ARTICLE

Beyond CoMI – The Duty to Cooperate under EU Insolvency Regulation 1346/2000

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Much time and effort has gone into the debate as to how the words 'Centre of Main Interests' (CoMI) should be interpreted in the context of the EU Insolvency Regulation ('The Regulation'). This debate is by no means ended and indeed the new Chapter 15 recently added to the US Bankruptcy Code picks up the same words and therefore the arguments regarding jurisdiction are set to go truly global.

However, what happens once the arguments have been settled in a specific case and those charged with carrying out the assignment have settled into their tasks?

This article looks at the issues facing the liquidators in the main and secondary proceedings and in particular the duty to cooperate enshrined in the Regulation.

Cooperation – a cornerstone of the Regulation

The Regulation's very purpose is to facilitate efficient and effective cross-border insolvencies[2] and was brought into being in an attempt to replace the previous anarchy that invariably ruled when the business of an insolvent company spread over more than one jurisdiction. This aim is set out at the beginning of the Recitals on the very first page of the text, second only to the need for freedom, justice and justice across the Union.

The route by which Main and Secondary Liquidation[3] might come into being should be well known by now and will not be discussed here. Suffice to say it is quite common for there to be one of each (and the possibility of more than one Secondary cannot be discounted).

The Regulation sets out a clear duty on the office holders:

> Subject to the rules restricting the communication of information, the liquidator in the main proceedings and the liquidators in the secondary proceedings shall be duty bound to communicate information to each other.[4]
>
> Subject to the rules applicable to each of the proceedings the liquidator in the main proceedings and the liquidators in the secondary proceedings shall be duty bound to cooperate with each other.[5]

Further guidance is to be found in the Recital to the Regulation:

> Main insolvency proceedings and secondary proceedings can (…) contribute to the effective realization of the total assets only if all the concurrent proceedings pending are coordinated. The main condition here is that the various liquidators must cooperate closely, in particular by exchanging a sufficient amount of information. In order to ensure the dominant role of the main proceedings the liquidator in such proceedings should be given several possibilities for intervening in secondary proceedings which are pending at the same time.[6]

The diligent reader will immediately notice some important features in the above extracts:

– The duty to cooperate extends to both parties. While the recitals[7] make it clear that the Main proceeding is the dominant one the Duty to Cooperate applies equally to both or all players.

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2 cf. EUIR Recital 2.

3 A term I use here to encompass all the various forms of insolvency to be found in the Union, cf. annex A & b of the Regulation.

4 Art. 31(1).

5 Art. 31(2).

6 Rec. 20.

7 Rec. 20 and 17.

– In the English text, the word 'cooperate' appears in both the Recital and the main text. The same equivalent word or the equivalent of 'collaborate' appears in the other languages.[8]

It is worth revisiting these definitions:

Cooperation: (i) the action or process of working together to the same end; (ii) assistance, especially by complying readily with requests.

Collaboration: the action of working with someone to produce something

(Oxford English Dictionary).

The clear intent here is that both parties should be working towards a common purpose although the example that the Oxford English Dictionary gives to demonstrate Cooperation under the second heading is perhaps not helpful: 'his captor threatened to kill him if he did not cooperate.'

– There is a complete absence of any guidance as to exactly how far the cooperation should extend. Given that the whole purpose of the Regulation is cooperation, one may reasonably assume that the cooperation duty is intended to be extensive. Chapter 15 also refers to the need to cooperate 'to the maximum extent possible'[9] but this gets us no further in detailing the scope.

– Both Articles of the Regulation quoted above start with the words 'subject to …,' giving plenty of freedom to interpret how much (or little) cooperation should be extended.

– There is no indication of who should have enforcement powers or what such enforcement powers should be in the absence of cooperation by one or both parties. It is possible that the creditors may be able to take action either through the courts or through the regulatory bodies if they consider that there has been a breach of duty by one or more of the liquidators. The putting to death of the liquidator may be a little extreme but some professional regulatory remedy might be appropriate.

This is what the lawmakers have given us. But what happens in practice?

Cooperation in practice

When it comes to cooperation, the Regulation has a fundamental flaw at its heart. It was clearly assumed that the use of secondaries would be restricted to consensual filings especially where the case was too complex to be handled from a single centre.[10] Indeed there is a provision for the Main Liquidator to open secondaries to help with his task.[11]

The reality is very different. The CoMI arguments that continue to rage are essentially about control and many secondaries have been filed with the express and sometime overt intention to thwart the Main Proceedings. This is especially the case when the CoMI is not at the place of the Registered Seat of the company and the secondary is opened in the place of the Seat often accompanied by expressions of anger that a foreign court had the effrontery to 'usurp' the courts in the place of the Seat. Often[12] the secondary is only opened as a second front after a battle to unseat the Main Liquidator has failed.

Thus like a knight in shining armour the Secondary Liquidator rides to rescue the innocent company from the hands of foreign marauders.

Meanwhile the Main Liquidator, having fought (and spent time and money) to avoid losing power over certain assets and fearful of a lack of coordination, regards the Secondary as a major irritant at best and (more likely) a major obstacle in his path to achieve any of his aims.

The very real additional problems of professional jealousy and concern over fees are further compounded by the complete absence in many instances of professional trust. Very few practitioners have a strong network among non-local practitioners and therefore are often meeting a person whom they have never met before and of whose qualifications to do a good job they are uncertain.

Even worse is the chronic lack of knowledge among practitioners of how insolvency laws work in other countries and hence exactly what the rules are governing the work of the respective Liquidators.

The generic belief among all practitioners that their local law is best and that most non-local practitioners are sharpsters is alive in the globalized 21st century despite the efforts of Insol.

The English practitioners, for example, have long prided themselves on their 'international' approach, but in practice many have no real practical knowledge of insolvency outside the Westminster system. The author is to the best of his knowledge the only UK licensed practitioner to be stationed in Continental Europe.

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8 For example compare the Italian and French language versions of the Regulation.

9 S1526(a) US Bankruptcy Code.

10 Rec. 19. Author's note: perhaps a reflection of the highly localized professionals working on insolvencies across most of Europe.

11 Art. 29.

12 e.g. Daisytek GmbH.

So, starting from a position of mutual hostility and mistrust. how are Practitioners going to implement the Regulation? There are four main areas that they need to consider:

– Who deals with which assets;
– How expenses and estate costs are to be controlled and allocated;
– How creditors are going to be handled in terms of communication and claims;
– How the closure of the case is to be effected.

Only four items, but experienced practitioners will recognize that together they amount to almost all the issues on the case!

Who deals with which assets?

This should be straightforward – the Secondary Liquidator handles the assets in his jurisdiction and the Main Liquidator gets the rest.[13] Article 2(g) sets out where the assets are deemed to be for the purposes of the Regulation under three headings:

Tangibles Property – the member state within the territory of which the property is situated.

This is straightforward. Any question over the word 'Property' is cleared by a look at the other languages that use terms akin to all physical objects (cf. the German: *Gegenständen*). Thus a table, a computer, a large piece of equipment are legally all where they physically sit.

Property and rights – ownership of or entitlement to which must be entered in a public register, the Member State under the authority of which the register is kept.

Again straightforward provided the practitioner is able to ascertain whether rights need to be registered. Problems do arise however in regard to:

(a) Property that should have been registered but has not actually been so. In practice this is rarely an issue because the failure to register usually removes the value from the asset anyway;

(b) Property registered outside the EU that would appear not to be covered by this section. Typical here would be a ship or aircraft registered under a flag of convenience. The author's view is that the intent of the legislators was to regard the property as wherever it is registered and therefore falling under the control of the Main Liquidator. However a German secondary seeing a Liberian-registered ship in Hamburg harbour may have a different view. particularly as the local harbour authorities may have a claim over the ship!

(c) Property registered centrally under EU-wide authority. Inter alia, this could cover patents and, in the future, shares in companies registered as 'European' rather than attached to any one country. In this case the issue of where the register is kept might be complicated by use of multi-site IT storage and maintenance.

More generally there is will be problems when for instance the Main liquidator (partly in an attempt to defeat a potential Secondary) hives down the tangible assets into the new corporate vehicle registered outside the Secondary territory.

Claims – the member state within the territory of which the third party required to meet them has the centre of his main interests as determined by Art 3(1)

This is where the problems really start! Numerous issues arise because this is not only counter-intuitive to many practitioners but also there is no clear mechanism for establishing the CoMI of a third party. With the debate on CoMIs still raging and in the absence of any court ruling (which court – the main, the secondary, that of a third party?) or indeed the question as to whether any court can determine the CoMI of a company outside the context of an insolvency filing, what are the (still possibly warring) practitioners to do?

The author tends to the practical here and recommends that the third party itself is asked to make a declaration as to his CoMI. This is not without difficulties however because:

(a) the third party may not be familiar with the Regulation and therefore lack the expertise (and the willingness to pay for advice) on the matter;

(b) the third party needs to be aware that such a declaration might have additional consequences if he or his creditors file for insolvency at a later date;

(c) the third party may have ulterior motives including the availability of set off and the allocation of costs;

(d) what happens if the Main or Secondary Liquidator (or even both!) disagree with the third party?

These are real issues that can only be considered on the merits of the particular case.

A further source of disagreement is the word 'claims'. By process of elimination it seems probable

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13 Art. 3(2).

that a claim is anything that is not a tangible property of a registerable asset. Thus it encompasses receivables, but also cash at bank and any other type of claim including litigation claims (unless one were to argue that litigation claims are 'registerable' with the court in which the litigation is taking place?). Again a look at the other languages tends to support this broad definition (e.g. *Forderungen* in German).

An interesting issue arises when a bank has a right to take an asset in settlement of an amount due but must remit any surplus to the company. Is the asset the original asset or the surplus that arises after settlement – the latter to be at the CoMI of the bank?

A further issue can arise when the claim is proposed litigation, for instance against directors for pre-filing misdemeanours, where by careful selection of CoMI the director may be able to defeat the actions of the Main or Secondary Liquidators.

A further point to note in the context of claims is that the location of intercompany accounts can be determined by considering the options to file for their insolvency proceedings to crystallize their CoMI.

How expenses and estate costs are to be controlled and allocated

This area is of course closely related to the preceding point since the concern only arises when there is a shortfall in one or other estate.

Particular care needs to be taken when dealing with continental filings where the practice of opening provisional proceedings ahead of formal opening is quite common. In these circumstances, the local law will determine how the costs incurred in the provisional phase would be allocated in a straightforward single jurisdiction case.

An interesting problem arose on *Daisytek* where the following sequence of event took place:

> 16 May 2003: Main (UK) proceedings opened;
>
> 19 May 2003: Provisional (German) competing main proceedings were opened;
>
> 10 July 2003: Full German main proceedings opened;
>
> 7 April 2004: Full German main proceedings revoked on appeal and German secondary proceedings opened.

The issue is who is responsible for the costs during the provisional and the subsequently revoked German Main proceedings given that the business had both traded and been substantially sold in the time covered by these proceedings. This is difficult even under German law but there is at least an argument that these should fall as unsecured in the subsequent German secondary, but the question remains whether these are caught as costs under the UK Main proceedings. In this particular case the UK Administrators argued that since they had no control over those costs and the contracting parties were on notice that the UK Administrators were appointed but had not commissioned the work, the Main proceedings would not recognize these costs as priority.

The lack of control over costs – itself a function of a lack of trust – is a major factor in preventing agreement on a cost-pooling agreement. One practical way around this is to consider a staff exchange. This would not only facilitate communication but also start the process of building a long- term relationship between practitioners.

The question of allocation of costs also requires consideration of the types of cost that are properly allowable as costs in the jurisdiction, as these are quite different across the continent. The two main areas are employee liabilities (including termination costs) and the continuation of pre-existing contracts. The Regulation says that contracts of employment shall be dealt with under the law of the employee's contract[14] but this hardly helps sort out the confusion!

How creditors are going to be handled in terms of communication and claims

Ultimately it is the creditors (including employees) who are most affected by an insolvency. It is the author's view that it is a duty of insolvency practitioners not to compound the write-off of debts with additional administrative burdens nor require them to take on unreasonable additional costs to protect their legitimate rights.

Thus, for example, the Italians require creditors to submit their claims to the court in Italian through a lawyer. But is it reasonable to expect a German dairy farmer to be familiar with the Italian proceedings, let alone know a good lawyer in Parma? The problem was resolved in the *Parmalat* case by preparing dual language versions of the claim form and inviting the farmers to submit their claims to a German agent of the Italian administrators for onward batch processing before the Parma court. That was relatively easy (once the Italian courts agreed to the process) because there was no secondary.

Now consider the confusion had there also been a German secondary liquidator asking for claims to be submitted in German in a different format and based on a different date for the opening of the proceedings.

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14 Art. 10.

The Regulation allows all creditors to claim in any or all proceedings;[15] however to do so is to invite administrative nightmare. The practical answer is for a joint letter to be sent by both (or all) liquidators to the creditors inviting them to submit claims only once and to do so in the location where their interests are best served. Some lawyers may baulk at this since they owe no duty of care to individual creditors and indeed may argue that the practitioner's duty to all creditors collectively means that they should endeavour to lower the priority of individual creditors wherever possible. However in most cases the priority levels of the creditors under each jurisdiction are easy for an experienced practitioner to determine and the matter should not therefore be contentious. Any residual problems can be dealt with on a case-by-case basis with most creditors benefiting from the simplified procedure and constructive help from the practitioners.

This is not the place to consider the wider context of the ranking of creditors under the regulation but the author will draw the readers attention to Recital 21 that states that

> in order to achieve equal treatment of creditors the distribution of proceeds must be coordinated.

Note the use of the word 'equal' here rather than equitable, implying that somehow all creditors should be equal – a concept which no country in Europe recognizes.[16]

A further problem always arises with regard to creditors' meetings. The timing and location of these is often set down in the local law. The continental approach is to hold such meetings in court under the supervision of the judge' whereas the English do not generally involve the court and say that the meeting should be held at a place which is convenient for the creditors. Here a little imagination is required if creditors are not going to be faced with multiple meetings. Provided it remains in compliance with UK rules[17] the English practitioner should recognize the difficulties of his continental counterpart and agree to hold his meeting at the court of the secondary. Where this is not possible then a little imagination is required. For instance, although the continental judge has no automatic right to sit in session outside his or her own jurisdiction, this can be achieved either by special request to a judge in the other location and/or by staging the meeting in such a way that any judicial decision that might be needed (e.g. to confirm proposals voted on by the creditors) can be reserved until the judge returns home.

Article 32(3) of the Regulation permits the participation of the liquidators in meetings of creditors, by extension including the right to sit on each other's committees. Although the extent of these powers and in particular the strength of voting power that each liquidator can carry in the other proceedings will be determined by the local laws governing general creditor power, this article can be used inter alia to push through proposals. It can also be used to apply persuasive pressure on liquidators fees!

Also on the subject of claims is the vexed question of cross-claiming between the liquidators. The Regulation sets out the following:

> The Liquidators in the main and any secondary proceedings shall lodge in other proceedings claims which have already been lodged in the proceedings for which they were appointed ...[18]

The issues here are numerous. Does the receiving liquidator have to verify the claim submitted by the other liquidator? In most cases (sadly), the approach taken will be that he does indeed have to verify the claim because (a) his local law requires him to verify all claims and more practically (b) he distrusts his fellow liquidator. This is not helpful, however, and arguably an ineffective use of the liquidator's time (and the creditor's money).

This still does not get over the core issue which is whether the cross claim is a single indivisible claim from one liquidator to the other or merely a batch of claims that the one submits to the other as agent for the individual creditor. The above wording does not clarify the point as even the use of the plural to the cross claim might easily be said to refer to a series of batched claims.

The wording, if taken literally, means that *all* claims lodged (my emphasis) should be cross-claimed, irrespective of whether the liquidator who received the original claim agrees with it or not. These leaves open the possibility of some smart arbitrage by creditors with disputed claims.

Equally the Regulation does not distinguish between claims that have been lodged and paid out (for example as preferential creditors) and those that have not received a distribution. Thus the bizarre effect could be that the unsecured creditors gain by benefiting from the submission of a claim on their behalf that is higher than the level of unsecured

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15 Art. 32(1) and 39.

16 cf. *European Commission v AMI Semiconductor Belgium* and Look Chan Ho (2005) 2(3) *International Corporate Rescue* 137–139.

17 cf. UK Insolvency Rules 1986, Rules 2.35(3) and 4.60.

18 Art. 32(2).

creditors. The subordination of inter-company claims in several jurisdiction compounds the problem.

The practical approach to cut through all of this is to agree that:

(a) The liquidators will confirm with each other that claims will not be subject to recheck. The legal point is avoided by appointing the other liquidator as agent for the purpose of checking the claim;

(b) Disputed claims will not be admitted, fighting any creditor on the matter where necessary;

(c) All other claims or all priorities will be treated as a single batch claim qualifying as unsecured in the other's jurisdiction.

How the closure of the case is to be effected

The Main Liquidator can apply for the closure of the secondary[19] but it would appear that the opposite is not the case. This makes sense because it would clearly be difficult for the Main proceeding to cease while the Secondary continues, not least because the definition of a Secondary requires there to be a Main Proceeding.

This however gives rise to two main difficulties – one of which is a particular problem for English practitioners:

– If the secondary is in the place of the Registered office, how can the company be finally dissolved other than by a local liquidation? Clearly the laws are different in each country but this is a point that needs to be considered early on. One alternative would be to seek a non-insolvency form of dissolution.

– Where the main proceeding comes to an end, for example by the completion of the tasks under the Administration, or where another procedure is required to distribute assets, can the Administration be converted into a new main procedure, since this would fall foul of the principle that there can only ever be one Main proceeding and any subsequent filings must be secondary?[20] Each of the English procedures is recognized by the Regulation as separate and distinct procedures[21] and therefore the switch from Administration to CVA or liquidation is fraught with problems including the loss of control to any Secondary still running elsewhere. The answer to this in an English context would seem to be s.428 scheme under s.425 UK Companies Act 1985.

Conclusion – don't try this at home

The forgoing outlines just some of the issues that practitioners need to consider when working with the Regulation. It is clear that a protocol will be needed whenever there is a secondary proceeding and the negotiation of that protocol is going to be long and difficult, especially if the secondary filing was hostile or the liquidators lack the expertise and experience to handle these cross-border cases.

An effective proceeding – main or secondary – under the Regulation will not be achieved by staying at home trying to carry out the case as if it were a local matter. Practitioners must be prepared not only to travel on specific cases but also to take time out at international conferences and even spend time working abroad to fully understand the issues at play

Those that look to the law – their own or that of the European Union – will not find all the answers. A practical, imaginative approach must be taken.

Trust is essential and it is the responsibility of every practitioner who wishes to use the Regulation to acquaint himself with the basic insolvency laws and with fellow practitioners across the Union. Equally the courts and/or creditors appointing practitioners to cases should consider carefully whether their appointee has the requisite skills.

Secondary appointments are destructive weapons. They almost always destroy value for the creditors and frequently destroy jobs. The basic rule of thumb isthat two insolvency practitioners mean three times the complications and cost. Therefore secondaries should be avoided wherever possible, even if this means conceding the priority claims of certain creditors.[22]

Where secondaries cannot be avoided, self-administration might be an answer[23] but this eminently practical approach is unlikely to find favour in many courts.

Where there is a secondary, the building of mutual trust between liquidators must be a priority. One means of doing this might be by agreeing a staff exchange but this too requires trust, to say nothing of the requisite language skills.

Nothing will be gained by trying to score points against each other in debates on the best insolvency system. Everybody already knows the answer – it is his or her own!

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19 Art. 34.

20 Art. 3(3).

21 Annex A and B.

22 cf. *Rover Espana SA and others*, Birmingham District Registry 11/5/2005.

23 cf. *Automold*, District Court of Cologne 23/1/04.