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**Featured Recommendation**

**Principles of Cross-Border Insolvency Law**

Reinhard Bork

January 2017  
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SECURITY RIGHTS
AND THE EUROPEAN
INSOLVENCY REGULATION

Edited by
Gerard McCormack
Reinhard Bork

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PREFACE

This book arises out of a research project that was very generously funded by the European Commission under the Civil Justice Action programme – grant JUST/2013/JCIV/AG/4631. We thank the European Commission for their funding.

The events of 23 June 2016 may cast a long shadow but we hope that they do not dim unduly the prospects for further European scientific research and cooperation.

This book is very much a team effort led by Gerard McCormack at the University of Leeds in the UK and including Reinhard Bork at the University of Hamburg in Germany, Laura Carballo Piñeiro and Marta Carballo Fidalgo at the University of Santiago de Compostela in Galicia, Spain, Renato Mangano at the University of Palermo in Italy and last, but certainly not least, Tibor Tajtj at the Central European University, Budapest, Hungary.

The book aims to analyse critically the provisions governing rights in rem (security rights) and transactional avoidance in the European Insolvency Regulation – now Regulation 2015/848 – and to address whether there is scope for reform of the law. Security rights are essentially rights over property intended to secure payment of a debt or other obligation. They are of fundamental importance to the granting of credit and are generally considered to increase the availability and lower the costs of credit with concomitant benefits for both debtors and the overall economy. But there are divergent views on the extent to which it should be possible to create and enforce security rights over assets.

The book also:

- assesses the extent of the protection given to security rights under the main EU legal traditions;
- evaluates the policy reasons behind protection;
- elaborates whether, and to what extent, this protection also applies in the context of insolvency proceedings affecting the debtor;
- assesses whether, and under what conditions, security rights created prior to the institution of insolvency proceedings can be set aside in those proceedings;

Moreover, it considers the need for further European harmonisation.

The first part of the book expounds common themes and ideas and suggests possible law reform measures. The project team as a whole has contributed to this part which considers the extent to which the relevant law in the EU countries
under review measures up against international benchmarks such as the World Bank Doing Business ‘getting credit’ and ‘resolving insolvency’ indicators and the UNCITRAL Legislative Guides on Secured Transactions and Insolvency. It asks whether there is any pressing need for reform at the national or EU level in light of these international benchmarks and whether reform is a realistic and achievable goal. Finally, it considers what form any reform measures might take. The focus is very much on the business debtor and it does not consider possible measures of consumer protection that may be appropriate in particular instances.

The first part of the book is followed by a second part containing chapters that address Germanic legal systems, the Common Law, Roman legal systems and Central and Eastern European legal systems. It should be noted that the book is based on reports submitted to the European Commission on 1 May 2016, although in some cases it has been possible to take into account developments after that date, such as changes to Italian law.

In the course of the project and in the writing of the book we have incurred many debts, not least to members of our International Advisory board and to those who spoke at the three international conferences that we organised as part of the project – London (May 2015), Erice (Trapani) in Italy (November 2015), and Santiago de Compostela (April 2016).

Those to whom we are indebted – in no particular order – include Lina Aleknaite-van der Molen (Kazimieras Simonavicius University, Vilnius, Lithuania); Paul Beaumont (University of Aberdeen, UK); Maya Boureghda Chebeane (JURISMED, Tunis); Catherine Bridge (European Bank for Reconstruction and Development); Michael Bridge (University College London); John Briggs (South Square Chambers, London); Richard Calnan (Norton Rose Fulbright LLP); Reinhard Dammann (Clifford Chance, Paris); Eric Dirix (Leuven); Ian Fletcher (University College London); Francisco Garcimartín Alferez (UAM, Spain), Anna Gardella (European Banking Authority); Robert van Galen (INSOL Europe); Louise Gullifer (University of Oxford); Santiago Hurtado Iglesias (Deloitte Abogados); Krzysztof Kaźmierczyk (Dentons, Poland); Andrew Keay (University of Leeds); Lisa Linklater (Exchange Chambers); Karolina Lyczkowska (DLA Piper, Spain); Jennifer Marshall (Allen & Overy LLP); Irit Mevorach (University of Nottingham); Karim Mouttaki (Mouttaki and Partners, Casablanca); Federico Mucciarelli (SOAS University of London, and University of Modena e Reggio Emilia); Paul Omar (Nottingham Trent University, UK); Jacinto José Pérez Benítez (High Court Pontevedra, Spain); Françoise Péronchon (Université de Montpellier, France); Juana Pulgar Esquerra (UCM, Spain); Magda Raczynska (University College London); Wolf-Georg Ringe (Copenhagen Business School, Denmark); Teresa Rodriguez de las Heras Ballell (UC3M, Spain); Felix Steffek (University of Cambridge); Andrew
Steven (Scottish Law Commission); Heinz Vallender (Judge, Cologne); and Anna Veneziano (UNIDROIT). We apologise for any inadvertent omissions.

We would especially like to thank the overall project administrator, Alexandra Braithwaite, who is based at the University of Leeds, and her colleagues in the partner universities. We are also grateful for the tremendous support from our staff, especially Philipp Hartmann (University of Hamburg), who contributed significantly to the success of our project.

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Gerard McCormack and Reinhard Bork
Leeds and Hamburg, July 2016
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Question 28: If so, describe briefly these rules highlighting in particular (a) the rationale for the rules; (b) the conditions for the application of the rules; (c) the length of the ‘suspect period’; (d) whether the rules apply to transactions with a cross-border element; (e) whether the rules operate more stringently in respect of transactions that favour parties who are connected to the debtor; and (f) any defences that may be availed of by a counterparty to the transaction, i.e. the defendant in an avoidance action.

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CHAPTER 8
SECURITY RIGHTS AND INSOLVENCY
LAW IN THE CENTRAL AND EASTERN
EUROPEAN SYSTEMS

Tibor Tajti

A. INTRODUCTION

1. The coverage of the report

1. This report addresses security rights and the avoidance of transactions from
the perspective of a select number of national laws from the region of Central
and Eastern Europe (CEE). The closure date for this Report was 30 March 2016,
save the mention of the most important changes introduced by the June 2016
amendments of the 2013 Hungarian Civil Code.

2. Hungary is herein the legal system discussed in most detail though the
coverage of Lithuanian and Polish laws will also provide the reader with a fair
insight into their security and insolvency laws not limited to their idiosyncratic
features. It is to be noted as well that this report is not a commentary of national
laws. It rather aims to provide a fairly in-depth insight into the Region's laws
but without commenting on each provision of the analysed laws. Consequently,
consulting local laws and counsel is essential whenever the application of these
laws comes into the picture.

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Simoniavicius University Law School, Vilnius, Lithuania), Krzysztof Kaźmierczyk (Dentsons
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(SJD) candidate at Central European University (CEU), Legal Studies, Budapest, Hungary).

See Act No. LXXVII of 2016 on the Amendment of Act No. V of 2013 on the Civil Code
(2016. évi LXXVII. törvény indokolása a Polgári Törvénykönyvről szóló 2013. évi V. törvény
módosításáról).
2. Methodology caveats

3. As this project aimed to canvass not only the positive law (i.e. black-letter law in force) but also to collect information and indicia on how the targeted laws work in reality – in particular the EU Regulation 1346/2000 on Insolvency Proceedings – the following caveats in particular ought to be highlighted. Needless to say, much more is known about how national secured transactions and insolvency laws work in practice compared to their cross-border kin.

4. On a national level the frequent amendments or the substantial rewriting of law creates considerable uncertainty yet not just in terms of their practical application. Due to lack of understanding, inappropriate travaux preparatoires and the speed of change, omissions, imperfect drafting and similar defects plague local laws, as a result of which it is often hard (or impossible) to provide proper answers even to questions that in other jurisdictions might be easy to answer. The reader therefore should not be puzzled that occasionally no crystal clear answers can be provided to some questions.

5. Although the number of publicised domestic court cases (or decisions/positions of regulatory bodies) has been growing in all the countries in the region during the last decade or so, the relatively small number of available reported cases continues to be an obstacle for the researcher.

6. The inadequacy and problems with access to empirical sources of law is even greater when we turn to the international scene, more precisely to cross-border insolvency cases and the recast Regulation 2015/848 on Insolvency Proceedings (Recast Regulation) or its predecessor Regulation 1346/2000. Here, the number of reported court cases are even fewer; some of the cases that reached the ECJ originate, however, in the region. What matters, however, is that often it is difficult to draw firm conclusions from these cases though some of the cases do reflect the emergence of issues known outside the region as well. Among these, the concept of the centre of main interest (COMI) seems to lead the way.\(^2\) Not infrequently the problem is that simply no empirical evidence is available.\(^3\) For these central reasons essentially it is impossible, or at least, difficult to pass

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\(^2\) For example, the only book specifically devoted to cross-border insolvencies in Hungary written by A. Csőke mentions three COMI-related cases from Hungary. See A. Csőke, A határokon átnyúló fizetésképtelenségi eljárások [Cross-Border Insolvency Proceedings] (HV/G ORAC, Budapest, 1st ed., 2008), 98–100.

\(^3\) One may point again to the fact that A. Csőke in his treatise, given the lack of cases on cross-border insolvency generated in Hungary – was forced to resort to foreign judicial decisions. Out of 37 cases used to explain and illustrate the mechanics of Regulation 1346/2000 only four stemmed from Hungary. Although the book was published in 2008 and some additional cases have emerged in the meantime in Hungary, the general feature has hardly changed.
a verdict on the quintessential question whether the Recast Regulation or its predecessor works fairly and efficiently in practice.

7. Although no empirical studies seem to have been made of less fathomable factors influencing the efficiency of a law such as the intensity of the bankruptcy stigma or the lack of a proper understanding of relatively novel branches of law such as secured transactions and insolvency, these are very much present in the region. As Professor Bork quite aptly put it commenting on the intensity and the omnipresence of the bankruptcy stigma in Germany, "[although] it may be tempting to disregard this factor as non-serious, but any earnest attempt to construct an efficient restructuring law must take it into account until there is a wide-ranging and sustained change in popular mentality." These factors still meaningfully impact the application of the EU cross-border insolvency regulatory regime. The most important caveat that follows from this is that the absence of court cases and other empirical evidence related to Regulation 1346/2000, should not be taken to mean that the Recast Regulation or domestic insolvency laws function impeccably in practice. Put simply, the fact that in a jurisdiction there are no, or only a few, cross-border insolvency-related cases should not be taken as meaning, therefore, that the law is perfect.

8. The caveats stated above should definitively be borne in mind when reading this report. Given these determinants, whenever the law is unclear on a point, this will be noted. Similarly, when no clear position could be taken as to whether a given provision or law properly works in practice, this will be clearly stated, although the empirical evidence is scarce.

9. From the perspective of CEE, however, a common EU insolvency and secured transactions law would be not just desirable but – in particular with respect to the similar paths of reforms and the many commonalities in the context of secured transaction and insolvency laws – possible and desirable.

3. The geographic reach of the report

10. This report extends to those countries within Central and Eastern Europe (CEE or the region) which have, since the fall of the Berlin Wall, acceded to the European Union. Geographically these include (proceeding from north to south):

(a) the Baltic States – namely Estonia, Latvia and Lithuania;
(b) Poland, the Czech Republic, Slovakia, Hungary and Romania; and

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(c) finally the two successor countries of the former Yugoslavia: Slovenia and Croatia.

11. The limits of this report, however, do not allow for providing equal attention to each of the jurisdictions.

12. The geographic proximity and the shared history of some of these countries is often of relevance to the topics touched upon in this report. For example, while the presence of Scandinavian banks is substantial in the Baltic States, that is not so in Central Europe, where German, Austrian, Italian and Spanish banks, together with a few domestic ones, dominate the market.

13. Needless to say, being part of the same state for decades meant also that many common elements of the legal super-structure were inherited by the successor countries – i.e. the Czech Republic and Slovakia on one hand and Croatia and Slovenia on the other. For example, the post-Yugoslav countries have no civil codes but property, contract and tort law are in separate statutory enactments. Consequently, while in Hungary and Romania secured transactions law is in the civil codes, in Croatia and Slovenia the applicable law can be found in distinct statutes.

14. However, no far-reaching conclusions should be drawn purely based on either geographic proximity or (more or less) shared common history with respect to fields of law covered by this Report.

4. Commonalities of the region's legal systems of relevance to the report

15. Primarily for the sake of orientation, two common features of the legal systems of the region ought to be stressed: first, these systems all belong to the civil law legal tradition (family) and, second, until the 1990s they were all socialist (communist) systems.

16. A few quite practical implications ensue from this for the purposes of this project.

4.1. The repercussions of belonging to the same legal family

17. The legal origins: Notwithstanding that fundamental differences exist among the systems of the region, a common ancestry remains of importance in some respects up until today. A few examples of relevance for this project ought to be mentioned.
18. First of all, this common ancestry is reflected in the sources of law relied on not just by courts and those applying the law but also by scholars. Similarly to German, but contrary to English law, the civil codes (or their equivalents) are the most important and thus most frequently referred to sources of law. Whilst according to conventional wisdom continental European civil codes are supposedly gap-less and answers to any and all disputes could be found in them, often what they contain are no more than general principles and rules rather than concrete answers. This is why of fundamental significance is the increasing importance of case law and the so-called ‘unifying positions’ of the supreme courts. Needless to say, this will be reflected in this report, as often key decisions close the gaps that arise in respect of new and fast-changing fields of law such as insolvency and securities law – both considered in this Report.

19. Although meaningful changes have occurred in most of the CEE states, what is the concrete rule of law is often obscure because only a small – though increasing – proportion of decisions gets reported.

20. Second, there is kinship which is due to the fact that most of the legal categories, principles and rules – or lack of these – are shared. Examples can easily be found among branches of law relevant to this report, such as the absence of the concept of ‘tracing’ known in common law systems, the conceptual unity of real and personal property law, or the accessory nature of in rem securities.5

4.2. The impact of the omnipresent bankruptcy stigma

21. The perception of insolvency, insolvency law and insolvency procedure, not only among the citizenry and businessmen, but also among lawyers, is negatively impacted by the stigmatisation of bankrupts. This feature is, unfortunately, such a commonality in the region that no analysis on insolvency law could disregard it. In this respect the region resembles, for example, such economically superior economies as that of Germany.

22. Another commonality of the region’s countries is the absence of a business rescue culture. Although the insolvency laws have also been upgraded following Western models in the post-1990 period – including the introduction of the local (close or remote) version of US Chapter 11 reorganisations, though looking at German or French law (typically) as the direct models – one could hardly speak

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of a major breakthrough in that respect as of yet. Obviously such a state of affairs is closely linked to the devastating effects of the omnipresent bankruptcy stigma.

23. As a consequence, if blue chip corporations (i.e. strategically important businesses) are being rescued, then they are bailed out by the government rather than finding a way out of insolvency through negotiations, workouts or other forms of private ordering.

4.3. **The socialist/communist past**

24. The socialist/communist past left its imprint on both the security and insolvency laws of the Region’s jurisdictions. This is a factor the importance of which has significantly diminished now, yet it would be a mistake to think that it is of no relevance anymore. For example, in a number of CEE countries (e.g. Serbia, Bosnia and Herzegovina), a significant part of the former state- or employee-owned economic sectors have not yet been privatised. Here it suffices only to emphasise that in the eyes of communist systems, credit and credit security were despised ideological enemies. As a result, during the years of communism the law on credit-securities was clearly in decline, although admittedly attitudes began to change for the better from the end of the 1970s onwards in some countries in the region.

4.4. **The post-1990 transition towards market economy**

25. At the time of the fall of the Berlin Wall the law on securities was underdeveloped in the entire region due specifically to the hostility of the former regime. It was not without reason that the EBRD itself was established precisely to help these countries to introduce (or reintroduce) market economy, and the reform of secured transactions laws became the EBRD’s first priority project.

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26. What this meant for the purposes of secured transactions law in particular is set out in the following paragraphs.

27. The available in rem (proprietary) security devices were essentially limited to possessory pledge and mortgage of immovables. As far as personal securities were concerned, especially in the 1980s and related to foreign trade, the use of bank guarantees and letters of credits were common.

28. The lack of a developed security law was mitigated in certain contexts by contractual penalties (though this was primarily characteristic of the USSR, less so of those countries that have in the meantime become Member States of the EU).

29. Primarily in the countries neighbouring Germany, some forms of non-registrable security devices (the so-called 'kautelarische Sicherheiten') have become common in practice. As latent securities, these caused priority problems following the introduction of the registration-based security interests as part of the post-1990 reforms. This was the case, for example, in Hungary and Poland. For Hungarians, it took a while to realise that the two systems could not co-exist: changes ensued only with the new 2013 Civil Code. In Poland, for example, these security devices continue to play a meaningful role.

30. Needless to say, as time passes by, the socialist past is of less and less relevance, especially in the systems that have reformed their security and insolvency laws.

5. Reformed and unreformed legal systems of the region

31. While some cross-fertilisation is detectable in some of the region’s countries, the rule is rather that each of the jurisdictions has had a distinct path of reform (where any reform has occurred) and post-1990 evolution of secured transactions and insolvency law. As a result, the systems' solutions often differ quite significantly. For example, the operation of the newly introduced registers for security interests on movables have been entrusted to different bodies and have been subject to differing rules, which might be a problem should the EU decide to link these registries in the future.

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