MYKOLAS ROMERIS UNIVERSITY
FACULTY OF LAW
INSTITUTE OF PRIVATE LAW

CRACIUN DUMITRITA
(EUROPEAN AND INTERNATIONAL BUSINESS LAW)

THIRD PARTIES' RIGHTS IN REM UNDER EUROPEAN INSOLVENCY REGULATION:

Master thesis

Supervisor of the Master Thesis:
Prof. Dr. Rimvydas Norkus

Vilnius 2017

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

EIR- European Insolvency Regulation

UNICTRAL- United Nations Commission on International Trade Law

MS- Member State

EU-European Union

COMI-Center of Main Interests

BREXIT-British Exit

ECJ-European Court of Justice

INTRODUCTION

Statement topic. Business world among EU MS is mainly based on multinational companies that merge in order to get profit, to diversify the products and services, to gain a leader position into the market, in few words, to face competition. In order to achieve this goal, many companies get financial collateral support- lenders that own money. But, in many cases business may fall down and companies are not being able to pay their debts at fall due, so they become subject to insolvency proceedings. The main concern of European legislation is COMI (Centre of Main Interest) meaning the brain or business activity in one MS, the state where main insolvency proceedings are opened. COMI is a vital element for the application of the most effective law for secured creditors. That's why European Insolvency Regulation was created to determine the conduct of cross-border insolvency proceedings within the European Community. Finally, after many years of negotiations among Member States, a uniform set of private international law rules regarding applicable law, jurisdiction and recognition of foreign judgements, has been established in order to reduce the risk of opportunistic behavior; to assure cross-border efficiency and legal certainty.

In my work, third party's rights in rem will be analyzed from the perspective of the Recast of European Insolvency Regulation. On 20 May 2015 the European Parliament approved the new European Insolvency Regulation (EIR) which mainly regards a clearer definition of insolvency proceedings, a better application and interpretation in the Regulation. The recast offers a second chance for the debtor; a more organized coordination of insolvency proceedings opening between creditors against same debtor; a balance between insolvency administration and protection of local creditor; as well as an interconnection between national registers. It makes the opening of secondary proceedings coordinated with the interests of local creditors and the objectives of the main proceedings. Accordingly, strengthens the main insolvency practitioner's role in this regard, because he will have the opportunity to apply for refusal or postponement of the opening of secondary proceedings, while the court of the establishment will be in position to be aware of any rescue or reorganization options explored by the main insolvency practitioner. Regarding national registers, they will be interconnected with each other through the European e-Justice portal. In this way will be protected rights of lodging a claim of foreign creditors and will be avoided opening parallel proceedings, as their right to lodge claims will be facilitated by a standard form. There has been less focus on rights in rem that may have been granted in favor of bank lenders and other secured creditors.

So regarding third party's rights in rem, in my work I would like to bring into discussion;

- what is a right in rem according to art. 5;
- where are secured assets located and the importance of the issue;
- are rights in rem affected by some kind of security enforcement stay provided under the main proceedings;
- Inter-creditor agreements regarding ranking;
- the applicable law and applicability in time under art. 5

The content of art. 5 of European Insolvency Regulation provides that "the opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets (both specific assets and collections of indefinite assets as a whole which change from time to time) belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings."[1] The aim is to protect secured creditors with rights such as mortgages or pledges, that offered finance to a debtor. *Lex concursus*, which consists of the assets of debtor that belongs to main proceedings, to the insolvency estate from which obligations are being discharged, does not affect rights in rem. "Article 5 is only applicable to rights which are in existence at the time of the opening of insolvency proceedings. In the event that these rights have been created after the opening of proceedings, Article 4 of EIR is fully applicable. According to Virgos-Schmitt a concern of art.5 is to protect the trade of the Member State where the assets are situated and the legal certainty of the rights over them and to improve credit system and wealth."[2] "Article 5 immunizes rights in rem from the effects of insolvency proceedings, but only where the secured assets are located in a Member State other than the one in which either main or secondary proceedings are commenced."[3] The term belonging covers legal ownership, economic ownership and property rights that according to the applicable law, belongs to the insolvency estate.

The question concerning rights in rem and the law that determine whether a right is to be regarded as a right in rem for these purposes, is covered by art. 5." According to article 5(3) a right which is entered in a public register and is enforceable against third parties shall be considered to be a right in rem."[4] According to Virgos-Schmitt Report the applicable law is the national one, where assets are located.

"A right in rem basically has two characteristics;

---

[1] Council Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings, Article 5.
[2] Virgos-Schmit Report on the Convention of Insolvency Proceedings, paras. 96-97.
[3] Jennifer Marshall – Allen & Overy (England), *Article 5 (Rights in rem)*, para 16, April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017) and Virgos-Schmit Report, para,95.
[4] Jennifer Marshall – Allen & Overy (England), Article 5 (Rights in rem), para 13, April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017).

- its direct and immediate relationship with the asset to which it relates, which remains linked until the debt has been satisfied;
- and the absolute nature of the allocation of the right to the holder. In other words, the person who holds aright in rem can enforce it against anyone who interferes with his right without his consent. Such rights are used to claim property over assets."[5]

Regarding the place where the secured assets are located, the relevant element is the presence of the assets in an EU MS or a third country. In order to be applied EIR, the assets should be located in a MS. Another requirement is the law applicable in dependence of the nature of the relevant assets, stated in article 2(g) of EIR. "Article 2(g) of the EIR gives some guidance as to where certain types of assets are located for the purposes of the EIR: (a) in the case of tangible property, the assets will be located in the Member State within which the property is situated; (b) in the case of property and rights where ownership or entitlement must be entered in a public register, those assets will be situated in the Member State under whose authority the register is kept; and (c) in the case of claims, the claim will be situated in the Member State where the third party required to meet the claim has its center of main interests."[6] If an asset is located in a third State, the effects of the opening of main proceedings will not be determined by art.5, but will be applicable *lex concursus*, according to private international law provisions. "If assets are under *lex situs* in one MS and main proceedings are carried out in another MS, there is a possibility of opening secondary proceedings (EIR, recital 25, 4 line) if one of the affected assets is an establishment. Lex situs will be considered the law governing the opening of secondary proceedings. affected by national law"[7]. However, opening secondary proceedings can give the possibility of abuse of the debtor, by transferring the assets that belongs to third parties' rights in rem. Some minor protection is offered in EIR art. 5(4).

"In relation to a stay of enforcement of security rights, stated in art. 25 EIR, the stay does not derogate from the underlying security interest but merely postpones the right to enforce. There is a debate on the issue, since recital 25 states that the proprietor of the right in rem should be able to continue to assert his right to segregation or separate settlement of the collateral security. Due to this, a secured creditor can enforce his right notwithstanding moratorium which might arise pursuant to the main proceedings."[8]

"Regarding inter-creditor agreements between the secured creditors, provides that, if the

[5] Jennifer Marshall – Allen & Overy (England), Article 5 (Rights in rem), para 14, April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017).
[6] Jennifer Marshall – Allen & Overy (England), Article 5 (Rights in rem), para 17, April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017).
[7] Virgos-Schmit Report, para 98.
[8] Jennifer Marshall – Allen & Overy (England), Article 5 (Rights in rem), para 23-24, April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017).

junior creditors receive any payments before the senior creditors have been paid in full, the junior creditors have to hand over the amount received. Article 4(2) of the EIR states that the law of the state of the opening of main proceedings will govern the question of when and how distributions of proceeds will take place. This law will also determine the ranking and treatment of claims in the insolvency proceedings, preferential claims. As well as whether a secured creditor that has obtained partial satisfaction of its claim, either through the exercise of a right in rem or by way of set-off, may make a claim in the insolvency proceedings for the balance of its claim."[9] Issues concerning different rules for the ranking of secured claims under the law of the state of the opening of proceedings and the law of the member state where the secured assets are located, will be further discussed.

"Article 43 of the EIR states that the provisions of the EIR shall apply only to insolvency proceedings opened after EIR entered into force. Acts done by a debtor before the entry into force of this Regulation shall continue to be governed by the law which was applicable to them at the time they were done."[10]

Finally, the aim of the topic is an evaluation of currently changing situation, taking into account The Recast of Insolvency Regulation, in order to clarify the situation of third party rights in rem and the lacks of the legal framework.

Relevance to the topic: This topic is important as it regards the new European Insolvency Regulation (EIR) that offers some changes in such areas as business restructuring and jurisdiction that is much more precise and clear. The EIR Recast regulates rights in rem of secured creditors that protect their holders against the risk of insolvency of the debtor and the interference of third parties. As well EIR Recast is very important with regard to the granting of credit and obtaining capital investment in EU. The Regulation imposes only an obligation to respect third parties' rights in rem over assets located within the territory of a State different from the State of the opening of proceedings.

Aim: To make a research regarding the importance and application of European Union Insolvency Regulation in the matter of protection of rights in rem of the secured creditors over assets located in MS and regarding the protection of the trade in the MS where the assets are situated and the legal certainty of the rights over them.

Objectives: - Comparison between EIR and EIR Recast;

- Research of principles of universality and territoriality;

[9] Jennifer Marshall – Allen & Overy (England), Article 5 (Rights in rem), paras. 27, 29, April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017).

[10] Jennifer Marshall – Allen & Overy (England), Article 5 (Rights in rem), para 31, April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017).

-Define and establish the effects of rights in rem according to EIR and property law;

-Making a comparative analyze of the security rights according to EIR and UNICTRAL;

- Making a comparative analyze of security rights between Lithuania and Moldova.

Review of the literature: My work is based on various researchers scientifically works relevant to the topic of third-party rights in rem as Benjamin, J. Interests in Securities; A Proprietary Law Analysis of the International Securities Markets; Bergström, C. Eisenberg, T. Sundgren, S. On the Design of Efficient Priority Rules for Secured Creditors: Empirical Evidence from a Change in Law. 2004; Bhandari, J. S. Weiss, L.A. Corporate Bankruptcy. Economic and Legal Perspectives; Black's Law Dictionary 9th ed; Clarke, A. Kohler, P. Property Law– Commentary and Materials Law in Context; Drobnig, U. Snijders, H. J. Zippro, E.J. Divergences of Property Law, an Obstacle to the Internal market?; Finch, V. Security, Insolvency and Risk: Who Pays the Price? ; Fleisig, H. Safavian, M. De la Pena, N. Reforming Collateral Laws To Expand Access to Finance; Goode, R. Principles of Corporate Insolvency Law; the analysis of legal acts as Council Regulation 1346/2000[11] and of practical cases of the Court of Justice of European Union.

The structure of the master thesis: The master thesis is divided into two chapters, sub-chapters, sections and subsections. First chapter is called Application of article 5 of EIR, where I will analyze the relevance of rights in rem of secured creditors in cross-border situations related to the EIR and EIR Recast. In this chapter, are defined rights in rem under insolvency law and property law; are studied issues as localization of assets-subjects to security rights, exercise of creditors rights and ranking agreements; principles of universality and territoriality; reorganization of debtor's business.

Second chapter, regards comparison between EIR and UNICTRAL Model Law as to understand how security rights located in third-party states and affected by insolvency proceedings can be protected and enforced. As well, is provided a comparison between Lithuania and Moldova's legal framework in the area of security rights and their protection when insolvency proceedings are opened.

The expected results of the research will be situated and discussed in conclusions with the linked recommendations towards my topic entitled "Third parties 'rights in rem under EIR".

[11] Council Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings, Article 5.

CHAPTER 1. APPLICATION OF ARTICLE 5 OF EUROPEAN INSOLVENCY REGULATION

In this chapter, I would like to present a legal research of European cross-border insolvency regulation, specifically an analysis of art. 5 of European Insolvency Regulation. The chapter is divided in two subchapters: "General notions regarding EIR" and "Third parties' rights in rem as an exception from *lex concursus*". The first subchapter's role is to confirm the relevance of EIR focusing on main notions as insolvency and cross-border transactions that operate inside EU. Moreover, the main reference of research is the EIR Recast, since I will accomplish a comparative analysis between EIR and EIR Recast. EIR Recast offers more modern approaches of communication between states regarding insolvency, therefore, we can observe efficacy and weaknesses of EIR. The results of this analysis regarding the improvements and disadvantages of EIR Recast will be presented in the section „Conclusions and Recommendations". My work will be focused on the applicable law, since in the first subchapter I will bring into discussion the notion of *lex fori concursus* as a consequence of universality concept and in the second subchapter, I will present *lex situs* as the law applicable to third parties rights in rem, as an effect of territoriality concept. In this subchapter, are defined rights in rem, classification of securities, localization of assets-subjects to rights in rem, the applicable law, exercise of creditor rights and ranking agreements. The second subchapter is the main part of my work since I am highlighting the question how secured creditors are protected under EIR and if this exception indeed benefits the debtor and the creditors of insolvency proceedings. The scientific problem of my thesis and the result from a legal perspective will be presented in the section "Conclusions and Recommendations".

SUBCHAPTER 1.1. GENERAL NOTIONS REGARDING EUROPEAN INSOLVENCY REGULATION

To apply and interpret EIR we should take into account the general principles of EU law and the law of freedoms that could improve the cooperation system between states in the area of insolvency. EIR regards just cross-border insolvency proceedings opened in case when assets belonging to insolvency estate are located in more than one MS. The main fundament of cross-border insolvency in an international sphere is cooperation between states. The regime introduced by EIR must be understood in the light of cooperation. If there is a level of conformity between

Regulation framework and cooperation that would enhance the functioning of internal market, the cooperation would be the base of efficient cross-border insolvency proceedings. This kind of cooperation should be exercised within the scope of EU law and the principle of supremacy, in order to achieve Community's objectives of European integration and economic growth.

"The necessity of a European Insolvency Regulation arose as a consequence of disparities of insolvency laws and private international rules of MS, creating a distortion of economic relationships between them. Therefore, the unpredictable and unfair insolvency proceedings, affected the desire of private parties to get involved in cross-border transactions. On an overall idea, the differences between cross-border insolvency affects in main part interstate trade and economic growth of EU. The EIR scope is to harmonize MS insolvency legislations and to maintain the economic European market developed"[12].

The subchapter is divided in two subsections "The scope of EIR analyzed through comparison with EIR Recast" and "Cross-border insolvency under EIR".

SUBSECTION 1.1.1. The SCOPE of EIR ANALYZED THROUGH COMPARISON with EIR RECAST

"To understand the scope and role of EIR we should take a look into the background of EIR, specifically the Brussels Convention from 1968 and Brussels I. These conventions regulate issues related to jurisdiction and recognition and enforcement of judgements from other EU states, but nothing regarding bankruptcy, winding-up proceedings of insolvent companies, judicial arrangements, compositions and analogous proceedings. European Court of Justice has established that judicial decisions in order to be excluded from regulation of Brussels Convention must be closely connected to insolvency proceedings. Brussels I even if does not apply to insolvency proceedings, is applicable to the winding up of solvent companies. The EC Convention was converted into Regulation, with an amendment of art.5 regarding floating charges and with a ratification of all MS and by offering power to ECJ to interpret the act without an express provision. The Regulation came into force on 31 May, 2002"[13].

The scope of EIR regards issues as opening main and secondary insolvency proceedings, the applicable law and recognition and enforcement of these proceedings in all MS. The main objectives are: an effective internal market function and to avoid possibilities for forum shopping, meaning that debtor can transfer assets and judicial proceedings from one MS to another. EIR is applicable only if COMI (Center of Main Interests) is located in a EU Member State and main

[12] Jona Israel, *European Cross-Border Insolvency Regulation*, (Antwerpen-Oxford: Intersentia, 2005), 1-4
[13] Roy Goode, *Principles of Corporate Insolvency Law*, (London: Sweet and Maxwell Limited, 2005), 564-565.

insolvency proceedings are opened in that state. Therefore, the law of that state or *lex concursus* is extended to all debtor's assets on a worldwide basis inside EU. In non-European countries recognition of *lex concursus*, especially of liquidator's powers is under jurisdiction and courts of that states. Regarding rights in rem, the regulation is applied with limits, but same conflict rules should apply if assets object of rights in rem are situated in a non-European country.

"In order that EIR could be applied are necessary some conditions as:

- opening of insolvency proceedings;
- proceedings should be collective;
- proceedings should entail the total or partial divestment of debtor and the appointment of a liquidator, meaning that it regards collective proceedings that ensures assets to pass from debtor possession to insolvency estate administered by the liquidator;
- proceedings must be opened in a MS; outside EU would not apply EIR;
- at the time of the opening, COMI must be located in one of MS, meaning that the relevant time is that of opening the insolvency proceedings, moment in which COMI should be in a MS and even if the company was incorporated in another state, EIR applies;
- the debtor is not an institution excluded from Regulation. Excluded institutions are the ones holding funds for third parties, as credit institutions, insurance undertakings and collective investment undertakings, where the State has the power to intervene offered[14]."

" As Regarding opening insolvency proceedings condition, these proceedings must be listed in Annex A of EIR and must be characterized as insolvency proceedings under national law, which may be different."[15]. "EIR Recast presents some changes into this area regarding pre-insolvency proceedings as proceedings opened for the restructuring and rehabilitation of financially distressed debtors in order to continue their business, even at the first stage of insolvency and leaving the debtor fully or partially in control of his assets and affairs; proceedings that adjusts the debt by reducing the amount of the debt or extending the period of payment for consumers and self-employed debtors; proceedings that ensures the restructuring of debtor's business by implementing a temporary moratorium for enforcement of claims belonging to individual creditors; proceedings that ensures the publicity of proceedings so that creditors could lodge theirs claims, at the same time ensuring the collective estate of proceedings and the possibility for creditors to go against chosen jurisdiction; proceedings that, under the law of some Member States, allows interim and provisional proceedings before a court confirms continuation of non-interim proceedings and

[14] Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, recital (9).
[15] Goode, *Principles of Corporate Insolvency Law*, 568.

proceedings opened to prevent future insolvency, even if the debtor faces non-financial difficulties."[16]

"Collective proceedings are described in Annex A of EIR, as winding-up proceedings, which regards collection, realization and distribution of assets and proceedings opened for restructuring and reorganization of debtor's business. Annex A of EIR establishes the voluntary liquidation, compulsory liquidation, voluntary arrangements under insolvency legislation administration liquidation by court order or without a court order. The latest represents a change made to Annex A by including in administration, appointments made by filling prescribed documents with the court. No regulation regarding appointment of a provisional liquidator is mentioned in Annex A, therefore does not constitute a collective proceeding. Art. 29 of EIR makes a reference to a temporary liquidator appointed till secondary proceedings are opened in order to safeguard assets by applying to the court of another MS where assets are situated to request measures to secure and preserve the assets object of secondary proceedings.

Winding-up proceedings according to article 2(1) of EIR means insolvency proceedings that involves realizing the assets of the debtor, including where the proceedings where closed by a restructuring plan or other measure terminating the insolvency or closed by reason of insufficiency of the assets. According to Annex B, winding-up proceedings regards voluntary winding-up, compulsory winding-up and through administration. There is a certain discussion regarding the notion of court as meaning "the judicial body or any other competent body of a MS empowered to open insolvency proceedings or to take decisions in course of such proceedings"[17], since it looks like the Regulation concerns only matters of compulsory winding-up. Nevertheless, the notion of court is freely interpreted in Recital 10 of EIR "Insolvency proceedings do not necessarily involve the intervention of a judicial authority; the expression "court" in this Regulation should be given a broad meaning and include a person or body empowered to open insolvency proceedings"[18]. The voluntary winding-up is made by passing a creditor resolution for winding up. The court in this case has the responsibility of confirm the winding up by qualifying the winding up proceeding in accordance with EIR."[19]

There are uncertainties found by insolvency, legal practitioners, courts and business practitioners, which EIR Recast reformed. The need for a reform in the field of European insolvency has led to the drafting of a new Regulation: EIR Recast that will entry into force on 26 June 2017. The EIR Recast is based on a Heidelberg-Luxembourg-Vienna Report accompanied

[16] http://bobwessels.nl/wp/wp-content/uploads/2015/09/EIR-Recast-Aug-2015-Technical-note.pdf (accessed on March 16, 2017).
[17] Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, art.2(d).
[18]Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, recital (10).
[19] Goode, Principles of Corporate Insolvency Law, 568-560.

by a proposal for adaptation of the Regulation presented by the European Commission. The proposal represents facts discussed in the said report, based on discussions and consultations with a group of experts and an appraisal of the effects on existing EU policy.

"The main issues covered by EIR recast are:

- the lack of certain insolvency proceedings as pre-insolvency, hybrid, some personal proceedings.

EIR recast lists all national names of insolvency proceedings, all insolvency names of insolvency practitioners, all repealed Regulations and establishes a correlation table of articles between EIR and EIR Recast;

- the problems of COMI as creating difficulties for debtor and allowing forum shopping.

EIR recast presents a possibility for judicial review of the rules of international jurisdiction[20]. "Also the presumptions regarding COMI are much more clear, since in the case of a company or legal person, the place of the registered office shall be presumed to be the COMI in the absence of proof to the contrary. This presumption shall only apply if the registered office has not been moved to another Member State within a period of 3 months prior to the request for the opening of insolvency proceedings. The same "suspect period" applies to professionals that exercise an independent business or professional activity. The COMI shall be presumed to be that individual's principal place of business in the absence of proof to the contrary. In the case of any other individual, the COMI shall be presumed to be the place of the individual's habitual residence in the absence of proof to the contrary. This presumption shall only apply if the habitual residence has not been moved to another Member State within a period of 6 months prior to the request for the opening of insolvency proceedings"[21];

- opening secondary proceedings resulted an obstacle for insolvency estate administration.

"EIR Recast offers the next solutions for an effective administration: abolishing the winding-up requirement for secondary proceedings; a court may refuse opening of secondary proceedings if this is not necessary to protect the interests of local creditors; improving cooperation between main and secondary proceedings though extending the present cooperation requirements between liquidators to the courts involved and to insolvency practitioners and courts"[22]. "Regarding the possibility for a seized court to open secondary proceedings or to refuse or postpone such opening, is allowed in the next cases:

[20] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), art. 4-5.
[21] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), art. 3, sec.1, 3rd and 4rd line.
[22] Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, art.31.

the insolvency practitioner in main proceedings has the possibility to give an undertaking to local creditors that they will be treated as if secondary proceedings had been opened; the court temporarily stays the opening of secondary proceedings"[23];

- no publication information regarding opening of insolvency proceedings necessary for lodging of claims.

"EIR Recast regulates the establishment and interconnection of insolvency registers; determines that the costs of establishing and interconnecting these registers are to be financed by the EU; provides rules for access to the information via the system of interconnection and for the publication in another Member States of a decision opening an insolvency proceeding and the decision appointing the insolvency practitioner."[24] " EIR Recast provides that lodging claims in the insolvency proceedings can be made by any means of communication, which are accepted by the law of the State of opening of such proceedings, made through a standard claims form and the minimum period for lodging by foreign creditors is 30 days following publication in insolvency register of state of opening."[25];

- EIR recast extends the cooperation between cross-border insolvency practitioners and courts[26]. "Therefore, insolvency practitioners and courts can enter into agreements in order to coordinate insolvency proceedings opened in more than one MS against the same debtor or members of the same group of companies, if these rules are compatible with each of the proceedings. Insolvency practitioners and the courts cooperate and communicate with each other as those involved in main and secondary proceedings relating to the same debtor and should never go against the interests of the creditors in each of the proceedings"[27];
- EIR does not regulate insolvency of groups of companies.

EIR Recast regulates this issue in Chapter V "Insolvency proceedings of members of a group of companies". "EIR Recast introduces procedural rules on the coordination of the insolvency proceedings of members of a group of companies, in order to ensure efficiency of the coordination and the respect of each group member's separate legal personality"[28]. "If there is a sole COMI of the group of companies, then the seized court can open insolvency proceedings

[23] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), art.36, art.38.
[24] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast, art.24-28.
[25]Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), art.53-55.
[26] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), art. 42-43.
[27]Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), recitals 49-50.
[28]Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), recital 54.

in a single jurisdiction and designate an insolvency practitioner in all concerned proceedings"[29]. "[30]

To sum up, EIR importance is certain. To maintain an EU market integrated is necessary that businesses across EU have access to the EU market and have freedom to operate inside EU. To obtain that freedom is necessary a unified system of laws that regulates insolvency matters. Therefore, the national rules of international private law should be subject to EU Law and under control of European Court of Justice. EIR Recast offers larger possibilities for rehabilitation and rescue of debtor; offers rules as to avoid forum shopping; ensures a more effective coordination between main and secondary proceedings; creates a more effective framework of cooperation between courts and insolvency practitioners; brings a reform in the area of company group insolvency proceedings: and ensures coordination between MS insolvency registers. All these improvements are incentives towards a larger investment in Europe. However, EIR Recast regulates some issues that are too complex. For example, there is no clarity regarding which proceedings are for winding-up and for restructuring, since they are mixed. Also, the EIR condemns just a bad form of forum shopping, somehow allows generally forum shopping. The definition of local creditor is incomplete. According to EIR Recast, article 3 (4), the creditor is the "creditor whose claim arises from or is in connection with the operation of an establishment situated within the territory of the Member State where the opening of territorial proceedings is requested." But, it should also include the location of COMI of the local creditor. The habitual residence, domicile or registered office should be in the place where the establishment is located. There is also an uncertainty in the area of company group coordination. The new Regulation states the main insolvency proceedings will be opened in the state where COMI of the group is situated. At the same time, it states the presumption that COMI should not be changed three months prior opening of insolvency proceedings. It is interesting if it will be considered forum shopping if in the "suspect period" the COMI will be transferred to another company from the group. A change in the regulation area is brought by BREXIT, since the regulation was drafted before BREXT. Therefore, the effects of EIR Recast will be retained over England regarding European transactions. Also, there will be uncertainty as cooperation between England insolvency practitioners and EU courts and vice versa. An option could be a Treaty regulating European matters between EU and England and bilateral agreements between England and European MS. But the private international regulation, in the absence of a common recognition system insolvency proceedings, could lead to a risk of competing insolvency proceedings.

[29] Idem, recital 53.
[30] http://bobwessels.nl/wp/wp-content/uploads/2015/09/EIR-Recast-Aug-2015-Technical-note.pdf (accessed on March 15, 2017).

SUBSECTION 1.1.2. CROSS-BORDER INSOLVENCY UNDER EIR

The main issues of cross-border insolvency are efficient deployment and distribution of assets to creditors, based on the rules of territoriality and universality. These two notions of deployment and equitable distribution will be further explained, but for the moment, we should understand what is cross-border insolvency and the legal question that creates regarding the opposition between territoriality and universality.

"Cross-border insolvency occurs when debtor's assets or liabilities are situated in two or more MS states and are subject to jurisdiction of those states, creating a conflict of interests. This conflict is generated by the interest of all creditors to get payed when insolvency proceedings are opened. Therefore, states involved should decide under what circumstances should exercise their jurisdiction, what actions should be taken regarding the assets located under their territoriality and what law to apply. Also, states should take position concerning insolvency proceedings opened abroad, the recognition possibilities for those proceedings and the effects of that recognition over the territorial proceedings. This issues are governed by two main rules which are universality, meaning that the insolvency proceedings opened in the state where is COMI, are affected by the law of that state. The law is *lex concursus*, which governs all assets and liabilities of the debtor, regardless where are situated. The second rule is territoriality, meaning that the effects of insolvency proceedings are limited to one state, governed by *lex situs* or *lex secundus*. The main concern of courts and insolvency legislators is to create a cooperation between territoriality and universality, by reconciling the opposing interests of these two conceptions. Universality allows collective proceedings, creating an efficient, less complicated and time cost insolvency proceedings system, but in contrast is less receptive to state and local creditors legitimate rights. Territoriality allows protection of local creditors against the risk of not having the debts repaid, but at the same time goes against the efficiency of collective proceedings"[31].

"The insolvency estate is considered as a "common pool"[32], where all creditors have the right to fish half of the fish, not the entire quantity, since will remain nothing left for other fisherman. So, a cooperation between creditors in order to recover each of them their debts from the half of the quantity of assets will enhance the common pool or the insolvency estate value. This regards the possibility for the debtor for going concern or continue the business for a longer period of time and to develop insolvency administration, in order to ensure a future payment to the creditors of the remaining debts, the other half of the insolvency estate. Therefore, by using the rules of common pool, will be possible to an optimization of deployment. That means the

[31] Jona Israel, European Cross-Border Insolvency Regulation, (Antwerpen-Oxford: Intersentia, 2005), 11-12.
[32] Jackson, *The logic and limits of bankruptcy law,* (Block-Lieb, 1986), 337.

determination of insolvency estate value and its realization and distribution that means repairing the suffered loss for each creditor. The narrow, economic meaning of deployment is wealth-maximization for single creditor, a debt-collection method used for creditors interest only that would yield the highest return for creditors. The economic perspective of insolvency law gives no preference for business continuation or reorganization. The broader perspective regards the problem of financial distress, that focuses more on reorganization of the business. That means that the main parties affected are not just the creditors with an enforceable claim under non-insolvency law, but also employees, suppliers with certain interest in continuing the business, the interest of the society regarding employment policies, economic infra-structure and regional development. Therefore, deployment may achieve a socially optimal result without highest satisfaction for the creditors. Distribution is based on the principle *paritas creditorum*, which means that creditors are situated on the same level and distribution of the realized value should be equitable. The two description, economic and open-ended, is relevant for distribution too. From economic point of view, individual distribution and a high return for each creditor is not possible, since insolvency proceedings are opened as collective, not individual. Nevertheless, *paritas creditorum* allows redistribution, as levels individual creditors with claims under non-insolvency law. Under this principle, redistribution is cheap and effective as levels unsecured creditors. From open-ended point of view, distribution is a necessary element of insolvency law, since each creditor ranking gets specific treatment, in dependence of the ability to create a risk of insolvency, to have an impact over insolvency or demand a collateral security. Normally, employees and creditors that may offer financial support, as extending a credit may be afforded some priority in insolvency proceedings"[33].

"The principle of territoriality is based on public order or state sovereignty and territorial limits. Collective proceedings are possible to be enforced and coordinated on a national level. On an international level, it demands the acceptance from other jurisdictions. During territorial proceedings, this acceptance lacks and local creditors are able to satisfy as many debts as possible. These creditors are situated in a positional advantage, because of the information they possess or the possibility to seek recourse to assets on an individual basis. Therefore, secured creditors are situated in this position, as they have the right on the assets situated in different jurisdictions, as they are collateral securities for debts payment."[34]

"The principle of universality regards two main points, the unique forum and the unique law-*lex fori concursus*. From deployment point of view, the unique court maintains the insolvency estate intact and under control, with less administrative costs. From distribution point of view is

[33] Israel, *European Cross-Border Insolvency Regulation*, 14-19.
[34] Israel, *European Cross-Border Insolvency Regulation*, 29.

inequitable, as all insolvency claims filling, time-bars for filling, publication of judgement commencing proceedings and notification of creditors shall be made in in one court, under *lex fori*. This is unfair for foreign creditors that supports much more expanses than local ones. The *lex concursus* governs all aspects of insolvency proceedings, insolvency estate value and distribution of dividends to creditors. As I have mentioned before about optimal deployment, is *lex concursus* the one who governs the economic or open-ended perspective. Also, distribution schemes, preferential claims are governed by *lex concursus*. The universality is opposite to states jurisdictions and somehow to legitimate expectations of creditors, that expects that rules of local insolvency proceedings could be applied. These expectations have no legal ground, as the universal forum is predictable and creditors should analyze *lex fori* and its effects."[35]

"No universality and territoriality are enough to satisfy foreign creditors and states interests. Nevertheless, the most efficient solution is cooperation between jurisdictions. To this regard, a solution is brought by *Comitas Europea* or Community Law that brings two ideas, the first is application of one jurisdiction under universality and second is application of national jurisdiction under territoriality. The man point is cooperation in order to reconcile the different jurisdictions and to eliminate inter-state trade obstacles."[36]

"EIR Recast regulates cross-border recognition of insolvency proceedings in art. (17) which states that any judgement regarding insolvency proceedings shall be recognized in all European MS. Also, the debtor's COMI is defined as "the place where the debtor conducts the administration of its interests on a regular basis and is ascertainable by third parties"[37].The main scope of EIR Recast is to slow the tendency of forum shopping. Regarding secondary insolvency proceedings, EIR Recast brings a change towards winding-up proceedings stated in Annex B of EIR that are excluded from secondary proceedings, as it was an obstacle for restructuring the groups of companies and divisions from EU. Also, interim measures are taken by court with the purpose of safeguard of assets for creditors 'interests. These measures are: debtor's divestment total or partial of assets and appointment of an insolvency practitioner; court's control over assets at creditors' request or by own initiative; stay of individual creditor's claim for negotiations between creditors and debtor. EIR brings a new legal institution as synthetic proceedings, which means that the main proceedings insolvency practitioner may give effect to realization and

[35]Israel, European Cross-Border Insolvency Regulation, 31-34.
[36] Israel, *European Cross-border Insolvency Regulation*, 325-326.
[37] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), art.3, sec. 1.

distribution of assets for local creditors, similar to the effect that would occur if secondary insolvency proceedings would be opened".[38]

To sum up, in this subchapter I pursued to outline the importance of cooperation between universality and territoriality, based on an analysis of EIR and EIR Recast, so that all secured creditors rights would be satisfied and debtor's business rescue would be possible. According to Virgos-Schmit Report, secondary proceedings have as auxiliary function, the protection of secured creditors. Therefore, possessors of secured rights in rem will not be affected by main insolvency proceedings, instead they will be subject to local proceedings, as a stay to lodge local claims or to start local restructuring proceedings. "The major obstacle would be restructuring under main proceedings. A negative point for European economic integration, is that immunity of secured creditors from main insolvency proceedings would decrease incentives to use secured credit by debtors."[39] As a principle of EU Law all secondary legislation should be in accordance with EU values and principles, therefore MS have less freedom regarding conflicts of interests in cross-border insolvency, since their cooperation in this area should have as main objective the economic integration of European market. Nor universality, nor territoriality principle responds to creditors inquiries and concerns of foreign states, as effective deployment and distribution requires cooperation of all jurisdictions under one law and court. At the same time, states can apply their jurisdiction as a consequence of sovereignty rule in order to protect local creditors' legitimate interests. Territoriality principle that governs opening of secondary proceedings is the main aspect of this subchapter since protects collateral security rights by opening secondary proceedings in the state where the collateral is situated. Therefore, secondary proceedings protect local creditors interests and facilitate cross-border proceedings when the insolvency estate is too complex to be administered by a unique liquidator and proceedings. Secondary proceedings have less cooperation role as regards application of national law. The rigidity of these proceedings have been diminished by EIR Recast that abolished the liquidation proceedings from opening secondary proceedings, as it was an obstacle for the business reorganization of the debtor. EIR failed to regulate protection of secured creditors when there is a stay or moratorium in lodging their claims, since EIR does not specifies the position of secured creditors when liquidation is stopped and is a risk for the insolvency estate to be damaged. Therefore, EIR Recast extends its regulation in the area of stay of liquidation proceedings. The cooperation and coordination was limited by EIR to insolvency practitioners, meanwhile EIR Recast offers a communication at insolvency practitioner- court level. In terms of cooperation, we can consider *Comitas Europea* as a solution that provides

[38] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), art. 36.
[39] Reinhard Bork, Kristin Van Zwieten, Commentary on the European Insolvency Regulation, (UK:Oxford University Press, 2016), 37-38.

cooperation between MS courts, as the courts are able to require help regarding insolvency matters from other courts that would respond in good faith. An effective cooperation will ensure protection of third parties rights in rem, by opening secondary proceedings governed by *lex situs* in conformity with Community Law, respecting the rules of collective deployment and distribution of debtor's assets.

SUBCHAPTER 1.2. THIRD PARTIES'RIGHTS IN REM as an EXCEPTION from LEX CONCURSUS

As an exception from the general rule mentioned in article 4 of EIR, rights in rem of third parties regards assets independent from application of *lex concursus* and universality rule, explained in subchapter I "The scope of EIR analyzed in comparison with EIR Recast". Article 5 of EIR has as purpose the immunization of these rights against the opening of main insolvency proceedings, when COMI and the assets object of rights in rem are located in different MS. Article 5 of EIR states:

"1. The opening of insolvency proceedings shall not affect the right in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets-both specific assets and collection of indefinite assets as a whole which change from time to time-belonging to the debtor which are situated within the territory of another MS at the time of the opening of proceedings.

2. The rights referred to in paragraph 1 shall in particular mean:

(a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;

(b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;

(c) the right to demand the assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;

(d) a right in rem to the beneficial use of assets.

3. The right, recorded in a public register and enforceable against third parties, under which a right in rem within the meaning of paragraph 1 may be obtained, shall be considered a right in rem.

4. Paragraph 1 shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m)"[40].

[40] Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, art.5.

Based on this article, this subchapter will contain responses to questions as what rights in rem are, how does the location of assets matters, in which way rights in rem may be affected by moratorium of enforcement of security under main proceedings, the applicable law, inter-creditor arrangements and the novelty is the regulation of rights in rem of third parties under EIR Recast.

The premise of article 5 is that rights in rem are rights created before opening insolvency proceedings by the debtor over his property in the benefit of a creditor, as a security or a guarantee of the repayment of debt. Therefore, the creditor has the right to enforce the secured property before unsecured or lower ranked creditors and to participate in obtaining the repayment of its debt. In cross-border transactions, the issue appears as a conflict of laws, since the security or rights in rem are created over assets located in another MS than the state where main insolvency proceedings are opened and the law of the later state does not apply on those assets.

Another importance of rights in rem is the commercial one as secured lending ensures financial help for companies and individuals. If lenders offer money on basis of a valid security governed by national law, they can enforce the security in the event of insolvency of debtor without being unsecure that in case in the debtor have its insolvency proceedings opened in another state, will have its security unenforceable. Therefore, based on Recital 64, there is a commercial certainty, as the lender will lend only when rights created over assets under the law of a MS, will be enforceable in case of insolvency of the debtor and opening of main insolvency proceedings in another state than the one where assets are located. In the case *Lutz v Bauerle* [41](Annex 1) the owner of rights in rem had the right of separation of its secured asset from insolvency estate and the right to enforce the asset and to realize it as to satisfy the secured claim[42].

The subchapter is divided in three subsections: "Rights in rem under insolvency law"; "Rights in rem under property law" and "Application of article 8 of EIR Recast".

SUBSECTION 1.2.1. RIGHTS IN REM UNDER INSOLVENCY LAW

Rights in rem regards property rights, that under EIR should accomplish two conditions: to be recognized as rights in rem under *lex situs* or the applicable law where assets are situated and to be recognized under the purpose of the Regulation with characteristics stated in art. 5(2)- "The rights referred to in paragraph 1 shall in particular mean:

[41] Case C-557/13 *Lutz v Bauerle* ECLI:EU:C: 2015:227, [2015] BCC 413.
[42] Virgos-Schmit Report, para.95 and Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, Recital 64.

(a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;
(b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;
(c) the right to demand the assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;
(d) a right in rem to the beneficial use of assets"[43].

The Regulation purpose by art. 5(2) is to complement the scope of *lex situs*, not to substitute the national law. Therefore, a right in rem is a property right to a tangible, intangible asset, opposed of personal right to an asset. Rights in rem are ownership with an interest of the debtor over the asset, a security interest, possession under a lease, mortgage, trust, fixed or floating charge, transfer of future property or identified or identifiable assets. To turn to art. 5 is necessary that the debtor had an interest in the asset under *lex causae* and the asset is part of the insolvency estate under *lex concursus* that determines the assets that form part of debtor 'estate. The protection offered to third parties does not extend to actions for avoidance and unenforceability of transactions detrimental to creditors according to art. 5(4) regulated by *lex concursus* under art. 4(m).

According to Virgos-Schmit Report, "rights in rem should have a direct and immediate relationship with the asset and the owner can enforce the right against third parties, a characteristic that differ from personal rights"[44]. "For example, in case of rights in rem the owner can recover the goods from a good-faith buyer that purchased the goods subsequently, the owner can enforce against claims made by unsecured creditors or in case of successive securities, by according first in time interest than later interest"[45]. If the debtor possesses a full and unqualified ownership than is considered that he has no interest on the asset. However, it is sufficing if is a limited interest. Art. 5(2) have as scope to harmonize differences that may exist among European MS. A right to demand an asset from a person in possession may be a right in rem under French Law, or may be a mere personal right under English Law, according to art. 5(1), but for sure, any of these cases could fall under art.5(2) classification. According to art. 5(3), "The right recorded in a public register and enforceable against third parties, under which a right in rem within the meaning of paragraph 1 may be obtained, shall be considered a right in rem"[46]. From this statement we can analyze three existing elements: the existence of a right that is not a right in rem; right in rem derives from the existing right; the existing right is registered and enforceable against third parties before creation of right in rem. So there is a right in rem under Regulation through registration

[43] Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, art.5, sec. 2.
[44] Virgos-Schmit Report, Para.103.
[45] Goode, *Principles of Corporate Insolvency Law*, 602-603.
[46] Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, art.5, sec. 3.

even if is not recognized under national law. So, there are two situations. The first is when national law recognizes right in rem, meaning that the registration of the right recognized under national law may be a formality to enforce the right against third parties, but essential to create a right in rem. The second situation is when under art. 5(3), the right in rem is created, meaning that the right even if registered and enforceable against third parties, is not recognized a s a right in rem under national law, but derives the right in rem. As an example of derived right in rem would be the contract of land sale or grant of an option to buy land, as registration of the contract based on conveyance ensures priority of possession against subsequent buyers.

Another issue regarding third parties' rights in rem would be the location of assets. Therefore, the main point is that assets must be located in a European MS, in order to apply EIR. According to *lex forum* conflict of laws rules, the *lex causae* (law chosen by forum court from diverse legislation to award a judgement) will be *lex situs* or the state where assets are situated. According to art. 2(g), is offered a description of the institution of Member State where an asset is situated:

- "tangible property regards to MS as the state in which territory is situated the tangible assets. This category includes goods, titles to goods, negotiable instrument or securities that can which ownership is transferred by physical delivery. A question that arises is when the negotiable title is located in one country and the relevant asset is located in a different country. This issue regards matters as control of third party over issue and visibility of rights in rem over assets. So the author Goode of the book "Principles of Corporate Insolvency Law" gives an example regarding the importance of control over assets. The example is a situation when goods are located in a store in England, the warehouseman issues a negotiable instrument regarding those goods in Switzerland, which is outside EU and main proceedings are opened in France. In this case, art.5 does not apply, since the control over assets is located in Switzerland. The applicable law will be under French conflict of law rules, since France is the state where main proceedings we opened"[47].
- "Property and rights possession of which must be entered in a public register regards MS as the state where the register is kept. This point creates two misunderstandings. The first uncertainty is whether the scope of registration is to create rights or is to protect rights created without registration. The second uncertainty is the relation between registered rights, tangible property and claims rights of third parties. We can assume that registration is a prerequisite to make rights enforceable against third parties and not as a prerequisite to create these rights. That is proved by the fact that registered securities can be shifted to

[47] Goode, *Principles of Corporate Insolvency law*, 606.

equity without being mentioned the name of the person who makes the change. As I have mentioned before, except control, there is requirement of visibility of third parties' rights, indicated by the authority where the relevant register is administered."[48]

- "Claims, regards MS as the state where the third person entitled to that claim has its center of main interests, determined in art. 3(1) of EIR. The location of COMI does not apply to negotiable instruments and securities, as the claims regarding these assets will be under the law of MS where assets are located. Also, COMI does not apply to registered securities, as underlying claims will be under the law of the state where the register is maintained. Therefore, COMI of third party entitled to claim applies only to securities not recorded in a public register, but possessed through an intermediary account to which only the account holder and those authorized by him can have access."[49]

The applicable law, as mentioned above is considered *lex situs*. The law cannot be understood from art. 5, as the article offers a conflict rule. Therefore, is the conflict of laws rules of the forum that decides the applicable law based on claimant's right in rem, its nature and content. The relevant time is considered the opening of proceedings, since than is the moment when pre-insolvency proceedings are being settled under national laws. Therefore, the applicable law will be the law of the state where the asset was located at the moment of opening proceedings. If before opening insolvency proceedings, the asset is moved in another states, then the applicable law will become the law of the last state. The applicable law should benefit the most the secured creditors.

Issues regarding location of third parties' rights in rem in non-EU country are not regulated by EIR, since is not proper that a EU Regulation to establish rules for assets located outside EU. "Nevertheless, rights in rem will be overseen by the law established by conflict of law rules of the forum, *lex concursus*."[50]

To sum up, article 5 of EIR has as purpose protection of secured creditors that are entitled to enforce their charged assets when the debtor is not able to fulfill the secured obligation of payment. In order to apply article 5 of EIR, there are some requirements to be fulfilled. Rights in rem must be recognized under *lex situs* and under article 5(2) of EIR. The debtor must have a security interest over the charged asset under *lex situs* and the charged asset must be part of insolvency estate. Rights in rem creates a direct and immediate relation between owner and asset, so the owner can enforce the asset against third parties. The assets should belong to the debtor and should be located in a European state at the moment when insolvency proceedings are opened. The applicable law, based on conflict of law rules should be the law of the state where assets are

[48]Goode, *Principles of Corporate Insolvency law*, 607.
[49]Goode, *Principles of Corporate Insolvency law*, 608.
[50] Goode, *Principles of Corporate Insolvency Law*, 608.

located, as being the most convenient law for secured creditors which can enforce their rights without being affected by insolvency of the debtor and by diminishing the value of the charged asset. The main purpose of article 5 of EIR is to ensure the credit flow and wealth into European market, by offering protection to financing institutions which are the secured creditors. However, is important to understand if article 5 affects a composition plan regulated by *lex concursus* in order to rescue debtor's business.

SUBSECTION 1.2.2. RIGHTS IN REM UNDER PROPERTY LAW

Security rights or right in rem are preferential rights offered to creditors over assets belonging to debtor in order to satisfy its claim with priority over other creditors. Therefore, these rights should be enforced independent from rights of other creditors or liquidation administrator. Into this subsection I would like to discuss aspects like enforcement of security rights against third parties, the ranking of creditors, especially when there is a common interest related to the asset and transfer of secured claims. According to the author Ulrich Drobnig, the real security rights are any right or device created by the law or the debtor, that confers to the creditor, the right to recover one or more assets from the estate of the debtor or to obtain a preferential payment out of the proceeds of these assets, in order to satisfy its claim against the debtor. The security rights offer a preferential payment in the distribution of proceeds or the right to a collateral.

In case when the creditors enforce their claims at the same time against the debtor's estate or a particular asset, is considered *concursus creditorum* and is applied the principle of *paritas creditorum*. The principle states equal treatment of creditors when they take recourse to the assets and their repayment is partial. It is regulated by the majority of Civil Codes, expressing the idea of equal footing with some exceptions as security rights or legal privileges. The principle also means that transactions should not be detrimental for rights of other debtors. So, the debtor has a certain freedom to prefer to satisfy a creditor's claim against another creditor or to grant security rights to a specific creditor, but without affecting the right of recourse of another creditor. Certain pre-insolvency transactions can be challenged by the insolvency administrator which is able to avoid security rights created before opening of insolvency proceedings within a certain time limit. The equity is reasonable in the field of law of obligations. When there are many creditors, the debts satisfaction cannot be acquired in full for all creditors, therefore they are considered in an equal position. The law of obligation matches the anteriority rule from property law, meaning that a right created earlier have preference than the later right. That concordance is based on the fact that the creditor at the beginning has an individual right to claim (law on obligations) that converts into a real right over the assets (property law). In case of insolvency, the estate of the debtor in a

"collective pool", is an amount of assets that passes from debtor's possession into liquidation administration for winding-up and reorganization proceedings.

All creditors position and entitlements are frizzed in collective proceedings, so the competition between creditors stops, as well as the possibility to harm other creditors. The entitlements are fixed in the moment of opening insolvency proceedings. Any security right or instrument in the benefit of a particular creditor should not affect other creditors. In insolvency, in order to have priority the debtor shall fill the security and take possession of its collateral. According to UCC 9-317, a security interest is subordinated to the rights of the trustee before security interest in perfected or before the debtor fills a security agreement and a financing statement. During insolvency stay proceedings, the holder of the security interest is not able to perfects its right. Therefore, the trustee has rights over unperfected security right under UCC or have the right to avoid the unperfected right under Bankruptcy Code of US. Parties may enforce their rights outside insolvency rules, without the necessity of recourse of those rights under insolvency law. The trustee can avoid an unperfected security right, for the amount of the claim as a lien creditor and for the benefit of all unsecured creditors. As mentioned above, after opening of insolvency proceedings, a secured creditor cannot obtain a better ranking that would prejudice other creditors. Once the insolvency proceedings are opened the fixation of positions stops the competition between secured creditors. The rule that secured creditors cannot strengthen their position after opening of insolvency proceedings is proved by two examples from Dutch and Belgium law, offered by the author Ulrich Drobnig. The first example is the conflict of competing undisclosed pledges on movable property. Regarding subsequent pledges, a prior pledge has priority than a later pledge. However, the conflict between pledges is determined by the date when an undisclosed pledge transforms into a public pledge by getting ownership over the asset, therefore a pledge can win over prior pledges including security rights of third parties, as an undisclosed pledge. When insolvency proceedings are opened, this change into the ranking of creditors is not permitted. Another case regards subsequent pledges and the conflict between them depends on the date of notification of the debtor, therefore a later pledge notified to the debtor can defeat an earlier pledge, unless insolvency proceedings are opened. Again, a change in the ranking of creditors in not allowed once that insolvency proceedings are opened.

The enforcement of security right shall be based on an efficient system of secured rights, that has not to be affected by collective proceedings. Which means that the secured creditor has the right to a priority payment and there is no obligation of participating to the costs of proceedings, only if the creditor has received benefits from those costs. However, the creditor's enforcement has some limits, as a stay in satisfying its claim with the purpose of debtor's business reorganization.

"The rule of *paritas creditorum* can be breached when regards reorganization of debtor's business, so the pre-insolvency ranking of creditors can be changed for that purpose, with some difficulty in the field of security rights. The case from Belgian *Cour de Cassation*[51] expresses such situation as the debtor made voluntary payments distributed to some creditors without taking into account the ranking of the creditors, with the purpose of restructuring the debt. Those creditors are considered as non-preferential creditors."[52]

"Security rights as an exception is based on the right of the debtor to obtain cheap credit by having the freedom to choose the creditors to whom to sell the assets or to use assets in order to secure a debt owed to specific creditors and to offer those creditors preferential rights. Since the rights are enforceable to third parties, there are limits imposed by property law. The rights should be regulated by the relevant legal system, since it offers protection to third parties regarding the effects of security rights and are less costs for getting informed of existence of security rights. The security right depends of the relevant security agreement. In civil law cases, if the mortgage contract is canceled, the mortgage loses its effects. Third parties can claim the nullity of a contract in such circumstances as "*ordre public*". Nevertheless, the statutory provisions related to nullity of a contract benefits third parties and other creditors are entitled to claim the invalidity of the agreement when the statutory provisions are breached. The affected parts can be the third parties that possess a secured claim, since the recognition of contract invalidity will abolish the security right of the third party as it never existed"[53].

"The power to dispose of the collateral regards entitlement of the grantor of security with property rights. However, the secured creditors and the third parties with property rights have different priority position. Therefore, if the security is created in relation to a tangible, moveable asset, the secured creditor with good faith is protected"[54]. "Also, if the pledgee at the moment taking the ownership of the collateral in possession of the debtor which is not the owner is in good faith, he cannot be challenged by third parties. The protection is offered when the pledgee knew he wasn't dealing with the owner and he could assume that he is dealing with a representative of the owner able to use the asset for security transactions."[55] Also, the protection is offered to a creditor's right of retention.[56] The debtor's property rights have some characteristics, as for example, if the property right are conditional, than the security right based on that property right

[51] Cass b 31 May 2001, RW 2001-2002, 596 note de Wilde.
[52] Ulrich Drobnig, Henk J. Snijders, Erik-Jan Zippro, *Divergences of Property Law, an Obstacle to the Internal Market*, (Munchen: European Law Publishers GmbH, 2006), 69-75.
[53] Chr Von Bar, Drobnig, *The Interaction of Contract Law and Tort and Property Law in Europe* (Munchen 2004), 352-353.

[55] Cass b 21 March 2003, RW 2004-05,1174; Cass b 12 February 2004, RW 2004-05, 1179 note Storme.
[56] Cass fr 22 May 1962, D 1965, jur 58 note Rodiere.

depends on the same condition. If debtor's property rights are avoided with retrospective effects, then is considered as the debtor had never the power to grant security rights. As exception from the rule could be a mortgage granted by the co-owners of an undivided asset, that preserve its effects, even if the asset is distributed or sold by auction. In jurisdictions like France or Belgium, secured creditors are protected from invalidity of property rights. For example, the French Supreme Court protects good-faith secured creditors that dialed with apparent owner, since if the original ownership is apparent, it means is invalid, but it does not affect security rights.

Rights in rem or security rights are justified and criticized at the same time. According to the author U. Dobring statement, based on the debate 'puzzle of secured debt" the justification is based on optimal allocation of monitoring costs that notifies positively the other creditors to publicize adequately secured positions. According to the work "The unsecured creditor's bargain" by LoPucki, security rights are considered as a bargain for tort claimants and for uninformed creditors and is in detriment for all creditors wealth. Anyway, the first argumentation is the winner, since security rights are a source of cheap credit and are incentives to economic growth. According to German jurisprudence [57], if there is a disproportion between secured debts and charged assets, that creates a unbalance between creditors, than the debtor can demand for a discharge of the assets.

The unsecured creditors are protected in different jurisdictions through "carve-out", which means that some of the assets are reserved to satisfy unsecured claims. In England, the administrator prescribes a part of the "floating charge", in Belgium the secured part of the assets is expressly specified and is limited to 50% of the stocks, in France, unsecured creditors are protected through "*nantissement de commerce*".

One of the main characteristics of property law is the publicity of the rights, in order to be enforceable against third parties, Also, third parties that can be affected by the rights have the right of being informed. In case of immovable property, registration of security rights is obligatory. The registration requirement determines enforceability against third parties and the ranking of all creditors. Under Belgian or Dutch law, a registered mortgage is unaffected by competing securities or prior mortgage that wasn't registered. In case of moveable property, the ranking of security rights depends on the perfection or filling of the right that determines priorities. The filing includes publicity and depending on the collateral, it can be realized by filling, taking the ownership of the collateral, taking "control" or even automatically. So the ranking depends on the moment of filling, first right filled has priority over the last one. If in some European countries publicity of moveable property is essential, in other countries as Germany, hidden security right are valuable. As an

[57] BGH 27 November 1997, NJW 1998, 671; BGH 8 December 1998, NJW 1999, 940.

example, the author Drobnig presents the transfer of ownership that avoids publicity and the possibility to enlarge the effects of reservation of title. Also, assignment of claims is valid for third parties from the moment of conclusion of the agreement between assignor and assignee and can be used for transfer of security.

The conflict between security rights is resolved based on priority rule, since security rights are real rights, therefore the priority rule of property law will be applied. The debtor uses the assets in the state in which they are at the moment, because in case that a security right was granted before, the debtor will use the underlying asset for security in the charged state of the asset by the past security right. In the absence of priority rule, the creditors are able to establish priorities through individual agreement between creditors. The ranking of claims depends on their appearance in time, so that a claim that arose earlier will have priority over the later one. The rule is based on accomplishing what parties would do for themselves in rule's absence. The rule is available for past and present collaterals existent in debtor's estate, granted or retained and indifferent of when the secured claims are formed. So the priority rule for security rights would be the moment of accomplishing the requirement of filling, notification or registration, when the owner of the security right takes control or the moment when agreement is concluded, in case of non-possessory rights.

The conflict between the security right holder and third parties that acquires the charged asset is determined by priority rule. The real security right, known as right in rem or droit de suite, ensures the secured creditor with a recourse against third parties that acquires the asset. In French and Belgium law, rights in rem regards immovable property or movable property that is registered. Therefore, a mortgage holder and a creditor with company charge is able to enforce rights in rem over the assets against third parties that acquired the immovable property or the company. A secured creditor that possesses the asset which is subject of pledge or a retention of title, is protected from subsequent acquired rights by third parties. Regarding rights is rem created over moveable property in possession of the debtor, is it possible to transfer the ownership of a secured asset to a third party that purchased the asset with good-faith. Therefore, the asset will be discharged. The good-faith test depends on the system of publicity and the nature of the transaction. A purchase made in the business ordinary course establishes valid the good faith test.

To sum up, the real security rights are any right or device created by the law or the debtor, that confers to the creditor, the right to recover one or more assets from the estate of the debtor or to obtain a preferential payment out of the proceeds of these assets, in order to satisfy its claim against the debtor. Another issue is the treatment of creditors when they have recourse at the same time to the debtor's estate. In this case is applied of *paritas creditorum* or the equal treatment of creditors that will be partially paid from debtor's estate. However, if the debtor offers preferential

rights to some creditors, this acts should not be detrimental for the rest of the creditors. When insolvency proceedings are collective, the competition between creditors stops and creditors cannot use their priority to harm other creditors. During insolvency stay proceedings, the holder of the security interest is not able to perfects its right. The rule of *paritas creditorum* can be breached when a reorganization plan is created, so that pre-insolvency ranking can be modified in order to obtain the rescue of debtor 'business. Security rights are used to obtain cheap credit so debtors have the freedom to choose the creditors to whom to sell the assets or to use assets and to offer them preferential rights. The secured creditors and the third parties with property rights have different priority position. Therefore, if the security is created in relation to a tangible, moveable asset, the secured creditor with good faith is protected and will have priority over third parties. Also, the secured creditor will have recourse asset over the charged asset acquired by a third party. If the property right is conditional, then the security right based on that property right depends on the same condition. So, if debtor's property rights are avoided with retrospective effects, then is considered as the debtor had never the power to grant security rights. Rights in rem are considered important for economic growth and cheap credit, however is in detriment of other's creditor welfare. As the purpose is achieving an effective restructuring plan, financing is necessary, therefore rights in rem are important. Anyway, unsecured creditors are protected through carve-outs or assets used to satisfy their claims. The priority rule for security rights would be the moment of accomplishing the requirement of filling, notification or registration, when the owner of the security right takes control or the moment when agreement is concluded, in case of non-possessory rights. Therefore, property law is necessary as to decide over the ranking of secured creditors over third parties and over unsecured creditors in insolvency proceedings and also, regulates the situation when the business restructuring is allowed through preferential rights offered to creditors without affecting other creditors.

SUBSECTION 1.2.2. APPLICATION of ARTICLE 8 of EIR

EIR Recast, third parties' rights in rem is regulated by article 8, with the same scope of protecting secured creditors from the default of distressed debtor, by having the possibility of recourse to its underlying collateral. Also, Recital 68 states that rights in rem are important for granting credit and support of EU trade, therefore, all EU jurisdiction should ensure validity and enforceability of rights in rem. If EIR Recast wouldn't apply, secured creditors would be affected by legal uncertainty caused by differences between national laws regarding the insolvency security arrangement. Art.5 EIR and art.8 EIR Recast allows creditors to enforce their rights under the law

of the state where the charged assets are located, even if main proceedings have been opened. Art. 8(1) regulates floating charge, as is not common under civil jurisdiction, being more used in English law.

Art.8 drafts two theories regarding applicable law: that rights in rem are already created and conferred to secured creditors at the time when the proceeding are opened, as any rights in rem created after opening are governed by *lex concursus* and that if the secured assets are located in the MS where COMI is located, respectively where main insolvency proceedings are opened, then the effects of proceedings regarding rights in rem will be governed by *lex concursus*. Also art. 8 states that *lex situs* is not specified in art.8(1), as it is mentioned only the basis, legitimacy and scope of rights in rem. Regarding the wording 'shall not affect" rights in rem, there are two views of its application: "the hard and fast" view and 'the pure and simple view".

The first view regards the situation when rights in rem of secured assets located in another MS than the state where main insolvency proceedings are opened are totally immune from application of any other jurisdiction than the one where secured assets are located. So, if the secured assets are located in another MS than the state where is COMI or the state where is an establishment of the debtor, then no insolvency proceedings will be opened in the state where are the assets located. This situation in an incentive for forum shopping, as the secured creditors, prior to the opening of insolvency proceedings or when insolvency is imminent, can force the debtor to move assets to other MS than the MS where COMI or where an establishment is located, in order to grant its collateral security[58]. The view has an advantage and that is a simplified administration. The main insolvency practitioner is able to decide whether the rights in rem can be governed by lex situs or whether secondary proceedings can be opened in the MS where assets are located, in order to create cost-efficiency.

The second view "pure and simple" means that rights in rem are protected from main insolvency proceedings, but not necessarily that decisions and orders made under main insolvency proceedings would not affect rights in rem. The view is in contradiction with the commercial scope of art.8 that regards the interest of the secured creditor to enforce and realize the asset indifferent of insolvency proceedings and with Virgos-Schmit Report that describes art.8 as a total exemption from the effects of main insolvency proceedings without limits. Nevertheless, the view matches the approach from Virgos-Schmit Report that rights in rem over assets located in one MS shouldn't be more affected by the jurisdiction of a MS than the jurisdiction of the MS where the assets are located. That would mean, that *lex situs* can allow the sale of the secured asset by an insolvency practitioner appointed the debtor, only if a reasonable part of the price will be afforded to the

[58] Virgos-Schmit Report, para. 105.

secured creditor, holder of a right in rem over the underlying asset. In case that the MS where assets are located is the state where secondary proceedings are opened, the main insolvency practitioner is able to appoint by himself the insolvency practitioner allowed to make the sale of the secured asset. Another example of application of this view is the registration of charges in accordance with public registration under *lex situs*, under UK law. So if a secured creditor is able to enforce and sell the charged asset before opening of secondary proceedings, then the most appropriate thing is to register the charge in order to benefit of that enforcement against other creditors. Otherwise, the main insolvency practitioner can start secondary insolvency proceedings in detriment of the secured creditor, because of unregistered charge that would not be ascertainable for third parties.

Therefore, art.8 does not specifies *lex situs* as the law applicable based on conflict of law. The *lex situs* rule is established through jurisprudence, specifically the case Lutz and Bauerle, where CJEU established that rights in rem should normally be governed by *lex situs*, and the case ERSTE Bank Hungary[59] (Annex1) where CJEU established that *lex situs* derogates from application of *lex concursus.* As a conclusion to application of art.8, the view accepted is "pure and simple", since even if rights in rem are not affected by opening main proceedings, the surplus of rights after enforcement of rights in rem and discharging secured debts will be part of insolvency estate and governed by *lex concursus*.

Secured creditors may be obliged to make payments to other creditors as a requirement to enforce its rights. This obligation is stated in UK insolvency act 1986, section 176A. Article 8 protects creditors from opening of main insolvency proceedings, but does not offer a better position than unsecured creditors.

As regarding the reform that EIR Recast is presenting in the area of assets. Article 2(9) offers a set of rules determining the place where the assets are situated. Therefore, for registered shares, the applicable law will be the state where the Company has its registered office; for book entry securities, the state where the relevant register or account is maintained; for cash in bank accounts, the state indicated by the bank's international banking account number (IBAN) or the state where central administration is located, in case that the account is held in a bank branch, the state where the branch is located; and for claims against third parties, in the state where the debtor has its COMI. A literal application of these provisions could give rise to devaluation and fragmentation of security rights that depends on where the charged assets are located when insolvency proceedings are being opened. It seems to depend upon the identity and COMI of customers of the debtor company or the identity of the company that issues shares from time to time.

[59] Case C-527/10 *ERSTE Bank Hungary Nyrt v Magyar Allam* [2012] ECR I-0000 ECLI:EU:C: 2012:417. Annex 1.

Another issue regulated by EIR Recast is the reorganization plan issued by main insolvency proceedings liquidator that can adjust or modify security rights. This question is unlikely to arise if the reorganization plan requires separate consent of secured and unsecured classes of creditors. Otherwise, if the majority of the unsecured creditors would vote for composition plan, it could affect the secured creditors, since the secured creditors wouldn't agree to a discharge of its security or reduction of the underlying debts, unless they are compensated. As a protection offered by EIR, there is article 33 regarding public policy limitations on recognition of judgements, by the protection is minimum and imposes a burden over courts to apply public policy on restructuring plan. Depending on the nature and value of charged assets and if is convenient to open secondary proceedings and to promote inter-dependent plans in each jurisdiction, that would offer the creditors an advantage of participating in reorganization plans as to protect their interests. A method of protection is inter-creditors deed that regulates the ranking of secured creditors and ensures that security rights are not undermined without the approval of secured creditors. The law that governs inter-creditor deed is the domestic law that governs composition or reorganization plan. If *lex concursus* allows modification of rights and obligations between secured creditors and company, giving a commercial effect to such modification, then the inter-creditor deed would be recognized. However, the modified rights wouldn't be regulated by article 8.

Article 8(4) states that article 8(1) does not exclude actions for voidness, voidability and unenforceability, as referred in article 7(2)(m). As regarding rights in rem, a transaction can be made in the detriment of another creditor, if a security right over assets located in one MS is created in the eve of opening main insolvency proceedings in another MS. In that case insolvency administrator is able to discard the security right created and to prevent a payment made to a creditor or to recover a payment made to a creditor after opening insolvency proceedings. Based on the case *Lutz and Bauerle*, the holder of the right must show that article 7(2)(m) is not applied and the security right is valid under *lex situs*, since the hardening period is shorter under lex situs than under *lex concursus*. Also the holder must show that even if *lex situs* and *lex concursus* are opened at the same time, the *lex situs* does not allow an avoidance action.

To sum up, the EIR Recast does not bring significant changes in the area of security rights, as its main purpose is rescuing and rehabilitation of debtor's business, focusing less on secured creditors protection. The Regulation presents some limits to the exception. Therefore, if assets are not located in a MS, in this case *lex concursus* conflict of law rules determines the applicable law. Another limit, is that after the enforcement of rights in rem the extra of local assets that remains are being regulated by *lex concursus*. Moreover, the exemption does not apply for new securities, created after opening of main insolvency proceedings, therefore the new securities will be subject to *lex concursus*. Despite the fact that rights in rem are immune

from main insolvency proceedings, the insolvency practitioner can abolish the right by paying the debt to secured creditor and the secured creditor can be forced to pay for insolvency expenses, as for administration of insolvency proceedings. The main uncertainty that EIR Recast does not regulate is that the secured creditor can be affected by some main insolvency proceedings, as moratorium. The regulation purpose is to extend the possibilities for business rescue of the debtor, including by imposing a stay on opening secondary proceedings or on enforcement proceedings, that would make difficult for secured creditor to get its collateral asset intact.[60]

[60] http://www.traverssmith.com/assets/pdf/legalbriefings/The_Recast_European_Insolvency_Regulation__impact_on_di.pdf (accessed on March 23, 2017)

CHAPTER 2. APPLICATION OF UNICTRAL AND INTERNATIONAL REGULATION IN THE AREA OF THIRD PARTIES' RIGHTS IN REM

As to have a better understanding of the protection offered by EIR to secured transactions and secured creditors, we should make an analysis of international regulation of secured rights.
In this chapter I will make a research of international regulation on insolvency matters based on UNICTRAL legislation. My aim is to have a clear distinction between EIR and UNICTRAL provisions regarding secured rights regulated by insolvency law, as to understand the cooperation that occurs on a regional background like EU and broadly, on a global background. Also, I am interested to discover which protection is more effective, EIR or UNICTRAL. This aspect will be discussed in a separate subsection entitled "Better protection of secured creditors- EIR or UNICTRAL". Moreover, I desire to bring an innovation to the topic of secured rights under insolvency law, by making a comparison between Moldova, as a non-EU state and Lithuania, as EU states. The comparative analysis will be presented in the subsection entitled "Comparison between Moldova and Lithuania". The chapter will be divided in two subchapters: "Comparison between EIR and UNICTRAL regarding third parties' rights in rem" and "Collateral securities located in non-EU Member States". Each subchapter is divided in two subsections. The first is divided in: "The role of UNICTRAL regarding insolvency matters" and "Better protection of secured creditors- EIR or UNICTRAL" and the second subchapter is divided in: "International regulation of insolvency proceedings for secured creditors" and "Comparison between Moldova, Lithuania".

"The legislative acts that regulates third parties' rights in rem governed by insolvency matters belong to UNICTRAL (United Nations Commission on International Trade Law). The main acts that will be studied and presented in my work are UNICTRAL Model Law on Secured Transactions; UNICTRAL Model Law on Cross-border Insolvency; and UNICTRAL Legislative Guide on Insolvency Law. However, the direct regulation of security rights is UNICTRAL Model Law on Secured Transactions.

"The UNICTRAL Model Law on Secured Transactions and the Legislative Guide 'purpose is to ensure in developing states transactions that creates security rights in moveable assets. Therefore, is promoted availability of secured credit and in the same time, economic growth. The model law is created as to be used by states with no transaction laws and states with existing laws, but not that efficient and that need to be harmonized with the laws of other states. The model law is based on the idea that efficient transaction laws are positive for the economic growth of the states and that adopts them, since domestic and foreign credit is being attracted thanks to them and therefore, domestic businesses, like small and medium-sized enterprises are

developed. Transaction laws are beneficial for consumers, since prices for goods and services become lower and consumer credit policy is changed, being available for consumers. To have the desired effect, an efficient enforcement system of transaction laws must be developed, through multiple mechanisms, including judicial power. Transaction laws are also, governed by insolvency in respect of rights derived from secured transactions laws, for example, UNCITRAL Legislative Guide on Insolvency Law. The key to the effectiveness of secured credit is that it allows businesses to use the value corresponding to their assets as a means of reducing the creditor's risk of non-payment. That means that creditors can make use of collateral assets in any moment in the case of non-payment of the secured obligation. As prospective creditors perceive that this risk is reduced in a proposed credit transaction, they are more likely to be willing to extend credit and to increase the amount or reduce the cost of the credit they provide. Therefore, a legal system that supports secured transactions is critical to reducing the resulted risks of transactions and promoting the availability of secured credit generally. Secured credit is more readily available to businesses in States that have efficient and effective laws that provide for consistent, predictable profits for secured creditors in the event of non-performance by debtors. On the other hand, in States where the absence of such laws means that creditors perceive the risks associated with credit transactions to be high, the cost of credit normally increases, as creditors require increased compensation to evaluate and assume the increased risk. In some States, the absence of an efficient and effective secured transactions regime or of an insolvency law regime, under which security rights are recognized, has resulted in the virtual elimination of credit for small and medium-sized commercial enterprises, as well as for consumers. "[61]"The Model Law and the guide also addresses concerns regarding secured credit. One such concern is that providing a creditor with a priority claim to all or substantially all of a person's assets may appear to limit the ability of that person to obtain financing from other sources. A second concern is the potential ability of a secured creditor to exercise undue influence over a business, to the extent that the creditor may seize, or threaten seizure of, the encumbered assets of that business upon bankruptcy. A third concern is that, in some cases, secured creditors may enforce their rights in most or all of a person's assets in the case of insolvency and leave little for unsecured creditors, who may not be in a position to bargain for a security right in those assets."[62]

As insolvency and commercial law are connected, it was possible to create an insolvency regulation at a regional level, respectively EIR. However, the increasing globalization of business and investment causing international insolvencies, involves non-participating States too. Therefore, UNICTRAL Model Law was drafted to ensure regulation for all. The international

[61] UNICTRAL Legislative Guide on Secured Transactions, page 1-2;
[62] Idem, page 3.

protocols provided innovative solutions to cross-border matters; have facilitated courts to address the specific facts of individual cases; obtained a more widespread harmonization of international insolvency law and practice and more information about them is being spread across the world.

SUBCHAPTER 2.1. COMPARISON BETWEEN UNICTRAL and EIR REGARDING THIRD PARTIES' RIGHTS IN REM

In order to analyze the application of EIR is necessary to make a comparison with UNICTRAL legislation, as to see the lacks of EIR and the possible solutions. Both UNICTRAL legislation on insolvency matters and EIR are considered soft-law, containing similar provisions and features that can be more mandatory in EIR and more discretionary in UNICTRAL. The main difference between the two legislations is that EIR is applied regionally, meanwhile UNICTRAL has a more global vision of the Model Laws: UNICTRAL Model Law on Insolvency and Cross-border Insolvency with their legislative guides. Also their scope differs, as EIR has as main scope maintaining and developing the European market and facilitating the trade and credit flow between businesses across Europe and UNICTRAL Model Laws has as scope coordinate insolvency proceedings and create an efficient communication system between insolvency practitioners when more than one jurisdiction is involved and is created a conflict of law, maintaining the sovereignty of states as a priority. Both legislations regulate two jurisdictions based on COMI and establishment where, according to EIR, are opened main and secondary proceedings and according to UNICTRAL, are opened main and non-main proceedings. Other aspects regarding effects of recognition and the available relief are also different.

As the business has a globalization element, it happens that European companies merge with international businesses. Therefore, in case of bankruptcy, both international legislation as UNICTRAL and EIR may be potentially applicable to the same debtor. Even though, there are differences in respect to cooperation rules, as in EIR there are provisions regarding choice of law and carve-out present just in this text of law. According to article 10 of EC Treaty, MS have the obligation to take all the measures in order to accomplish the scope of the treaty that is superior to domestic laws and article 3 from UNICTRAL Model Law on Cross-border Insolvency allows subordination of the text to other treaties or agreements entered by the enacting state in order to regulate insolvency aspects. Therefore, the Model Law is more flexible. Also, the Model Law may offer additional protection to a foreign representative as a European one, from being influenced by other national rules. However, EIR is more rigid in this area. A concurrent application of both texts seems to be a good idea, even though if European MS would adopt the Model law would be

ensured a more uniform regulation, since the Model Law offer much more information regarding cooperation and communication. In this area, the Model Law recognizes the possibility of opening proceedings based on a recognition request that facilitates subsequent coordination between proceedings against the same debtor which applies to EU too. The concurrent application of the Model Law outside EU and recognition of the opened proceedings by EU courts using at the same time EIR, offers the possibility of a simultaneous application of both texts.

A harmonization between the two legislations is seen in the new EIR Recast which is based on UNICTRAL Model laws and Legislative Guides provisions. This interaction happens in the field of group of companies, since EIR Recast requires all insolvency practitioners and courts to comply with the rules of cooperation and coordination when main and secondary proceedings are opened against the same debtor (UNICTRAL Model Law on Insolvency, Chapter V, section 1); an insolvency practitioner may require the opening of a "group coordination proceeding" that would enhance the restructuring plan and reduce the costs for coordinating the proceedings, each proceeding should have a reasonable cost (UNICTRAL Model Law on Insolvency, Chapter V, Section 2) There is a continuous need of improvement in the area of cooperation at the opening of insolvency proceedings at the international and European level. That is the reason why I intend in this subchapter to present the similarities and differences between UNICTRAL and EIR, especially in the field of protection for secured creditors.

SUBSECTION 2.1.1. THE ROLE of UNICTRAL REGARDING INSOLVENCY MATTERS

In this subsection I would like to make a research of the legal background of insolvency matters under UNICTRAL and the protection that insolvency law offers to secured rights over encumbered assets located internationally**.** The legislative acts in this domain are The UNICTRAL Model Law on Cross-border insolvency and the UNICTRAL Legislative Guide on Secured Transactions jointly with UNICTRAL Legislative Guide on Insolvency regulates secured rights. The UNICTRAL Model Law on Cross-border insolvency regulates three aspects:

(1) the granting of access to local courts to representatives of foreign insolvency proceedings and creditors;

(2) according recognition to certain orders issued by foreign courts;

(3) cooperation among the courts of the States where the debtor's assets are located;

"The first aspect, providing the person administering a foreign insolvency proceeding with access to the courts of the enacting State, allows the foreign representative to seek a temporary "breathing space", and allows the courts in the enacting State to determine what coordination among the jurisdictions or other relief is warranted for optimal disposition of the insolvency. The second

aspect regards determining when a foreign insolvency proceeding should be accorded "recognition" and what the consequences of recognition may be. The third is permitting courts in the enacting State to cooperate more effectively with foreign courts and foreign representatives involved in an insolvency matter; providing a transparent regime for the right of foreign creditors to commence, or participate in, an insolvency proceeding in the enacting State; authorizing courts in the enacting State and persons administering insolvency proceedings in the enacting State to seek assistance abroad; providing for court jurisdiction and establishing rules for coordination where an insolvency proceeding in the enacting State is taking place concurrently with an insolvency proceeding in a foreign State; establishing rules for coordination of relief granted in the enacting State to assist two or more insolvency proceedings that may take place in foreign States regarding the same debtor. Therefore, the Model Law offers effective cross-border cooperation framework for courts that have experience in dealing with cross-border insolvency cases and for courts that desire to gain experience in this field."[63]

"The model represents the interaction of insolvency law, national judicial and civil procedure laws. Scope of application of UNICTRAL model is to extend to any foreign insolvency proceeding regarding reorganization or liquidation of the debtor if the proceeding is collective (whether judicial or administrative) and the assets and affairs of the debtor are subject to court control or supervision, where the court may be a judicial or other authority competent to control or supervise insolvency proceedings. Based on these characteristics, a variety of collective proceedings would be eligible for recognition, whether compulsory or voluntary, corporate or individual, winding-up or reorganization, or those in which the debtor retains some measure of control over its assets, or under court supervision. There are some legal institutions which are not regulated by Model law, like banks or insurance companies specially regulated with regard to insolvency under the laws of the enacting State."[64]

"In addition to the general right of access, a foreign recognized representative has procedural standing to commence a local insolvency proceeding in the COMI State, under the conditions applicable in that State; may initiate actions to avoid or otherwise annul acts detrimental to creditors; may participate in an insolvency proceeding in the COMI State; may also intervene in proceedings concerning individual actions in the COMI State affecting the debtor or its assets."[65]

[63] UNCITRAL Model Law on Cross-Border Insolvency Law with Guide to Enactment and Interpretation, page 19-20.
[64] UNCITRAL Model Law on Cross-Border Insolvency-A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency, page 318.
[65] UNCITRAL Model Law on Cross-Border Insolvency-A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency, page 321.

"In addition to providing direct access for foreign representatives, the Model Law applies non-discrimination between local and foreign creditors. That minimum level requires that a country treat a foreign creditor in a distribution at least as well as a general unsecured creditor, provided that the equivalent local claim would receive at least that treatment. As foreign creditors have access to the courts of the COMI State for the purpose of commencing an insolvency proceeding or participating in a local proceeding. The premise is that creditors have primary economic interest in the profit so they have an interest to obtain their part from debtor's business when insolvency proceedings ae opened."[66]

"UNICTRAL Legislative Guide on Insolvency scope is establish an efficient and effective legal framework as to solve the problem of insolvency of debtors. It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations. The advice provided in the Guide aims at achieving a balance between the need to address the debtor's financial difficulty as quickly and efficiently as possible and the interests of the various parties directly concerned with that financial difficulty, principally creditors and other parties with a stake in the debtor's business, as well as with public policy concerns. The Guide discusses issues central to the design of an effective and efficient insolvency law, which, despite numerous differences in policy and legislative treatment, are recognized in many legal systems. It focuses on insolvency proceedings commenced under the insolvency law and conducted in accordance with that law, with an emphasis on reorganization, against a debtor, whether a legal or natural person, that is engaged in economic activity. Issues specific to the insolvency of individuals not so engaged, such as consumers, are not addressed."[67] Also the guide addresses questions as to the restructuring negotiations made voluntarily between creditors and debtor and represents a guide of enactment of the UNICTRAL Model Law on Cross-border insolvency

. To sum up, UNICTRAL Model Law on Cross-border insolvency has been drafted as a necessity caused by the absence of international regimes that coordinates cross-border insolvency proceedings. Such absence created uncertainty, inadequacy of approaches to cross-border insolvency and represented an obstacle for the protection of the value of the assets of insolvent businesses and for their rescue. UNICTRAL Legislative Guide on Insolvency stipulates the necessity of effective and efficient insolvency regimes. Efficient insolvency regimes are important for preventing or limiting insolvency and for a rapid rescue of the business that is in financial distress. Such regimes are effective as to recover financial resources from a business that is

[66] UNCITRAL Model Law on Cross-Border Insolvency-A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency, page 321.
[67] UNICTRAL Legislative Guide on Insolvency Law, page 1.

winding-up; to support insolvent companies search for investment and administrators to rescue the business and maintain employment and increase the credit flow. The guide makes important recommendations as to company group insolvency, since company group is an important element for international trade and finance. And at the international level, regulation of company group insolvency appeared recently, for example EIR Recast. Therefore, jointly the UNICTRAL text laws have as scope regulating insolvency matters as liquidation and restructuring of multinational companies when more than one jurisdiction in involved. However, the cooperation between national governments have improved in the area of cross-border transactions and less in the area of cross-border insolvency, remaining a field with inefficient solutions to cross-border insolvencies.

SUBSECTION 2.1.2. BETTER PROTECTION OF SECURED CREDITORS- EIR or UNICTRAL?

Based on the research made in the first chapter regarding the regulation of third parties' rights in rem under European legislation, I would like to make a comparative analysis of UNICTRAL Legislation on secured transaction and insolvency matters. My purpose is to observe the efficiency or the lacks of EIR in the area of secured creditors' protection.

UNICTRAL Legislative Guide on Secured Transactions and UNICTRAL Legislative Guide provides clauses regarding protection of third parties secured rights created over assets belonging to insolvency estate. The Legislative Guide on Secured Transactions jointly with The Legislative Guide on Insolvency regulates different legal aspects, but the interaction happens when the rights regulated by secured transactions are affected by the opening of insolvency proceedings. "A secured transactions law seeks to promote secured credit, because security for an obligation reduces the risk of nonpayment of the obligation ("default"). It allows debtors to use the full value of their assets to obtain credit and develop their enterprises. In the case of default by a debtor, a secured transactions law seeks to ensure that the value of the encumbered assets protects the secured creditor. It focuses on effective enforcement of the rights of individual creditors to maximize the likelihood that, if the secured obligations owed are not performed, the economic value of the encumbered assets can be realized to satisfy the secured obligations. An insolvency law, on the other hand, is principally concerned with collective business and economic issues. It seeks, among other objectives, to preserve and maximize the value of the debtor's assets for the collective benefit of creditors and to facilitate equitable distribution to creditors. The achievement of these objectives will be assisted by preventing a race among creditors to enforce individually their rights against a common debtor, and by facilitating the reorganization of viable business

enterprises and the liquidation of businesses that are not viable. For these reasons, an insolvency law may affect the rights of a secured creditor in different ways once insolvency proceedings commence.''[68] EIR and EIR Recast has as main scope opening collective proceedings that affect all creditors to whom the debtor owes a substantial part of its debts; proceedings involving financial creditors; and proceedings of liquidation of debtor's assets and cessation of its activities involving all creditors. Also, the Regulations has focused more on business restructuring. "The scope of this Regulation should extend to proceedings which promote the rescue of economically viable but distressed businesses and which give a second chance to entrepreneurs. It should, in particular, extend to proceedings which provide for restructuring of a debtor at a stage where there is only a likelihood of insolvency, and to proceedings which leave the debtor fully or partially in control of its assets and affairs. It should also extend to proceedings providing for a debt discharge or a debt adjustment in relation to consumers and self-employed persons"[69]. Therefore, in order to accomplish the scope of reorganization, third party rights in rem may be affected by the stay of enforcement that could decrease the value of the charged assets.

According to UNICTRAL Guide on Insolvency the security right belonging to third parties that is legally effective, enforceable and with priority, recognized under secured transaction law, will be protected by insolvency law. However, the main goal of insolvency proceedings is restructuring debtor's business which can affect or modify secured creditors interests. The necessity of insolvency clear rules regarding insolvency proceedings on the rights of a secured creditor is to determine secured creditors to make a risk assessment of debtor's insolvency as to decide on further extending credit and on what terms. Secured rights are regulated by article 5 of EIR and article 8 of EIR Recast as an exception from *lex concursus* which does not apply over encumbered assets located in another MS than the state where the main insolvency proceedings are opened. The main purpose of security rights is developing the flow of capital and trade inside EU based on the certainty that secured creditors receive when their charge assets remain intact from insolvency proceedings.

The aspect of the applicable law under UNICTRAL over creation and ranking of third party security rights before and after commencement of insolvency proceeding, becomes a concern when the insolvency assets are located in more than one state or when insolvency proceedings are opened in two states because of the international nature. According to recommendation 31 of UNICTRAL Insolvency Guide, the applicable law to commencement, conduct and closure of insolvency proceedings is *lex fori* or the law of the state where insolvency proceedings are opened.

[68] UNICTRAL Legislative Guide on Secured Transactions, Chapter XII "The impact of insolvency on a security right'', page 423, para. 2-3.
[69] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, Recital 10.

Lex fori uses its rules of conflict of interest to decide over the applicable law that governs third-party security right existing at the time of the commencement of insolvency proceedings. [70] According to UNICTRAL Insolvency Guide, the exceptions from *lex fori* must be established in a limited number and clearly specified in insolvency law. "The position of the real security interest in insolvency proceedings commenced abroad will not be established by the *lex fori concursus*, but by the insolvency rules of the law applicable to the security interest. Otherwise, the application of the *lex fori concursus* may affect the legal framework for secured lending, introducing a factor of instability that may increase the domestic cost of finance.''[71]According to EIR the applicable law is *lex concursus* of the state where main insolvency proceedings are opened. "The *lex concursus* governs all the conditions for the opening, conduct and closure of the insolvency proceedings."[72]Based on its conflict of law rules, the applicable law established for security rights is the law where the assets are situated. "The basis, validity and extent of rights in rem should therefore normally be determined according to the *lex situs* and not be affected by the opening of insolvency proceedings."[73]Lex situs is considered as the law that satisfies secured creditors expectations. However, if there is a surplus from the sale of an encumbered asset it will pass to the insolvency estate and will be governed by *lex fori*. As well, *lex fori* applies to the security rights created after commencement of insolvency proceedings.

" The UNCITRAL Insolvency Guide recommends that the estate formed on commencement of the proceedings will typically include all property, rights and interests of the debtor, including rights and interests in property, whether tangible (movable or immovable) or intangible, wherever located (domestic or foreign), and whether or not in the possession of the debtor at the time of commencement. The debtor's rights and interests in encumbered assets and in third party-owned assets, as well as assets acquired by the debtor or the insolvency representative after commencement of the proceedings and assets recovered through avoidance actions, should also be included in the estate.''[74] As regarding encumbered assets, is important to identify the included and excluded assets into and from debtor's estate and as regarding third-party owned assets and applying a stay on starting certain actions with respect to security rights. The importance relates to business rescue or reorganization that can be achieved through charging an essential asset that is part of debtor's estate. UNICTRAL Insolvency Guide recognizes that secured

[70] Idem, page 425-426.
[71] UNCITRAL Insolvency Guide part two, chapter I, paras. 88.
[72] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, Recital 66.
[73] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, Recital 68.
[74]UNICTRAL Legislative Guide on Secured Transactions, Chapter XII "The impact of insolvency on a security right'', para.19

creditors satisfaction should be balanced with rescuing debtor's business. The question of encumbered assets is whether assets shall be included in insolvency estate or shall remain unaffected by insolvency proceedings. In the first case, by Including encumbered assets in the estate and thus limiting the exercise of rights by secured creditors on commencement of proceedings offers the possibility of equal treatment for all creditors and business rescue if the charged assets are essential for rescue procedure. A stay or a moratorium of enforcement of security rights does not deprive secured creditors of their rights over the charged assets, just limits the exercise of those rights. In the second case, secured creditor may enforce all their legal and contractual security rights. However, if the encumbered assets may be crucial to the rescue proceedings, some insolvency laws allow courts to prevent enforcement of charged assets." It will be advantageous for the insolvency law to include a mechanism that will permit third-party-owned assets to remain at the disposal of the insolvency proceedings, subject to protecting the interests of the third-party owner and to the right of the third party to dispute that treatment..''[75]

According to EIR, "The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets, both specific assets and collections of indefinite assets as a whole which change from time to time, belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings."[76]Therefore, there are clearly stated the assets that are part of the exception and the terms of where are located. What we can observe is a definition of concrete assets, tangible, intangible, moveable, immovable, but also of a collection of indefinite assets as a whole which change from time to time, the floating charge, recognized as security right under English law. Floating charge can be considered as a highly ranked security right, but much more uncertain than other security rights and also uncertain for unsecured creditors that are not equally being payed after the sale of the floating charge. The holder of a floating charge will be able to enforce its rights in the moment when the floating charge crystallizes. As regarding future assets, they must exist when insolvency proceedings are being opened. As requirements for all assets, is that they must be situated in a European MS and belong to the debtor when insolvency proceedings start. The idea of belonging to the debtor includes a legal and an economic ownership over assets that are attributed to the insolvency estate. According to article 2 (g), the applicable law is in case of tangible assets, the law of the state where the asset is located; in case of property rights, ownership rights or entitlement to such rights registered in a public register, the law of the place

[75] UNICTRAL Insolvency Guide, part two, chapter II, paras. 7-12.
[76] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, article 8.

where the register is located; and in case of claims, the state where the person required to meet such claims has its main center of interest.

As a requirement for assets to be subject to protection under UNICTRAL legislation, is necessary the rights over assets to be created before opening insolvency proceedings." The UNCITRAL Insolvency Guide provides that an asset acquired by the debtor after the commencement of insolvency proceedings generally is part of the insolvency estate. Accordingly, even though the secured creditor may have a security right in future assets of the debtor, the security right should not extend to assets acquired by the debtor after the commencement of the insolvency proceedings, unless the secured creditor is providing additional funding. The reason is that the secured creditor would unfairly benefit from the increase of charged assets acquired after opening insolvency proceedings, that would satisfy other creditor claims. However, if the assets acquired by the debtor after the commencement of the insolvency proceedings consist of proceeds of assets in which a secured creditor had a security right that was effective against third parties before the commencement of the insolvency proceedings or was made effective against third parties after commencement but within any applicable grace period, the security right should extend to those proceeds..''[77] According to EIR, rights in rem exception is only valid to rights which already exists at the time of the opening of insolvency proceedings. Otherwise, if that these rights have been created after the opening of proceedings, Article 4 is fully applicable.

As a requirement to save the business and satisfy collectively all the creditors, proceedings of stay may be required to secured creditors during reorganization or liquidation. Security rights are created as a bargain in case of debtor's default and a measure that would diminish the secured creditor's ability to recover the debt, as a stay, would be unfair and would affect the availability of affordable credit. However, by allowing creditors to separate their charged asset and realize it can affect rescuing the business. Therefore, the scope of UNICTRAL Model Law is restructuring the business offering protection to creditors that accepts the stay of enforcing their claims. "As a general principle, where the insolvency representative's function is to collect and realize assets and distribute proceeds among creditors by way of dividend, the secured creditor may be permitted to freely enforce its rights against the encumbered asset to satisfy its claim without affecting the liquidation of other assets. Some insolvency laws thus except secured creditors from the scope of the stay. However, is possible to maximizes the value of the assets for the collective benefit of all creditors if the stay is applied to secured creditors. Measures as protection of the value of the encumbered assets, payment of interest and provision of relief from the stay where the encumbered assets are not sufficiently protected or where they are not necessary to the sale of the entire business

[77]UNICTRAL Legislative Guide on Secured Transactions, Chapter XII "The impact of insolvency on a security right'', page 428, para.21-23.

or a productive part of it, may protect secured creditors interest"[78]." It may be desirable for the stay to apply to secured creditors for a sufficient period of time to ensure that the reorganization can be conducted in an orderly manner without the possibility of assets being separated before it can be determined how those assets should be treated in reorganization and an appropriate plan approved. However, the period should be limited as to ensure a degree of certainty and predictability as to the duration of the period of postponement of their rights and the treatment of those rights in the plan. Alternatively, a fixed time period might be specified. Once that liquidation proceedings are started the stay should be for a brief period of 30-60 days."[79]

The aim of insolvency law should be of protecting secured creditors from diminishing the value of encumbered assets by the applied stay above mentioned. In that situation, the court must take provisional measures of protection. According to UNICTRAL Insolvency Guide, "The insolvency law should specify that, upon application to the court, a secured creditor should be entitled to protection of the value of the asset in which it has a security interest. The court may grant appropriate measures of protection that may include: (a) Cash payments by the estate; (b) Provision of additional security interests; or (c) Such other means as the court determines."[80] Another type of protection measure could be a relief from stay or the release of charged assets. The insolvency law establishes that once the stay is lifted, the secured creditor may enforce its right over charged asset under the applicable law. According to UNICTRAL Insolvency Guide, there is a special treatment when charged assets are being sold free of security right, including there is a protection offered to secured creditors that are being notified regarding the sale of assets and regarding their right to object.

"In both liquidation and reorganization proceedings, an insolvency representative may require access to funds to continue to operate the business. The estate may have insufficient liquid assets to cover anticipated expenses, in the form of cash or other assets that will be converted to cash (such as anticipated proceeds of receivables) and that are not subject to pre-existing security rights effective against third parties. Where there are insufficient unencumbered liquid assets or anticipated cash flow, the insolvency representative must seek financing from third parties. Often, these parties are the same lenders that extended credit to the debtor prior to the commencement of insolvency proceedings, and typically they will only be willing to extend the necessary credit if they receive appropriate assurance (either in the form of a priority claim on, or priority security rights in, the assets of the estate) that they will be repaid."[81]UNICTRAL Insolvency guide makes recommendations regarding security rights created by post-commencement financing and that has

[78] UNICTRAL Insolvency Guide, paras 39-40.
[79] UNICTRAL Insolvency Guide, paras 56-57.
[80] UNICTRAL Insolvency Guide, recommendation 50.
[81] UNICTRAL Secured Transactions, para 37.

priority ahead pre-commencement security rights. That would be that pre-commencement secured creditors should be protected from diminution of the encumbered assets.

A secured transaction may be considered avoidable if is about "a transaction that occurred within a specified period of time prior to commencement of the insolvency proceedings (often referred to as the "suspect period") and may be avoided as a preferential transaction, an undervalued transaction or as a transaction intended to defeat, hinder or delay creditors from collecting on their claims"[82]Therefore, if a debtor charged its assets at the opening of insolvency proceedings advantaging a creditor or diminished the value of its charged assets in detriment of a creditor, is called a preferential or undervalued transaction.

" Where encumbered assets are part of the insolvency estate and the rights of secured creditors are affected by insolvency proceedings, secured creditors should be entitled to participate in the insolvency proceedings. That participation may take different forms. Under some laws, it includes the right to be heard and to appear in the proceedings, while under other laws, it includes the right to vote on certain specified matters, such as selection (and removal) of the insolvency representative and approval of a reorganization plan, the right to provide advice to the insolvency representative as requested or on matters specified in the insolvency law, and other functions and duties as determined by the insolvency law, the courts or the insolvency representative. In some cases, the extent of a secured creditor's right to vote on certain issues may depend upon whether the secured obligation exceeds the value of the encumbered assets; if the secured creditor is under secured, it might participate as an unsecured creditor to the extent that its obligation is not satisfied from the encumbered asset."[83]

The participation of secured creditors into the approval of a reorganization plan depends on how secured creditors are treated by insolvency law, if the reorganization plan impairs or modify security rights and if the value of the charged asset satisfies creditor's claim, in the last case if the value is not proportional with the claim, then the creditor can participate as a secured and as an unsecured creditor. In case that the reorganization plan impairs or modifies the security rights, the secured creditors may participate in the approval of the plan. The creditors are classified in dependence of their rights and interest or are participating as a separate group from unsecured creditors. If the secured creditors are voting as a class and the majority requires approval of the reorganization plan, those who voted against or didn't vote are being paid as if liquidation was opened or they would be paid in full later with interest at the market rate." There are several examples of ways in which the economic value of security rights may be preserved in a reorganization plan even though the security rights are being impaired or modified by that plan. If

[82] UNCITRAL Insolvency Guide, recommendation 8.
[83] UNICTRAL Secured Transactions, para 45, page 434.

a plan provides for a cash payment or for cash payments in instalments to a secured creditor in total or partial satisfaction of the secured obligation, the cash payment or the present value of the cash instalment payments should not be less than what the secured creditor would have received in liquidation. In determining such value, consideration should be given to the use of the assets and the purpose of the valuation. The basis of such a valuation may include not only the strict liquidation value but also the value of the asset as part of the business as a going concern, which means that the value of the asset will be determined as being an asset of the going-concern business."[84] EIR Recast regulates the possibility of participation of secured creditors in the reorganization plan in order to protect their rights from being diminished. EIR offers solutions as to protect secured creditors, the application of public policy on recognition of judgements and inter-creditor deed agreement, that regards a change of rights from senior to junior creditors.

"In recent years, significant attention has been given to the development of expedited reorganization proceedings (that is, proceedings commenced to give effect to a plan negotiated and agreed to by affected creditors in voluntary restructuring negotiations that took place prior to commencement of insolvency proceedings, where the insolvency law permits the court to expedite the conduct of those proceedings). Voluntary restructuring negotiations undertaken before the commencement of proceedings will generally involve those creditors, including secured creditors, whose participation is required to ensure an effective reorganization or whose rights are to be affected by the reorganization."[85] The requirements for an expedited restructuring commenced by the debtor are "(a)Is or is likely to be generally unable to pay its debts as they mature; (b) Has negotiated a reorganization plan and had it accepted by each affected class of creditors; and (c) Satisfies the jurisdictional requirements for commencement of full reorganization proceedings under the insolvency law."[86] The reorganization plan confirmed by court creates effects on the debtor, creditors involved and equity holders affected by the plan.

Satisfaction of secured claims should not affect unsecured creditors. Both secured transactions and insolvency law establishes priority for secured rights ahead competing claimants as administration expenses, wages, taxes. "Such laws provide that secured claims should be satisfied from the proceeds of the sale of the specific encumbered assets or from general funds, depending upon the manner in which the encumbered assets are treated in the insolvency proceedings."[87] The situation is different is the value of the encumbered assets has been maintained by making expenses from unencumbered assets from estate. These expenses will rank firstly. "Other insolvency laws rank secured claims after administration costs and unsecured claims like

[84] UNICTRAL Secured Transactions Guide, para 50, page 435.
[85] UNICTRAL Secured Transactions Guide, para 54, 435-436.
[86] UNICTRAL Insolvency Guide, recommendation 160.
[87] UNICTRAL Secured Transactions, paras 59, 437.

wages or taxes or limit the amount with respect to which a secured claim will be given a higher ranking to a fixed percentage of the claim. The higher ranking given to certain unsecured claims, which is often based on social policy considerations, has an impact upon the cost and availability of secured credit. The approach of restricting the amount recovered by a secured creditor from the value of the encumbered assets is sometimes taken with respect to a security right in the entirety of a debtor's assets in order to provide some protection to unsecured creditors."[88] The priority offered to unsecured rights must be clearly states and maintained as the minimum level, so the secured creditors could make a risk assessment of extending credit. As mentioned above in my work, post-commencement security rights may have priority over pre-commencement security rights. Also, similar to post-commencement security rights, it was established subordination that is, a change of priority of a security right by agreement, by order of a court or even unilaterally. The subordinated creditors may not have a higher ranking than it would have as an individual creditor or as part of the class of secured creditors under applicable non-insolvency law.[89]

To sum up, both EIR and UNICTRAL Model Laws have as scope the rescue of debtor's business as to satisfy subsequently the claims of all creditors. Therefore, that could affect secured creditors that may be required to stay the enforcement of their rights over encumbered assets or the secured creditors may be imposed to make insolvency administration payments, in case when there are no liquid assets or cash available. Both legislations share the principle of collective proceedings, since they are open with the intention of collective benefit for creditors. EIR and UNICTRAL are similar because of the rules intending to rescue debtor's business even by using the encumbered assets. However, the secured creditors are being protected from losing the value of their charged assets. That's the reason why the creditors shall make a risk assessment as to decide on extending credit to the debtor. As regarding the applicable law, both legislations recognizes lex fori or the law of the state where main insolvency proceedings are opened and regulates the opening, conduct and closure of insolvency proceedings, as well regulates the ranking of creditors. However, UNICTRAL outlines that security rights are regulated by the insolvency rules of the applicable law to rights in rem, but does not clearly distinguish that law, as it is distinguished lex situs applicable to rights in rem under EIR. Both laws accept the neutrality of security rights from *lex fori*, as a protection for secured creditors from remaining without the value of the encumbered asset that is being realized for the satisfaction of all creditors. EIR "pure and simple rule: offers an interconnection between *lex fori* and *lex situs*, as security rights are protected from *lex fori*, but anyway the orders and decisions from main insolvency proceedings may influence security rights. UNICTRAL offers a broader regulation than EIR as to the encumbered

[88] UNICTRAL Secured Transactions, paras 60, 437.
[89] UNICTRAL Secured Transactions, paras 63, 438.

assets and assets belonging to third-parties. Also UNICTRAL outlines the necessity of the encumbered assets and third party owned assets for the debtor's business reorganization. To accomplish that goal, the assets may be included in the insolvency estate. I would like to outline some distinctions. That would be the type of assets and interest included into estate. UNICTRAL regulates that insolvency estate includes all assets, even those that are not in the possession of the debtor when insolvency proceedings are opened, while EIR just stipulates general provisions regarding "assets which form part of the insolvency estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings." Also, UNICTRAL states that debtor's interests in encumbered assets and third party owned assets, should make part of the insolvency estate, contrary from EIR, where the encumbered assets remain unaffected by the opening of main proceedings. Both legislations, protects encumbered assets with the purpose of offering legal certainty to creditors in order to offer further financing. Both UNICTRAL and EIR regulates that generally the security rights acquired after commencement of insolvency proceedings are part of insolvency estate, as it would be unjust that a secured creditor has a benefit from the increased value of the encumbered assets after opening insolvency proceedings. However, in both laws there are exceptions to the rule, as UNICTRAL stipulates that security rights may be created over assets achieved after commencement of proceedings if the rights were made enforceable against third parties before commencement or after, with a grace period and EIR, may regulate security rights achieved after opening of proceedings if the rights where in rem when they were pursued by the holder of the right. UNICTRAL provides a broader regulation and explanation of the need and effect of stay of enforcement of secured claims, than EIR does. UNICTRAL specifies the business restructuring method as is increasing the value of the assets for the collective benefit of creditors by applying the stay on secured creditors; methods of protection conferred to creditors as measures of protection of the value of the encumbered assets, payment of interest and provision of relief from the stay where the encumbered assets are not sufficiently protected or where they are not necessary to the sale of the entire business or a productive part of it, may protect secured creditors interest; and the period of time of the stay necessary for restructuring or liquidating the debtor's business. As regarding reorganization plan, both legislation regulates the possibility of secured creditors to participate in realizing the plan, in order to defend their interests and avoiding losing the value of their assets. However, UNICTRAL provides measures as cash payment or cash payment in installments, that are applied as to safeguard the economic value of security rights modified by the reorganization plan. UNICTRAL regulates more aspects regarding secured creditors and much more detailed, as the contracts, claims of secured creditors, the ranking of their rights after opening insolvency agreement, with the purpose of satisfying their claims and offer further financing to the debtor. Therefore,

UNICTRAL protects better creditors. However, EIR Recast, also establishes a solid legal background of which secured creditors can avail as to defend their rights. The difference between legislations may be the fact that EIR has a less extension of its rules than UNICTRAL, as it applies just in Europe, having as main purpose the welfare of business across Europe. There is a need of cooperation between UNICTRAL and EIR much deeper in the area of secured transactions. EIR Recast is an example of such cooperation, as it is a reform based mostly on UNICTRAL provisions, especially in the field of cooperation and coordination of insolvency proceedings.

SUBCHAPTER 2.2. COLLATERAL SECURITIES LOCATED in non-EU MEMBER STATES

Security rights located in non-EU states are subject to both national and international regulation. EIR states that the matters which does not relates to EIR, but is connected to a EU state, are regulated by article 4. *Lex concursus* applies its rules of private international law as to establish the applicable law. According to the WBG Doing Business Report's Legal Rights Index is intended to establish a balance between collateral and bankruptcy laws as to expand access to credit. The report points some features of the laws like: moveable assets can be accepted by financial institutions as collateral while they are under possession of the collateral provider; nonpossessory security rights can be extended to all assets, including moveable as long as there is a description of the secured assets; security rights can involve future assets or proceeds and replacements of the original assets; secures assets have priority if debtor enters n default outside insolvency proceedings or when the business is liquidated; when the restructuring is supervised by a court the secured creditors are not subject to stay; the parties of a collateral agreement can agree that the enforcement of the collateral could be outside the court. In this subchapter, I would like to make a research of international regulation over security rights and of their position when insolvency proceedings are opened. The first subsection is entitled "International regulation of insolvency proceedings for secured creditors" and the second subsection is "Comparison between Lithuania and Moldova".

SUBSECTION 2.2.1. INTERNATIONAL REGULATION of INSOLVENCY PROCEEDINGS for SECURED CREDITORS

I have presented in my work, the main international regulations in the area of insolvency that provides rules for security rights too, UNICTRAL Model Law and EIR. However, we should have an understanding of the present international rules and sources of law applicable in

insolvency. The legal framework is based on international treaties and conventions; international rules and model laws; European jurisprudence; private international rules; principles of law in the area of cross-border insolvencies; comity of law. International treaties and conventions have a narrow effect over insolvency matters, because usually they involve two countries. According to "Principles of International Insolvency" by Wood, the existing treaties and conventions don't have a large enough geographical scope. Some treaties as he Nordic Bankruptcy Convention of 1933 and the Montevideo and Bustamante Conventions with regard to Latin America have a more cross-border coverage. The reason is that the countries regulated by these treaties have similar insolvency regimes and they trust in each other's legal systems. The limited effect of treaties is caused by the different legal systems that cause legal uncertainty in the area of insolvency.[90] International rules and model laws refers specifically to UNICTRAL Model Law on Cross-border insolvency and Cross border insolvency Concordat approved by the Council of the Section on Business Law of the International Bar Association (IBA) in September 1995. Both legal initiatives have as purpose providing efficient solutions in the area of cross-border insolvency. The Model Law as I have stated above provides mechanisms to improve cooperation between courts of different jurisdictions; to create efficient administration of insolvency proceedings; create legal certainty for investors; and rescue businesses in financial distress. The new European cross-border insolvency regime was based on an existing EU legal and institutional framework, in contrast to international law. The new regulation on insolvency proceedings was adopted covers insolvency issues not related to entities as credit institutions, insurance undertakings, investment firms and collective investment schemes. Other two directives have been adopted concerning the winding-up and reorganization of insurance undertakings and of credit institutions, the EU Winding-up Directive for insurance undertaking and the EU Winding-up Directive for credit institutions. These laws recognize and coordinates insolvency proceedings opened in EU, however insolvency law is under competence of national law. International private law represents a set of rules that exist in every state's legal system and where questions regarding cross-border insolvency can be found and their answers as well. Cross-border insolvency questions are subject to more than one national law that can be unreconciled with another laws. So, an insolvency national legal system that claim to have cross-border effects in certain states, may not be recognized in the jurisdiction where cross-border effects are supposed to be recognized. Principles of law applicable to insolvency cases determine the private international law of a specific country with regard to the conflict-of-law questions that may arise. The principles are the universality of insolvency proceedings which means that the insolvency "adjudication of bankruptcy is effective *erga omnes* in the other

[90] Annex A: Cross-border aspects of insolvency, A13, https://www.bis.org/publ/gten06c.pdf (Accessed on 28 April, 2017).

countries in which the insolvent debtor may have assets or branches, without there being any need to seek judicial authorization to have the decision recognized as such, but without prejudice of course to the own conflict of law rules of the foreign jurisdiction concerned *(lex fori*)."[91] The second is the principle of territoriality "is the principle of plurality or territoriality of bankruptcy, whereby bankruptcy proceedings are effective only in the country in which they are initiated and proceedings therefore also have to be initiated in every country in which the bankrupt party holds realizable assets. For each estate, courts will apply their own laws as *lex fori* and will appoint their own liquidator. This territoriality principle leads to the initiation of as many proceedings as there are countries in which assets or branches are located."[92] Comity of law represents a concept meaning that courts and other judicial authorities from different jurisdictions cooperate between each other without any applicable international law. The courts seek for assistance in each other's jurisdiction in order to achieve a commercial purpose. The requirement is the mutual respect for the territorial integrity of each other's jurisdiction, however this is not an obstacle for two courts to cooperate as regarding assets and persons residing within the territory of the another jurisdiction. These legal texts governing insolvency, also governs the protection of security rights.

Collateral securities are provided through contractual arrangements that has the purpose of protecting a party from insolvency, by providing finance. The other party is protected by the default of the other party that does not fulfill its obligation. The general advantage of collateral securities is that provides stability to financial market, as ensures a credit flow. The applicable law to collateral securities should provide predictability and certainty in the case of insolvency. The parties are entitled to establish in advance the applicable law that will apply in case of insolvency in order to ensure an effective collateral security arrangement. An important aspect is how a collateral security is realized under a financial contract in case of insolvency. However, there is no clear regulation in this area which causes obstacles as to the use of the collateral. "As regards the law applicable to such arrangements, the *lex rei sitae* principle is generally recognized and usually applied to the effect that the law of the country where the securities are located/registered is applicable. With regard to the law applicable to securities held through a securities settlement system within the European Union, the Settlement Finality Directive contains rules that create legal certainty in this respect held through a securities settlement system within the European Union, the Settlement Finality Directive contains rules that create legal certainty in this respect. Pursuant to these provisions, the traditional *lex rei sitae* rule is clarified in relation to book-entry

[91] Annex A: Cross-border aspects of insolvency, A18, https://www.bis.org/publ/gten06c.pdf (Accessed on 28 April, 2017).
[92] Annex A: Cross-border aspects of insolvency, A18, https://www.bis.org/publ/gten06c.pdf (Accessed on 28 April, 2017).

securities in such a way that the law applicable shall be the law of the so-called place of the relevant intermediary (PRIMA). According to the PRIMA principle, the rights of a holder of securities provided as collateral will be governed by the law of the country where the right to the securities collateral is legally recorded on a register, account or centralized deposit system. Through the national implementation of the Settlement Finality Directive, this principle is applicable in all EU countries. This is also reflected in the carve-outs included in the recent EU insolvency legislation, such as the EU Winding-up Directive for credit institutions. The principle of *lex rei sitae*, as applicable with regard to the choice of law applicable to collateral security rights, is generally embraced also by the non-EU countries studied within this project, the United States and Japan. In addition to certainty with regard to the laws applicable to a specific collateral security arrangement, the rules of those laws have to be sufficiently clear in order to allow parties to structure their transactions accordingly. In general terms, the purpose of collateral taken under financial contracts is to achieve protection from the effects of insolvency, either through the creation of a valid security interest or by an absolute transfer of title arrangement. The Collateral Directive provides for a uniform regime for parties as takers of "financial collateral" consisting of transferable securities and cash. The protection of the rights granted under the Collateral Directive is suggested to be extended to collateral security rights irrespective of the purpose or type of underlying transaction, and would be applicable in all the EU member states. The Directive also aims to enhance the legal certainty with regard to the enforcement of security rights over collateral through the inclusion of provisions that entitle the collateral taker to realize the collateral without being subject to a waiting period in the event of default of the collateral provider."[93]

To sum up, the international sources that regulates matters of insolvency and security rights are based on international treaties; international rules and model laws; European jurisprudence; private international rules; principles of law in the area of cross-border insolvencies; comity of law. The less legal assistance offers international treaties that have a narrow extent on cross-border insolvency cases. The discrepancies between national legislations involved in an international treaty creates legal uncertainty. Another less protective is private international law, since is regards regulation of distinct states over the same insolvency matters, that can create legal differences. The UNICTRAL Model Law on Cross-border insolvency and Cross border insolvency Concordat are effective as they offer flexible and effective solutions for cross-border insolvency cases. European legislation is efficient as it is based on a well-established legal framework that regulates insolvency cases that arise in Europe. However, insolvency is under competence of national law and not European institutions. The principles of universality and territoriality clearly distinguish the

[93] Annex A: Cross-border aspects of insolvency, A21-A22, https://www.bis.org/publ/gten06c.pdf (Accessed on 28 April, 2017).

applicable law when there are or there are not establishments in another states. The comity of law is important and more reform in this direction is required as regards the cooperation between courts. In case of collateral securities, the parties should decide over the applicable law that ensures predictability and certainty in case of insolvency. That would be *lex situs* or the law of the state where collateral assets are located. In case of securities settlement system in EU, the Settlement Finality Directive contains rules as to the applicable law. In case of book-entry securities, the applicable law is the law of the country where the right to the securities collateral is legally recorded on a register, account or centralized deposit system, so-called PRIMA. For financial collaterals, the applicable legislation is the Collateral Directive that ensures the possibility of the collateral to realize the charged asset even in case of default of the collateral provider. The *lex situs* rule is applicable for non-EU countries as well. The cross-border commercial activity is developing, even if there are territorial limitations as to the application of insolvency law that are creating obstacles regarding the insolvent debtor business rescue. Therefore, is important to have an efficient regulatory and legal framework for cross-border insolvency cases.

SUBSECTION 2.2.2. COMPARISON BETWEEN LITHUANIA and MOLDOVA

In Lithuania security rights are created in dependence of the type of asset involved. Therefore, for immovable property, including ships and aircrafts, there is the mortgage that secures the performance of a monetary obligation. The mortgage generally secures the payment of the obligation, the recovery of the interest arising from the claim and the expenses incurred by enforcement of mortgage. Due to the fact that the transfer of possession of the mortgaged asset to the creditor is not possible, the asset may be a collateral for several mortgages. Even if the asset is secured by a mortgage bond, it can be transferred to another party. According to Lithuanian legislation, there are two general types of mortgages: contractual mortgage and forced mortgage. The contractual mortgage represents that the parties may enter into an agreement for the mortgage over one or more immovable assets. The mortgage may secure its own debts or debts of third parties, excluding cases when is not allowed to secure debts.[94]

"The mortgage may be created over an individual immovable object, registered in the public register, which according to applicable law may be foreclosed. If, when the principal object is mortgaged, the parties do not agree otherwise, it is considered that all present and future appurtenances added to the principle object by the will of the owner or as a result of natural events

[94] file:///C:/Users/User/Downloads/LIT%20-%20Ieva%20Dosinaite%20Jurate%20Misonyte%20-%20Tark%20Grunte%20Sutkiene.pdf (accessed on April 27, 2017)

are also mortgaged. Only an insured object may be mortgaged with the exception of land. The mortgage of an immovable object covers the insurance indemnity. For the mortgage of buildings, the plot of land on which the buildings are situated must be mortgaged together with the buildings themselves or the mortgage must provide the right of lease (right of use) in respect of the plot of land required for the use of the building."[95]

As regarding movable assets and ownership rights, the security used is the pledge that ensures payment of an existing or future debt. The pledge in contrast to mortgage allows the transfer possession of asset or right to creditor, third party or the possession may remain to the pledger. In case that the debtor enters into default being unable to pay its debt the pledgee will be entitled to satisfy his claim prior to other creditors.[96] "The assets encumbered by pledge must be identified e.g. in respect of goods, savings, deposits, securities, funds, contractual rights, rights to receive deposit, rights to receive dividends, etc. Usually the pledge of an object covers appurtenances and undivided fruits. However, Lithuanian law generally does not recognize floating charges, i.e. the collateral must be described precisely, identifying the pledged object and the quantity thereof. The law provides for one exception to the requirement to indicate the quantity of the pledged objects. Pursuant to the law, running stock, running inventory or a bank account of the pledger may be pledged. When describing the collateral, the nature of the stock or inventory, the value thereof and the place where they are kept must be identified. In this case, the composition and form of the pledged stock or inventory may change, subject to the condition that the accumulated value thereof will not decrease below the agreed value. The value of the collateral must be agreed between the parties to the pledge bond. Upon a failure to agree, the value will be established by the appraiser. Since public auction is a method of last resort upon disagreement between the parties and since the creditors of the pledger or debtor whose obligation was secured may dispute the value for which the collateral was sold, the value of the collateral established at the moment the pledge is created does not have substantial influence on the value at which, at the time of foreclosure, the collateral will be sold."[97]

"Another type of security are financial collateral arrangements that secures the payment of obligations owed to supervised financial institutions. Therefore, the collateral must be a legal entity. The Law on Financial Collateral Arrangements of the Republic of Lithuania provides for a higher protection standard, specifically in insolvency proceedings, to the creditors whose claims are secured by financial collaterals. According to the Law on Financial Collateral Arrangements of the Republic of Lithuania, under the financial collateral arrangement, the collateral taker

[95] Lithuania Survey on: claw-back of security in insolvency: 1, Accessed on April 27, 2017.
[96] file:///C:/Users/User/Downloads/LIT%20-%20Ieva%20Dosinaite%20Jurate%20Misonyte%20-%20Tark%20Grunte%20Sutkiene.pdf (accessed on April 27, 2017).
[97] Lithuania Survey on: claw-back of security in insolvency: 2, Accessed on April 27, 2017.

(creditor) will have the right, if the debtor defaults on his relevant financial obligations secured by financial collateral, to satisfy his claim from the financial collateral or its value prior to other creditors. In this case, on the occurrence of an enforcement event as opening of insolvency proceedings, the collateral taker will have the right to unilaterally realize financial collateral provided under the financial collateral arrangement in the manner prescribed in the above mentioned law and subject to the terms agreed in the financial collateral arrangement. This is one of the major differences from the procedures of settlement of the creditor's claims secured by the regular pledge in the debtor's (pledger's) insolvency proceedings, wherein the realization of the pledged financial collateral is effected in the regular course of insolvency proceedings managed by the enterprise administrator."[98]

"In case that the debtor failed to pay the debt secured by mortgage, the secured creditor is able to enforce its claim by appealing to the public notary. The mortgagee is entitled to ask the mortgage judge to sell the charged asset by public auction and to be fully paid from the proceeds of sale or to be appointed as the administrator of the asset, only after the seizure of assets and notification of the debtor by the mortgage judge as regarding the discharging of the obligation. If the mortgagee does not satisfy his claim administering the charged asset, he can ask the mortgage judge to start the public auction. The auction is subject to the Code of Civil Procedure of Republic of Lithuania or other rules if the owner of the charged asset is a legal person affected by bankruptcy or legal restructuring. If the claim is not entirely satisfied from the auction of the asset, the creditor is entitled to ask recovery of his claim from other properties of the debtor.

If the debtor does not pay its debt secured by pledge, the pledgee has to notify by written consent the debtor about the fact that he will enforce its claim if the debtor fails to make the payment in a preferential period of 20 days or other agreed term, but not less than 10 days. If the pledge is registered in the Mortgage Register, then the debtor and all persons with rights over the charged assets will be notified through the register. If the debtor does not transfer the possession of the charged asset to the creditor, the later one has the right to address the public notary in order to seize the collateral asset and transfer to its possession. Based on agreement between the pledger and the pledgee, the collateral is sold or is transferred to the pledgee. In case that the agreement fails, the collateral is sold by auction. In case the collateral is subject to more than one pledge, the asset is sold to one of the creditors based on the agreement between all involved creditors. If the amount resulted from the sale of the pledged asset is not sufficient to cover the debt, that the pledgee may recover the rest of the amount from other proprieties o the debtor. However, he has no priority against other creditors.

[98] Lithuania Survey on: claw-back of security in insolvency: 2, Accessed on April 27, 2017.

Once that insolvency proceedings are opened, the enforcement may be stayed if the debtor as mortgagor or pledger decides to open application of bankruptcy or legal restructuring. That implies certain measures taken as to determine the validity, termination or modification of the secured right, that may protect the debtor. In that case the asset is part of insolvency estate and is administered by the insolvency administrator. After paying the fee for administration, the secured creditor or mortgagee will be firstly paid from the proceedings of sale of the asset secured by mortgage or the asset is transferred to the mortgagee. However, if the amount received from proceedings of sale is higher than the amount of creditor's claim, the surplus will remain in the estate and distributed to other creditors. In case of the pledge, once that insolvency proceedings are opened, the pledgee or the secured creditor must file the secured claim and all the claims that were created before the opening of insolvency proceedings against the pledger or the debtor. In case that the pledgee does not file his claims in due time, he will lose the right to demand the payment and other creditors will be satisfied from pledger assets, including the charged assets."[99] "The Enterprise Bankruptcy Law of the Republic of Lithuania confers to the enterprise administrator a variety of rights pertaining to enterprise bankruptcy proceedings. These obligations encompass the right and duty of the enterprise administrator to organize the sale of the assets according to the procedure prescribed by the above mentioned Act and to sell or transfer the assets to the creditors, and to satisfy the creditors' claims allowed according to the procedure established by the Act. "[100]

Moldovan legislation contains various text laws regarding the creation of mortgage, its enforcement and termination. Mortgage and pledge cover the same assets in as related above, regarding Lithuanian legislation. Both, the Pledge Law No. 449-XV dated 30 July 2001 and the Moldovan Civil Code relating mortgage (Book II, Title IV, Chapter V – Articles 454 to 495) regulates the mortgage assets and the parties related to the secured transactions, the mortgagor and mortgagee; the creation and public registration of the mortgage and of any amendments regarding the mortgage; legal effects of mortgage between parties and third parties; disposal of the mortgaged assets; judicial and procedural aspects of enforcement of the mortgage. Besides the immovable property, the mortgage may include unfinished constructions or parts of unfinished constructions. Property Cadaster Law must also be amended so as to extend the registration process over unfinished immovable property. Mortgage transactions should ensure the protection of rights of all involved parties. According to Moldovan Civil Code, article 479 (2), "the mortgagee likewise should be protected in cases of expropriation of the property and avoidance of the ownership title. Law should provide that a property may only be returned (*restitutio*) after receipt of an equitable

[99] Lithuania Survey on: claw-back of security in insolvency: 7-9, Accessed on April 27, 2017.
[100] Lithuania Survey on: claw-back of security in insolvency: 9-10, Accessed on April 27, 2017.

indemnity for the returned property, which indemnity will be subject to mortgage by operation of law."[101] "For the cases when the prohibition to alienate the mortgaged immovable property is breached, the law should make it a right of the mortgagee to opt either for avoiding the alienation transaction or for enforcing against such alienated property."[102] In case that the claim of the mortgagee is not fulfilled by realizing the mortgage asset, the mortgagee should be given the right of using a pledge in accordance with the law over other property of the mortgagor. As regarding the rights of the mortgagor, there is possibility of obtaining new income by leasing the charged asset until the maturity of the secured obligation with the requirement that the lessee will lose its right when the secured claim is enforced.

The enforcement of the mortgage should protect the interests of the debtor, but also ensure that the creditors will enforce their rights in due time and without obstacles. According to articles 809 to 816 of the Civil Code, the enforcement is realized through public auction. The law does not lay down how a mortgage over the same asset can be enforced by several creditors with different security ranking. A solution would be that the enforcement of one creditor entitles another creditor to accelerate the maturity of his claim and to participate in the enforcement process. The third parties are protected from a detrimental sale of asset. "Any third party whose situation would be aggravated as a result of the sale of the property is entitled to settle the secured obligation and subrogate the mortgagee."[103] The purchaser of secured rights could be protected by subrogating in all rights and obligations related to the property that belonged to the previous owner of the right. However, the law does not provide this kind of protection. The enforcement is realized through two procedures, forced dispossession of the charged asset from the debtor and through forced sale. The first one represents an ordinance issued by court in order to seize the asset and to transfer the asset to the creditor and second is the sale under court supervision and by the judicial enforcer.

"The Insolvency Law No.632- XV dated 14 November 2001, article 128 sets forth that any property, including rights of claim, subject to a pledge may be applied by the insolvency administrator who will take into account the pledgee's proposal to hand over the property to him. After hearing both the pledgee and the administrator, the court will fix the period of time in which the pledged property is to be sold by the pledgee; after it has expired the administrator is authorized to apply the property. This procedure disadvantages the pledgee, to whom legal barriers –

[101] European Bank for Reconstruction and Development by Progressive Banking Solutions Ltd Dublin, Ireland, "Assessment of the current Mortgage Lending Market and Recommendations on How the Market can be Further Stimulated": 48, may 2005, Accessed on April 27, 2017.
[102] European Bank for Reconstruction and Development by Progressive Banking Solutions Ltd Dublin, Ireland, "Assessment of the current Mortgage Lending Market and Recommendations on How the Market can be Further Stimulated": 49, May 2005, Accessed on April 27, 2017.
[103] European Bank for Reconstruction and Development by Progressive Banking Solutions Ltd Dublin, Ireland, "Assessment of the current Mortgage Lending Market and Recommendations on How the Market can be Further Stimulated": 50, May 2005, Accessed on April 27, 2017.

endangering his enforcement of the pledge – are created. The removal of these barriers by allowing the pledgee to enforce the pledge under the general rules would reduce legal uncertainty, motivating lenders to accept as security the mortgage – on the primary market- and the pledge of mortgage claims as collateral for mortgage securities – on the secondary market."[104]

To sum up, the main two securities regulated by Lithuanian and Moldovan laws are mortgage and pledge. Even though in Moldova the securities are being regulated by the same laws and creates the same legal effects. Mortgages in both legislations represent securities over immovable property. In Moldova, the mortgage includes unfinished construction or part of it. Both legislations regulate enforcement through public auction. However, Lithuanian law specifies certain measures to be taken before public auction. These measures are the possibility for mortgagee to administer the charged asset and for pledgee to sell or receive the charged asset' possession based on an agreement between debtor and creditor. As contrary to Moldovan legislation, the Lithuanian law regulates the situation when an asset is subject to more than one pledge. In this case the ownership of the collateral is transferred to one of the secured creditors based on an agreement between parties. In both legislations, is provided seizure of the asset in case that the d

ebtor fails to fulfill his obligation of payment, called in Moldova forced dispossession of the charged asset, and the forced sale of the mortgage asset demanded by the judge. In Lithuania is a much clearer protection offered to secured creditors than in Moldova, having a much extended legal background as EIR. In Moldova, the pledgee' s right to enforce the charged asset is based on the agreement with insolvency administrator and the decision of the court. However, in Lithuania is clearly stated that the mortgagee may enforce his right prior to other creditors and the pledgee has the same right, if he fills the relevant claims against debtor once insolvency proceedings are opened. The two legislations are similar as regarding the secured transactions laws, but different regarding security rights under insolvency law. Moldova as a young candidate to EU is applying the EU Regulations which creates a legal framework convenient for reforms, including improving the position of secured creditors during insolvency proceedings.

[104] European Bank for Reconstruction and Development by Progressive Banking Solutions Ltd Dublin, Ireland, "Assessment of the current Mortgage Lending Market and Recommendations on How the Market can be Further Stimulated": 61, May 2005, Accessed on April 27, 2017.

CONCLUSIONS

Considering the afore mentioned legal analysis, we may conclude that there is an extended European and International legal background regarding the creation, enforcement and termination of security rights under insolvency law.

I have reached some specific results and conclusions for each objective mentioned in the introduction.

1. By comparing EIR and EIR Recast, I have concluded that even if EIR Recast is a reform of EIR that improves many fields, as: the scope of EIR; international jurisdiction; secondary proceedings; cross-border cooperation and communication; and group company insolvency, there is no clear regulation regarding coordination between secured rights in rem and debtor's business rescue.
2. By making a research of the principles of territoriality and universality under EIR, I have concluded that there should be a balance between the application of the two principles. Security rights in rem belonging to local creditors are protected by the opening of secondary insolvency proceedings governed by territoriality principle, however it creates an obstacle to reorganization of debtor's business that is subject to universality principle.
3. Rights in rem under EU insolvency and property law are similar as regards real security rights created as an instrument to ensure that the secured creditor will be able to enforce their claims over the charged asset, including the case when insolvency proceedings are opened. However, these rights, also known as preferential rights can be breached if they are useful for debtor's business reorganization.
4. Based on the comparative analysis of UNICTRAL Model Law and EIR, I have observed that UNICTRAL Model Law provides a more extended regulation regarding the nature of the charged assets; the effects of the stay of secured claims 'enforcement; and compensation of secured creditors when the stay is applied. An eventual reform in the field of rights in rem under EIR could be based on the UNICTRAL Model Law provisions.
5. I have reached the objective of comparing laws of two different states as Lithuania and Moldova in the area of security rights. Lithuanian secured transactions law is based on EIR in contrast to Moldovan Law. Therefore, the protection offered by Lithuanian Law to security rights located in EU is much more efficient than the protection offered by Moldovan Law. That is proved by the fact that in Lithuania, secured creditors may enforce its rights prior to other creditors, however in Moldova that is possible only with the court

or insolvency administrator approval.

6. The scientific problem of my thesis represents whether security rights can be affected when a restructuring plan is applied and whether secured creditors are protected enough under European Insolvency Regulation.

Regarding the research problem above mentioned I shall state the next conclusions:

- EIR main purpose is the rescue of debtor's business which affects all involved creditors and in some circumstances secured creditors. At the same time, security rights or rights in rem should be protected from being affected by business rescue since they are an instrument of financing which provides financial aid to companies before entering into insolvency proceedings with the scope of preventing insolvency. In case that insolvency proceedings are opened, the secured lenders are considered as post-commencement of insolvency proceedings financers. Therefore, rights in rem are an incentive for businesses rescue and development.
- Security rights' purpose under EIR is to ensure capital flow and trade development inside EU. In order to assure that lenders will continue investing in EU businesses is necessary to be offered legal certainty regarding the enforcement of their security rights. That certainty is ensured by article 5 of EIR or article 8 of EIR Recast, as states that once that insolvency proceedings are opened, secured creditors are able to enforce their charged assets irrespective of *lex concursus* or the law of the state where main insolvency proceedings are opened.
- According to UNICTRAL Model Law if a charged asset is vital for the rescue of debtor's business, the enforcement of the secured asset can be stayed or postponed until the reorganization procedure is realized. EIR does not regulate the possibility of such a stay, however, since EIR purpose is debtor's business rescue, indirectly implies the possibility of a stay so the charged asset could be realized for the business rescue.
- Also, the enforcement of security rights should not affect other unsecured creditors rights, as it would be breached the principle of *paritas creditorum*. Therefore, is needed a coordination between enforcement of security rights, satisfaction of unsecured creditors' claims and realization of secured assets for business restructuring.
- EIR offers protection to secured creditors, however is required a further harmonization into this area between EIR and international insolvency regulation, like UNICTRAL Model Law.

In a nutshell my opinion based on my research is that new EIR should include a reform of article 8, focusing more on creating a balance between third 'party rights in rem and business restructuring.

RECOMMENDATIONS

1. EIR should specify if protection is offered to the security interest or the secured debt, as well as the position of secured creditors in a reorganization plan and their treatment and compensation of secured creditors in case that the secured asset is sold for the rescue of the debtor's business. As a solution to the mixed proceedings, could be the involvement of insolvency practitioners in sorting the proceedings into three categories, proceedings for insolvent companies, proceedings for solvent companies and proceedings for both types of companies. A clarification is required in EIR text about what does "bad" or "good" forum sopping means. For example, it could be "good" forum shopping or not detrimental to the body of creditors, the situation regarding company group insolvency, when COMI is moved in the "suspect period" of three months in another state where a branch is located. Local creditors definition should include the location of the COMI of the creditor. As a solution to BREXIT consequences into insolvency area could be a bilateral treaty between EU and England;
2. Regarding the protection offered by secondary proceedings to secured creditors, it should be applied a stay of the enforcement of secured debts if the charged assets are required for the reorganization of the business. However, the secured creditor should be compensated. In order to ensure the cooperation between main and secondary proceedings, the opening of the latest should be in conformity with EU law;
3. The 'excessive' protection granted by EIR should be replaced by a more balanced approach. The option of applying the law of the Member state where the asset is located should be given serious consideration. As mentioned in the thesis, secured creditors have priority over third parties if there is ownership over the same asset. However, should be taken in consideration the treatment or compensation for those third parties that acquire the asset with good-faith;
4. The legislator of EIR should take a more global vision and introduce global standards into European legislation as directives, in order to instigate an international trade and not only the trade into European market. There should be a standardization of insolvency goals on a regional and international level, in such areas as priorities of creditors, rescue proceedings, company group insolvency;
5. Moldovan lacks legal certainty in comparison with Lithuania. Therefore, Moldovan security rights effects into the relations with EU countries could improve by adopting the new EIR Recast, based on the EU-Moldova Association Agreement

LIST OF BIBLIOGRAPHY

Books:

- Jona Israel, *European Cross-Border Insolvency Regulation*,(Antwerpen-Oxford: Intersentia, 2005);
- Roy Goode, *Principles of Corporate Insolvency Law*, (London: Sweet and Maxwell Limited, 2005);
- Jackson, *The logic and limits of bankruptcy law*, (Block-Lieb, 1986);
- Reinhard Bork, Kristin Van Zwieten, *Commentary on the European Insolvency Regulation*, (UK: Oxford University Press, 2016);
- Ulrich Drobnig, Henk J. Snijders, Erik-Jan Zippro, *Divergences of Property Law, an Obstacle to the Internal Market*, (Munchen: European Law Publishers GmbH, 2006);
- Chr Von Bar, Drobnig, *The Interaction of Contract Law and Tort and Property Law in Europe* (Munchen 2004);
- Benjamin, J. *Interests in Securities; A Proprietary Law Analysis of the International Securities Markets*, (UK: Oxford University Press, 2000);
- Bergström, C. Eisenberg, T. Sundgren, S, *On the Design of Efficient Priority Rules for Secured Creditors: Empirical Evidence from a Change in Law*, 2004;
- Bhandari, J. S. Weiss, L.A. *Corporate Bankruptcy. Economic and Legal Perspectives*, (Cambridge University Press, 1996);
- Clarke, A. Kohler, P. *Property Law– Commentary and Materials Law in Context*, (Cambridge University Press, 2009);
- Fleisig, Heywood; Safavian, Mehnaz; de la Peña, Nuria. 2006. *Reforming Collateral Laws to Expand Access to Finance.* Washington, DC: World Bank. © World Bank. https://openknowledge.worldbank.org/handle/10986/7100 License: CC BY 3.0 IGO.

Online books:

- Jennifer Marshall – Allen & Overy (England), *Article 5 (Rights in rem),* April 6 2011, http://www.eir-reform.eu/uploads/PDF/Jennifer_Marshall.pdf (accessed on May 1, 2017);
- Annex A: Cross-border aspects of insolvency, A13, https://www.bis.org/publ/gten06c.pdf (accessed on 28 April, 2017);
- Lithuania Survey on: claw-back of security in insolvency. Accessed on April 27, 2017;

- European Bank for Reconstruction and Development by Progressive Banking Solutions Ltd Dublin, Ireland, "Assessment of the current Mortgage Lending Market and Recommendations on How the Market can be Further Stimulated", may 2005, Accessed on April 27, 2017.

Legal texts:

- Council Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings;
- Virgos-Schmit Report on the Convention of Insolvency Proceedings;
- Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast);
- UNICTRAL Secured Transactions Guide, Chapter XII "The impact of insolvency on a security right'';
- UNCITRAL Model Law on Cross-Border Insolvency Law with Guide to Enactment and Interpretation;
- UNICTRAL Legislative Guide on Insolvency Law;
-

Websites:

- http://bobwessels.nl/wp/wp-content/uploads/2015/09/EIR-Recast-Aug-2015-Technical-note.pdf (accessed on March 16, 2017);
- file:///C:/Users/User/Downloads/LIT%20%20Ieva%20Dosinaite%20Jurate%20Misonyte%20-%20Tark%20Grunte%20Sutkiene.pdf (accessed on April 27, 2017)

Case law:

- Case C-557/13 Lutz v Bauerle ECLI:EU:C: 2015:227, [2015] BCC 413;
- BGH 27 November 1997, NJW 1998, 671; BGH 8 December 1998, NJW 1999, 940;

ABSTRACT

The research of the thesis is based on the application and interpretation of European Insolvency Regulation regarding protection of rights in rem; the application of principles of territoriality and universality on rights in rem; the analysis of article 5 of EIR, specifically the nature of rights in rem, localization of the charged assets, the applicable law and the ranking of the secured creditors, according to property law; the application of UNICTRAL to security rights and the comparison between UNICTRAL and EIR as to determine the best protection for security rights. The objectives of the research are to compare EIR and EIR Recast; EIR and UNICTRAL and Lithuanian and Moldovan law in the field of protection of security rights; and to analyze of principles of territoriality and universality and the effects of security rights under insolvency and property law.

The results of the research are based on how security rights and restructuring plan can be inter-connected for proper insolvency proceedings. The effects of security rights have advantages as to credit flow and incentive for investment, and disadvantages for satisfaction of unsecured claims and claims belonging to third parties. EIR Recast is an innovation for insolvency law, however, there are legal discrepancies in EIR Recast that need to be analyzed. Another result achieved from the research on the coordination between EIR and UNICTRAL, is understanding how EIR should regulate the protection of rights in rem based on the provisions of UNICTRAL. European MS are more protected in the field of security rights, than non-EU states. That is proved by the comparison between legislations of Lithuania and Moldova. The legal legislation of Lithuania is based on a more developed legal framework, including EIR and UNICTRAL, however Moldovan legislation is less supported by international legislation.

Keywords: Security rights; insolvency; restructuring plan; EIR; UNICTRAL; trade flow; investment; unsecured creditors; secured creditors; third parties.

SUMMARY

The aim of my thesis entitled "Third parties 'rights in rem under EIR" is to make a research over the importance and application of European Insolvency Regulation over third parties rights in rem located in another Member State than the state where main insolvency proceedings are opened and over the trade of the MS where the assets are situated and the legal certainty of the rights over them.

The objectives of my thesis are: to make a comparison between the application of EIR and EIR Recast; to make a research of the principles of universality and territoriality; to make a research over the effects of rights in rem under insolvency and property law; to make a comparison between application of EIR and UNICTRAL over security rights; to make a comparison between Lithuanian and Moldavian law over security rights.

The structure of the thesis is based on the MRU Methodological Instructions. Therefore, the thesis is structured into introduction, content, conclusions, recommendations, list of bibliography, abstract, summary, annexes and honesty declaration.

The content is divided into two chapters: "Application of article 5 of the EIR" and "Application of UNICTRAL and international insolvency regulation in the area of third parties' rights in rem". The first chapter is divided into two subchapters: "General notions regarding European Insolvency Regulation" and "Third parties' rights in rem as an exception from *lex concursus*". The first subchapter is divided into two subsections: "The scope of EIR analyzed through comparison with EIR Recast" and "Cross-border insolvency under EIR" and the second subchapter is divided into three subsections: "Rights in rem under insolvency law", "Rights in rem under property law" and "Application of art. 8 of EIR Recast". The second chapter is divided into two subchapters: "Comparison between EIR and UNICTRAL regarding third parties' rights in rem" and "Collateral securities located in a non EU MS". The first subchapter is divided into: "The role of UNICTRAL regarding insolvency matters" and "Better protection of secured creditors- EIR or UNICTRAL?" and the second subchapter into: "International regulation of insolvency proceedings for secured creditors" and "Comparison between Moldova and Lithuania".

Main results of the research are that EIR jointly with EIR Recast offers the possibility for secured creditors to enforce their rights irrespective of *lex concursus*. The possibility to apply *lex concursus* appears when a reorganization plan is applied. In order to ensure an efficient administration and protection for all creditors, is necessary to balance the principle of territoriality and universality. EIR Recast brings reforms in area of coordination and cooperation and rehabilitation of debtor's business. However, there is no reform in the field of rights in rem. More cooperation should be ensured between EIR and UNICTRAL regarding security right.

ANNEX No. 1

Form approved on 20 November 2012 by the decision No. 1SN 10 of the Senate of Mykolas Romeris University

HONESTY DECLARATION
16/05/2017
Vilnius

I, **Craciun Dumitrita**, student of

Mykolas Romeris University (hereinafter referred to University), Faculty of law, European and International Business Law,

confirm that the Master thesis titled

"Third parties' rights in rem under European Insolvency Regulation"

1. Is carried out independently and honestly;
2. Was not presented and defended in another educational institution in Lithuania or abroad;
3. Was written in respect of the academic integrity and after becoming acquainted with methodological guidelines for thesis preparation.

I am informed of the fact that student can be expelled from the University for the breach of the fair competition principle, plagiarism, corresponding to the breach of the academic ethics.

Craciun Dumitrita
(*Signature*) (*Name, Surname*)