

EUROPEAN INSOLVENCY REGULATION – JURISDICTION ISSUES

Introduction

In an article (attached to these Notes), “The European Insolvency Regulation – the case for urgent reform”, (2006) 19 *Insolvency Intelligence* 1, Professor Paulus and I looked at a number of key topics with a view to suggesting urgent reforms.

One of these areas was the definition of the Centre Of Main Interests “COMI”), which of course is a key basis for jurisdiction to open main proceedings under Article 3(1) of the Regulation. The case law since the article, published in January 2006, has mainly focused on jurisdiction to open main proceedings, although there has been a little case law on jurisdiction to open secondary proceedings.

The points we made in January 2006 in relation to COMI were that the concept was not defined in the Regulation (unlike “establishment”, which is defined in Article 2(h)), that Recital (13) was not designed to provide a definition, that one had to look to paragraph 75 of the Virgos-Schmit Report for further guidance and that as a result of the lack of any definition, different courts in different countries had approached the question of COMI very differently and put different emphasis on different features. We made reference to the *Eurofood* case, on which the European Court of Justice had not yet given judgment.

Eurofood [2006] BCC 397

The *Eurofood* case is too well known to require elaboration. With regard to the question of jurisdiction to open main proceedings and COMI, it really only decides two things. The first is that the presumption based on the location of the registered office can only be rebutted by objective facts, ascertainable to third parties. Secondly, the presumption was not rebutted by the fact that the parent company, located in another Member State, had control of the policy of the debtor company.

Eurofood was a special purpose vehicle which was used by the Parmalat Group to raise finance and only took part in three transactions. It had no office of its own or employees

and was maintained by Bank of America in a special low tax zone in Dublin. Nevertheless, on the basis of the ECJ ruling, the Irish courts held that the COMI was in Ireland and that the Irish courts had jurisdiction to open main proceeding, even though the Italian courts had held that the COMI was in Italy. By reason of the ECJ's ruling on the time of opening (as being when the provisional liquidator was appointed by the court without notice to the company), the Irish courts had opened main proceedings first and therefore their decision prevailed.

The national case law in the Member States was not really affected by this ruling, other than the fact that in each case they needed to check that the facts were objective and ascertainable by third parties. I would suggest that these were obvious criteria in any event.

The ECJ did not deal directly with what has been called the "head office functions" test first used in the *Enron Directo* case. The good sense of the head office functions test was accepted by the Advocate General in his Opinion in *Eurofood*, but is not clearly mentioned by the ECJ itself although it could be said to have hinted at it.

The head office functions approach, on the basis of paragraph 75 of the Virgos-Schmit Report suggests that the presumption based on the location of the registered office is to be displaced if it can be shown that the head office functions of the debtor company are carried out in a Member State other than the place of registration. This was a particularly useful test for groups of companies where the company was controlled from one Member State, even though its day-to-day activities were in another (*Enron Directo*, *Daisytek*, *Collins & Aikman*, *Nortel* and several other cases in the UK, France, Germany Italy, Hungary etc. Understood correctly, the head office functions test was of course based on objective facts ascertainable by third parties and therefore consistent with the ECJ judgment in *Eurofood*.

The *Stanford* case

The UNCITRAL Model Law copied the concept of COMI from the EC Regulation. However, and despite the citation of the *Eurofood* case from time-to-time, the US courts

had taken a materially different view for the purposes of Model Law, as enacted in the United States by Chapter 15 of the US Bankruptcy Code.

The *Stanford* case was a contest between liquidators in the British Virgin Islands, the place of registration, and receivers in the United States, where the alleged fraudsters lived and operated. The debtor company had its headquarters in the BVI but, it was alleged, was actually run from the US.

The preliminary issue was whether the meaning of COMI was the same in the Model Law as in the EC Regulation. The English Court of Appeal held that it was.

The next issue was where COMI was located. This is where ascertainability became critical. Third parties were unable to tell that the secret alleged fraud and manipulation by US residents controlled the debtor bank, rather than the headquarters in the BVI. The Court of Appeal found that the BVI was the ascertainable COMI, based on the presumption relating to the registered office and the lack of evidence of objective facts ascertainable by third parties in relation to the United States.

The corporate debtor in the *Stanford* case was an operating offshore bank and it was easy to establish that, as well as the registered office, the head office functions were also carried out in the BVI.

Re Kaupthing Capital Partners [2010] EWHC 836 (Ch)

This case concerned a Guernsey registered limited partnership which under Guernsey law could be (and was in this case) registered with separate corporate personality. Although Guernsey is not part of the EU, and therefore the Regulation does not apply, under English domestic law an administration proceeding can only be opened in respect of a debtor registered abroad as a separate legal person if the debtor is registered within the EEA Member State or has its COMI in an EEA State other than Denmark.

Administrators had been appointed out of court about 18 months earlier and the question was whether COMI was in Guernsey or in England, the UK being an EEA Member State but Guernsey being outside the EEA. The Judge held that as far as outside creditors were

concerned the debtor was being run from London, even though the relevant acts were being done by other group companies under contract to the debtor. The fact that Guernsey had been registered as the debtor's principal place of business was given less weight than the location where creditors sent their invoices.

This was another case of a special purpose vehicle, but this time the control of the related companies was held to be critical and effective in locating the COMI.

The head office functions test for seeing whether the presumption based on the location of the registered office has been displaced has continued to be applied by the national case law in the EU since the *Eurofood* decision. The later cases have emphasised the need for the relevant facts to be objective and ascertainable by third parties. Despite this, a degree of confusion has remained, to be found even in the Court of Appeal judgments in *Stanford* as to the relationship between the head office functions test and the need for the facts to be objective and ascertainable. It seems to me therefore that the definition I suggested in 2006 in the Article mentioned above reflects the effect of case law in Member States and would be a useful definition of COMI for the purposes of amending the Regulation.

That proposed definition of COMI for companies and other legal persons was as follows:-

“The centre of a debtor's main interest for the purposes of Article 3(1) shall mean, in the case of companies and legal persons, the place of the registered office, except that, where the head office functions of the debtor are carried out in another Member State and that other Member State is ascertainable to prospective creditors as the place where such head office functions are carried out, it shall mean the Member State where such head office functions are carried out”

COMI for individuals

There has been less interest in the case law in the COMI in respect of individuals. In the context of individual debtors, Recital (13) is particularly obscure and unhelpful. Resort

must be had to paragraph 75 of the Virgos-Schmit Report as elaborated in *Virgos and Garcimartin: The European Insolvency Regulation Law & Practice*.

In the *Stoyevic* case bankruptcy proceedings were opened as main proceedings in England. Mr Stoyevic was the *de facto* director of an English company which had entered into substantial transactions, including borrowing large sums from a Czech bank. The English Commercial Court had ruled that these loans had been obtained improperly and made Mr Stoykovich personally liable in damages in addition to the liability of his company. The bankruptcy order in England was obtained by the Czech bank as creditor under the terms of the English court judgment.

Subsequently a creditor in Austria requested and obtained the opening of bankruptcy proceedings in Vienna in ignorance of the proceedings already opened in London. Under Austrian academic writings this opening was also regarded as the opening of a main proceeding, since it was not declared to be the opening of a secondary proceeding. No application was ever made to set aside the Austrian opening, but the Austrian Supreme Court in related litigation in effect treated the Austrian proceeding, though in principle a main proceeding, in substance as a secondary proceeding, whose effect was limited to the territory of Austria.

Subsequently, Mr Stoyevic applied to set aside the opening in England on the grounds that his COMI was in Austria. The English court set aside the opening on the grounds that Mr Stoyevic's habitual residence was in Austria, even though he *de facto* ran an English company in England. His actions as a director controlling the English corporation did not count towards the location of *his* habitual residence, which was the correct test in the case of an individual not carrying out a profession or business in his own right. This was entirely in accordance with paragraph 75 of the Virgos-Schmit Report.

The Report and Virgos and Garcimartin suggest that in the case of a professional person the COMI is at the professional's principal office or principal location from which his profession is conducted and that in a case of a person in business on his own account one looks to the place from which that business is conducted.

In the Article mentioned above in 2006 I suggested a definition in the case of individuals as follows:-

“The centre of a debtor’s main interests for the purposes of Article 3(1) shall mean in the case of individuals, the place of habitual residence, except that in the case of professionals it shall be the professional’s principal office or principal location from which his profession is conducted.”

In the light of the elaboration by Virgos and Garcimartin, I would now add:-

“... and in the case of an individual conducting his own business the place or principal place from which that business is conducted”.

This approach accords with page 43 of Virgos and Garcimartin.

Jurisdiction to open territorial proceedings

Again, there has been much less case law on this subject.

The question has been considered by the English Court of Appeal in the case of *Shierson v Vlielland-Boddy* in which the debtor left his wife and family and moved to Spain before the request was lodged to make him bankrupt. At first instance the Judge held that the debtor by the material time had neither a COMI or “establishment” in the UK. The Court of Appeal agreed with the conclusion relating to COMI but found a very strange “establishment” to exist in the UK. The debtor controlled a BVI company which was the landlord of leasehold premises in England. The Court of Appeal held that this was an “establishment”. As far as I can see, this is very difficult to fit in with the definition in Article 2(h).

An issue which arises from time-to-time is whether, if there used to be an establishment in a jurisdiction, but there is no establishment remaining at the time the request to open proceedings is made, but there are still assets and creditors, whether the court can take jurisdiction to open territorial proceedings.

The Tallinn District Court in *R AB* of the 14th June 2006 opened a secondary proceeding in the case of a Swedish company with its COMI in Sweden where the debtor company had a previous economic activity in Estonia which had ceased but had begun a new activity building a hunting cabin and developing hunting tourism. The summary of the facts suggests that the debtor company had a branch office in Estonia and therefore the jurisdiction based on “establishment” appeared to be justifiable. Additionally, however, the Court also considered, by way of a dictum, that a discontinued activity could be relied on for the purposes of founding territorial jurisdiction, if the debtor had had an establishment as defined by the Regulation in the past and there were still assets left in the relevant Member State from that activity: see the discussion in *Moss, Fletcher & Isaacs: The EC Regulation on Insolvency Proceedings* at paragraph 8.37 and *Moss, “Hunting Establishment in Estonia”* (2007) 20 *Insolvency Intelligence* 43. For those who can read Hungarian, there is a citation of this case and a detailed discussion by Dr. Andrea Csoeke in her book on *Cross Frontier Insolvency Proceedings* published in 2008 by HVG-ORAC, Budapest at pages 116-117.

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