European Cross-Border Insolvency: An Overview and Update

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The EC Regulation on Insolvency proceedings does not make particularly easy reading.[1] It is a Brussels-made law in the form of a Directive, which took effect in all EU member states (except Denmark, which opted out) on 31 May 2002. Making sense of its provisions involves understanding some slightly unfamiliar concepts, some containing a rather circular logic. That is why there is a rapidly growing body of case law on the key issues. On the positive side, one issue that has been significantly clarified is the meaning of the debtor's **centre of main interests (COMI),** the most fundamental concept of the EC Regulation.

Main proceedings

One of the broad objectives of the EC Regulation is to facilitate the interplay of the patchwork of different insolvency laws across the member states of the EU, so as to simplify the process of dealing with cross-border insolvencies. The basic premise of the EC Regulation is that there can only be one set of main proceedings in relation to a debtor (whether an individual or a company). The main proceedings are to be opened in the state where the debtor has its COMI. The EC Regulation allows insolvency proceedings to be instituted in other member states, but these must be secondary or territorial proceedings. Article 4 of the EC Regulation provides that:

> *'The law applicable to insolvency proceedings and their effects shall be that of the member state within the territory of which such proceedings are opened.'*

This applies to all types of proceedings whether main, secondary or territorial. However, Article 4 is subject to several important carve-outs, contained in Articles 5-15 inclusive.

Article 4(2) clarifies the extent to which the law of the insolvency proceedings is to apply in other member states by listing specific matters in Article 4(2)(a)-(m), including, for example:

- the assets that form part of the estate;
- the respective powers of the debtor and the liquidator;
- the treatment of creditors' claims;
- the rules governing the distribution of the proceeds of realisations; and
- the ranking of claims.

The intention of the EC Regulation is that there will be a single fund out of which all the ordinary unsecured creditors will eventually be paid and that unsecured creditors, wherever they are located in the EU, will be treated on an equal basis.

Secondary and Territorial Proceedings

According to Article 3(3), secondary proceedings can only be opened in another member state after the opening of main proceedings in the member state in which the debtor's COMI is situated. Secondary proceedings must be winding-up proceedings and can only be commenced if the debtor has an establishment in that other state. The effect of the secondary proceedings is to apply only to the debtor's assets in that other state. Territorial proceedings are basically secondary proceedings started in a member state in which the debtor has assets, but which is not its COMI and can only be opened prior to the opening of main proceedings (subject to the conditions contained in Article 3(2) and 3(4)). In contrast to secondary proceedings, territorial proceedings can be rehabilitation proceedings, as well as winding-up proceedings.

EXCEPTIONS TO THE APPLICATION OF THE LAW OF THE STATE OF THE PROCEEDINGS (ARTICLES 5-15)

The rights of certain local creditors are, by the EC Regulation, specifically excluded from the effects of the opening of insolvency proceedings in another member state. These important carve-outs to the application of the law of the state in which the insolvency proceedings are opened are as follows. Article 5 (entitled 'Third parties' rights *in rem'*) provides that the rights of fixed and floating charge holders over both 'tangible or intangible, moveable or immoveable assets' will continue to be determined by the law of the member state where the assets are situated, not by the law of the main proceedings. Other carve-outs relate to:

- creditors' rights of set-off (Article 6);
- the rights of suppliers under retention of title (Article 7);
- contracts relating to 'immoveable property' (Article 8);
- payment systems and financial markets (Article 9);
- contracts of employment (Article 10); and
- rights in ships and aircraft registered in public registers (Article 11).

Other carve-outs include:

- for community patents and trade marks;
- detrimental acts;
- protection of third-party purchasers; and
- Article 15 – the effects of insolvency proceedings on law suits pending.

JUDICIAL CLARIFICATION OF ARTICLE 15: LAW SUITS PENDING

The recent Court of Appeal decision in ***Syska (Elektrim SA) v Vivendi Universal SA*** **[2009]** has clarified the effect of the EC Regulation where there are arbitration proceedings in place in another EU member state.

As stated above, the basic rule contained in Article 4 of the EC Regulation provides that the law applicable to insolvency proceedings will be that of the member state where the insolvency proceedings are opened. Article 4.2(f) provides for an exception in the case of lawsuits pending. Article 15 also deals with lawsuits pending and states:

> *'The effects of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested shall be governed solely by the law of the member state in which that lawsuit is pending.'*

The meaning and interaction of these two articles and Article 4(2)(e), which provides that the law of the insolvency proceedings shall determine the effects of the proceedings on current contracts, was not clear on the face of the legislation and *Syska* provides welcome clarification. *Syska* involved a Polish company called Elektrim that had an agreement with Vivendi Universal SA (Vivendi), under which Vivendi would acquire a Polish mobile telephone company. The agreement contained a clause providing for arbitration in London under English law, in the event of dispute. Vivendi commenced arbitration proceedings in London against Elektrim, claiming damages for breach of the agreement. After the commencement of those proceedings Elektrim was declared bankrupt in Poland. Following its bankruptcy, Elektrim objected to the arbitration proceedings continuing under the English jurisdiction. Unimpressed with that argument, the tribunal made a substantial award in Vivendi's favour.

Subsequently, the High Court in England upheld the decision of the tribunal that the arbitration was a lawsuit pending within the meaning of Articles 4.2(f) and 15 of the EC Regulation, with the result that English law must be applied to determine the effect of the insolvency proceedings on the arbitration proceedings and whether the arbitration should continue. The Court of Appeal confirmed that the existing arbitration in London was a pending lawsuit within the meaning of Articles 15 and 4.2(f). The Court of Appeal referred to the distinction between, on the one hand, proceedings by way of execution or enforcement and, on the other, lawsuits to establish liability. The Court of Appeal held that in relation to an execution 'the creditor satisfies their interest directly', whereas, in the case of lawsuits to establish liability, the creditor 'obtains a decision on the merits that does no more than allow them to join the body of creditors with an established claim'. The Court of Appeal also held that this principle is not restricted to lawsuits for execution of claims over the debtor's assets or to proprietary claims only.

Elektrim, the debtor company, had argued at first instance that the arbitration agreement fell within the description 'current contracts to which the debtor is party' in Article 4.2(e) and, as such, fell to be governed by the law of the bankruptcy, that is, Polish law. Under the Polish Bankruptcy and Reorganisation Law the agreement would have been brought to an end. *Syska* therefore provides important clarification of the meaning of the phrase 'lawsuits pending' used in Articles 4 and 15. It includes arbitration proceedings existing at the time of commencement of insolvency proceedings in another EU member state and such lawsuits will continue to be subject to the law of the member state in which the suit is pending, as opposed to the law of the state of the insolvency proceedings.

COMI

The concept of COMI is central to the EC Regulation. Article 3.1 of the EC Regulation provides:

> *'The courts of the member state within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.'*

Following the decision of the European Court of Justice (ECJ) in the well-known *Re Eurofood IFSC Ltd* [2005], there is a much clearer guide as to what is meant by COMI. In *Eurofood* the ECJ ruled that:

> *'Where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different member states, the presumption [in Article 3(1)] whereby the centre of main interests of that subsidiary situated in the member state where its registered office is situated can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which location at that registered office is deemed to reflect.'*

The judgment also stated that where main insolvency proceedings are opened by a court of a member state:

> *'They must be recognised by the courts of other member states, without the latter being able to review the jurisdiction of the court of the opening state.'*

This is simply a reiteration of the final sentence of paragraph 22 of the preamble to the EC Regulation.

RECOGNITION OF THE MAIN PROCEEDINGS

In the recent ***MG Probud (Area of Freedom, Security and Justice)*** **[2010]** before the ECJ, another company registered in Poland was declared insolvent by a Polish court. Through a branch it had been trading in Germany and the Principal Customs Office of Saarbrucken in Germany seized assets of the company, based on an attachment order made by the local Saarbrucken court after the date of the order opening the Polish insolvency proceedings. The ECJ held that since there were no secondary proceedings in Germany, the German court was not entitled to make an order attaching the debtor company's assets because under the law of Poland – the law of the main proceedings – no such action was permitted. *MG Probud* is straight forward and unsurprising, but it provides confirmation of the important principle that the courts of all member states must recognise the validity of the order of a court in another member state opening main proceedings and the primacy of those proceedings in their own jurisdiction.

Why is it important to establish the COMI of a company?

It is important from a restructuring point of view, as well from a formal insolvency point of view, to know where the COMI is. From a restructuring point of view, it is usually advantageous if companies within the same group have their respective COMI in the same jurisdiction. For obvious reasons, both lenders and suppliers will want to make a note of where they think the COMI of their customer is.

In *Eurofood* the judgment of the ECJ stated that:

> *'Where a company carries on its business in the territory of the member state where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another member state is not enough to rebut the presumption laid down in the Regulation.'*

In ***Re Lennox Holdings plc*** **[2008]** Lewison J had to decide the COMI of two Spanish companies that were part of a group with an English holding company. The holding company was listed on the AIM market and supplied food products to expatriates living in Spain. The judge found that the COMI of both the Spanish subsidiaries was in the English jurisdiction and made administration orders in respect of them. The judge considered that the COMI was in England because that is where the strategic, operational and financial management of the company was conducted, where the board met and the accounts were audited by English auditors. *Lennox* shows that the *Eurofood* decision does not preclude a finding that the COMI of subsidiary companies can be in the member state from which their parent company directs their business, but presumably that fact must be transparently clear to its creditors, as well as to the judge.

Shifting COMI

In ***Hellas Telecommunications (Luxembourg) II SCA*** **[2009]** the English court (Lewison J) had to decide whether the COMI of the company had been effectively transferred to England to take advantage of the more beneficial laws concerning restructuring. The judge decided that the COMI had moved, based on evidence of the following:

1. the company's head office and principal operating address was in London;
2. it had notified its creditors that it had relocated to England and there had been a press release to that effect;
3. it had an active bank account in London;
4. it had registered under the Companies Act 2006 in England;
5. negotiations between the company and its creditors had taken place in England; and
6. the company's senior creditors were prepared to approve a pre-pack sale following an English administration order.

The judge decided the evidence clearly pointed to the COMI being in England, despite the fact the company's registered office remained in Luxembourg, where it retained a bank account and possibly a liability to pay tax. The judge also stated that there must be 'clear, objective and ascertainable facts' to rebut the presumption that a company's COMI is in the jurisdiction of its registered office, and that the purpose of COMI was to enable creditors to know where the company was located and where they may deal with it. The judge decided that the company's COMI had to be determined as at the date of the hearing, which was 29 November 2009. *Hellas* confirms that the English court will recognise the deliberate shift of COMI, from the state where the debtor company is registered, to England, for the purpose of restructuring and to take advantage of English law in the restructuring. *Hellas* demonstrates that it is not necessary to shift the registered office itself to rebut the presumption contained in Article 3(1) of the EC Regulation that the COMI is the place of the registered office.

Note

1. *Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings.*

References

Re Eurofood IFSC Ltd [2005] BCC 397

Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC 3199 (Ch)

Re Lennox Holdings plc [2008] EWHC B11 (Ch)

MG Probud (Area of Freedom, Security and Justice) [2010] EUECJ C-444/07

Syska (Elektrim SA) v Vivendi Universal SA [2009] EWCA Civ 677