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The Centre of Main Interest and the Administration of Daisytek

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One grey December day in December 2003, 30 German creditors attended a meeting in Düsseldorf airport about three German companies which were subject to English insolvency legislation. In an era when such meetings held in England are often sparsely attended, it was encouraging to have a meeting well attended, with creditors taking seriously their opportunity to question the administrators and their proposals and to hold them to account. Part of the attraction was undoubtedly the novelty of finding out who were these English administrators and what did they think they were doing? Another part was the fact that this was the first time that the appointment of administrators under English insolvency legislation to a German company under the EU Insolvency Regulation has been challenged in court.

The decisions from the legal challenges are important in establishing how the EU Regulation can be applied and work in practice. They offer hope that insolvency practitioners will be able to apply collective procedures across a European group of companies in order to maximise the return for the stakeholders and minimise the conflict between insolvency practitioners in different jurisdictions.

The Daisytek ISA case is an early example of the use of the EU Regulation to apply the insolvency regime of one member state to a company registered in another member state, and it demonstrated the approach that the English judiciary takes to the application of the regulation. The case concerned a group of companies with headquarters in Bradford, England and trading subsidiaries in Germany, France, Italy and Scandinavia as well as the UK, dealing in the retail and wholesale of computer peripherals. The UK parent was itself a subsidiary of a US company, Daisytek Inc, which became subject to Chapter 11 insolvency proceedings in May 2003. The European group was profitable, but key suppliers were common to the European and US companies and these started to restrict supplies and credit terms; as supplies dried up, the companies were unable to source stock for sale and it was clear that the group had collapsed and would continue to deteriorate without the protection of some form of formal insolvency arrangement.

PricewaterhouseCoopers was instructed to advise the European group's secured creditors and to undertake a distressed merger and acquisition disposal exercise of the entire European Group's operations. The firm contacted a number of potential purchasers of the business but formal insolvency proceedings were needed before a sale could be completed so the Group's directors petitioned the court for administration orders. After legal advice, the directors decided to petition for the French and German subsidiaries to be placed into UK administration as well as the English companies. In supporting the directors in this, the PricewaterhouseCoopers advisers were mindful of the fact that the key creditors were common to all the companies and that common control of all the proceedings could allow the advisers to leverage from their earlier distressed M&A work and rapidly achieve a sale of all the businesses and assets as going concerns, to the benefit of the creditors.

All the companies in the Group were either insolvent or would have become so shortly and a better realisation of all their assets would be obtained in an administration than in a liquidation. The English court could therefore grant administration orders over all the companies, provided it had the jurisdiction to do so.

Article 3(1) of the EU Insolvency Regulation states that a member state court has the jurisdiction to open main insolvency proceedings where the debtor has its "centre of main interests" (COMI) in that jurisdiction. There is no definition of COMI in the Regulation, but there is a presumption that it will be in the country of the company's registered address. This can be rebutted where the company conducts the administration of its interests in another member state on a regular basis, such that the COMI would be ascertainable to be in that other state by third parties.

In the case of the French and German subsidiaries of Daisytek ISA, the following key factors were taken into account by the English court in determining that their COMIs were in England:

– The UK head office in Bradford negotiated some 70% of the supply contracts for French and German companies. This is significant in that the majority of creditors by value would regard the Bradford head office as the place where the companies had their COMI. In addition, two of the UK parent companies had given guarantees to many of the suppliers (in

respect of French and German debt), providing a further link to the UK.

- The funding for the subsidiaries' operations had been arranged through English financial institutions. Again, these substantial creditors would have recognised Bradford as the place where the key decisions over these companies were taken.
- The Group's CEO was based in Bradford and formulated the overall group strategy. He was also a director of the French company and the German holding company, and this involved him spending a significant amount of his time in the UK on these companies.
- Financial information was compiled in compliance with UK accounting principles and reviewed at head office.
- Head office approval was required for all expenditure in excess of EUR5,000 and for the appointment of senior employees.
- At least 15% of sales were negotiated on a pan-European basis from Bradford.
- Information technology support was run from the UK head office, which also dealt with all corporate branding and identity.

Having concluded that the companies' COMIs were in England, the Court proceeded to grant administration orders over the companies on 16 May 2003.

Initially neither the French nor the German courts accepted that the English court had the jurisdiction to grant administration orders over companies that neither traded nor were registered in England. The local directors of the companies came under pressure from local lawyers and insolvency specialists, who were aghast at the thought of the EU Regulation being applied in this way in their country, and advised that the administration orders would not protect the directors from personal liability for failing to file for an insolvency proceeding under the national laws. They accordingly filed for insolvency in the local courts. The pressure that these individuals were subject to by local professionals was intense.

The immediate practical effect of filing for insolvency locally was that the UK administrators were no longer in control of the French and German companies and could not proceed to deal with their stakeholders. Elsewhere the administrators followed up the initial leads from the earlier distressed M&A exercise and were soon in negotiations for a sale. The UK, Irish and Scandinavian businesses were sold with a full recovery for some 85% of the creditors in the UK and 100% of the creditors in Norway, Sweden and Northern Ireland, and some 1,200 jobs were saved. The successor companies are now, it is understood, financially stable and profitable.

In France the UK administrators were banned from the site and could not get any cooperation from the *administrateur judiciaire*; they did not have information on who the creditors were so could not inform them what was happening. In Germany, the local administrator was happier to work with the UK administrators and formally instructed them to act as advisors on the sale of the business and assets.

In Germany the courts were reluctant to accept that, main proceedings already having been opened in England, they could only appoint a liquidator in secondary proceedings. Following an appeal, the German courts have now accepted that an administration order made in England pursuant to the EU Regulation must be recognised in Germany if the English court has been satisfied that the COMI is in England. PricewaterhouseCoopers appointment is therefore recognised on one of the three companies, but rejected on the other two on a technicality which is currently being appealed.

In France the commercial court took the view that the EU Regulation only applied to branch offices and not to companies within a group with separate legal entities. This decision cast a major doubt over the enforceability of the EU Regulation, so the PricewaterhouseCoopers team appealed. On 4 September, the appeal court at Versailles confirmed that the English court could appoint an administrator to a French company where it was satisfied that the COMI was in the UK. It also overturned the appointment of the *administrateur judiciaire* completely, holding that the commercial court was wrong to have opened separate main proceedings in France. Almost four months after their appointment, UK administrators were finally able to control the French assets, complete the business sale and notify the creditors.

The EU Regulation offers the prospect of collective procedures being applied across a European group of companies, allowing companies that are significantly dependent on one another to be dealt with together. But the practical difficulties that remain should not be underestimated; although the insolvency is run according to the law under which the appointment was made – English in these cases – and this determines the ranking of creditors' claims, local laws will still determine matters such as employees' rights, retention of title and the exercise of security over assets. These may often be in conflict with the normal conduct of the insolvency proceeding. Local knowledge and advice is thus vital, and PricewaterhouseCoopers greatly valued the input of its strong business recovery teams in France and Germany. It is clear that anyone who wishes to undertake such a pan-European restructuring will need to have access to strong local resource to avoid pitfalls.

Despite the difficulties of this case, what has been clearly established for the UK, Germany, France and Spain (via the Enron case) is that the judiciary is

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prepared to recognise the English administration procedure, which:

1. enables a practitioner to seek a sale of a pan-European business;
2. provides a medium for secured creditors to collect their security and realise their assets in a going concern environment; and
3. allows one practitioner to make the quick and necessary decisions to transfer ownership of the business to a third party, thus maximising realisations.

There will be many legal challenges on how the different laws interact as new cases come along. Indeed, since it appears that the French Procurator General is to appeal the decision of the Versailles court, there is likely to another challenge even on this case.

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