THE AFTERMATH OF "EUROFOOD"—BENQ HOLDING BV AND THE DEFICIENCIES OF THE ECJ DECISION

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Keywords to Follow

The *Eurofood* decision of the European Court of Justice (ECJ) was long awaited as what quite a number of commentators expected to be the "last clearing word" on the issue of what constitutes the notorious "centre of main interests" (COMI) pursuant to Art.3(1) of the EC Regulation on insolvency proceedings (1346/2000) (hereafter referred to as EIR). After Advocate General Jacob's Opinion[1] it actually did not come as a real surprise that the court itself did not open its mind to the need for modern insolvency law to develop a particular set of rules for the insolvencies of a group of companies. Therefore, even though it is fair to say that the decision is (more or less) based on a valid *lege artis* interpretation, it leaves the somewhat insipid feeling that the tremendous changes which have taken place within the decade or so after the drafting of the European Insolvency Convention and the Explanatory Report by Virgós and Schmit have not been appreciated (let alone taken into consideration). Due to the involvement of the International Monetary Fund, the World Bank and, in particular, UNCITRAL, insolvency law has gained such an enormous increase in importance just in this period that it is no exaggeration to state that this field of law has developed in these few years more than in decades (if not centuries) before.

However, the ECJ's reasoning is one thing; what national courts make of it is another. The decision of the Amsterdam Arrondissement Court in another COMI battle demonstrates very clearly what might be called "second generation" problems, i.e. problems resulting from the ECJ's "clarification". This decision relates to the holding company—BenQ Holding BV (henceforth called the debtor)—belonging to a group of companies which had been sold not very long before by Siemens to a Taiwanese company.

BenQ OHG is a subsidiary of our debtor. In mid-2006, it filed a petition in Munich, Germany, and a provisional administrator (*vorläufiger Insolvenzverwalter*) was appointed by the Munich insolvency court. At that time our debtor was still in tolerable economic shape but acted in a somewhat irritating way. It was incorporated as a Dutch corporation—BV—probably for tax reasons. Most of its activities, however, were carried out in and from Munich—to be more precise, from the place of the said subsidiary's "seat" and mainly through the employees of this subsidiary. Some of its employees worked up to 70 per cent of their working time for the debtor holding company. On the other hand, the debtor holding, too, had employees—and they worked in Amsterdam; but they did so almost exclusively for other group companies all over the world.

Similarly puzzling is the situation with respect to the board of directors. Our debtor had two: one residing quite outside of Amsterdam in Holland; the other residing fairly often in Munich and working there also for BenQ OHG; the Amsterdam court describes him as a "travelling part-time manager". As a matter of fact, this director decided virtually everything that the debtor holding did or did not do. But due to the articles of incorporation, this director needed, for all his decisions, the consent of the other director, which was quasi-automatically granted in practically every case. The other director—until a few months before the filing still a juridical person, then replaced by a natural person—in contrast, had the power to decide on his own, but never did so. All that he did was to agree with what his travelling companion had already decided.

On December 27, 2006, BenQ OHG (followed later by another subsidiary) filed a petition seeking a *surséance van betaling*[2] (a kind of moratorium which is listed as one of the Dutch proceedings in Annexe A of the EIR) for the debtor. The Amsterdam court granted an immediate, but preliminary, order. Just two days later the Munich subsidiary, BenQ OHG, also filed a petition seeking the opening of an "*Insolvenzverfahren*" for the debtor—which could be a main or a secondary proceeding—with the insolvency court in Munich. The judge immediately granted the opening of a preliminary proceeding without having to decide at that point which type of proceeding this would become. In preparation for making this judgment, a few days later, the Munich judge phoned his fellow judge in Amsterdam—for this purpose making use of an interpreter—in order to co-ordinate further developments. The result was that the Munich judge told the Dutch judge that he would defer to the latter's decision. Finally, on January 31, 2007, the Amsterdam court opened a main proceeding and a few days later the Munich court opened a secondary proceeding. Both decisions were subject to a right to apply to set aside; but in the meantime both applicants have settled with the *status quo* in both cases.

The case offers a plethora of issues and peculiarities. Some of them will be just mentioned here but not explored in detail, under the heading "Issues", and only two will be addressed in a little more detail under the heading "Two Spin-offs", because they amply demonstrate how interpretations and decisions have the potential to deviate from the legislator's initial intentions.

Issues

As to the issues in general, it deserves to be strongly emphasised that the judges communicated with each other despite the fact that Art.31 of the EIR (duty to co-operate) refers expressly only to "liquidators" (defined as various kinds of insolvency administrators set out in Annexe C to the EIR) and is silent with respect to courts and judges, and—even more noteworthy—despite the fact that many commentators declared that judges from the Continent lacked, for historical reasons, the knowledge, capacity and experience of such case management. Even if judicial communication is a tool which can be used only under somewhat restricted circumstances,[3] this example fits nicely into the endeavours currently undertaken by Professor Virgós and Professor Wessels on a European scale in conjunction with Insol Europe and by Professor Fletcher, Professor Wessels, Gabriel Moss Q.C., Nick

Segal and others on a global scale in conjunction with American Law Institute and International Insolvency Institute.

As is generally known, the opening of a secondary proceeding is dependent on the existence of an "establishment" as defined in Art.2(h) of the EIR. The question whether the debtor holding uses "human means" in Munich even though these persons are employed by a subsidiary company but do spend most of their time working for the debtor has been answered by the Munich judge in the affirmative. And he is right—pursuant to the said definition, the decisive test is that these persons are to follow the directions of the debtor and not who is paying them for their labour.

A highly complicated issue stems from the fact that the Dutch law, unlike the German one, does not provide for the subordination of those claims in an insolvency proceeding which result from a loan given by a shareholder that replaces equity. Therefore, that Dutch side argued (inter alia) that the claim on which the filing in Amsterdam was based does not exist due to a set-off with a counter-claim of the holding against the Munich affiliate. Seen from the perspective of German law, however, this set-off is invalid pursuant to s.387 of the German Civil Code (BGB) because, due to the said subordination, the claims are not comparable. Thus, the application of the Dutch law in this area of conflict is likely to lead to different results than the application of the German one. Under the guidance of Art.28 of the EIR, the Munich judge appears to be justified in opening a secondary proceeding because German law[4] prohibits a set-off in cases where the two claims are not of the same kind ("*gleichartig*").

Two Spin-offs

The issues to be presented here in a bit more detail have been dealt with by the ECJ in its *Eurofood* decision. The first one relates to the question under which circumstances the presumption in Art.3(1), 2nd sentence, of the EIR, can be rebutted in case of a group insolvency constellation (1); and the second one has to do with the dilution of the Regulation's clear distinction between preliminary proceeding and opened proceeding (2).

Ascertainability of the COMI

The ECJ states at [36] of the *Eurofood* decision:

> *"By contrast, where 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."*

For all its reliance on traditional notions of interpretation, the ECJ opens up, through this statement, the possibility of having a single place of jurisdiction for a group of insolvent companies. What it says is that in order to establish such a place the mere demonstration of some inter-group decision making does not suffice. This, however, leads to the following argument *e contrario*: if there is more than just that, then the presumption might well be rebutted. What is needed for this "more" is the combination of objective facts and their ascertainability by third parties.

At this point it is telling to compare this ECJ approach with the one of the Amsterdam judge. He reasons:

> *"From the ECJ's deliberation one has to conclude that the presumption (of Art. 3 par. 1, 2nd s EIR) can be rebutted only when and if the legal entity at the place of its registration carries out no activities or only very few ones."*

This understanding is almost diametrically opposed to the ECJ's one! It closes the door for a group insolvency jurisdiction almost entirely. Moreover, with respect to the ascertainability by third parties, the judge concludes that in the present case there were no relevant third parties; since the debtor's only creditors were other companies belonging to the same group!

This somewhat strange conclusion hints at a serious deficiency of the ECJ's decision which fails to clarify who qualifies as a "third party". After all, in the *Eurofood* case, it was the creditor Bank of America which had full knowledge of the facts and situation and which, for that very reason, did not want to have the proceeding opened in Italy. And even though the ECJ quotes from the Virgós/Schmit report which obviously deems creditors to be such third parties[5] the Luxemburg court does not go into this question—at least not explicitly. But this is indispensable under the present circumstances: after all, third parties are those who are decisive in relation to the ascertainability of the objective facts.

Seen from a dogmatic perspective, one fundamental question needs to be answered here—namely, are the third parties those individuals which, in the case at hand, are the ones which had been in contact with the debtor before its petition or are they quasi-abstract parties or potential creditors—in short, do the concrete or hypothetical creditors matter? Since the latter are fictitious entities, it is obvious that their "mouthpieces" are the judges who decide over the case in the final instance—in *Eurofood*, thus, the Luxemburg judges who, indeed, seem to favour this approach of abstraction.[6]

However, does it need to be emphasised that an insolvency proceeding exists for the reconstruction of the relationships of the debtor with its existing (rather than potential) creditors? Needless to point out that they are very real persons and entities. From an abstract point of view, one would deem it therefore self-evident that it is their perception which has to be decisive for the required ascertainability. However, despite the fact that the proceeding plays an essential role for the concrete stakeholders, it should be equally self-evident that an inquiry with all of them as to what they consider to be the debtor's COMI cannot be carried out in each case. Therefore, it is the judge's task to make the COMI concrete—but from the specific perspective of the parties involved. Thus, if the name of the company had not been "Eurofood" but rather "Parmalat Financial Services" or something of that kind, this objective fact would have been quite likely sufficiently ascertainable by the individual stakeholders.

The Amsterdam judge directs attention to a further question in this context—namely, how distant has someone to be from the debtor in order to be qualified as a third party? Strictly speaking, any director of a company is a third party; the same is true, for instance, for the employees, the postman, the company's bankers, a group member, a supervisory authority, or any other creditor. Since the answer should be given on a Europe-wide basis rather than made dependent on the peculiarities of the national laws which might have no privileged or subordinated creditor ranking or no concept of related persons, etc., it appears to be preferable to have a clear-cut solution. And this would be to include in the "third party pool" all stakeholders who are not employed by the debtor. Thus, the directors and the labour force do not belong to this circle, whereas all others mentioned above do.

To be sure, this solution does not solve all potential or existing problems—what happens, for instance, if the lender bank has someone on the debtor's board of directors? Should this fact turn the bank from a third party into an insider? The answer in such a case would be negative, since, after all, this creditor knows very well where the debtor's COMI is situated. Coming back to the Amsterdam decision: there is no reason to exclude other group members from the third party pool; if it were correct to exclude them, insolvencies of holding companies would practically always be without third parties—and, thus, the designation of their COMI would be left entirely to the discretion of the judges.

Preliminary v opened proceeding

A further shortcoming of the ECJ decision in *Eurofood* is that it blurs the clear distinction in the EIR between what constitutes a preliminary proceeding and what an opened proceeding.[7] In [58] it states: "Such divestment implies that the debtor loses the powers of management that he has over his assets". There is no need to repeat the arguments against this understanding.[8]

The Amsterdam court, however, followed by the court in Munich, assumes that the preliminary part of *surséance van betaling* is an opened insolvency proceeding! Both courts do so even though this proceeding is far from establishing the debtor's total divestment; all that it does is to put at the side of the debtor a monitoring person whose consent is needed for certain commercial activities. The debtor and its directors act otherwise as they did before.

In the light of this spin-off, it needs to be emphasised as forcefully as possible that the ECJ's misinterpretation of the fundamental distinction between a preliminary and an opened proceeding should be restricted to the extent possible. A preliminary proceeding, generally, does not hinder the initiation of another one in another Member State, as Art.18 of the EIR states in all clarity; nor does it exclude the possibility of another Member State's court opening a main proceeding during the time this preliminary proceeding is pending.

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1 Opinion of September 27, 2005; available at [2005] B.C.C. 1021; see also my comments on it in: (2005) (Nov) *Global Turnaround* 10 and following.
2 For a description of (inter alia this proceeding see Kortmann, Faber, Nowak and Veder, "National Report for the Netherlands" in McBryde, Flessner and Kortmann (eds), *Principles of European Insolvency Law* (2003), pp.483 *et seq*.
3 On this issue, *cf.* Westbrook, "International Judicial Negotiation, Texas Judicial Negotiation" (2003) 38 *Texas Int'l Law Journal* 567; ders., "The Duty to Seek Cooperation in Multinational Insolvency Cases" in Peter, Jeandin, Kilborn (Hgg.), *The Challenges of insolvency Law reform in the 21st Century*, s.361; Paulus, "Judicial Cooperation in Cross-Border Insolvencies", available at *http://siteresources.worldbank.org*.
4 Note that Art.28 speaks about "the law of the member state" whereas Art.4 restricts its applicability just to the respective "insolvency law".
5 *cf.* para.75 of the Report.
6 See Paulus, "Der EuGH und das moderne Insolvenzrecht" (2006) *Neue Zeitschrift für Gesellschaftsrecht* 609 *et seq*.
7 [45]ff.
8 Suffice it here to refer to Gabriel Moss Q.C., "Asking the Right *Questions*? Highs and Lows of the European Court of Justice (ECJ) Judgment in Eurofood" (2006) 19 Insolv. Int. 97.

MAKING USE OF THE RULES MORE USER FRIENDLY

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Keywords to Follow

The Insolvency Act and Rules 1986 have been with us for a little over 20 years. They have been amended from time to time—both by amendment to the primary legislation (such as the Insolvency Act 1994 and the Insolvency (No. 2) Act 1994 and more recently the Enterprise Act 2002) and there have been many Insolvency (Amendment) Rules, the most recent of which was the Insolvency (Amendment) Rules 2007.[1]

A consolidation and modernisation exercise of the Insolvency Rules is now underway and a consultation period in respect of the proposed draft new Rules has recently ended. The purpose of the changes is said to be to:

- provide a new simplified structure in Pt 1 and to remove unnecessary repetition;
- separate the provisions regarding members' voluntary liquidations, creditors' voluntary liquidations and compulsory winding-up provisions in Pt 4;
- remove common insolvency procedures from each of the Parts into a new separate "Common Part"—this is to achieve greater consistency between the similar procedures applicable to the various types of insolvencies.

In addition, changes will be introduced regarding advertising and the requirements to file certain documents in court such as copies of the *Gazette* Notice.

Enterprise Act Changes

It was strange that when changes to the Act and the Rules were introduced as a result of the Enterprise Act and the amendments to the Insolvency Rules consequent upon those changes, reference was still made to affidavits rather than witness statements when witness statements were introduced as an alternative to affidavits in 1999. Indeed, there is still much confusion as to whether there are any insolvency procedures which