Article 13 of the EIR: The double test

Evert Verwey and Erwin Bos report on the recent decision Lutz [2015] EU ECJ C-577/13 in which the European Court provides insights into defences available to defeat insolvency challenges

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Recently the European Court of Justice (ECJ) provided useful guidance on how to interpret Article 13 of the European Insolvency Regulation (EIR).

Before this decision, the ECJ had already decided that if insolvency proceedings have been opened, the court where these insolvency proceedings are pending has jurisdiction in cases where the insolvency office holder wants to challenge a transaction based upon Article 13 of the EIR.[1] The ECJ decided that this is also the case if a defendant is domiciled in a non-Member State.

The case of *Lutz v Bäuerle* ([2015] EU ECJ C-557/13) considers the position of a creditor or a third party in respect of a commercial transaction in the event that such commercial transaction is later challenged by a insolvency office holder. In particular, the case discusses to what extent such parties can rely on the defence that the detrimental transaction could not be challenged by the law governing that transaction. The case itself might not be very unusual, but the interests of numerous non-parties who submitted observations to the court, including the European Commission and the German, Greek, Spanish and Portuguese governments, shows that many awaited the outcome.

Article 13 of the EIR

In accordance with Article 13, the law of the Member State where insolvency proceedings are opened (*lex concursus*) does not apply where the beneficiary of an act detrimental to all the creditors provides proof that:

1. the act is subject to the law of another Member State (*lex causae*); and
2. that law does not allow any means of challenging that act in the relevant case.

The application of Article 13 entails a 'double test'. An act is only subject to annulment because of prejudice to creditors if this is the case according to both the *lex concursus* and the *lex causae*. If pursuant to one jurisdiction the act is not contestable, the claim of the insolvency office holder cannot be granted.[2]

The case

ECZ Autohandel GmbH (**ECZ Germany**) was a German company which sold cars. Through an Austrian subsidiary of ECZ Germany (**ECZ Austria**) Mr Lutz purchased a car, but the car was never delivered to him. Lutz commenced legal proceedings before the District Court of Bregenz (Austria) against ECZ Austria to recover the purchase price. The Austrian court issued an enforceable payment order against ECZ Austria in favour of Lutz. Subsequently the Austrian court also authorised Lutz to enforce the payment order and three Austrian bank accounts of ECZ Austria were attached. Thereafter the Austrian company went into insolvency proceedings in Germany and a German insolvency office holder was appointed (**Insolvency Office Holder**). Although the Insolvency Office Holder instructed the Austrian bank not to pay out the cash balance to Lutz, the bank did pay out the sum to Lutz that was previously attached.

More than one year after the opening of the insolvency proceeding, the Insolvency Office Holder brought proceedings in the German District Court and challenged Lutz's attachment of the bank accounts. The Insolvency Office Holder sought to set aside the payment made from ECZ Austria's bank accounts in Austria which had arisen as a result of the enforceable payment order in Mr Lutz's favour awarded before the insolvency proceedings had been opened. It should be noted, however, that the payment from the accounts was made after the German court had commenced insolvency proceedings in respect of ECZ Austria.

If German law applied *(lex concursus)* to the challenged

attachment and payment, Lutz's original attachment of the bank accounts would have been invalid due to the opening of the insolvency proceedings. Under German law, the limitation period for bringing an action to set a transaction aside is three years. However, if Austrian law applied (*lex causae*), then the Insolvency Office Holder's challenge could potentially be barred by the Austrian law. Austrian law states a limitation period of one year from the date when the insolvency proceedings were opened for commencing an action to set aside. The referring court notes that that period was not respected in the case in the main proceedings. This could mean that the Insolvency Office Holder would have been too late with his action.

The question of which law applied depended on the interpretation of Article 13 of the EIR. After appeal, the Bundesgerichtshof (Federal Court of Justice) in Germany referred the following questions to the ECJ:

1. Is Article 13 of the EIR wide enough to enable the beneficiary of the act to rely on limitation periods or other time-bars available under the law which governs the challenged transaction?
2. Are the relevant procedural requirements for asserting a claim for the purpose of Article 13 of the EIR also to be determined according to the law governing the transaction or by the law governing the insolvency proceedings?

The decision

Article 13 of the EIR does also apply to a situation in which a payment, challenged by a Insolvency Office Holder, of a sum of money attached before the opening of the insolvency proceedings, was made only after the opening of those proceedings.

Moreover, it means that the defence which it includes also applies to limitation periods or other time-bars relating to actions to set aside transactions under the *lex causae*. This is in accordance with article 12 (1) (d) Rome I Regulation (EC) No 593/2008 and article 15(h) Rome II Regulation (EC) No 864/2007.

The ECJ decided that both the procedural and substantive provisions of the law governing the act complained of (i.e. not the law of the insolvency proceedings) would be available to provide a defence to a challenge brought by the Insolvency Office Holder in the context of the insolvency proceedings. In this particular case, Mr Lutz relied upon a limitation defence that was available to him as a matter of Austrian law, namely that the application to challenge the payment had not been made within the appropriate time limit. The European Commission argued that if procedural aspects were excluded from Article 13 of the EIR it would result in an arbitrary approach, because it would be driven by how individual Member States categorised whether something was procedural or substantive. It was noted that the wording of Article 13 draws no distinction between the type of defences available under that provision. Likewise, in relation to question 2, the ECJ held for similar reasons that the law governing the detrimental act also determined the procedural requirements needed to assert the defence in Article 13 of the EIR.

Choice of law

In conformity with the principle of party autonomy, Article 3 of the Rome I Regulation gives parties the opportunity of choosing the applicable law to an agreement. This could involve a choice of law by parties for a more friendly (Member) State with the purpose of making the transaction more immune against avoidance actions by a future insolvency office holder.

It is difficult for an insolvency office to contest such choice of law as parties are free to choose an applicable law. Some authors argue that a choice of law should be legally invalid if it has been made after the act has taken place or if the choice of law is only made exclusively to reduce or eliminate the risk of a challenge by a (future) insolvency office holder.[3,4] ■

Footnotes:

1 Seagon - Deko Marty (C - 339/ 07) and H. vs. H.K. (Case C-295/13)
2 Asser/Kramer & Verhagen, 10-III, no. 402.
3 Asser/Kramer & Verhagen, 10-III, no. 405.
4 Bertrams & Kruisinga, Overeenkomsten in het internationaal privaatrecht en het Weens Koopverdrag, 2014, p. 63.

TO WHAT EXTENT CAN PARTIES RELY ON THE DEFENCE THAT A DETRIMENTAL TRANSACTION COULD NOT BE CHALLENGED BY THE LAW GOVERNING THAT TRANSACTION?