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Missing the Mark: Insolvency Set-Off and the Case of CeDe Group v KAN

Case note on ECJ 21 November 2019, C-198/18, ECLI:EU:C:2019:1001 (*CeDe Group/KAN)*

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Abstract

Article 4 EIR, which states the main rule that the law of the Member State where insolvency proceedings are opened is applicable to the proceedings and their effects, must be interpreted as not applying to an action brought by the liquidator of an insolvent company established in one Member State for the payment of goods delivered under a contract concluded before the insolvency proceedings were opened in respect of that company, against the other contracting company, which is established in another Member State.

Keywords

Action brought by the liquidator for the payment of delivered goods. The conditions to invoke set-off by the contracting party

Case note

Introduction

1. This case contains all the ingredients for a landmark ruling on cross-border insolvency set-off, but unfortunately it has missed the mark. The Swedish Supreme Court (*Högsta domstolen*) referred five questions, but the ECJ only answers the first. The less-than-stellar phrasing of the questions by the Swedish court as well as their narrow interpretation by the ECJ have led to this result. Nevertheless, the unanswered questions are interesting enough to discuss in this case note.

2. The facts of the case are as follows. The liquidator in Polish insolvency proceedings opened against the Polish company PPUB Janson sp.j., brings a lawsuit before the Swedish courts against CeDe Group AB. Before the opening of the insolvency proceedings CeDe Group and PPUB Janson concluded a contract for the supply of goods. This contract is governed by Swedish law pursuant to a choice-of-governing-law clause. The liquidator now seeks payment from CeDe Group for the goods delivered under that contract by PPUB Janson. Defendant CeDe Group claims set-off of its contractual obligation with claims arising from the same supply agreement. During the proceedings before the Swedish courts, the liquidator transferred the claim to KAN sp. z o.o., another Polish company. Shortly after this transfer insolvency proceedings are opened with regard to assignee KAN in Poland. The liquidator in that insolvency procedure has not taken over the proceedings against Cede Group, so that KAN

remains a party to these proceedings. Against this background, the Swedish Supreme Court has asked for a preliminary ruling, in short, whether the pending legal action is governed by the *lex concursus*, and if so, which law governs set-off (see recital 26 for the five referred questions).

Scope of the lex concursus

3. Unless provided otherwise, the law applicable to insolvency proceedings and their effects is that of the Member State within the territory of which the insolvency proceedings are opened. See Article 4(1) EIR and (currently) Article 7(1) EIR (recast). This *lex concursus* determines the conditions under which a set-off can be invoked. See Article 4(2)(d) EIR and (currently) Article 7(2)(d) EIR (recast). The European Insolvency Regulation therefore has a system of so-called *Gleichlauf*: as a principle the applicable law follows the international jurisdiction. See also recital 30.

4. If the liquidator brings an action that is part of the insolvency proceedings, the courts of the Member State in which the insolvency proceedings have been opened shall have jurisdiction regarding such action, which shall furthermore be governed by the lex concursus. It is settled case law, which has now been partially codified in the recast EIR, that only actions that derive directly from insolvency proceedings or which are closely connected with them fall within the scope of the international jurisdiction of Article 3 EIR (and currently: Articles 3 and 6(1) EIR (recast). The decisive factor is not the procedural context of that action, but its legal basis. The right or obligation on which the action is based must arise from derogating rules specific to insolvency proceedings and not from the ordinary rules of civil and commercial law. Cf. recitals 31-32 and recently ECJ 6 February 2019, C-535/17, EU:C:2019:96 (NK/BNP Paribas).

5. The Court now adds that the scope of the lex concursus also extends to claims that are the direct and inseparable consequence of the insolvency proceedings (legal ground 33-34). Under the European Insolvency Regulation the designated insolvency law therefore has a broader scope than the international jurisdiction. The mere fact that the legal claim is based on a contract where a party to that contract is subject to insolvency proceedings, does not suffice to make the claim the result of the insolvency proceedings (see recital 35). The same applies to the fact that the liquidator has brought the action (see recital 36).

6. This seals the fate of the action at hand. The liquidator's legal action for the payment of goods delivered under an agreement concluded before the opening of insolvency proceedings is (of course, I dare to say) not an “insolvency claim”. This claim for payment could have been brought by the creditor of the obligation independent of the opening of insolvency proceedings. The liquidator’s action is therefore not governed by the lex concursus. Cf. recitals 36-37 and 39.

7. The answer to the first question referred is therefore negative: Article 4 EIR does not apply to an action brought by the liquidator of an insolvent company established in one Member State for the payment of goods delivered under a contract concluded before the insolvency proceedings were opened in respect of that company, against the other contracting company, which is established in another Member State. The Court does not answer the remaining four questions posed by the Swedish Supreme Court because they depended on an affirmative answer to the first question. This is a pity, as the decision that the liquidator’s action is not governed by the lex concursus only takes us so far. It is still necessary to determine what law does apply to the set-off claim. This is clear when we turn to recital 38 where the Court states that its judgment (that the action in question is not an “insolvency law action”), does not in any way prejudge the law applicable to the application for set-off or the relevant rules for determining the law applicable to the action in the main proceedings.

Insolvency Set-Off

8. The offsetting of contractual obligations is in principle governed by the law applicable to the claim against which set-off is invoked (the “main claim”), as follows from Article 17 Rome I Regulation. In this case, the main claim is the contractual claim of the bankrupt company against

CeDe Group. This claim was the basis of the action brought by the Polish liquidator. Since Swedish law governs that claim, Swedish law also applies to the conditions for offsetting that claim by defendant CeDe Group.

9. The European Insolvency Regulation contains a specific rule for set-off during insolvency proceedings in Article 4(2)(d) EIR/Article 7(2)(e) EIR (recast). This rule derogates to Article 17 Rome I Regulation. In case of an insolvency proceedings being opened, it is the lex concursus that determines under which conditions a counterparty of the debtor can invoke set-off. This is irrespective of the fact that the main claim itself is not governed by the law applicable to the insolvency proceedings. I stress that the precise scope of the rule is not entirely clear. It is likely that the rule does not interfere more than strictly necessary with set-off powers that exist outside of insolvency under the law designated by Rome I. The lex concursus determines to what extent a power to set off is limited, excluded or extended as a result of the insolvency proceedings. If the law on insolvency set-off builds on the ordinary rules on set-off, such as in the Netherlands, then only the specific consequences of the insolvency proceedings apply to set-off. In this sense, see also (i) Virgós & Garcímartin, *The European insolvency regulation* 2004/183 and (ii) the Opinion of A-G Bobek in this case at para. 59-62. This brings me to the fourth question referred by the Swedish Supreme Court. It asked whether the lex concursus applies to the set-off at hand between CeDe and the Polish liquidator. The answer is obviously yes.

10. However, the EIR contains an important exception to the main rule: the opening of insolvency proceedings shall 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: see Article 6(1) EIR and Article 9(1) EIR (recast). This provision protects the right of the counterparty to rely on set-off according to the lex causae. Indeed, the creditor may have a justified expectation that set-off will be assessed according to the law governing his debt to the insolvent debtor (the main claim). See also recital 24 EIR/recital 70 EIR (recast). The reference to the lex causae of the main claim is a reference to the insolvency law of that legal system: see, inter alia, the Virgós/Schmit Report, § 109. With its fifth question, the referring court basically asked whether the exception applies only if the lex concursus entirely excludes set-off or whether it also applies in other cases where the specific conditions of access to a set-off differ. In my view,the exception protects a right to set-off that exists in the specific case under the law applicable to the main claim. This does not require the lex concursus to exclude that set-off. It suffices that the lex concursus would put the creditor in a worse position: for a similar analysis, see the Conclusion of A-G Bobek in this case at para. 72-75. The right to set-off for the creditor under the exception can, in my opinion, be assessed simply by determining whether the creditor would be allowed to a set-off in the hypothetical situation that the insolvency proceedings had been opened in the country of the lex causae of the main claim.

11. The case at hand contains a little twist that was caused by the assignment of the main claim by the liquidator to a third party during the action brought against the contractual counterparty. The question is whether after such an assignment of the main claim the insolvency proceedings still have an impact on the set-off invoked by the creditor. This issue is raised with the second referred question. A-G Bobek, in para. 47 of his Opinion, considers that due to the assignment, the insolvency proceedings will no longer affect the possibility of set-off. With respect, I disagree with the Advocate-General on this point. The law applicable to the assigned main claim governs the question as to whether the debtor is permitted to invoke set-off against the assignee of that claim. This follows from Article 14(2) of the Rome I Regulation that states that the law governing the assigned claim shall determine, among other things, the relationship between the assignee and the debtor and whether the debtor's obligations have been discharged. In a specific case, this law of the assigned claim may exclude set-off, whereas set-off was allowed according to the lex concursus before the main claim was assigned. To me it does not appear justified that the debtor of the main

claim should be worse off because of the assignment of his debt to a third party. Such an outcome would be inconsistent with the security function of set-off and the expectations of the debtor about the applicability of the lex concursus after the opening of the insolvency proceedings. For that reason, my view is that the insolvency proceedings continue to affect the set-off in favor of the debtor of the assigned main claim.

12. After the assignment of the main claim insolvency proceedings were opened against the assignee, KAN. To make it a little more complicated, the liquidator in that insolvency procedure did not take over the action against Cede Group, so that the insolvent company KAN remains a party to action before the Swedish courts. The third referred question raises the issue whether the insolvency proceedings against the assignee affect the possibility for the debtor of the main claim to invoke set-off. The A-G gives no consideration to this question. The answer seems to me to be that in the insolvency proceedings of the assignee of the main claim, the conditions for invoking set-off are, as a starting point, governed by the lex concursus. However, the creditor retains its right to set-off according to the lex causae of the main claim. These laws, the lex concursus and the lex causae of the main claim, will have to determine to what extent a defendant can rely on set-off in a pending lawsuit to which the debtor was a plaintiff and the action is not taken over by the liquidator.