BRUSSELS: six points to consider when shifting COMI

Jack Barton, 23 August 2016

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A recent debate in Brussels considered the virtues of different insolvency regimes in the US and EU for the purpose of choosing a centre of main interest (COMI) – and found that forum shoppers are probably best off in America.

The debate was contested on six points and took place at the Fifth Annual Insolvency and Restructuring Congress in Brussels, held by the German Bar Association in partnership with Spain's Association of Insolvency Administrators on 16 to 17 June.

Dan Glosband, of counsel at Goodwin Law's Boston practice and one of the key authors of Chapter 15 of the US Bankruptcy Code, represented the US, while **Hervé Diogo Amengual**, a partner in the Paris practice of Latham & Watkins, conveyed the merits of a range of EU jurisdictions and encouraged participation from an audience of insolvency and restructuring practitioners from across Europe.

The neutral moderator of the debate, appropriately, was Swiss partner **Brigitte Umbach-Spahn** of Wenger Plattner in Zurich.

Tailoring proceedings

"Chapter 11 gives the US an advantage due to its flexibility", Glosband opened. A company only needs to demonstrate that it has minimal property in the US and that it would benefit from filing a case. That enables it to do insolvency planning and possibly a pre-pack restructuring. While Chapter 11 contemplates that the debtor and its management will remain in possession and control, they often engage chief restructuring officers (CROs), both to obtain experienced assistance and to provide comfort to creditors.

Diogo Amengual argued that many European jurisdictions had similar advantages in terms of flexibility, a variety of insolvency proceedings and a range of pre-insolvency proceedings. In France, he said, in insolvency proceedings, the management is only removed if they were gravely negligent or committed an offence; in most jurisdictions official administrators are appointed as part of initiating any official proceeding but, as in France, they essentially supervise management that remains in office.

Cram-down

Glosband again cited flexibility as a strength in the US system in regards to cram-down options and in generally dealing with contracts. He pointed out that US law provides avenues through which debtors can breach contracts or assign them to third parties – though it is required of debtors to negotiate with unions before resorting to court proceedings regarding employees' contracts.

Diogo Amengual said that the law of contractual obligations varied throughout European jurisdictions, with varying levels of rigidity surrounding the fallout of a failure to meet a contract that then leads to insolvency proceedings. In France there is no option to reassign contracts (with the exception of supply contracts in bankruptcy sales) but contracts cannot be terminated by the creditor for breaches prior to the insolvency proceedings whereas the court-appointed judicial administrator may terminate or continue contracts. In Germany it is possible to pick up a contract where it was left off.

The UK differs from many European jurisdictions as its parliament has, since the 1980s, held that contracts must stand even during an insolvency, Diogo Amengual noted. After being called on for his thoughts from the audience, Stephen Harris, an insolvency practitioner from Ernst & Young in London, added that with the exception of certain essential suppliers a contracting party may utilise the termination provisions in a debtor's insolvency, whereas insolvency termination provisions are of no effect in many other EU jurisdictions.

Harris said that this position is often debated in the UK. The concept of a targeted moratorium, whereby a debtor may target a supplier potentially for continuity of supply is considered an attractive proposition by some experts. This, followed by a class cram down, may assist a debtor in survival. Other experts believe such an approach detracts from the concept of survival of the fittest.

Harris suggested that the phrase "consenting supplier" – a creditor who is open to negotiating and forfeiting some of their contractual claims – has entered the insolvency vocabulary in the UK in recent years, meaning there could be more flexibility in contractual obligations on the horizon.

DIP financing

As regards debtor-in-possession (DIP) finance, Diogo Amengual pointed out that new money provided in conciliation proceedings (less formal amicable court-supervised restructuring proceedings) takes priority over secured creditors in France in the event of a subsequent insolvency, but that super-priority financing is not equally available in other EU jurisdictions.

In the Chapter 11 process DIP financiers are generally safe, said Glosband. He added that as the financing landscape in the US has evolved, with multiple layers of secured debt, there are few unencumbered assets to provide security for new DIP lenders. That means that new financing is now more likely to come from an existing creditor, as "creditors see the opportunity to gain leverage in proceedings."

Creditors' committees

Glosband highlighted that creditors' committees are well-established in the US and enable creditors to take an active role in the bankruptcy process.

Again, Diogo Amengual said the landscape in Europe was highly varied. In France, he said, creditors are divided up into 3 groups (the equivalent of classes) which all get to vote on plans (holders of bank, trade or bond debt), whereas the structure of creditor classes is more complex in jurisdictions such as Germany. He said it was worth noting that, while employees have no say in the process in France, their wages are protected (up to a cap) by a mandatory insurance mechanism.

With support from audience members from the two jurisdictions, Diogo Amengual briefly added that in Germany and the UK, the framework is better established and allows different classes of creditors to have some influence, though unsecured creditors usually have less influence in the UK.

Jurisdiction recognition

The one parameter in which the structure of the debate allowed the EU to come out on top was in cross-border recognition of COMI. Diogo Amengual pointed out that the EU, aside from Denmark, has an all-but-unified front on how to establish COMI.

Glosband noted that the US bankruptcy court's jurisdiction can be invoked over a debtor with minimal property in the US, including nothing more than a bank account. In practical terms, if the debtor's country of registration and its operations are outside the US, and key counterparties are not supportive of its Chapter 11 case, the US court cannot effectively enforce its jurisdiction outside of the country and the Chapter 11 case is likely not worth the expense.

Both sides conceded that the UK schemes of arrangement often lie outside these rules and can be frequently accessed regardless of jurisdiction – Glosband pointed out that there have been a number of examples of European companies using a UK scheme of arrangement that is then recognised by a US bankruptcy court.

Costs against return

Commenting finally on costs, Diogo Amengual noted fees are largely set by the market across Europe, and in France, the cost of the proceedings themselves (including those of the bankruptcy officials) are based on tariffs that are "not prohibitive".

"It's expensive," Glosband admitted succinctly, "but worth it".

In closing remarks, Umbach-Spahn declined to call a winner. However, she reflected that seeing the scale of the task that faced Diogo Amengual in representing a range of jurisdictions was perhaps most valuable for an audience that had gathered to assess the progress of harmonising insolvency laws across the EU.

Directors' liability – a new entry to the COMI debate

In addition to the debate on COMI, the day included a presentation from **Lucas Kortmann**, partner at Amsterdam insolvency boutique Resor, on recent developments in directors' liability in the European insolvency landscape. The Netherlands updated its legislation on directors' liability with a bunch of reforms that entered into force on 1 July.

Kortmann drew on the established principles of directors' liability under German law, which gave rise to interesting questions in a high-profile insolvency case last year.

In *Kornhaas v Dithmar*, the Court of Justice of the European Union ruled last December that German law on directors' liability should apply to a UK-registered company with its COMI in Germany, because the European Insolvency Regulation dictated that the law of the jurisdiction in which insolvency proceedings were filed should apply.

This ruling ran contrary to earlier precedent on directors' liability, which relied on article 49 of the Treaty on the Functioning of the European Union (TFEU) to determine which jurisdiction's law to apply: the place of registration or the COMI. Under the TFEU, a company established in one EU state with its operations in another, has its internal affairs governed by the law of the state of establishment.

In Kornhaas, it was notable that the German liability law cited in the case formed part of German insolvency law and the claim was brought in the context of insolvency proceedings, so it is understandable that the court should consider the Europe Insolvency Regulation's rules on COMI as the most appropriate way of ascertaining the relevant jurisdiction, said Kortmann.

But he imagined a situation in future in which insolvency practitioners might use inconsistencies in different legal regimes to bring liability claims against multinational companies under the laws of their places of registration or COMI, wherever is most favourable. For example, a Dutch administrator might find Dutch liability law to be advantageous: in the Netherlands a company's director can be another company, and the natural person who is the ultimate parent of this chain can be found liable for mismanagement of the company being administered. However, if the parent is a foreign-incorporated company, there might be uncertainty over whether liability can be traced to the natural person at the top of the chain.

This uncertainty could lead to a creditor or an administrator bringing an action in a different jurisdiction and undermining the harmonisation efforts of recent years, Kortmann said. It must be addressed, he argued, and in the meantime it must be borne in mind when it comes to considering choice of COMI.

The previous day of the conference featured an assessment of the progress Europe has made so far in harmonising European insolvency regimes, and the relative merits of pre-insolvency arrangements in different European jurisdictions.