European Focus

Understanding "Centre of Main Interests": Where Are We?

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2002 was a seminal year for restructuring and insolvency professionals in the UK. In November of that year the eagerly anticipated Enterprise Act of 2002, which was intended to lay the statutory foundations for the "rescue culture," received royal assent. Six months earlier, with considerably less fanfare, the EC Regulation on Insolvency Proceedings (EC No 1346/2000) (the "Regulation") was introduced throughout the EU (except Denmark). A clear understanding of how these twin pieces of law operate is crucial when reviewing a stakeholder's options once a company becomes distressed.

Nearly five years on and it is clear that the Enterprise Act of 2002, apart from generating a relatively modest amount of case law around the edges, largely on procedural matters, is a reasonably well understood piece of legislation. The Regulation is anything but well understood.

Background

At the heart of the Regulation is the concept of a company's "centre of main interests," or COMI. All companies are envisaged to have one and, as will be seen below, the geographical location of a company's COMI will govern whether the courts of a particular member nation can open insolvency proceedings against that company, irrespective of where its registered office is located. It can no longer be assumed, for example, that an English-egistered company can be placed into English insolvency proceedings in every case. This is a novel situation for English

judges, who now have to ask themselves: Do I have international jurisdiction (under the Regulation) as well as domestic jurisdiction (under the Insolvency Act of 1986) to place a particular company into, for example, administration?

Almost unbelievably, the cornerstone concept of COMI is not defined in the Regulation. One is forced to look to the recitals for any sort of guidance. Recital 13 of the Regulation provides that:

> [T]he 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.

Further assistance is found in Article 3(1) of the Regulation, which provides that the place of a company's registered office shall, in the absence of proof to the contrary, be presumed to be the place where its COMI is located.

The history of the Regulation since its inception is one of advisors and courts in various member nations grappling with: (i) what the words of Recital 13 mean; and (ii) how strong the Article 3(1) rebuttable presumption is. The paucity of the definition has been brought into sharper focus in recent years, with increasing amounts of capital finding a home in increasingly complex capital structures of companies that do business on a cross-border basis. With the proliferation of cross-border commercial activity, it is inevitable that a proportion of these businesses will become distressed and, as they do, the opportunity to use the Regulation and the potentially powerful concept of COMI increases.

Where a company produces its finished goods in one jurisdiction, has employees in another jurisdiction, is initially financed by its local bank (which might then sell its position to a number

of international hedge funds) and has customers throughout the EU and possibly beyond, working out where its COMI is located can be a daunting task. Some have argued that, even though a stated aim of the Regulation is to prevent forum shopping, this is exactly what it has encouraged — by removing certainty as to where insolvency proceedings can be opened against a particular company. This has led to instances where there has been a conscious shift of COMI as a means of implementing a financial restructuring. Such an approach has been de rigueur in Germany of late. Deutsche Nickel and, more recently, Schefenacker successfully shifted COMI to England as a prelude to entering into English company voluntary arrangements with their creditors.

Why Is COMI So Important?

The Regulation classifies insolvency proceedings in one of two ways. If an insolvency proceeding is opened in the country where a company has its COMI, those insolvency proceedings will be classified as "main" proceedings. If an insolvency proceeding is opened elsewhere (for which purpose an "establishment" in that country is required), the insolvency proceedings will be classified as "territorial" or "secondary" proceedings. Secondary proceedings can coexist with main proceedings, and indeed a key aspect of the Regulation is the way in which it governs how main proceedings and secondary proceedings operate in conjunction with one another.

Main proceedings in one member state will be recognized automatically in other member nations such that the law governing the main proceedings, subject to a number of exceptions, will govern the insolvency proceedings in relation to the company across all jurisdictions of the EU. The

main proceedings office holder (a legal entity akin to a bankruptcy trustee in the US) has the authority to collect in and deal with all assets of the company in the EU as if the law governing the process under which the office holder was appointed extended to the other member states. However, the jurisdiction of the main proceedings office holder is ousted in a particular member nation if secondary proceedings are opened in that member nation. Office holders appointed in relation to territorial or secondary proceedings (*i.e.*, in a jurisdiction where COMI does not exist) only have authority to deal with assets in that particular jurisdiction and will only be recognized in that jurisdiction. An appointment as a main proceedings office holder is the holy grail for insolvency practitioners and COMI is central in achieving this.

What Determines COMI?

This is the key question to which, unfortunately, there is still not a clear answer. As courts throughout the various member nations attempt to come to terms with the concept of COMI, only one major case (*Re Eurofood IFSC Ltd*) has been referred to the European Court of Justice ("ECJ") with respect to this issue. Arising out of the Parmalat collapse, Eurofood IFSC Ltd, an Irish subsidiary in the Parmalat group, was first placed into provisional liquidation in Ireland and, shortly afterwards, was placed into extraordinary administration in Italy. The extraordinary administration was categorized by the Italian court as main proceedings. Following that, the Irish court opened full winding-up proceedings over Eurofood and concluded that Eurofood's COMI was in Ireland. That action was appealed to the Irish Supreme Court, which referred matters to the ECJ.

Although advisors waited with a degree of bated breath for the ECJ's decision, they were ultimately to be disappointed. Despite some encouragement from the Advocate General (a

functionary who renders advisory opinions to the court) in his official opinion to the ECJ, the ECJ itself did not elaborate on what was meant in Recital 13 by the words "administration of interests" or "ascertainable by third parties," and hence there is still a lack of higher court guidance on the fundamentals of COMI beyond that which is being developed by individual member nations' courts. In the main these have been decisions of lower courts, often in response to uncontested ex parte applications.

Nevertheless, in the English courts at least, a line of authority is starting to emerge which suggests that the "administration of a company's interests" is something akin to the performance of head office type functions. As for the identity of the elusive "third parties," it seems the perception of a company's creditors will be a significant factor. Examples of what constitute head office functions that have emerged from English cases such as *Re Enron Directo SA*, *Re Daisytek-ISA Ltd/ISA Daisytek SAS*, *Crisscross Communications*, *MG Rover* and *Collins & Aikman*, among others, are:

- Internal accounting;
- Treasury management;
- Human resources;
- Purchasing control;
- Contract pricing control;
- IT systems;
- Strategic control;
- General supervision; and
- Corporate identity and branding.

In addition, the domicile of directors and the place where board meetings take place have also been held to be of significance.

While not in any way determinative as to what constitutes COMI, the criteria above at least provide a flavor of how the English courts have been approaching this issue.

When Is COMI Determined?

It may be apparent from what has been said so far that it is quite possible for COMI to shift jurisdictions. There is nothing to stop a company that is "administering its interests" in one country from relocating that administration to another country. So at what point in time is COMI assessed? In the English case of *Shierson v Vlieland-Boddy*, the court in the first instance took the view that COMI should be measured as of the date the judgment opening the insolvency proceedings is delivered, and not at any earlier point in time (such as the date the application for the insolvency proceedings is in fact lodged with the court). In the Court of Appeal (a rare Court of Appeal decision on COMI, albeit a discrete aspect of it), it was held that COMI should be measured at the time when the court is first required to decide whether to open insolvency proceedings — normally the hearing date of the relevant application.

In the later case of *Re Staubitz-Schreiber*, the ECJ reached a different conclusion when it held that COMI should be tested at the time when the request to open insolvency proceedings was made — in other words, at the time the application for the insolvency is lodged with the court. Any attempt to shift COMI after that date would be ineffective for the purposes of determining where a debtor's COMI was located.

Who Determines COMI?

If a particular member-nation court is asked to hold that a company's COMI is in the jurisdiction of that member state and the court accedes to such a request, that is the court which first asserts jurisdiction over the matter, and it is to that court that any appeal against a finding on COMI must be brought. What the Regulation does not permit is a situation where main proceedings can be opened in multiple jurisdictions, with individual courts throughout the EU taking it upon themselves to make a finding of COMI with complete lack of regard to another member-nation court's earlier finding of COMI. This would result in legal chaos. Clearly, to operate effectively, there must be mutual trust and understanding between the various courts of the member nations. Despite some early problems in France, Italy and Germany, this seems to be settling down now. Indeed, the case of *Hans Brochier Ltd v Exner* demonstrates that the English court is more than ready to reverse its own earlier finding of COMI.

On the face of it this is all very sensible, but the irony is that it often creates what is referred to as "the race" to the court. Creditors of a company in one jurisdiction may seek to open insolvency proceedings earlier than they may otherwise have done if they take the view that other creditors, or the debtor itself, will seek to open insolvency proceedings elsewhere. This is not exactly conducive to the modern-day rescue culture.

Unresolved Issues

While there is reasonable certainty in relation to when COMI is to be tested and who determines COMI, there remains considerable uncertainty in relation to:

- The development of consistent COMI criteria;
- The practical effect of a successful appeal against COMI where main proceedings have been in operation for some time; and
- The strength of the registered office presumption.

UNCITRAL Model Law on Cross-Border Insolvency

It should also be noted that COMI has an even broader reach now as a result of the adoption by certain countries (including the UK and the US) of the UNCITRAL Model Law on Cross-Border Insolvency (in the US, via enactment of chapter 15 of the Bankruptcy Code). The Model Law (which is potentially available to all countries around the world), like the Regulation, relies on the concept of COMI as a means of establishing jurisdiction over main and nonmain proceedings. It too contains no definition of COMI, but envisages that courts in adopting states will look to the Regulation cases and the decisions of courts of other countries which have adopted the Model Law as a means of clarifying the COMI concept.

For advisors looking for certainty among a body of case law that will be developed over time from the UK to the US via Mexico, Eritrea and the British Virgin Islands, the road ahead will be challenging.

Re Eurofood IFSC Ltd (Case C-341/04).

Re Enron Directo SA (unrep., 4 July 2002).

Re Daisytek-ISA Ltd/ISA Daisytek SAS [2003] BCC 562.

Crisscross Communications (unrep., 20 May 2003).

MG Rover (unrep., 14 August 2006).

Collins & Aikman (unrep., 15 July 2005).

Shierson v Vlieland-Boddy [2005] EWCA Civ. 974.

Re Staubitz-Schreiber (Case C-1/04) [2006] BCC 639.

Hans Brochier Ltd v Exner [2006] EHWC 2594 (Ch).

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