

THE CHANGING LANDSCAPE IN EUROPEAN INSOLVENCY

THE EUROPEAN INSOLVENCY REGULATION IN RECENT FRENCH CASES

The development of an international economy necessarily leads to situations of company failures involving several States, and therefore international bankruptcies.

A bankruptcy is treated as being international provided that it involves extraneous factors, i.e., when the debtor owns assets in several States or has creditors established abroad.

With a view to organizing insolvency proceedings among the various Member States of the European Union, **EU Regulation 1346/2000 was adopted on May 29, 2000.**

In France, this EU Regulation is referred to only under Article 1 of the 2005 Decree relating to determination of the French Court having territorial jurisdiction in relation to debtors not having their headquarters on French territory, and Article 66 of that Decree relating to the lodgment of claims by foreigners.

Its objective is not to harmonize the law governing collective proceedings at the EU level, but to coordinate the various domestic laws among themselves.

This coordination consists, through two kinds of proceedings, of determining the applicable law and the Court having jurisdiction.

The jurisdiction applicable to the main insolvency proceedings is that of the Member State in which the proceedings are commenced;

- the other Member States must recognise the administrator/liquidator appointed in the main insolvency proceedings;
- the administrator/liquidator appointed in the main insolvency proceedings can dispose of assets and subsidiaries situated in the other Member States without having to apply for *exequatur*
- the secondary proceedings are carried out under the management of the main proceedings.

The EU regulation has been established mainly in order to avoid **forum shopping** by managers.

It endorses the criterion of the Centre of Main Interests (COMI) in order to enable a Court in one Member State to hold that it has jurisdiction to try reorganization or winding-up proceedings relating to a business group, the head office of which is located in another Member State. Those proceedings where the COMI is located are known as "main" and may lead to one or more "secondary" proceedings.

For legal entities, the centre of main interests is presumed to be the location of the registered office.

Once main proceedings have been opened in one Member State, the Courts of other Member States have no further jurisdiction to open such proceedings against the debtor. The jurisdiction is accordingly exclusive.

The Regulation provides for one exception, however: if the debtor has an establishment (i.e., devoid of legal personality) in one such Member State, so-called secondary proceedings may be opened by the Courts of the Member State concerned, but these may only be winding-up proceedings.

The main effect of this allocation of jurisdiction is to make the debtor subject to the law of the State of opening. This is relevant only for the main proceedings insofar as the establishment subjected to secondary proceedings will be subject to the law of the Member State where it is located.

The centre of main interests is briefly defined in recital 13 of the regulation which provides that "*the centre of main interests should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties*".

This criterion's flexibility highlights both the Regulation's usefulness and its weakness: by denying the debtor the option to connect to the legislation which he considers to be most favorable, the regulation achieves its stated aim of avoiding any forum shopping. On the other hand, as several Courts may hold that they have jurisdiction, disputes can arise, despite the principle of mutual recognition.

THE LEADING CASES

The four cases mentioned below are the most recent and correspond to different treatments of EU proceedings on French territory involving a Europe-wide dimension.

Isa Daisytek case

The **Isa Daisytek** case is the first significant precedent relating to implementation of the EU regulation.

It concerned a group consisting of a parent in the USA and a subsidiary in England, which itself had a number of subsidiaries in Europe including one in France, within the circuit of the Pontoise Commercial Court.

Under the regulation and having regard to the difficulties faced by the group (in particular, the US parent was in Chapter 11), the High Court of Justice in Leeds, by administration order dated May 16, 2003, opened single main insolvency proceedings against the 14 companies (including one French subsidiary).

Shortly afterwards, the manager of the French subsidiary filed a report of suspension of payments with the Registry of the Pontoise Commercial Court and judicial reorganization proceedings were opened by a judgment dated May 26, 2003.

The English administrators entered a third-party objection against the judgment opening the proceedings. The Pontoise Commercial Court dismissed it on July 1, 2003.

A further third-party objection was entered against that judgment before the **Versailles Court of Appeal which, by judgment dated September 4, 2003, recognized the primacy of the English main proceedings** and reversed the two judgments of the Pontoise Commercial Court relating to opening of the proceedings and the first third-party objection.

An appeal to the French Supreme Court was then lodged on the grounds that, unlike the English procedure, the presence of the staff representative and his testimony are mandatory in France.

The Supreme Court is now to rule on this issue.

Commentary

This judicial process, while it has made the background complex, has not prevented the proceedings, both English and French, from being directed at the best interests of the parties involved through a highly pragmatic solution. This case shows the use of one of the preferred tools of mediation. An agreement was developed between the French and English professionals and approved by the Courts in both countries. Under that agreement, the French professional sold the business and implemented the redundancy plan. He then handed the funds over to his English counterpart pending the final ruling on jurisdiction. It should be borne in mind that the mutual interest is the same: "selling businesses in the best possible manner at the best possible price".

On the other hand, judicial rivalries become relevant when it is necessary to allocate the proceeds of sale. The court-appointed agents in each country will be required to ensure

that domestic creditors are treated fairly in structures of different nationalities, whichever proceedings are treated as the main proceedings. Difficulties will necessarily arise according as one country or another has waived its State's privileges or not.

Rover France case

The High Court in Birmingham opened insolvency proceedings against SAS Rover France's parent, in which it considered, under Article 3 of the EU Regulation on insolvency proceedings, that the SAS Rover France's centre of main interests was in England, and opened insolvency proceedings against it.

The debtor filed a declaration of suspension of payments with the Nanterre Commercial Court.

By judgment dated May 19, 2005, the French Court, within the circuit of which the SAS Rover France had its registered office, was accordingly called upon to rule on the High Court's jurisdiction.

The English administrators appointed pursuant to the insolvency proceedings opened by the High Court in Birmingham asserted the following contrary arguments.

1. The centre of main interests of the SAS Rover France, the criterion for territorial jurisdiction pursuant to the aforementioned Regulation, was determined by the High Court of Justice in Birmingham on the basis of evidence reviewed by the English judge: **"the subsidiary has indeed no independence in day-to-day management**, in particular with respect to the management of human resources, no financial or accounting independence, no independence in terms of commercial and marketing decisions, and third parties are well aware that the centre of main interests of the SAS Rover France is located not at its registered office but at Longbridge in England";
2. "No particularly serious circumstance that could be analyzed as a manifest breach of French public policy has been demonstrated."

Applying Article 3 of the aforementioned Regulation, whereby "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", **the Court held that the English Court had jurisdiction**, on the grounds that "the English judge, in order to rebut the presumption [...] **listed for Rover France the significant action taken in England; whereas he thereby obtained a conviction that the centre of Rover France's interests was located in Longbridge and accordingly conferred on him jurisdiction to open insolvency proceedings relating to that company**".

Pointing out that **"recourse to public policy is conceivable only where the recognition or enforcement of the judgment delivered in another Contracting State would be an unacceptable infringement of the legal system in the requested State"**, the Nanterre Commercial Court considered that it was in no way proven that there had been an

essential breach of the law or of a fundamental right, which alone could support the public-policy exception.

The Court, having reviewed the position of employees which was the basis for the Public Prosecutor's recourse to public policy, held that they were sufficiently protected, since the effects of the English insolvency proceedings would not deprive them of any of the rights that would have arisen from French proceedings if the latter had been opened.

EMTEC case

This case shows how the solutions work reciprocally: since EC Regulation 1346/2000 of May 29, 2000 had come into effect, no French Court had been required to rule on the reverse situation and to open insolvency proceedings relating to a parent company and its subsidiaries established in other Member States. This has now happened with the judgment of the **Nanterre Commercial Court in the EMTEC case (February 15, 2006)**. This judgment opened judicial reorganization proceedings in relation to the **French companies** considered as being **parent companies** and as actually **managing** the entire group. It then opened separate judicial reorganization proceedings against the subsidiaries located in other Member States (Spain, Austria, Poland, the Benelux countries and Italy), and in Singapore.

It is interesting to note that the Court did not extend the proceedings to the foreign subsidiaries, but opened separate proceedings ("Might this not be a sign of caution on the part of the judges, caused by the *Metaleurop* case which reminded lower-Court judges that the **extension of proceedings required the finding of a real commingling of the companies' assets, a particularly difficult requirement** for companies under different laws ?" Question raised by Mr. Vallens, judge and associate professor at the Université Robert-Schumann).

Thus, it may be concluded that the French case-law is now established. The COMI determined by the Court having jurisdiction will not be disputed by the French Court, which either acknowledges its finding or opens secondary proceedings if it so sees fit.

The Court used several criteria to locate the COMI:

- the location of meetings of the Board of Directors
- the location where the main contracts are made
- the geographical location of the major customers
- the geographical location of the group's main financial institutions
- the location where commercial policy is determined

- the need for a subsidiary to obtain its parent's consent for financial decisions
- the location of the head office (location of accounting or human resources departments, etc.).

What will happen if the COMI is not the registered office? It will be necessary to ascertain the location of the real COMI in order to open the main proceedings at the right location.

The Court pointed out that it must always be possible to open secondary proceedings in order to protect the interests of employees and creditors; the former will enjoy the benefit of domestic legislation relating to welfare rights (redundancy plan, placement, unemployment insurance, security of salaries, etc.), and the latter will maintain their occasional privileges or ranking in the pay-out.

The Nanterre Court, after ascertaining that the COMI was indeed located in France, ordered the opening of main proceedings in France involving the group's various subsidiaries. These main proceedings in France will accordingly be governed by French law.

Concerning the German subsidiary (MPOTEC), the Court noted that:

- the shareholders had no influence over the management of the companies in France;
- management decisions were indeed made by the French managers;
- in matters of financing, commercial activity and accountancy, decisions lay with the directors of a parent company situated in France;
- the same decision-makers situated in France provided the supply of all goods. A monthly meeting took place on the subject in France. The goods were bought and paid for by one of the French parent companies;
- the group's commercial policy was determined and put into practice in France;
- the development of the products sold was carried out in France, including design;
- the invoicing contract had been signed in France;
- MPOTEC had notional capital of 25 000€, while the debt to the French parent companies reached almost 8 million E;
- all liquidities were to be found in France;
- the commercial agreement with the main client was signed in France; and
- the employees confirmed that the head-office functions and the management of the subsidiary was carried out in France.

The arguments were the same for the other subsidiaries.

Some concern has been displayed among French Commercial Court judges and professionals regarding the possible effects of excessively opportunistic forum shopping on both French companies and their creditors: to date, secondary proceedings may only be winding-up proceedings, and no-one has yet seen how the proposed allocation of proceeds of sale of global companies will be determined in future.

It is well known that certain sales have been carried out "globally", integrating parents and subsidiaries. How will the subsidiaries be valued, and how will these proceeds, if identified, be allocated among domestic creditors, including in particular priority creditors such as the unemployment-insurance funds or the Public Treasury?

One hardly dares to ask the question for unsecured creditors.

Against heated discussion and situations that will crystallize national resentment and feed litigation, there is a reasonable course. Prior negotiation and the tools of mediation or even arbitration could be used to develop reasonable pragmatic solutions.

Other European courts take the same position, in that they consider that combining the proceedings against the subsidiaries into the main proceedings is appropriate.

ENERGOTECH case

More recently, the Lure Court in France, by an order dated March 29, 2006, commenced main proceedings against ENERGOTECH, a Polish legal entity, a builder of metal structures, with its registered office in Myslowice/Poland, which is a subsidiary of a French parent company, EUROCOOLER, the object of insolvency proceedings.

French administration was extended to ENERGOTECH as it filed a bankruptcy petition in Lure.

The Court mentions in its decision that in establishing where the COMI of the subsidiary was situated it relied on a number of elements, the same as those listed by the Nanterre Court, that is:

- the president and vice-president of ENERGOTECH are the same as for the parent company;
- the manager of the Polish subsidiary acts only with the French directors' consent;
- the parent company provides technical assistance;

- the parent company deals with all issues in connection with the products and their delivery, the sales, the budget, the commercial relationship with customers; the parent company deals with all market negotiations instead and for the subsidiary;
- the parent company deals with all technical documentation and manufacturing standards;
- the parent company's orders account for 93% of the subsidiary's turnover;;
- the parent company sets the prices for the subsidiary's products.

Under these conditions the Court considers that we are dealing here with more than a mere program of technical assistance: the parent company imposes on the subsidiary its own choices in all technical and commercial problems.

The Polish subsidiary is proved to have no independence in terms of industrial, commercial or financial policies.

The Lure Court, like the Nanterre one, has thus chosen to order the commencement of main insolvency proceedings concerning the subsidiary, instead of extending to the Polish subsidiary the assignment over the parent company. Also like the Nanterre Court, the Lure Court helps in this way to bridge the gap in the Regulation concerning the treatment of corporate group insolvencies.

FOREIGN CREDITORS IN INSOLVENCY PROCEEDINGS OPENED IN FRANCE

All creditors are required to lodge their claims at the time of opening of insolvency proceedings. Unchanging case-law accepts that all creditors, regardless of nationality, may lodge claims (report receivables) in proceedings opened in France, and lays down a principle of non-discrimination and equal treatment among French and foreign creditors.

Foreign creditors are granted, however, an additional two months to lodge their claims, i.e., 4 months after publication of the judgment in the BODACC (Bulletin Officiel des Annonces Civiles et Commerciales/ Official Gazette).

If the foreign creditor has not lodged a claim in time, he has available, like French creditors, an action for relief from the expiry of time limits, which must be exercised within one year after the decision opening the proceedings. A judgment of the Paris Court of Appeal dated December 17, 1999 held, however, that creditors domiciled abroad are allowed a two-month extension to apply for relief from the expiry of time

limits (the creditor is required to prove that he is not responsible for the failure to lodge a claim, or that there was a willful omission by the company).

In addition, a foreign secured creditor having had the security interest publicized in France will be given notice of the opening of proceedings personally or, if applicable, at the domicile elect of the proceedings. Personal notice to the creditor shall not apply, however, if the security interest or leasing agreement has been publicized abroad.

A foreign creditor will be required to comply with the forms of lodgment imposed by the Commercial Code, which must:

- contain the amount of the receivable due on the date of the judgment opening the proceedings, stating the amounts due in future and their maturities;
- specify the nature of any liens or security interests attaching to the receivable;
- contain evidence in support of the receivable's amount and existence if it is not documented, or its evaluation if it is not determined;
- contain the terms of computation of interest if no rate is specified; and
- specify the Court seized if the receivable is the object of litigation.

The claims are to be lodged in the French language or in a foreign language and accompanied by a French translation. This was held by the Lyons Court of Appeal in two judgments dated March 15 and September 7, 2001.

A foreign creditor will be allowed, however, to remedy the defect either by translating directly into French or by attaching a translation, until the bankruptcy judge acts upon acceptance or denial of the claim.

As regards the denomination of the claim in a foreign currency, the law has provided for two cases:

At the date of opening for judicial reorganization and at the date of conversion for judicial liquidation, the conversion into euros will be performed at the exchange rate on the date of such judgment.

French law will be applicable only if the claim has been found to be valid under the law governing the contract, or the foreign law in the case of a tort-based claim.

Stays of individual proceedings are binding on foreign creditors, together with the principles of the ban on registration of security interests and suspension of the accrual of interest. A foreign creditor may nevertheless act abroad, where the debtor owns property, insofar as the French ruling is not recognized by foreign authorities.

If a foreign creditor has a current contract with the French debtor, he may, under the Act, be required by the Administrator to maintain that agreement. In practice, especially if the agreement is to be performed abroad, a ruling by a foreign Court will be required to compel the contracting party's compliance with the maintenance decision.

The EU Regulation of 29 May 2000 dedicates many provisions to the situation of creditors in the Member States. In addition to those mentioned above, they are provided with more sophisticated notice. Article 40 of the Regulation provides that information is to be provided to creditors through the sending of individual notices including the time limits to be observed, the penalties laid down in regard to those time limits, the body or authority empowered to accept the lodgment of claims and other measures laid down. A form bearing, in all the official languages of the European Union's institutions, the heading "Invitation to lodge a claim - Time limits to be observed" shall be used for that purpose.

In addition, EU creditors of the debtor *in rem* enjoy the benefit of Article 5 of the Regulation, which provides that opening of the insolvency proceedings shall not affect their rights. This information shall be provided by the liquidator, who shall inform the known creditors.

Any creditor may lodge a claim in connection with both the main proceedings and any secondary proceedings opened, which protects the creditors if the debtor has substantial assets in another Member State. In order to secure the equal treatment of creditors, a system of return and imputation is provided for, so that the creditor is not afforded more favorable treatment than others.

However, creditors enjoying the benefit of Articles 5 and 7 (which protect rights *in rem* or based on a reservation of title) are not affected by the return mechanism provided for under Article 20 of the Regulation. Rights *in rem* accordingly remain subject to their own law and avoid the law applicable to the insolvency proceedings. It follows that creditors need not submit to the rule of stay of individual proceedings and may avoid the rules for ranking of priorities provided for under the law of the proceedings.

However, in the event of sale of an asset belonging to the debtor, the excess proceeds of sale of the asset subject to the right *in rem* are to be paid to the liquidator of the main proceedings. In addition, if the creditor *in rem* does not realize the asset, the liquidator may sell it in compliance with the forms required by the law of the Member State where he proposes to act, provided that he satisfies that creditor.

Foreign creditors, like any others, may apply for appointment as controllers of the proceedings (Article L.621-11).

The administrator may invite banking institutions or suppliers accounting for more than 5% of supplier liabilities to join the creditors' committees called upon to analyze and vote on the proposals in the rescue or reorganization plan.

Conclusion:

Such judgments are of great importance; they represent a pragmatic point of view and they may bring a solution to the corporate group insolvency issue through the choice of the use of the COMI in decisions upon jurisdiction. However, the fight over the European Insolvency Regulation is certainly not over.