

COMI, BANKRUPTCY TOURISM AND PROVING JURISDICTION*

INTRODUCTION

Recital 4 of the EC Regulation on Insolvency Proceedings No 1346/2000 (OJ L 160, 30.6.2000) states:

“It is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position (forum shopping)”.

Has this worked and why has the UK has become an “insolvency paradise”?

THE EC REGULATION: SOME BASIC PRINCIPLES

- The courts of the Member State within the territory where the debtor’s centre of main interests (“COMI”) is situated shall have the jurisdiction to open insolvency proceedings. In the case of a company or other legal person, the place of the registered office shall be presumed to be the COMI in the absence of evidence to the contrary (article 3(1), recitals 12 and 13).
- The COMI should “*correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties*” (recital 13).
- The law of the place where the main proceedings are opened (i.e. where the petition is presented¹) determines the conditions for the opening of those proceedings, their conduct and their conclusion (article 4).
- The judgment opening the proceedings produces the same effects in any other Member State as under the state of the opening of proceedings unless the EC Regulation provides otherwise, with the consequence that main proceedings

* This is an updated version of a paper given to the Insolvency Lawyers’ Association in February 2009 by Marcia Shekerdeman (11 Stone Buildings) and Mr Registrar Baister

¹ Re *Staubitz-Schreiber* [2006] ECR I-701 [2006] BPIR 510

opened in one Member State can affect the rights creditors in a different Member State (art 17).

- The “*time of the opening of proceedings*” means “*the time at which the judgment opening proceedings becomes effective, whether it is a final judgment or not*” (art 2(f)).
- “[T]o protect the diversity of interests”, secondary proceedings may be opened to run in parallel with the main proceedings; “*secondary proceedings may be opened in the Member State where the debtor has an establishment*”². “*The effects of secondary proceedings are limited to the assets located in that state*” (recital 12 and art 3(2) and (4)).
- The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible assets which are situated in the territory of another Member State (article 5).

WHAT IS COMI?

- Only one COMI per debtor (Mr Registrar Jaques in *Stojevic v OR* [2007] BPIR 141 at para. 6) (see also HHJ Howarth in *Skjevesland v Geveran Trading Company Ltd* [2003] BPIR 924).
- No definition of COMI in the EC Reg in the case of individuals.
- In *re Eurofoods IFSC Ltd* (Case C-341/04) ([2006] 3 WLR 309), the ECJ, discussing Recital (13) said:
“The concept of the centre of main interests is peculiar to the Regulation. Therefore, it has an autonomous meaning and must therefore be interpreted in a uniform way, independently of national legislation”
- The Virgos-Schmit report (on the original Convention on Insolvency Proceedings) is now universally accepted as an aid to interpretation of the EC Reg (see the European Court in *re Eurofoods*); see also *Official Receiver v Stojevic*, below).
- Paragraph 75 of Virgos-Schmit:
“The concept of ‘centre of main interests’ must be interpreted as the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.

² “*Establishment*’ shall mean any place of operations where the debtor carries out a non-transitory economic activity with human means and goods” (art 2(h)).

By using the term ‘interests’, the intention was to encompass not only commercial, industrial or professional activities, but also general economic activities, so as to include the activities of private individuals (eg consumers). The expression ‘main’ serves as a criterion for the cases where those interests include activities of different types which are run from different centres.

In principle, the centre of main interests will in the case of professionals be the place of their professional domicile and for natural persons in general, the place of their habitual residence ...”.

- Relevant “interests”: general economic ones, not “emotional” ones (see Chadwick LJ in *Shierson v Vlieland-Boddy* [2005] BPIR 1170) (also HHJ Howarth in *Skjevesland v Geveran Trading Company Ltd* [2003] BPIR 924).
- In the case of individuals, the COMI will be where the relevant interests are administered. Usually (but not invariably), the country of the debtor’s habitual residence, unless he/she is a professional person, in which case it may be the place of his professional domicile, or his main place of business, if he/she is carrying on business in his/her own right (see the analysis in *Stojevic* at paras 34-36).
- Ascertainability, see para. 75 of Virgos-Schmidt: the debtor’s visibility to potential creditors. Where can the creditors expect to find the debtor? See also HHJ McGonigal in *re Daisytek-ISA Ltd* [2004] BPIR 30.

HOW TO DETERMINE COMI: CASE LAW

Stojevic v Official Receiver (20.12.2006) [2007] BPIR 141

- Mr Registrar Jaques “*that the true inquiry...must be as to [the debtor’s] habitual residence*”.
- On the facts it was now clear that S’s COMI was in Austria. That was his place of 'habitual residence' within the meaning of para 75 of the Virgos-Schmit Report.
- Habitual residence and ordinary residence were very different and should not be confused
- Although S spent a considerable time in London, much of that time was spent in carrying out his duties as a shadow director of an English company.
- Being a company director and administering the affairs of that company does not equate to administering one’s own economic interests
- It would be wrong to equate S's indirect economic interests in the company with his own economic interests. (Applying *Salomon v Salomon* [1897] AC 22), the

separate personality of the company had to be respected. S was not conducting business in his own right, even if he did control the company.

- The Registrar found an analogy in the *Eurofoods* case, in which the COMI of an Irish registered subsidiary of an Italian registered parent was under consideration: “*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.*”
- Note the potential difficulties which can arise as a consequence of “*the fundamental difference between the English legal system, which is adversarial, and the Continental legal system, which is inquisitorial*”

***Official Receiver v Eichler* [2007] BPIR 1636**

A UK bankruptcy order was made against E, a German doctor on the basis that his COMI was in England and Wales and that the proceedings were main proceedings. According to the affidavit and statement of affairs sworn in support of the petition, he was employed by a UK company and was working in the UK as a locum consultant for radiology and nuclear medicine, and was earning £500 per month. His services were contracted the company of which he had been a director (he had now resigned). He had no significant assets. He had only three creditors totalling £206,700. All three creditors were in Germany. There were no UK creditors. The sum due to the two principal creditors arose as a result of a judgment given against the debtor in proceedings brought in Germany.

The Official Receiver applied to the court for directions as to whether or not the bankruptcy order should have been made on the basis that the debtor’s centre of main interests was in fact in Germany. The OR claimed that E’s COMI was in fact Germany, relying on the following

- i) The debts and the creditors were all in Germany;
- ii) E had moved to England in October 2006 and lived in temporary accommodation provided in connection with his employment.
- iii) His locum work was by its very nature temporary.
- iv) E’s wife continued to live in Germany.

- v) His earnings of £500 pcm. were a fiction. His services were contracted through a company of which he had been a director (he had now resigned); his wife remained a director, and the company was taking the benefit of his true earnings, leaving nothing for the Official Receiver to seek to attach by way of income payments. The set up was a sham to deprive creditors of money they might otherwise expect to go towards the payment of a dividend.
- vi) E had owned a property in Germany some time ago which had been transferred into his wife's name; proceedings to investigate and undo the effects of that transaction, if appropriate, could more conveniently be taken in Germany than from the UK.
- vii) The insolvency had arisen as a result of a judgment given against E in connection with his business affairs in Germany.
- viii) The conduct of the insolvency here, as opposed to in Germany, could be prejudicial to the creditors.

E's response (inter alia) was that:

- (i) He had genuinely moved to this country to work here and remained working here and to that extent his UK address was a true address.
- (ii) The move was not temporary and there was no evidence to support the contention that it was such. In common with many EU qualified doctors, he had come here to work as he was entitled to
- (iii) Although his wife remained in Germany, but he spent more time here in connection with his work than he did in Germany.
- (iv) The arrangements by which his services were contracted were not a sham. In addition to giving him a wage, the company which employed him paid for his accommodation and transport; it also arranged insurance, and there were other expenses which had to be covered.
- (v) His being here was not temporary, as his continued presence demonstrated.

Held: (Chief Registrar Baister) E's COMI was here.

- E was free to change his COMI from Germany to the UK.

- E continued to work here and there was no basis on which to conclude that his presence here was purely temporary.
- *“it is also plain that his habitual residence, in the sense of the residence where he is most often to be found, is here...To the extent that it may be relevant (which I doubt) it would also appear that his professional domicile is here if all the expression means is that it is the place where he is carrying on his profession at the present time”*
- The fact that E’s debts were all in Germany was not a relevant factor.
- There was no evidence that Dr Eichler’s creditors would be prejudiced. The Official Receiver or any trustee appointed would be obliged to investigate his affairs and realise any assets which may be available so as to pay a dividend to creditors irrespective of their location.
- Geographical convenience for the trustee was a matter which could properly be taken into account, either on consideration of the OR’s application or when the court considers whether or not to open proceedings.
- It was not appropriate to take into account whether the basis on which Dr Eichler was employed was a sham. This could be investigated in an English insolvency more conveniently than it could be in a German one.
- Even if it could be said that Dr Eichler’s presence here was purely temporary that would not necessarily, of itself, prevent his centre of main interests from being here³.
- There is no authority which establishes or even considers any “minimum” period of time which a person must spend in a Member State before it can be said to have become his COMI. A few days (or even a few weeks) would be unlikely to suffice because that would be at odds with conducting the administration of one’s

³ But what about the fact that E’s wife lived in Germany? Compare the approach of Mr Registrar Jaques in *Stojevic*, who took into account the fact that S’s wife continued to live in Vienna in concluding that S’s COMI was in Austria: *“it would be very odd indeed if the debtor and his wife had different habitual residence, given that they lived together as man and wife, together with their children, until the children went to university abroad”*.

interests in a place “on a regular basis” (as well as being at odds with the idea of an “habitual residence”)⁴.

MOVING COMI

Chadwick LJ in *Shierson v Vlieland-Boddy* [2005] BPIR 1170

“that there is nothing... which prevents a debtor’s centre of main interests from being changed from time to time”.

Mann J at first instance:

“I do not think that a deliberate attempt to remove oneself from the English jurisdiction is necessarily something undesirable or to be guaranteed against - since a centre of main interests can be changed, there is nothing necessarily wrong or sinister in making a choice to do it”

An individual debtor can easily move COMI⁵. This has given rise to the increase in forum shoppers. For the Courts, the availability of COMI migration has generated three particular questions:

1. At what stage is COMI to be determined? (A question of law)
2. Is it ever too late to change COMI? (A question of law)
3. Is the particular change of COMI genuine or a sham? (A mixed question of fact and law).

WHEN TO MOVE COMI? AND WHEN IS IT TOO LATE TO MOVE?

UK Case Law

Shierson v Vlieland-Boddy [2005] BPIR 1170

Held by the Court of Appeal:

⁴ See also *Re Ci4net.com Inc* [2004] EWCH 1941 (Ch), HHJ Langan QC, COMI must have some element of permanence).

⁵ In the case of companies, it may now be harder, depending on the national law. See ECJ’s decision in *Cartesio Oktato és Szolgáltató Bt* (C-210/06). Held: a national law restricting a company from moving its real seat to another EU Member State (where the company wished to retain its status as a company governed by the law of the Member State of incorporation) was not a restriction on the right of establishment and was therefore not contrary to EU law.

- A debtor could move his centre of main interests. “*There is no principle of immutability. A debtor must be free to choose where he carries on those activities which fall within the concept of 'administration of his interests'*”
- The debtor’s COMI had to be established at the point that the Court is required to decide whether to open insolvency proceedings – normally (where proceedings have been commenced by petition) at the hearing of the petition⁶;
- In determining COMI, the Court should have regard not only to what the debtor has been doing, but also to what he is perceived, on an objective basis:

“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...”

He must be free to relocate his home and his business. And, if he has altered the place at which he conducts the administration of his interests on a regular basis - by choosing to carry on the relevant activities (in a way which is ascertainable by third parties) at another place - the court must recognise and give effect to that.

It is a necessary incident of the debtor's freedom to choose where he carries on those activities which fall within the concept of 'administration of his interests', that he may choose to do so for a self-serving purpose. In particular, he may choose to do so at a time when insolvency threatens. In 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 scrutinise 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.” (Emphasis supplied)

- the country in which a debtor’s debts were incurred is not a relevant consideration in establishing where his centre of main interest might be⁷.

EC Case Law

⁶ In *Vlieland - Boddy*, the CA was considering an application to serve out of the jurisdiction, hence the time for determining COMI was on the hearing of that application.

⁷ Compare the case law under section 265(1) and its predecessor, which continues to apply to non EC Regulation cases. Business debts in this jurisdiction will be sufficient to found jurisdiction, see *Re Brauch* [1978] Ch 316, *Theophile v Solicitor General* [1950] AC 186.

Re Staubitz-Schreiber (Case C-1/04) [2006] BPIR 510.

S was in business as a sole trader in Germany until 2001. In April 2002 she moved to Spain to live and work there. She applied for a bankruptcy order in Wuppertal but the Amtsgericht refused to open the proceedings on the ground that there were no assets. The Landgericht dismissed her appeal against that order. She appealed to the Bundesgerichtshof which made a reference to the Grand Chamber of the European Court.

The question for the ECJ for preliminary ruling was:

“Does the Court of the Member State which receives a request for the opening of insolvency proceedings still have jurisdiction to open insolvency proceedings if the debtor moves his or her [COMI] to the territory of another member state after filing the request, but before the proceedings are opened or does the court of that other Member State acquire jurisdiction?”.

Whilst upholding the right of a debtor to change his COMI, the ECJ ruled that Article 3.1 of the EC Regulation had to be interpreted as meaning that the court of the Member State, within the territory of which the debtor’s COMI was situated at the time when she lodged her request to open proceedings, retained jurisdiction to open them even if the debtor moved her COMI to the territory of another Member State after lodging proceedings but before they were opened.

The Court held that the transfer of jurisdiction from the court originally seized of the proceedings to the Court of another Member State would be contrary to the objectives of the EC Reg, especially recital 4 (the avoidance of incentives for parties to transfer assets or judicial proceedings from one Member State to another). This objective could not be achieved if a debtor could move his COMI between Member States in the time between lodging his request for the opening of proceedings and the time of the delivery of judgment.

SUBSTANCE OR ILLUSION?

A question of fact and each case will be decided on its facts with evidence being called in the usual way. The threshold is “*substance not illusion*”, see *Vlieland-Boddy*, above. If facts are in dispute, the evidence must be tested in the usual way, with live evidence and cross examination, unless the untested evidence is plainly incredible. See *Vlieland-Boddy*, per Chadwick LJ at paras. 37-40 and 56, citing Rimer J in *Long v Farrer & Co* [2004] EWHC 1774 (Ch), [2004] BPIR 1218:

“It is by now familiar law that, subject to limited exceptions, the court cannot and should not [my emphasis] disbelieve the evidence of a witness given on paper in the absence of the cross-examination of that witness”.

RECENT DEVELOPMENTS

The secretary of state for business, enterprise and regulatory reform sought the winding up in the public interest of a number of companies providing services to German bankrupts; and the official receiver has recently made a number of applications for the annulment of bankruptcy orders said to have been improperly obtained on debtors’ petitions. Many have gone uncontested but for a recent case that was contested see *Re Mittelfellner* [2009] BPIR forthcoming.