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ARTICLE

Practical Problems in Applying Regulation 1346/2000

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Introduction

The global crisis has led to the initiation in recent years of a number of Regulation 1346/2000[1] insolvency proceedings against Polish registered entities; that in turn has led to a number of recent practical and legal problems in applying the Regulation and in the interpretation and application of local EU Member state insolvency law.

This article will provide comments on the recent (May 2010) Polish Supreme Court resolution on the application of domestic law on the basis of the Regulation – the bankruptcy and recovery law in force in Poland, hereinafter 'BRL', and the right of creditors to initiate secondary proceedings.

The topic goes well beyond the application of country specific regulations, and will be of broader interest to insolvency law practitioners.

Application of national law

In the recent European Court of Justice, 'ECJ', ruling of C-444/07 on the insolvency of the Polish limited liability company MG Probud Gdynia sp. z o.o., the ECJ announced that pursuant to the opening of the main insolvency proceedings in one EU Member State the competent authorities of another EU Member State, where secondary insolvency proceedings have not been initiated, are – as a rule – obliged to recognise and enforce every judicial decision in the main insolvency proceedings and that the authorities do not have authority to order enforcement against the assets of the debtor – involved in the main insolvency proceedings – situated in that other EU Member State, if the legislation of the state of the main insolvency proceedings does not allow such enforcement. The ECJ concluded that *the law of the EU Member State where the main insolvency proceedings have been initiated regulates not only the opening of the insolvency proceedings, but also the course and termination of them*. That does not seem to be a novel conclusion, but merely recognition of the principles that stem directly from the Regulation.

The application of Regulation 1346/2000 under the Polish Supreme Court ruling

The resolution of the Polish Supreme Court, which is presented hereinafter, is on the application of art 29 (b) of the Regulation, and on that basis the relevant provisions of the BRL, as local law.

Background to the resolution of the Supreme Court

In 2008, Belvedere S.A a French registered company and six of its Polish registered affiliated companies were in financial difficulties (all subsidiaries guaranteed the debt of Belvedere S.A.) which led to all initiating the French protective procedure – *procedure de sauvegarde*. The COMI of each was, to no surprise, found to be in France. The justification for the petition for the *sauvegarde* procedure was, apparently, the intention of some of the Belvedere S.A. bond holders to claims satisfaction before the maturity of the bonds.

During the proceedings, reorganisation plans (*plan de sauvegarde*) for Belvedere S.A and each Polish subsidiary in the main insolvency proceedings were accepted, in the autumn of 2009.

Nonetheless, The Bank of New York Mellon registered in the USA, 'BONY', a creditor of the Belvedere group, filed in the District Court in Rzeszów, Poland, petitions to open secondary insolvency proceedings against each of the six affiliates, including the Polish registered company Polmos Łańcut S.A., one of the six Polish subsidiaries of Belvedere S.A.. The case of Polmos Łańcut S.A. was the reason the Polish Supreme Court adopted the resolution.

The Supreme Court resolution

The Polish Supreme Court (file number: III CZP 115/09) issued on 20 January 2010 a resolution, in answer to the question of law referred to it by the court of appeal in Rzeszów, on the issue of creditor rights to initiate secondary insolvency proceedings.

Notes

1 Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings (hereinafter the 'Regulation').

The history of the case in a nutshell is as follows: in May 2009, the District Court in Rzeszów dismissed a petition filed by BONY to initiate secondary insolvency proceedings against Polmos Łańcut S.A. because BONY did not have a registered address in Poland and, therefore, the petition had to be dismissed. BONY appealed claiming, inter alia, that art. 29 (b) of the Regulation had been applied improperly and, in consequence, the general provisions of BRL (art. 20) which regulate who can apply to open secondary proceedings is to apply and not the international provisions of BRL (art 407 which defines the right to bring proceedings) The Court of Appeal which was not clear on which part of the BRL to apply referred a question of law to the Supreme Court, to resolve the issue.

The legal background to the case is the following. The court of first instance argued for dismissal of the petition because BONY was a legal entity that had a registered office in the USA and was not entitled to seek commencement of secondary insolvency proceedings in Poland under art. 407 (1) of BRL. The Regulation provides that '... court commences secondary insolvency proceedings if requested by a creditor having a place of residence or registered office in Poland'. Whereas the provision of the art. 20 (1) BRL stipulates that '... petition for insolvency may be filed by a debtor or any of its creditors'.

BONY appealed the decision to the Court of Appeal, which in turn caused the Court of Appeal to submit to the Supreme Court the question whether under BRL, when following art. 29 (b) of the Regulation, art. 407 BRL or art. 20 of BRL applies to define who is authorised to submit a claim to open secondary insolvency proceedings. The Supreme Court resolved that under Polish law – the BRL – art. 407 BRL and not art 20 BRL determines who is authorised, as a creditor, to initiate secondary insolvency proceedings.

It is understandable that, in consequence, BONY's petition to open secondary insolvency proceedings against Polmos Łańcut S.A. was dismissed, as BONY was a US registered entity.

The Supreme Court rational for the resolution can be summarised as follows:

Regulation 1346/2000 applies directly to Poland from the date Poland acceded to the EU, on 1 May 2004. The provision of art 29 (b) of Regulation 1346/2000 defines the entities that can petition for secondary insolvency proceedings.

The Polish version of art 29 (b) of the Regulation provides 'A petition for the opening of *secondary insolvency* proceedings can be filed by (a) an administrator in the main insolvency proceedings or (b) any other person or authority entitled to file *a petition* under the law of an EU Member State in the country in which the petition for *initiation of the secondary insolvency* proceedings is being filed.'

The Supreme Court argued that the Polish language version of the provision differs, as do the Lithuanian and the German versions, from other language versions and, therefore, there is to be applied provisions on starting secondary insolvency proceedings and not general rights defining who is authorised to open insolvency proceedings.

To be able to comment on that point, a comparison can be made to the English[2] or the French[3] language versions which indicate in art. 29 (b) that any one who is authorised under local law (to initiate insolvency proceedings) of a Member State can open secondary proceedings. The Polish language version, however, implies that that right is granted to someone authorised under local law to initiate secondary insolvency proceedings. The difference is, therefore, clear as the Polish language version of art. 29 (b) leads to the provisions of the Polish law (art. 407 BRL) that regulate the right of persons who are authorised to initiate secondary insolvency proceedings and not to those who can initiate insolvency proceedings under general rules.

Further, because of such differences in language versions – each of which is authentic and has the same legal validity- judge Stanisław Dąbrowski, chairman of the adjudicating panel, commented before the hearing in the Polmos Łańcut S.A. case that perhaps that is an issue that should be determined by the ECJ as it relates to the application of Community law.

The Polish Supreme Court further stated in the interpretation *lex specialis derogat legi generali*; i.e., that a law governing a specific subject matter (*lex specialis*) overrides a law that only governs general matters (*lex generalis);* i.e., art. 407 of BRL has priority over art. 20 of BRL.

The Supreme Court, therefore, in the justification of the resolution stated that art. 29 of Regulation 1346/2000 makes direct reference to the law of a specific EU Member State on initiating secondary insolvency proceedings, and that that for Poland implies the application of art. 407 BRL. In some countries where local laws may not distinguish between who can initiate main or secondary proceedings that reference would probably make no difference, but in Poland however it does.

Notes

2 The opening of secondary proceedings can be requested by, a) a liquidator in main proceedings b) any other person or authority authorised to request the opening of insolvency proceedings under the law of the Member State in which the opening of secondary proceedings is requested.

3 *L'ouverture d'une procédure secondaire peut être demandée par: a) le syndic de la procédure principale; b) toute autre personne ou autorité habilitée à demander l'ouverture d'une procédure d'insolvabilité en vertu de la loi de l'État membre sur le territoire duquel l'ouverture de la procédure secondaire est demandée.*

The interpretation, according to the Polish Supreme Court, complies with the provision of art. 28 of Regulation 1346/2000 which stipulates that, unless Regulation 1346/2000 provides otherwise, secondary insolvency proceedings are to be governed by the law of the EU Member State in which the proceedings have commenced. In consequence, it is up to the EU Member State to decide which law is to apply.

The Supreme Court was of the opinion that art. 20 of BRL would only apply, in the commented case, if the Regulation had excluded the possibility for EU Member States to regulate differently the rights of persons to initiate main and secondary proceedings, which is not so; art. 29 of the Regulation proves that there is no such exclusion under the Regulation. Therefore, the provisions that apply to the commented case are those in the second part of BRL, viz, 'The provisions of international insolvency proceedings' (art. 378-417 of BRL).

The consequence of that interpretation by the Supreme Court is that only creditors that are resident, or have a registered office, in Poland can apply to open secondary proceedings.

To support the Supreme Court's opinion, reference can also be made to art. 4 of the Regulation which implies the same conclusion reached by the Supreme Court under art. 28 of the Regulation which also states that, unless the Regulation state differently, the law of the state where insolvency proceedings have been started will apply to the proceedings.

Further, generally, it can be argued that secondary proceedings are included in the Regulation primarily to protect local creditor rights and, therefore, it is reasonable to grant the right to initiate such proceedings only to those who have a local interest, which can be evidenced by having a local registered address. It would, therefore, under that opinion be a 'long shot', to take the position that granting a US registered creditor the right would be protecting local creditor interests.

The Supreme Court resolution is, however, seen by many to be controversial and does not reflect the true meaning of the Regulation.

The first argument in support of that is that, in fact, art. 29 (b) of the Regulation was not intended to limit the rights of creditors by the requirement of the necessity to have a specific interest when initiating secondary insolvency proceedings, and not to subordinate the rights of a creditor to initiate secondary insolvency proceedings to any legal status of a specific creditor in secondary insolvency proceedings.[4]

The problem with the Supreme Court resolution mostly stems from the fact that the international part of the BR is an enactment of the UNCITRAL Model Law on Cross-border insolvency of 1997.

Poland had implemented UNCITRAL Model Law in 2003 when changing insolvency regulations, by the then novel BRL. The international part of the BRL followed most of the UNCITRAL Model Law, but in some parts not verbatim

Despite general similarities of UNCITRAL Model Law and Regulation 1346/2000 on the principles regulating main and secondary insolvency proceedings, the use of common terms which are defined, and similar legal concepts, there are also fundamental differences which are not limited to merely basic principles. The UNCITRAL Model Law envisages a procedure of recognising foreign insolvency proceedings (art. 15-24, implemented into BRL art. 385-404 BRL), whereas under art. 16 (1) of Regulation 1346/2000 a ruling on initiating the insolvency proceedings, by a court of a specific EU Member State, competent for the initiation of the main insolvency proceedings, must be recognised in each other EU Member State at the time when the ruling becomes effective in the state of initiation of the proceedings. Therefore, the recognition of a ruling is automatic under Regulation 1346/2000. The same applies to any other rulings during the proceedings (art. 25 of the Regulation).

Under Polish law, it is art. 378 of BRL that determines whether the section of BRL which regulates international insolvency proceedings is to apply to the recognition of foreign insolvency proceedings, or whether different rules apply under Poland's international obligations.[5] Many practitioners opined, before the Supreme Court resolution, that the implication was exclusion of the application of the international part of the BRL, in preference for EU Regulation 1346/2000.

That seemed to be also the official justification of the lower house of the Polish parliament[6] that was provided during adoption of the Bankruptcy and Reorganisation Law, whereby it was stated that the provisions of international insolvency proceedings of BRL were not to apply to insolvency proceedings conducted in the EU after the accession of Poland to the EU. Those proceedings were to be governed by EU law; i.e., specifically Regulation 1346/2000, and the BRL regarding

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4 Miguel Virgos, Etienne Schmit, 'Report on the convention on insolvency proceedings', pp. 311-312, 'The report was prepared to accompany the European Convention on Insolvency Proceedings [...]. This carries no official status and is not decisive regarding the meaning of the regulation 1346/2000 but, as the regulation is based so closely on the text of the convention, courts across the EU are using it in determining the intention and the scope of many provisions of the regulation.' – City of London Law Society 2009.

5 M. Barłowski, 'Cross-Border Insolvency' – A Commentary on the UNCITRAL Model Law, 2006 Globe Business Publishing, p. 132.

6 Attachment to form no. 809, Warsaw, 29 August 2002, p. 39.

international insolvency proceedings is to only apply to insolvency proceedings by entities whose place of residence or registered office is outside the EU. Bearing in mind the foregoing, the general provisions of BRL by which it would be possible to initiate secondary insolvency proceedings in the commented case of Polmos Łańcut S.A. would have to apply. That would be art. 20 of BRL which gives the right to initiate insolvency proceedings (and, therefore, secondary proceedings) to any creditor (subject to other limitations in the BRL).

It, however, needs to be noted that the Supreme Court did in fact comply with the distinction between the provisions of UNCITRAL Model Law, as implemented in the international part of the BRL, and the application of the Regulation. It, in fact, did refer to the Regulation (as the main proceeding had to be 'recognised') and it was upon the direct application of the Regulation that it concluded that provisions of the international part of BRL apply.

The provision of arts. 28 and 29 of Regulation 1346/2000 relating to 'petitioning for secondary proceedings', however, seems to confer liberty to specific EU Member States to set the rights of a creditor to initiate secondary proceedings, and in this context give a novel application of art. 378 of BRL. That seems to have been of importance in the commented Supreme Court resolution.

Conclusions

It is stated in the enactment of the UNCITRAL Model Law on Cross-border insolvency into the BRL, or the internal insolvency regulations of any other (EU member) that that is not an attempt to unify at national level the procedural and substantive insolvency laws of states that have followed the model law. It, does, however, provide a set of universal principles that apply irrespective of the state that enacted the model law.

The Regulation was also meant, although to a lesser extent, to harmonise insolvency proceedings in the EU, while recognising the national differences in insolvency legislation. The application of the expression *lex fori concursus* both in main insolvency proceedings (art. 4), and in secondary insolvency proceedings (art. 28) determines that, in general, the national laws of one specific state are to apply directly in another EU Member State dealing with problems resulting from insolvency of non-financial subjects.

In practical terms, despite the similarities of the UNCITRAL Model Law and the Regulation, it is difficult to envisage how both sets of rules could be applicable at the same time. The application of both sets of rule which differ in detail at a national level, which was indicated in the example of the Supreme Court resolution, can be justified in legal terms, but many would think that there is a fundamental contradiction in applying two sets of rules during one proceeding.

The preamble of Regulation 1346/2000 provides that mandatory rules of coordination of secondary and main insolvency proceedings guarantee uniformity of proceedings in the EU, which is indispensable. The specific objective of secondary insolvency proceedings is subordination to the objectives of the main proceedings. The national law of a specific EU Member State, therefore, should not relate to a set of rules or principles which other EU Member States have not accepted. If so, then the model law would have provided for the same rules and principles as the Regulation. That, of course, does not imply that the legal status of a party initiating proceeding, as clearly provided by the Regulation, does not lie within the sole jurisdiction of each Member State that applies the Regulation.

The Polish Supreme Court instead of clarifying the application of rules has, in fact, caused the opposite and created even more uncertainty in how to apply the Regulation.

If the boundaries for the capital flow are being systematically abolished worldwide and they practically do not exist in the EU Member States, including Poland as regards the entities from developed countries, why should there be boundaries for those entities in lodging their claims in the insolvency proceedings within the EU territory on a national level? Such a diversification is contradictory to the proper functioning of the internal market and threatens with the transfer of assets from one EU Member State to another, in the purpose of obtaining a more favourable legal position (*forum shopping*). It has to be emphasised that sustaining a limitation to file a petition for secondary insolvency proceedings on a national level in favour of local creditors would prevent foreign creditors from lodging their claims if any of the local creditors would not be interested in opening of the secondary insolvency proceedings in that particular EU Member State.

Thus levelling the entitlements of creditors notwithstanding of their domicile as regards to filing the petition for opening of the secondary insolvency proceedings pursuant to the opening of the main insolvency proceedings would not be contradictory to the protection of local creditors established in particular in the provision of point 17 of the preamble to the Regulation 1346/2000. The foregoing protection reserves the right to open secondary insolvency proceedings for local creditors only when the main insolvency proceedings has not been initiated yet.

Bearing in mind the foregoing it must be emphasised that there is no rational explanation for application of the provisions of a national law of particular EU Member State regarding the secondary insolvency proceedings which are contradictory to the general ideas underlying the assumptions of the insolvency proceedings included in the preamble of the Regulation 1346/2000.

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