

Cash Pooling and the European Insolvency Regulation

Bart de Man

Kennedy Van der Laan N.V.

1. Introduction

A cash pooling arrangement is often used in an international context, whereby the group of companies included in the arrangement are situated in different jurisdictions. In this chapter we expand on cross-border jurisdiction issues, when one or more participants to the cash pooling arrangement are located in the European Union and become subject to insolvency proceedings.

2. EU Insolvency Regulation

On May 31 2002, the EU Insolvency Regulation came into force.¹ The regulation is applicable in the jurisdictions of all EU member states, except Denmark. The regulation is only applicable to insolvency proceedings whereby the centre of main interests of the debtor is located in the European Union.² The centre of main interests of a company is presumed to be located in the jurisdiction where that company has its registered office.³ The regulation provides a set of rules for the competence of the courts, the recognition and execution of decisions and for applicable law – all in the context of insolvency proceedings and actions that directly derive from insolvency proceedings and are closely linked to them.⁴

3. Relevance of the regulation for cash pooling arrangements

If one or more of the companies participating in the cash pooling arrangement have their centre of main interests in the European Union and become subject to insolvency proceedings opened in an EU member state, the insolvency proceedings will be recognised by all the other EU member states from the time that it becomes effective in the state of the opening of proceedings.⁵

¹ Council Regulation (EC) No 1346/2000 of May 29 2000 on insolvency proceedings (*Official Journal of the European Union* June 30 2000, L160/1).

² The various insolvency proceedings that fall under the scope of the regulation are listed in Annexes A and B, as referred to in respectively Article 2(a) and (c) of the regulation.

³ Article 3(1) of the regulation. The most significant European Court of Justice cases regarding determination of the centre of main interests to date are: judgment of May 2 2006 in *Eurofood IFSC Ltd* (C-341/04) [2006] ECR I-3813 and judgment of October 20 2011 in *Interdil Srl (in liquidation) v Fallimento Interdil Srl* (C-396/09).

⁴ See the judgment of the European Court of Justice of February 12 in *Seagon v Deko Marty Belgium NV* (C-339/07) [2009] ECR I-767.

⁵ Article 16 of the regulation.

The law of the state of the opening of proceedings (the *lex concursus*) shall determine the conditions for the opening of those proceedings, their conduct and their closure.⁶

It is important to learn what law or which laws govern the rights and obligations of the parties to the cash pooling arrangement, the transactions performed under the arrangement and when and how to affect those rights, obligations and transactions.

Hereafter we describe the legal issues arising from application of the EU Insolvency Regulation in relation to:

- agreements in general;
- setting-off;
- security rights;
- joint and several liability as well as (parent) guarantees;
- fraudulent conveyance;
- directors' and officers' liability;
- corporate matters such as *ultra vires*, financial assistance (maintenance of capital) and conflict of interests; and
- what will happen if the bank becomes subject to insolvency proceedings.

3.1 Agreements in general

A cash pooling arrangement is a multi-party agreement, between a bank and two or more companies belonging to the same group of companies. Article 4(2)(e) of the EU Insolvency Regulation says that the law of the state of the opening of proceedings determines the effects of insolvency proceedings on current contracts to which the debtor is a party. The regulation does not define the term “current contracts”.

The law of the state of the opening of proceedings therefore also determines whether and to what extent the bank (or any other party to the cash pooling agreement) has a right to terminate that agreement, even if such a right would be granted under the agreement if insolvency proceedings are opened.

How much the law of the state of the opening of proceedings will determine in relation to current contracts can differ substantially from jurisdiction to jurisdiction. Insofar as the law of the state of the opening of proceedings does not determine what the effects of the insolvency

⁶ Article 4(2) of the regulation.

proceedings are, these will still be determined by the law applicable to the agreement (the *lex contractus*).

If one or more participating companies enter into insolvency proceedings, the consequence thereof could be that the cash pooling agreement is terminated by law (as a result of the law of the state of the opening of proceedings) or by the bank (or one of the remaining participating companies) using its contractual termination right. This could be a partial termination – that is to say it is terminated only with regard to the participant in insolvency proceedings – or a full termination with regard to all parties to the agreement. The parties to the cash pooling agreement will have to take these possible consequences into account when concluding it, and may want to include an arrangement for the remaining participants that are not subject to insolvency proceedings.

3.2 Setting-off

The basis of a cash pooling agreement is that claims and obligations of the participants towards the bank are set-off. Article 4(2)(d) of the EU Insolvency Regulation says that the law of the state of the opening of proceedings determines the conditions under which a right of set-off may be invoked. It also determines the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings through a set-off.⁷ The opening of the insolvency proceedings does not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim under Article 6 of the regulation.

Article 6 of the regulation is only applicable to set-off of mutual obligations which have been entered into prior to the opening of insolvency proceedings. After the opening of insolvency proceedings Article 4 of the regulation is applicable. A set-off can still be void, voidable or unenforceable as referred to in Article 4(2)(m) of the regulation.⁸

One might think that Article 9 of the regulation is also applicable to cash pooling agreements, as it speaks of “payment or settlement systems”. A cash pooling agreement can be considered to qualify as some kind of a settlement system. Nevertheless, Article 9 of the regulation is not intended to apply to cash pooling agreements. Paragraph 27 of the preamble to the regulation explains the rationale of Article 9, which is to be found in transactions as governed in particular by the EC Directive on settlement finality in payment and securities settlement systems.⁹ The

⁷ Article 4(2)(i) of the regulation.

⁸ Article 6(2) of the regulation.

⁹ Directive 98/26/EC of the European Parliament and of the Council of May 19 1998 (*Official Journal of the European Union* June 11 1998 L166/50), amended by Directive 2009/44/EC of the European Parliament and of the Council of June 10 2009 (*Official Journal of the European Union* June 10, 2009 L146/37).

payment systems referred to therein, should be designated by the member states and notified to the European Commission.

3.3 Security rights

Security rights in favour of the bank usually form part of a cash pooling agreement, in particular – but not necessarily limited to – a security right over the credit balances of all accounts that are part of the arrangement.

Security rights of creditors over assets that, at the time of the opening of proceedings, are located in other EU member states are not affected by the opening of insolvency proceedings according to Article 5 of the EU Insolvency Regulation. More specifically Article 5 of the regulation says that the opening of insolvency proceedings shall not affect “rights *in rem*” of creditors in respect of assets belonging to the debtor, which are situated within the territory of another member state at the time of the opening of proceedings.

is the regulation does not define what a “right *in rem*” is. It will be determined by the law applicable to the assets where they are located at the relevant time.¹⁰ Where an asset is located will be determined by the private international law rules of each member state jurisdiction, including applicable EU rules.

Under Article 5(2) of the regulation the rights *in rem* referred to mean, in particular:

- (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.*

Article 5 of the regulation only applies to rights *in rem* created before the opening of proceedings. If the assets are situated in a non-EU member state, Article 5 of the regulation is not applicable.

Article 5(1) of the regulation does not preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m) of the regulation.¹¹

3.4 Joint and several liability as well as (parent) guarantees

¹⁰ See Virgós and Schmit *Report on the Convention on Insolvency Proceedings* dated July 8, 1996 (6500/1/96 ANNEX).

¹¹ Article 5(4) of the regulation.

Most cash pooling agreements contain provisions to the effect that all participating companies are jointly and severally liable to the bank. Moreover, the agreement will usually contain a guarantee from the parent company and master account holder.

What the validity of these provisions will be after insolvency proceedings are opened against one or more of the participating companies is primarily a matter of the rule applicable to current contracts. This is discussed above at paragraph 3.1.

If one of the participants makes a payment under the joint and several liability obligations, or as a guarantor, it will have a claim for compensation against the non-paying debtor and group company that is involved in the insolvency proceedings. The law of the state of the opening of proceedings will determine what rights this paying creditor has against the debtor/group company accordingly. Under Article 4(2)(g) and (i) of the the EU Insolvency Regulation the law of the state of the opening of proceedings determines:

- the claims which are to be lodged, and the treatment of claims; and
- the rules governing the distribution of proceeds and the ranking of creditors.

3.5 Fraudulent conveyance

It may be argued that under certain circumstances a cash pooling agreement can be detrimental to the rights of other creditors of a participating company, in particular when this company becomes subject to insolvency proceedings. All EU jurisdictions have provisions of some sort regarding the voidance, avoidability or unenforceability of legal acts if they are or could be detrimental to the rights of other creditors ('fraudulent conveyance'). Reference is made to several chapters in this book in which this risk is recognised.

The EU Insolvency Regulation contains specific provisions regarding fraudulent conveyance.

The general rule is given in Article 4(2)(m) of the regulation, which says that the law of the state of the opening of proceedings determines rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all creditors.

Article 4(2)(m) does not apply however, if the person who benefited from such detrimental act provides proof that:

- that act is subject to the law of a member state other than the state where the insolvency proceedings were opened; *and*

- that law does not allow any means of challenging that act in the relevant case.¹²

This is an important rule, providing a way out for the benefiting creditor if he succeeds in passing this double test.

3.6 Directors' and officers' liability

The EU Insolvency Regulation does not contain any specific rules regarding jurisdiction or applicable law in relation to directors and officers liability.

However, the courts of the member state within the territory of which insolvency proceedings have been opened, have jurisdiction under Article 3(1) of the regulation to decide about actions that directly derive from insolvency proceedings and are closely linked to them, even if the defendant has its registered office in another member state.¹³ This includes actions to set aside transactions by virtue of insolvency. It also includes claims that an administrator or liquidator in insolvency proceedings has against (former) directors and officers of a company subject to insolvency proceedings.¹⁴ This jurisdiction seems to be exclusive.¹⁵

under Article 25 of the regulation, the courts of other member states have to recognise such decisions of the courts of other member states.

The regulation does not contain any rules regarding the applicable law in relation to directors' and officers' liability. This will be determined by the private international law of each member state.

3.7 Corporate matters such as *ultra vires*, financial assistance (maintenance of capital) and conflict of interests

The EU Insolvency Regulation does not contain specific rules regarding jurisdiction or applicable law in relation to *ultra vires*, financial assistance (capitalisation requirements) and conflict of interests.

¹² Article 13 of the regulation.

¹³ See European Court of Justice judgment of February 12 2009 in *Seagon v Deko Marty Belgium NV* (C-339/07) [2009] ECR I-767.

¹⁴ This can be derived from the *Seagon v Dekon Marty* case. It has been explicitly confirmed by the Netherlands Court of First Instance in Dordrecht in a judgment of February 3, 2010 (*Gilhuis v X*), JOR 2010/90. This case was about insolvency proceedings opened in the Netherlands and the Belgian director being held liable in the Netherlands.

¹⁵ Again, although not explicitly stated, this can be derived from the judgment in *Seagon v Deko Marty*, and it was stated explicitly by the Netherlands Court of Appeal in Amsterdam in a judgment of November 3 2009 (*Groet Houdstermaatschappij v Conrads*), JOR 2010/244. This case concerned a German liquidator claiming exclusive jurisdiction for the courts of Germany where insolvency proceedings were opened in relation to a fraudulent conveyance action. The Amsterdam Court of Appeal decided that the German courts had exclusive jurisdiction.

It could be argued that claims of an administrator or liquidator to set aside transactions, based on *ultra vires*, capitalisation requirements or conflict of interests are to be brought before the courts of the member state within the territory of which the insolvency proceedings have been opened. Such claims are directed at the same assets as, or assets additional to, those pursued by the claim arising from the right to seek to have a transaction set aside by virtue of insolvency (see paragraph 3.6 above). A question in relation to maintenance of capital has been referred to the European Court of Justice by the German Court of First Instance in Essen.¹⁶ It is uncertain what will be decided by the European Court of Justice. An argument against what is proposed above could be that these actions do not derive from the insolvency proceedings and are not closely linked to them, since they derive from the corporate legal system in a country and do not have a direct link to the insolvency proceedings. Rather, these actions have only an indirect link with the insolvency proceedings, from the administrator or liquidator starting an action based thereon for the purpose of increasing the estate in the insolvency proceedings.

3.8 Bank becomes subject to insolvency proceedings

The EU Insolvency Regulation does not contain any rules regarding jurisdiction or applicable law in relation to insolvency proceedings of banks or other financial institutions.

The rules regarding the reorganisation and winding up of credit institutions have been incorporated in national legislation by the EU member states as a result of the Directive of the European Parliament and of the Council dated April 4 2001.¹⁷

¹⁶ Landgericht Essen November 25 2010, ZIP 2011, 875.

¹⁷ Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (*official Journal of the European Union* May 5 2001 L125/15).