## **International Corporate Rescue - Special Issue**

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# Meeting of French Administrateurs Judiciaires and Mandataires Judiciaires: Belgium 17 November 2011

David Marks QC, Barrister, South Square, London, UK

On 17 January 2011, the National Council of French Administrators and Liquidators, otherwise known as the Conseil National des Administrateurs Judiciaires et des Mandataires Judiciaires met for their annual Colloquium, this time in Brussels. There were over 130 delegates. It is by far the most important reunion of professionals in the French insolvency industry. The overriding theme of the Colloquium was the consideration of the development of the EC Insolvency Regulation 1346/2000.

The Colloquium, which lasted for a whole day, was structured on the basis of a series of round tables, with each round table comprising four or five separate speakers, analysing particular aspects of and relating to the European Regulation. It was held at the Sheraton Hotel in Brussels on the basis that this displayed the requisite degree of European-ness in order in turn to reflect the general theme of the gathering. The President of the National Council was kind enough to invite a number of foreign speakers, including the author of this Article to comment, in particular, on specific national views on various aspects of the Regulation.

It was clear that the theme was sufficiently important by those who organised the conference because of a perception, perhaps largely unjustified, that many people in the French insolvency industry were not particularly wholly familiar with and were even sometimes not particularly receptive to the thrust and intentions, not to mention the underlying philosophy of the Regulation.

The conference was opened by Madame Viviane Reding, the European Justice Commissioner in charge of matters relating to justice, human rights and related matters such as citizenship.

The first round table dealt with the important interrelationship between the EC Regulation and what were called procedures which involved no divestment. This was prompted by the relatively recent introduction into French law of what is called the Law of Safeguard, initially on 26 July 2005, thereafter reformed by further

Regulations introduced on or about 18 December 2008. The relevant text can be found in Chapter VI of the French Code de Commerce. A word should perhaps be said about the distinction that exists in French insolvency procedure and practice between Administrateurs Judiciaires and Mandataires Judiciaires. They both emanate from a former and single profession known as the profession of Syndic-Administrateur Judiciare, but now encompass two separate functions. In general terms, judicial administrators assist, or on rare occasion, replace directors with a view to restructuring the relevant business. On the other hand and by way of contrast, Judicial 'Mandataires' represent the collective voice of the creditors as a whole and whenever there is deemed to be an inability on the part of the enterprise or the company to restructure itself, they, in effect, are responsible for the realisation of assets with a view to effecting distributions in accordance with laws which reflect the English system of paying dividends. They are also responsible for dealing with the fallout from any cessation of employment by employees. In round terms, there are in France 421 professionals who encompass both profession with the Administrateurs Judiciaires numbering some 113 persons, while there are 308 Mandataires Judiciaires, both professions in question employing a total of some 3,000 employees. More and more of these professionals have formed themselves into a corporate structure, there being some 28 companies or groups dealing with judicial administration, and 68 or so groups dealing with the business of carrying on activities as Mandataires Judiciaires.

A word should perhaps be said about the role of the National Council. The Council consists of two 'colleges' representing the two distinct branches of the overall profession. These colleges, in effect, act, in a very loose way, as trade unions for the professional organisations and, of course, the National Council is responsible for continuing education as well as disciplinary and related matters.

#### Notes

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Reverting to the first round table, being the first of four which were held throughout the day, the theme was prompted by the fact that taking, for example, English law, the main proceedings which are addressed by Annex A to the European Regulation omit schemes of arrangement and the proposed restructuring moratorium for the United Kingdom. This is true of both Annexes A and B. With regard to Annex B alone, administration other than winding up through administration, is also excluded. The question was therefore posed on a general European basis as to whether such proceedings should be in or out, and whether indeed the issue was important. The French clearly took the view that the new form of safeguard which is called Accelerated Safeguard, should be included and a passionate plea was made for that by Reinhard Dammann of Clifford Chance in Paris and Madame Hélène Bourbouloux, a very well-known and highly respected judicial administrator. Patricia Godfrey, a former President of INSOL Europe, and a partner of Messrs Nabarro dealt with the English approach, while apart from the two French speakers mentioned above, Jean-Pierre Farges, a partner of the French Paris office of Messrs Ashurst made a similar plea for inclusion of the new French systems within the EC Regulation. It was perhaps significant that much support was made for the consideration of, if not the inclusion of, 'non-divesting' type mechanisms, both in force and contemplated as coming into force by the person who presided over the first round table, namely, Monsieur Jean-Bertrand Drummen, the current President of the Association of Consular Judges in France. The round table ended with a discussion between those who formed part of the round table on the one hand, and the floor of the house on the other. with the mood being, as indicated above, that there should be a greater inclusiveness in any amendments proposed or otherwise of the EC Regulation.

The next round table dealt with what, on any basis, is a hot issue, namely, the question of the extent to which, if any, the current Regulation deals with groups of companies, a matter which has grown in importance ever since the well-known Eurofood decision. Here, a well-known and highly respected academic lawyer, Professor Menjucq, presided over a largely Franco-Italian panel, but the panel also comprised a well-known Netherlands lawyer, Nicolas Tollenaar and a leading Italian judge from Turin, also very well known in this area, namely, Luciano Panzani. It is perhaps fair to say that INSOL Europe, an organisation already mentioned above, is heavily involved in the compiling of a report which makes extensive suggestions for amending the EC Regulation, including but not limited to, the question of groups. This may well be the subject of a future article in the pages of this publication. Case studies were given by this particular round table, in particular, the story of how Nortel was dealt with within the French system. However reference was also made to the well-known matters of *Daisytek* and *Rover*, both of which had substantial French elements. Other cases which are well known to English lawyers include *Enron*, *Brac rent-a-car* and *Crisscross* as well as the *Eurofood* affair itself.

The round table stressed the way in which French domestic law tended to deal with group insolvencies as in a case called *Emtec*, dealt with by one of the leading courts dealing with insolvency matters in France, namely the Tribunal de Commerce in Nanterre in 2006. It was also pointed out that although Eurofood did not itself present a formal barrier to a proper consideration of group insolvencies, it could nonetheless be said that the European Court of Justice in that case had stressed that there was really no mechanism whereby group insolvencies as such could be addressed, save through the concepts which the Eurofood case itself had considered. Reference was also made to the Eurotunnel affair in 2006 where 17 procedures of safeguard were opened on a concurrent basis followed by, in effect, a protocol, and an agreement, whereby there was coordination about the structure of these parallel regimes. It was also pointed out that in the Daisytek matter which has been referred to above, in 2006 the highest French court, namely the Cour de Cassation, had endorsed the application of the EC Regulation with regard to groups of companies in the sense that it had centralised the affairs of that particular matter in France to ensure that on a commercial basis at least, due recognition was made of the fact that most of that company's activities were conducted in France so as to justify the opening of main proceedings in France with secondary proceedings being held, as it were, held in check while the French main proceedings were pursued and finalised. Overall, the round table, along with the floor of the house, was completely in favour of there being some major reform respecting the general desired view that if there were subsidiary companies, then any insolvency regimes attaching to those subsidiary companies should be subject to some form of primary proceeding, i.e. a main proceeding, and thereby in principle the law of the Member State where the principal trading company was situated. Obviously, that is a conclusion that is easier to state than implement either in terms of a proposed reform to the EC Regulation or otherwise. This theme was revisited several times during the conference, the watch-word no doubt being that flexibility would be key in considering what form of amendment should be made to the EC Regulation with regard to groups as a whole. One thing was agreed upon, namely, that there can be no such separate concept as a group insolvency and at the very least it was required that there be some form of coordination of procedures within a group with regard to those companies within the group which suffered financial difficulties and which went into some form of formal insolvency subject to the EC Regulation.

In many ways this was the most important practical aspect that emerged from the whole day, although clearly, as will be seen and has been seen already, the other subjects that were covered were of immense importance. The reason why perhaps group insolvency is something of a hot issue as indicated above is that the European Commission is required to report on the application of the Regulation before 1 June 2012 and if needs be, submit proposals for its adaptation at about that time. The main difficulty which has been manifested in the wake of the Eurofood case is the fact that the opening of secondary proceedings can very often frustrate the objective of achieving a coordinated sale under the control of a single officeholder. Local courts opening secondary proceedings with respect to foreign subsidiaries will generally appoint different local officeholders leading to multiple appointments within the same group. Since most assets of the local subsidiaries are located in the local jurisdiction where the secondary proceedings are opened, then the secondary proceedings will effectively cause the officeholder in the main proceedings to lose any real control on the foreign assets and any foreign operations. Despite what is indicated above, it could be said that the duty of each officeholder is to cooperate, and the power of the main officeholder to stay any local liquidation proceedings are a weak substitute and, in practice, rarely provide an adequate remedy for these sometimes intractable problems.

This was one of the themes which emerged at various points throughout the entire meeting. To adopt a group COMI approach, usually involves at a practical level, an attempt in effect to fend off secondary proceedings by preventing there being multiple officeholders. Another important reason to prevent secondary proceedings being opened is that secondary proceedings have to be liquidation proceedings, again posing a real threat to the successful going concern of the sale.

This has led to the options which have been touched on already. One option is to seek to transfer all local assets of the foreign subsidiary to a new company established under the laws of the jurisdiction where the group COMI is deemed to be located: what can be called a hive-off. This would mean that local assets that would otherwise fall into the scope of secondary proceedings would be converted into a different form of assets, namely, shares falling under the scope of the main proceedings. One possible problem is that although Article 18 of the Insolvency Regulation appears expressly to permit such a transfer, that kind of transfer could possibly distort local priorities and lead to allegations of abuse or other wrongful conduct. Furthermore, a transfer of assets might not be allowed under the finance documents or it might require consent from the junior lenders. In addition, a hive-off of local assets into a new company might well prevent there being an effective solution if the assets are encumbered with security rights or other rights in rem.

One alternative is that the officeholder in the main proceedings tries to convince local creditors and/or local courts not to open secondary proceedings. In the well-known collapse of Collins & Aikman, the UK administrators in the main proceedings managed to prevent secondary proceedings by representing that they would respect local priorities and treat local creditors as if secondary proceedings were opened. In the event, the English court determined that the administrators were allowed to make such representations. However, this is not to say that the approach in Collins & Aikman will always be allowed in other jurisdictions. For example, in Germany, many lawyers are convinced that the representations made by the administrators in Collins & Aikman would not be permitted under their law. In Nortel, one of the case studies dealt with at length at the meeting, the UK administrators in the main proceeding sent letters to the local courts in the jurisdictions of the subsidiaries requesting to be heard before any petition to open secondary proceedings be decided. That fairly unorthodox request had to be seen in the light of the MG Rover case, another matter mentioned above, where the French Court of Appeal, after having heard the UK administrators in the main proceedings denied the request to open secondary proceedings following the argument of the UK administrators that secondary proceedings could negatively impact realisations and therefore provide no real advantage. Another approach was that adopted in the *Emtec* matter also mentioned above. In that case, the petition to open main proceedings with respect to all group companies in France and abroad contained the explicit representation that secondary proceedings would be opened with respect to the foreign subsidiaries after the sale had been concluded, and that the proceeds of local assets would be kept in the local jurisdiction and then distributed according to the order of priority stipulated by the local secondary proceeding.

All the above techniques contrast in many ways with the decision of the Belgian court in the matter of *Megapool*. In that case, the court held that secondary proceedings could no longer be opened in Belgium because at the time of the request to open the secondary proceedings, the main liquidators in the Netherlands had already liquidated the assets and activities of the Belgian establishment.

The above shows how difficult and complex this area is. One often debated technique is that the court can determine on the basis of the head office functions of the group the place where the main business is carried on by the controlling parent company and therefore the COMI of each individual group can be based in the same place as the COMI of the controlling parent. That may not fit all sizes.

Apart from the proposal which could well emanate from the current INSOL Europe Working Group, Working Group V of UNICTRAL has specifically considered whether the COMI principle adopted by the Model Law

should be modified to apply to the entire group. So far, the Working Group has rejected the concept of a group COMI whereby all insolvency proceedings of the group would be administered from one jurisdiction, as being unworkable. It may well be that the European legislature will also regard any argument in favour of a group COMI as being equally problematic. This is no doubt for the very simple reason that from the viewpoint of the European legislature, no insolvency system will be regarded, or indeed should be regarded, as better or worse than any other. It follows, therefore, that one key element of successfully dealing with group insolvencies is to have the same officeholder appointed in the proceedings of all the relevant entities. Ideally, the most critical phase of an insolvency should be the first phase in which the value of the business and assets have to be realised, preferably through a global sale and the need to ensure that any potential investor needs to have only one party, rather than multiple parties, to negotiate with. Protocols clearly are an excellent means of further improving coordination. However, there is a strong feeling that having the same officeholder appointed is still preferable to having multiple officeholders appointed in the group, even if they are encouraged to cooperate.

The third round table was one which included the author of this Article and Mickaël Jaffe, a well-known lawyer from Munich, Germany. In addition, the panel was graced by the presence of Yves Lelièvre, President of the Tribunal de Commerce de Nanterre, the eminent court which has been mentioned already. There were two outstanding French speakers who joined the panel, namely, Marc André, a well-known Mandataire Judiciaire and Dr Emmanuelle Inacio of the University of Boulogne. The panel was presided over by Professor

Carolyn Henry. Here, the theme was judicial cooperation, as well as officeholder cooperation. From an English point of view, much was said about the Model Law which of course is not, in any way as yet integrated into French law. President Lelièvre spoke about the practical need for officeholders to be realistic and to take into account the real requirements of employees and creditors when considering coordination, either on an intra-national basis or as between States. There was also an interesting discussion involving the floor of the house, as it were, as to the extent to which, if any, judges across frontiers can speak to each other about coordination of relevant proceedings. On the whole, it was felt that this was a matter which had to be dealt with on a very subtle and detailed basis given the risk of trespassing upon respective jurisdictions which had their own rules and procedure and practice.

The fourth and final panel dealt with the extraterritorial effects of various aspects of insolvency procedures, in particular, employment rights and reservation of title claims. This also involved extremely eminent academics and practitioners. For reasons of space, it is not thought appropriate to say anything more about this, save that the contents of the presentations can be found online at the website of the National Council and the relevant address is the following, namely, <www.cnajmi.fr>.

The entire day was not only extremely well organised and richly provided for in the extremely comfortable setting of the Hotel Sheraton in Brussels, but also represented a reminder of the abiding need for all insolvency practitioners across the European Union to continue dialogues of this sort with a view to deeply needed improvements in insolvency procedure and practice within Europe and beyond.

# Lornamead Acquisitions Limited v Kaupthing Bank HF [2011] EWHC 2611 (Comm)

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#### Introduction

A dispute having arisen between Lornamead Acquisitions Limited ('Lornamead') and the insolvent Icelandic bank, Kaupthing Bank HF ('Kaupthing'), Lornamead commenced proceedings in the English Commercial Court seeking various declarations as to the correct interpretation of a series of inter-related agreements (which were subject to English jurisdiction clauses) between Lornamead and Kaupthing, in particular to the effect that these agreements had the effect of discharging or otherwise bringing to an end any liabilities Lornamead may have had to Kaupthing under various 'Hedging Confirmations', which were expressed to be subject to the exclusive jurisdiction of the Reykjavik court.

Thereafter Kaupthing issued an application for an order that (i) Lornamead's claim be struck out or stayed on the basis of Article 116 of the Icelandic Bankruptcy Act (No 21/1991) ('the Icelandic Bankruptcy Act') and Regulation 5(1) of the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 ('the 2004 Regulations'); (ii) insofar as necessary in light of (i) a declaration that the English Court has no jurisdiction over Lornamead's claim under Article 17 of the Lugano Convention or otherwise; and/or (iii) an order that the Court should not exercise any jurisdiction which it may have and/or should stay the proceedings on *forum non conveniens* and/or on case management grounds.

On 16 and 17 February 2011 Gloster J heard argument in relation to Kaupthing's application. At the conclusion of that hearing she reserved judgment.

#### The decision in Rawlinson

Thereafter, but before Gloster J handed down her judgment, on 26 March 2011 Burton J handed down judgment in another case, Rawlinson & Hunter Trustees SA v Kaupthing Bank HF [2011] EWHC 566 (Comm). In that case trustees holding interests on behalf of the Tchenguiz family had commenced proceedings against Kaupthing in the English courts seeking substantial sums for, inter alia, alleged fraudulent misrepresentation and other claims relating to contracts which contained exclusive jurisdiction clauses in favour of the English courts. Kaupthing applied for a stay of

those proceedings on the basis that the insolvency proceedings in Iceland had effect in England by virtue of Regulation 5(1) of the 2004 Regulations.

Burton J dismissed Kaupthing's application holding that (i) In July 2010, when the proceedings were commenced, Kaupthing had not been subject to an EEA insolvency measure within the meaning of the 2004 Regulations because the regime to which Kaupthing was then subject was neither a 'reorganisation measure' nor 'winding up proceedings' with the meaning of the same; (ii) Kaupthing only became the subject of such an insolvency measure on the making of the winding up order by the Icelandic court on 22 November 2010, by which time the proceedings had already been commenced so that under Article 32 of Directive 2001/24/EC on the reorganisation and winding up of credit institutions ('the 2001 Directive') the effect of that measure was to be determined by English law, as the law of the place where the proceedings were pending; and (iii) under English law, the effect of Article 17 of the Lugano Convention was that the English court had exclusive jurisdiction.

In light of Burton J handing down his judgment in *Rawlinson* on 13 and 14 June 2011 a further hearing of Kaupthing's application in respect of the claim brought by Lornamead was convened before Gloster J, at which the question of whether she should follow the decision in *Rawlinson*.

#### Issue 1: Should the decision in Rawlinson be followed?

Logically the first issue which Gloster J was called on to decide was therefore whether she should follow *Rawlinson* and apply Burton J's decision that Kaupthing was not subject to an EEA insolvency measure within the meaning of the 2004 Regulations in May 2010, when Lornamead commenced its proceedings.

On this issue Kaupthing submitted that the decision in *Rawlinson* should not be followed because it was wrong. Heavy reliance was placed in this regard on what was said to follow from Burton J's decision, that is that or the period from April 2009 to November 2010 the English court had no jurisdiction to make a winding up order or an administration order, or to appoint provisional liquidators, and yet Kaupthing's insolvency

proceedings in Iceland were deprived of all effect in the EEA, outside Iceland, even though it was a hugely insolvent credit institution whose creditors required protection. This consequence was said to be so surprising as to suggest an error on Burton J's part. Broken down his supposed errors were said to be (i) failing to take the broad and flexible approach necessary to allow the fulfilment of the purpose of the 2001 Directive as a cross-border insolvency code for credit institutions within the EEA; and (ii) concluding that Kaupthing was not subject to any insolvency measure between April 2009 and November 2010.

On the other hand on behalf of Lornamead it was submitted that *Rawlinson* should indeed be followed, not only because it was correct, but also because the decision was made after hearing full argument on the point and further was set out in a cogent and fully reasoned judgment. Ultimately this was the approach taken by Gloster J, who concluded that, in the interests of judicial comity and the deployment of judicial resources, the appropriate course was indeed to follow Burton J's judgment, in view of the fact that, notwithstanding some doubts, she was not convinced that Burton J was wrong.

Issue 2: On the hypothesis that Burton J's decision in Rawlinson is wrong, and Kaupthing was indeed subject to an EEA insolvency measure in May 2010, does Regulation 5(1) of the 2004 Regulations required the English court to stay the proceedings brought by Lornamead?

In light of the possibility that, the Court of Appeal having granted Kaupthing permission to appeal in *Rawlinson*, Burton J's decision would be reversed, Gloster J went on to consider whether, on the hypothesis that Kaupthing was in fact subject to an EEA insolvency measure at the relevant time, Regulation 5(1) of the 2004 Regulations required the English court to stay the proceedings brought by Lornamead.

On this issue on behalf of Kaupthing it was submitted that Lornamead's proceedings if brought in Iceland would have been struck out by the Icelandic court, having been brought whilst a Moratorium Order made by the Icelandic court was in force. Moreover it was said that Regulation 5(1) of the 2004 Regulations must be construed purposively to give all aspects of the Icelandic insolvency process which might be relevant in England effect in England as though part of English insolvency law including, in particular, the moratorium on commencing claims.

On the other hand Lornamead submitted that Regulation 5 of the 2004 Regulations was not engaged because Kaupthing had no property or assets in relation to the Hedging Confirmations to which the EEA insolvency measure could take effect.

Notwithstanding Lornamead's submission to the contrary, Gloster J decided this issue in Kaupthing's

favour. If Kaupthing were subject to an EEA insolvency measure in May 2010 any attempt by the English court to determine even for the purportedly limited purpose of deciding whether Kaupthing had any 'property or assets' would undermine the purpose of the 2001 Directive, being to give effect throughout the EEA to all aspects of the relevant insolvency regime of a credit institution's home state as part of a universal and unitary process including its moratorium and dispute resolution processes. This is a way of avoiding potentially predatory first come, first served action by creditors and the consequent dissipation of the insolvent credit institution's resources through litigation expenditure.

Issue 3: On the hypothesis Kaupthing was not subject to an EEA insolvency measure, does the Icelandic court nonetheless have exclusive jurisdiction under Article 17 of the Lugano Convention?

Leaving aside the impact of a successful appeal in Rawlinson, Gloster J returned to the hypothesis she had accepted, that Kaupthing was not subject to an EEA insolvency measure at the relevant time, with the next question to be addressed being whether the Icelandic court nonetheless has exclusive jurisdiction under Article 17 of the Lugano Convention.

On this issue Kaupthing submitted that the disputes which were the subject of Lornamead's claim were properly construed as concerned with the Hedging Confirmations, which were expressed to be subject to the exclusive jurisdiction of the Reykjavik court. If that was correct, applying Article 16 of the Lugano Convention the Icelandic courts had exclusive jurisdiction to determine Lormamead's claim.

Lornamead on the other hand submitted that its claim was one which in fact invited the court to make declarations in respect of the interpretation and effect of provisions of various other agreements entered into by Kaupthing and Lornamead, which contained English jurisdiction clauses.

Gloster J accepted Lornamead's argument in this regard, concluding that its claim fell within the English jurisdiction clauses in the aforementioned agreements such that it was entitled to bring its claim in the English courts. That, she said, was what the parties should be taken objectively to have intended.

Issue 4: On the same hypothesis, should the proceedings be stayed nonetheless on the basis of forum non conveniens and/or case management grounds?

The final issue and Kaupthing's last resort was whether, even on the footing Kaupthing's other contentions were rejected, the proceedings should nonetheless be stayed on *forum non conveniens* and/or case management grounds because the Reykjavik District Court is

clearly the forum in which the dispute could most suitably be tried in the interests of the parties and for the ends of justice.

Gloster J dealt with this argument shortly noting that the mere fact that Kaupthing is now subject to an Icelandic winding-up order does not make it more appropriate for the claim brought by Lornamead to be determined by the Icelandic court overseeing the insolvency process. Moreover, she said, Lornamead was not trying to steal a march on Kaupthing's other creditors; Lornamead was not a creditor. On Kaupthing's own case Lornamead is a debtor and on Lornamead's case there is no debt at all. Finally Gloster J attached little or no weight to the fact Kaupthing's witnesses may be in Iceland since this was cancelled out by the fact that Lornamead's witnesses are likely to be in England. As such she declined to stay the English proceedings on forum non conveniens or case management grounds.

#### Conclusion

Having found in Lornamead's favour on the first, third and fourth issues discussed above Gloster J dismissed Kaupthing's application to strike out or stay Lornamead's claim. Kaupthing were however given leave to appeal on the question of whether Kaupthing was subject to an EEA insolvency measure within the meaning of the 2004 Regulations at the relevant time, not least because the issue was going to the Court of Appeal in *Rawlinson* in any event. As such this may well not be the end of this complex jurisdictional dispute and, particularly in view of the potential consequences of Burton J's decision in *Rawlinson*, as discussed above, those with an interest in cross border insolvency will eagerly await what happens next.

## EC Insolvency Regulation: Is it Reform Time?

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#### Introduction

The European Commission has recently launched a consultation examining the current European insolvency regime. The consultation is wide ranging. It seeks to elicit views on a number of fundamental aspects of the present regime. In particular, it asks what views there are about the general effectiveness of the EC Insolvency Regulation in facilitating cross-border proceedings, whether the scope of the Regulation should be expanded to include pre-insolvency proceedings, whether the concept of 'Centre Of Main Interests' (COMI) is workable and has withstood the rigours of recent experiences, whether there are problems with the interaction between the Insolvency Regulation and the Brussels Regulation and how the Regulation works in a multi-national and/or group situation.

The Commission's Committee on legal affairs issued a report on 17 October 2011. It formulated a request to the Commission to submit to the European Parliament on the basis of various key articles in the mian Treaty, particularly Articles 50, 81(2) and 114, one or more legislative proposals relating to an EU corporate insolvency framework following detailed recommendations set out in an Annex which the Committee produced in order to ensure what it called a level playing field. Appended to a motion in the above terms for a resolution by the European Parliament were detailed recommendations as to the content of the proposal requested. The first part of the Annex dealt with recommendations regarding the harmonisation of specific aspects of insolvency and company law. The second part contained recommendations regarding the revision of the EC Regulation which is the subject matter of this piece, while the third part dealt with recommendations of the insolvency in groups of companies and the fourth and final part dealt with recommendations on the creation of a EU wide insolvency register.

It follows that change is very much in the air, or at least a discussion for change. With that in mind, INSOL Europe, which had previously prepared and issued a publication now available on its website on certain aspects of possible harmonisation of individual insolvency systems within the European Member States, has now provided a report which in effect attempts to address the key areas in some detail which in its working party's view might be susceptible to reform. The

drafting committee (the Committee) was led by Robert van Galen of the Netherlands and five main members who were drawn from some of the principal regimes within the Member States, i.e. France, Germany, the United Kingdom and Belgium, and also had among its membership another Dutch lawyer deputed to assist the Chairman.

In any event, Article 46 of the Regulation stipulates a five year review period, at the end of which on a recurring basis, the Commission is to present to the European Parliament and the Council and the Economic and Social Committee, a report on the application of the Regulation. In April 2011, Monsieur Carriat, the Director General of the Justice Department within the European Commission formally stated that the Commission would make legislative proposals in 2013.

#### **INSOL** Committee's working procedures

The Committee held a number of meetings to consider and put together various drafts prepared by all its members and then held two main consultation rounds to which the main experts in the field across the European Union were invited. The final version represents, in effect, a fusion of the Committee's own deliberations and proposals, coupled with the observation and commentaries proposed by the experts.

There is no hiding the fact that the proposals overall are really based on the practitioner's point of view, albeit based on a legal analysis of the Regulation and the underlying case law. The aim, even if not ultimately achieved, was to further the proper functioning of the Regulation by amending the substantive aspects within it and by improving technical aspects of the rules which find expression within the Regulation.

The main upshot was the provision of three new chapters. These chapters are given the titles Chapters V, VI and VII. The first of these contains provisions which prescribe powers addressing the coordination of insolvency proceedings with regard to groups of companies (one of the matters focused upon by the European Commission). Chapter VI sets out rules on what is called a European Rescue Plan for groups of companies located in different European jurisdictions and the final additional chapter, namely, Chapter VII, concerns the recognition of and provision of assistance

with regard to insolvency proceedings opened outside the European Union.

Although not the subject of a separate chapter, another major proposal concerns the opening of main proceedings. The Committee felt that the overall practical experience with the Regulation over the past 10 years or so has shown that there have been important cases in which the Centre of Main Interests, i.e., COMI, was changed in order to create a new venue for main proceedings. This led to much criticism and comment and despite some protestations from some extremely eminent sources, the Committee finally proposed, first the inclusion of a revised definition of COMI in Article 2 and a new and additional requirement in Article 3(1) that in some cases the main proceedings must be opened in the Member State in which the former COMI was located.

Other large scale proposed changes concern the rights of secured creditors under Article 5, new provisions with regard to the treatment of agreements under Article 31a and changes with regard to expenses within the estate in accordance with Article 20(3). Those who are familiar with the Regulation will know that these last two topics are not fully addressed, if they are addressed at all, under the present Regulation.

#### Summary of proposals

The Report sets out at page 3 and following a summary of the principal recommendations. They are numerous and not all of them will be mentioned in this survey.

In the case of Article 2 the definition of COMI is included within the Article. In the case of companies and legal persons COMI means the place of the registered office except where the operational head office functions of the company or of such a legal person are carried out in another Member State and that other Member State is ascertainable to prospective creditors as the place where such operational head office functions are carried out and in such a case it shall mean and refer to the Member State where such head office functions are carried out.

Article 3(1) it is suggested, should provide that if a company has moved its COMI less than one year prior to the request for the opening of the insolvency proceedings only the courts of the Member State where the COMI was located one year prior to the request will have jurisdiction to open insolvency proceedings, if the debtor has left unpaid liabilities caused at the time when its COMI was located in this Member State. This will be the position unless all the creditors who are the cause of the said liabilities have agreed in writing to the transfer of COMI out of this Member State. As indicated above this is a contentious matter and a number of practitioners felt that this did disservice to the philosophy behind the Regulation. This will be reverted to below. However, the Committee felt there was no

compelling reason why secondary proceedings could or should not be reorganisation proceedings ,a view which is perhaps more widely shared.

With regard to Article 5(1) the Committee was very sensitive to the fact that there had been a discrepancy with regard to the treatment of security rights depending on whether insolvency proceedings had actually been opened in the Member State where the assets are located. It was felt that the distinction might be understandable for historical reasons but that in practical terms and in modern conditions such a distinction was no longer justified. The suggested amendment to Article 5(1) was one which involved the insertion of provisions similar to the provisions of Articles 8 and 10 to the effect that the effect of insolvency proceedings on the rights in rem of creditors or third parties should generally be governed only by the law of the Member State within which the assets are situated.

Article 13 was also carefully considered. The Committee considered it to be undesirable that a legal act should be made 'avoidance proof' by selecting the law applicable to the contract. However, the Committee also felt that it had to be borne in mind that a relocation of the COMI might be detrimental to the other party to an agreement if under the law of the new COMI avoidance action could be easier to institute. The amended text therefore went along the following lines, namely that Article 4(2)(m) should not apply if the law of the Member State where COMI was situated at the time of the legal act did not allow any means of challenging that legal act in the relevant case.

The interplay between Article 14 and Article 4(2)(f) has of course been the subject of judicial consideration in England in the Vivendi litigation. The expression 'proceedings brought by individual creditors' in the latter Article concerns primarily what are called individual enforcement actions. Clearly the relationship between the collective feature of insolvency proceedings and individual actions by creditors is primarily a matter for the lex concursus. An exception is generally made for lawsuits which are pending at the time of the opening of proceedings in other Member States. The Committee therefore proposed that it be made clear that this Article, ie Article 4(2)(f) applies to actions or proceedings brought by way of enforcement alone. In other words the Committee proposed that it be made explicit that the exception for lawsuits pending should apply both to court proceedings and to arbitrations.

The problems generated in the case law in particular in the  $\it Vivendi$  decision in the Court of Appeal in England reflected the fact that the present wordings in the two articles do not match. The earlier article, ie Article 4(2)(f) provides that the law of the State of the opening of proceedings should determine in particular the effects of insolvency proceedings on proceedings brought by individual creditors with the exception of lawsuits pending. On the other hand the current text of Article 15 provides that the effect of insolvency proceedings

on a lawsuit pending concerning an asset or a right of which the debtor has been divested should be governed solely by the law of the Member State in which that lawsuit is pending. The Committee observed and felt that the provisions do not correspond because the later Article is limited to lawsuits concerning an asset or right of which the debtor has been divested. The suggestion therefore is that deleting this limitation in Article 15 and providing that the 'lawsuits pending' rule cover all civil and commercial matters otherwise subject to the Brussels Convention as well as arbitration proceedings should be catered for.

In the present Article 20(3) the Committee proposes that it should be provided that if administrative expenses have been incurred during the course of insolvency proceedings and have been caused by the liquidator or by a court then such costs should be borne in proportion to the proceeds which have been realised in insolvency proceedings and which have to contribute to the payment of administrative expenses from those proceedings.

With regard to Article 27 there has been an extensive debate on the question whether the possibility of secondary proceedings is desirable and whether this concept should be maintained. Quite apart from the submissions made to the Committee and its own deliberations there is an extensive periodical literature on the subject. The Committee therefore proposed that the court which has jurisdiction under Article 3(2) should have a discretionary power to appraise and assess the need for secondary proceedings in view of the interests of one or more creditors and an adequate administration of the estate. This could be said in passing to lessen the problems that might arise where main proceedings are opened based on COMI in a particular Member State and thereafter secondary proceedings are opened, the choice being made to do so being decided upon by the liquidator in the main proceedings but in circumstances where it is not clear that the jurisdictional provisions providing for the creation or existence of an establishment had been properly addressed or more importantly dealt with in accordance with the spirit and intent behind the Regulation as a whole.

With regard to Article 37 the Committee felt strongly that there was no compelling reason why secondary proceedings could not be reorganization proceedings. This necessitated in the Committee's view a proposed change to the last sentence of Article 3(3) so as to delete the phrase 'these latter proceedings must be winding up proceedings' and further providing that the liquidator of the main proceedings have the same conversion rights with respect to the secondary proceedings as the liquidator of the secondary proceedings is entitled to request the court to convert winding up proceedings into reorganisation proceedings or vice versa then the liquidator of the main proceedings should enjoy the same right.

#### The three new chapters

There is no doubt that one of the most important practical issues thrown up in the wake of the Regulation since its inception is the occurrence of group company insolvency. This has become an increasingly frequent phenomenon almost crying out for rules on co-ordination of insolvency proceedings. Essentially the Committee's proposal is that if a subsidiary and its ultimate parent company both enter into insolvency proceedings then the liquidator of the latter should be given powers similar to those that the liquidator in main proceedings has with regard to secondary proceedings. In other words the starting point should be the application in an analogous fashion of the provisions of Articles 27 and following of the Regulation taking into account, however, the differences between main and secondary proceedings with respect to the same debtor on the one hand and the insolvency proceedings of multiple group companies on the other.

The problem on any basis is one of definition. The Committee took the view that the group main proceedings should be the main insolvency proceedings of the ultimate parent with its COMI in the European Union that is itself in an insolvency proceeding. This entailed definitions of the following phrases and terms, namely 'group of companies', 'parent company', 'subsidiary', 'ultimate parent company' and 'group main proceedings'. These definitions as drafted by the Committee are now included in Article 2.

Moreover, it was strongly felt that the centrepiece of the group proceedings should be the possibility of proposing a plan covering one or more group companies. This should be in effect a restructuring mechanism which ensures that each creditor will at least receive value which on the one hand equals a distribution in the case of the winding up of its debtor and on the other procures that conglomerates are saved and do not fall victim to a lack of co-ordination in an international context.

With regard to the new Chapter VI and the European Rescue Plan it was stressed by the Committee that there is no replacement in this instance of any legislation within the Member States with regarding to compositions and rescue plans. Instead what was proposed was an introduction of an initial instrument for the adoption of cross border rescue plans involving groups. It was strongly felt by the Committee as a whole that such an instrument would considerably further the proper functioning of the internal market since it would provide a means for restructuring conglomerates engaged within the common markets on an international level.

Basically, the following main principle was put forward. First, the proceedings with regard to the Plan should take place in the court which opened the proceedings with regard to the parent company. Second, the Plan might be proposed by either the parent company or its liquidator. Third, the creditors should be divided into classes: moreover creditors of different companies should be placed into different classes while creditors with differing ranks in respect of the assets of a particular company should also be put in different classes. Finally, the creditors should vote by class whereby each class determines whether it accepts the Plan with acceptance requiring a qualified majority of two thirds of the amount of the creditors voting within the concerned class.

The provisions of the Plan are openly inspired by the US Chapter XI regime as well as by several modern and well known reorganisation plan regimes in Member States. However, there remain important differences. First, classification of claims will not be part of the Plan itself but will be decided upon by the court separately and in the event that individual creditors oppose the Plan cram down possibilities will be much more restrictive than under Chapter XI. Furthermore, the Chapter XI regime principally concerns single companies whereas the European Rescue Plan applies only to groups.

With regard to Chapter VII in effect the Committee proposed the incorporation of much, if not all, of the UNCITRAL Model Law provisions into the Regulation. The paradigm situation was the opening of insolvency proceedings outside the European Union. In such a case the UNCITRAL Model Law provides assistance supported by the global community which created it. Contrary to the European Regulation the Model Law is not based on similar principles to those finding expression in what is called community trust and therefore the effect of foreign proceedings within the receiving state will be much less pronounced with more elaborate reviews than under the Regulation. To take one example, there is no automatic recognition of the powers of the foreign liquidator but instead there is a two tier review system. First, the court of the receiving State considers whether the foreign insolvency proceedings meet the standards of recognition and whether there is a COMI or establishment as the case may be and whether the same is indeed located in the country where the proceedings have been opened. However, even if the recognition of the foreign proceeding is obtained this will not entail the consequence that the foreign liquidator can exercise all his powers in the receiving State; if, therefore, for example he desires to sell assets of the debtor which are located in the receiving State he has to obtain relief from the courts of the receiving State and those courts will investigate and consider whether the interests of the creditors and other interested parties such as the debtor are adequately protected.

The Committee was, therefore, firmly of the view that it was desirable that these provisions be incorporated within the Regulation. This would lead to a unified approach to insolvency proceedings opened outside the Union and it was strongly felt that this would enhance the proper functioning of the internal market and support a unified external trade policy.

#### The main recommendations: selected Articles

Article 1 in its present form says that the Regulation should apply to collective insolvency proceedings entailing the partial or total divestment of a debtor and the appointment of a liquidator. The definition of 'insolvency proceedings' in Article 2(a) refers to both the collective proceedings referred to in Article 1(1) as well as to the listing in Annex A. INSOL Europe proposes to change that provision so that reference is made to Annex A alone. In other words, Article 1(1) will have no direct effect on the meaning of 'insolvency proceedings' within the Regulation, but will only serve as a guideline to determine whether or not proceedings should be listed within Annex A. As for the ingredients of the overall definitions, INSOL Europe proposes with regard to the first criterion that the 'collective' nature of the proceedings be expanded so as to include rescue and reorganisation proceedings as provided for in the Directives on credit institutions and insurance companies. As to the requirement that proceedings be based on a debtor's 'insolvency', INSOL Europe looked back to its own earlier report on the harmonisation of national laws and took the view that there was a need to define the criteria to be applied for the opening of all insolvency proceedings. In addition, the Committee was very conscious of the need to remove, if at all possible, any gap between the Brussels Convention and the EC Regulation so that court proceedings and judgments opened in Member States and rendered by courts in Member States excepted under Article 1(2) of the Brussels Convention fall under the scope of the present Regulation unless specifically excepted. Moreover, as between the two classic tests of insolvency, namely that based on liquidity and that based on a balance sheet solvency, again, in the light of its earlier report, the Committee took the view that the liquidity test appeared to be the more common of the two within the European Union and indeed was the preferred single test promoted by the UNCITRAL Model Law. Consequently, the amended draft contains two criteria: first, the inability to pay debts as they mature, and secondly, the concept of insolvency based on the fact that the debtor could in the foreseeable future be unable to pay its debts as they mature.

Article 2 contains a number of critical definitions. In particular, INSOL Europe suggests that the definition of COMI be included within Article 2. The definition now expanded in the proposals is directed to and addresses the case of both companies and legal persons: ther COMI is to be the place of the registered office except that where the operational head office functions of a company or the legal person be carried out in another Member State and that other Member State is ascertainable to actual or prospective creditors, then it shall mean and refer to the Member State where such operational head functions are carried out. Moreover, the proposals are that where the company or legal

person is a mere holding company within a group with head office functions in another Member State, then the COMI as defined should be located in that other Member State. The definition goes on to say that the mere fact that the economic choices and decisions of a company are or can be controlled by a parent company in another Member State other than the Member State of the registered office will not cause the COMI to be located in the latter Member State. In the case of individuals, COMI shall mean 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.

It is well known that the courts across Europe have used a variety of connecting factors in order to identify COMI. They need not be listed here. What is clear is that there is no necessary correlation or indeed consistency between the factors which have been employed in the major cases even those in the ECJ, e.g. in the Interedil litigation, culminating in the ECJ decision of that name (see Case C-396/09). However, the Committee employed the expression 'operational office functions', not as a means of introducing a completely new concept, but simply to follow the existing case law. Moreover, as can be seen from what has been said above, there is no reason why a COMI cannot be established in a jurisdiction other than the place of an operational head office if certain key functions are performed elsewhere. Such would be the case for example where internal management or the financial strategic decisions were located or taken in a particular Member State as well as that State being the location relevant to the contractual relationship with employees and/or its suppliers and so on. However, the Committee was firm in its belief that the requirement of ascertainability by third parties would not just be another factor by which to determine the place of the operational head office. It would constitute a second and individual test to apply besides the test for the operational head office.

There are other substantial recommendations made with regard to Article 1 and the definitions it contains. They cannot be mentioned here for reasons of space. There is however a new proposed definition of the term 'liquidator' to take into account the possibility that no separate person is inevitably appointed as liquidator and that the debtor can in effect be appointed as liquidator and that the debtor or management itself might administer the insolvency. Moreover, as already indicated, the new definition includes a reference to reorganisations.

Article 3 is another key Article. It sets out the basis of international jurisdiction within the Regulation. Article 3 has been the subject perhaps to the most extensive literature and case law as well as extended academic debate. Much argument has occurred over what happens when an enterprise is 'moved' at the time of an approaching financial crisis, sometimes with the explicit intention of opening proceedings under Article 3

in a second and subsequent Member State and thereby invoking the insolvency law of the new COMI. A variety of terms have been used for this phenomenon, e.g. forum shopping, COMI-shift and sometimes insolvency tourism

There is no doubt that overall there is a shared desire to curtail the abuse of forum shopping. Indeed Recital 4 of the Regulation says as much in terms. One of the key aspects of the debate is where the starting point exists. INSOL Europe takes the view that those who enter into a contract with a debtor or become creditors in another way rely, and should be able to rely, on the insolvency regime that will apply when and if the debtor enters into insolvency proceedings. As a working rule, such reliance should be honoured. However, there may be cases where such reliance cannot be honoured, at least not in perpetuity, typically where a debtor moves its COMI to another Member State and an 'old' creditor or set of 'old' creditors remain in place. The amendment to Article 3(1) which is proposed introduces further rules to protect the reasonable expectation of creditors. There may be a somewhat arbitrary aspect to this, but the Committee took the view that if a company has moved its COMI less than a year prior to the request for opening of insolvency proceedings, and there remain debts which are incurred prior to the shift, then the Member State relating to the 'old' COMI will have jurisdiction unless the 'old' creditors agree to the COMI-shift.

During the formulation of the recommendations, there was much contentious debate about this suggestion. First, it is claimed that there is no principled basis for an arbitrary look-back period of, in this case, one year. It is also claimed that the proposed amendment fails to reflect the paramount consideration which, in effect, is the interests of creditors as a whole. Moreover, it is said that the policy reflected in Recital 4 referred to above which is against forum shopping applies only to fraudulent steps taken to damage creditors. It is also said that the proposed amendment would seriously restrict the ability of a debtor to move its COMI in order to achieve or obtain a rescue or some other reorganisation proceeding in a jurisdiction which is in some material way 'better' for creditors as a whole.

All this lies at the heart of the Regulation itself it could be said. Against these very powerful contentions it can be said first that in practice, it is extremely difficult to ascertain whether a transfer is fraudulent or not. This is why INSOL Europe took the view that the distinction between fraudulent and good faith COMIshifts was not only inappropriate but also not workable. Moreover, it failed to take into account the fact that the so-called 'old' creditors might even agree to the new regime. Second, any fraud- based test would involve to some degree the application of subjective criteria and the application of such criteria would be even more problematic than those which apply at present. In a case where a COMI-shift could be said to be beneficial to some creditors and prejudicial to others, it might be

difficult to define what would constitute a fraudulent COMI-shift. In addition, a court of the Member state of the old COMI might look upon such matters quite differently from the attitude taken by the court of the Member State of the new COMI. Hence, INSOL Europe took the view that, on balance, objective criteria should apply provided sufficient leeway was given in the sense that if all old creditors had been paid, there would be no issue, and if they were not paid, they could be asked to consent or, indeed, they might formally consent to the shift. These are but a selection of the very powerful arguments for and against the suggested amendment.

Another major Article which underwent suggested proposals for change is Article 5. Article 5 provides in general terms that the opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets. As is well known, Article 5 is really an exception to the general rule set out in Article 4, that the law applicable to insolvency proceedings, i.e. the *lex concursus* will determine the effects of the insolvency proceedings, i.e. the so-called universalist effect. Overall, INSOL Europe agrees with the objection that secured creditors are, if anything, over protected as a result of the existing and somewhat inflexible wording of the current text. If nothing else, Article 5 had generated a deep split as to its proper interpretation among serious commentators. Relevant questions included whether, and if so to what extent, the right in rem was limited, e.g. only to the extent that the limitations of the *lex rei sitae* matched with those of the *lex concursus*. By and large, although the position is not by any means settled, commentators have taken the view that the right in rem was neither affected by the lex concursus nor by the lex rei sitae. In practical terms, this means that the holder of the right in rem can exercise its or his rights without any exception or limitation. It is this so-called hard and fast rule which led to the degree of over-protection which INSOL Europe was sensitive to. Drawing a line between the competing arguments, INSOL Europe suggests that there be an amendment to Article 5(1) to the effect that there be a provision that the right in rem be limited only to the extent that the limitations of the lex rei sitae match with those of the lex concursus.

INSOL Europe also suggests amendments to Article 13. The current version is that Article 4(2)(m) dealing with the general applicability of the *lex concursus* shall not apply where the person who benefited from an act detrimental to all the creditors proves that the act in question is subject to the law of the Member State other than that of the law of the State of the opening of proceedings and that latter law does not allow any means of challenging that act in the relevant case. The suggested variation is that Article 4(2)(m) shall not apply if the law of the Member State where the COMI of the debtor was situated at the time of a legal act does not allow any means of challenging that legal act in

the relevant case. In other words, the suggested amendment simplifies matters by saying that it is the law of the State of the opening of the proceedings which is the arbiter as to the substantive rules determining the voidness, voidability or unenforceability of legal acts detrimental to all creditors. The present version has regard to the applicability of the law of the contract as a means of protecting the counterparty that relied on the transaction in question. It therefore gives that other party the possibility of asserting that the avoidance action also has to be judged by the law that was applicable to the legal transaction itself.

However, INSOL Europe was very conscious of the objections that had been made to the current version. The risk is that the present Article leads to the undesirable result that the parties to a contract detrimental to the mutuality of creditors might succeed in protecting it from being challenged by introducing into it a choice of law clause in favour of a legal system not permitting challenge. To the Committee, there seemed no compelling reason why a party should be allowed to presume that an act can only be invalidated if the law that applies to the act allows such invalidation. Indeed, there is US Supreme Court authority to that effect. See e.g. Canada Southern Railroad v Gebhard 109 US 527 (1883). This is why in simple terms INSOL Europe proposes that Article 4(2)(m) should not apply if the law of the Member State where the COMI is situated at the time of a legal act simply does not allow for any means of challenge. There are interesting side issues as to the effect, if any, of a secondary proceeding with some authors having suggested that the secondary liquidator could avoid such acts only when such acts are at the expense of the State of the secondary proceedings. Indeed, the Virgos-Schmit Report itself, at para 224, refers to the power of the secondary liquidator to avoid an act outside the State in question and to claim back goods that have been transferred after the opening of secondary proceedings to another Member State to the detriment of the creditors in the secondary proceedings. Overall, INSOL Europe felt that the liquidator should initially have the power to avoid the legal act and that the power to act under secondary proceedings be limited to situations in which the estate of the secondary proceedings, and no other estate, suffers. This area is one which was the subject of suggested harmonisation by the earlier INSOL Europe report on harmonisation across

Article 15 has generated important case law, particularly in England. Its current version specifies that the effects of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested shall be governed solely by the law of the Member State in which that lawsuit is pending. The amended version as suggested by INSOL Europe is that the procedural effects of insolvency proceedings on lawsuits pending should be governed solely by the law of the Member State in which that lawsuit is pending.

Such lawsuits include all civil matters subject to the Brussels Convention as well as arbitration proceedings. Moreover, Article 15 should not have the effect of altering the law applicable to any question of the validity of a current contract or to any other substantive issue in the lawsuit pending.

This is a complex area and, again, one not free from seriously arguable rival contentions by commentators. Article 4(2)(f) states that the law of the insolvency proceedings determines the effect of insolvency proceedings on proceedings brought by creditors with the exception of lawsuits pending. On any basis, the present versions of Article 4(2)(f) and 15 do not match, or properly square-up with each other. This alone was the reason for revisiting this issue. Article 15 is a major exception to the general rule set out in Article 4 that insolvency proceedings be governed by the lex concursus. The current version of Article 15 attaches a good deal of importance to the domestic law of the forum, i.e., the *lex fori processus*. Again, the current version of Article 15 suggests that the position is different from the general position under the Regulation in the case of lawsuits already pending or in progress where the insolvency proceedings are opened and concerning an asset or right of which the debtor has been divested. The intention is perhaps clear. Article 15 was designed and at the moment remains designed to avoid what would otherwise be the application of the rule of vis attractiva concursus which often applies in Member States and means that pending proceedings can be removed from the civil or commercial courts in which the proceedings had been opened and placed under the exclusive control of the relevant insolvency tribunal. The real difficulty in the present drafting is to equate the meaning of lawsuit pending in both Articles 4 and 15. One particular difficulty stems from the argument that individual enforcement actions such as attachment which might otherwise be regarded as being a lawsuit pending, is outside Article 15. For one thing there would have been no divesting of any asset or right otherwise held or claimable by the debtor.. On this view, any pending action which seeks a determination on the merits could have continued past the date of commencement of the insolvency after judgment so as to be the basis for a claim to a distribution in the insolvency. However, such a judgment could not be employed to justify a seizure or some other form of enforcement of the judgment upon the debtor's assets. The position is further complicated by linguistic differences in the various texts. Two language versions of the Regulation contain references to 'lawsuits' being limited to court proceedings, whilst the other nineteen versions refer to terms which do not expressly limit the scope of either Article 4(2)(f) and Article 15 to court proceedings. As is perhaps well known in the Court of Appeal decision in this country in *Elektrim v Vivendi* [2009] EWCA Civ 677, the English court took the view that the phrase 'proceedings brought by individual creditors' in Article 4(2)(f) referred to what had been called, even in this survey, individual enforcement actions, i.e. proceedings brought by way of execution, as well as actions brought solely to establish a claim. The latter at least meant that there was no reason for restricting the term 'lawsuit pending' such as to exclude arbitrations.

Article 27 deals with the opening of proceedings in the context of secondary proceedings. The present version specifies that the opening of proceedings referred to in Article 3(1), i.e. main proceedings, is not a bar to the opening in another Member State which has jurisdiction under Article 3(2) which latter court will have jurisdiction to open secondary insolvency proceedings. The principal change suggested by INSOL Europe is that there be some provision that in the case where main proceedings have been commenced with regard to a debtor, secondary proceedings can be commenced without having to establish the insolvency of the debtor in another Member State. In other words, there is no binding and immutable principle that secondary proceedings be governed by the relevant national law in accordance with Article 4. In practical terms, this would mean that the court of the secondary proceedings does not always have to investigate whether the local test of the opening of proceedings has been passed.

This is clearly a deep change in principle. Underlying all this is again another extensive debate between expert commentators on the question of whether the possibility of secondary proceedings is desirable at all or whether indeed the whole concept should be maintained. The special regimes with regard to credit institutions and insurance companies simply do not provide for secondary proceedings. The overriding and somewhat generalised desirability behind secondary proceedings is that they serve to protect local interests. However, secondary proceedings might indeed unnecessarily complicate the administration if only because they will cause coordination and boundary disputes and invariably cause costs to increase. This is why INSOL Europe suggests that the court which has jurisdiction under Article 3(2) should enjoy a discretionary power to appraise and assess the need for secondary proceedings in view of the interests of one or more creditors and the need for an adequate administration of the overall estate.

In the light of these changes, changes were also suggested to Article 33. The current version entitles the court opening secondary proceedings to stay the process of liquidation, in whole or in part, on receipt of a request from the liquidator in the main proceedings provided that the latter can take any suitable measure to guarantee the interests of the creditors in the secondary proceedings. The suggested new version takes issue with the apparent lack of clarity with regard to the term and expression 'process of liquidation': does this refer to secondary proceedings, or only to the process regarding the liquidation of assets within those

proceedings? There is at least one individual Member State decision which suggests that Article 33 only stays the process of liquidating assets, and not the secondary proceedings as a whole. This is now the subject of a suggested amendment by the Committee. Moreover, pursuant to the suggested amendments to Article 3(3), secondary proceedings no longer need be winding up proceedings, but can also be reorganisation proceedings. INSOL Europe takes the view that it should be explicitly provided that Article 33 does not only concern the liquidation of assets, but also other activities of the liquidator at the secondary proceedings which may undermine the integrity of the enterprise such as determination of vital contracts.

#### Groups of companies

Perhaps the most problematic area within the present Regulation deals with groups of companies. There are simply no provisions dealing with this question in any way whatsoever. This is not the place or occasion to review the various options available, but simply to summarise in as brief a way as possible the view that was ultimately taken by the Committee. On balance, the Committee took the view that the group main proceedings should be the main insolvency proceedings of the ultimate parent with its centre of main interests in the European Union that might be an insolvency proceeding. As to the definition of parent company, the suggestion is that this be the company which has the majority of the shareholders' or members' voting rights in the other company, and if no such company meets that definition, then it will be the company that has the right to appoint or remove the majority of the members of the administrative management supervisory body of the other company, or the company that has the right to exercise what could be called a dominant influence over another company of which it is a shareholder or member. Helpful parallels are sought to be drawn with definitions of parent companies and other regimes, in particular, the 7<sup>th</sup> Council Directive 83/349 EC of 13 June 1993 dealing with the consolidated accounts in the context of Article 54(3)(g) of the Treaty which led the Committee to set out suggested definitions of the well-known notions of 'group of companies', 'parent company', 'subsidiary', 'ultimate parent company' and 'group main proceedings', etc.

The US doctrine of substantive consolidation is also suggested as being a proper means of consolidating two or more insolvent companies where it is not possible to determine which assets or liabilities or contracts belong to which company, with the ultimate decision being taken by the court supervising the parent's main proceedings as being the court most appropriate to supervise the consolidated proceedings.

The centrepiece of the group provisions as promoted by the Committee is the possibility of proposing a plan covering two or more group companies. This, in effect, would be a restructuring mechanism which on the one hand ascertains and determines that each creditor will at least receive value which equals a distribution in case of the winding up of his or its debtor, and on the other, procures that conglomerates are saved and do not fall victim to a lack of coordination in an international setting.

There are therefore a number of new suggested Articles, beginning with a suggested Article 43 and following, dealing with the various aspects of this new regime, namely, the opening of group main proceedings, the powers of a liquidator within group main proceedings, a rescue plan, substantive consolidation and so on.

#### The European Rescue Plan

The European Rescue Plan is the brainchild of the Committee. The provisions which are suggested do not replace legislation within Member States with regard to composition and rescue plans, but simply introduce an additional instrument for the adoption of crossborder rescue plans involving groups. As indicated at the outset of this particular survey, INSOL Europe takes the view that such an instrument will considerably assist in the proper function of the internal market since it will enable and facilitate the restructuring of conglomerates which have several locations within the European Union.

The Plan aims to take into account the fact that the creditors of various subsidiaries in question, as well as the parent company's creditors, may well occupy different standpoints. On the other hand, it should not be possible for the creditors of simply one subsidiary to sink the whole Plan by voting against it if the benefits they are to receive under the Plan are greater than those they would have received is the subsidiary were completely wound up, etc.

INSOL Europe therefore sets out a number of guiding principles which apply to the contemplation of and implementation of the European Rescue Plan. The following list is not exhaustive, but the factors which are set out by the Committee include the desirability of having proceedings with regard to the Plan taking place in the court which opened the proceedings with respect to an ultimate parent company, secondly, the need to divide creditors into appropriate classes, thirdly, the use of cram-down provisions if one or more classes reject the Plan and in the event of acceptance, confirmation of the Plan unless a creditor or shareholder objects to it and the Plan can be seen to unfairly favour one or more creditors or shareholders, or a creditor or shareholder junior to the creditor who does not receive any value etc.

Overall, the provisions regarding the European Rescue Plan are inspired by the US Chapter XI provisions,

but there are important differences. First, classifications of claims will not be part of the Plan itself but will be decided upon by courts separately and in the event that individual creditors oppose the Plan, cram-down possibilities will be more restrictive than under Chapter 11. In addition, Chapter 11 does not principally concern single companies whereas, as is clear, the European Rescue Plan applies to groups alone.

## Insolvency proceedings opened outside the European Union

The new Chapter VII of the Working Party's recommendations within the amended Regulation deals with in effect the imposition of the UNCITRAL Model Law on an insolvency or set of insolvency proceedings where insolvency proceedings are opened outside the European Union and where recognition occurs within the Union. Overall, it was thought that there should be a unified approach to insolvency proceedings, especially with regard to those opened outside the European Union so as to enhance the proper functioning of the internal market.

There was extensive discussion within the Committee as to whether the bases in the Treaty on the Functioning of EU were solid enough to build a regime for the recognition of non-EU insolvency proceedings as incorporated now in the suggested Chapter VII. Overall it was felt that there was a sufficient juristic basis, if only because the Union had created a system for the recognition of the EU insolvency proceedings which in the Committee's view meant that it could also assume such powers in respect of non-EU insolvency proceedings. See e.g. and cf Case 22/70 Commission of the EC v Council of the European Community [1971] ECR 263. In effect, the criterion relied on is that EU institutions can exercise any power 'reasonably necessary' to the achievement of an objective set forth in the EU family of Treaties, even in the absence of an express power of action provided for in relation to that objective.

This in effect enabled the Working Party to engraft the Model Law as a new Chapter VII to the proposed amendments of the EC Regulation with a large number of Articles in effect reflecting the principal provisions of the Model Law already embodied in the UK Cross-Border Regulations.

#### Miscellaneous

There are substantive amendments to the Annexes, some of which have been pointed out above in this suvey. In addition, the Committee's report contains a lengthy appendix dealing with the suggested harmonised rules on detrimental acts in turn revisiting, in effect, the harmonisation principles considered in the INSOL Europe report in 2010 on the national harmonisation of insolvency laws within the EU. Finally, there is a substantial bibliography amounting to about 40 pages of materials, reflecting the immense body of work that has been produced already by commentators of all sorts and sometimes of the most eminent level in its area since the inception of the Regulation.

#### Footnote

INSOL Europe is now a major institution reflecting the considered views of practitioners across the length and breadth of Europe. On any basis, this report is a substantial piece of research and body of work. As at the date of this present article, the EC Commission has formally taken delivery of the Committee's report and it is hoped and tentatively expected will take it into account in considering the next steps that have to be taken in the life cycle of the Regulation as a whole.

It is hoped that the contents of the report at least will stimulate even more debate and argument about the workings of cross-border insolvency reflective of the increasing importance of this subject in today's legal and financial environment.

# Akers and anr v Deutsche Bank AG (Re Chesterfield United Inc and Partridge Management Group SA) [2012] EWHC 244 (Ch)

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#### Introduction

Akers and anr v Deutsche Bank AG (Re Chesterfield United Inc and Partridge Management Group SA) [2012] EWHC 244 (Ch) is a cross border insolvency case that is demonstrative of the Court's increasing willingness to use its powers under English law when exercising its discretion to treat foreign insolvency office holders as if they are domestic office holders.

Before Mr Justice Newey were applications made by the joint liquidators of two companies incorporated in the British Virgin Islands, Chesterfield United Inc ('Chesterfield') and Partridge Management Group SA ('Partridge'), seeking orders requiring Deutsche Bank AG ('Deutsche Bank') to produce various documents. The joint liquidators were appointed by the Eastern Caribbean Supreme Court on 10 May 2010 and the applications were made pursuant to Article 21(1) of the UNCITRAL Model Law on Cross Border Insolvency, as incorporated into English law by the Cross Border Insolvency Regulations 2006.

#### **Background**

The applications arose in relation to various transactions entered into by Chesterfield and Partridge in August and October 2008. In short, between them, Chesterfield and Partridge paid EUR 450 million for credit linked notes ('CLNs') issued by Deutsche Bank. The CLNs provided for Chesterfield and Partridge to receive interest payments and ultimately to have the sums invested returned to them. However, in the event that a 'credit event' occurred in relation to Kaupthing hf ('Kaupthing'), Chesterfield and Partridge could lose both the principal and the right to further interest payments (both Chesterfield and Partridge being owned by offshore vehicles which were in turn owned by high net worth individuals associated with Kaupthing).

As well as the CLNs, Partridge entered into a credit default swap ('CDS') with Deutsche Bank, with Partridge paying EUR 50 million to Deutsche Bank at the outset. If a credit event did not occur in relation to Kaupthing, Deutsche was to pay Partridge EUR 50 million on maturity.

Of course, on 8 October 2008, Kaupthing, Singer and Friedlander Limited went into administration, with a Resolution Committee being appointed in respect of Kaupthing itself the following day. As this constituted a credit event under the terms of the CLNs, Chesterfield and Partridge lost all the money that had been invested.

#### Information sought

In his evidence in support of the applications, one of the joint liquidators stated that it was 'very difficult to see how the transactions made commercial sense from the point of view of Chesterfield and Partridge' and the request for information was said to be to enable to joint liquidators to explore how Chesterfield and Partridge might have expected to benefit from the aforementioned transactions. Only once they had this information, it was said, would the joint liquidators be able to perform their statutory duties properly. In this regard the point should be made that Deutsche Bank's position was that the CNLs were not commercially unusual or unreasonable.

#### The applications

As noted above, the joint liquidators' applications were made pursuant to Article 21(1) of the UNCITRAL Model Law on Cross Border Insolvency, as incorporated into English law by the Cross Border Insolvency Regulations 2006. The relevant part of Article 21(1), on which the joint liquidators relied provides:

'Upon recognition of a foreign proceedings, whether main or non-main, where necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief; including: ...

- (d) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities ...
- (g) granting any additional relief that may be available to a British insolvency office holder under

the law of Great Britain, including any relief provided under paragraph 43 of Schedule B1 to the Insolvency Act 1986.'

The joint liquidators argued that Article 21(1)(g) enables foreign representatives to take advantage of section 236 of the Insolvency Act 1986 (pursuant to which the court can make an order for the production of books, papers or other records relating to the relevant company or 'the promotion, formation, business, dealings, affairs or property of the company'). Against this Deutsche Bank argued that where the provision of information is sought, Article 21(1)(d) must prevail. Otherwise, it was averred, there would simply have been no need in Article 21(1)(d) to make express provision for the delivery of information. On this point Mr Justice Newey agreed with the joint liquidators; Article 21(1) (d), he said, 'was intended to set a common minimum standard' and, if local law provides for the possibility of additional relief, a foreign representative can seek such relief under Article 21(1)(g).

It followed, of course, that the scope of Article 21(1) (d) was therefore irrelevant for the purposes of the joint liquidators' applications.

A number of other submissions were however made on behalf of Deutsche Bank. Thus it was pointed out that Article 21(1) provides for the court to have power to grant relief 'where necessary to protect the assets of the debt or the interests of the creditors'. Mr Justice Newey considered though that this did not serve to limit the court's ability to grant relief under sections 236 in a case like the one before him at all, as relief under section 236 is appropriate where an office holder 'reasonably requires' to see documents in order to carry out his functions (see British & Commonwealth Holdings plc v Spicer and Oppenheim [1993] AC 426). As Mr Justice Newey rightly notes in his judgment, 'if a foreign representative "reasonably requires" material with a view to establishing whether a company has a valuable cause of action, relief is likely to be necessary to protect the assets of the debtor or the interests of creditors'.

As to the suggestion that the liquidators were 'fishing' in making the applications, Mr Justice Newey noted that, within limits, section 236 can properly be used for what might be called 'fishing', that is, an office

holder can legitimately invoke section 236 precisely because he wants to investigate.

Further submissions were made as to the fact that section 236 gives the court a discretion which must be exercised after a careful balancing of the factor involves - on the one hand the reasonable requirements of the administrator to carry out his task, on the other hand the need to avoid making an order which is wholly unreasonable, unnecessary or 'oppressive' to the person concerned (per Lord Slynn in British & Commonwealth Holdings plc v Spicer and Oppenheim [1993] AC 426 at 439). Weighing up the issues in the case before Mr Justice Newey was however satisfied that in the circumstances of the case before him it was appropriate to grant the relief sought. It was, he said, inevitable that an order would put Deutsche to some inconvenience and expense, but he was not persuaded that the burden would be unreasonable, there being little evidence before the Court as to the costs that would be incurred in complying with the order. In short, he considered that the balance in this case clearly came down in favour of ordering disclosure.

Finally, as to the issue of costs, Mr Justice Newey, noting again that the evidence did not suggest that the costs of compliance would be large, held that the costs of compliance should be dealt with after the order has been complied with. He also required the liquidators to give undertakings as to confidentiality.

#### Conclusion

As such it was held that the power in the UNCITRAL Model Law on Cross Border Insolvency, incorporated into English law by the Cross Border Insolvency Regulations 2006, to treat overseas office holders in the same way it would domestic office holders should not be construed narrowly.

What is more though, taking a step back one from the facts of this case itself, one can see this case as a prime example of the Court's increasing willingness to use its powers under English law when exercising its discretion to treat foreign insolvency office holders as if they are domestic office holder. We may well see more applications along these lines in the future.

## Lehman Brothers International Europe: Client Money Decision

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#### Decision

The Supreme Court handed down judgment in the Lehman Brothers Client Money Application on 1 March 2012. The majority (Lords Clarke, Dyson and Collins) dismissed the appeal by GLG. Lord Dyson gave the lead judgment for the majority. The majority held:

- that the client money trust arises upon receipt and not upon the segregation of client money, irrespective of whether the firm adopted the 'normal' or 'alternative' approach to segregation of client money;
- 2. that on a firm's insolvency all client money identifiable, in whatever account of the firm into which client money has been received, is pooled for distribution; and
- 3. that the client money pool is to be distributed to all clients in accordance with each client's respective contractual entitlement to have had client money segregated for it at the date of pooling and irrespective of whether any money had in fact been so segregated or had been recorded by the firm as having been so segregated.

#### Wider relevance

The decision is likely to have significant consequences for the administration of Lehman Brothers including in particular the identification of client money held in accounts other than the firm's segregated accounts.

The decision will extend to all current financial service insolvencies. The Client Assets chapter of the FSA's Handbook ('CASS') has not been substantially revised in the years following the administration of Lehman Brothers in September 2008 and the rule, as now explained by the Supreme Court, will apply to the administration of a number of other estates including the special administration of MF Global UK.

#### Key issues

#### Trust on receipt / on segregation

The first key issue was whether the statutory trust arose upon the receipt of client money or only upon its segregation. (So far as client money which arose otherwise than by receipt, e.g. where the firm was required to appropriate and segregate client money from its own resources for a particular client, the Court of Appeal had held that the trust arose only upon appropriation and segregation of the specific sum. Permission to appeal against that aspect of the decision had already been refused). The point taken to the Supreme Court concerned money received from clients and/or third parties on their behalf where the firm operated the 'alternative approach'. It was common ground that the 'normal approach' did not allow the firm any freedom to deal with client money, so that the trust arose upon receipt of the funds.

The Supreme Court held that the 'alternative approach', which allowed a firm to receive client money into its own account for a time, was only one method that a firm might adopt to comply with its obligation to segregate client money and that that method did not affect or undermine the obligation to hold client money as trustee from the moment of receipt.

#### Client money pool

The second key issue was whether the pool of client money constituted upon a firm's failure extended to all client money, in whatever accounts, or only to money which had been segregated as at the date of pooling.

No judge in the Supreme Court accepted the first instance judge's conclusion that money outside the firm's segregated account was not pooled but might be traced and claimed in equity. The majority (Lords Clarke, Dyson and Collins) held that the pool extended to all client money in whatever account. The minority (Lords Hope and Walker) said that a limited reconciliation

#### Notes

1 Members of South Square represented various parties at all levels of the Client Money Application. In the Supreme Court, the Appellants were represented by Antony Zacaroli QC, David Allison and Adam Al-Attar, and Richard Fisher appeared as part of the team representing the administrators. Robin Knowles QC and Felicity Toube QC appeared for other parties at earlier stages of the proceedings.

should be conducted upon pooling to identify client money received since the last point of segregation before the firm's failure.

There are a number of issues relating to the constitution of the client money pool which are left unresolved by the Supreme Court decision, in particular as at the rules to be applied in seeking to identify client money within the firm's own accounts, the type and nature of the firm's accounts included within the process, and the extent to which it is permissible to trace into other assets acquired with client money subject to the statutory trust.

#### Claim basis/contribution basis

The third key issue, and in respect of which the Supreme Court was divided sharply, was whether the pool of client money should be distributed on a 'claims' basis or a 'contributions' basis. The former required a distribution relative to clients' contractual entitlements as at the date of pooling, and irrespective of whether or not any client money had been segregated for a given client, whereas the latter required a distribution relative to what had been contributed by or for a client and which remained identifiable as at the date of pooling. The majority (Lords Clarke, Dyson and Collins) favoured the claims basis whereas the minority (Lords Hope and Walker) favoured the contributions basis. Lord Dyson said, at [153], that:

'[T]he calculation [of a client's entitlement] involves an assessment of the client's actual and objective entitlement in respect of client money. It has nothing to do with the amount which may or may not in fact have been segregated for the client, nor with the ledger entries which the firm may have made in respect of any particular segregation or reconciliation.'

#### Lord Walker, dissenting, said, at [85], that:

'Lord Dyson and the others in the majority evidently regard it as realistic to suppose that those segregated clients accepted the risk of having the bulk of their beneficial interests divested in order to compensate other non-segregated clients who, immediately before the PPE, had no beneficial interest in any identifiable trust property (and of whom, and of whose affairs, the segregated clients knew nothing). The majority's decision makes investment banking more of a lottery than even its fiercest critics have supposed.'

The sharp disagreement between the majority and the minority in the Supreme Court is, therefore, likely to play-out in a substantial difference in outcome in a number of insolvencies involving the distribution of client money. The remainder of this article outlines some of the questions which remain to be resolved.

#### Client money entitlement

The key question for unsegregated clients, and now for any client, has always been: what is my claim?

The alternative to the 'contributions' basis in the Lehman litigation was a contractual 'claims' basis. The Supreme Court (and the Court of Appeal) each endorsed a contractual claims basis, but the majorities' speeches (and the judgments in the Court of Appeal) are not clear as to what items should be taken into account in working out a client's contractual entitlement.

The broader view is that a client's entitlement is whatever he is entitled to under the terms of his contract.

The narrower view, and the view which is closer to the language of their Lordships' speeches, is that a client's entitlement is the product of that client's individual client balance (ICB) and client equity balance (CEB). ICB and CEB are terms defined in Annex 1 to CASS 7 and the Glossary to the FSA's Handbook. ICB is free money and the net cash due to a client in respect of delivery versus payment transactions in respect of securities. CEB is the amount which would be owed to or by a client by or to the firm upon the notional close out of an open position. If CEB is positive, ie reflective of an amount owed to the client, there is an entitlement to client money in that amount. The submission made by the unsegregated clients was that ICB and CEB, as referred to in what was CASS 7.9.7R, provide a 'complete' and 'objective' basis for the calculation of entitlement. Lord Dyson seems to have endorsed this approach at [153].

The narrower view, however, would appear to leave some items out of account. A basic question is whether the definitions of ICB and CEB are broad enough to capture every item which should, as a matter of contract, make up a client's entitlement to have client money segregated for him. The question may largely turn on what is meant by free money. There are arguably indications in Annex 1 that ICB and CEB are limited to something less than the full extent of a client's contractual entitlement. Paragraph 12 provides as follows:

- '12. In determining the client money requirement under paragraph 6, a firm:
- (1) should include *dividends* received and *interest earned and allocated*;
- (2) may deduct outstanding fees, calls, rights and interest charges and other amounts owed by the client which are due and payable to the firm (see CASS 7.2.9 R);
- (3) need not include client money in the form of client entitlements which are not required to be segregated (see CASS 7.4.27 G) nor include client money forwarded to the firm by its appointed representatives, tied agents, 2field representatives and other agents, but not received (see CASS 7.4.24 G);

- (4) should take into account *any client money arising* from CASS 7.6.13 R (Reconciliation discrepancies); and
- (5) should include *any unallocated client money*.' (Emphasis added.)

Items such as client money arising from discrepancies and unallocated client money will fall into the CMP but do not correspond to any contractual entitlement of a client. Such items appear only to swell the CMP. There are however items such as dividends and interest which should obviously be taken into account in working out a client's contractual entitlement but which are not within the definitions of ICB and CEB. The unreasonableness of excluding such items leads to the broader view, which appears to be the view of Lord Clarke and Lord Collins. The broader view is the 'mini-liquidation' for clients described by Arden LJ.

#### Set-off

To adopt the broader view begs that question whether amounts owed to the firm should be taken into account to workout an overall entitlement for each client. At first instance, Briggs J ruled against set-off, applying the general law that a trustee cannot set off a debt owed to him by the beneficiary against the beneficiary's property under the trust. It may be that that conclusion will be upheld against any set-off between a client's definitive share of the CMP and a debt owed to the firm by that client. The validity of that conclusion does not however exclude the prior question of whether some debts should be taken into account in working out that client's share of the CMP.

In this respect, paragraph 12, with its reference to outstanding fees and other amounts owed to the firm, suggests that if a final reconciliation on a client-by-client basis is required such a set-off should be permitted. The wrinkle is that Paragraph 12 makes such a deduction discretionary at the option of the firm. It is not at all clear if or how that discretion is to apply (if at all) post-failure. If it does not, a firm might segregate on the basis of a set-off (ie by reference to 'net' client claims) with any distribution ignoring such set-off (ie by reference to 'gross' client claims). Without ironing out the wrinkle, even in the case of a perfectly compliant firm the CMP might be out of kilter with the claims against it depending upon how the firm had elected to exercise its discretion when segregating.

#### Hindsight

Another matter which might affect a client's client money entitlement is the application of hindsight to the valuation of positions open as at the point of failure and closed out after that time. Briggs J concluded that

clients' claims against the CMP were not to be valued with the benefit of hindsight. He rejected the argument based upon *White v Eckhardt Marine GmbH* [2004] 1 AC 147 that an open position was to be valued in the same way as any other contingent debt in a liquidation, such as a claim under an insurance policy where the insured-against event had occurred post-liquidation but pre-distribution. He thus rejected the contention that the subsequent close out value should be taken as the best evidence of the value of the contingent debt as at the PPE.

'The hindsight principle is pervasive in the valuation of claims and the taking of accounts in bankruptcy and winding up': see *Re MS Fashions Ltd* [1993] Ch 425 per Hoffmann LJ. In *Wight*, Lord Hoffmann explained that: 'Hindsight is used because it is not considered fair to a creditor to value a contingent debt at what it might have been worth at the date of the winding up order when one now knows that prescience would have shown it to be worth more. The same must be true of a contingent debt which prescience would have shown to be worth less'.

The question, which is the subject of an application in MF Global, is why, if the client money rules enact a 'mini liquidation' for clients, hindsight should be excluded from apply to the value of clients' claim. The principle applies to the valuation of such claims for the purpose of a distribution from the general estate.

#### **Estoppel**

It is well established that a mere representation as to beneficial entitlement does not support a claim to a share of a trust fund: see, for example, *Re Harvard Securities*. The same result is likely to follow in respect of a firm's bare representation as to a client's client money entitlement. Without more, it should fall short of a contractual entitlement capable of supporting a claim against the CMP.

There is however an important distinction between a representation that client money is held for a client (when in fact it is not) and other representations which might estop a firm from denying a right to client money protection. For example, if a contract is on absolute title transfer (ATT) terms unless otherwise notified and there is a course of dealing and representations consistent with client money protection, there is an argument that the receipt of money in such circumstances should give rise to a client money entitlement. The firm is arguably estopped from relying on the ATT terms.

A similar point arises in relation to client classification. In certain instances the validity of ATT terms turns upon client classification and so representations as to categorisation may impact upon client money entitlement.

#### **Preference**

The prospect of representations by a firm a giving rise to a client money entitlement is linked to the problem of 'last minute' changes in client status and/or the terms between the firm and a client. A firm's employees might make (unauthorised) changes to a client's status at the request of a client who fears the worst for the firm. There is an argument that such a change, if binding as a matter of contract, is a preference. If a preference, it is an unusual preference, being at the expense of the trust and not the estate. It is therefore unclear whether the Court would strike down such a transaction or, if so, what remedy it would grant. The question of preference is however open in the light of the Supreme Court decision. Whereas as previously a client would only have had a share if an amount had been held for him. an entitlement can now be conferred by a 'last minute' switch irrespective of any contribution.

# Rastelli Davide e C Snc v Hidoux (in his capacity as liquidator appointed by the court for the company Mediasucre International) (Case C-191/10)

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#### Introduction

On 15 December 2011, the European Court of Justice (the 'ECJ') handed down judgment in the matter of *Rastelli Davide e C Snc v Hidoux* (Case C-191/10). The case considers a tension between the rules of international jurisdiction contained in article 3 of Council Regulation (EC) 1346/2000 (the 'Insolvency Regulation') and the choice of laws rule contained in article 4 of the Insolvency Regulation. In particular, the ECJ considered whether domestic provisions in the law of the country where main proceedings are pending for joining foreign companies into a single, consolidated, domestic insolvency could be used to bypass the jurisdictional rules contained in article 3 of the Insolvency Regulation.

#### The facts

Article 3 of the Insolvency Regulation, dealing with international jurisdiction, provides:

- '1. The courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.
- 2. Where the centre of a debtor's main interests is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Member State'.

The law applicable to insolvency proceedings is specified by article 4 of the Insolvency Regulations as follows:

'the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened ...' Article l. 621-2 of the French Commercial Code provides as follows:

'The competent court will be the Tribunal de commerce [Commercial Court] if the debtor is a trader or he is registered with the craftsmen's register. The Tribunal de grande instance [High Court] shall be competent in other cases.

One or more other persons may be joined to opened proceedings where there property is intermixed with that of the debtor or the legal entity is a sham. The court that has opened the initial proceedings shall remain competent for this purpose'.

Rastelli Davide e C Snc v Hidoux was concerned with the latter part of Article L 621-2, which is aimed at the consolidation or amalgamation of certain insolvency proceedings. Mediasucre International had its centre of main interests in Marseilles in France. On 7 May 2007, the Tribunal de Commerce de Marseilles made an order placing Mediasucre in liquidation. Jean-Charles Hidoux was appointed liquidator of Mediasucre.

Rastelli was a company incorporated under the laws of Italy and whose registered office was in Robbio, Italy. Rastelli had no establishment in France within the meaning of article 3(2) of the Insolvency Regulation.

Following his appointment as liquidator of Mediasucre, Mr Hudoux brought proceedings against Rastelli before the Tribunal de Commerce de Marseilles. He requested that Rastelli be joined to the insolvency proceedings that had been opened against Mediasucre on the ground that the property of the two companies had been intermixed within the meaning of Article L 621-2 of the French Commercial Code.

The Tribunal de Commerce de Marseilles declined jurisdiction. Referring to article 3 of the Insolvency Regulation it held that Rastelli's registered office was in Italy and it had no establishment in France. That judgment was set aside by the Cour d'Appel d'Aixen-Provence, on the grounds that the liquidator's application was not intended to 'open' insolvency proceedings within the meaning of article 3 but to join Rastelli to the proceedings already opened against Mediasucre.

Ruling on a further appeal brought against that judgment, the Cour de Cassation decided to stay the proceedings and to refer two questions to the ECJ for a preliminary ruling:

- '(1) where a court in a Member State opens the main insolvency proceedings in respect of a debtor, on the view that the centre of the debtor's main interests is situated in the territory of that Member State, does [the regulation] preclude the application, by that court, of national law conferring upon it jurisdiction to join to those proceedings a company whose registered office is in another Member State solely on the basis of a finding that the property of the debtor and the property of that company have been intermixed?
- (2) If the action for joinder falls to be categorised as the opening of new insolvency proceedings in respect of which the jurisdiction of the Member State first seised is conditional on proof that the company to be joined has the centre of its main interests in that Member State, can such proof be inferred solely from the finding that the property of the two companies have been intermixed?'

The First Question: Does the Insolvency Regulation prevent the courts of a member state applying domestic law permitting the joining of a foreign company to extant insolvency proceedings?

Mediasucre's liquidator argued that as a matter of French law Article L 621-2 of the Commercial Code did not have the consequence of commencing new proceedings against Rastelli but had the sole consequence of extending the initial proceedings to another entity. French law was the law applicable to Mediasucre's insolvency by virtue of article 4 of the Insolvency Regulations and, in French law, extending the main proceedings simply joins an additional debtor whose property is inseparable from that of the first debtor, to proceedings that have already been opened.

The ECJ rejected that argument. The Court noted both the effect of article 4 of the Insolvency Regulations and the decision in *Seagon v Deko Marty Belgium* Case C-339/07 [2009] 1 WLR 2168, where it was held that the courts of the state of the opening of main proceedings also have jurisdiction to hear actions deriving from the initial insolvency proceedings and which are closely connected with them. However, it went on to hold that even if Rastelli's assets had been mixed with those of Mediasucre, it remained a separate legal entity. From Rastelli's point of view, the effect of Article L 621-2 of the French Commercial Code would have the same effect as the decision to open insolvency proceedings against it.

In addition, the ECJ had previously held in *Re Euro-food IFSC led* C-341/04 [2006] All ER (EC) 1078 that each separate entity in a group of companies has

a separate centre of main interests and that in the system established by the regulation for determining the competence of member states, which is based on the centre of the debtor's main interests, each debtor constituting a distinct legal entity is subject to its own court jurisdiction. As the jurisdiction conferred under article 3(1) is exclusive and based around the concept of a debtor's centre of main interests, the French Court could only have made an order under Article L 621-2 of the French Commercial Code if the jurisdictional requirements of article 3 had also been met.

The Second Question: is presumption that a company's centre of main interests is other than in the place of its registered office can be rebutted solely from the finding that the property of the two companies have been intermixed?

The ECJ initially referred to Eurofood and Interedil v Fallimento Interedil Srl Case C-396/09 on the requirement for a uniform interpretation of the term 'the centre of a debtor's main interests', independent of national legislation, and on the need for it to be ascertainable by third parties. The Court went on to affirm that intermixing of property does not necessarily imply a single centre of main interests, that such a criteria would not be ascertainable by third parties and, in any event, there may be many cases where such intermixing is organised from two management and supervision centres situated in two different member states: 'it is necessary that an overall assessment of all the relevant factors allows it to be established, in a manner ascertainable by third parties, that the actual centre of management and supervision of the company concerned by the joinder action is situated in the member state where the initial insolvency proceedings were opened'.

#### Comment

The Insolvency Regulation does not expressly consider the effect of domestic rules permitting a liquidator to join another company into a single, extant insolvency proceeding. Nevertheless, the approach of the ECI in Rastelli Davide e C Snc v Hidoux is unsurprising. It reaffirms the primacy and exclusivity of the concept of a debtor's centre of main interests under the Insolvency Regulations. Had the ECJ allowed Rastelli to be liquidated in French proceedings even though it had no establishment in France and its centre of main interests was in Italy, it would have accepted that domestic law could circumvent and undermine the system established by the Insolvency Regulation. Any other conclusion would have given rise to the risk of conflicting claims to jurisdiction between the courts of different member states, which the Insolvency Regulation specifically intended to prevent.

## Trillium (Nelson) Properties Limited v Office Metro Limited [2012] EWHC 1191 (Ch)

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#### Introduction

Trillium (Nelson) Properties Limited v Office Metro Limited [2012] EWHC 1191 (Ch) is a decision of Mr Justice Mann on a winding up petition presented in respect of Office Metro Limited ('the Company') where the English Court was called on to interpret the term 'establishment' in the context of opening secondary proceedings under the EC Insolvency Regulation (No. 1346 /2000) ('the Insolvency Regulation'). Much of the previous case law on the Insolvency Regulation of course concerns the concept of a 'centre of main interests' ('COMI') in the context of the opening of main proceedings.

The winding up petition in issue was actually presented (on 5 October 2011) on the basis that the English winding up proceedings would be main proceedings as defined in Article 3 of the Insolvency Regulation. However, it then came to light that the Company was, in fact, already the subject of insolvency proceedings in Luxembourg (a Luxembourg liquidator having been appointed on 21 September 2011), those proceedings being main proceedings in light of the Company having shifted its COMI to Luxembourg. That was accepted by Trillium (Nelson) Properties Limited ('the Petitioner') and as such the question for Mr Justice Mann to decide was whether the Company had an establishment in this jurisdiction at the relevant time, such that the English Court has jurisdiction to open secondary proceedings.

#### Establishing an establishment

Article 3(2) of the Insolvency Regulation makes clear that an establishment is pre-requisite for secondary proceedings stating that:

'Where the centre of a debtor's main interests is situated within the territory of a Member State, the court of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Member State. The effects of those other proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Member State.'

Article 2(h) of the Insolvency Regulation then defines 'establishment' as meaning 'any place of operations where the debtor carries out a non-transitory economic activity with human means and goods'.

Some guidance as to how the concept of an 'establishment' is to be interpreted is provided by the Virgos-Schmit report at paragraph 70, where it is said that:

'For the sake of an overall consensus on the Convention, those States agreed to abandon the present of assets as a basis for international competence provided that the concept of establishment is interpreted in a broad manner but consistently with the text of the Convention. This explains the very open definition given in Article 2(h). In the Convention the mere presence of assets (e.g. the existence of a bank account) does not enable local territorial proceedings to be opened. The presence of an establishment of the debtor within the jurisdiction concerned is necessary.'

Mr Justice Mann accepted the need to interpret the concept of an 'establishment' broadly, in the sense that it needs to be interpreted realistically, bearing in mind that it is concept operating in a commercial context; this is the test by reference to which it is held proper that insolvency proceedings be commenced and 'not some sort of box-ticking exercise'.

As well as that general point, Mr Justice Mann extracted the following points from the Virgos-Schmit report (in particular from paragraph 71). First, there must be some activity external to the company itself, and which is apparent to the outside world; internal activities which do not operate on the market are not sufficient. Second, there has to be something which amounts to a place of operations; operations by themselves, not linked to some sort of location, are not sufficient. 'Presumably', Mr Justice Mann suggests in this regard, 'it is intended that liability to secondary proceedings should depend on the possibility of identifying such a physical location. Thus a collection of roving salesmen, without some sort of additional location from which the activities could be said to be conducted, would not be sufficient.'

Reference was also made on behalf of the Petitioner to a European decision, *Interedil Srl v Fallimento Interedil Srl* (Case C 396/09) where (at paragraph 63) it is said that '...the existence of an establishment must be determined, in the same way as the location of the centre of main interests, on the basis of objective factors which are ascertainable by third parties.' Of this statement Mr Justice Mann said 'It is referring to the facts underpinning the absence or presence of establishment, and how they are to be viewed. It is not saying that the question of whether there is an establishment must be decided by reference to what third parties would think. The question of whether or not there is an establishment is a matter of law, not a question of what third parties would think.'

Mr Justice Mann did however accept that, insofar as the requirement for 'human means' is concerned, it is not necessary for the humans in question to be employees of the Company; they could be employees of another group company, or indeed independent contractors — what is required is human instruments through which economic activity can be conducted. He also agreed that 'goods' should be interpreted more widely than 'chattels', with money and land also being covered.

#### When must an establishment be established?

As to when an establishment must be established, on behalf of the Petitioner it was argued that the relevant date is the date of the transaction in question, rather than the date of the opening of insolvency proceedings or the making of an order. Reliance was placed on an Estonian case called Re AB (see paragraph 23 of the judgment) which, it was said, appeared to have proceeded on the basis that, if the debtor had an establishment in the past which met the requirements, and there were assets left from that activity, then that should be considered sufficient for the opening of secondary proceedings. Reference was also made to an English case called Re Energea Umwelttechnologie GmbH (apparently heard in the Leeds District Probate Registry on 10 March 2009) of which the only account appears in Marshall on Cross Border Insolvency (at paragraph 2.083), where the editor observes that it seems to be inherent in that decision that a historical establishment is sufficient for the purposes of opening secondary proceedings (though she is critical of that reasoning).

Rejecting the Petitioner's submission in this regard, Mr Justice Mann said that Article 3(2) of the Insolvency Regulation (quoted above) seems to point to a single point in time, with there being nothing in the wording to suggest that one can look back to the date of a previous transaction. As to the case law on which the Petitioner sought to rely, insofar it decides that a historic establishment is sufficient for the opening of secondary proceedings, Mr Justice Mann considered it

to be wrong. He therefore held that the relevant date is that date of the opening of the insolvency proceedings (so in this case that date of presentation of the winding up petition).

#### Application to the facts

Applying all this to the facts, the question for Mr Justice Mann to decide was thus whether, at the date of presentation of the petition, the Company had an establishment (i.e. a place of operations where it carried out a non-transitory economic activity with human means and goods) in the jurisdiction.

In light of what is said above, the first relevant inquiry is where the 'place of operations' might be. As there was only one candidate (the registered office in Chertsey), it was therefore necessary for Mr Justice Mann to consider whether, at the date the petition was presented, the Company carried out economic activity there with human means and assets in a manner which was non-transitory.

The Company did not occupy the Chertsey premises (having neither a lease nor a licence) and it had no employees there. Insofar as any activities had to be conducted for the Company in England, they were conducted by a service company. The service company provided accounting and legal services to the Company and some limited administrative services, including forwarding post from the registered office to Luxembourg. The only other relevant 'activity' of the Company was its on-going guarantee liability.

Mr Justice Mann considered that these residual activities of the Company were not economic activities for the purposes of the Insolvency Regulation, saying 'Being in a state of liability, with the need sometimes to pay out on that liability and take a bit of advice, is not an economic activity for the purposes of the Regulation. Neither is seeking accounting or legal assistance on other matters. Forwarding post... is not an economic activity carried on there. It is something which goes on so that someone can carry it on somewhere else.'

Moreover, Mr Justice Mann said that, even if he was wrong he that regard, he did not consider that they are non-transitory. As such there was no establishment at the relevant time and the petition was dismissed.

#### Discretion

Had Mr Justice Mann been satisfied that the Company had an establishment in the jurisdiction at the relevant time, before making a winding up order he would also have needed to be satisfied that it would be proper to make a winding up order in this jurisdiction; it is necessary for secondary proceedings to have a useful purpose. In light of the conclusion reached on establishment, this point did not have to be decided and

Mr Justice Mann therefore only briefly expressed a view on the Petitioner's arguments in this regard. Ultimately he doubted that he would have come to the conclusion that there is any real benefit to secondary winding up proceedings in this jurisdiction had it been necessary for him to reach a conclusion on that point.

As to the particular points raised, the Petitioner argued that:

- some prior transactions should be investigated to see if they could be set aside, and time limits for that were more favourable in England than they are in Luxembourg;
- (ii) wrongful trading (which needed investigating) required aggravated negligence in Luxembourg, but not in England;
- (iii) there are concerns as to whether the Luxembourg liquidator is prepared to act promptly enough because it is said he has not been sufficiently responsive to requests for activity; and
- (iv) it is more difficult to engage with a liquidator in Luxembourg.

In short, Mr Justice Mann, considered that, whilst the opportunity for challenging preferences where connected persons are involved, and transactions at an undervalue, may be greater in this jurisdiction in that the time periods are more favourable (two years in this jurisdiction; six months in Luxembourg), the evidence suggests no more than that there are some questions which need to be asked and do not indicate any particularly realistic claim. Further, it was not clear that any wrongful trading type claims are more advantageous to a liquidator here and the suggestions that the Luxembourg liquidator is not prepared to act promptly enough and that he is not easy enough to get hold of were not borne out by the evidence.

#### Conclusion

Following a number of cases on COMI and the opening of main proceedings, we therefore now have a case providing helpful guidance on how the concept of 'establishment' in the context of secondary proceedings is to be interpreted, though of course the question of whether an establishment exists will need to be looked at on the facts of each particular case.

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