was still a going concern. A narrow interpretation would restrict the phrase to matters which but for insolvency would not have arisen.

4. <u>The Inter-Relationship Between Main and Territorial Insolvencies and Special Claims</u>

[32] Case 133/78, (1979) ECR 733.
[33] See above, footnote 3.

The ideal in cross border bankruptcy is the universal estate based in one place, operating in one place, according to universal legal principles and, accordingly respected and enforced by all. It is no exaggeration to say that we are some distance from this and even within a relatively small and homogenous group of developed countries, the Regulation has had to make provision for a certain amount of derogation. Nevertheless, the Regulation does display a strong sense of the importance of the centrality of the bankruptcy of a debtor whose assets are spread through different Member States and this can be especially observed in Chapter III which lays down mandatory co-operation and communication arrangements between the main and territorial insolvency proceedings.

Nor is this simply a matter of trying to keep the family together for its own sake. There may be significant money issues. One reason for initiating a territorial insolvency will surely be because the local creditors believe that through this they will get a better deal. That must presuppose the possibility that the local assets will be realised exclusively for the payment of the claims of local creditors. The chapter is equivocal about this and we will shortly consider the relevant provisions. However, under article 35, the possibility is raised of a surplus being left after "all claims allowed under those [the territorial] proceedings" have been met. In such circumstances, the territorial liquidator is placed under an absolute and immediate duty to transfer any such surplus to the liquidator in the main proceedings.

This raises two questions. First, what happens where, rarely, there is no main insolvency process? As we have observed this is possible.[34] My answer would be that the surplus should be transferred to the debtor, to whom it would seem to belong. Secondly, what would be the fate of any surplus after a creditor with a right in rem had exercised his or her or its right to have the collateral sold and the claim paid out of the proceeds? There is no obligation laid on anyone under the Regulation, although preamble 25 ("If a secondary proceeding is not opened, the surplus on sale of the asset covered by rights in rem must be paid to the liquidator in the main proceeding") is quite unequivocal as to what should happen.

[34] Art. 3(4)(a).

In domestic proceedings, any surplus would automatically belong to the liquidator by reason of, in the U.K. at least, the ownership of that surplus being vested in the debtor. In a cross border case, the liquidator in the main proceedings, could, it would seem, take one of two courses, first simply to take action against whoever holds the surplus, in the hope that the appropriate legal principles will recognise that the insolvent estate is entitled to the surplus. Alternatively, the liquidator in the main proceedings might exercise the power conferred on him or her by article 29(b) and seek a territorial liquidation in the Member State where the surplus is being held. He or she will, of course, have to show that the debtor had an establishment in the jurisdiction where the territorial insolvency is to be opened, but if this is the case, the liquidator may be well advised to adopt this course.

Indeed, it may be an occasion for being proactive and, if possible, initiating the territorial insolvency before the creditor with the right in rem has exercised his or her rights. This would enable the liquidator in the main proceedings to oversee the exercise by the creditor of his right. Thus, if that collateral is worth much more than the debt, there might not otherwise be a sufficient incentive on the creditor to ensure that the best price is obtained. This might lead to some interesting differences. Some countries may welcome and encourage the main liquidator to do this. Other countries may follow principles which give the secured creditor unfettered freedom in the exercise of their enforcement rights.

The licence to open territorial insolvency proceedings does not extend to initiating the full range of domestic regimes designated by Appendix A. That full range of liquidation and rescue regimes is only permitted to main insolvency proceedings. Territorial proceedings, on the other hand, can only be opened as any of the proceedings designated by Appendix B, the essential difference being that a business rescue is not a permitted. The opening of territorial proceedings is thus restricted to liquidation proceedings. To some extent, this reflects the nature of the proceedings, limited as they are to the assets in that territory. However, it is not inconceivable that, but for the restriction imposed by the

Regulation, a business rescue in respect of the local establishment might have been approved. What then lies behind this restriction?

The answer may be found in the provisions of article 34, which deals with the measures *ending* the territorial proceedings (as opposed to opening those proceedings). While liquidation is the most likely end, it is specifically provided that "[w]here the law applicable to secondary proceedings allows for such proceedings to be closed without liquidation by a rescue plan, a composition or a comparable measure, the liquidator in the main proceedings shall be empowered to propose such a measure himself".[35] Despite the apparent exclusivity of this sentence, it would seem that this other than liquidation closing of the territorial proceedings may also be possible even where it is not proposed by the liquidator of the main proceedings – where, presumably it is proposed by the liquidator of the territorial proceedings, or even by a creditor or the court itself (if this is permitted by the law of that territory). This seems to follow from the next sentence in the same article, which provides,

> "Closure of the secondary proceedings by a measure referred to in the first subparagraph shall not become final without the consent of the liquidator in the main proceedings; failing his agreement, however, it may become final if the financial interests of the creditors in the main proceedings are not affected by the measure proposed."

The explanation for this complex article would seem to be that a non-liquidation solution is permissible provided that it is what the liquidator in the main proceedings wants. Above all, a solution which works well for the local creditors but which is inimical to the main insolvency is to be avoided as being entirely contrary to the spirit of the Regulation. While this seems utterly appropriate, the drafting of the article creates an anomaly. In the UK, for example, there are at least two regimes which satisfy the definition of "a composition or comparable plan". These are the Company Voluntary Arrangement under the Insolvency Act 1986 (which is designated in Appendix A, but not Appendix B) and a

[35] art. 34(1).

compromise or arrangement under section 425 of the UK Companies Act, which has been brought within the provisions of the insolvency regime of Administration under the Insolvency Act 1986 (which is also designated in Appendix A, but not B).

The better solution would be to hold that either of these regimes are permitted closures of territorial insolvency proceedings if this is what finds favour with local creditors and the liquidator of the main proceedings, despite the fact that these are not licensed regimes for the opening of territorial insolvency proceedings. To insist that neither is permissible on account of the combined effect of Appendixes A and B would seem absurd. I expect that similar observations might be made on non-liquidation closures to domestic insolvency proceedings in other jurisdictions within the EU. Yet, in the case of the CVA, the procedure for starting this is set out in the Insolvency Act 1986 and it would mean that if this turned out to be the desirable end to the territorial proceedings, that procedure would have to be begun anew – which is what is not permitted in terms of article 3 and Appendix B! The same observation may also be made of a section 425 compromise or arrangement, although the process here is less formal than that of the CVA and which could simply emerge in the course of territorial proceedings.

The theme of the control of the territorial proceedings by the liquidator of the main proceedings runs right through the chapter dealing with territorial insolvency proceedings. Indeed, as we have already pointed out, it may be very much to the liquidator's advantage of the main proceedings to initiate territorial proceedings. The example above was based on the need for the liquidator to ensure that any sale of the debtor's assets was at the best price so as to ensure that any surplus over after the payment of local claims was as large as possible. Territorial proceedings may also suit the liquidator where the local assets present a complex set of problems which might best be dealt with by a local court assisted by local professionals.

The Regulation also polices closely the opening of territorial proceedings in advance of the opening of main proceedings or, where main proceedings may not be available, to the exclusion of such proceedings. If territorial insolvency proceedings are to be opened at the request of a local creditor, the latter must be a person “who has his domicile, habitual residence or registered office in the Member State within the territory of which the establishment is situated or whose claim arises from the operation of that establishment”.[36] The Regulation also alerts the local creditor, seeking to open territorial proceedings, to the possibility of having to make an advance payment of costs or to provide appropriate security, if the local legal provisions provide for this. These articles seek to ensure some seriousness of purpose, where the territorial proceedings are opened by a local creditor and minimise the risk of deliberately spoiling tactics by a largely unconnected person The liquidator of the main proceedings would not be slow to urge the payment of security provision on the local court, where he anticipated trouble from the local creditors.

Yet, and here is the ambiguity of secondary proceedings, there is always the chance that the local court will be favourably disposed to the local creditors. There is also the undeniable reading of territorial proceedings as designed to satisfy, in full, the claims of local creditors, where the debtor’s establishment there prospered as opposed to the rest of the estate. So, while every attempt is made to tilt the secondary proceedings in the direction of the main proceedings, it cannot be denied that they do provide an opportunity for the ringfencing which is the very threat which treaties of this kind are designed to avoid.

There are other provisions which will serve to ensure that the local proceedings are bound in as closely as possible with the main proceedings. Thus there is a duty on the liquidators to co-operate and communicate with each other, especially on matters which might affect other proceedings and on progress with the lodging and verifying of claims. The liquidator of the main proceedings must be given an early opportunity to submit proposals on the liquidation or the use of the assets in the territorial proceedings. Furthermore, the liquidators of the main and secondary proceedings are specifically

[36] art. 3(4).

authorised to participate in the other proceedings "on the same basis as a creditor, in particular by attending creditors' meetings".[37]

But what clearly underlines the control which the liquidator can exercise over the territorial proceedings is the power which he or she is given to request the local court to stay the liquidation proceedings. The liquidator may be required to provide some suitable guarantee of the interests of the creditors, but if this is done and it cannot be shown that the liquidator's request is manifestly of no interest to the creditors of the main proceedings, the liquidator of the territorial proceedings must comply with the request.[38] During any such stay of the liquidation proceedings, only the liquidator of the main proceedings, or the debtor with that liquidator's consent, may propose the ending of the proceedings without liquidation and by a rescue plan, composition or comparable measure.

The fear is that through secondary proceedings local creditors may either secure a better deal for themselves even to the point of achieving some kind of independence for the local establishment or, just as bad, make such a nuisance of themselves so as to blackmail the liquidator of the main proceedings into acceding to their demands. Either way, secondary proceedings would be seen as a wooden horse undermining the qualified universality for which the Regulation strives and which, given a fair wind and favourable interpretation it may achieve.

5. Conclusion

We have identified at least three separate sites for possible legal resolution within the same insolvency. In this, the Regulation has recognised the inevitable. However much closer together the internal market has brought the member states, we have to recognise the gap between successful trade on the one hand and, on the other, the ferocity of the conflicts of interests when there is insufficient money to go round to meet legitimate

[37] Art. 32(3).
[38] Art. 33(1).

debts. The former breeds harmony by reason of its success, the latter promotes discord, which is exacerbated by the existence of many different interests, both within domestic regimes and as between those different interests in different jurisdictions. The former runs smoothly, the latter needs the apparatus and bureaucracy of lawyers and the courts to bring order through the implementation of just, resolving principles.

We need to ensure as far as possible that those in the forefront of these clashes of interests are given the tools that are appropriate to produce the measure of fairness which will instil the essential element of confidence in the system. No one can doubt that the EC's Regulation on Insolvency Proceedings makes a profound attempt to meet this challenge. The fact that certain disputes and claims fall to be resolved outside the main insolvency may, on the one hand, be regarded as damaging to the ideal of universalism. Equally, the likelihood that in some bankruptcies, employees of the same bankrupt entity will fare differently in what they recover depending on whether they worked in country A or country B, is difficult to square with the notions of fairness and equal treatment on which domestic insolvency systems have been nurtured.

Yet it would be absurd not to accept that in the complex world that is cross border insolvency, imperfections will abound. Even at the domestic level we are far from achieving the much vaunted principle of the equal treatment of creditors. With the acceptance of the demands of interests such as employees and business financing, we are as far from achieving this principle as ever. How much more difficult, therefore to achieve the ideals of universalism in cross border insolvency, where national boundaries, among other things, are at least as powerful obstacles as the demands of certain classes of creditors.

In the circumstances, the approach of the EC's regulation, of seeking to eliminate obstacles where this will not excite destructive opposition, and to accept certain inevitable imperfections, whether inherited from domestic systems or arising from the increased complexity of national boundaries, must be reckoned at least a very promising beginning.

Of course, much now depends on the response of those who will be making decisions and advising action on the basis of the Regulation. There may be said to have been a substantial development in judicial co-operation across borders, based on and nurtured by a growing awareness of the commercial, financial and industrial problems which may arise in cross border insolvency. If this increasingly enlightened approach can spread through the apparatus and bureaucracy which will administer the Regulation, the promising beginning will enable us to progress to the next stage, which I take to be further harmonisation, achieved without the powerful opposition which it would receive today.