ARTICLE

A Teleological Application of the EC Insolvency Regulation: *European Commission v AMI Semiconductor Belgium*

Look Chan Ho, Attorney-at-Law and Solicitor, Freshfields Bruckhaus Deringer, London, UK[1]

While all eyes have been on the European Court of Justice ('ECJ') deciding the *Eurofood* case[2] in due course, the ECJ has recently rendered its very first decision concerning the operation of Council Regulation (EC) 1346/2000 on Insolvency Proceedings ('the Insolvency Regulation') in *European Commission v AMI Semiconductor Belgium*.[3] This ECJ decision concerns principally Articles 4(2)(f), 16 and 17 of the Insolvency Regulation. In summary, the ECJ held that the principles laid down in the Insolvency Regulation apply with equal force to proceedings brought before the Community courts (as opposed to national courts), despite the fact that the Insolvency Regulation contains no reference to the Community courts.

The facts and decision

For the purposes of this commentary, the material facts are as follows. On 8 June 1998, the European Community, represented by the Commission, entered into a contract with a number of companies ('the defendants') incorporated in various Member States in the context of Esprit Project No. 26927 'Electronic Commerce Fulfilment Service for the Electronics Industry (ECFS/E)' ('the project'). The purpose of the project was essentially to establish and put on the market an internet-based trading platform for electronic components.

The contract contained the following arbitration clause: 'The Court of First Instance of the European Communities, and in the case of appeal, the Court of Justice of the European Communities shall have exclusive jurisdiction in any dispute between the Commission and the contractors concerning the validity, application and interpretation of this contract.'

In December 1999, having concluded that the services provided by the defendants were defective, the Commission terminated the project prematurely. On 21 December 1999, the Commission demanded reimbursement of the sums advanced by it to the defendants under the contract. On 12 August 2002, since no payment had been received by the Commission, it commenced proceedings against the defendants before the Court of First Instance. The action was then forwarded to the ECJ.

Meantime, one Austrian defendant and one German defendant had gone into Austrian and German insolvency proceedings on 25 July 2002 and 19 July 2002 respectively. Thus, the question for the ECJ was whether the action against these two insolvent defendants could proceed in light of the Insolvency Regulation. It was common ground that, under the relevant Austrian and German insolvency provisions, an action of the kind brought by the Commission would have been held to be inadmissible if brought against those companies before national courts.

The arguments of the parties centred on the proper interpretation of Articles 4(2)(f), 16 and 17 of the Insolvency Regulation. Article 4(2)(f) provides that *lex fori concursus* shall determine 'the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending'. Article 16(1) provides that '[a]ny judgment opening insolvency proceedings handed down by a court of a Member State ... shall be recognized in all the other Member States ...' Article 17(1) provides that '[a]ny judgment opening insolvency proceedings handed down by a court of a Member State ... shall be recognized in all the other Member States ...' In other words, the combined effect of Articles 16 and 17 is that the opening of insolvency proceedings in a Member State is to be recognized in all the other Member States and is to produce the effects attributed thereto by the *lex fori concursus*.

The Commission argued that the proceedings it launched should not be stayed under the Insolvency Regulation because the Insolvency Regulation only

Notes

1 Many thanks to Dr Riz Mokal for his comments. All views expressed and any errors made are my sole responsibility.

2 Case C-341/04. See *Re Eurofood IFSC* [2004] IESC 45 (27 July 2004, Supreme Court of Ireland) for the questions referred to the ECJ.

3 Case C-294/02 (17 March 2005) (all unattributed paragraph numbers in this commentary are references to this judgment).

concerned the effects of insolvency proceedings in the Member States. The Insolvency Regulation did not contain any provision expressly prescribing its application to proceedings before the ECJ. The ECJ's procedural rules similarly did not mention the Insolvency Regulation. Thus, so the Commision argued, the Insolvency Regulation had no effect whatsoever on the admissibility of an action before the ECJ.

The ECJ was not persuaded by the Commission's arguments and declared inadmissible the action against the two insolvent defendants. Resorting to the spirit and purpose of the Insolvency Regulation, the ECJ reasoned as follows:[4]

> [T]he aim of the [Insolvency] Regulation was to ensure the efficiency and proper coordination of insolvency proceedings within the European Union and thus to ensure equal distribution of available assets amongst all the creditors. The Community institutions would enjoy an unjustifiable advantage over the other creditors if they were allowed to pursue their claims in proceedings brought before the Community judicature when any action before national courts was impossible.

Interpretive matters

While there is no doubt that the Commission's arguments are defensible in literal terms, the ECJ's decision and its mode of reasoning are hardly surprising. This ECJ decision has only confirmed that the Insolvency Regulation is to be interpreted in the same way as other Community measures, namely in a teleological manner.[5] 'A sound teleological argument may well defeat a good literal one.'[6]

Recall that the Austrian and German insolvency proceedings in this case were commenced only a few weeks prior to the proceedings launched by the Commission. If this sequence of events were reversed, it would have triggered Article 15 of the Insolvency Regulation which provides that '[t]he effects of insolvency proceedings on a lawsuit pending ... shall be governed solely by the law of the Member State in which that lawsuit is pending'. Using the same teleological approach, one can safely predict that then it would be the ECJ's procedural rules that determine whether the proceedings launched by the Commission should be stayed. However, given the ECJ's emphasis on the underlying purpose of the Insolvency Regulation, it is probably unlikely that the actual outcome would have been different had Article 15 been triggered,[7] although 'neither the Statute of the [ECJ] nor its Rules of Procedure contain any specific provisions concerning the treatment of applications brought against parties against which insolvency proceedings have been commenced'.[8]

Be that as it may, a teleological interpretation can play a legitimate function only if the court has a firm grasp of the teleology. In this case, the ECJ saw the teleology of the Insolvency Regulation as being 'to ensure the efficiency and proper coordination of insolvency proceedings within the European Union and thus to ensure equal distribution of available assets amongst all the creditors'. In other words, the Insolvency Regulation is meant to facilitate the efficient management of insolvency proceedings and hence to maintain the principle of equality of distribution among all creditors. This statement of the rationale of the Insolvency Regulation is somewhat startling. As has been repeatedly pointed out elsewhere, the management of collective insolvency proceedings cannot be equated with the rule of equality of distribution for the former may not have anything to do with the latter.[9]

Moreover, the ECJ's emphasis on the equality of distribution among all creditors is inconsistent with the insolvency distribution rules in many Member States. One commentator has aptly pointed out the following:[10]

Notes

4 Para. 70.

5 'The European court, in contrast to English courts, applies teleological rather than historical methods to the interpretation of the Treaties and other Community legislation. It seeks to give effect to what it conceives to be the spirit rather than the letter of the Treaties; sometimes, indeed, to an English judge, it may seem to the exclusion of the letter. It views the Communities as living and expanding organisms and the interpretation of the provisions of the Treaties as changing to match their growth.' *R v Henn* [1981] AC 850, 905 (Lord Diplock). See also M. Virgós and F. Garcimartín, *The European Insolvency Regulation: Law and Practice*, (Kluwer Law International, The Hague, 2004), pp. 4–7.

6 A. Briggs and P. Rees, *Civil Jurisdiction and Judgments* (3rd edn, LLP, London, 2002), p. 27.

7 For an English court's view of the operation of Article 15, see *Mazur Media v Mazur Media* [2004] EWHC 1566 (Ch); [2004] 1 WLR 2966. See also L. C. Ho, 'Out of the Insolvency Regulation and into the Judgments Regulation: *Mazur Media v Mazur Media*' (2004) 19 JIBFL 357.

8 Para. 68.

9 R. Mokal, *Corporate Insolvency Law: Theory and Application* (OUP, Oxford, 2005), pp. 102–106. See also M. Bridge, 'Collectivity, Management of Estates and the *Pari Passu* Rule in Winding-up' in J. Armour and H. Bennett (eds) *Vulnerable Transactions in Corporate Insolvency* (Hart, Oxford, 2003), p.1; L. C. Ho, 'On *pari passu*, equality and hotchpot in cross-border insolvency' [2003] LMCLQ 95.

10 J. Dalhuisen, *Dalhuisen on International Commercial, Financial and Trade Law* (2nd edn, Hart, Oxford, 2004), p. 849 (footnotes omitted, original emphasis). See also P. Wood, *Principles of International Insolvency* (Sweet & Maxwell, London, 1995), § 1–14: 'In practice even the most cursory examination of bankruptcy internationally shows that the *pari passu* rule is nowhere honoured.'

> The equality of creditors ... or the so-called *par conditio creditorum* is not truly the basis of the system of creditors' protection or a fundamental legal principle, although endlessly paraded as such. If it were, it would only be honoured in the breach and it distorts the discussion. In my researches of bankruptcy law I have always found that it is equitable, *not* equal, distribution that is the key, and what is equitable in this respect is now mostly a matter of statutory definition in domestic bankruptcy acts. It is therefore the *ranking* ..., and *not* the equality, that is the essence of bankruptcy and of creditors relationships more generally.

It is therefore odd (to put it mildly) that the ECJ should subscribe to the fallacy of equality of distribution among all creditors as being the underlying purpose of the Insolvency Regulation. This fallacy does not inform the teleological interpretation of the Insolvency Regulation. It only denatures analysis and may lead to an unjustifiable outcome when a court has to resort to teleological interpretation before exercising its discretion, for example, pursuant to Article 15.

Enforcement of English security interests

A similar teleological interpretation may be required in the context of enforcing English security interests pursuant to Article 5 of the Insolvency Regulation which is an exception to the general application of *lex fori concursus*. Article 5(1) provides thus (emphasis added):

> 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.

The effect of Article 5 is that rights *in rem* are shielded from the application of *lex fori concursus* and the insolvency law of the *lex rei sitae*.[11]

While the existence of a right *in rem* is to be determined by the national law,[12] it is envisaged that Article 5 would include a floating charge under English law.[13] However, the House of Lords decision in *Buchler v Talbot*[14] may mean that an English floating charge falls outside the scope of Article 5 for the following reason. Recall that Article 5 only protects rights *in rem* in respect of assets 'belonging to the debtor'. The House of Lords in *Buchler v Talbot* laid down a general, sweeping statement of law that 'assets ... subject to the floating charge ... belong beneficially to the debenture-holder',[15] not the debtor. If it were indeed correct that 'the charged assets belong to the debenture holders,'[16] a debenture holder enforcing his floating charge would fall outside Article 5 because he would not be asserting a right *in rem* in respect of assets 'belonging to the debtor'; the debenture holder would only be asserting a right *in rem* in respect of assets belonging to himself.

Needless to say, any such conclusion would be most extraordinary and unpalatable, standing the purpose of Article 5 on its head. One way out of this unintended implication of *Buchler v Talbot* would be to resort to a teleological approach to Article 5. When interpreting Article 5 in the context of English security interests (be they charges or mortgages), the court may either disregard the phrase 'belonging to the debtor' altogether or hold that the phrase 'belonging to the debtor' has an autonomous Community meaning. Accordingly, the fact that *Buchler v Talbot* may be out of sync with the received understanding of the operation of Article 5 becomes immaterial.

Conclusion

A teleological approach to the interpretation of the Insolvency Regulation can be a powerful and useful tool. Express legislative words may be ignored in order to ward off untoward consequences arising from incomplete legislative drafting (as the decision in *European Commission v AMI Semiconductor Belgium* shows) and to sidestep inconvenient domestic decisions that might jeopardize the proper operation of the Insolvency Regulation (as the discussion above concerning Article 5 and *Buchler v Talbot* shows). However, in order for a teleological approach not to become an oppressive and dangerous tool, the court must have a firm grasp of the relevant teleology, in this case the intent of the Insolvency Regulation. Subscribing to the international fallacy of equality of distribution among all creditors as being the animus of the Insolvency Regulation, as the ECJ did in *European Commission v AMI Semiconductor Belgium*, is devoid of rational justification.

Notes

11 M. Virgós and F. Garcimartín, *The European Insolvency Regulation: Law and Practice*, (Kluwer Law International, The Hague, 2004), p. 93.

12 M. Virgós and E. Schmit, *Report on the Convention of Insolvency Proceedings* (1996), para. 100.

13 Ibid, para. 104.

14 [2004] UKHL 9; [2004] 2 AC 298.

15 Ibid, para. 30. For powerful and trenchant criticisms of this rather unorthodox view of the law, see R. Mokal, 'Liquidation expenses and floating charges – the separate funds fallacy' [2004] LMCLQ 387.

16 *Buchler v Talbot* [2004] UKHL 9; [2004] 2 AC 298, para. 16.