

The EC Insolvency Regulation: three years on

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A number of judicial decisions have interpreted and applied the provisions of Council Regulation (EC) No. 1346/2000 on Insolvency proceedings (Regulation) since it came into effect on 31 May 2002. This chapter considers:

- The principle provisions of the Regulation.
- Interpretive case law relating to the Regulation, including:
 - *Enron Directo SA (Ch Div, Lightman J, 4 June 2002, unreported) (Enron Directo)*;
 - *In the matter of BRAC Rent-a-car international Inc. ([2003] EWHC 128 (Ch)) (BRAC Rent-a-car)*;
 - *Crisscross Communications Ltd (in the UK High Court, 20 May 2003, unreported) (Crisscross)*;
 - *In Re Daisytek-ISA Ltd and others (Ch Div, Leeds District Registry, 16 May 2003) (Daisytek-ISA)*; and
 - *In the matter of Eurofood IFSC Ltd. ([2004] IESC 45, 23 March 2004, Kelly J, unreported) (Eurofood)*.
- Potential future developments of the Regulation.

PRINCIPLE PROVISIONS OF THE REGULATION

This section considers the following aspects of the Regulation:

- Its ambit.
- Its application in main proceedings.
- Its application in secondary proceedings.
- Automatic recognition of insolvency proceedings in member state jurisdictions.

Ambit

The Regulation is directly effective in 24 of the 25 EU member states, and Denmark (the remaining member state) is expected to incorporate it into its domestic law soon.

The Regulation does not replace the national insolvency regimes applicable in each member state. Instead, it is designed as an instrument to mediate between the courts of each member state and to determine which country has jurisdiction over the insolvency of a particular debtor (and, therefore, which courts can open insolvency proceedings for that debtor) (*recital 15 of the Preamble to the Regulation (Preamble)*).

The Regulation acts as a tool to avoid judicial conflict in pursuit of European integration, in the same way that Council Regulation (EC) 44/2001 on Jurisdiction and the recognition and enforcement of judgments in civil and commercial matters legislates for non-insolvency civil and commercial contentious proceedings.

The Regulation does not apply to insurance undertakings or credit institutions (*Article 1(2), Regulation*). The EU has promulgated specific Directives for these bodies. In addition, there are no express provisions relating to groups of companies. However, this has not prevented the courts from applying the Regulation to them (*see below, Crisscross and Daisytek-ISA*).

Application in main proceedings

The courts that have principal jurisdiction over an insolvency are those of the EU member state in which the debtor has its centre of main interests (COMI) (*recital 12, Preamble*). The COMI is presumed to be the location of incorporation or registration of the debtor (*Article 3(1), Regulation*). However, this presumption is rebuttable and the Regulation also provides that the COMI "should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties" (*recital 13, Preamble*).

The Regulation applies to "collective insolvency proceedings which entail the partial or total investment of a debtor and the appointment of a liquidator" (*Article 1(1), Regulation*). The proceedings that come within the scope of the Regulation in each country are identified exhaustively and include both winding-up and reorganisation types of proceedings (*Annex A, Regulation*). Notably, out-of-court proceedings and solvent liquidations are excluded from the scope of the Regulation.

Once the location of the main proceedings has been determined, the law of that member state applies universally to the debtor and its assets. In particular, this includes matters such as the:

- Powers of the insolvency practitioner.
- Conditions for set-off.
- Criteria for lodging and verifying claims.
- Rules governing the realisation and distribution of assets.

However, this rule is subject to some important specific exceptions, notably:

- **Security interests.** If secured assets are situated in another member state, the enforcement of security is governed by the law of that member state (*Article 5, Regulation*).

- **Set-off.** The provisions of the Regulation do not affect the rights of creditors to demand set-off against a debtor, if set-off is permitted by the law applicable to that debtor's claim (*Article 6, Regulation*).
- **Employment contracts.** The applicable law is the law of the member state applicable to the employment contract (*Article 10, Regulation*).
- **Financial market settlement systems.** The applicable law is that of the member state in which the system exists (*Article 9, Regulation*).
- **Contracts relating to immovable property.** The law to apply is that of the member state in which the property in question is located (*Article 8, Regulation*).

Application in secondary proceedings

Once main proceedings have been opened in one member state, only secondary proceedings can be opened in another member state. These can be opened in any member state where the debtor has an establishment, which is defined as "any place of operation where the debtor carries out a non-transitory economic activity with human means and goods" (*Article 2(h), Regulation*). This generally requires the existence of a branch office or similar place of business activity, rather than the mere presence of assets.

Secondary proceedings can only comprise liquidation or winding-up proceedings, and are limited in scope to the realisation of the debtor's assets within that jurisdiction. These ancillary proceedings should only be used when necessary, for example if:

- Local interests need to be protected.
- The debtor's estate is very complex and diverse.
- There are significant differences between the legal systems in the main and secondary jurisdictions.

To ensure the dominance of the main proceedings, the insolvency practitioner in the main proceedings can intervene in the secondary proceedings, and can even request a stay of secondary proceedings if it might benefit the creditors in the main proceedings.

Automatic recognition in member state jurisdictions

One of the principal provisions of the Regulation is that any judgment opening main or secondary proceedings is automatically recognised, and can be applied immediately, with the same effect, in other EU member states without the need for further formalities, unless:

- An exception in the Regulation applies (*see above, Application in main proceedings*).
- Secondary proceedings have been opened in the other member state.
- The other member state refuses to recognise proceedings brought in the originating member state on the basis that recognition would be manifestly contrary to the public policy of the other member state (*Article 26, Regulation*). This dis-

cretion has already been exercised by the courts in Ireland (*see below, Eurofood*).

INTERPRETIVE CASE LAW RELATING TO THE REGULATION

Initially, the Regulation was met with a large degree of scepticism, on the basis that it did not expressly deal with the insolvency of groups of companies, but only focused on the COMI of individual companies. It was thought that this would result in multiple competing proceedings in different jurisdictions. Criticism was also made about the unclear definition of the COMI.

However, these concerns about the limited use of the Regulation have been laid to rest by extensive judicial interpretation, particularly in the UK. The most notable interpretive cases include:

- *Enron Directo*.
- *BRAC Rent-a-car*.
- *Crisscross*.
- *Daisytek-ISA*.
- *Eurofood*.

Enron Directo

This UK case is significant because it signalled the beginning of an era of judicial activism relating to the application of the Regulation. UK administration proceedings were commenced for *Enron Directo*, an Enron group company incorporated in Spain, on the grounds that its COMI was in the UK because its headquarters (where all strategic and business decisions were made) were located there.

BRAC Rent-a-Car

In this case, UK administration proceedings were begun for *BRAC Rent-a-car*, a US company, on the grounds that, even though it was incorporated in Delaware, its COMI was located in the UK because:

- All of *BRAC Rent-a-car*'s employees were based in the UK.
- UK law governed all of the employment contracts.
- The business was administered in the UK.
- *BRAC Rent-a-car* was registered as an overseas company in the UK.

This decision represented a major expansion in the scope of application of the Regulation, which was originally thought to apply only to companies incorporated within the EU. However, the UK courts reasoned that if this was the case, the Regulation would have expressly stated so and that an overly strict interpretation of the Regulation would permit companies to avoid its application altogether by incorporating outside the EU.

This case sets an important precedent in that, arguably, the Regulation can now be used to begin insolvency proceedings in an EU

member state against a company incorporated anywhere in the world, provided that it can be shown that its COMI is in that member state.

Crisscross

The decision in *Crisscross* has silenced any criticism of the Regulation on the grounds that it could not suitably be applied to a group of companies.

Administration orders were issued by the UK courts for a group of eight companies that were located, and had assets and creditors, in several EU member states and Switzerland. Although the decision is unreported, the court is known to have reasoned that the companies, in effect, formed one single undertaking managed from the UK.

The effect of the *Crisscross* decision is that the Regulation has been moulded into a pan-European restructuring mechanism available in the UK.

Daisytek-ISA

This case represents the first public test of how the Regulation would achieve its stated aim of regulating and resolving disputes between competing national jurisdictions.

UK administration orders were issued for an entire group of companies, including a French and German company, on the grounds that, even though the registered offices of these companies were abroad, their COMI was in the UK because their management and administration were effectively dependent on their UK parent company. More importantly, the UK court argued that creditors of the companies would consider the companies' main interests to be administered in the UK, and determined that their COMI was, therefore, in the UK within the meaning of recital 13 of the Preamble.

Proceedings were subsequently begun in the French courts. At first instance, the French Commercial Court held that only it had jurisdiction to begin insolvency proceedings for a company registered in France. This decision seems to be the result of a literal interpretation of the Regulation (which is the approach that was feared when it was first introduced) and contrasts with the wide interpretation adopted by the UK courts. In addition, the French Commercial Court held that it could review the basis of the UK court decision to determine whether the Regulation had been applied correctly.

The Court of Appeal in France dismissed these rulings and stated that, once the UK court had determined that it had jurisdiction to open main proceedings, the French courts could not question the decision, but was obliged to accept the UK court's assertion of jurisdiction and, therefore, to recognise the relevant insolvency order that it issued.

The French litigation is currently awaiting further appeal before the French Supreme Court. Proceedings in Germany relating to the German Daisytek subsidiary have followed a similar course.

Eurofood

Eurofood is the latest, and perhaps most important, development in the interpretation and application of the Regulation. Whereas *Daisytek-ISA* demonstrates the use of judicial comity to resolve

difficult jurisdictional disputes, the inability of the Irish and Italian courts to resolve the dispute at the heart of *Eurofood* illustrates the significant uncertainties that still exist in this area.

Eurofood was an Irish subsidiary of the Parmalat group of companies (a multinational group based in Italy). In January 2004, a provisional liquidator was appointed to the subsidiary in Ireland without reference being made to the Regulation. However, in February 2004, main proceedings for the administration of *Eurofood* were commenced in Italy on both of the following grounds:

- General principles of Italian insolvency law.
- *Eurofood's* COMI was located in Italy (because the executive directors were based there and *Eurofood* had no real presence in Ireland).

Crucially, the Italian court did not consider whether the appointment of the provisional liquidator in Ireland precluded it from opening main proceedings in Italy.

In March 2004, the Irish court of first instance disagreed that the appointment of a provisional liquidator was an irrelevant consideration for the opening of main proceedings in Italy. It made the following determinations:

- By making the provisional liquidator appointment order in January 2004, it had opened main proceedings prior to the Italian court and therefore had jurisdiction. It used the following facts, among others, to show this:
 - *Eurofood's* registered office was located in Ireland;
 - *Eurofood* was subject to Irish fiscal and regulatory provisions;
 - third party creditors considered the company to be located in Ireland;
 - there were no other factors to suggest that the COMI was located anywhere other than Ireland.
- It was entitled to review the Italian court's decision to open main proceedings, as the Italian court did not have jurisdiction to do so.
- It could refuse to recognise the Italian proceedings on the public policy grounds identified in Article 26 of the Regulation, because the company's creditors had not been given any notice of the Italian hearing, and the Irish provisional liquidator had only been given one working day's notice, which amounted to a breach of the parties' right to a fair hearing under the European Convention on Human Rights.

On appeal by the administrator appointed previously to the Italian Parmalat companies (Enrico Bondi), the Supreme Court in Ireland decided to refer the following questions to the European Court of Justice (ECJ):

- Does the appointment of a provisional liquidator amount to the opening of main proceedings for the purposes of the Regulation?

- What factors are relevant in determining the location of a debtor's COMI?
- What are the parameters for the operation of the public policy exception set out in Article 26?

The ECJ has refused an application to fast-track its decision and judgment will be delayed for between 12 and 18 months.

The European Commission has recently commissioned a report on the practical effects of the Regulation. The fact that this report was commissioned much earlier than anticipated indicates both the importance of the Regulation and the level of uncertainty surrounding it. Until the ECJ decision and Commission report are published, the uncertainty will continue, with possible paralysing effects in some cases.

POTENTIAL FUTURE DEVELOPMENTS OF THE REGULATION

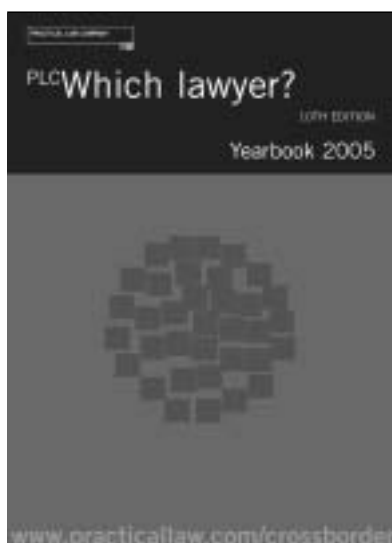
It is likely that the ruling of the ECJ in *Eurofood* will be similar to that given in the twin cases of *Erich Gasser GmbH v MISAT Srl* (Case C-116/02 [2003] ECJ) and *Turner v Grovit* (Case C-159/02 [2004] ECJ), which relate to Council Regulation 44/01/EC (see above, *Ambit*).

In this decision, the ECJ upheld the right of the domestic court that first considers a matter to determine the extent of its own jurisdiction without interference (either at the time or subsequently) from any other EU member state court, even if the parties have expressly agreed that the other court should be the sole forum for the resolution of their dispute. The ECJ effectively recognised that, for pan-European mediation provisions to work successfully, it is essential that any court which is asked to decide a matter that another member state court has previously ruled on be bound by the decision of the first court, even if the original decision is manifestly incorrect or one (or both) of the parties acts in bad faith.

A similar decision, upholding the jurisdiction of the Irish court, is likely to be made in *Eurofood*, as the Regulation states that "the decision of the first court to open proceedings should be recognised in the other member states without those member states having the power to scrutinise the court's decision" (*recital 22, Preamble*). Respecting the first court's decision that it has jurisdiction to open main proceedings is essential if the Regulation is to achieve its aim of avoiding the duplication of proceedings.

The practical result of a decision to this effect will be that debtors who wish to use insolvency proceedings in a particular jurisdiction should ensure that they make an application to the courts in that jurisdiction quickly, and that there are credible arguments to show that their COMI is in that jurisdiction.

A debtor that wishes to use the insolvency proceedings of a particular jurisdiction may be able to meet the COMI requirement by forum shopping (that is, moving its management to, and appointing directors from, the desired jurisdiction). The Regulation set out to combat the incidence of forum shopping within the EU (*recital 4, Preamble*). Recent case law has assisted the achievement of this aim. In *Shierson v Vlieland-Boddy* ([2004] EWHC 2572 (Ch)), which involved an individual bankruptcy, whilst the UK court held that neither the time that the debts were incurred, nor the time that the petition for insolvency was made, can be absolute considerations for determining COMI and that "the enquiry as to where the debtor's centre of main interests [is,] is an overall enquiry which takes into account all relevant facts, giving to each of the facts such weight as is appropriate to the circumstances of the particular case" (*paragraph 23*), it also held that "[a]ny change must be genuine, and the court should ... guard against a situation in which the debtor claims to have moved [its] centre, but in fact the situation is that it is no more than a move of temporary convenience designed in the short term to take the debtor out of an inconvenient jurisdiction in insolvency terms" (*paragraph 36*).



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