EU Insolvency Regulation and Multiregulational Combines

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1 Introduction

The growing internationalisation of business activity has created a growing need for regulating insolvency procedures affecting business operating in more than one country. For this reason UNCITRAL, for example, has in recent years developed recommendations on the acceptable standard to be applied to the regulation of insolvency proceedings affecting multinational groups, among others.[1]

UNCITRAL's recommendations have greatly influenced the insolvency laws of several countries, e.g. that of the USA and also the new Chinese insolvency law.[2]

When, in 2004, the UN General Assembly adopted UNCITRAL's *Legislative Guide on Insolvency Law*, it was enjoined that "all States give due consideration to the Legislative Guide when assessing the economic efficiency of their insolvency regimes and when revising or adopting legislation relevant to insolvency".[3] UNCITRAL's work in the field of insolvency continues, and in 2010 rules appeared for insolvency proceedings involving groups with subsidiaries in several countries.[4]

It should also be mentioned that the International Monetary Fund (IMF), in common with the World Bank, has drawn up recommendations on international insolvency proceedings.[5] *The American Law Institute* (ALI) in turn has issued recommendations in response to a growing number of bankruptcies where the creditor's assets have been located in more than one of the countries which are parties to the *North American Free Trade Agreement* (NAFTA).[6]

The EU has had an Insolvency Regulation (EIR) since 2002, its *raison d'être* being that the proper functioning of the internal market demands rules for cross-border insolvency proceedings.[7] The purpose of the present essay is to show how the COMI concept set forth in art. 3 of EIR should be applied to insolvency proceedings involving multinational groups.

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1 *See* "www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html". *See* also Mevorach, I, *Insolvency within Multinational Enterprise Groups*, 2009, p. 81.

2 *See* Lee, E., & Ho, H. *China's New Enterprise Bankruptcy Law - Great Leap Forward, but Just How Far*, International Insolvency Rev. Vol. 19 pp. 145 ff. (2010) and Wessels, B, Markell, B. A. & Kilborn, J. J. *International Cooperation in Bankruptcy and Insolvency Matters*, 2009, pp. 237 ff.

3 UN General Assembly, resolution 59/40.

4 *See* "www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html".

5 *See* International Monetary Fund, *Orderly and Effective Insolvency Proceedings*, 1999, "www.imf.org/external/pubs/ft/orderly"/ and World Bank, *Principles for insolvency and Creditor Rights System*, "http://web.worldbank.org".

6 *See* American Law Institute, *Principles of Cooperation Among the NAFTA Countries*, 2003.

7 *See* preamble recital 3 EIR.

2 The EU Insolvency Regulation

It is a characteristic of EIR that it includes rules on choice of law and jurisdiction but no substantive rules on insolvency.[8] The pivotal provision of EIR comes in art. 3 (1):

> "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 or legal person, 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".

EIR is constructed in such a way that the first court receiving a petition and judging the company's Centre of Main Interest – COMI – to be located within its jurisdiction can open insolvency proceedings.[9]

Recital 13 of the preamble to EIR lays down that the company's COMI shall "correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties". Under art. 3 (1) of EIR, the company's registered office shall be presumed its COMI, failing proof to the contrary.

The Regulation takes as its starting point the impossibility of introducing insolvency proceedings with universal scope within the entire community, due to the widely differing substantive laws of the States Parties, not least, for example, on the subject of security interests.[10]

The substantial differences between the insolvency laws of the States Parties provide an incentive for forum shopping. Great Britain has proved an especially popular choice of venue for insolvency proceedings[11], one reason being that English insolvency law facilitates the efficient administration of insolvency proceedings. The special reconstruction procedure in English law known as *Company Voluntary Arrangement* (CVA) is looked on as a flexible way of reconstructing a company's operation. It is above all German companies that have moved their COMI to Britain, so as to be able to open insolvency proceedings there under the rules of CVA.[12] This procedure also has the advantage of being familiar to American credit providers.[13]

EIR does not indicate how the COMI of a multinational group is to be determined. If insolvency proceedings are filed against one company in a group, then under EIR the group's member companies are regarded as separate debtors, even if in practice they are closely intertwined.

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8 Council Regulation (EC) No 1346/2000 of May 29 2000 on insolvency proceedings.

9 Centre of Main Interests.

10 *See* recital 11, preamble EIR.

11 *See* McCormack, G., *Jurisdictional Competition and Forum Shopping in Insolvency Proceedings*, The Cambridge Law Journal. Vol. 68, pp.169 ff. (2009).

12 *See* Ringe, H-G, *Forum Shopping under the EU Insolvency Regulation*, European Business Organization Law Review (EBOR), Vol. 9, pp. 579 (2009).

13 *See* Part I sec. 1-7 Insolvency Act 1986.

3 The Application of EIR to Multinationals

One reason for EIR not expressly including multinational groups is that, even if in many cases the group operates as an economic unit, companies are still regarded as separate legal entities despite being members of a group. German and Portuguese law are an exception, which have rules of group law applying outside the sphere of reference and, as regards the protection of minority shareholders and the creditors of a subsidiary, treat groups as legal entities.

Even though companies belonging to a group are usually considered as separate legal entities, experience has shown that if one subsidiary becomes insolvent, this often leads to other companies in the group doing the same. [14] If so, there can be as many insolvent companies, creditor collectives and bankruptcy suits as there are companies in the group, in which case there is a manifest danger of it being impossible for the insolvency proceedings to be efficiently conducted.

4 How has the COMI Concept been Interpreted in Case Law where Multinational Groups are Concerned?

There are various possible ways of determining the COMI when subsidiaries of a multinational group become insolvent. One possibility is for the parent company's COMI also to apply to the subsidiaries. All insolvent companies in the group will then come under the same procedure and a pool of assets will be created for the entire group. An order of this kind is already being applied in American law.[15] The other possibility is that of separate proceedings, with each member company in the group having its own receiver or reconstructor.

English case law makes clear that the COMI of a multinational group is determined by the location of the parent company's registered office, always provided that it is the parent company which in practice administers the operations of the subsidiaries.

The English *Daisytek case* is perhaps the most widely noted example.[16] Daisytek-Isa Ltd had 15 subsidiaries in France, Germany and a number of other EU Member States. Daisytek in turn had an American parent company. That company got into financial difficulties and applied for reconstruction under American law. At the same time, Daisytek and its EU subsidiaries petitioned an English court for reconstruction. The English ruled that all the European companies had their COMI in England, on the grounds that the subsidiaries' operations were administered by Daisytek.

14 *See* Paulus. Ch. G., *Group Insolvencies – Some Thoughts About New Approaches*, Texas International Law Journal, Vol. 42, pp. 819 (2007).

15 *See* 11 U.S.C. § 105 and Mevoarach, I., *Appropriate Treatment of Corporate Groups in Insolvency: A Universal View*, EBOR, Vol. 8, pp. 179 (2007).

16 In re Daisytek-ISA Ltd [2003] BCC 562.

That decision has been criticised above all in French and German law as being contrary to the basic view underlying the Regulation, namely that proceedings must take the individual company as their starting point, even if that company belongs to a group. The presumption in art. 3(1) EIR means, the critics maintain, that proceedings should take place in the countries where the subsidiaries were registered.

This criticism notwithstanding, the Daisytek decision has impacted on English, French and German case law. [17] There are case-law instances of the parent company's COMI deciding where the main insolvency proceedings for the entire group are to take place.[18] A uniform insolvency procedure for the entire group is considered to create more efficient proceedings than separate proceedings for each member company of the group.[19]

In its *Eurofood* decision, the ECJ considered how the COMI concept was to be construed in the event of companies forming part of a multination group becoming insolvent.[20] That judgement concerned the collapsed multinational Parmalat group. Parmalat, registered in Italy, was the group's parent company and Eurofood was one of its subsidiaries, registered in Ireland. This subsidiary's operations were concerned with providing financial services to the other companies in the group. The reason for Eurofood being established in Ireland was that country's favourable corporate taxation. Eurofood's activities were administered by Parmalat, the parent company, in accordance with an agreement between the companies. The Irish High Court found Ireland to be Eurofood's COMI. Insolvency proceedings for the whole group had opened in Italy, but the ECJ ruled that insolvency proceedings for Eurofood were to take place in an Irish court and that the parent company's COMI did not include the Eurofood subsidiary.[21] The ECJ, invoking recital 13 of the preamble to EIR, ruled that a company's COMI corresponds to "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties."

According to the ECJ, rebuttal of the presumption in art. 3 of EIR of the COMI being the place where the company's head office is registered is only possible if factors which are both objective and ascertainable by third parties indicate otherwise. This could be the case with a letterbox company which does not carry on business in the EU member state in which its registered office is situated. The ECJ ruling continues: "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 by that Regulation".

The ECJ can be criticised for not explaining in its Eurofood decision the meaning of third party in the EIR. For example, creditors who are professional

17 *See* Paulus in Texas International Law Journal, Vol. 42 pp. 819 (2007).

18 *See* Wessels, B., Markell, B. A. & Kilborn, J. J., *International Cooperation in Bankruptcy and Insolvency Matters*, 2009, pp. 122.

19 *See* Mevorach pp. 181.

20 Case C-341/04, 2006, p. I-3813.

21 *See* Carrara, C., *The Parmalat Case*, Rabels Zeitschrift, Vol. 70, pp. 538 (2006).

credit providers presumably know, in the great majority of cases, whether a company forms part of a group, but this is not always so, for example, with a small-scale supplier or consumer.

The Eurofood decision is unclear on certain points, which perhaps explains why there are still instances in Member State case law of insolvency proceedings for all subsidiaries being conducted where the parent company has its COMI.[22]

5 Conclusion

In its Eurofood judgement, the ECJ does not exhaustively answer the question of how the COMI of multinational groups is to be determined. There are several conceivable solutions.[23] The centre of gravity of such a group's activities can be hard to pin down.[24]

American law offers the possibility, where groups with subsidiaries in more than one state are concerned, of appointing a single receiver for all companies in the group.[25] There are obvious advantages to such a uniform procedure. It reduces the risk of problems arising through lack of co-ordination between different proceedings.[26]

Thus it may also be a suitable scheme of things, for EIR purposes, for a common COMI to be determined where the group's head office is located. In most cases this should coincide with the parent company's COMI.[27] A group's head office is characterised by the conduct there of functions overarching the whole group, e.g. matters concerning the financing of the subsidiaries or the venue for joint board meetings of the companies included in the group. But a rule of this kind can hardly be universally applicable, When judging where the group's COMI is located, it is important to consider that a group can vary in character depending on how it is organised. In cases where the subsidiaries are autonomous and there is no overarching group administration, no joint proceedings can be opened either.[28] The crucial point, in the light of the Eurofood decision, is whether a third party had objective grounds for perceiving the group as a financial unit.

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22 *See* Mevorach pp. 181 and Moss G., *Group Insolvency: the European Experience under English Pragmatism*, Brook. Int'l Rev., Vol. 32, pp. 1005 (2007).

23 *See* Mevorach, I., *Appropriate treatment of Corporate Groups in Insolvency: A Universal View*, EBOR, Vol.. 8, pp. 179 (2007).

24 *See* Lo Pucki, L. M., *Cooperation in International Bankruptcy: a Post Universalist Approach*, Cornell L. Rev., Vol., 84, pp. 696 (1999).

25 Se Paulus in Texas International Law Journal, Vol. 42, pp. 819 (2007).

26 Cf. art. 31 EIR.

27 *See* Mevorach, pp. 196 and Paulus. Texas International Law Journal, Vol. 42, p. 819 (2007).

28 *See* Mevorach, pp. 196 ff.

Finally, it should be noted that under articles 3 (3) and 27-39 EIR a creditor can request secondary insolvency proceedings in a Member State where the company possesses an establishment. Every creditor domiciled or registered in the Member State where the establishment is located or whose claim derives from activities in that establishment has a possibility of this kind.

English case law includes examples of a court accepting a request for the employees of a French subsidiary to have the same benefits as if secondary proceedings had been opened in France, in the light of what would have been the outcome of secondary proceedings filed with a French court. Thus we are faced here with secondary proceedings which take place concurrently in a court conducting the main proceedings, in order to take into account substantive differences in the insolvency laws of the countries involved. The point at issue may, for example, be the treatment of preferential claims of different kinds. Under German, Italian and Austrian law, for example, a loan from parent company to subsidiary has lower priority than loans from other creditors. In French law the employees' wage claims have top priority, which is not the case, for example, in English or German law.[29]

29 *See* Hirte, H. *Towards a Framework for the Regulation of Corporate Groups' Insolvencies*, European Company and Financial Law Rev., 2008, p. 213 and Mevorach, EBOR, 2007, p. 219.