Center of Main Interest: The EU Insolvency Regulation and Chapter 15

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Editor's note: *The number of insolvencies is soaring: There was, for example, a 52.6 percent rise in U.K. administrations from the first quarter of 2008 to the first quarter of 2009.[1] Given the increasingly complex and international nature of business in recent years, an increasing number of insolvencies contain a cross-border element (Nortel, Lyondell Basell, General Motors, to name but a few).*


Adam Gallagher

The EU Insolvency Regulation (EUReg) aimed to harmonise the commencement of cross-border insolvency proceedings throughout the European Union.[2] Main proceedings can only be commenced in the member state where the debtor's center of main interests (COMI) is located. The law of that member state governs proceedings throughout the EU (subject to some exceptions), with the courts of all member states recognizing an officeholder appointed under the main proceedings. The officeholder can exercise powers throughout the EU without making court applications in other member states.

The law that governs insolvency proceedings can be key to the success or failure of a restructuring plan. Establishing where a company's COMI is located can be crucial. In England, the party controlling the restructuring may be able to select the insolvency officeholder. In Germany, the Netherlands and France, however, the officeholder is court-appointed. In the Netherlands and Germany, that officeholder is usually a lawyer, perhaps in a small firm and without the resources to manage a large-scale restructuring. The position in Germany may be further complicated by different local courts having jurisdiction over different group companies, meaning that several officeholders may be appointed. Coordinating a sale in such circumstances can be highly problematic.

1 Insolvency Service statistics for insolvencies in England and Wales; first quarter 2009 statistics are provisional.
2 Except Denmark.

About the Authors

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Michael Broeders examines how EUReg operates and how practitioners can use it to assist in coordinated restructurings, especially of groups. He also considers the interface with the U.S.: The United Nations Commission on International Trade Law (UNCITRAL) Model Law and chapter 15 use the same concepts of COMI and main proceeding as EUReg. A coordinated approach to these concepts could facilitate cross-border insolvencies, maximising value for stakeholders, but COMI's conflicting determinations could further complicate such processes.


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European Update

The EUReg or, as it is officially called, the Council Regulation on Insolvency Proceedings (EC) No. 1346/2000 of 29 May 2000 (EUReg)[3] came into force on 31 May 2002.[4] This article examines some of the European Court of Justice (ECJ) cases dealing with a pivotal concept of EUReg, the COMI, which has particular relevance for restructuring scenarios involving groups of companies operating throughout the EU[5] (including those also operating outside it), although EUReg does not specifically cater to such restructurings. We have seen companies "moving" their COMI from one jurisdiction to another so that all group companies may file in the same jurisdiction, simplifying the restructuring process.

There is a link between chapter 15 of the U.S. Bankruptcy Code and the EUReg. Chapter 15 enacts the UNCITRAL Model Law on cross-border insolvency (the Model Law),[6] largely following its exact wording. Concepts central to the Model Law (and chapter 15) are "foreign main proceeding," "foreign non-main proceeding" and "center of main interest," concepts that are derived from EUReg. The drafters of EUReg and its predecessor, the EU-convention of 1995 on insolvency proceedings, which never made it into law, were closely involved in the preparation of the Model Law.[7] There are three reasons for those in the U.S. to look at interpretation of the EUReg:

- Restructurings are gathering pace, so EUReg and its interpretation will increasingly be in the spotlight;
- EUReg can, in certain circumstances, apply to companies incorporated in the U.S. and to EU-incorporated companies that form part of U.S. groups; and
- The interpretation of concepts used in EUReg may (although the emphasis must be on "may") be relevant to interpretation of chapter 15 concepts in the U.S.[8]

3 All references to articles are to EUReg articles.
4 The EUReg does not apply to (1) insurance undertakings, (2) credit institutions, (3) investment undertakings and (4) collective-investment undertakings.
5 References to the EU exclude Denmark, which opted out of EUReg.
6 *See* www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html.

International Jurisdiction: Main Proceeding vs. Secondary and Territorial Proceeding

Significance of the Main Proceeding

EUReg provides for commencement of a single "main proceeding," which can only be commenced in the court of the member state where the debtor's COMI is located. Commencement of a main proceeding is highly significant because, under article 4, the bankruptcy law of the member state where the

7 *See* Jay Lawrence Westbrook, "Multinational Enterprises in General Default: Chapter 15, the ALI Principles and the EU Insolvency Regulation," *Bankr. L .J.* 1 (2002), p. 2-3. The Virgós/Schmit report (1996), originally prepared as an explanatory document to the 1995 convention, provides an important guide to the EUReg. It has no official standing on EUReg, but since EUReg is almost exactly copied from the 1995 convention, it is still valuable and is consulted in (national) court decisions when dealing with questions of interpretation on the EUReg.
8 Several writers and practitioners have pointed to this (*e.g.,* Wessels, *op. cit.*, nr. 10234).

main proceeding is opened is the *"lex concursus," i.e.,* the law applicable to the insolvency throughout the EU (subject to exceptions discussed below). The effects of the main proceeding, and the powers of an insolvency practitioner appointed under it, are recognized throughout the EU (article 16).

Notwithstanding the exceptions below, the main proceeding and the *lex concursus* governing it largely determine the parameters of any restructuring attempts. The following are a few, but clearly relevant, variables:

- whether the relevant *lex concursus* is debtor- or creditor-friendly;
- whether an officeholder will be appointed and how that officeholder is selected; and
- whether it is possible to carry out a consolidated administration of a group of companies.

Application to Non-EU debtors

EUReg does not address whether it applies to companies incorporated in countries outside the EU but with activities in the EU. The ECJ has not addressed whether a company with its registered office outside the EU—but with significant activities inside a member state—may commence a main proceeding under EUReg. However, in the case of *In re Brac Rent-A Car International Inc.*,[9] an England court found that Brac, a company incorporated under the laws of Delaware, had its COMI in the U.K. Brac had a registered office in the U.S. but had never traded there. It was registered in the U.K. as an overseas company and conducted the majority of its business activities in the U.K., Europe and the Middle East. On the current law, the courts of a member state will have international jurisdiction with regards to a debtor company incorporated in a non-EU state, where the company's COMI is in a member state.[10]

Secondary Proceedings, Territorial Procedures and Other Applications of Local Law

There are exceptions to the pan-European application of *lex concursus*. Most importantly, creditors may be able to commence "secondary proceedings" or "territorial procedures" in any other member state where the debtor has an "establishment" (article 3).[11] The scope of the secondary proceeding is limited to the debtor's assets located in that member state. Other exceptions deal with *in rem* security rights, set-off rights, disadvantageous acts, real estate and labor contracts, all governed solely by local law.

Similar to "non-main proceedings" in chapter 15, EUReg recognizes a hierarchy between the main and secondary proceedings. It requires insolvency practitioners in both proceedings to cooperate, but it allows the insolvency practitioner in the main proceeding to request suspension of liquidation activities in the secondary proceeding.[12] Despite this, achieving a harmonized restructuring can be complicated.

Conflict between the bankruptcy laws of different member states is particularly problematic in the restructuring of groups of companies. There is anecdotal evidence that such restructurings may be easier where there is, as far as possible, one *lex concursus* for all main proceedings. EUReg does not specifically cater for the restructuring of groups, but practitioners have found ways to work around this limitation, albeit with various degrees of success. The concept of COMI plays an important part in this.

COMI: The Principles Behind Its Establishment

Even though the concept of COMI plays an important role in how EUReg operates, it is inherently vague. Article 3 provides that, in the absence of proof to the contrary, the place of a company's registered office shall be presumed to be its COMI. Recital 13 attempts to clarify: COMI should correspond to the place where the debtor conducts the administration on a regular basis and is ascertainable by third parties. The Vigrós/Schmitt report gives further "clarification," stating that:

- COMI normally corresponds to the head office;
- COMI corresponds to the place where the debtor conducts the business' administration and has centralized the management of the affairs (*i.e.,* the location from which he or she contracts with third parties); and
- COMI does not correspond to the place where the assets of the debtor, whatever the value, are located, nor to the place where goods are manufactured.

Assessing where COMI is located is a matter of fact. A debtor's COMI can move but it can only have one COMI at any given time.

It is worth noting that, in practice, it is often the debtor that makes the first filing, and therefore has the opportunity to present an argument to the court as to why its COMI is located in a particular jurisdiction. EUReg does not indicate which party bears the burden of proof to rebut the presumption in article 3 or of what such proof should consist, but being first to court in its chosen jurisdiction will often, in practice, assist the debtor.

Approach in Group Restructurings

On the basis of the presumption in article 3, groups of companies (*e.g.,* a parent and subsidiaries) would frequently end up with more than one and, depending on the group's size and international spread, perhaps numerous main proceedings. This seems particularly inappropriate since, in practice, a group will often have operated as a single functional entity, not necessarily organized along the lines of the companies that form the group. Proof to the contrary and recital 13 may come to the rescue. There have been several examples where a debtor, which was parent to a group of companies, was successful in arguing that the subsidiary companies—including subsidiaries incorporated under foreign law—had their COMI in the same member state and at the same location as the parent.

Establishing such consistency of COMI can greatly simplify a going-concern sale of the business: One administrator can effect the sale under one *lex concursus*. Clearly, the chances of such a sale are greatly reduced when main and secondary proceedings exist in various jurisdictions with multiple insolvency practitioners—each acting for their own constituency of creditors and having to liaise. Examples of "group filings" (*i.e.,* with a single *lex concursus*) are *Daisytek, Collins & Aikman* and *Nortel*. The ECJ has decided a number of cases that shed further light on COMI, particularly in the context of subsidiaries.

COMI decisions of the ECJ

Under article 68 of the Treaty on the European Community, the High Court of a member state can refer questions on the interpretation of EU legislation to the ECJ.[13] So far, only a limited number of cases on EUReg have made it to the ECJ, and its application still raises questions. The

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9 High Court of Justice, Chancery Division, Feb. 7, 2003, [2003] EWHC (Ch) 128. *See* Wessels *op. cit.*, nr. 10572.

10 Where a debtor's COMI cannot be located in a member state, the EUReg does *not* provide a basis for international jurisdiction. Each member state's domestic laws determine the consequences of an insolvency procedure commenced under domestic laws governing jurisdiction in international matters.

11 A "secondary procedure" is commenced following the opening of a main proceeding. A "territorial procedure" is commenced in a member state where the debtor has an establishment, where its COMI is located elsewhere in the EU.

12 Article 33.

13 *See* http://europa.eu/lisbon_treaty/full_text/index_en.htm.

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number of such referrals is only likely to increase in the current economic climate.

The first case dealing with COMI was *Susanne Staubits/Schreiber*.[14] The debtor had moved its COMI between lodging a request to open proceedings and commencement of the proceedings. The ECJ ruled that the court of the member state in which the COMI was situated when the debtor lodged the request to open proceedings retains jurisdiction to open those proceedings even if the debtor moves its COMI to another member state. In the well publicized *Eurofood* case[15] (related to Parmalat), the ECJ held the determining factors for identifying a subsidiary company's COMI to be, in summary:

- The presumption (that COMI is where the registered office is) can be rebutted only if objective factors, 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;
- That may be the case, in particular, where a company is not carrying out any business in the member state in which its registered office is situated; and
- By contrast, where a company carries on its business in the member state where its registered office is situated, the 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.

The assessment of COMI is fact-based, and the facts at the time of petition filing appear decisive. That said, it is not clear whether only the facts at the time of filing are relevant or whether historical facts should also be considered. Arguably, taking historical facts into account allows more room for discussion.

In *Eurofoods*, the ECJ also found that the decision of the first court to open a main proceeding should be recognized in another member state unless that decision was in flagrant breach of the fundamental right to be heard, which a person concerned by such proceedings enjoys. Courts in other member states cannot review the first court's decision and cannot open a second main proceeding. The only means of preventing a commencement of a main proceeding in a particular member state, once the debtor or a creditor (in case of an involuntary filing) has argued that the COMI is in that member state, is by appealing the decision of the first court. Thus, *Eurofoods* does not disrupt the practice developed for dealing with groups of companies.

What Can Creditors Do?

European debtor filings seeking commencement of an insolvency procedure are generally made *ex parte*, and creditors learn only afterwards that a filing has been made. Since time periods to appeal in insolvency matters typically are short, the establishment of COMI will more often than not be a *fait accompli* for all but the most watchful creditors.

Model Law and Chapter 15

So, how is this relevant to the U.S.?

The Model Law distinguishes between "main" and "nonmain" proceedings. A main proceeding is in the debtor's home country, (*i.e.*, the jurisdiction where its COMI is located). In a similar way to EUReg, there is a presumption that a company's place of incorporation forms its COMI. A proceeding in another country may only be recognized if the debtor has an "establishment" in that country. Again, the definition is similar to that in the EUReg. Following recognition, only the main proceeding will benefit from the general stay under article 20 of the Model Law.

The position on recognition is the same under chapter 15, which again uses the concepts of main and nonmain proceedings and COMI. The wording and concept are very different from what one would typically expect in the U.S. Apparently the drafters of chapter 15—following suggestions by American commentators that they change to a more usual formulation—decided to stick to the language with the aim of having uniform worldwide terminology.[16]

Since there will often be a link to the U.S. in large European restructurings, it seems likely that European officeholders might seek recognition of their proceeding as a main proceeding, each claiming their jurisdiction to be the debtor's COMI for chapter 15 purposes. Theoretically at least it is possible that the court of an E.U. member state could establish that the COMI of a company (or group of companies) is in that member state, and yet the U.S. courts conclude that the COMI lies elsewhere. Clearly this would be less than ideal. The main proceeding in Europe would not be the same as the main proceeding recognized in the U.S. Potentially, there would be two insolvency practitioners with competing powers—one top dog in the U.S., the other in Europe. There are good reasons to attempt to unify COMI's meaning on both sides of the Atlantic, as the drafters of the Model Law and chapter 15 envisaged.

Conclusion

Although the challenges presented by doing so should not be underestimated, there have been several cases where the COMI of subsidiaries were "moved" to match the parent company's COMI. This allows one *lex concursus* to govern the insolvency of the group. This practice addresses the problem of the EUReg not dealing with the insolvency of groups of companies.

COMI's concept is pivotal to this practice, which is also used in the Model Law and chapter 15. Under the EUReg where the COMI lies determines the applicable insolvency law, and under chapter 15, it determines which relief is available. EUReg influenced the drafters of the Model Law and chapter 15, and intended COMI to have the same meaning under both the Model Law (and so chapter 15) and the EUReg.

Despite these common threads, there is a risk of conflicting interpretations within the EU and U.S. legal frameworks. For instance, the U.S. court may find that the COMI of Company X is in Paris, while an English court has established it to be in London. While one is unable to overrule the other, that seems likely to have an adverse effect on any restructuring attempts and so, ultimately, on creditor value, particularly when dealing with groups of companies. ■

14 *Susanne Staubits-Schreiber*, Sept. 6, 2005, C-1/04.
15 *Eurofood*, (ECJ 2 May 2006, C/341-04), JOR 2004/211/.
16 Westbrook, *op. cit.*, p. 19.