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# EUROPEAN AND AMERICAN PERSPECTIVES ON THE CHOICE OF LAW REGARDING CROSS-BORDER INSOLVENCIES OF MULTINATIONAL CORPORATIONS – SUGGESTIONS FOR SOUTH AFRICA

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# EUROPEAN AND AMERICAN PERSPECTIVES ON THE CHOICE OF LAW REGARDING CROSS-BORDER INSOLVENCIES OF MULTINATIONAL CORPORATIONS – SUGGESTIONS FOR SOUTH AFRICA

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## 1 Introduction

An increase in economic globalisation and international trade in the past two decades[1] has amounted to an increase in the number of multinational enterprises[2] that have debt, own assets and conduct business in various jurisdictions around the world. [3] Coupled with the recent worldwide economic recession this has inevitably caused the increased occurrence of multinational financial default, also known as cross-border insolvency (CBI).[4] CBI deals with the situation where insolvency proceedings are initiated in one jurisdiction with regard to a debtor's estate and the debtor also has property, debt or both in at least one other jurisdiction.[5]

When a multinational enterprise is in financial distress, the structure of such an enterprise poses significant challenges to the question of how to address its insolvency. This is due to the fact that, although the multinational enterprise is found in different jurisdictions around the world, the laws addressing its insolvency are local. The prospect of restructuring the multinational enterprise or liquidating it in order to satisfy creditor claims depends largely upon the ease with which the insolvency law regimes of multiple jurisdictions can facilitate a fair and timely resolution to the financial distress of that multinational enterprise.[6] In instances where there is a lack of statutory provisions dealing with the CBI of a debtor, states

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1 Sarra 2008-2009 *Tex Int'l L J* 547-576.

2 For a discussion of what constitutes a multinational enterprise, see Mevorach *Insolvency within Multinational Enterprise Groups* 9-31.

3 Meskin, Kunst and King *Insolvency Law* 17-1; Stander 2002 *Journal for Juridical Science* 72-87.

4 Westbrook 2002 *Am Bankr L J* 1-41.

5 Meskin, Kunst and King *Insolvency Law* 17-1; Stander 2002 *Journal for Juridical Science* 73.

6 Sarra 2008-2009 *Tex Int'l L J* 548.

turn to their own domestic law to regulate the CBI proceedings.[7] The liquidator/trustee of the debtor in a local jurisdiction (known as the foreign representative in other jurisdictions) will have to follow up property and interests situated in foreign jurisdictions in order to attempt to attach them for the benefit of the local creditors. Usually the foreign representative will have to bring an application in a foreign jurisdiction to be recognised as such. The foreign representative will have to abide by the legal principles of the foreign jurisdiction where the assets and interest are located, as the foreign law will be applicable to all assets located within that jurisdiction.[8] An additional difficulty to CBI matters is the fact that some jurisdictions adopt a universalist approach to CBI matters, whilst other jurisdictions adopt a territorialist approach to said matters. The differing approaches lead to conflict in the determination of the proper forum where CBI proceedings should be instituted[9] and prevent the harmonisation of international insolvency law.

The legal response to this problem has produced two important international instruments that were designed to address key issues associated with CBI. Firstly, the United Nations Commission on International Trade Law (UNCITRAL) adopted the *UNCITRAL Model Law on Cross-Border Insolvency* (the Model Law) in 1997,[10] which has been adopted by nineteen countries[11] including the United States of America[12] and South Africa.[13] Secondly, the European Union (EU)[14] adopted the *European Council Regulation on Insolvency Proceedings* (EC Regulation) in 2000.[15]

7 Stroebel *Protocols as a Possible Solution* 2.

8 Alternatively, the foreign representative might attempt to open another (concurrent) bankruptcy proceeding in the relevant foreign jurisdiction. Should the foreign representative succeed, there will be a multiplicity of insolvency proceedings in the relevant foreign jurisdiction. See Olivier and Boraine 2005 *CILSA* 373-395.

9 Stroebel *Protocols as a Possible Solution* 2.

10 Hereafter referred to as the Model Law.

11 See UNCITRAL 1997 www.uncitral.org for a list of all of the countries that have adopted the Model Law. The Model Law provides a set of procedural recommendations that the adopting states should incorporate into their national bankruptcy laws. It does not provide substantive laws requiring the adopting states to materially alter their rules with regard to insolvency proceedings. See Silkenat and Schmerler *Law of International Insolvencies* 489; Beckering 2008 *Law & Bus Rev Am* 300.

12 Hereafter referred to as the US.

13 The Model Law was adopted by South Africa by the enactment of the *Cross-Border Insolvency Act* 42 of 2000.

14 Hereafter referred to as the EU.

15 The *Council Regulation (EC) 1346/2000* of 29 May 2000 on Insolvency Proceedings (EC Regulation).

These two instruments address the management of general default by a debtor[16] and are aimed at providing a legal framework which seeks to enhance legal certainty, cooperation, coordination and harmonisation between states in CBI matters throughout the world. The US adopted the Model Law in 2005 by enacting Chapter 15 of the *United States Bankruptcy Code* (hereafter referred to as Chapter 15).[17]

Both the EC Regulation and Chapter 15 adopt a "modified universalist" approach[18] towards CBI matters. Furthermore, both of these instruments distinguish between "foreign main proceedings", which are insolvency proceedings in the jurisdiction where the debtor has its centre of main interest (COMI), and "foreign non-main proceedings",[19] which are insolvency proceedings in the jurisdiction where the debtor has an "establishment".[20] *Prima facie* it seems that the US and the EU adopt different approaches when determining the COMI of a debtor. Against this background, this article will address:

- the question of whether or not there are any real differences in the determination of the "COMI concept" by the EU and the US;
- the various requirements and approaches in determining the COMI of a debtor under the EC Regulation and Chapter 15;
- the EU and US approaches to the presumption in favour of the jurisdiction of incorporation; and

16 Westbrook 2002 *Am Bankr L J* 4.

17 Additionally, the American Law Institute has drafted the *Principles of Cooperation in Transnational Insolvency Cases Among the Members of the North American Free Trade Agreement* (2003) (the ALI principles) that also provide guidelines in CBI matters.

18 A central question that arises in CBI matters is whether the jurisdiction of the insolvency court should be confined to local assets or should cover all of the debtor's assets to be found worldwide (Goode *et al Transnational Commercial Law* 544). The four main diverging approaches supported by academics are traditional territorialism, cooperative territorialism, traditional universalism and modified universalism. For an in-depth discussion of these different approaches, see Botha and Stander 2011 *Journal for Juridical Science* 19-31; Stroebel *Protocols as Possible Solutions* 5; Westbrook 2005 *Am Bankr L J* 713-728; LoPucki 1999-2000 *Mich L Rev* 2216-2251; Westbrook 2006 *Tex Int'l L J* 321-337; LoPucki 2005 *Am Bankr L J* 79-103; Howell 2008 *Int'l Law* 113-151; Adams and Fincke 2008-2009 *Colum J Eur L* 43-87; Westbrook 1999-2000 *Mich L Rev* 2276-2328; Bufford 2005 *Am Bankr L J* 105-142; and Mevorach *Insolvency within Multinational Enterprise Groups* 65-85.

19 Under the EC Regulation non-main proceedings are named "secondary proceedings". See Recital 12 of the EC Regulation.

20 See a 3(1)-3(2) of the EC Regulation and s 1517(b) of Chapter 15 of the *United States Bankruptcy Code* (Chapter 15).

- the problems concerning business enterprise groups that are not addressed by the EC Regulation or Chapter 15.

An analysis and comparison of the legal principles relating to the COMI concept, the "establishment" concept and the related aspects that are mentioned above, will set out the guiding principles indicating the practical approaches that should be adopted in South Africa in connection with CBI matters.

South Africa has also adopted the Model Law approach by ratifying the Model Law and enacting national legislation, namely the *Cross-Border Insolvency Act* 42 of 2000. Although this Act came into operation on 28 November 2003 it is not yet effective in South Africa as the Minister of Justice has not yet designated any states in respect of which the Act will apply in terms of section 2(2)(a) of the Act.

Europe and the United States of America are currently the world leaders in the area of CBI and the CBI legislation adopted and applied in these jurisdictions seems to be effective. As South Africa's Cross-Border Insolvency Act is not yet effective, there is no local policy guidance available to insolvency practitioners with regard to the application of the Model Law. An analysis of the European and American approaches to CBI matters will therefore provide South African practitioners with valuable insight, knowledge and lessons that will be used to understand and apply the principles adopted and applied in terms of the EC Regulation and Chapter 15, specifically the COMI concept, the "establishment" concept in the case of integrated multinational enterprises and related aspects.

## 2 Foreign main proceedings: COMI[21]

It is of significant importance to have a proper understanding of the meaning of COMI and "establishment" in order to ensure that foreign proceedings are recognised correctly as foreign main proceedings, foreign non-main proceedings or

21 This paragraph concerns mainly the following case law, which are in the possession of the authors: *Eurofood IFCS Ltd - Bondi v Bank of America NA* (Case C-341/04, OJ [2006] C 143/11); *SAS ISA Daisytek* Court of Appeals Versailles, 4 Sep 2003, JOR 2003/288; *Re BRAC Rent-A-Car International Inc.* [2003] 2 All ER 201; *In the Matter of Daisytek-ISA Limited* English High Court (Leeds Registry), 16 May 2003 BCC 562.

neither. The question as to what happens in a jurisdiction where there is no COMI or "establishment" should also be examined.

### *2.1 Interpretation and application of COMI under the EC Regulation*

The purpose of this section is to analyse closely the legal definition of COMI, the time for determining COMI, the legal system applicable to main insolvency proceedings and the substantive law provisions covered by such proceedings. As this article focuses on corporate entities, there will be a closer look at the presumption contained in the EC Regulation with regard to companies and legal persons. In addition this chapter will illustrate some practical problems concerning the determination of the COMI of a debtor company that have been encountered since the EC Regulation came into existence and how courts have dealt with these problems.

#### *2.1.1 Introduction*

It should be noted that the EC Regulation provides rules concerning the intra-community consequences arising from insolvency proceedings only, and applies only to disputes arising within the EU.[22] Additionally, the EC Regulation will apply to insolvency proceedings only where the COMI of the debtor is located within the EU[23] and such insolvency proceedings were opened on or after 31 May 2002.[24]

Article 3(1) of the EC Regulation states that the court of the Member State within the territory where a debtor's COMI is situated shall have jurisdiction to open insolvency proceedings.[25] Such insolvency proceedings are main insolvency proceedings,[26]

22 Wessels *International Insolvency Law* 235.

23 Recital 14 of the EC Regulation. The only exception is that Denmark is neither bound by the EC Regulation nor subject to its application. See Recital 33 of the EC Regulation. Therefore where the COMI of the debtor is located *outside* the EU, the EC Regulation will not apply (see the discussion in par 2.1.7 below). In such an instance the private international law branch of the relevant Member State will govern the question as to whether insolvency proceedings may be opened against the debtor, the rules that will apply to such proceedings and the legal consequences of such proceedings. See Wessels *International Insolvency Law* 235.

24 The EC Regulation entered into force on 31 May 2002. See a 47 of the EC Regulation.

25 The connecting factor that is thus used to determine if a court will have jurisdiction is the debtor's COMI (Torremans "Coming to Term with the COMI Concept"). In *SAS ISA Daisytek* Court of Appeals Versailles, 4 Sep 2003, JOR 2003/288 (hereafter referred to as the *Daisytek*-case) it

which have universal scope[27] and, therefore, encompass all of the debtor's assets to be found worldwide.[28] The EC Regulation guarantees this universality by creating a system of mandatory and automatic (*ex lege)* recognition of the main insolvency proceedings in all of the Member States.[29] Main insolvency proceedings may be winding-up or reorganisational proceedings.[30] The determination of a debtor's COMI will always be a question of fact.[31] COMI is an autonomous concept in the sense that the term is unique to the EC Regulation. It should be applied uniformly throughout the EU and should be interpreted independently from the national laws of the various Member States.[32] Furthermore, COMI is described as a concept that is flexible and has an open character, because it can be applied to any class of debtors or any organisational structure of a debtor.[33]

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was held that the only test, as far as jurisdiction to open main insolvency proceedings is concerned, is the location of the COMI of the debtor-company.

26 The proceedings are "main" because if local (secondary) proceedings are opened, these local proceedings will be subject to the mandatory rules of coordination and subordination of the "main" proceedings. See para 14 of the Virgós and Schmit *Report* 269, hereafter referred to as the Virgós-Schmit Report.

27 The proceedings will be "universal" because all of the assets of the debtor will be encompassed in such proceedings, regardless of where they may be located, unless local (secondary) proceedings are opened in a state where the debtor has an establishment. See para 14 of the Virgós-Schmit Report 269. Some of the most important legal consequences of such universal application of the main insolvency proceedings include the following: (i) all assets located outside the Member State opening the main insolvency proceedings are also included in such proceedings; (ii) the proceedings encompass all of the creditors of the debtor; (iii) the effects of the main insolvency proceedings are automatically recognised in all other Member States; (iv) the liquidator appointed in the main insolvency proceedings has the automatic authority to act in all other Member States; and (v) the individual execution against assets of the debtor found in any Member State is not possible. See para 19 of the Virgós-Schmit Report 269-270.

28 Recital 12 of the EC Regulation. The EC Regulation can, however, guarantee universal scope only within the EU as such. Its scope outside the EU depends on whether the foreign state in question allows for this or not. The laws of the foreign state outside the EU should therefore be consulted in order to see if the EU proceedings effectively extend to the assets located outside the EU. See Virgós and Garcimartín *European Insolvency Regulation* 54.

29 The automatic recognition entails that in any of the Member States the same effects are produced as under the law of the Member State opening the main insolvency proceedings. The recognition is immediate in the sense that it takes place by virtue of the EC Regulation (*ex lege Regulatorae*) without it being necessary to resort to preliminary proceedings or other formalities (such as publication). See Wessels *Current Topics* 21.

30 Such winding-up and reorganisational proceedings are listed in Annexure A of the EC Regulation. See para 16 of the Virgós-Schmit Report 269. By contrast, secondary proceedings may be winding-up proceedings only. See para 29 of the Virgós-Schmit Report 271.

31 Wessels *International Insolvency Law* 300. As Chapter 15 does not state that non-main (secondary) proceedings may be winding-up proceedings only, it is presumed that non-main proceedings under Chapter 15 may be winding-up or reorganisational proceedings.

32 Para 31 *Eurofood IFCS Ltd - Bondi v Bank of America NA* (Case C-341/04, OJ [2006] C 143/11) hereafter referred to as the *Eurofood*-case. Also see *Interedil Srl (In Liquidation) v Fallimento Interedil Srl* (C-396/09) [2012] *Bus LR* 1583 and Virgós and Garcimartín *European Insolvency Regulation* 37.

33 The EC Regulation does not make any distinctions based on the capacity or the nature of the debtor (eg public or private; trader or non-trader) or the way in which an organisation is

### *2.1.2 Definition of COMI*[34]

The legal definition of COMI is contained in Recital 13 of the EC Regulation which states that:

> The centre of main interest should correspond to the place where the debtor conducts the administration of his interest on a regular basis and is therefore ascertainable to third parties.

Virgós and Garcimartín[35] submit that this legal definition of COMI contained in Recital 13 is a combination of three fundamental ideas which cumulatively create the test of application in determining the COMI of a debtor:

(i) The primacy of the "administrative connection"

According to the legal definition, the administration of the debtor's interests is of primary relevance in the determination of international jurisdiction. In this context "administration" must be understood as referring to the management and control of the debtor's interests whilst "interests" refers to the debtor's economic affairs.[36] A very interesting and insightful fact is that the "administrative connection" (which is the place of management and control of the debtor) takes precedence over both the "operational connection" (which is the place of the debtor's business or operation) and the "asset connection" (which is the place where the assets of the debtor are located). With regard to subsidiary companies, the "administrative connection" will be the place where the head office (the main centre of administration) of each separate subsidiary company is located.[37] According to Virgós and Garcimartín[38] the fact that

structured (eg a company, partnership, association). See Virgós and Garcimartín *European Insolvency Regulation* 38.

34 The EC Regulation does not give a definition of "centre of main interest" provided for in a 3(1). Wessels submits that courts base their interpretation of the COMI concept mainly on two elements, namely the 33 recitals of the EC Regulation which form part of the preamble of the EC Regulation and the Virgós-Schmit Report. See Wessels *Current Topics* 150-160. Like the EC Regulation, Chapter 15 also has no definition of COMI.

35 Virgós and Garcimartín *European Insolvency Regulation* 40.

36 Virgós and Garcimartín *European Insolvency Regulation* 40. "Interest" encompasses not only commercial, industrial and professional activities, but also includes general economic activities in order to include the activities of private individuals such as consumers. See para 75 of the Virgós-Schmit Report 281.

37 Virgós and Garcimartín *European Insolvency Regulation* 40-41.

38 Virgós and Garcimartín *European Insolvency Regulation* 41.

decisions of subsidiary companies are taken in accordance with instructions received from the parent company or shareholders living elsewhere[39] does not influence the determination of the COMI of the subsidiary companies.[40]

(ii) The primacy of the "external sphere"[41]

As insolvency is a foreseeable risk it is important that international jurisdiction[42] should be based on a place which is known to the debtor's potential creditors. This enables creditors to calculate the legal risks which have to be assumed in the case of the insolvency of the debtor.[43] The debtor's COMI must, therefore, be "ascertainable by third parties", which entails that it must be visible[44] to creditors and potential creditors.[45]

The debtor cannot claim that its COMI is situated in a place other than the place which third parties have been led to believe is the place where the debtor's decisions are taken and the management of its affairs takes place.[46] In the matter of *Ci4Net.Com and DBP Holdings*[47] it was held by the High Court of Justice Chancery Division Leeds that a business must have a COMI which has some element of

39 The subsidiary accordingly makes a decision based on instructions from its parent, but the decision is made by the subsidiary at its place of administration.

40 In the *Eurofood*-case it was held that the mere fact that a parent company can or may control the economic choices of its subsidiary which is located in another Member State will be insufficient to rebut the presumption in favour of the jurisdiction of incorporation contained in a 3(1) of the EC Regulation. See para 37 of the *Eurofood*-case.

41 When determining the COMI of a debtor, the external organisation (which refers to the way the debtor manifests itself on a regular basis to the outside world) plays an important role. The term "on a regular basis" indicates a quality of presence. It also refers to a degree of permanence, but no minimum time period is implicitly imposed by the EC Regulation.

42 The Member State which opens the main insolvency proceedings has "international jurisdiction" in the insolvency proceedings, as the national insolvency laws of that Member State govern the insolvency proceedings. See para 75 of the Virgós-Schmit Report 281. Also see para 2.1.4 below.

43 Para 75 of the Virgós-Schmit Report 281.

44 Virgós and Garcimartín *European Insolvency Regulation* 42.

45 Wessels *International Insolvency Law* 298. In *Ci4Net.Com Inc and DBP Holdings Ltd* High Court of Justice Chancery Division Leeds, ZIP 2004, 1796, EWiR 2004, 20 May 2004 847 it was held that the most important third parties referred to in Recital 13 of the EC Regulation are the potential creditors. Also see *Parkside Flexibles SA* High Court Leeds Registry, 9 Feb 2005; *BenQ Mobile Holdings BV* 1503 IE 4371/06, Local Court of Munich, 5 Feb 2007 discussed in para 3.3 below.

46 Virgós and Garcimartín *European Insolvency Regulation* 41. That could be so particularly in the case of a so-called "letterbox" company not carrying out any business in the territory of the Member State where the registered office is located. See para 35 of the *Eurofood*-case.

47 *Ci4Net.Com Inc and DBP Holdings Ltd* High Court of Justice Chancery Division Leeds, ZIP 2004, 1796, EWiR 2004, 20 May 2004.

permanence. The company's COMI cannot shift as its principal director moves from one country to another. In this case, the company presented itself to its most substantial creditor as having its principal executive offices in London and, therefore, it was found that the debtor-company had its COMI in the United Kingdom (UK).[48]

Similarly, in *Shierson v Vleiland-Boddy*[49] the Court of Appeal of England declared: [50]

> It is important, therefore, to have regard not only to what the debtor is doing but also to what he would be perceived to be doing by an objective observer. And it is important, also, to have regard to the need, if the centre of main interests is to be ascertainable by third parties, for an element of permanence. The court should be slow to accept that an established centre of main interests has been changed by activities which may turn out to be temporary or transitory.

In *Eurofood IFCS Ltd-Bondi v Bank of America NA*[51] it was held that the COMI of a debtor must be identified by reference to criteria that are both objective and ascertainable by third parties. These criteria are necessary in order to ensure legal certainty and foreseeability concerning the determination of the court with jurisdiction to open main insolvency proceedings.[52] The "objective ascertainability" of the debtor's COMI is of importance as it enables creditors to determine the commercial or financial risks they might face if the debtor they deal with becomes insolvent.[53]

In the matter of *Re Stanford International Bank Ltd (In Receivership)*[54] one of the questions before the court was what the meaning of the phrase "ascertainable" was. In response to this question, Justice Lewison held that: [55]

> [w]hat was ascertainable by a third party was what was in the public domain, and what a typical third party would learn as a result of dealing with the company.

48 See also Wessels *International Insolvency Law* 297.
49 *Shierson v Vleiland-Boddy* Court of Appeal (Civil Division), 27 Jul 2005 [2005] EWCA Civ 974 (hereafter referred to as the *Shierson*-case).
50 Para 55(3) *Shierson*-case.
51 Para 35 *Eurofood*-case.
52 Para 33 *Eurofood*-case. Legal certainty and foreseeability are all the more important in that, in accordance with a 4(1) of the EC Regulation, the determination of the court with jurisdiction entails the determination of the law which is to apply.
53 Virgós and Garcimartín *European Insolvency Regulation* 42.
54 *Re Stanford International Bank Ltd (In Receivership)* [2009] BPIR 1157.
55 Para [62] *Re Stanford International Bank Ltd (In Receivership)* [2009] BPIR 1157. For a discussion on this matter, see Wessels 2011 *Insolvency Intelligence* 17-23.

(iii) The principle of unity

A debtor can (and must) have one COMI only at any given time as only one set of main insolvency proceedings may be opened under the EC Regulation.[56] The word "main" in the term "main interests" serves as a criterion for the case where the interests of the debtor include activities of different types that are run from different centres that the debtor may have.[57] If a debtor has more than one place of management, the place of "central administration" must be determined by establishing which one of the places of management is the "directing centre" where the head office functions are carried out.[58] It should further be reiterated that once main proceedings have been opened in a Member State, only secondary (territorial) proceedings may be opened in other Member States.[59]

*2.1.3 The reference date for determining COMI*

Article 3(1) of the EC Regulation states that the courts of the Member State within which the COMI of the debtor is situated shall have the jurisdiction to open main insolvency proceedings. The question arises as to exactly when the COMI should be located in a Member State for its courts to have international jurisdiction over the insolvency proceedings. There seem to be two viewpoints concerning this question. Firstly, in *Genevan Trading Co Ltd v Kjell Tore Skjevesland*[60] it was held that the COMI of a debtor should be located in a Member State at the moment the court decides to open (or not to open) insolvency proceedings. The second view is expressed by Virgós and Garcimartín, who submit that the relevant time that the COMI of a debtor must be located in a specific jurisdiction in order to determine international jurisdiction is the moment the application to open insolvency

56 Para 73 of the Virgós-Schmit Report 281. The EC Regulation adopts a model that is based on a single main insolvency proceeding which can be supplemented by one or more territorial (non-main) proceedings.

57 Wessels *Current Topics* 161.

58 In order to determine the COMI of the debtor, one would look at various factors, such as the place where strategic decision-making takes place, where the relationships with shareholders are, where the general supervision of the business takes place, and where the central treasury management takes place. See Botha and Stander 2011 *Journal for Juridical Science* 31 ff for an in-depth discussion of this subject.

59 This refers to the procedural rule of *lis pendens*. See aa 16(1) and 16(2) of the EC Regulation.

60 See *Genevan Trading Co Ltd v Kjell Tore Skjevesland* High Court, 11 Nov 2002 [2003] BCC 391.

proceedings is filed.[61] This approach is in accordance with the principle of *perpetuatio fori,* which entails that the transfer of a debtor to a different state after an application for the opening of insolvency proceedings has been filed does not alter the jurisdiction of the court.[62] In support of their view, Virgós and Garcimartín refer to the *Susanne Staubitz-Schreiber*-case,[63] in which the European Court of Justice[64] held that the court of the Member State within the territory of which the debtor's COMI is situated when the debtor lodges the request to open insolvency proceedings retains the jurisdiction to open such insolvency proceedings even if the debtor moves its COMI to the territory of another Member State after lodging the request but before the proceedings are opened.[65] It is submitted that the approach suggested by Virgós and Garcimartín should be adopted, as this approach was affirmed by the ECJ[66] and is accordingly binding on all Member States.[67] Additionally, this approach will prevent forum shopping by a debtor and will give rise to legal certainty across the EU.[68]

A debtor's COMI is not fixed[69] in the sense that it can change. Companies can, therefore, consciously decide to change their COMI for valid business reasons or as part of insolvency planning.[70] For example, in the *Dentist Changing House*-case[71] the debtor moved its COMI from Germany to the UK before it filed for insolvency proceedings.[72] The court ruled that the debtor's COMI was in the UK, regardless of the fact that all of the claims against it had been incurred in Germany, because the

61 Para 55 *Shierson*-case. Also see Virgós and Garcimartín *European Insolvency Regulation* 49-50.
62 Virgós and Garcimartín *European Insolvency Regulation* 50.
63 *Susanne Staubitz-Schreiber* ECJ, 17 Jan 2006, C-1/04, JOR 2006/59. Hereafter referred to as the *Susanne Staubitz-Schreiber*-case.
64 Hereafter referred to as the ECJ.
65 Wessels *International Insolvency Law* 326.
66 In the *Susanne Staubitz-Schreiber*-case.
67 Marshall (ed) *European Cross Border Insolvency* 2-56 (para 2.016).
68 Also see Moss, Fletcher and Isaacs *EC Regulation on Insolvency Proceedings* 47- 48.
69 In the *Shierson*-case it was held that it would be inconsistent with the language of a 3(1) of the EC Regulation to hold that the COMI of a debtor was fixed by some past event. See para 41.
70 Smits and O'Hearn "Multinational Insolvency Forum Shopping" 487; Goode *et al Transnational Commercial Law* 495. In the *Shierson*-case it was held that there is no principle of immutability and a debtor must be free to choose where he carries on those activities which fall within the concept of "administration of his interests". See para 55(4).
71 *Dentist Changing House* AG Celle, 18 Apr 2005 (29 IN 11/05).
72 Also see the matter of *Trillium (Nelson) Properties Ltd v Office Metro Ltd* [2012] ILPr 30. In this matter the debtor company, which was registered in England, had changed its COMI and transferred its main headquarters and place of administration from England to Luxembourg. The debtor company changed its COMI three years prior to its liquidation. The court subsequently opened main insolvency proceedings in Luxembourg.

COMI of a debtor at the time of filing determines the international jurisdiction for the purposes of article 3 of the EC Regulation. It is, accordingly, a necessary incident of the debtor's freedom to choose where it carries on those activities which fall within the concept of "administration of its interests", and the debtor may choose to change its COMI for a self-serving purpose. In particular the debtor may even choose to do so at a time when insolvency threatens.[73] From the wording of the EC Regulation it would seem that in instances where the debtor transfers its COMI from one state to another before an application to open insolvency proceedings is brought before a court, the court may (depending on the circumstances of the case) possibly uphold the jurisdiction of the state where the debtor's new COMI is located.[74] In this regard it was held in the *Shierson*-case that:[75]

> [i]n circumstances where there are grounds for suspicion that a debtor has sought, deliberately, to change his centre of main interests at a time when he is insolvent, or threatened with insolvency, in order to alter the insolvency rules which will apply to him in respect of existing debts, the court will need to scrutinize the facts which are said to give rise to a change in the centre of main interests with that in mind. The court will need to be satisfied that the change in the place where the activities which fall within the concept of "administration of his interests" are carried on which is said to have occurred is a change based on substance and not an illusion; and that that change has the necessary element of permanence.

It is additionally submitted that, should a debtor change the location of its COMI, it must comply with the requirements set out in the *Eurofood*-decision of being identifiable objectively and being ascertainable by third parties.[76]

An example of where a debtor could change the location of its COMI would be where it begins as a small company in state A, where it is registered. A few years later, when the company has expanded, it starts to take part in business activities in state B. As time goes by most of the company's business activities with its clients are conducted in state B, it shifts its administrative section and operational decision-

73 Para 55(5) *Shierson*-case.

74 Although this might increase the opportunity for debtors to "forum shop", there are certain elements that reduce this kind of conduct. Firstly, a new location should be the place where the debtor "conducts" the administration of his main interests on a "regular basis", which means that there needs to be stability in the new location; secondly it is usually relatively costly to change the location of a company; thirdly, the general rules of fraud may be invoked to prevent forum shopping. See Virgós and Garcimartín *European Insolvency Regulation* 50-51.

75 Para 55(5) *Shierson*-case.

76 See para 2.2.6 below for the approach adopted by the US courts in instances where a "tax haven" is involved.

making to state B, all of its assets are located in state B and all of its employees work in state B. From the facts it can be seen that the COMI of the company might have shifted after a certain time. When the company first started, it was operational only in state A, where it was registered, and its COMI would probably have been located there. If one evaluates the situation a few years later, however, when nearly all of its ties are to state B (except that it is registered in state A), it is highly probable that its COMI would now have shifted to state B.

### *2.1.4 Law applicable to the main insolvency proceedings*

The law of the Member State within the territory of which the main insolvency proceedings are opened (known as the *lex (forum) concursus*)[77] will generally[78] be the law applicable to the insolvency proceedings[79] and will, therefore, govern the opening, conduct and closure of the insolvency proceedings.[80] Insolvency matters that are always governed by the *lex concursus* include set-offs, the proving of debts, the powers conferred upon a liquidator, the distribution of assets and the avoidance of antecedent debts.[81] The *lex concursus* is applicable to the main insolvency proceedings as well as the secondary insolvency proceedings and it determines both the procedural and substantive effects[82] of the insolvency proceedings.[83] The *lex concursus* of one Member State is, therefore, "exported" to another Member State. The opening of main insolvency proceedings under article 3(1) of the EC Regulation will be limited by the opening of secondary (territorial) proceedings in terms of article 3(2). In order to protect the interest of local creditors, the national law of the Member

77 Wessels *International Insolvency Law* 245.

78 There are some exceptions. For example the *lex concursus* will not apply to secondary proceedings concerning a creditor's rights *in rem*, rights under a contract of employment, certain set-off rights and the reservation of title clauses. See aa 5-15 of the EC Regulation which sets out specific rules for certain matters. Also see Smits and O'Hearn "Multinational Insolvency Forum Shopping" 487; Goode *et al Transnational Commercial Law* 572-573.

79 Article 4(1) of the EC Regulation.

80 Article 4(2) of the EC Regulation. See a 4(2)(a)-(m), which lists the proceedings governed by the *lex concursus* in particular.

81 Smits and O'Hearn "Multinational Insolvency Forum Shopping" 487. When the COMI of a debtor is located within the EU, the EC Regulation provides choice-of-law rules for cooperation amongst the relevant courts as well as jurisdictional rules.

82 An example of a procedural aspect of insolvency proceedings is the time that is provided for giving notice to creditors of the pending insolvency proceedings or a meeting of creditors. An example of a substantive aspect of insolvency proceedings is the distribution priority for creditors' claims. See also para 2.1.5 below.

83 Wessels *International Insolvency Law* 250.

State opening the secondary proceedings will apply to all assets located in that Member State. The main proceedings may influence the conduct of such secondary proceedings due to coordination and sub-coordination rules which derive from the EC Regulation and to which the secondary proceedings are subject.[84]

If a debtor has its COMI in state A and has assets and creditors in state B, the insolvency law of state A will determine the realisation procedure of the assets and distribution priority of the creditors located in state A and state B. If the debtor should have an "establishment" in state B where secondary insolvency proceedings are instituted, the insolvency law of state B would determine the realisation procedure of the assets located there and the distribution priorities of the local creditors.

*2.1.5 Substantive law falling within the scope of article 3(1) of the EC Regulation*

The EC Regulation applies to any debtor, irrespective of the characteristics of that debtor, the nature of the debtor's activities or the nature of the debtor's debts.[85] Although article 3(1) of the EC Regulation confers international jurisdiction upon the courts located in the debtor's COMI in relation to insolvency proceedings, the extent of such jurisdiction is not defined in the EC Regulation.

Virgós and Garcimartín[86] identify three categories of proceedings that fall within the jurisdiction of the court that opens the main insolvency proceedings, namely:

a) the opening, conduct and closure of insolvency proceedings as well as all questions forming part of the core insolvency procedure itself;[87]
b) actions which, although not forming part of the insolvency procedures itself, are directly derived from the insolvency proceedings and are closely linked with such proceedings;[88] and

84 Wessels *Current Topics* 22.
85 Wessels *International Insolvency Law* 237. The debtor may be a natural person or a legal entity and may relate to debts which are of public, commercial or private nature.
86 Virgós and Garcimartín *European Insolvency Regulation* 60.
87 Examples of such proceedings include matters concerning (a) the appointment of a liquidator; (b) the divestment of the debtor; (c) the administration of the insolvent estate; (d) modification or termination of stay proceedings; (e) the determination of the ranking of claims; (f) the collection and liquidation of assets; and (g) the distribution of the proceeds of the assets to the creditors. See Virgós and Garcimartín *European Insolvency Regulation* 60.

c) preservation measures which are ancillary to either of the two previous categories.[89]

The EC Regulation will, however, not be applicable to insolvency proceedings that concern insurance undertakings, credit institutions, investment undertakings which provide services involving the holding of funds or securities of third parties, or to collective investment undertakings.[90]

*2.1.6 Presumption with regard to companies and legal persons*

In order to enhance legal certainty[91] article 3(1) of the EC Regulation states that the place of registration[92] of a company or legal person[93] shall be presumed to be its COMI in the absence of proof to the contrary. The main advantage of the presumption under article 3(1) is that it allows for the quick and straightforward

88 There are two requirements that must be fulfilled before the court opening the insolvency proceedings will have the jurisdiction with regard to such actions. Firstly, the outcome of the proceedings must depend on insolvency law (the legal foundation of the action must, substantively speaking, be insolvency law) and secondly, from a procedural point of view the action must be closely connected with the insolvency proceedings. Examples of such proceedings include: (a) disputes between the liquidator and the debtor related to whether an asset belongs to the estate of the debtor or not; (b) disputes regarding the exercise of power by the liquidator and (c) proceedings to determine, avoid or recover preferences, fraudulent conveyances or any other acts which are to the detriment of the general body of creditors. See Virgós and Garcimartín *European Insolvency Regulation* 60-61.

89 There are three conditions that need to be satisfied. Firstly, the provisional order or preservation measures should be aimed at ensuring the effectiveness of the insolvency proceedings; secondly, the debtor must have its COMI in a Member State; and thirdly, the insolvency proceedings must be included in the Annexes of the EC Regulation. See Virgós and Garcimartín *European Insolvency Regulation* 66. Examples of preservation measures include: (a) interlocutory measures to do something or refrain from doing something; (b) the appointment of a temporary administrator; and (c) an order for the attachment of assets. See para 78 of the Virgós-Schmit Report 282.

90 Article 1(2) of the EC Regulation.

91 Torremans "Coming to Term with the COMI Concept" 175.

92 Whilst the English version of the EC Regulation refers to "registered office", the linguistic version of the EC Regulation refers to "statutory seat". The term "statutory seat" is known in the company laws of all of the EU Member States except the UK and Ireland, who use the term "registered office". These terms should, however, be construed as interchangeable with regard to CBI matters. The "registered office" or "statutory seat" refers to the place which is designated as the official address of the entity by the founders or the members of a company or legal person. The registered office will be located at the place pointed out as such in the instrument of formation of the entity, its statutes, or in a separate document. See Virgós and Garcimartín *European Insolvency Regulation* 45.

93 In this context "company or legal person" should be understood in a wide sense and encompass legal persons (whether corporations, foundations or associations) as well as unincorporated associations and partnerships which are subject to insolvency proceedings (although they have no separate legal personality). See Virgós and Garcimartín *European Insolvency Regulation* 44.

determination of a single court that possesses the jurisdiction to deal with the whole insolvency of the debtor-company.[94]

This presumption is rebuttable[95] and the burden of proof will rest upon any party wishing to displace the presumption.[96] There will be sufficient proof to the contrary if it is established that the administration of the debtor-company's main interests are conducted on a regular basis from a Member State other than the Member State where the registered seat of the debtor-company is situated.[97] If other connections are claimed and proven, but there is still no reasonably clear result in favour of the location of a debtor's COMI in a state other than the state where its registered office is found, the presumption will prevail.[98]

An example of a matter where the presumption was rebutted is the case of *Enron Directo Sociedad Limitada.*[99] The debtor-company was incorporated in Spain. One of its creditors filed for the opening of administration proceedings as main insolvency proceedings in the UK. The court accepted evidence that all the main executive, administrative and strategic decisions concerning the financial and other activities of the debtor-company were conducted in London. Accordingly the High Court of London held that, although the registered office of the debtor was in Spain, its COMI

94 Torremans "Coming to Term with the COMI Concept" 176-178.

95 Wessels *Current Topics* 155. The fact that the presumption is rebuttable means that in certain cases, for example where the "debtor has nothing more than a letterbox in the place where it is registered, the formal criterion can be set aside in favour of a flexible determination of the debtor's COMI on the basis of the facts of the specific case". See Torremans "Coming to Term with the COMI Concept" 177.

96 Wessels *International Insolvency Law* 313.

97 Torremans "Coming to Term with the COMI Concept" 175; Wessels *International Insolvency Law* 313. In the matter of *Rastelli Davide e C Snc v Hidoux (C-191/10)* [2012] All ER (EC0 239 (ECJ (1st Chamber)) (hereafter referred to as "the *Rastelli*-case"), the ECJ held that the fact that the property of the two companies was intermixed was not sufficient to show that the COMI of the second company was also located in the Member State where the first company had its COMI. In order to reverse the presumption under Regulation 3(1) of the EC Regulation, it is required that an overall assessment of all the relevant factors (in a manner that is ascertainable by third parties) indicates that the actual centre of management of supervision of the second company is situated in the Member State where the initial main insolvency proceedings were opened, before a court may find that the COMI of the second company is also located in the Member State of the first company. See paras 32 and 39 of the judgement.

98 Virgós and Garcimartín *European Insolvency Regulation* 44. Torremans "Coming to Term with the COMI Concept" 177 submits that the presumption provides "the right balance between legal certainty on the one hand and flexibility on the other hand".

99 *Enron Directo Sociedad Limitada* High Court of London, 4 Jun 2002 (unreported).

was located in London, where main insolvency proceedings could be opened, as its head office was located in England.[100]

### *2.1.7 Position with regard to debtor-companies incorporated outside the EU*

An interesting situation occurs in instances where a debtor-company has its COMI within the EU but is registered outside the EU. The question that arises is whether or not the EC Regulation is applicable in such instances. This situation was addressed in *Re BRAC Rent-A-Car International Inc,*[101] where the English High Court was confronted with the question of whether or not the EC Regulation applies only to legal persons that are incorporated within the European Union. In this case the debtor-company was incorporated in Delaware and had its registered office in the US, but its operations were almost entirely conducted in the UK.[102] The company petitioned for an administration order before the English High Court. Fearing that they would be negatively affected by the administration of the company in the UK, two of the judgment creditors objected to the proceedings and contested that the English court did not possess the jurisdiction to make an administration order. They argued that the legal measures of the EC should not be presumed to apply to entities incorporated outside the EU. They further maintained that the EC Regulation dealt with the position between different Member States and should not be read as having extra-territorial effect outside the Community.[103] After consideration of the various applicable sections of the EC Regulation, including article 3 and Recital 13, the court rejected the submissions of the judgment creditors. The court held that the courts of a Member State would have jurisdiction to open insolvency proceedings in respect of a company that is incorporated outside the Community if the company's COMI is situated within that Member State, which was the case in this instance. In determining if the EC Regulation is applicable in respect of a debtor-company, the only test is whether or not that debtor's COMI is to be found within the relevant

100 See also Wessels *Current Topics* 165; *AvCraft International Ltd ZIP* 2005, 1611; EWiR 2005, 791 District Court Weillheim, 22 Jun 2005; *Re Finnish LLC* Court of Appeal Svea, No Ö4105-03, 30 May 2003 (unreported); *3T Telecom Ltd* [2005] EWHC 275 (Ch) for examples of cases where the presumption of a 3(1) was rebutted.

101 *Re BRAC Rent-A-Car International Inc* [2003] 2 All ER 201.

102 The company traded from an address in England, all of its employment and trading activity contracts were governed by the English law, and it was registered as an overseas company in terms of the UK's *Companies Act* of 2006. See para 4-5.

103 Par 20 *Re BRAC Rent-A-Car International Inc* [2003] 2 All ER 201.

Member State, irrespective of where it is incorporated.[104] The court further held that:[105]

> Turning to *purposive interpretation*, it seems to me that a reading of the regulation which limited it (as regards legal persons) to debtors who are incorporated in any of the member states would prevent the regulation from achieving some of the purposes which are described in the recitals and would leave it open to avoidance, providing an incentive for artificial operations … It would allow those who use corporate bodies to arrange that, although their business, assets and operations are based in a member state, the relevant corporate body is incorporated outside the Community, so that the provisions of the regulation would not apply to it or its assets. That would be inconsistent with the aim described in recital (3), and such an incentive for manipulation would be at least as inconsistent with the objectives of the regulation as the examples of forum-shopping among Member States mentioned in recital (4).

### *2.1.8 The problem regarding multinational groups of companies*

One important problem that has not been addressed by the EC Regulation[106] is that it does not contain any provision concerning groups of affiliated companies (parent-subsidiary schemes).[107] If insolvency proceedings are instituted against a company which is related to another company in some or other way, the former company is considered to be a separate debtor in accordance with the rule that every legal person is a single debtor under the application of the EC Regulation.[108] Each debtor-company must be considered separately and the concept of COMI, therefore, refers to the COMI of each separate debtor, not to the COMI of the group.[109]

104 Paras 24 and 31. *Re BRAC Rent-A-Car International Inc* [2003] 2 All ER 201.

105 Para 27 *Re BRAC Rent-A-Car International Inc* [2003] 2 All ER 201. The same line of reasoning was followed in *Norse Irish Ferries and Cenargo Navigation Limited* High Court of Justice, 20 Feb 2003 (unreported) as well as *Salvage Association* High Court of Justice, 9 May 2003, [2003] EWHC 1028 (Ch).

106 Torremans "Coming to Term with the COMI Concept" 177.

107 Para 76 of the Virgós-Schmit Report 282. Torremans submits that a 3(1), as it currently stands, needs to be applied separately to each of the affiliated companies as far as each of them has a separate legal entity. See Torremans "Coming to Term with the COMI Concept" 177 and *Re BRAC Rent-A-Car International Inc* [2003] 2 All ER 201 para 27.

108 Wessels *International Insolvency Law* 330. Also see *Rastelli Davide e C Snc v Hidoux* (C-191/10) [2012] All ER (EC0 239 (ECJ (1st Chamber); para 30 of the *Eurofood*-case.

109 Virgós and Garcimartín *European Insolvency Regulation* 46. In order to open or consolidate insolvency proceedings against any of the related companies as a principal or jointly liable debtor, jurisdiction must exist in terms of the EC Regulation for each of the individually concerned debtors with a separate legal entity. See para 76 of the Virgós-Schmit Report 282.

Torremans[110] submits that the EC Regulation "therefore fails to provide an adequate solution for the instances where it would be desirable to let a single court deal with the whole set of insolvency cases concerning closely related affiliated companies". From case law it seems that courts have, in certain circumstances, been able to find a common COMI for a whole affiliate group in order for the whole group of debtor-companies to be jointly administered under one main proceeding. For example, the case of *In the Matter of Daisytek-ISA Limited*[111] concerned an English holding company which had three German subsidiary companies and one French subsidiary company. The holding company applied to the English High Court for an administration order, which included its German and French subsidiaries. The English Court found that the COMI of each of these subsidiaries was also located in England. The court took various surrounding circumstances into consideration when coming to this decision. One of the decisive factors was that the majority of the administration of the German and French subsidiaries took place in England. Furthermore, the court stated that, in determining the main interest of a debtor, a court has to consider the scale of the interest administered in a specific jurisdiction as well as the importance of the interest administered in that jurisdiction. Then the court should consider the importance and scale of the debtor's interests administered in any other jurisdiction that might qualify as the COMI of the debtor. Recital 13 of the EC Regulation requires that the COMI of a debtor "be ascertainable by third parties". The most important third parties referred to are creditors and potential creditors. In the given set of facts, the financiers and trade suppliers were the most important creditors of the subsidiary companies. Financing of the subsidiaries was organised in England and seventy per cent of the goods that were supplied to the subsidiaries took place by way of contracts concluded in England. Accordingly, the functions performed in England were of an important scale and of a significant nature. Additionally, the functions performed locally in Germany and France were quite limited. Therefore, the court held that the presumption in favour of the

110 Torremans "Coming to Term with the COMI Concept" 177-178.

111 *In the Matter of Daisytek-ISA Limited* English High Court (Leeds Registry), 16 May 2003 BCC 562. For an in-depth discussion of this case, see Botha and Stander 2011 *Journal for Juridical Science* 34 ff.

jurisdiction of incorporation[112] had been rebutted and the COMI of the three German and the one French subsidiaries were located in England.[113]

One of the legal questions before the ECJ in the *Eurofood*-case was what the determining factor is for identifying the COMI of a subsidiary company where it and its parent have their respective registered offices in different Member States.[114] Eurofood IFCS Ltd (Eurofood) was a company which was a wholly owned subsidiary of Parmalat SpA (Parmalat).[115] Eurofood had its registered office in Ireland, whilst Parmalat was incorporated in Italy. Parmalat controlled the policy of Eurofood as it was in a position to do so by virtue of its shareholding and power to appoint directors. Eurofood, however, conducted the administration of its interests on a regular basis (in a manner ascertainable by third parties) in Ireland and in complete and regular respect for its own corporate identity. In considering where the COMI of Eurofood was situated, the ECJ held that:[116]

> [w]here a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by the Regulation.

Relying heavily upon the provisions of article 3(1) of the EC Regulation,[117] the ECJ held that the debtor's COMI was located in Ireland, where it was incorporated.[118]

According to Mevorach[119] the degree of integration and centralisation of management may differ from one multinational enterprise to another. It may occur

112 Contained in a 3(1) of the EC Regulation.
113 See paras 3, 13, 14, 16 and 17 of the *Daisytek*-case. Similarly, in *Cirio del Monte NV* Civil Court of Rome, Bankruptcy Section, 13 Aug 2003, the Italian Court held that all of two Italian companies and their Dutch subsidiary had their COMI in Rome. In this case the respective insolvency proceedings of each debtor-company were placed under the supervision of the same court and the same liquidator was appointed for the group of companies. See Smits and O'Hearn "Multinational Insolvency Forum Shopping" 498.
114 Whereby the COMI of that subsidiary is situated in the Member State where its registered office is situated. See para 26 *Eurofood*-case.
115 Parmalat SpA was therefore the parent company and Eurofood was its subsidiary. For an in-depth discussion of this case, see Botha and Stander 2011 *Journal for Juridical Science* 37 ff.
116 Para 37 *Eurofood*-case.
117 Article 3(1) of the EC Regulation states that, in the case of a company or legal person, its place of registration will be presumed to be its COMI, in the absence of proof to the contrary. Also see para 2.1.6 above.
118 See para 2.3.1 below for Westbrook's criticism of the *Eurofood*-case.
119 Mevorach *Insolvency within Multinational Enterprise Groups* 34.

that the degree of integration and centralisation of management of a multinational enterprise

> [does] not necessarily correlate with the legal structure opted for by the enterprise (i.e. the corporate group form), which provides for full separation among group companies. As a result, the application of concepts of separateness between entities and limited liability to the group case may collide with the actual way the group operates, and therefore may achieve different outcomes compared with the single company case. The problem becomes clearer when considering the ability of the enterprise to exploit the group structure to the detriment of certain stakeholders of the group, as well as the benefits the group may be deprived of if strict adherence to the legal separateness of its elements is always adopted.

Mevorach[120] believes that, in general, the insolvency proceedings of integrated (or inter-related) corporate entities[121] should be centralised. She describes the following advantages of this approach:

(a) The jurisdiction in which the insolvency proceedings are instituted will likely meet the creditors' expectations and correspond with their legitimate interests;[122]
(b) it will prevent forum shopping;[123] and
(c) it will enable creditors to be involved in the insolvency proceedings and provide for appropriate creditor representation.[124]

However, it seems that the European courts may in certain instances be reluctant to hold that the insolvency proceedings of integrated entities should be centralised. For

120 See Ronen-Mevorach 2006 *JBL* 468-486; Mevorach 2008 *ICLQ* 427-448; and Mevorach 2011 *JBL* 666-681.

121 Integrated (or inter-related) multinational enterprises are those enterprises that operate on a worldwide basis and (i) are centrally controlled; (ii) are managed jointly as a group and coordinated single business; or (iii) where various components of the enterprise are inter-linked resulting in a "significant financial and administrative interdependence" between the various entities or subsidiaries of the multinational enterprise. See Mevorach 2008 *ICLQ* 431-432.

122 The expectations and views of the all of the creditors of the inter-related entity, as a whole, should be taken into account when determining the jurisdiction in which the insolvency proceedings should be instituted. See Ronen-Mevorach 2006 *JBL* 473.

123 See Ronen-Mevorach 2006 *JBL* 473-474.

124 However, there are certain disadvantages to centralising the insolvency proceedings of a multinational enterprise. Eg, certain creditors that are situated a great distance from the jurisdiction dealing with the insolvency of the inter-related multinational enterprise may not have the financial means to travel that distance and to be involved in those proceedings, there might be certain language barriers, and decisions may be made that will benefit the creditors as a whole but disadvantage certain individual creditors. See Ronen-Mevorach 2006 *JBL* 474-476.

example, in the *Rastelli*-case[125] the French Commercial Court found that the COMI of the debtor company ("the French company") was situated in France and, accordingly, opened main insolvency proceedings in France. The liquidator of the French company applied to the French Commercial Court for an order that a second company, which had its registered office in Italy ("the Italian company") be joined in the insolvency proceedings opened against the French company for the reason that the property of the two companies was intermixed. Taking the presumption under article 3(1) of the EC Regulation into consideration,[126] the French court refused to join the Italian company to the main insolvency proceedings in France, because the Italian company's registered office was in Italy and it did not have an establishment in France. The ECJ was asked to provide a preliminary opinion on whether or not the courts of a Member State which had opened main insolvency proceedings against a company could, under the national laws of that Member State, join to those insolvency proceedings a second company (which had its registered office in another Member State) based solely on the fact that the property of the two companies was intermixed. The ECJ held that the courts of a Member State which had opened main insolvency proceedings against a company could, under the national laws of that Member State, join to those insolvency proceedings a second company (which had its registered office in another Member State) only if it is shown that the COMI of the second company was also located in that Member State.[127]

### *2.1.9 Conflicts of jurisdiction*

As already stated, a debtor may have only one COMI at any given time as there may be only one set of main insolvency proceedings opened in the EU. As COMI is an autonomous concept, it should be applied uniformly throughout the EU and should be interpreted independently from the national laws of the various Member States.[128] There are, however, two types of jurisdictional conflicts that occur in practice.

125 *Rastelli Davide e C Snc v Hidoux* (C-191/10) [2012] All ER (EC0 239 (ECJ (1st Chamber).
126 See the discussion in para 2.1.6 above.
127 See paras 22-29 of the *Rastelli*-case.
128 See para 2.1.1 above.

a) Positive conflict

Firstly, a Member State may determine that a debtor's COMI is located within its jurisdiction, whilst another Member State may also find that the debtor's COMI is located within its jurisdiction. Accordingly, two different Member States may be equally convinced that a debtor's COMI is located in their respective territories.[129] This is known as a positive conflict.[130] Obviously this creates a problem as a debtor may have only one COMI at any given time. Article 16(1) of the EC Regulation provides the solution to this problem by stating that:

> [a]ny judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction … shall be recognised in all the other Member States from the time that it becomes effective in the State of the opening of proceedings.

In accordance with the first-in-time rule[131] (also known as the principle of temporal priority)[132] Recital 22 of the EC Regulation states that the decision of the first court to open proceedings should be recognised in other Member States and those other Member States do not have the power to scrutinize the first court's decision.[133] The court that opened insolvency proceedings first will, therefore, be the court possessing the appropriate jurisdiction.[134] If an interested party (who has the view that the debtor's COMI is situated in a Member State other than that the one in which the main insolvency proceedings were opened) wishes to challenge the jurisdiction assumed by the court which first opened the main insolvency proceedings, it may use the remedies prescribed by the national law of that Member State.[135]

An example of a matter where this problem came into consideration was the *Daisytek*-case.[136] Daisytek was a company incorporated under the laws of France.[137]

129 Wessels *International Insolvency Law* 327.
130 Virgós and Garcimartín *European Insolvency Regulation* 51.
131 Wessels *International Insolvency Law* 327.
132 Virgós and Garcimartín *European Insolvency Regulation* 51.
133 In the *Eurofood*-case it was held that Recital 22 of the EC Regulation makes it clear that "the principle of mutual trust requires that the courts of the other Member States recognise the decision opening main insolvency proceedings, without being able to review the assessment made by the first court as to its jurisdiction." See para 42.
134 Wessels *International Insolvency Law* 327.
135 Para 43 of the *Eurofood*-case.
136 See also para 2.1.8.

After having found that the COMI of Daisytek was located in the UK, the High Court of Leeds subsequently opened insolvency proceedings against Daisytek on 16 May 2003. On 26 May 2003, following a filing of a petition for insolvency, the Commercial Court of Pontoise in France put Daisytek under administration. The administrators appointed by the High Court of Leeds applied to have the judgment of the Commercial Court of Pontoise set aside, because they considered that the insolvency proceedings opened in the UK prevented the opening of other main insolvency proceedings in France. The Commercial Court of Pontoise, however, dismissed the application of the administrators, whereupon they appealed to the Court of Appeal in Versailles. The Court of Appeal held that the only test, as far as jurisdiction to open main insolvency proceedings is concerned, is the COMI of the company. Furthermore, the court stated that the English judge correctly found that the presumption of article 3(1) of the EC Regulation had been rebutted and that, as far as the French company was concerned, the Bradford office in England was the COMI of Daisytek. As stated above, article 16 of the EC Regulation states that any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to article 3 must be recognised in all the other Member States. As the High Court of Leeds had jurisdiction over Daisytek, the administration order of 16 May 2003 should have been recognised in France and prevented any French Court from opening subsequent main insolvency proceedings. Accordingly, it was held that the Commercial Court of Pontoise had no jurisdiction to put the debtor-company under administration on 26 May 2003. The Court of Appeal subsequently overturned both the judgement to open main insolvency proceedings in France and the judgement dismissing the administrators' application given by the Commercial Court of Pontoise.[138]

b) Negative conflict

Secondly, it can occur that the court located in the jurisdiction of the registered office of the debtor rejects the request to open insolvency proceeding on the ground of lack of international jurisdiction, because the court considers the debtor's COMI to be

137 Daisytek was a subsidiary company of an English holding company. The holding company also had three German subsidiaries.

138 For an in-depth discussion of this case, see Botha and Stander 2011 *Journal for Juridical Science* 34 ff**.**

located in another (second) state. The court of the second state before which the matter is then brought also denies that the COMI is situated within its jurisdiction. This is known as a negative conflict.[139] In such an instance, the court of the second state cannot reject its own jurisdiction by claiming that the court of the first state was competent to seize the matter.[140] The court of the second Member State has to accept, and take into account, the decision of the first Member State when determining if it has jurisdiction to seize the matter. The courts of a Member State should, based on the principle of mutual trust, recognise judgments delivered by the courts of other Member States.[141]

### *2.2 Interpretation and application of COMI under Chapter 15*[142]

#### *2.2.1 Introduction*

Chapter 15 of the *US Bankruptcy Code*[143] aims to harmonise foreign and domestic bankruptcy proceedings of multinational corporations and to minimize the expenses

139 Virgós and Garcimartín *European Insolvency Regulation* 51; 53.

140 Virgós and Garcimartín refer to a matter in which a Swedish debtor had emigrated to and was habitually resident in Spain. (The matter was decided by the Svea Court in October 2002; see Virgós and Garcimartín *European Insolvency Regulation* 53.) The Swedish court found that the debtor had no COMI in Sweden. Accordingly, if a request for insolvency proceedings were to be made in Spain, the Spanish court would have to accept that the debtor does not have a COMI in Sweden. Any doubt as to whether the debtor's COMI is situated in Sweden or Spain would be resolved in favour of the latter jurisdiction.

141 Recital 22 of the EC Regulation. Grounds for non-recognition should, however, be reduced to a minimum. See the case of *SAS Rover France* Commercial Court Nanterre, 19 May 2005. Additionally, the EC Regulation does not recognise the principle of *forum non convenience* and a court may therefore not refuse to accept the jurisdiction accorded to it under the EC Regulation on the ground that, in the court's opinion, it would be more appropriate for the case to be dealt with on proceedings opened in another Member State. See Wessels *International Insolvency Law* 303.

142 This paragraph concerns mainly the following case law, which are in the possession of the authors: *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd* 374 BR 122 (Bankr SDNY 2007); *In re Lernout & Hauspie Speech Products NV* 301 BR 651 (Bankr D Del 2003); *In re Lernout & Hauspie Speech Products NV* 308 BR 672 (D Del 2004); *In re Owens Corning* 419 F3d 195 (3rd Cir 2005); *In re SPhinX* 351 BR 103 2006 371 BR 10 (SDNY); *In re Tri-Continental Exchange Ltd* 349 BR 627, 47 Bankr Ct Dec 31; *Lernout & Hauspie Speech Products NV v Stonington Partners Inc* 268 BR 395 (D Del 2001); *In re Betcorp Ltd* 400 BR 266.

143 Chapter 15 replaces s 304 of the *US Bankruptcy Code*, which governed foreign ancillary proceedings. See Silkenat and Schmerler *Law of International Insolvencies* 491; Westbrook 2005 *Am Bankr L J* 717. As Chapter 15 came into operation only about five years ago, there is currently not an abundance of case law dealing with its interpretation.

of such proceedings.[144] It applies when there is a foreign insolvency proceeding relating to a debtor that is subject to any kind of bankruptcy matter in the US.[145]

### *2.2.2 The ALI principles*[146]

The Principles of the American Law Institute (ALI Principles) were drafted with Chapter 15 in mind.[147] These Principles provide authority for the resolution of a number of issues that are not fully addressed in Chapter 15. Although the ALI Principles were developed for use specifically amongst the NAFTA countries (the US, Mexico and Canada),[148] the ALI concluded that they should be applied generally to multinational insolvency matters in the US courts.[149] It should be noted that the ALI Principles are merely "unofficial best-practice recommendations" and are, accordingly, not legally binding.[150]

### *2.2.3 The relevance of the EC Regulation in ascertaining the meaning of COMI under the Model Law*

Section 1508 of Chapter 15 states that:

> [i]n interpreting this chapter, the court shall consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions.

144 Beckering 2008 *Law & Bus Rev Am* 281-312; Mason "United States" 197.

145 Chapter 15 will therefore apply to the insolvency of any multinational corporation that is a US corporation or a foreign corporation with operations or assets in the US. See Westbrook 2005 *Am Bankr L J* 715.

146 The ALI is arguably the most prestigious and influential of all American law-reform organisations. See Westbrook 2001-2002 *Conn J Int'l L* 99-106.

147 Westbrook 2002 *Am Bankr L J* 33.

148 Thus, at a regional level.

149 The ALI Principles were developed by the Transnational Insolvency Project, due to the need for a private-sector initiative to CBI matters. Their aim was to develop cooperative procedures to be used in business insolvency cases that involve companies with assets or creditors in more than one of the three NAFTA countries. The integration and cooperation by the NAFTA countries in CBI matters is essential to fully realise the free flow of investments among these countries. This entailed that lawyers and judges had to become familiar with the insolvency laws of all the NAFTA countries in order to function effectively in CBI matters where the NAFTA countries were involved. The ALI Principles provided the solution by providing a set of principles, procedures and practices to narrow the range of uncertainty in insolvency proceedings in the NAFTA countries. See Westbrook 2002 *Am Bankr L J* 3-33; Westbrook 2005 *Am Bankr L J* 715.

150 Westbrook 2002 *Am Bankr L J* 33. For a further discussion on the ALI Principles, see Westbrook 2001-2002 *Conn J Int'l L* 99-106.

The EC Regulation is relevant for the purpose of understanding Chapter 15, because it inspired the Model Law. Although the Model Law came into force prior to the EC Regulation, the EC Regulation was completed first[151] and the EC Regulation accordingly served as a source of some key concepts that were adopted in the Model Law, including the COMI concept.[152] As the Model Law was heavily influenced by the EC Regulation, the EC Regulation itself as well as case law on the meaning of COMI under the EC Regulation will serve as the most persuasive authority when determining the COMI concept under Chapter 15.[153] One significant example is the definition of COMI provided by the *UNCITRAL Legislative Guide on Insolvency Law* (the Legislative Guide),[154] which states that the COMI of the debtor "is the place where the debtor conducts the administration of its interests on a regular basis and that is therefore ascertainable by third parties".[155] This definition is identical to the definition of COMI provided in Recital 13 of the EC Regulation.

### *2.2.4 Recognition of foreign proceedings under Chapter 15*

A case under Chapter 15 commences by the filing of a petition for the recognition of a foreign proceeding.[156] Section 1517(a) states that there are three requirements that need to be complied with before an order recognising a foreign proceeding will be entered. Firstly, the foreign proceedings must qualify either as foreign main or non-main proceedings within the meaning of section 1502.[157] A foreign main

151 The Model Law was adopted by UNCITRAL in 1997, whilst the EC Regulation came into force only in 2000. However, the concept of COMI originated from the 1995 *EU Convention on Insolvency Proceedings*, which was reproduced as the EC Regulation. See Westbrook 2002 *Am Bankr L J* 2.

152 Westbrook 2002 *Am Bankr L J* 2; Hammer and McClintock 2008 *Law & Bus Rev Am* 257-280.

153 Another source of authority that a US court is obliged to treat as persuasive is the *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency*, UN Gen Ass UNCITRAL 30th sess, UN Doc A/CN.9/442 (1997) which was promulgated in connection with the approval of the Model Law. The Guide explains that the use of the concept "where the debtor has the centre of its main interests" as the determinant that a foreign proceeding is a "main" proceeding was modelled on the use of that concept in the *EU Convention on Insolvency Proceedings* (1995), which was already in the process of being adopted when UNCITRAL drafted the Model Law. See *In re Tri-Continental Exchange Ltd* 349 BR 627, 47 Bankr Ct Dec 31 634[3], hereafter referred to as the *Tri-Continental Exchange*-case. Also see Westbrook 2002 *Am Bankr L J* 2.

154 *UNCITRAL Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency* (2010) (the Legislative Guide).

155 Paras 4; 41 of the Legislative Guide.

156 Sections 1504 and 1509(a) of Chapter 15.

157 Sections 1517(b)(1) and s 1502(4). Although the phrases "principal place of business", "chief executive office" and "real seat" are more familiar to American judges and lawyers, Chapter 15 was drafted to follow the Model Law as closely as possible. According to Westbrook the drafters

proceeding refers to a foreign proceeding that is pending in the country where the debtor has its COMI. No definition is provided for the meaning of COMI under Chapter 15.[158] A foreign non-main proceeding refers to a foreign proceeding where the debtor has an "establishment" in the foreign country where the proceeding is pending.[159] An "establishment" refers to any place of operations where the debtor carries out a non-transitory economic activity.[160] Secondly, the foreign representative applying for recognition must be a person or body. Thirdly, the petition for recognition and accompanying documents must comply with the requirements set out in section 1515. This section concerns the application for recognition of foreign proceedings by a foreign representative, which is done by way of a petition for recognition.[161]

Should a court grant recognition of the foreign proceedings, the foreign representative has direct access to the US courts to petition for appropriate relief.

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of Chapter 15 believed that the COMI jurisdictional test should be uniform around the world. See Westbrook 2005 *Am Bankr L J* 719; Westbrook 2006-2007 *Brook J Int'l* L 1019-1040. If the foreign proceedings are pending in a country where the debtor has neither its COMI nor an "establishment", then such foreign proceedings will not meet the definitional requirements of s 1502 and cannot be recognised under Ch 15. See Glosband 2007 *American Bankruptcy Institute Journal* 2.

158 See Recital 13 of the EC Regulation. For a discussion, see para 2.1.2 above.

159 Section 1517(b)(2) of Chapter 15. Chapter 15 provides different relief for foreign main and foreign non-main proceedings. S 1519 deals with the effects of recognition of foreign main proceedings. Upon recognition of foreign main proceedings, the assets of the debtor-company will be subject to an automatic stay under s 362 of the *US Bankruptcy Code*. This means that the foreign representative will have the authority to operate the debtor's assets, which includes the power to lease, use or sell the assets of the debtor under s 363 and s 552 of the *US Bankruptcy Code*. The foreign representative may additionally commence a plenary case in terms of s 301 or 302 of the Code. Foreign non-main proceedings, on the other hand, are not subject to automatic relief, but s 1521(a)(6) of Chapter 15 states that a court may grant similar relief in foreign non-main proceedings at the request of the foreign representative. See Morton 2005-2006 *Fordham Int'l L J* 1312-1363.

160 Section 1502(2) of Chapter 15. See para 3 below for a discussion on non-main proceedings and the meaning of an "establishment".

161 The petition must be accompanied by the following documentation: (i) a certified copy of the decision commencing such proceedings and appointing the foreign representative; (ii) a certificate from the foreign court affirming the existence of such foreign proceedings and appointment of the foreign representative; (iii) any evidence acceptable to the court of the existence of such foreign proceedings and of the appointment of the foreign representative in the absence of evidence stated in (i) and (ii); and (iv) a statement identifying all foreign proceedings with respect to the debtor that are known to the foreign representative. It is said that Chapter 15 provides a simple, objective standard for the recognition of foreign proceedings. Under s 304 of the *US Bankruptcy Code*, which has now been repealed and replaced by Chapter 15, there were subjective requirements. See Glosband 2007 *American Bankruptcy Institute Journal* 2. He submits that there is no flexibility when it comes to the recognition of foreign proceedings. There is, however, flexibility in granting, modifying or denying relief under Chapter 15 or communicating and coordinating amongst multiple proceedings. See ss 1501(a), 1511, 1512, 1519, 1521, 1522 and 1523 of Chapter 15; Glosband 2007 *American Bankruptcy Institute Journal* 2.

The foreign representative has the capacity to sue or be sued in a US court and the courts will grant comity and cooperation to that foreign representative.[162]

### *2.2.5 The reference date for determining COMI*

In *Lavie v Ran (in re Ran)*[163] the debtor (Ran) had emigrated from Israel to the US eight years before the application for recognition of foreign bankruptcy proceedings against him was brought before the US courts by an Israeli foreign representative (Lavie). The foreign representative applied for recognition of the foreign proceedings in Israel either as main or non-main proceedings. After taking various objective factors into account,[164] the court found that the debtor's COMI was situated in the US and that the foreign proceedings could accordingly not be recognised as foreign main proceedings. The foreign representative subsequently raised the argument that the court should look at the operational history of the debtor and, since his COMI had been situated in Israel some years before, the court should find that his COMI is situated in Israel. The United States Court of Appeals, however, disagreed with the argument of the foreign representative and furnished three reasons for its decision. Firstly, section 1502[165] of Chapter 15 is written in the present tense, which leads to the conclusion that the COMI determination has to be present. Accordingly, the time when a debtor's COMI should be present in a specific jurisdiction is at the time when the petition for recognition is filed. Secondly, if courts were to assess the COMI of a debtor by focussing on its operational history, the possibility of conflicting COMI determinations by different courts would increase[166] and would accordingly defeat the purpose of Chapter 15 (and the Model Law) of harmonising CBI matters worldwide. In the third place, the COMI of the debtor should be ascertainable by third parties. If third parties know that the main interests of a debtor are in a certain

162 Section 1509(b) of Chapter 15.
163 *Lavie v Ran (In re Ran)* 607 F3d 1017 (5th Cir 2010).
164 Some factors that the court took into consideration were that the debtor, together with his family, had emigrated from Israel to the US more than eight years earlier, the debtor had no intention to return to Israel, the debtor was employed and resident in the US, the debtor was a permanent legal resident of the US and the debtor maintained his finances exclusively in the US. See *Lavie v Ran (In re Ran)* 607 F3d 1017 (5th Cir 2010) para [8] .
165 Section 1502 sets out the definitions of Chapter 15. S 1502(4) and states that a foreign main proceeding "means a foreign proceeding pending in the country where the debtor has the centre of its main interest".
166 Some courts may, for example, attach more importance to activities that took place in their jurisdictions in the past or may attach different weight to certain evidence which could lead to conflicting COMI determinations.

country, the fact that its main interests were located in another country some years earlier should be irrelevant. It is submitted that the reasoning of the court on this point was correct and its approach will undoubtedly lead to legal certainty and increased harmonisation of international insolvency law around the world. It should be noted that, although this matter concerns an individual person, it is presumed that the general principle laid down by the court will apply to debtor companies and other juristic persons too.[167]

### *2.2.6 Presumption under Chapter 15*

As is the instance under the EC Regulation,[168] article 1516(c) of Chapter 15 contains a rebuttable presumption[169] which states that, in the absence of evidence to the contrary, the registered office[170] of a debtor-company is presumed to be its COMI.[171] Both the Model Law and the EC Regulation refer to "proof to the contrary", whilst Chapter 15 refers to "evidence to the contrary".[172] In the *Tri-Continental Exchange*-case it was held that the substitution conforms to the US terminology and makes it clear that the burden of proof is on the foreign representative who is applying for recognition of the foreign proceedings as main proceedings.[173] It was held that: [174]

> The registered office, however, does not otherwise have special evidentiary value and does not shift the risk of no persuasion, i.e. the burden of proof, away from the foreign representative seeking recognition as a main proceeding. Thus, if the foreign proceeding is not in the country of the registered office, then the foreign representative has the burden of proof on the question of "centre of main interests".

167 However, in the matter of *In re Millennium Global Emerging Credit Master Fund Ltd* 458 BR 63 (Bankr SDNY 2011) it was held that the appropriate date at which to determine the COMI of a debtor is not the date that the petition for recognition is filed, but on or about the date of the commencement of the foreign proceeding for which recognition is sought. See para 76.

168 See a 3(1) of the EC Regulation. For a discussion, see para 2.1.6 above.

169 See the matter of *In re SPhinX 351* BR 103 2006 371 BR 10 (SDNY) para 117[11], hereafter referred to as the *SPhinX*-case.

170 "Registered office" refers to the place of incorporation or the equivalent for an entity that is not a natural person. See the *Tri-Continental Exchange*-case.

171 Contrary to the EC Regulation, Chapter 15 also has a presumption with regard to individuals. S 1516(c) states that in the absence of evidence to the contrary, the habitual residence of an individual is presumed to be its COMI.

172 Article 16(3) of the Model Law states that "[i]n the absence of proof to the contrary, the debtor's registered office ... is presumed to be the centre of the debtor's main interests" and a 3(1) of the EC Regulation states that "… [i]n the case of a company or legal person, the place of registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary".

173 *Tri-Continental Exchange*-case para 634[3]. Also see the *SPhinX*-case para 117[11].

174 *Tri-Continental Exchange*-case para 635[4]-[6].

> Correlatively, if the foreign proceeding is in the country of the registered office, and if there is evidence that the centre of main interests might be elsewhere, then the foreign representative must prove that the centre of main interests is in the same country as the registered office.

Accordingly, although there is a difference in wording, there seems to be no real difference in the meaning of the term. The presumption is "included for speed and convenience of proof where there is no serious controversy"[175] and may be of less weight in the event of a serious dispute.[176]

In the *SPhinX*-case[177] the debtor (SPhinX Ltd) was a hedge funds corporation which was incorporated and registered in the Cayman Islands. The provisional liquidators of the corporation applied to the Southern District of New York for recognition of the Cayman Island proceedings as main proceedings under Chapter 15. As Chapter 15 does not state the type of evidence required to rebut the presumption under section 1516(c), the court held that there are various factors which could (individually or jointly) be relevant to such a determination. These factors are:

(i) the location of the debtor's headquarters;
(ii) the location of the debtor's management;
(iii) the location of the debtor's primary assets;
(iv) the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and/or
(v) the jurisdiction whose law would apply to most disputes.[178]

The court pointed out that these factors should, however, not be applied mechanically, but should be viewed in the light of the emphasis on protecting the reasonable interests of the parties and the maximisation of the debtor's value instead. The court noted that the winding-up proceedings in the Cayman Islands would primarily have affected investors who had not opposed the petition for recognition of the proceedings as foreign main proceedings. Of significance in this

175 This was taken from the text of the *US House Report* (HR Rep No 109-31 at 113 (2005)). Also see Westbrook 2006-2007 *Brook J Int'l L* 1033.
176 See the *SPhinX*-case para 117[11].
177 See the *SPhinX*-case para 117[11].
178 *SPhinX*-case para 117[12]. The court also took the *Eurofood*- case into consideration. See para 2.1.8 above. These factors were reaffirmed in the matter of *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd* 374 BR 122 (Bankr SDNY 2007), hereafter referred to as the *Bear Stearns*-case.

matter is the fact that, by taking this factor, *inter alia*, into account the court went on to state that it "might be inclined to find the debtor's COMI in the Cayman Islands and recognise the proceedings as foreign main proceedings".[179] In its discretion, the court declined to do so, however. The decision of the court was based on the fact that the application for recognition of the proceedings as foreign main proceedings was filed for the improper purpose of obtaining an automatic stay in order to prohibit an appeal against the settlement.[180] After refusing to recognise the foreign insolvency proceedings as foreign main proceedings, the court found the foreign proceedings to be non-main proceedings.[181]

The matter of *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd*[182] dealt with facts similar to the *SPhinX*-case.[183] The court rejected the argument by the petitioners that the court should recognise the foreign proceedings as foreign main proceedings because the registered offices of the debtors were in the Cayman Islands and no objections had been filed against holding that the Cayman Islands proceedings were main proceedings. Judge Lifland held that:[184]

179 This statement caused serious critique. See below.

180 *SphinX*-case para 121[14], [15].

181 The *SphinX*-case has been heavily criticised. See, for example, Glosband 2007 *American Bankruptcy Institute Journal* 1-4; Westbrook 2006-2007 *Brook J Int'l L* 1024-1028; Chan Ho 2007 *JIBLR* 636-641 and the *Bear Stearns*-case discussed below. Glosband raises three main points of criticism against the *SPhinX*-case. Firstly, the court neglected to apply the eligibility requirements for foreign proceedings to qualify for recognition under Chapter 15. Secondly, the court disregarded the purely objective and non-discretionary standard for recognition provided under Chapter 15. In the third place, the case severs the determination of whether a foreign proceeding qualifies as a foreign main proceeding or a foreign non-main proceeding as part of the recognition determination. Glosband further criticises the *SPhinX*-case by stating that the judgement "creates a wholly unnecessary, serious and regrettable breach of European case law on the meaning of key concepts taken from a European statute. It threatens to break the very unanimity that is meant to be at the heart of the Model Law and the goal of uniform interpretation throughout the world reflected in §1508". See Glosband 2007 *American Bankruptcy Institute Journal* 1; 4.

182 *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd* 374 BR 122 (Bankr SDNY 2007).

182 *SphinX*-case para 121[14], [15].

183 The debtor companies were registered in the Cayman Islands, but they had no employees or managers there. The investment manager and administrator were located in the US and all of the liquid assets were in the US.

184 *Bear Stearns*-case paras 126[1], 130[7]. This was confirmed in the matter of *In re Basis Yield Alpha Fund (Master)* 381 BR 37 (Bankr SDNY 2008) 40[1]. It is submitted that judge Lifland is correct in coming to this decision. The COMI of a debtor must be ascertained by making use of objective criteria and is ascertainable by third parties (see para 33 of the *Eurofood*-case). The recognition requirements set out in Chapter 15 are also objective. See Glosband 2007 *American Bankruptcy Institute Journal* 2. Also see para 2.2.6 above. The mere fact that there is no objection by creditors and other interested persons to a jurisdiction qualifying as the COMI cannot be taken to indicate that the jurisdiction is the COMI, especially where the jurisdiction in

> Recognition under s.1517 is not to be rubber stamped by the courts. This Court must make an independent determination as to whether the foreign proceeding meets the definitional requirements of sections 1502 and 1517 of the Bankruptcy Code... In so holding, I part with the dicta in the *SPhinX* decision opining that if the parties in interest had not objected to the Cayman Islands proceeding being recognised as main, recognition would have been granted under the sole grounds that no party objected and no other proceeding had been initiated anywhere else ... To the extent that no objection would make the recognition process a rubber stamp exercise, this Court disagrees with the dicta in the *SPhinX* decision.

By taking the *Eurofood*-case into consideration, the court held that the place where the debtor conducted the administration of its interests on a regular basis and was therefore ascertainable by third parties was the US. Accordingly, the presumption under section 1516(c) was rebutted as the debtor's COMI was held to be situated in the US.

In *In re Tri-Continental Exchange Ltd*[185] the presumption was upheld. The creditors of debtor companies (insurance companies incorporated under the laws of St. Vincent and the Grenadines (SVG)) sought recognition of the debtors' foreign liquidation proceedings in SVG under Chapter 15 as foreign non-main proceedings, as opposed to main proceedings. The debtors were parties to an insurance scam, as they sold insurance policies in the US and Canada without the required insurance licences. Their only offices were located in SVG, where they had approximately twenty employees. The court found that the debtors conducted regular business operations at their registered offices in SVG, in a manner that equated with a "principal place of business" under concepts of US law.[186] That was sufficient to qualify SVG as the COMI of the debtors even though the insurance scam was primarily conducted in the US and Canada. Accordingly, the winding-up proceedings in SVG were recognised in the US as foreign main proceedings.[187]

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question is a tax haven with very few objectively relevant connecting factors pointing to its being the COMI. Also see para 2.3.1.1 below for Westbrook's criticism of the *SPhinX*-case.

185 *In re Tri-Continental Exchange Ltd* 349 BR 627, 47 Bankr Ct Dec 31.

186 *Tri-Continental Exchange*-case para [3].

187 Also see the matter of *In re British American Isle of Venice (BVI) Ltd* 441 BR 713 (Bankr SD Fla 2010), where the court held that the COMI of the debtor company, which had been formed under the laws of the British Virgin Islands (BVI), was located in BVI. In coming to its decision the court took the following factors into consideration: (i) the headquarters of the debtor was located in BVI; (ii) the debtor's liquidator, who had managed the debtor and its subsidiaries since his appointment more than a year prior to the court hearing was located in BVI; (iii) more than eighty percent of debtor's total assets were located in BVI; (iv) the debtor's corporate books and records were maintained with the debtor's registered agent in BVI; and (v) it was likely that third parties

It should be noted that not everyone is pleased with the presumption under section 1516(c). Adams and Fincke[188] submit that the presumption facilitates forum shopping in the sense that a debtor-company can easily change its official residency for the purpose of filing bankruptcy proceedings in a more favourable jurisdiction. They agree with the solution proposed by Bufford[189] to make forum shopping more difficult, namely establishing a "residency rule". The "residency rule" would require a debtor-company to have its COMI in a jurisdiction for a minimum period of time, before it can qualify to file a "domestic enterprise-wide" insolvency case. This rule would provide judges with the power of looking beyond the COMI of a debtor-company in instances where the debtor has not met the minimum requirement of the "residency rule". [190] Bufford[191] suggests that the minimum period that a debtor's COMI should have been located in a jurisdiction before filing for insolvency is six months, but a year may even be a more appropriate period.

It is submitted that the residency rule carries merit, as implementation thereof as an additional requirement for determining the COMI of a debtor would certainly aid the minimisation of "forum shopping". This requirement would be an objective criterion (as required by the *Eurofood*-case) which would support the requirement that the COMI of a debtor must be ascertainable by third parties. Creditors and other third parties might not immediately take notice of the fact that a debtor had changed location (for example, its headquarters) as it might not influence their day-to-day business. It is, however, reasonable to presume that after a certain period (six months, for example) a change of location would be widely known. Additionally, an individual debtor would not be able to side-step the insolvency courts of the jurisdiction where he resides by merely emigrating to another country.

It is interesting to note the principle in the EU that the courts of a Member State would have jurisdiction to open insolvency proceedings in respect of a company that is incorporated outside the Community if the company's COMI is situated within that

considered the debtor's offices in BVI to be its COMI. Accordingly, the court recognised the insolvency proceedings in the BVI as foreign main proceedings.

188 Adams and Fincke 2008-2009 *Colum J Eur L* 84-85.

189 Bufford 2005 *Am Bankr L J* 139.

190 Adams and Fincke 2008-2009 *Colum J Eur L* 84-85.

191 Bufford 2005 *Am Bankr L J* 139-140.

Member State. The only test is if that debtor's COMI is to be found within the relevant Member State, irrespective of where it is incorporated.

### *2.2.7 Corporate groups*[192]

#### 2.2.7.1 The problem with corporate groups

Most multinational corporate empires are corporate groups, often consisting of hundreds of legally separate entities.[193] Such corporate groups may consist of independent subsidiaries, corporations, partnerships, business trusts, unincorporated businesses, branches and other entities.[194] Therefore, it is surprising that neither the EC Regulation, the Model Law nor Chapter 15 currently addresses the insolvency of corporate groups (also known as business enterprise groups)[195] operating in multiple jurisdictions as a whole.[196] The EC Regulation, the Model Law and Chapter 15 currently require that each legal entity should be considered separately for the purpose of determining its COMI.[197] Adams and Fincke[198] submit that, whilst this approach had the advantage of predictability, it "creates vast economic insufficiencies when multiple courts administer what are essentially multiple main cases" in instances when one is dealing with corporate groups.

There is a question of fairness in dealing with how to protect the notion of the separate legal personality of each of the entities to a corporate group, whilst creating a fair and effective insolvency system that recognises the residual interests of creditors. It might happen, for example, that the employees of a subsidiary situated in state A work hard to generate great wealth for that subsidiary. The profits of the subsidiary are, however, transferred to the parent company situated in state B on a

192 This sub-section addresses the problems that arise when dealing with corporate group insolvencies under Chapter 15 (which is also a problem under the EC Regulation). See the discussion in para 2.1.8 above.
193 General Motors, for example, is a corporate group that consists of more than 500 corporations. See LoPucki 2005 *Am Bankr J L* 92; Adams and Fincke 2008-2009 *Colum J Eur L* 83.
194 See Sarra 2008-2009 *Tex Int'l L J* 549-551; Adams and Fincke 2008-2009 *Colum J Eur L* 83.
195 An "enterprise group" refers to two or more enterprises that are interconnected by control or significant ownership. An "enterprise" refers to "an entity, regardless of its legal form, that is engaged in economic activities and may be governed by the insolvency law". See the Legislative Guide 3-4; Sarra 2008 *INSOL Int Insolv Rev* 73-122.
196 Sarra 2008-2009 *Tex Int'l L J* 549-551.
197 LoPucki 2005 *Am Bankr J L* 93.
198 Adams and Fincke 2008-2009 *Colum J Eur L* 83.

daily basis. If the subsidiary in state A should become insolvent in the future, the employees may have claims against the subsidiary that has no assets in state A.[199]

2.2.7.2 Forms of corporate groups

The discussion to follow distinguishes between the two form of corporate groups, namely independently operated groups and highly integrated groups.

a) Independently operated groups

The respective entities of the group may operate relatively independently of one another (constituting truly separate legal entities) but simultaneously have a considerable amount of control exercised between these entities. When one or more of the entities of a corporate group goes insolvent, the creditors located in the place of registration of each of these entities will seek to make use of domestic law to realize their claims. According to Sarra,[200] in instances where the entities of the group operate independently from one another, it might not pose a huge problem to deal with the insolvency of each separate legal entity.[201]

b) Highly integrated groups

A corporate group can be highly integrated and operated or governed as a single global unit of which the capital structure thereof is centralized, in the sense that a parent company or business entity wholly owns and largely controls its subsidiaries (each of which has its own separate legal personality). Sarra[202] submits that in instances where one is dealing with such a highly integrated corporate group, the insolvency proceedings in each of the jurisdictions can pose huge problems, which could result in premature liquidation of the multinational enterprise in order to satisfy the multiple claims of creditors located in multiple jurisdictions.

199 Sarra 2008-2009 *Tex Int'l L J* 551.
200 Sarra 2008-2009 *Tex Int'l L J* 549-551; Westbrook 2002 *Am Bankr L J* 38.
201 See para 2.1.8 above for a discussion on the position under the EC Regulation.
202 Sarra 2008-2009 *Tex Int'l L J* 549-551.

2.2.7.3 Proposed solutions in the US context

The ALI Principles propose two innovative rules concerning subsidiaries.[203] Firstly, a subsidiary should be allowed to file for insolvency in the home country of its parent company in order to reorganise on a group basis, even if it would not ordinarily be allowed. This would allow the group to reorganise administratively in a single jurisdiction, which would lead to saving time and costs. Secondly, corporate groups should be reorganised from a worldwide perspective, just as within a single company, but subject to the necessity of allocating value with regard to the corporate form. This will lead to maximised cooperation and coordination, despite the necessary legal adjustments that have to be made in order to reflect the rights that arise from different claimants that have rights against different entities.[204]

LoPucki[205] submits that the most sensible solution to the corporate group problem is to administer highly integrated groups together in the COMI of the corporate group as a whole, whilst administering the independently operated corporate group entities separately in each of their respective COMI's. Bufford[206] states that the solution proposed by LoPucki on this point is "exactly correct".[207] Adams and Fincke[208] also agree with the proposed solution and submit that a legal framework which allows for the reorganisation or liquidation of an entire economic unit would be of more advantage than one that dealt with the corporate parts separately.[209]

203 See Procedural Principles 23 and 24 of the ALI Principles 12. Procedural Principle 17 states that in instances where there are parallel proceedings and assets are to be sold, the domestic administrator of each proceeding should seek to sell the assets in cooperation with other administrators in order to produce the maximum value for the assets of the debtor as a whole, across national borders. The relevant domestic courts should subsequently approve such sales. This entails that the assets should be sold to realise the greatest value for all creditors worldwide, despite any lost advantage that the local creditors in a specific jurisdiction might have had if a territorial approach had been followed. The local creditors will accordingly have no say if territorial proceedings would be to their advantage, but universal proceedings would produce the greatest value of the sold assets (being more advantageous to the *concursus creditorum* as a whole). This is simply an application of the general principle of "modified universalism" that realising assets and sharing the value of the proceeds should take place on a worldwide basis rather than on a territorial basis. See Westbrook 2002 *Am Bankr L J* 38.

204 Westbrook 2002 *Am Bankr L J* 38.

205 LoPucki 2005 *Am Bankr J L* 94.

206 Bufford 2005 *Am Bankr L J* 136-137.

207 Bufford states that "the universalist solution is to modify the COMI definition to provide that the corporate group venue decision is based on the collective COMI of all of the legal entities that operate together as an integrated economic unit." See Bufford 2005 *Am Bankr L J* 136.

208 Adams and Fincke 2008-2009 *Colum J Eur L* 83-84.

209 Mevorach also agrees that "global group-wide solutions" should be applied to integrated corporate groups that face CBI and that the insolvency proceedings of an integrated multinational enterprise should be centralised. The unification or centralisation of the insolvency of affiliates of

The determining factor will accordingly be the degree of economic integration within the corporate group. None of LoPucki, Bufford, or Adams and Fincke suggest a method for determining the degree of economic integration between companies belonging to the same group. Bufford, Adams and Fincke do, however, state that specialised bankruptcy courts might be necessary. It is thus evident that the determination of the COMI of a corporate group will require a more sophisticated judiciary and a more complex economic analysis. Judges will accordingly need appropriate training due to the complexity of the matters. When making a determination as to the economic integration of a company, there will have to be an enquiry into the functional realities of its corporate administration as well as its corporate and financial structure. [210]

Sarra[211] points out the disadvantages of the approach suggested above. According to her, a "business enterprise group COMI" may prove problematic for the rights of creditors in several of the corporate group jurisdictions. Problems might arise where a creditor located in a specific jurisdiction deals with a debtor-company in the jurisdiction where it is registered and subsequently institutes a claim and would like a remedy in that jurisdiction. Additionally, the recognition of a "business enterprise group COMI" will create an "inappropriate extension of domestic law" of a jurisdiction, which could prejudice the creditors located in other jurisdictions where the distribution priority differs. The COMI-test does not really make provision for corporate enterprise groups, unless they are so highly integrated that a court can "pull aside the corporate veil", which is a rare occurrence.[212]

As an alternative solution to overcome some barriers in determining the COMI of a business enterprise group, Sarra[213] proposes the implementation of protocols, also

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a corporate group will probably result in maximised wealth and the reduction of costs and will promote reorganisations. See Mevorach *Insolvency within Multinational Enterprise Groups* 327. For further reading on Mevorach's views regarding the centralisation of insolvency proceedings relating to integrated multinational enterprises, see Ronen-Mevorach 2006 *JBL* 468-486; Mevorach 2008 *ICLQ* 427-448; and Mevorach 2011 *JBL* 666-681.

210 See Adams and Fincke 2008-2009 *Colum J Eur L* 84; Bufford 2005 *Am Bankr L J* 137.

211 Sarra 2008-2009 *Tex Int'l L J* 561-562.

212 It is submitted that the reservations expressed by Sarra are not unfounded. See para 2.2.7.4 below.

213 Sarra 2008-2009 *Tex Int'l L J* 562.

known as "cross-border agreements".[214] Protocols can allow parties to negotiate cross-border cooperation, which includes recognition of procedural coordination and substantive consolidation to be applied when a business enterprise group is liquidated or wound up.[215] These two forms of cooperation, which are discussed below, are found in the *UNCITRAL Legislative Guide on Insolvency Law* (the Legislative Guide),[216] which deals with the treatment of enterprise groups in insolvency.

i) Procedural coordination

Procedural coordination entails that all of the assets and liabilities of each member of the corporate group involved in the procedural coordination remain separate and distinct from one another.[217] Procedural coordination accordingly allows for the coordination of proceedings in multiple jurisdictions in respect of multiple members of a group enterprise.[218] The integrity and identity of each of the members and the substantive rights of creditors are preserved. The effect of procedural coordination is limited to the administrative aspects of the proceedings. It does not concern any substantive rights of the creditors. The claim of a creditor may not exceed the value of the assets of the particular group member to which the claim relates.[219] An order for procedural coordination may streamline multiple proceedings in various ways. It may involve, for example, the appointment of a single insolvency representative, the establishment of a single creditor committee, cooperation among two or more courts (including the coordination or combining of hearings), cooperation between insolvency representatives (including the sharing of information and the coordination of negotiations), the joint provision of notice, coordination between creditor

214 Protocols are mechanisms that are often used to establish cross-border cooperation and coordination among corporate groups. Protocols set out the importance of comity and cooperation whilst recognising that each court is entitled to exercise its independent jurisdiction and authority regarding the matter before the court. See Stroebel *Protocols as a Possible Solution* 28; Sarra 2008-2009 *Tex Int'l L J* 562.

215 The courts in the relevant jurisdiction approve such protocols. See Stroebel *Protocols as a Possible Solution* 29; Sarra 2008-2009 *Tex Int'l L J* 576.

216 *UNCITRAL Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency* (2010) (the Legislative Guide).

217 See the Legislative Guide 4 for the definition of procedural coordination. Procedural coordination has two main purposes, namely (i) the facilitation of the administration of insolvency proceedings, whilst respecting the separate legal personality of each of the group members and (ii) the promotion of cost-efficiency and betters returns to creditors. See the Legislative Guide 27.

218 Sarra 2008-2009 *Tex Int'l L J* 564.

219 Sarra 2008-2009 *Tex Int'l L J* 565.

committees, the coordination of procedures for the submission and verification of claims, and the coordination of avoidance proceedings. The scope and extent of the procedural coordination should be specified by the court. [220]

A court may order procedural coordination at the request of a person permitted to make an application or on its own initiative. The coordination might either involve different courts[221] competent in respect to different group members, or a single court that is competent in respect of a number of different insolvency proceedings.[222] The court should specify the scope and extent of the procedural coordination. A court may take appropriate steps to coordinate with any other court by means of procedural coordination of the insolvency proceedings concerning two or more enterprise group members.[223]

The Legislative Guide stipulates that the insolvency laws of each state should say that the administration of insolvency proceedings regarding two or more enterprise group members[224] may be coordinated for procedural purposes.[225] The persons who are permitted to apply for procedural coordination are:

(a) an enterprise group member that is subject to an application for the commencement of insolvency proceedings or subject to insolvency proceedings;
(b) the insolvency representative of an enterprise group member; or
(c) a creditor of an enterprise group member that is subject to an application for the commencement of insolvency proceedings or subject to insolvency proceedings.[226]

220 See the Legislative Guide 23-24, 28 (para 204) .
221 Although it is not clear from the Legislative Guide, it is presumed that the courts concerned may be located in different jurisdictions or states (thus, different courts within the USA as well as courts from other states such as Canada, for instance).
222 Para 203 of the Legislative Guide 27.
223 Para 207 of the Legislative Guide 28.
224 Although not expressly stated in the Legislative Guide, it is presumed that this provision covers instances where two or more group members are located in the same jurisdiction or different jurisdictions.
225 Para 202 of the Legislative Guide 27. An application for procedural coordination may be made at the same time as an application for the commencement of insolvency proceedings or at any subsequent time. Para 205 of the Legislative Guide 28.
226 Para 206 of the Legislative Guide 27. A creditor does not have to be a creditor of all the group members in respect of which it is seeking procedural coordination in order to be eligible to make an application for procedural coordination. See para 208 of the Legislative Guide 28.

ii) Substantive consolidation

The Legislative Guide provides that, in general, the insolvency laws of each state should respect the separate legal identity of each member of an enterprise group.[227] There are only two exceptions to this general principle where a court[228] may order substantive consolidation.[229] The first exception is where a court is satisfied that the assets or liabilities of the enterprise group members are intermingled to such an extent that the ownership of assets and the responsibility for liabilities cannot be identified without disproportionate expense or delay.[230] There are various factors that are relevant in determining whether or not substantive consolidation will be justified. These standards are set out in paragraph 220 of the Legislative Guide and include the presence of consolidated financial statements for the whole enterprise group, if there is a single bank account used by all of the the members of the group, the unity of interests and ownership between the various group members, and whether or not there are intra-group loans.[231] The second exception is where a court is satisfied that enterprise group members are engaged in a fraudulent scheme or activity that has no legitimate business purpose and substantive consolidation is essential to rectify that scheme or activity.[232] The type of fraud referred to in this context means the instance where there is a total absence of a legitimate business purpose which may relate to the reasons for which the corporate group was formed, or activities undertaken by the corporate group after it came into existence.[233]

227 Para 219 of the Legislative Guide 58. Also see the matter of *In re Owens Corning* 419 F3d 195 (3rd Cir 2005) 211[8]-[12].

228 The relevant court here is the court having jurisdiction over the commencement and conduct of the insolvency proceedings, which includes matters arising in the course of such proceedings. See recommendation 13 of the *UNCITRAL Legislative Guide on Insolvency Law, Part One* (2005) 44.

229 The circumstances that support substantive consolidation are very limited and are subject to strict evidentiary rules. This is due to the effects of substantive consolidation, including that it overturns the separate entity principle and the potential unfairness caused to a single creditor group or one member group when forced to share *pari passu* with the creditors of a less solvent group member. See the Legislative Guide 50.

230 Para 220 of the Legislative Guide 58-59.

231 For further elements, see para 112 of the Legislative Guide 51 and Sarra 2008-2009 *Tex Int'l L J* 571-572.

232 Para 220 of the Legislative Guide 58-59.

233 An example of such fraud would be where a debtor transfers all of its assets to a newly-formed entity or to a self-owned entity in order to preserve those assets for its own benefit and to hinder, delay or defraud its creditors. See para 114 of the Legislative Guide 52.

Accordingly, substantive consolidation[234] entails the treatment of the assets and liabilities of two or more enterprise group members as if they were part of a single insolvent estate,[235] thereby disregarding the separate legal personality of each of the group members. The assets of the members of the group are accordingly treated as if they were part of a single estate, for the general benefit of all of the creditors of the consolidated group, and claims against group members included in the order are treated as if they were claims against the single insolvent estate. The claims and debts between group members included in the order are extinguished.[236]

Sarra[237] submits that courts should seek to minimize the degree of prejudice that creditors may suffer due to the substantive consolidation order. Courts should do this by carefully considering the amount, degree and type of prejudice that creditors may suffer[238] and whether or not the potential benefits[239] of substantive consolidation outweigh that prejudice to creditors.[240]

An application for substantive consolidation may be made together with an application for the commencement of insolvency proceedings with respect to enterprise group members or at any subsequent time. The insolvency law should therefore specify the persons that are permitted to make an application for substantive consolidation, that may include an enterprise group member, a creditor, or the insolvency representative of any such enterprise group member.[241]

234 Which will be granted only where there is compliance with one of the two recognised exceptional circumstances discussed above.

235 Legislative Guide 4. Substantive consolidation has three main purposes. Firstly, it provides legislative authority for substantive consolidation, while at the same time respecting the basic principle of the separate legal identity of each member to an enterprise group. Secondly, it specifies the very limited circumstances in which the remedy of substantive consolidation may be available in order to ensure transparency and predictability. Thirdly, it specifies the effect of an order for substantive consolidation, which includes the treatment of security interests. See the Legislative Guide 58.

236 Legislative Guide 49, 59 (para 224).

237 Sarra 2008-2009 *Tex Int'l L J* 571.

238 A court should, for example, consider whether the creditors that might be prejudiced will have the opportunity to make submissions to court. The court should not order substantive consolidation where it would cause smaller creditors and employee groups not to have the opportunity to participate in hearings in a foreign jurisdiction. See Sarra 2008-2009 *Tex Int'l L J* 571.

239 The potential benefits include harmonising and coordinating activities and promoting orderly and efficient administration of proceedings.

240 The court should accordingly "balance the promotion of international cooperation" on the one hand and the "respect for independence and integrity of domestic proceedings" on the other hand. See Sarra 2008-2009 *Tex Int'l L J* 571.

241 Paras 222 and 223 of the Legislative Guide 59.

An important provision of the Legislative Guide is that the priorities established under the insolvency law of the state and applicable to individual enterprise group members prior to an order for substantive consolidation should, as far as possible, be recognised in the substantive consolidation.[242] This entails that, in instances where a creditor has an employee claim (which is a priority claim) in respect of a specific group member, the creditor's priority should (as far as possible) be recognised in the substantive consolidation of the enterprise group as a whole.

The court granting the order for substantive consolidation may exclude specified assets and claims from that order and specify the circumstances in which those exclusions might be ordered.[243] Generally, the rights and priorities of a creditor holding a security interest over an asset of an enterprise group member should, as far as possible, be respected in substantive consolidation. The Legislative Guide, however, gives meaningful exceptions where this principle will not be applied, namely where:

(a) the secured indebtedness is owed solely between enterprise group members and will be extinguished by an order for substantive consolidation;
(b) it is determined that the security interest was obtained by fraud in which the creditor participated; or
(c) the transaction granting the security interest is subject to avoidance in accordance with recommendations 87, 88 and 217.[244]

Substantive consolidation orders have been approved by US courts in the past.[245] In *In re Owens Corning*[246] the United States Court of Appeals considered the

242 Para 226 of the Legislative Guide 60.
243 Para 221 of the Legislative Guide 59. This is known as partial substantive consolidation. Such exclusions will be rare, however. The circumstances where an asset might be excluded are where the ownership of a specific assets can be identified, where part of the business activities of the consolidated group can be separated from the rest as not being part of the fraudulent scheme, where including the assets might worsen the consequences of a fraudulent scheme, or where assets are burdensome in the sense that they would be difficult to administer or carry an environmental liability. See para 136 of the Legislative Guide 57. Also see Sarra 2008-2009 *Tex Int'l L J* 567.
244 Para 225 of the Legislative Guide 59. Plainly put, this is where impeachable dispositions occurred (eg voidable preference, undue preference and collusive disposition).
245 See, for example, the matter of *In re Owens Corning* 419 F3d 195 (3rd Cir 2005); *Soviero v National Bank of Long Island* 328 F2d 446 (2d Cir 1964); *In re Commercial Envelope Mfg Co* 3 Bankr Ct Dec 647 1977 WL 182366 (Bankr SDNY 1977)*; Genesis Health Ventures Inc v Stapleton (In re Genesis Health Ventures Inc)* 402 F3d 416, 423 (3rd Cir 2005). See Sarra 2008-2009 *Tex Int'l L J* 569.

circumstances in which the substantive consolidation of a business enterprise group could take place. The court held that substantive consolidation exists as an equitable remedy[247] which may be available in two circumstances. The first instance is where the entities of the corporate group disregarded the separateness of the corporate entity so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity. This is a new factor additional to those factors referred to in paragraph 220 of the Legislative Guide discussed above. The second instance is that in which their assets and liabilities are so scrambled that separating them would be costly and would harm all creditors.[248] This factor is noted in paragraph 220 of the Legislative Guide. The court further provided certain principles that should be considered when determining whether or not substantive consolidation would be appropriate in a given matter. The first principle, which has already been referred to above, is that courts should generally respect the separateness of an entity in the absence of compelling circumstances that call equity into play.[249] Furthermore, the court added three additional principles that have not yet been referred to. These factors are (i) there must be more gained from substantive consolidation than mere administrative convenience;[250] (ii) substantive consolidation should rarely be applied and qualifies as a remedy of last resort after the consideration and rejection of other possible available remedies;[251] and (iii) substantive consolidation may not be used offensively in order to tactically disadvantage certain creditors, but will be justified only when every creditor will benefit from such consolidation.[252]

#### 2.2.7.4 Summary

None of the Model Law, the EC Regulation or Chapter 15 currently addresses the problems associated with the insolvency of an enterprise group. Each of the

246 *In re Owens Corning* 419 F3d 195 (3rd Cir 2005).
247 *In re Owens Corning* 419 F3d 195 (3rd Cir 2005) para 210[7].
248 *In re Owens Corning* 419 F3d 195 (3rd Cir 2005) para 211[13-15].
249 The harms that are addressed by substantive consolidation are nearly always those caused by the debtors who disregarded the principle of separateness.
250 For example, allowing a court to simplify a matter by avoiding other issues or making post petition accounting more convenient are hardly sufficient reasons to allow substantive consolidation.
251 There should be no possibility of more precise remedies under the *US Bankruptcy Code*.
252 *In re Owens Corning* 419 F3d 195 (3rd Cir 2005) para 211[8-12]. For a further discussion on the matter, see Sarra 2008 *INSOL Int Insolv Rev* 97-99.

members of the enterprise group should be regarded separately for the purpose of determining each of their COMIs. This position poses no problem when one is dealing with an independently operated group. This approach may, however, pose problems when one is dealing with a highly integrated enterprise group. Locating the separate COMI of each group member might pose a major task which is excessively time and cost consuming and consequently might not even be to the advantage of creditors.

Various academics have proposed solutions to this problem. LoPucki, Bufford, Adams and Fincke all agree that in such instances the enterprise group should be administered in the COMI of the enterprise group as a whole. Sarra proposes that cross-border agreements (or protocols) should be implemented in such situations. These cross-border agreements might either provide for procedural coordination of the administrative aspects of the insolvencies of the separate group members, or for substantive consolidation of the enterprise group as a single unit. Substantive consolidation will occur in instances (i) where the group members are highly integrated, (ii) where the entities of the corporate group disregarded the separateness of the corporate entity so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (iii) where the group members were engaged in fraudulent schemes. This solution seems to identify the interests of the creditors as a whole as the determinative factor. In instances where one is dealing with an enterprise group and it would be to the advantage of the creditors as a whole that each of the group members be liquidated separately, an order for procedural cooperation could be made to make the individual liquidations quicker and cheaper. In instances where it would be to the advantage of the creditors as a whole, substantive consolidation of the whole group could be ordered.[253] However, it is submitted that the protocol solution may be idealistic in the sense that it is highly improbable that a protocol will exist in every jurisdiction where corporate groups operate.

253 The Legislative Guide complements the Model Law. As Chapter 15 is based on the Model Law, it should not be very difficult to incorporate the principle contained in the Legislative Guide concerning CBI matters in the US. It seems that these principles may have already been incorporated in the US through the *Owens*-case.

### *2.2.8 EU adoption of the Model Law*

Currently the EU has not yet adopted the Model Law. This is probably due to the fact that it has the EC Regulation to rely upon in CBI matters. It should, however, be kept in mind that the EC Regulation only has intra-community application.[254] The question that arises is what happens in instances where the CBI of a debtor involves non-Member States.

Westbrook[255] submits that the adoption of the Model Law by the EU Member States would serve some important purposes. Firstly, such an adoption would be regarded as "a very friendly gesture" in other countries. Secondly, adopting the Model Law would produce a uniform law within the EU as to CBI matters concerning non-EU companies.[256] Up to now, the Model Law has been adopted by only five EU countries,[257] which seems to be no more than a start. It is submitted that all other EU countries should adopt the Model Law, which would provide a legal framework when dealing with CBI matters that involve non-EU countries. This would contribute to legal certainly and the harmonisation of international insolvency law.

## ***2.3 The presumption of incorporation under the EC Regulation and Chapter 15***

After discussions concerning the presumption of incorporation when determining the COMI of an enterprise under the EC Regulation[258] and Chapter 15[259] respectively, the question arises as to whether or not there is a divergence between the EC Regulation and Chapter 15 as to the weight to be placed upon the presumption in favour of the jurisdiction of incorporation.

254 Wessels *International Insolvency Law* 235.
255 Westbrook 2002 *Am Bankr L J* 39-40.
256 The EC Regulation is applicable to CBI matters only where the COMI of the debtors is situated within the EU. See a 3(1) and Recital 22 of the EC Regulation. See the discussion in para 2.1.7 above.
257 These countries are Great Brittan, Greece, Poland, Romania and Slovenia. See UNCITRAL 1997 www.uncitral.org for a list of all of the countries that have adopted the Model Law.
258 See para 2.1.6 above.
259 See para 2.2.6 above.

*2.3.1 Westbrook's opinion regarding the interpretation of COMI under Chapter 15*

Westbrook[260] suggests that there are two policy factors that should influence the best standard for determining the COMI under Chapter 15, namely predictability and the likely quality of the substantive law of the chosen jurisdiction.[261] Each of these factors will be discussed below.

2.3.1.1 Predictability

A balance should be struck between flexibility on the one hand and the utmost predictability on the other hand when determining the COMI of a debtor. It is quite possible that the creditors of a corporation may rely upon the laws of the state of its incorporation or principal place of business to regulate the management of the general default by such corporation.[262]

Westbrook[263] criticizes the *SPhinX*-case[264] by stating that the case

> [c]arries the flexible interpretation of COMI to an extreme. The analysis of the court's opinion offers much to admire at specific points, but overall it seems to virtually eliminate predictability in determining COMI, consigning each case to the unrestrained discretion of the judge.

The implicit rule derived from the *SPhinX*-case is that the creditors and other interested parties may simply agree upon the COMI of a debtor and can be deemed to have done so if they have not affirmatively objected to the proposed COMI.[265] According to Westbrook[266] this boils down to finding that the COMI of a debtor could be "based purely on creditor consent". The *SPhinX*-case therefore essentially eliminates predictability and transparency in CBI matters. It is submitted that Westbrook's view is not unfounded, due to the fact that, although Chapter 15 gives

260 Westbrook 2006-2007 *Brook J Int'l L* 1022.
261 Westbrook submits that both these factors are important when interpreting COMI, but that the factors may differ in importance between the Model Law and the EC Regulation, which would cause differences in the interpretation of COMI under the two instruments. See Westbrook 2006-2007 *Brook L Int'l L* 1022.
262 In the matter of *Canada S Ry Co v Gebhard* 109 US 527, 537-538 (1883) it was held that every person who deals with a foreign corporation implicitly subjects himself to the laws of the foreign government where the corporation is located.
263 Westbrook 2006-2007 *Brook J Int'l L* 1024.
264 See para 2.2.6 above.
265 See Westbrook 2006-2007 *Brook J Int'l L* 1025.
266 Westbrook 2006-2007 *Brook J Int'l L* 1025.

the courts discretion to grant or deny relief, the recognition of foreign proceedings and the subsequent finding of such proceedings to be main or non-main invokes objective principles to which effect must be given.[267]

Westbrook goes on to criticise the *Eurofood*-case[268] by stating that it "overemphasises predictability". In this matter the question before the ECJ was whether, under the provisions of the EC Regulation, the debtor's COMI was situated in the place of its incorporation (Ireland) or the place of its administration (Italy). Relying heavily upon the provisions of section 3(1) of the EC Regulation,[269] the ECJ held that the debtor's COMI was located in Ireland, where it was incorporated. The overemphasis on predictability circles around creditor reliance. The US has "weak laws regarding the disclosure of the jurisdiction of incorporation" to creditors.[270] In this regard Westbrook[271] states that the alleged importance of a creditor's reliance "rests on the shaky and undemonstrated premise of creditor knowledge and reliance without even a strong intuition that it is true".[272] Additionally, corporations are often incorporated in so-called "tax havens".[273] If there were to be a strong presumption that the COMI of a debtor is its jurisdiction of incorporation in such an instance, the laws of the "tax haven" might be applicable, laws which might not be transparent to the majority of legal practitioners.[274]

267 See para 2.2.4 above. Also see Westbrook 2006-2007 *Brook J Int'l L* 1026.

268 See para 2.1.8 above.

269 Article 3(1) of the EC Regulation states that, in the case of a company or legal person, its place of registration will be presumed to be its COMI, in the absence of proof to the contrary. Also see para 2.1.6 above.

270 If the law of a country requires that a corporation must disclose the jurisdiction of its incorporation on every piece of paper it emitted, this would substantially increase the plausibility of the reliance on the jurisdiction of incorporation by creditors. Currently, there seems to be no country with such requirements.

271 Westbrook 2006-2007 *Brook J Int'l L* 1029.

272 It is submitted that although this contention may have merit, the creditors of a debtor-company might very easily be able to obtain information concerning that debtor's jurisdiction of incorporation from various sources. These sources include the internet (for example the website of the debtor), a contract concluded with the debtor, the constitution of incorporation of the debtor that might be available, making an enquiry from the registries office, or merely directly contacting the debtor and making such an enquiry. Large creditors of a debtor-company will presumably be well informed of the status of such a debtor before concluding an agreement with the debtor, including where it was incorporated. If the creditor were a bank for example, the debtor might have to disclose its jurisdiction of incorporation (among other things) in order to obtain such credit.

273 See, for example, the *SPhinX*-case and the *Bear Stearns*-case, in both of which the debtor was incorporated in the Cayman Islands, which is regarded as a "tax haven".

274 Westbrook 2006-2007 *Brook J Int'l L* 1030. This contention is supported by an abundance of case law (for example the *SPhinX*-case, the *Bear Stearns*-case and the *Tri-Continental*-case discussed above). Accordingly it seems that "tax havens" are a major concern in the US and

2.3.1.2 Acceptability of the substantive law

The substantive law of the jurisdiction where main insolvency proceedings take place will have an important influence on outcomes under the Model Law. Accordingly, when interpreting COMI under Chapter 15, the likely quality of the substantive law of the COMI jurisdiction should be taken into account to a certain extent. Westbrook[275] submits that, when "tax havens" are considered, it is unlikely that there will be a[276]

> [r]obust, fair and transparent reorganisation process designed to save jobs and preserve communities through a financial restructuring or a sale of assets. The lack of these opportunities will create externalities that other jurisdictions must bear, while [the tax haven] enjoys the professional fees associated with liquidation.

There is, however, a reason why the quality of the substantive law of the COMI jurisdiction should be taken into account to a certain extent only. As the Model Law follows a system of "modified universalism", it must accept different substantive outcomes due to the differences in policy judgements. The problem that arises when the substantive law of a tax haven is applicable is that it is "too likely to fall outside the range of acceptable outcomes". Additionally, the substantive law of the tax haven may also "lack essential procedural characteristics" such as an acceptable judicial system and adequate transparency.[277] Courts might accordingly rely upon the public policy exception[278] in order to apply the domestic law, which in turn reverts to territorialism.

Westbrook[279] is accordingly of the opinion that the COMI concept should not be interpreted under Chapter 15 in such a way as to allow a tax haven to serve as the COMI of a multinational corporation in instances where the headquarters and operations are located in other jurisdictions. If the presumption under section 1516(c)

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Westbrook argues that the presumption under s 1516(c) should be applied carefully when a "tax haven" could possibly qualify as the COMI of a debtor, especially when the substantive acceptability of the insolvency laws of the "tax haven" is questionable. See the discussion in para 2.3.1.2 below.

275 Westbrook 2006-2007 *Brook J Int'l L* 1031.

276 Westbrook 2006-2007 *Brook J Int'l L* 1031.

277 Westbrook 2006-2007 *Brook J Int'l L* 1032.

278 Section 1505 of Chapter 15 states that nothing contained in Chapter 15 prevents a court from refusing to take an action governed by Chapter 15 if the action would be manifestly contrary to the public policy of the US. A 6 of the South African *Cross-Border Insolvency Act* 42 of 2000 (which is also based on the Model Law, like Chapter 15) contains a similar provision.

279 Westbrook 2006-2007 *Brook J Int'l L* 1032.

were to be relied upon too heavily, this might however just be the position. Accordingly, interpreting COMI in the most predictable way might not be the best solution under Chapter 15.

2.3.1.3 Is there a divergence in the approaches evident above?

According to Westbrook,[280] the position with regard to the interpretation of COMI under the EC Regulation and Chapter 15 seems to differ. The *Eurofood*-case in which the court relied heavily upon the presumption in favour of incorporation was based on mutual trust between the Member States.[281] If the courts in an EU country assume that the insolvency laws of each EU Member State are reasonably transparent and comply with reasonable commercial expectations, much of the objection against a strong presumption in favour of the jurisdiction of incorporation disappears.[282] With regard to CBI matters there are, however, important differences between cooperation between EU Member States under the EC Regulation on the one hand, and cooperation among countries (such as the US with its Chapter 15) in terms of the Model Law on the other hand. Westbrook[283] accordingly submits that the interpretation of the same COMI phrase may legitimately diverge in two contexts, by stating that: [284]

> [d]espite having the same standard in both the EU Regulation and the Model Law, it is plausible that it will be permissible to interpret them somewhat differently. The reason is that predictability can safely be given more weight in the EU on the assumption that all member states have laws and procedures within the acceptable range and none of them are havens.

It should be kept in mind that whilst the EC Regulation has only regional application, Chapter 15 has international application. The EC Regulation was drafted specifically to suit the needs and circumstances of the EU Member States and applies only in the "controlled environment" of the EU. The presumption contained in section

280 Westbrook 2006-2007 *Brook J Int'l L* 1034.
281 See para 39-40 of the *Eurofood*-case.
282 Especially with the "safety-valve" created by the ECJ, entailing that mere "letter-box" headquarters are excluded. See Westbrook 2006-2007 *Brook J Int'l L* 1034.
283 Westbrook 2006-2007 *Brook J Int'l L* 1035.
284 Westbrook 2006-2007 *Brook J Int'l L* 1040. It should immediately be admitted that the writers know too little about tax havens' substantive insolvency laws to unconditionally express well-informed opinion on this view of Westbrook.

1516(c) of the Model Law was taken from the EC Regulation, but the Model Law does not function in the same environment and circumstances as the EC Regulation.[285] Accordingly, it follows logically that there will be a divergence in approach, as the US has to deal with the problem of "tax havens" and possibly inadequate substantive law, fators which are not experienced in the EU.

### *2.3.2 Chan Ho's opinion regarding the interpretation of COMI under Chapter 15*

Chan Ho[286] agrees with Westbrook that there appears to be a divergence with regard to the weight that is to be placed on the presumption in favour of the debtor's registered office as COMI under the EC Regulation and Chapter 15. The interpretation of COMI is nevertheless correct under each of these instruments as the COMI concept performs different functions under each instrument. Under the EC Regulation, the COMI concept determines which jurisdiction will be able to open main insolvency proceedings. Under Chapter 15, however, the COMI concept merely determines the nature of the foreign insolvency proceedings[287] and does not determine the jurisdiction that opens the insolvency proceedings at all.[288] Accordingly, the COMI concept "plays a much more significant role" under the EC Regulation than under Chapter 15.[289] Chan Ho explains further that: [290]

> [w]hen one is concerned with the monopoly of jurisdiction to open insolvency proceedings within the EU, the certainty of jurisdiction becomes much more important for a host of reasons. .... On the other hand, the Model Law may tolerate more uncertainty with regard to the location of COMI. Provided a foreign proceeding may be recognised as either a main or a non-main proceeding, there is plenty of scope for the recognising court to tailor its relief according to the circumstances of the case. "Flexibility in granting, modifying or denying relief and in communicating and coordinating among multiple proceedings is a hallmark of chapter 15".

Based on the function of each instrument, It is submitted that this contention of Chan Ho's is acceptable. However, Chan Ho's submission that the Model Law "may

285 It applies internationally in an "uncontrolled environment".
286 Chan Ho 2007 *JIBLR* 639.
287 The foreign proceedings can qualify either as main proceedings or non-main proceedings, or may otherwise not qualify as foreign insolvency proceedings under Chapter 15 at all.
288 Chan Ho 2007 *JIBLR* 639. Should there be recognition of foreign main proceedings, it "just produces automatic effects under s 1520 that can be modified for cause". See Glosband 2007 *American Bankruptcy Institute Journal* 3.
289 Glosband 2007 *American Bankruptcy Institute Journal* 3.
290 Chan Ho 2007 *JIBLR* 639.

tolerate more uncertainty with regard to the location of COMI" is questionable, as practical application thereof will lead to legal uncertainty. It is submitted that there are objective requirements that need to be complied with in order to qualify either as foreign main proceeding or foreign non-main proceedings and the distinction between the two should not be blurred due to a desire for flexibility.

### *2.3.3 Sarra's opinion regarding the interpretation of COMI under Chapter 15*

According to Sarra[291] the EU countries and the US have "diverged in their approach" to the COMI concept. The *Eurofood*-decision sets a high threshold for rebutting the presumption in article 3(1) of the EC Regulation, which wording is similar to the presumption contained in section 1516(c) of Chapter 15. The US courts, on the other hand, make use of a "command and control" test when ascertaining where the COMI of a debtor is located.[292] In the *Muscletech Research and Development*-case, the US and Canadian courts agreed that the COMI of the debtor was located in Canada. The factors that the courts took into consideration in reaching this decision were the debtor's place of registration; the place of decision-making; where the financial control and banking was located; and operational and administrative factors. In support of her viewpoint Sarra heavily relies upon the following quote of Judge Markell in the *Betcorp*-case:[293]

> [t]his inquiry examines the debtor's administration, management, and operations, along with whether reasonable and ordinary third parties can discern or perceive where the debtor is conducting these various functions.

Sarra[294] also states that the significance of the US approach to COMI concerning a multinational enterprise is that in instances where the operations thereof "are highly integrated and centralized in the jurisdiction of one entity" (for example the parent company), the courts may find that the COMI of the other entities is situated in the

291 Sarra 2008-2009 *Tex Int'l L J* 555.
292 Sarra refers to the *SPhinX*-case, the *Bear Stearns*-case, the matter of *In re Muscletech Research and Development* Order of Judge Rakoff 04 MD 1598, 06 Civ 538 (SDNY) (hereafter referred to as the *Muscletech Research and Development*-case) and the matter of *In re Betcorp Ltd* 400 BR 266 (hereafter referred to as the *Betcorp*-case).
293 *Betcorp*-case 290.
294 Sarra 2008-2009 *Tex Int'l L J* 561.

same jurisdiction as the parent company (or other controlling entity) in order to recognise administrative coordination and consolidation.[295]

Sarra[296] further submits that the effect of the divergence evident in the approaches to the COMI concept under Chapter 15 and the EC Regulation "raises significant challenges" for future CBI matters involving enterprise groups with entities in both the US and the EU. She submits that a solution to this problem would be that all of the EU Member States should adopt the Model Law to deal with CBI matters concerning non-Member States, as suggested above.[297] When faced with a CBI matter concerning non-EU countries, the courts in the relevant Member State could in turn look at the interpretation and application of the COMI concept under the Model Law by jurisdictions that have already adopted the instrument, such as the US. As the COMI concept is interpreted and applied differently under the EC Regulation and the Model Law, the EU Member States will have two separate "tests" for the COMI concept, one test where the EC Regulation is applicable and another test where the Model Law is applicable.[298] This will ensure that there is uniformity in the application of the Model Law internationally and contribute to legal certainty in CBI matters worldwide.

With regard to the Sarra's use of a "command and control" test in determining the COMI of a debtor, it is submitted that in fact this test does not differ much from that used in the EU. Sarra singles out the same objective factors[299] which are ascertainable by third parties. Nevertheless, it is submitted that these factors will presumably point to the correct jurisdiction qualifying as the COMI. Additionally, the "command and control" test will prevent "tax havens" from qualifying as the COMI of a debtor. With regard to the substantive consolidation it seems that courts in the EU have also been willing to apply this approach (indirectly)[300] and it is submitted that it

295 See the discussion in para 2.2.7.3 above.
296 Sarra 2008-2009 *Tex Int'l L J* 561.
297 See para 2.2.8 above.
298 The presumption in favour of the jurisdiction of incorporation will carry more weight with intra-community CBI matters than with CBI matters concerning non-Member States.
299 See the discussion in para 2.1.2 above.
300 See, for example, the matters of *In the Matter of Daisytek-ISA Limited* English High Court (Leeds Registry), 16 May 2003 BCC 562 and *Cirio del Monte NV* Civil Court of Rome, Bankruptcy Section, 13 Aug 2003. Also see the discussion in para 2.1.8 above.

should be adopted as long as implementation thereof would be to the advantage of the creditors as a whole.

### *2.3.4 Suggested approaches to determine COMI under Chapter 15*

#### 2.3.4.1 A dual COMI under Chapter 15

Westbrook[301] submits that in most countries the standard for locating a corporation on a basis other than its place of incorporation will probably be the identification of either that corporation's headquarters[302] or the place of its operations,[303] which he collectively refers to as the "dual COMI". Often the two standards will indicate the same jurisdiction, especially when one is dealing with a small or medium sized corporation. There will, however, be instances where the two standards indicate different jurisdictions. [304] With regard to the policy consideration of predictability, the dual COMI will still most likely have a workable result in such a situation, as creditors will probably have predicted that either of the two jurisdictions would be the "home of the corporation's default". The dual COMI concept will most likely also satisfy the policy consideration of acceptability of the substantive law, as it will be quite unusual that a "tax haven" would qualify as either the headquarters or the place of operations of a debtor.[305] Regarding the question of whether the headquarters or the place of operations should be applied in instances where the two standards point to different jurisdictions, both Westbrook and Chan Ho generally prefer the headquarters, but not exclusively so.[306]

301 Westbrook 2006-2007 *Brook J Int'l L* 1036-1037.
302 Also referred to as the "real seat" or "chief executive office" of a corporation.
303 Also referred to as the place where the "principal assets" of a corporation are to be found. See Westbrook 2006-2007 *Brook J Int'l L* 1035.
304 For example, in the matter of *In re Maxwell Communications Corp* 170 BR 800 (Bankr SDNY 1994) the debtor's headquarters were located in England, but its assets were located at the offices of its American subsidiaries. This is hereafter referred to as the *Maxwell*-case.
305 For example, in the *Maxwel*l-case the substantive law of either the US or England would be within the range of acceptable commercial regulations.
306 The advantages of holding that the headquarters of a corporation is its COMI are that the headquarters is fairly predictable and it permits the centralisation of a corporate group in one court. On the downside, the headquarters can be manipulated more easily than the place of operations. See Westbrook 2006-2007 *Brook J Int'l L* 1039; Chan Ho 2007 *JIBLR* 639.

2.3.4.2 The "most substantial relationship" test

Luna[307] suggests that the "most substantial relationship" test should be used to determine where the COMI of a debtor-company is situated. This test is universally applied to determine the applicable law where there is a conflict of law situation.[308] The test is designed to indicate the law of the country that has "the most significant relationship to the transaction and the parties". Various connecting factors are taken into consideration by courts when determining the country with the greatest interest in the dispute.[309] In the bankruptcy context, the location of the debtor's assets, the location of the creditors and the place where the transactions between the parties occurred would be taken into consideration in order to determine where the COMI of a debtor is located. According to Luna[310] this approach will prevent potential forum shopping by debtors in the sense that a debtor-company will be unable to change its COMI by simply moving its assets to another jurisdiction.

It is submitted that the connecting factors suggested by Luna might not cumulatively point to the same jurisdiction, which would defeat the purpose of ascertaining the COMI. The location of the debtor's assets might be scattered and might be moved from one jurisdiction to another on the eve of a filing for bankruptcy. If this connecting factor were to be supplemented by the "residency rule" proposed by Bufford,[311] forum shopping might be made more difficult. Like the other two connecting factors, namely the location of the creditors and the place where the transactions between the parties occurred, a multinational corporation will generally have creditors in various jurisdictions leading to transactions being entered into in various jurisdictions. Accordingly, it is submitted that the connecting factors suggested by Luna do not provide the best solution to determine the COMI of a debtor-company. The connecting factors suggested by Sarra[312] in terms of the "command and control" test seem more appropriate and in fact correspond to

307 Luna 2007 *Fla J Int'l L* 671-696.
308 This test is commonly used under the *Convention on the International Sale of Goods* (1980). See Luna 2007 *Fla J Int'l L* 681.
309 These connecting factors include the place of performance, the characteristics of the performance, the location of assets and the location of the parties involved. See Luna 2007 *Fla J Int'l L* 681.
310 Luna 2007 *Fla J Int'l L* 681-682.
311 See the discussion in para 2.2.6 above.
312 Sarra 2008-2009 *Tex Int'l L J* 558-561.

Westbrook and Chan Ho's "headquarters" and "place of operations". These factors include the debtor's place of registration, the place of decision-making, where the financial control is located, and the location of the debtor's operational and administrative functions. These connecting factors are both objective criteria and ascertainable by third parties, and accordingly seem more appropriate as determinants of the COMI of a debtor- company.

### *2.3.6 Conclusion*

Various approaches to determining the COMI of a debtor-company are suggested in terms of Chapter 15. Westbrook[313] submits that a dual COMI approach would pose a solution. This approach entails that one should first look at the jurisdiction of incorporation, as there is the presumption that the jurisdiction of incorporation is the COMI of a debtor. Then one should determine whether the headquarters of the debtor or the place of operations of the debtor indicates that there is another COMI.[314] Luna[315] suggests that certain connecting factors should be taken into consideration in order to determine the jurisdiction with "the most substantial relationship" to the debtor in order to ascertain its COMI. Sarra[316] suggests other connecting factors in order to determine the jurisdiction where the "command and control" of the debtor takes place. Bufford[317] additionally suggests that a "residency rule" should be implemented when determining the COMI of a debtor in order to prevent forum shopping.

From the above it is evident that there is still no established test for the determination of the COMI of a debtor-company under Chapter 15. Currently there is very little case law on the exact point. It does seem to be clear, however, that there is a difference in the approach adopted by courts in the EU and those in the US. A major factor leading to this conclusion is the fact that there is a clear divergence between

313 Westbrook 2006-2007 *Brook J Int'l L* 1036-1037.
314 Regarding the question of whether the headquarters or the place of operations should be preferred as the determinant of the COMI in instances where the two standards point to different jurisdictions, both Westbrook and Chan Ho generally prefer the headquarters, but not exclusively so. See Westbrook 2006-2007 *Brook J Int'l L* 1039; Chan Ho 2007 *JIBLR* 639.
315 Luna 2007 *Fla J Int'l L* 681-682.
316 Sarra 2008-2009 *Tex Int'l L J* 555-561.
317 Bufford 2005 *Am Bankr L J* 139.

the EC Regulation and Chapter 15 as to the weight to be placed upon the presumption in favour of the jurisdiction of incorporation qualifying as the COMI of a debtor.[318] Whilst it seems that this presumption is heavily relied upon under the EC Regulation, academics are *ad idem* that the same presumption under Chapter 15 should not carry as much weight, especially in instances where a "tax haven" could possibly qualify as the COMI of a debtor.

## 3 Foreign non-main proceedings: "establishment"

The local existence of an "establishment" is the requirement under the EC Regulation, the Model Law and Chapter 15 for a debtor to have non-main or secondary insolvency proceedings in a jurisdiction. Virgós and Garcimartín[319] submit that the concept of an "establishment" is an autonomous concept in the sense that its definition should be ascertained independently from any national law. Unlike the situation with a COMI, where neither the EC Regulation nor Chapter 15 provides a explicit definition, all three CBI instruments contain a similar definition of an "establishment" and have similar requirements for an "establishment" to exist. A single discussion on "establishment" is accordingly sufficient.

### *3.1 Statutory provisions*

Article 3(2) of the EC Regulations states as follows:

> Where the *centre of a debtor's main interest 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*[320] *an establishment within the territory of that Member State.*[321]

Article 17(2)(b) of the Model Law states:

318 See para 2.3 above.
319 Virgós and Garcimartín *European Insolvency Regulation* 159.
320 The word "possession" is not used in a legal or technical sense. It does not matter whether the facilities (that constitute an "establishment") are owned, rented or otherwise at the deposal of the debtor. All that matters is that the "establishment" must be subject to a certain degree of control and direction by the debtor. See Virgós and Garcimartín *European Insolvency Regulation* 162.
321 Own emphasis added. See para 3.2 below for the definition of an "establishment" contained in a 2(h) of the EC Regulation.

> The foreign proceeding shall be recognised as a *foreign non-main proceeding if the debtor has an establishment* within the meaning of subparagraph *(f)* of article 2 in the foreign State.[322]

Section 1517(b)(2) of Chapter 15 states that

> [f]oreign proceedings shall be recognised as a *foreign non-main proceeding if the debtor has an establishment* within the meaning of section 1502 in the foreign country where the proceeding is pending.[323]

### *3.2 Definition of "establishment"*

An "establishment" is the minimum requirement for recognition of foreign insolvency proceedings in a jurisdiction.[324] The determination of foreign non-main proceedings is a definitional matter, not a discretionary matter.[325] When determining if a debtor has an "establishment", a broad objective test is to be used.[326] Whether or not there exists an "establishment" is a question of fact and the test used to determine if an "establishment" exists is a "reality test".[327] Although the definition of an "establishment" is almost identical in the EC Regulation, the Model Law and Chapter 15,[328] there are slight differences, which I set out below.

i) Under the EC Regulation, an "establishment" is "any place of operations where the debtor carries out non-transitory economic activity with human means and goods".[329]
ii) Under the Model Law an "establishment" is "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services".[330]

322 Own emphasis added. See para 3.2 below for the definition of an "establishment" contained in a 2(f) of the Model Law.
323 Own emphasis added. See para 3.2 below for the definition of am "establishment" contained in s 1502(2) of Chapter 15.
324 Wofford 2008-2009 *Tex Int'l L J* 665-689.
325 Chan Ho 2007 *JIBLR* 641.
326 Wofford 2008-2009 *Tex Int'l L J* 676; Virgós and Garcimartín *European Insolvency Regulation* 161; and *Interedil Srl (In Liquidation) v Fallimento Interedil Srl* (C-396/09) [2012] Bus LR 1583.
327 Fictions that may exist under national laws are therefore not applicable. For example although in some jurisdictions a person will be treated as continuing the business of an entity until its debts are settled, this is not sufficient for the existence of an "establishment". See Virgós and Garcimartín *European Insolvency Regulation* 161.
328 Also referred to as the three instruments.
329 Article 2(h) of the EC Regulation.
330 Article 2(f) of the Model Law.

iii) Under Chapter 15 an "establishment" is "any place of operations where the debtor carries out non-transitory economic activity".[331]

As seen from above, the EC Regulation contains the term "with human means[332] and goods", while the Model Law additionally adds "… or services" after this term. In order to avoid unintended results in terms of US terminology, this qualification is completely left out of Chapter 15. Accordingly, the US has the broadest definition of "establishment" with the specific purpose of encompassing as many trade activities, economic activities and entities as possible.[333]

### *3.3 The general requirements for having an "establishment"*

The mere presence of assets of the debtor in a specific jurisdiction will not constitute the existence of an "establishment" in that jurisdiction under any of the three instruments.[334] Additionally, the fact that a debtor has no assets in a specific jurisdiction will not automatically mean that there is no "establishment" there.[335] With reference to the definition of an "establishment", there are four main requirements which are contained in all three instruments that have to be satisfied in order to constitute an "establishment". [336]

i) The debtor must have an economic activity

The economic activities could be professional,[337] commercial[338] or industrial,[339] and they need not relate to the assets of the debtor.[340] As stated above, the EC

331 Section 1502(2) of Chapter 15.
332 The term "with human means" entails that a minimum level of organization is needed. See Wofford 2008-2009 *Tex Int'l L J* 676.
333 Wofford 2008-2009 *Tex Int'l L J* 675. If the term "with human means" were to be included in the definition, the term might be interpreted incorrectly, for example by not including enterprises that operate in a strictly electronic environment.
334 Chan Ho 2007 *JIBLR* 636. The reason for this is to restrict creditors from availing themselves of the personal and tactical advantages that may be gained through non-main (secondary) proceedings. See Moss, Fletcher and Isaacs *EC Regulation on Insolvency Proceedings* 52.
335 Whether or not a debtor has assets in a specific jurisdiction will be a consideration, but it should not be seen to be a determining factor with regard to the existence of an "establishment" in that jurisdiction. See Wofford 2008-2009 *Tex Int'l L J* 684.
336 Wofford 2008-2009 *Tex Int'l L J* 677.
337 Examples of professional activities that are sufficient to establish economic activity include medical care, accounting work and legal work. See Wofford 2008-2009 *Tex Int'l L J* 677.

Regulation furthermore requires "human means and goods" whilst the Model Law requires "human means and goods or services" in addition to the four requirements stipulated. It can be argued, however, that these requirements are redundant as it would seem that they are covered by an "economic activity" which could be of professional, commercial or industrial nature and would accordingly encompass human means,[341] goods,[342] and services.[343]

ii) The economic activity must be non-transitory in nature[344]

"Non-transitory" requires that the economic activity must be permanent in nature; a mere occasional conducting of an operation will usually not satisfy the requirement to prove the existence of an "establishment". A certain degree of stability is required.[345] Stability entails an element of continuation and there will be no "establishment" if the debtor had no intention that its transactions should form the basis of a sustained and systematic economic operation in that jurisdiction. A court will therefore not rule that an "establishment" exists in circumstances where a debtor has carried out one (or possibly even several) business transactions within the jurisdiction of a state where there is no stable location from which the transactions were conducted.[346] An

338 Examples of commercial activities include trade transactions for the supply or exchange of goods or services, distribution agreements and consulting. See a 1(1) of the *UNCITRAL Model Law on International Commercial Arbitration* (1985).

339 It is submitted that examples of industrial activities include construction work and engineering.

340 Wofford 2008-2009 *Tex Int'l L J* 677-678; para 71 of the Virgós-Schmit Report.

341 Professional, commercial and industrial activities would require human intervention and participation in order for them to occur. For example, a lawyer or doctor is required for professional activities; a commercial business will need a manager, staff and employees, and industrial activities will need contractors to plan and execute the industrial operation and labourers to perform the work.

342 Commercial activities might involve dealing in goods, like importing fruit or vehicles. Industrial activities might involve the production of goods, like constructing a bridge or erecting mining equipment.

343 Professional activities involve rendering services, as when a lawyer provides his client with legal advice or a dentist provides his client with dental care. Commercial activities could also entail the rendering of services. For example, a transport company renders a service to its clients by transporting certain goods. Industrial activities might also entail services being rendered, as in the engineering sector.

344 There is no indication that the term "non-transitory" is interpreted differently in the EU and the US, and it is accordingly presumed that the term is interpreted uniformly in these jurisdictions.

345 *See Interedil Srl (In Liquidation) v Fallimento Interedil Srl* (C-396/09) [2012] Bus LR 1583. In this matter, the Court of Justice of the European Union held that the presence of immovable assets of a debtor alone in a jurisdiction or the mere fact that a debtor company has a bank account in a jurisdiction does not, in principle, meet the definition of an "establishment".

346 See para 71 of the Virgós-Schmit Report and Fletcher *Insolvency in Private International Law* 376.

objective test is used to determine if an economic activity is seen as non-transitory. The Virgós-Schmit Report[347] provides that the decisive factor is how the economic activity appears externally, not the subjective intention of the debtor. The question is if it would appear to a third party that the conduct of the debtor was actually occurring in a non-transitory manner. There is no minimum duration of time during which the debtor had to be conducting such non-transitory activity. The debtor will meet this requirement of an "establishment" if there is an "objective showing of sufficient permanence"[348] which can be observed by third parties. In *BenQ Mobile Holding BV*[349] a Dutch debtor-company had a branch office in Germany. The German court held that the debtor-company possessed an "establishment" in Germany and was accordingly prepared to open secondary insolvency proceedings there. The factors that the court took into consideration when coming to this decision included that (i) the managing director spent most of his time residing in Germany where he negotiated deals between the debtor-company and foreign banks from the German branch office; (ii) the employees of the debtor-company worked at the German branch office under the supervision of the managing director; and (iii) these activities were ascertainable by third parties. The court accordingly found that the branch office had been used for non-transitory economic activities.[350]

iii) The non-transitory economic activity must be at a place of operations[351]

Virgós and Schmit[352] submit that the place of operations means "the place[353] from where economic activities are exercised on the market". The presence of an office, employees and directors in a specific jurisdiction may indicate the existence of a place of operations,[354] but it is not decisive. It appears that the effect which the

347 Para 71 of the Virgós-Schmit Report 281.
348 Wofford 2008-2009 *Tex Int'l L J* 678.
349 *BenQ Mobile Holdings BV* 1503 IE 4371/06, Local Court of Munich, 5 Feb 2007.
350 See Marshall (ed) *European Cross Border Insolvency* 2-186 (para 2.083/3).
351 There is no indication that the term "place of operations" is interpreted differently in the EU and the US and it is accordingly presumed that the term is interpreted uniformly in these jurisdictions.
352 Para 71 of Virgós-Schmit Report 281.
353 "Place" refers to the physical location from which the debtor carries out its economic activities. See Wessels *International Insolvency Law* 286.
354 Wofford 2008-2009 *Tex Int'l L J* 679.

economic activities have is decisive in this regard. According to Virgós and Schmit[355] it is required that the economic activity of the debtor has an external effect on the immediate market where the operations take place.[356] It will not be sufficient if the debtor fulfils only a passive role with regard to an economic activity.[357] In *BenQ Mobile Holding BV*[358] it was held by a German court that for a debtor to have an "establishment" where its branch office was located, the debtor needs to possess a business at the branch office which is ascertainable to third parties.[359] Mere "internal business activities" would not be sufficient.[360] Wofford[361] further submits that it would also not be sufficient if the economic activity affected only the market of another jurisdiction.[362]

The *SPhinX*-case concerned the provisional liquidation of a debtor corporation in the Cayman Islands. As already explained, the debtor, SPhinX Funds, was a hedge funds corporation which was established in the Cayman Islands as a "limited liability corporation". The provisional liquidators of the corporation applied for recognition of these foreign proceedings in New York as main proceedings under Chapter 15. The debtor had minimum ties with the Cayman Islands[363] and the court therefore found

355 Para 71 of the Virgós-Schmit Report 281; Wofford 2008-2009 *Tex Int'l L J* 679. For example a company specialising in the distribution of fresh food produce to supermarkets has an immediate effect on the market where operations take place.

356 Also see Virgós and Garcimartín *European Insolvency Regulation* 160-161.

357 This will be insufficient due to the lack of an influence on the external market. See Wofford 2008-2009 *Tex Int'l L J* 679. See the discussion of the *Bear Stearns*-case below. Virgós and Garcimartín also provide certain instances that will not constitute an "establishment", such as (i) the mere presence of the debtor's assets in a jurisdiction; (ii) the presence in a jurisdiction of permanent elements which lack a certain degree of organisation (eg a postal address); (iii) the presence of permanent elements in a jurisdiction that are linked to a business activity, but do not have an external presence in the market of the relevant jurisdiction (eg a storage facility or a computer server used for storing data bases). See Virgós and Garcimartín *European Insolvency Regulation* 161.

358 *BenQ Mobile Holdings BV* 1503 IE 4371/06, Local Court of Munich, 5 Feb 2007.

359 It seems that the court took Recital 13 of the EC Regulation into account, which is actually applicable to determining the COMI of a debtor. It is not pertinently stated anywhere in the EC Regulation that an "establishment" must be ascertainable to third parties. See Marshall (ed) *European Cross Border Insolvency* 1-41 (para 1.008).

360 See Marshall (ed) *European Cross Border Insolvency* 1-41 (para 1.008).

361 Wofford 2008-2009 *Tex Int'l L J* 680. It is unlikely that the debtor will have any creditors in a jurisdiction where his economic activities have no effect on a specific jurisdiction.

362 Virgós and Garcimartín agree. They state that from an external point of view an "establishment" must involve a distinct presence by the debtor in the market of the jurisdiction in question. See Virgós and Garcimartín *European Insolvency Regulation* 160.

363 No trade or business was conducted there, no employees of the debtor were to be found there and it had no physical office in the Cayman Islands. Except for corporate books and records, the debtor had no assets in the Cayman Islands and its business was actually conducted from New York in the US.

that the debtor's COMI was situated outside the Cayman Islands. The court accordingly refused to recognise the foreign insolvency proceedings as foreign main proceedings. Without discussing the requirements for an "establishment" the court found the foreign proceedings to be non-main proceedings and held that[364]

> [w]hen so many objective factors point to the Cayman Islands not being the debtor's COMI, and no negative consequences would appear to result from recognising the Cayman Islands proceedings as non-main proceedings, that is the better choice.

The *SPhinX* decision has, however, been convincingly criticised by academics.[365] Glosband[366] submits that "the objective facts did not show any 'establishment' in the Cayman Islands". Consequently, the debtor had no COMI or "establishment" in the Cayman Islands and was therefore "simply not eligible for recognition under Chapter 15". Westbrook[367] submits that transparency and predictability under Chapter 15 have considerable importance, and noted that the requirement of these qualities is essentially nullified by decisions such as the *SPhinX*-case.

The facts in the *Bear Stearns*-case[368] were similar to those in the *SPhinX*-case*.* The provisional liquidators of two debtor companies applied to the Southern District of New York for recognition of foreign insolvency proceedings in the Cayman Islands as foreign main proceedings, or foreign non-main proceedings in the alternative. The debtors were registered in the Cayman Islands as "exempted liability companies" whose business consisted of investing in various types of securities. The investment manager and administrator of the debtors were found in the US, however. In addition, the principal interests, assets and management of these debtors were located in the US. After having found that the foreign proceedings in the Cayman Islands were not main proceedings,[369] the court went on to consider if the proceedings could be recognised as foreign non-main proceedings. Due to the fact that these companies were registered in the Cayman Islands as "exempted liability

364 *SphinX*-case para 122.
365 See for example Glosband 2007 *Am Bankr Inst J* 3; Westbrook 2006-2007 *Brookl J Int'l L* 1024-1028; Chan Ho 2007 *JIBLR* 636-641*;* Hammer and McClintock *Law & Bus Rev Am* 272-275.
366 Glosband 2007 *Am Bankr Inst J* 3.
367 Westbrook 2006-2007 *Brookl J Int'l L* 1026.
368 *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd* 374 BR 122 (Bankr SDNY 2007).
368 *Bear Stearns*-case para 121[14], [15].
369 See para 2.2.6 above.

companies", they were prevented by statute from engaging in any local business in the Cayman Islands, except in order to further business otherwise carried on outside the Cayman Islands. The court found that in order for a debtor to have an "establishment" it must conduct non-transitory economic activities within the jurisdiction of the foreign insolvency proceedings.[370] This meant that the debtor had to have had a local place of business in the jurisdiction of the foreign proceedings. It was found that the debtors did not conduct non-transitory economic activity in the Cayman Islands, because the debtors did not conduct any local activity there. Accordingly the court held that the debtor companies did not have an "establishment" in the Cayman Islands and therefore the foreign proceedings could not be recognised as foreign non-main proceedings either.[371]

iv) The non-transitory economic activity must be carried out by the debtor[372]

The presence and activities of a debtor's employees are to be considered as activities being carried out by the debtor.[373] Although there remains some uncertainty, it seems that this requirement will be satisfied where a corporate agent carries out activities on behalf of the debtor.[374] It will be deemed that these activities are carried out by the debtor. It is generally accepted that, if an affiliate or subsidiary of a parent company has a separate legal personality from the parent company, it will not be considered to be an "establishment" of the parent company.[375] In *Telia AB v Hilcourt Docklands Ltd*[376] the debtor was a Swedish company which had a subsidiary in the UK. The petitioners requested the English High Court to recognise the UK subsidiary as an "establishment" of the parent company in Sweden in order

370 *Bear Stearns*-case para 131.
371 See para 3.9 below for the consequences of non-recognition under Chapter 15 and the EC Regulation.
372 There is no indication that the term "carried out by the debtor" is interpreted differently in the EU and the US and it is accordingly presumed that the term is interpreted uniformly in these jurisdictions.
373 Wofford 2008-2009 *Tex Int'l L J* 681. The employees carrying out the work of the debtor need not even be employed by the debtor itself. In the *BenQ Mobile Holdings*-case it was held that the "human means" requirement would be satisfied if the employees of another group company were spending time working for the debtor in question. See Marshall (ed) *European Cross Border Insolvency* 1-42 (para 1.008).
374 Wofford 2008-2009 *Tex Int'l L J* 681-682. Also see the *Bear Stearns*-case and *In re Amerindo Internet Growth Fund Ltd* No 07-10327 (Bankr SDNY Feb 9, 2007).
375 Wofford 2008-2009 *Tex Int'l L J* 682-684; Virgós and Garcimartín *European Insolvency Regulation* 162.
376 *Telia AB v Hillcourt Docklands Ltd* [2002] EWCH 2377 (Ch).

for them to be able to initiate proceedings in the UK. The court refused the request and held that the mere presence of a business premises of the debtor in the UK was insufficient to constitute an "establishment" for the purposes of article 3(2) of the EC Regulation.[377]

There are, however, arguments in favour of allowing a subsidiary or affiliate to be considered an "establishment" of its parent company. Firstly, the definition of an "establishment" does not deal with the relationship such an "establishment" should have to the debtor. In the second place, the creditors of the subsidiary might have the legitimate expectation that the subsidiary bears the same economic resources as its parent company. In the third place, multinational insolvency proceedings might be defeated if there were to be separate legal proceedings for each separate legal entity.[378] Virgós and Garcimartín submit that there are certain special circumstances in which a subsidiary may be deemed to constitute an "establishment" of its parent. An example would be where the subsidiary behaves in the market as a branch of its parent by performing economic activities that are very like those of its parent. In such an instance, the subsidiary will appear to be an operational extension of its parent company in the market.[379] Based on the above, it seems that a rule can be formulated: generally a subsidiary will not be regarded as an "establishment" of its parent company, unless there are exceptional circumstances (for example where the subsidiary acts as an operational extension of its parent).

It should be noted that the discussion above deals only with the general requirements for the existence of an "establishment" as defined in all three of the models. As Chapter 15 has no further requirements, all that need be complied with in order to constitute an "establishment" are the four general requirements. The EC Regulation additionally requires that the economic activity should be carried out "with human means and goods"; whilst the Model Law requires that the economic activity should be carried out "with human means and goods or services". Virgós and Garcimartín[380] state that the reference to "human means and goods" in the EC Regulation suggests that some form of organisational presence is required in the

377 *Telia AB v Hillcourt Docklands Ltd* [2002] EWCH 2377 (Ch) para 856-857.
378 See Wofford 2008-2009 *Tex Int'l L J* 683.
379 See Virgós and Garcimartín *European Insolvency Regulation* 162.
380 Virgós and Garcimartín *European Insolvency Regulation* 161.

relevant jurisdiction, such as a branch office, a workshop or a factory. According to Wessels[381] "human means" refers to "employees or other people who have the power to create legal relationships between a creditor and a debtor, for example an employee or an agent". There are two types of "goods", namely goods which facilitate the economic activity (such as office furniture, cars and advertising materials) and goods which are the result of the economic process (such as the raw materials, the semi-manufactured materials and the end products).[382] As stated above, it can however be argued that these additional requirements under the EC Regulation and Model Law are unnecessary, as it would seem that they are already included in an "economic activity", which can be of a professional, commercial or industrial nature and accordingly encompasses human means, goods and services.

### *3.4 Scope of the non-main proceedings*

The position under the EC Regulation, the Model Law and Chapter 15 is that non-main proceedings are always "territorial" in nature and therefore limited to the assets located in that jurisdiction.[383] It is immaterial whether or not those assets are linked to the economic activities of the "establishment".[384] The law applicable to the secondary insolvency proceedings under the EC Regulation is the local law of the jurisdiction opening the non-main proceedings.[385] Upon opening non-main proceedings, the local liquidator of those territorial proceedings has exclusive powers

381 Wessels *International Insolvency Law* 287.

382 Wessels *International Insolvency Law* 287. Moss, Fletcher and Isaacs submit that the reference to "goods" should actually read as a reference to "assets", as goods are limited to tangible movables, whilst assets include movable and immovable property. Accordingly, the ownership of or an interest in land will be sufficient to constitute an "establishment". See Moss, Fletcher and Isaacs *EC Regulation on Insolvency Proceedings* 243-245. It should be noted that in none of the sources found on this topic and referred to in the text is there an explanation as to the exact meaning of "services" in this context.

383 See a 3(2) of the EC Regulation and para 24 of the Virgós-Schmit Report 271. The EC Regulation contains uniform rules of location in order to resolve any uncertainties presented by the territorial location of assets (see a 2(g) of the EC Regulation). The relevant time for determining the location of the debtor's assets is the time that the insolvency proceedings are opened. If assets are therefore removed from a jurisdiction after non-main insolvency proceedings have been opened, the liquidator may act outside his territory to recover such assets (see a 18(2) of the EC Regulation). See Virgós and Garcimartín *European Insolvency Regulation* 163.

384 Virgós and Garcimartín *European Insolvency Regulation* 163.

385 Para 27 of the Virgós-Schmit Report 271. Also see aa 4(1) and 28 of the EC Regulation. Non-main proceedings accordingly offer an exception to the universal effect that is accorded to main insolvency proceedings. See Moss, Fletcher and Isaacs *EC Regulation on Insolvency Proceedings* 50.

over the debtor's assets to be found in that territory and the direct powers of the liquidator in the main insolvency proceedings no longer applies to those assets.[386] Local proceedings are, however, not exclusively reserved for local creditors, and all of the creditors of the debtor to be found worldwide may participate in local proceedings.[387] This approach is in accordance with the principle of the equal treatment of creditors.[388] It should further be noted that whilst there may be only one set of main insolvency proceedings (situated where the debtor has its COMI), there is no limit on the number of secondary proceedings that may be opened.[389]

### *3.5 Function of non-main proceedings*

According to Virgós and Schmit,[390] non-main proceedings have two main functions. Firstly, such proceedings "protect local interests" in the sense that local creditors may apply for the opening of local insolvency proceedings in order to protect themselves from the effect of foreign laws. Where main insolvency proceedings are conducted in another jurisdiction, the local creditors can ensure that their legal position will be the same in local proceedings. Secondly, non-main proceedings serve as "auxiliary proceedings" to the main insolvency proceedings. The liquidator in the main insolvency proceedings may also request the opening of secondary proceedings if it is required for the efficient administration of the debtor's estate.[391]

386 De Boer and Wessels "Dominance of Main Proceedings" 190.

387 Article 32 of the EC Regulation and s 1513(a) of Chapter 15. Participation in the local insolvency proceedings takes place directly through the liquidator of the main proceedings. See para 27 of the Virgós-Schmit Report 271.

388 Para 27 of the Virgós-Schmit Report 271.

389 If the debtor has a number of "establishments" in various jurisdictions, secondary insolvency proceedings may be opened in each of those jurisdictions. See Wessels *International Insolvency Law* 284.

390 Para 32-33 of the Virgós-Schmit Report 271-272.

391 Irrespective of whether non-main proceedings are referred to as non-main proceedings, auxiliary proceedings or secondary proceedings, all of these terms refer to the same type of proceedings with the function of protecting local creditors and serving the main proceedings. The purpose of the non-main proceedings is therefore to facilitate the administration of the insolvency proceedings and the realisation of the debtor's assets. This might be required in instances where the estate of the debtor is too complex to administer as a single unit or where there are major differences in the legal systems of the jurisdictions concerned. See Virgós and Garcimartín *European Insolvency Regulation* 156 and para 32-33 of the Virgós-Schmit Report 271-272.

### *3.6 The reference date for determining if an "establishment" exists*

There seem to be differing views among US and European academics as to what the reference date for the existence of an "establishment" should be. Wofford[392] submits that the requirements for an "establishment" must be present within the state in question[393] at the time when the foreign proceedings are opened,[394] not necessarily when the petition for the recognition of the proceedings is filed. The legal question before the court in *Müller Gerüstbau GmbH*[395] was if the Dutch court opening secondary insolvency proceedings possessed international jurisdiction to do so where the German debtor-company had ceased to have an "establishment" in the Netherlands more than eight months before opening such proceedings. Taking the wording of article 3(2) of the EC Regulation into account, the District Court of Dordrecht found that the question as to the existence of an "establishment" must be assessed by the court at the time of the court's decision to open or not to open secondary insolvency proceedings. If, at that time, the debtor does not possess an "establishment" in the court's jurisdiction, no secondary proceedings may be opened. Accordingly, the judgment opening secondary proceedings was set aside.[396]

On the other hand, in *Lavie v Ran (in re Ran)*[397] the US Supreme Court of Appeal held that the relevant time to determine whether or not a debtor possesses an "establishment" in a specific jurisdiction is the time that the petition for recognition of the foreign proceedings was filed.[398]

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392 Wofford 2008-2009 *Tex Int'l L J* 685.

393 Fletcher *Insolvency in Private International Law* 377.

394 It will not be sufficient if an "establishment" existed at some time in the past only.

395 *Müller Gerüstbau GmbH* District Court of Dordrecht, LJN; AQ6547; NIPR 2004/372, 11 Aug 2004.

396 In the matters of *Trillium (Nelson) Properties Ltd v Office Metro Ltd* [2012] ILPr 30 and *Interedil Srl (In Liquidation) v Fallimento Interedil Srl* (C-396/09) [2012] Bus LR 1583 it was held that the relevant date for determining the existence of an establishment is the date of the presentation of the petition for recognition of the insolvency proceedings.

397 *Lavie v Ran (In re Ran)* 607 F3d 1017 (5th Cir 2010).

398 *Lavie v Ran (In re Ran)* 607 F3d 1017 (5th Cir 2010) para [12]. One reason given by the court for this decision is the fact that s 1502 of Chapter 15 is written in the present tense, which implies that a court should consider whether a debtor has an "establishment" in a certain jurisdiction when the application for recognition of the foreign insolvency proceedings is filed. Also see para 2.2.5 above for a discussion of the facts of the matter. However, in the matter of *In re Millennium Global Emerging Credit Master Fund Ltd* 458 BR 63 (Bankr SDNY 2011) it was held that the appropriate date at which to determine the COMI of a debtor is not the date on which the petition for recognition is filed, but on or about the date of the commencement of the foreign proceeding

Wessels,[399] Virgós and Garcimartín[400] submit that the moment at which the application for insolvency proceedings is filed is decisive in this regard. This is the only reference date which is aimed at the prevention of forum shopping, which is one of the aims of the EC Regulation.[401] Accordingly, any changes that occur after this date will have no effect on the jurisdiction of a court to open non-main insolvency proceedings.[402] It is submitted that this position is correct as it will lead to legal certainty worldwide and prevent forum shopping. Additionally, this reference date also seems to be the most appropriate reference date for determining COMI under both the EC Regulation and Chapter 15.[403]

### *3.7 Local proceedings under the EC Regulation*

Under the EC Regulation, non-main proceedings (or local proceedings as they are termed)[404] may be instituted either before main proceedings have been instituted or thereafter. "Local proceedings" are divided into "independent proceedings" and "secondary proceedings".[405] If non-main proceedings are instituted before main proceedings,[406] those proceedings are termed "independent proceedings".[407] Such proceedings may be winding-up or reorganization proceedings.[408] There are only two instances where a court of a Member State may open "independent proceedings", namely:

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for which recognition is sought. The court held further that the same date should be used to determine whether or not a debtor has an "establishment". See para 76 of the judgment.

399 Wessels *International Insolvency Law* 285.

400 Virgós and Garcimartín *European Insolvency Regulation* 159.

401 See Recital 4 of the EC Regulation.

402 If the "establishment" of a debtor in state A is therefore relocated to state B after the date that an application to open non-main insolvency proceedings is filed, courts in state A will retain their jurisdiction to open non-main proceedings (although the basis for such jurisdiction does not exist any more). This position is in accordance with the principle of *perpetuation fori*. See Virgós and Garcimartín *European Insolvency Regulation* 159.

403 Accordingly, the question of whether or not a debtor possesses an "establishment" in a specific jurisdiction will be determined at the same point in time as the determination of the COMI. See Marshall (ed) *European Cross Border Insolvency* 2-171.

404 Called "local insolvency proceedings" by Virgós and Schmit, due to their territorial nature. See the Virgós-Schmit Report 271.

405 Virgós and Garcimartín *European Insolvency Regulation* 170-171. It should be noted that Chapter 15 does not make any reference to such independent territorial proceedings and refers only to non-main proceedings.

406 This will be the instance where insolvency proceedings are instituted in a jurisdiction where the debtor possesses an "establishment", although main insolvency proceedings have not been instituted in the jurisdiction where the debtor's COMI is located.

407 There are no main proceedings to which the "independent proceedings" are subordinate.

408 Para 31 of the Virgós-Schmit Report 271.

i) where the insolvency laws of the state where the COMI is located do not permit main insolvency proceeding to be opened there;[409] or
ii) where a local creditor or a creditor of a local "establishment" requests the opening of territorial proceedings.[410]

Fletcher[411] submits that these limited instances where creditors can request the opening of independent territorial proceedings are aimed at preventing disruptive and possible pre-emptive tactics by creditors who do not have a close personal *nexus* to the jurisdiction where the "establishment" of a debtor is located.[412] In a matter before the Commercial Court of Tongeren[413] the debtor-company was incorporated in the Netherlands and possessed an "establishment" in Belgium. The Belgian tax authority applied for the opening of non-main proceedings in Belgium. The court opened independent territorial proceedings in Belgium, as no main proceedings had been opened in the Netherlands where the debtor's COMI was located.

Once main insolvency proceedings have been opened the independent proceedings become secondary proceedings.[414] Secondary proceedings may normally only be winding-up proceedings,[415] but if preceding independent proceedings were reorganisation proceedings, subsequent secondary proceedings may continue to be

409 An example of such a case would be if the debtor is a public company which is not permitted to be declared insolvent under the insolvency law of the state where the COMI is to be found.
410 Article 3(4) of the EC Regulation. Also see Recital 17. The opening of independent territorial proceedings under a 3(4) of the EC Regulation can be requested only by a creditor "who has his domicile, habitual residence or registered office in the Member State within the territory of which the establishment is situated, or whose claim arises from the operation of that establishment".
411 Fletcher *Insolvencies in Private International Law* 375.
412 Recital 17 of the EC Regulation states that independent territorial proceedings are "intended to be limited to what is absolutely necessary".
413 Case nr AR A/03/1126, Commercial Court Tongeren, 31 May 2003. See Wessels *International Insolvency Law* 289.
414 Para 25 of the Virgós-Schmit Report 271. The secondary proceedings are legally linked to the main proceedings. There must be coordination between the secondary proceedings and the main proceedings, which entails a certain degree of subordination of the former to the latter. See Virgós and Garcimartín *European Insolvency Regulation* 157.
415 See a 27 of the EC Regulation. The reason is that proceedings that are aimed at restructuring a debtor-company require global decisions which affect all of the assets of the debtor. Accordingly, a complete restructuring of a debtor-company can take place only in a jurisdiction where the decisions made have a global scope (not mere territorial scope, as is the instance with secondary proceedings). See Virgós and Garcimartín *European Insolvency Regulation* 175.

reorganisational in nature, unless the liquidator in the main proceedings requests otherwise.[416]

### *3.9 Consequences of non-recognition*

#### *3.9.1 Position under the EC Regulation*

In instances where the debtor possesses neither a COMI nor an "establishment" in a Member State, courts in that Member State will not have the international jurisdiction to open main or secondary insolvency proceedings in that specific Member State under the EC Regulations.[417] An example of such a situation would be where a debtor has its COMI in state A and assets in state B, although it does not have an "establishment" (or its COMI) in state B. The courts of state B will not be able to open main or secondary insolvency proceedings against the debtor under the EC Regulation. The assets located in state B will belong to the estate of the main insolvency proceedings in state A.[418] Presumably[419] the creditors located in state B will have to prove their claims and take part in the foreign insolvency proceedings, when foreign insolvency proceedings have been instituted.

#### *3.9.2 Position under Chapter 15*

In the *Bear Stearns*-case it was held that in instances where the debtor does not possess a COMI or an "establishment" in a jurisdiction, the foreign proceedings "are not eligible for relief as main or non-main proceedings under Chapter 15". Nevertheless, the non-recognition of foreign proceedings under Chapter 15 does not leave petitioners without the ability to obtain relief from the US courts. In order to ensure that a foreign representative is not left without any remedy upon non-recognition of the foreign proceedings, section 303(b)(4) of the *US Bankruptcy Code*

416 Para 31 of the Virgós-Schmit Report 271.
417 Wessels *International Insolvency Law* 286.
418 See a 4(2)(b) of the EC Regulation.
419 There are no indications of the consequences to be found in the sources found on this topic and referred to in this text.

provides that a foreign representative may commence proceedings under Chapter 7 or 11 of the *US Bankruptcy Code*. Section 1509(f) of Chapter 15 states that[420]

> [t]he failure of a foreign representative to commence a case or to obtain recognition under this chapter does not affect any right the foreign representative may have to sue in a court in the United States to collect or recover a claim which is the property of the debtor.

It is submitted that this approach should be adopted in all CBI matters in which the Model Law is applicable, in order to create legal certainty throughout the world.

## 4 Choice-of-law

In a CBI matter, the court must perform a choice-of-law analysis in order to determine the validity of a creditor's claim as well as the distribution priority of that claim. Westbrook[421] submits that there are two separate legal issues that have to be addressed in this regard. Firstly, the existence and amount of a claim will be governed by the "non-bankruptcy law". When making this determination, a court should consider the normal choice-of law factors, such as the place where a contract was concluded[422] and the parties' choice of law.[423] Secondly, the distribution priority of the claim is governed by the "bankruptcy law". When making this determination, a court should consider the debtor's affairs as a whole on a worldwide basis and determine the debtor's COMI.[424] In CBI matters where a territorial approach is adopted, however, the court that determines the existence and amount of the claim will also choose its own bankruptcy law to determine the distribution priority of a claim.[425] Where the "modified universalism" approach is adopted, however, the "bankruptcy law" and "non-bankruptcy law" will often be different legal systems. A practical example would be where the debtor has its COMI in state A and it has a creditor in state B where they concluded a contract. The law of state B (the non-bankruptcy law) will determine the validity and amount of the creditor's claim, whilst

420 Additionally, the operation of ss 1525, 1526, 1527 and 1529 of Chapter 15 does not depend upon the existence of foreign main or non-main proceedings. See Chan Ho 2007 *JIBLR* 640.
421 Westbrook 2005 *Penn St Int'l L Rev* 626.
422 See Forsyth *Private International Law* 6-8; 190-206 for a discussion on connecting factors.
423 See Forsyth *Private International Law* 294-295; 304-307 for a discussion on choice-of-law and party autonomy.
424 Westbrook 2005 *Penn St Int'l L Rev* 632.
425 Westbrook 2005 *Penn St Int'l L Rev* 626.

the bankruptcy law of state A would determine the distribution priority of the creditor's claim.

In *Lernout & Hauspie Speech Products NV v Stonington Partners Inc*[426] the US courts failed to apply this choice-of-law analysis correctly. The debtor-company (Lernout) was incorporated and managed in Belgium, but had acquired and merged with two US companies less than two years before its bankruptcy. When bankruptcy proceedings were instituted, its largest group of assets was located in the US. The claimants (Stonington), who consisted mainly of persons located in the US, alleged that Lernout had defrauded them when they accepted Lernout's stock in exchange for the companies that they had owned. They subsequently claimed damages from Lernout. There was a conflict between the bankruptcy law of the US and the bankruptcy law of Belgium as to the distribution priority of the Stonington creditor claims. In terms of the US bankruptcy law the Stonington creditor claims would fall subordinate to the unsecured creditor claims, resulting in the creditors receiving nothing in the bankruptcy proceedings. If Belgian law were to be applied, the creditors would be treated the same as the other unsecured creditors with non-priority claims.[427] This entailed that they would receive a *pro rata* distribution after the priority claims had been paid out. Accordingly, if US bankruptcy law applied the creditors would receive nothing, but if the Belgian bankruptcy law applied they would be entitled to a dividend. The choice-of-law ruling made by the court was that the US bankruptcy law governed the distribution priority of the creditor's claims.[428] Accordingly, the US law governed both the existence and amount of the creditor's

426 The first decision by the bankruptcy court was unreported. The decision of the court *a quo* was re-affirmed on appeal by the District Court. See *Lernout & Hauspie Speech Products NV v Stonington Partners Inc* 268 BR 395 (D Del 2001).

427 This was due to the fact that Belgian Law prohibits discrimination among creditors of the sort allowed under US Law.

428 The decision of the court was affirmed by the District Court on appeal (see *Lernout & Hauspie Speech Products NV v Stonington Partners Inc* 268 BR 395 (D Del 2001). The claimants appealed to the Court of Appeal (see *Lernout & Hauspie Speech Products NV v Stonington Partners Inc* 310 F3d 118 (3d Cir 2002)), which held that the choice-of-law by the court *a quo* was fundamentally flawed and had to be reconsidered and accordingly remanded the case to the court *a quo*. Before the court *a quo* the debtor presented a Chapter 11 liquidating plan, which was approved by the court after there were negotiations with the Belgian trustees and subsequent amendment. The court, however, still relied upon its initial choice-of-law determination that the US bankruptcy law was applicable to the distribution priority of the claims. See *In re Lernout & Hauspie Speech Products NV* 301 BR 651 (Bankr D Del 2003). This decision was once again re-affirmed by the District Court. See *In re Lernout & Hauspie Speech Products NV* 308 BR 672 (D Del 2004).

claims as well as the distribution priority of those claims. The problem with this decision is that it follows the territorialist approach, whilst the US follows the modified universalist approach to CBI matters.[429] In this regard Westbrook states that:[430]

> On that basis, a court committed to a form of universalism would be wrong to approve a plan such as the one approved in *Lernout*. Not only was it a territorialist plan, but it denied the stock-fraud claimants the benefit of the Belgian distribution rules to which, on the above analysis, they were entitled and would reasonably have expected to see applied in the bankruptcy of a Belgian company.

Westbrook points out that the choice-of-law analysis by the US courts was "fundamentally flawed" as the courts confused the choice of bankruptcy law with the choice of substantive law governing the claims themselves. The courts made the "basic mistake" of relying on the US contracts and interests of the creditors in order to determine the bankruptcy law.[431] The US courts should instead have applied the US law to determine the validity and amount of the creditor claims and then independently have determined what bankruptcy law should have been applied to determine the proper distribution priorities.[432]

## 5 Conclusion

### *5.1 Legal principles applicable to the determination of the COMI and "establishment" of a multinational enterprise*

Under the EC Regulation, Chapter 15 and the Model Law main proceedings are instituted in the jurisdiction where the debtor has its COMI. The EC Regulation states that the court within which the COMI of the debtor is situated will have the jurisdiction to open main insolvency proceedings, which are universal in scope. The COMI of a debtor should correspond to the place – the directing centre - where that debtor

429 Westbrook 2005 *Penn St Int'l L Rev* 629.
430 Westbrook 2005 *Penn St Int'l L Rev* 635.
431 Westbrook 2006 *Tex Int'l L J* 335.
432 Taking the circumstances of the matter into account, the COMI of the debtor would according to Westbrook probably have been in Belgium, and consequently the bankruptcy law of Belgium should have prescribed the distribution priority of the creditors' claims. See Westbrook 2005 *Penn St Int'l L Rev* 632; Westbrook 2006 *Tex Int'l L J* 335. It is submitted that this view is open to critique. It is the writers' opinion that the debtor's COMI was situated in the US.

conducts the administration of his interests – the so-called head office functions - on a regular basis and is therefore objectively ascertainable to third parties.

A debtor's COMI is not fixed and can accordingly be changed. The legal definition of a COMI, however, requires a new location to be genuine, in the sense that it should be the place where the debtor conducts the administration of his main interests on a regular basis.

In determining if the EC Regulation is applicable in respect of a debtor-company, the only test is whether or not that debtor's COMI is to be found within the relevant Member State, irrespective of where it is incorporated. The EC Regulation will accordingly be applicable in instances where a debtor-company has its COMI within the EU but is registered outside the EU.[433]

Under the EC Regulation, the Model Law and Chapter 15, a debtor must possess an "establishment" in a jurisdiction in order for non-main proceedings to be instituted in that jurisdiction. Non-main proceedings are territorial in nature. An objective test is used to determine if a debtor possesses an "establishment" in a jurisdiction. Under all three instruments, there are four general requirements that have to be complied with in order for an "establishment" to exist, namely (i) the debtor must have an economic activity in the relevant jurisdiction; (ii) the economic activity must be non-transitory in nature; (iii) the non-transitory economic activity must be at a place of operations; and (iv) the non-transitory economic activity must be carried out by the debtor. Although it is not pertinently stated anywhere in the EC Regulation that an "establishment" must be ascertainable to third parties, this element is definitely relevant. The EC Regulation furthermore requires "human means and goods" whilst the Model Law requires "human means and goods or services" in addition to the four requirements. This qualification is completely left out of Chapter 15. It can, however, be argued that these requirements are unnecessary as it would seem that they are included in any "economic activity", which can be of professional, commercial or

433 See the matter of *BRAC-Rent-A-Car International Inc* [2003] 2 All ER 201. For a discussion of the matter, see para 2.1.7 above.

industrial nature and accordingly encompasses human means, goods and services.[434]

In instances where the debtor possesses neither a COMI nor an "establishment" in a Member State of the EU, the courts in that Member State will not have the international jurisdiction to open main or secondary insolvency proceedings in that specific Member State under the EC Regulations. The position in the US is that in instances where the debtor does not possess a COMI or an "establishment" in a jurisdiction, the foreign proceedings are not eligible for relief as main or non-main proceedings under Chapter 15. However, this does not leave petitioners without the ability to obtain relief from the US courts, as the foreign representative may commence proceedings under Chapter 7 or 11 of the *US Bankruptcy Code*.

In a CBI matter, the court must perform a choice-of-law analysis in order to determine the validity of a creditor's claim as well as the distribution priority of that claim. These are two separate legal issues. Firstly, the existence and amount of a claim will be governed by the "non-bankruptcy law". When making this determination, a court should consider the normal choice-of-law factors, such as the place where a contract was concluded and the parties' choice-of-law. Secondly, the distribution priority of the claim is governed by the "bankruptcy law". When making this determination, a court should consider the debtor's affairs as a whole on a worldwide basis and determine the debtor's COMI. [435]

### *5.2 The reference date for determining the COMI and "establishment"*

The ECJ has held that the reference date for determining the COMI under the EC Regulation is the moment that an application to open insolvency proceedings is filed.[436] This position is accordingly binding throughout the EU. The US Court of Appeals has held that the reference date for determining the COMI under Chapter 15 is the time that the petition for recognition of the insolvency proceedings is filed.[437] There seems to be a divergence in opinion as to the reference date for determining if

434 For a discussion, see para 3.3 above.
435 For a discussion, see para 4 above.
436 For a discussion, see para 2.1.3 above.
437 For a discussion, see para 2.2.5 above.

an "establishment" exists. The US Court of Appeals[438] held that the relevant time to determine if a debtor possesses an "establishment" in a specific jurisdiction is the time that the petition for recognition of the foreign proceedings was filed. The only problem with this is that non-main proceedings may be instituted before main proceedings. Although main insolvency proceedings have not been instituted in the jurisdiction where the debtor's COMI is located, non-main insolvency proceedings may be instituted in a jurisdiction where the debtor possesses an "establishment".

### *5.3 The presumption in favour of the jurisdiction of incorporation*

Both the EC Regulation and Chapter 15 contain a presumption to the effect that the registered office of a debtor-company is presumed to be its COMI, in the absence of evidence (or proof) to the contrary.[439] The EC Regulation refers to "proof to the contrary" whilst Ch 15 refers to "evidence to the contrary", but there seems to be no real difference between the two instruments as to the meaning of the term. There seems to be a clear divergence between the EC Regulation and Chapter 15 as to the weight to be placed upon the presumption in favour of the jurisdiction of incorporation qualifying as the COMI of a debtor.[440] Whilst it seems that this presumption is heavily relied upon under the EC Regulation,[441] academics are *ad idem* that the same presumption under Chapter 15 should not carry as much weight, especially in instances where a "tax haven" could possibly qualify as the COMI of a debtor.[442]

Courts in the US held, correctly it is submitted, that the mere fact that there is no objection by creditors and other interested persons to a jurisdiction's qualifying as the COMI (or place where the debtor has an establishment) cannot be taken to indicate that the jurisdiction is the COMI (or place where the debtor has an establishment), especially where the jurisdiction in question is a "tax haven" with very few objectively relevant connecting factors pointing to it's being the COMI. The COMI of a debtor (or place where the debtor has an establishment) must be ascertained by making use of

438 For a discussion, see para 3.6 above.
439 For a discussion, see para 2.2.6 above.
440 See para 2.3 above.
441 See the discussion of the *Eurofood*-case in para 2.1.8 above.
442 See the discussion of the *Sphinx*-case, the *In re Bear Stearns*-case and the *In re Tri-Continental Exchange*-case in para 2.2.6 above.

objective criteria, is ascertainable by third parties, and the recognition requirements set out in Chapter 15 are objective.

Not everyone is pleased with the presumption in favour of the jurisdiction of incorporation, as it could facilitate forum shopping. A debtor-company can easily change its official residency for the purpose of filing bankruptcy proceedings in a more favourable jurisdiction. Bufford proposes a solution to this problem that will make forum shopping more difficult, namely establishing a "residency rule".[443]

### *5.4 The problem with corporate groups*

A problem not currently addressed by the EC Regulation, Chapter 15 or the Model Law is the insolvency of members of a business enterprise group. It seems that the determining factor will be the degree of economic integration within the corporate group. Neither LoPucki, Bufford or Adams and Fincke provide for a method of determining the degree of economic integration between companies belonging to the same group. Bufford, Adams and Finke do state, however, that specialised bankruptcy courts might be necessary. It is thus evident that the determination of the COMI of a corporate group will require a more sophisticated judiciary as well as a more complex economic analysis. Judges will accordingly need appropriate training due to the complexity of the matters. When making a determination as to the economic integration of a company, there will have to be an enquiry into the functional realities of its corporate administration as well as its corporate and financial structure. In instances where the members function independently from one another, they each of them should be administered and liquidated separately from one another and the COMI of each one of the members should be determined separately. Procedural coordination will then be allowed. When one is dealing with a highly integrated business enterprise, on the other hand, the answer is not that simple. It seems that, should it be to the advantage of creditors, the business enterprise group should be administered and liquidated as a whole (by disregarding the separate legal personality of each member) and determining the COMI of the

443 For a discussion see para 2.2.6 above.

enterprise group as a whole. This is known as substantive consolidation.[444] The rights and priorities of a creditor holding a security interest over an asset of an enterprise group member should, however, as far as possible be respected in substantive consolidation.

### *5.5 The divergence between the EC Regulation and Chapter 15 with regard to the COMI concept*

Currently there is still no established test for the determination of the COMI of a debtor-company under Chapter 15. Up to now there has been very little case law on the exact point. It does seem clear, however, that there is a difference in the approach adopted by courts in the EU and those in the US. A major factor leading to this conclusion is the fact that there is a clear divergence between the EC Regulation and Chapter 15 as to the weight to be placed upon the presumption in favour of the jurisdiction of incorporation qualifying as the COMI of a debtor, as discussed above.

It should be kept in mind that whilst the EC Regulation has only regional application, Chapter 15 has international application. The EC Regulation was specifically drafted to suit the needs and circumstances of the EU Member States and applies only in the "controlled environment" of the EU. The presumption contained in section 1516(c) of the Model Law was taken from the EC Regulation, but the Model Law does not function in the same environment and circumstances as the EC Regulation.[445] Accordingly, it follows logically that there will be a divergence in approach as the US has to deal with the problem of "tax havens" and possibly inadequate substantive law, which is not the case in the EU. Predictability can well be given more weight in the EU on the assumption that the insolvency laws of each EU Member State are reasonably transparent and comply with reasonable commercial expectations. Further, under the EC Regulation, the COMI concept determines which jurisdiction will be able to open main insolvency proceedings. Under Chapter 15, however, the COMI concept merely determines the nature of the foreign insolvency proceedings and does not determine the jurisdiction that opens the insolvency proceedings at all.

444 See para 2.2.7.3 above.
445 It applies internationally in an "uncontrolled environment".

Diverging approaches to the COMI concept under Chapter 15 and the EC Regulation may raises significant challenges for future CBI matters involving enterprise groups with entities in both the US and the EU. A solution to this problem would be that all of the EU Member States should adopt the Model Law to deal with CBI matters concerning non-Member States. When faced with a CBI matter concerning non-EU countries, the courts in the relevant Member State could in turn look at the interpretation and application of the COMI concept under the Model Law by jurisdictions that have already adopted the instrument, such as the US. As the COMI concept is interpreted and applied differently under the EC Regulation and the Model Law, the EU Member States would have two separate "tests" for the COMI concept, one test where the EC Regulation is applicable and another test where the Model Law is applicable. The presumption in favour of the jurisdiction of incorporation would carry more weight with intra-community CBI matters than with CBI matters concerning non-Member States. This approach would facilitate the aims of the Model Law by providing a legal framework which seeks to enhance legal certainty, cooperation, coordination and harmonisation between states in CBI matters throughout the world.

### *5.6 Suggestions for South Africa*

(a) COMI

Relating to the tests for determining the COMI, it is submitted that the "command and control" test is acceptable for determining the COMI of multinational enterprises. The requirements of this test do not significantly differ from those of the test that was applied in the *Eurofood*-case. The only difference is the degree of predictability that is required. Furthermore, the "command and control" test is similar to Westbrook's test for determining the "headquarters" or "place of business" of a multinational enterprise. All of the tests discussed above have two similarities, namely (i) they consider the same objective factors and (ii) ascertainability by third parties is paramount. These two factors play a primary role in determining the COMI of a debtor, which will always be a question of fact.

The identification of a COMI involves a combination of three fundamental ideas: (1) the first is that "administrative connection" (which is the place of management and control of the debtor) takes precedence over both the operational connection (which is the place of the debtor's business or operation) and the asset connection (which is the place where the assets of the debtor are located). With regard to subsidiary companies, the "administrative connection" will be the place where the head office (the main centre of administration) of each separate subsidiary company is located. (2) The "external sphere" idea requires the element of being "ascertainable by third parties", which entails that the relevant factors must be visible to third parties. The most important third parties referred to are creditors and potential creditors. The external organization refers to the way the debtor manifests itself on a regular basis to the outside world. The term "on a regular basis" indicates a quality of presence. It also refers to a degree of permanence. (3) The unity idea asks which one of the places of management is the "directing centre" where the functions of the head office are carried out.

Should a debtor change the location of its COMI, it must still comply with the requirements set out in the *Eurofood*-decision of being identifiable objectively and being ascertainable by third parties. The court will need to be satisfied that the change in the place where the activities (which fall within the concept of the "administration of its interests") are carried on is a change based on substance and not an illusion; and that that change has the necessary element of permanence.

It is submitted that the residency rule carries merit, as implementation thereof as an additional requirement for determining the COMI of a debtor will certainly aid the minimisation of "forum shopping". This requirement is an objective criterion (as required by the *Eurofood*-case) which may support the requirement that the COMI of a debtor must be ascertainable by third parties. Creditors and other third parties might not immediately take notice of the fact that a debtor has changed location (for example, its headquarters) as it might not influence their day-to-day business. It is reasonable, however, to assume that after a certain period (a year may be appropriate) a change of location would be widely known. Additionally, an individual debtor would not be able to side-step the insolvency courts of the jurisdiction where he resides merely by emigrating to another country.

The reference date for determining the COMI and "establishment" of a debtor company should be the moment when the application to open insolvency proceedings is filed, or as with Chapter 15, the time that the petition for recognition of the foreign proceedings was filed. Such an approach would lead to uniformity in determining the site of the COMI and "establishment" of a debtor company around the world, which would facilitate the harmonisation of international insolvency laws and lead to legal certainty. In addition, this approach would contribute to the prevention of forum shopping, as a debtor would not be able to successfully change its COMI or "establishment"in search of the more favourable insolvency laws of another jurisdiction after the application for the recognition of insolvency proceedings had been filed.

(b) The presumption in favour of the jurisdiction of incorporation:

As is the position under Chapter 15, South Africa would adopt an international approach to CBI matters, as CBI proceedings would not take place in a "controlled environment" (as is the position with the EC Regulations). It is submitted that the US approach relating to the presumption in favour of the jurisdiction of incorporation should be followed in South Africa. The element of predictability in the determination of the COMI of a debtor would be important, but would have to be applied in a balanced and flexible manner. This factor should not be over emphasised, due to the fact that the knowledge of the creditors might not always be based on the true facts at hand.

It is illuminating to note that the mere fact that a subsidiary's economic choices are or can be controlled by the parent company might not be sufficient to rebut the presumption in favour of the jurisdiction of incorporation. Furthermore, a court would not be compelled to recognise foreign proceedings as foreign main proceedings merely because the registered office of the debtor was in one jurisdiction and no objections had been filed against holding that the insolvency proceedings instituted in that jurisdiction were main proceedings. The criterion that would have to be taken into consideration would be the determination of the place where the debtor conducts the administration of its interests on a regular basis (the nerve centre or main centre of administration), which would have to be ascertainable by third parties.

Only if it were found that the debtor conducted regular business operations at its registered office in a manner commensurate with a "principal place of business" would it be possible to found an establishment.

(c) Establishment

The four general requirements for an establishment of a debtor company to exist were discussed above. With reference to the requirement that the economic activity must be non-transitory in nature, a certain degree of stability would be required. Stability entails an element of continuation and there would be no "establishment" if the debtor had had no intention that its transactions should form the basis of a sustained and systematic economic operation in that jurisdiction. A court would therefore not rule that an "establishment" existed in circumstances where a debtor had carried out one (or possibly even several) business transactions within the jurisdiction of a state where there was no stable location from which the transactions were conducted.

In evaluating the requirements of "non-transitory economic activity" and "place of operations" the courts would take various factors into consideration, including whether or not:

- it would *appear to a third party* that the conduct of the debtor was actually occurring in a non-transitory manner;
- there was an objective showing of sufficient permanence which *could be observed by third parties*;
- these activities were *ascertainable by third parties*; and
- the place of operations at a branch office was *ascertainable to third parties*.

In line with these factors and with reference to the requirement that "the non-transitory economic activity must be carried out by the debtor", the rule could be formulated that, generally, a subsidiary will not be regarded as an "establishment" of its parent company unless exceptional circumstances exist, such as where the subsidiary acts as an operational extension of its parent. Again, how the subsidiary company appears to the outside world would be important.

Where main insolvency proceedings had not been instituted in the jurisdiction where the debtor's COMI was located it would nevertheless be possible to institute non-main insolvency proceedings in a jurisdiction where the debtor possessed an "establishment".

The ALI Principles contain helpful guidelines in instances where there are parallel proceedings and assets are to be sold. The domestic administrator of each proceeding would seek to sell the assets in cooperation with other administrators in order to produce the maximum value for the assets of the debtor as a whole, across national borders. The relevant domestic courts would subsequently approve such sales. This would entail that the assets would be sold to realise the greatest value for all creditors worldwide, despite any lost advantage that the local creditors in a specific jurisdiction might have had if a territorial approach had been followed. The local creditors would, accordingly, have no say if territorial proceedings would have been to their advantage, but universal proceedings would produce the greatest value of the sold assets (being more advantageous to the *concursus creditorum* as a whole). This is simply an application of the general principle of "modified universalism", that realising assets and sharing the value of the proceeds should take place on a worldwide basis rather than on a territorial basis.

As for as it concerns the problem regarding multinational groups of companies,the most sensible solution to the corporate group problem would be to administer the independently operated corporate group entities separately in each of their respective COMIs whilst administering highly integrated groups together in the COMI of the corporate group as a whole.

In the latter instance there would have to be an enquiry into the functional realities of the group's corporate administration and its corporate and financial structure. In determining the main interest of a debtor, a court would consider the scale of the interest administered in a specific jurisdiction and the importance of the interest administered in that jurisdiction. Thereafter the court would consider the importance and scale of the debtor's interests administered in any other jurisdiction that might qualify as the COMI of the debtor. This should be of a significant nature. The determining factor would, accordingly, be the degree of economic integration within

the corporate group. However, there would still be no suggested method for determining the degree of economic integration between companies belonging to the same group. Specialised bankruptcy courts might be necessary as the "business enterprise group COMI" might prove problematic for the rights of creditors in various of the corporate group jurisdictions. This might occur in instances where a creditor located in a specific jurisdiction dealt with a debtor-company registered in the jurisdiction in which it instituted a claim, and would like a remedy in that jurisdiction. In addition, the recognition of a "business enterprise group COMI" would create an "inappropriate extension of domestic law" of a jurisdiction, which could prejudice the creditors located in other jurisdictions where the distribution priority differs.

It is submitted that the process of considering the different elements would be important in each matter and that this task should indeed be placed in the hands of persons with specialised experience in the area of CBI. Nevertheless, this research shows that the "business enterprise group COMI" is one issue that undeniably needs further investigation in the EU, the US and in South Africa, due to the complexity of the rights of all the stakeholders.

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**List of abbreviations**

| | |
|---|---|
| Am Bankr L J | American Bankruptcy Law Journal |
| Brook J Int'l L | Brooklyn Journal for International Law |
| CBI | cross-border insolvency |
| CILSA | Comparative and International Law Journal of South Africa |
| Colum J Eur L | Columbian Journal of European Law |
| COMI | centre of main interest |

| | |
|---|---|
| Conn J Int'l L | Connecticut Journal of International Law |
| EC | European Commission |
| ECJ | European Court of Justice |
| EU | European Union |
| Fla J Int'l L | Florida Journal of International Law |
| Fordham Int'l L J | Fordham International Law Journal |
| ICLQ | International Comparative Law Quarterly |
| INSOL Int Insolv Rev | INSOL International Insolvency Review |
| Int'l Law | The International Lawyer |
| JBL | Journal of Business Law |
| JIBLR | Journal of International Banking Law & Regulation |
| Law & Bus Rev Am | Law and Business Review of the Americas |
| Mich J Int'l L | Michigan Journal of International Law |
| Mich L Rev | Michigan Law Review |
| NAFTA | North American Free Trade Agreement |
| PELJ | Potchefstroom Electronic Law Journal |
| Penn St Int'l L Rev | Penn State International Law Review |
| Tex Int'l L J | Texas International Law Journal |
| UNCITRAL | United Nations Commission on International Trade Law |

# EUROPEAN AND AMERICAN PERSPECTIVES ON THE CHOICE OF LAW REGARDING CROSS-BORDER INSOLVENCIES OF MULTINATIONAL CORPORATIONS – SUGGESTIONS FOR SOUTH AFRICA

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## SUMMARY

An increase in economic globalisation and international trade has amounted to an increase in the number of multinational enterprises that have debt, own assets and conduct business in various jurisdictions around the world. This, coupled with the recent worldwide economic recession, has inevitably caused the increased occurrence of multinational financial default, also known as cross-border insolvency (CBI).

The legal response to this trend has, *inter alia*, produced two important international instruments that were designed to address key issues associated with CBI. Firstly, the United Nations Commission on International Trade Law (UNCITRAL) adopted the *UNCITRAL Model Law on Cross-Border Insolvency* (the Model Law) in 1997, which has been adopted by nineteen countries including the United States of America and South Africa. Secondly, the European Union (EU) adopted the *European Council Regulation on Insolvency Proceedings* (EC Regulation) in 2000. Both the EC Regulation and Chapter 15 adopt a "modified universalist" approach towards CBI matters.

Europe and the United States of America are currently the world leaders in the area of CBI and the CBI legislation adopted and applied in these jurisdictions seems to be effective. As South Africa's Cross-Border Insolvency Act is not yet effective, there is no local policy guidance available to insolvency practitioners with regard to the

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application of the Model Law. At the basis of this article is the view that an analysis of the European and American approaches to CBI matters will provide South African practitioners with valuable insight, knowledge and lessons that could be used to understand and apply the principles adopted and applied in terms of the EC Regulation and Chapter 15, specifically the COMI concept, the "establishment" concept in the case of integrated multinational enterprises and related aspects.

**KEYWORDS:** Cross-border insolvency; CBI; UNCITRAL Model Law on Cross-Border Insolvency; European Council Regulation on Insolvency Proceedings; insolvency of integrated multinational enterprises