EU Insolvency Regulation : A Primer

Patrick Wautelet
Today's menu...

- Three basic scenarios
- The European Insolvency Model
- The European Insolvency Regulation: the main principles
I. Three basic 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, but yet unpaid?
  – Will the authority of Spanish receiver be recognized in France?
I. Three basic scenarios

- **Case 2**: German bank is about to lend money to a business incorporated in Germany – discussion on payment 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. Three basic scenarios

- Case 3: medium sized group distributing computer supplies in various EU Member States, headquartered in England, with subsidiaries operating in MS; cash strapped due to the current 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?
II. 'European insolvency' : the model

• Starting point : diversity remains; no harmonization of substantive law (though i) works of World Bank, ii) trend towards greater emphasis on reorganization)

• Choice between 2 main schemes (in theory):
  1. 'To each its proper due'
  2. 'The winner takes it all'
II. The model

• 'To each its proper due':
  
  I. Each MS remains fully responsible for the elements of insolvency on its territory (debtor's assets, operations, employees, etc.)
  
  II. Advantage: each MS may retain its own preferences (liquidation / salvaging business;
II. The model

• 'The winner takes it all':

  I. One MS 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.

  II. Crucial technical question: how do you allocate jurisdiction?

  III. Policy issue: will other MS accept such far-reaching solution, given that insolvency law remains national?
III. The EU Insolvency Regulation

• Model adopted by the EU Insolvency Regulation:

  I. Principle: one single MS is responsible for the insolvency

  • its courts and agents have overall responsibility
  • its law applies
  • Includes assets in all MS – pan European effects (eg: stay)
  • Receiver may freely operate in all MS

II. Nuances:

• other MS may intervene whenever debtor has an
III. The EU Insolvency Regulation

• Allocation of primary responsibility:

I. Basic concept: Centre of Main Interests (COMI) – art. 3 InsReg

1. 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”

2. 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 »
IIIa. Allocation of primary responsibility

• Basic concept: *Centre of Main Interests* (COMI) – art. 3 InsReg
  1. Even with 'definition' of Recital 13, concept is rather vague – probably on purpose, to allow room for variety of situations
  2. Article 3(1) introduces a rebuttable presumption in favor of the «place of the registered seat»
  3. Difficulty: must be assessed for each legal person independently
IIIa. Allocation of primary responsibility

- Difficulty of locating the COMI: 2 cases

I. First case: the 'mixed' letterbox company: SPV established in favorable jurisdiction, e.g.:

- in framework of securitisation of assets
- Or tax vehicle: established in favorable jurisdiction to benefit from generous tax regime (e.g. 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)
IIIa. Allocation of primary responsibility

• Difficulty of locating the COMI:

I. Mixed letterbox company: no real physical life (premises, staff, operations), but involvement in substantial economic operations

1. SPV: issues asset backed bonds and concludes Receivables Purchase Agreement with originator

2. Tax subsidiary: holds shares of operating subsidiaries and redistributes dividends among companies of the group (loans, etc.)
IIIa. Allocation of primary responsibility

• Difficulty of locating the COMI: mixed letterbox company: test of “conduits of administration”?

  – Impeccable corporate housekeeping done in local jurisdiction, with required publicity (*Official Gazette*, registrar of the court, Companies House, etc.)

  – Contacts with local tax authorities and local advisers

  – But no secret that actual management of tax vehicle / SPV exercised from another jurisdiction..
IIIa. Allocation of primary responsibility

• Difficulty of locating the COMI: second case: the subsidiary

   I. Dutch business active in IT-services, with operations all over Europe

   II. Local operations in other MS: sometimes directly through Dutch company, sometimes local company incorporated

   III. Austrian subsidiary is in very bad shape, about to file for bankruptcy
IIIa. Allocation of primary responsibility

• May a creditor of the Austrian subsidiary argue that since the subsidiary is 100% owned by the Dutch group, that local management did not act independently, that it negotiated debt directly with Amsterdam etc. that COMI is located in the Netherlands?

• Interest for the creditor: profit from a more creditor-friendly insolvency framework under Dutch law
IIIa. Allocation of primary responsibility

- Until now, vast majority of case law relating to Insolvency Regulation focused on COMI, and in particular on issue of COMI in the framework of groups of companies

I. Enron Directo
II. Daisytek
III. Eurotunnel
IV. Parmalat – Eurofood, etc.
IIIa. Allocation of primary responsibility

- Principle that subsidiary's COMI may be located at seat of corporate parent is accepted

- Agreement that 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: “where a company carries on its business in the territory of the MS where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another MS is not enough to rebut the presumption laid down by the Regulation”)

- Difficulty: no agreement on nature of evidence / circumstances needed to overturn presumption in favor of
IIIb. The compromise: nuances to the COMI's monopoly

• 1st nuance: opening of secondary proceedings

  I. Possibility to open secondary proceedings if debtor has 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
IIIb. The compromise: nuances to the COMI's monopoly

- *E.g.*: Spanish company with some operations in France, declared insolvent under Spanish law
- Local creditor in France has right of preference under French law, but position is much less comfortable under Spanish law
- May seek opening of proceedings in France as a way to pressure Spanish administrator to treat him right...
IIIb. The compromise: nuances to the COMI's monopoly

• Secondary proceedings are autonomous:
  – Local receiver has full jurisdiction on local assets
  – Local law applicable (art. 28)
  – Local court supervises secondary proceedings
IIIb. The compromise: nuances to the COMI's monopoly

- Secondary proceedings do not 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)
IIIb. The compromise: 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
IIIb. The compromise: nuances to the COMI's monopoly

• Nuances to monopoly granted to MS of COMI:

I. Applicable law:

1. Principle: law of the MS where COMI is located (lex concursus) – governs all issues related to insolvency

2. Nuance: several exceptions in Artt. 5 ff. - meant to protect legitimate expectations of creditors
IIIb. The compromise: nuances to the COMI's monopoly

- *Eg.*: German bank lends money to Dutch business operating in Germany through local establishment – as a security, pledge over all receivables owed by German customers is granted
IIIb. The compromise : nuances to the COMI's monopoly

• If insolvency proceedings opened in the Netherlands in respect of Dutch business :

I. Principle : application of Dutch law (Art. 4) to determine whether pledge may be opposed to administrator – this may not be anticipated by bank

II. 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
IIIb. The compromise: nuances to the COMI’s monopoly

- Application of Art. 5:
  I. Pledge on receivables qualifies as a right in rem
  II. Pledge on receivables: where are they 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