

Cross Border Insolvency in the EU : A Primer

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Today's menu...

- The landscape : a few scenarios
- How to Cope with Cross-Border Insolvency : the Models
- The European Insolvency Regulation: the main principles

I. The landscape : a few scenarios

- Case 1 : Company established in Spain, selling furnitures all over Europe, comes in troubled waters due to large inventory and fixed costs
- Insolvency proceedings opened by Spanish court upon request of creditors ("*concurso necesario*" - under Spanish Act 36/2003) and receiver appointed
 - _ May the receiver claim furnitures delivered to French client with a reservation of title, but yet unpaid?
 - _ Will the authority of Spanish receiver be recognized in France?
 - _ Should the receiver act in accordance with French regulations?

I. The landscape : a few scenarios

- Case 2 : German bank is about to lend money to a business incorporated in Germany
- Discussion on guarantees to be offered to bank – money lender offers a *pledge on account receivables* – some of the customers of the lender are located in other MS
- How can bank make sure that its pledge will be upheld in these MS in case of insolvency of lender?

I. The landscape : a few scenarios

- Case 3 : medium sized group distributing computer supplies in various EU Member States, headquartered in England, with subsidiaries operating in MS
- Group is cash strapped due to the consequences of crisis; directors and principal creditor (bank) would like to open reorganization procedure ('administration' – English law) in order 1°) to restructure debt and 2°) try to sell the group as going concern.
- May administrators also take charge of subsidiaries in other EU MS, if they demonstrate that it would be beneficial for the group and the creditors? Or is there a need for separate proceedings in each MS?

II. How to cope with cross-border insolvency : the models

- Starting point :
 - General trend towards approximation of (substantive) insolvency laws (through e.g. work of World Bank and Uncitral : World Bank Principles for Effective Insolvency and Creditor Rights Systems / UNCITRAL Legislative Guide on Insolvency Law : int'l consensus on best practices – such as need to emphasize reorganisation before liquidation)

 - Unlikely, however, that a consensus will appear on detailed legal framework for insolvency and creditor rights – e.g. position of employees and employees' claims in insolvency; debtor-in-possession schemes, etc.

II. How to cope with cross-border insolvency : the models

- Hence need to have a legal framework for cross-border insolvency, coping with diversity of laws and national preferences
- Choice between 2 main schemes (in theory):
 - 'To each its proper due'
 - 'The winner takes it all'

II. How to cope with cross-border insolvency : the models

- 'To each its proper due' :
 - _ Division of insolvency and assets along national lines, each State remains fully responsible for the elements of insolvency on its territory (debtor's assets, operations, employees, etc.)
 - _ Advantage : each State may retain its own preferences (liquidation / salvaging business; creditors / stakeholders, etc.)
 - _ Drawback : no coordination, may lead to a 'race to the assets', equality among creditors may come under pressure

Antithesis of the European idea...

II. How to cope with cross-border insolvency : the models

- 'The winner takes it all' :
 - *One State has overall lead in insolvency:*
 - Its law applies to all insolvency issues
 - Insolvency encompasses all assets, wherever located
 - Its court oversees insolvency : appointment of administrator, settles disputes with creditors, etc.
 - Crucial *technical* question : how do you allocate jurisdiction?

II. How to cope with cross-border insolvency : the models

- 'The winner takes it all'-model is preferable (from efficiency point of view) but far more difficult to implement because of strong reluctance of States to give up control - reluctance is understandable given that insolvency law remains national
- Model may only be adopted in very *strong* federal systems, where mutual trust is given - or if special circumstances so require (see e.g. EU regime for insolvency of banks / insurance companies - mirrors home country control - Directives 2001/24 and 2001/17)

II. How to cope with cross-border insolvency : the models

- Absent such a special context, a *compromise* solution is more likely to be accepted
- This is the case in the EU
- EU Insolvency Regulation based on a compromise between the 2 models

III. The EU Insolvency Regulation : a first look

- EU Insolvency Regulation as a compromise solution
 - *Principle* : one single MS is responsible for the insolvency of a company with cross-border activities
 - its courts and agents have overall responsibility
 - its law applies (including on distribution of assets)
 - Includes assets in all MS – pan European effects (eg : stay)
 - Receiver may freely operate in all MS
 - *Nuances* :
 - other MS may intervene whenever debtor has an *establishment* on territory – and take control of this part of the insolvency
 - (Narrow) exceptions to application of law of MS taking the lead in insolvency
 - Strong obligation for MS to cooperate

III. The EU Insolvency Regulation : a first look

- Before examining model in further details, note that:
 - Regulation does not apply to banks / insurance companies
 - On several issues, Regulation only offers 'backbone' – needs to be supplemented by additional rules (e.g. cooperation between insolvency practitioners appointed in several proceedings – Code of cooperation May 2010 Italy - France)
 - Application of Regulation is due for evaluation in June 2012

IV. The EU Insolvency Regulation : a closer look

Case 1 – allocation of primary responsibility



- Construction company established in Nice, France – started with construction work in Nice area but gradually moved its activities to Ventimiglia region
- After a few years, bulk of its work is done between Torino and Genova – most clients are established there
- Supplies are also procured in Northern Italy and most employees live there
- Business is administered from France (accounts, relationships with the banks, etc.)
- In case of insolvency, which court takes the lead?

IV. The EU Insolvency Regulation : a closer look

Case 1 – allocation of primary responsibility



- Allocation of primary responsibility:
 - Crucial because defining for all aspects of insolvency (applicable law, courts, etc.)
 - 'Life' of a company may, however, be situated at various places simultaneously :
 - Corporate life (strategic decisions, management)
 - Actual operations
 - Relations with 3rd parties – e.g. creditors

IV. The EU Insolvency Regulation : a closer look

Case 1 – allocation of primary responsibility



- EIR : choice for a new concept : *Centre of Main Interests* (COMI) – art. 3 Ins.Reg
 - New concept - no recycling of 'real seat' or other established concepts of national laws → see ECJ in *Eurofood* § 31: The concept of COMI “is peculiar to the Regulation”
 - No definition in EIR – but some guidance in Recital 13 of the Preamble : « The ‘centre of main interests’ 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 »

IV. The EU Insolvency Regulation : a closer look

Case 1 – allocation of primary responsibility



- Where is the *Centre of Main Interests* (COMI)?
 - Even with 'definition' of Recital 13, concept remains rather evasive – probably on purpose, to allow room for variety of situations
 - Article 3(1) introduces a rebuttable presumption in favour of the « *place of the registered seat* »

IV. The EU Insolvency Regulation : a closer look

Case 1 – allocation of primary responsibility



- Where is the COMI of the French/Italian construction company ?
 - Starting point : in France, where the registered seat is located
 - Presumption may only be overturned if it is clear for everyone (and 3rd parties) that the company conducted the administration of its interests from Italy
 - In practice, many substantial links with Italy (customers, suppliers, etc.) - but not enough to overturn presumption

IV. The EU Insolvency Regulation : a closer look

Case 2 – allocation of primary responsibility



- Major European industrial group with origins in the Netherlands is 100% controlled by Luxemburg company
- Luxemburg company set up to benefit from generous tax regime (i.e. reduce the withholding tax on dividends paid within the group under Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different MS)
- Only activity of Luxco : receive dividends each year and use them for group financing purposes – various intragroup loans are concluded each year to reinject part of the dividends in the group

IV. The EU Insolvency Regulation : a closer look

Case 2 – allocation of primary responsibility



- Where is the COMI of the Luxco?
- Starting point : registered seat – Luxembourg
- If the Luxco was a 'pure' letterbox company (no activity at all) : no difficulty in overturning the presumption to look further (courts routinely hold that COMI of a letterbox company is located in another MS than that of its registered seat)

IV. The EU Insolvency Regulation : a closer look

Case 2 – allocation of primary responsibility



- Luxco is, however, more than a 'pure' letterbox company
- Not much activity in Lux – no operational activity and no real physical life (premises, staff, operations)
- However, Luxco is involved in substantial economic operations - it holds shares of operating subsidiaries and redistributes dividends among companies of the group (loans, etc.)

IV. The EU Insolvency Regulation : a closer look

Case 2 – allocation of primary responsibility



- If one looks at the test of the 'conduct of administration', things are not easier:
 - Formally speaking, business is conducted from Luxbg – board of administration meets there, and take decisions, and corporate housekeeping done in local jurisdiction, with required publicity (*Official Gazette*, registrar of the court, Companies House, etc.)
 - But in practice, actual management of tax vehicle / SPV exercised from another jurisdiction...

IV. The EU Insolvency Regulation : a closer look

Case 3 – allocation of primary responsibility



- German business active in IT-services, with operations all over Europe
- Local operations in other MS : sometimes directly through German company, sometimes local company incorporated
- Austrian subsidiary is in very bad shape, about to file for bankruptcy

IV. The EU Insolvency Regulation : a closer look

Case 3 – allocation of primary responsibility



- May a creditor of the Austrian subsidiary argue that since the subsidiary is 100 % owned by the German group, that local management did not act independently, that it negotiated debt directly with Munich etc., COMI is located in Germany ?
- Interest for the creditor : profit from a more creditor-friendly insolvency framework under German law

IV. The EU Insolvency Regulation : a closer look

Case 3 – allocation of primary responsibility



- Principle : COMI of each separate legal person must be assessed on its own
- However, accepted (by very abundant case law) that subsidiary's COMI may be located at seat of corporate parent
- Mere fact that a corporation is part of a group is not sufficient to overturn presumption in favor of statutory seat (ECJ in *Eurofood* at § 36)
- Difficulty : no agreement on nature of evidence / circumstances needed to overturn presumption in favor of subsidiary's

IV. The EU Insolvency Regulation : a closer look

Case 3 – allocation of primary responsibility



- Qaere for the Austrian subsidiary?
- If all important decisions are taken in Germany, no strategic or operational autonomy and third parties (banks, suppliers, employees etc.) are aware of this : possible to hold that COMI is located in Germany

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- Greek airlines is in trouble – cash strapped and no further financing possible
- Files for special insolvency proceedings under Greek law – open to large companies
- Insolvency trustee finds out that the company had a small office in the Netherlands – 4 employees handling flights, reservations etc. from Amsterdam airport
- What is the fate of these employees?

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- Principle : employees fall within insolvent estate – their fate will be determined on the basis of Greek law (insolvency as automatic termination of employment contracts?) and decisions taken by Greek trustee (possibility to keep employees active if Dutch operations are really necessary)

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- Nuances to the monopoly of Greek law and Greek
- 1st nuance : art. 10 of the Regulation : consequences of the insolvency on employment contracts governed solely by the law of MS applicable to the contract of employment
- Which law applies to contracts of employment? Art. 8 Rome I Regulation – most probably Dutch law

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- 2nd nuance : possibility to request opening of 'secondary proceedings' – separate insolvency proceedings for local part of insolvent estate, governed by local law
- Advantage for employees:
 - Dealing with local administrator
 - Application of local law to issue of ranking of claims and distribution of proceeds

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- Requirement in order to : debtor must have an 'establishment' (art. 3 § 2)
- Establishment : any place of operations where the debtor carries out a non-transitory economic activity with human means and goods
- Mere bank account / assets or transient activity (a few contracts) not sufficient

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- Secondary proceedings are in principle autonomous:
 - Local receiver has full jurisdiction on local assets (what are 'local' assets?)
 - Local law applicable (art. 28)
 - Local court supervises secondary proceedings

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- Secondary proceedings do not, however, operate in full independence : various coordination mechanisms between main and secondary proceedings
 - Receiver of main proceedings may intervene and request a *stay* of local proceedings (art. 33)
 - Assets left over in secondary proceedings after all local claims have been met, must be *transferred* to the liquidator of the main proceedings (art. 35)
 - Creditors may file in all proceedings (main and secondary) (art. 32)
 - cross-filing of all claims by receivers of main and secondary proceedings
 - Publicity of main proceedings in all MS where establishment (art. 21)

IV. The EU Insolvency Regulation : a closer look

Case 4 – nuances to the COMI's monopoly

- General principle of *cooperation* between receivers of main and secondary proceedings (art. 31) : guideline more than detailed and enforceable rule
- See European Communication and Cooperation Guidelines for Cross-Border Insolvency Proceedings (Wessels/INSOL)

IV. The EU Insolvency Regulation : a closer look

Case 5 – nuances to the COMI's monopoly



- German bank lends money to Dutch business operating in Germany through local establishment – two security mechanisms:
 - Mortgage over immovable located in Luxbg
 - Pledge over all receivables owed by German customers

IV. The EU Insolvency Regulation : a closer look

Case 5 – nuances to the COMI's monopoly



- German bank worries about possible default of Dutch business
- What will happen if insolvency proceedings opened in the Netherlands in respect of Dutch business ?

IV. The EU Insolvency Regulation : a closer look

Case 5 – nuances to the COMI's monopoly



- Principle : law of the MS where COMI is located (*lex concursus*) – governs all issues related to insolvency – part of the 'monopoly' granted to the COMI
- In this case : if insolvency proceedings opened in the Netherlands in respect of Dutch business, application of Dutch law (Art. 4 EIR) to determine whether mortgage/pledge may be opposed to administrator

IV. The EU Insolvency Regulation : a closer look

Case 5 – nuances to the COMI's monopoly



- May German bank in some way challenge application of Dutch law?
- Several exceptions in Artt. 5 ff. EIR - meant to protect legitimate expectations of creditors
- Art. 5 : if creditor has a right *in rem* on asset located outside jurisdiction where main proceedings were opened, right *in rem* remains subject to local law and avoids application of *lex concursus*

IV. The EU Insolvency Regulation : a closer look

Case 5 – nuances to the COMI's monopoly

- How does Art. 5 work?
 - Mortgage on immovable and pledge on receivables qualifies as a right *in rem*

 - Can security be exercised without consideration of Dutch law?
 - Mortgage : yes, because asset located in France
 - Pledge on receivables : where are underlying assets located? Claims are deemed to be located in the MS where the debtor has its COMI (art. 2 letter *g* – 3rd indent) → pledge on receivables owed by German customers → German law applies

IV. The EU Insolvency Regulation : a modest appraisal

- Good compromise between need for efficiency and concern of MS to keep some say on insolvency affecting their economy
- Biggest shortcoming : no specific rules for groups of companies; however, practice has shown *de facto* consolidation is possible
- In some respects, some rules of the Regulations are more general guidelines than detailed legislative enactments → need some flesh on the bone