IN THE HIGH COURT OF JUSTICE **No. of 2002**
CHANCERY DIVISION
COMPANIES COURT

IN THE MATTER OF ENRON DIRECTO SOCIEDAD LIMITADA
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

SKELETON ARGUMENT ON BEHALF OF THE PETITIONER

A Introduction

1 This is the skeleton argument on behalf of Enron Power Operations Limited (in administration) ("EPOL"), a creditor of Enron Directo Sociedad Limitada ("the Company"). EPOL seeks the making of an administration order in relation to the Company.

2 In accordance with the Insolvency Proceedings – Practice Note 1/2002, the administration petition states (and verifies) that the Company's centre of main interests is in England, that the EC Regulation on Insolvency Proceedings [Council Regulation (EC) No 1346/2000] ("the EC Regulation") applies, and that the proceedings will be main proceedings, as defined in Article 3 of the EC Regulation.

3 There are two witness statements in support of the Petition:-

3.1 The Witness Statement of Mr Lomas dated 4 July 2002.

3.2 The Witness Statement of Mr Cooke dated 4 July 2002.

4 The 2.2 Report is exhibited to the Witness Statement of Mr Cooke at "CKCC3" and to the Witness Statement of Mr Lomas at "AVL2". [For ease of reference, future references to the 2.2 Report are to the internal pagination within that report.]

B The Enron Group

5 Both EPOL and the Company are members of the Enron Group, one of the largest energy, commodities and services groups in the world. The ultimate parent company of the Enron Group is a US company, Enron Corp, which is in Chapter 11 in the US (Witness Statement of Mr Cooke, paragraph 2). A structure chart showing the

position of the Company within the Enron Group is at page 1 of "CKCC 2". Further details of the relationship between the Company and the Enron Group are contained in section 1 of the 2.2 Report (pages 2-3).

6 The direction and high level administration of all Enron European companies was centralised in London and carried out by EPOL, which paid all costs in the nature of payroll, travel, some information technology, professional fees, stationery and entertainment, before recharging them to group companies (Witness Statement of Mr Cooke, paragraph 3.4.3(viii)). As a result of this role, EPOL is a creditor of the Company in the sum of €1.5 million (Witness Statement of Mr Lomas, paragraph 1.6).

C Business of the Company

(1) Background

7 The Company is a Spanish incorporated company which was part of the energy services division of the Enron Group. The Enron Group consisted of a number of businesses which purchased gas and electricity from wholesale suppliers and sold them on to commercial consumers. In Europe these businesses traded under the umbrella of the Enron Direct division of the Enron Group. Further details of the trading activity of the Company are contained in Section 1 of the 2.2 Report (pages 3-4) and section 3.1 of the Witness Statement of Mr Cooke, paragraph 2.

8 The Enron Direct business was successfully traded in the UK, the Netherlands and was in the process of being established in Ireland. Following de-regulation in the Spanish electricity market in 2000, the Company was established with the intention that it would operate an Enron Direct business model in Spain. The Company's business was launched in July 2000 with the aim of exploiting the de-regulated Spanish market. The Company took advantage of the existence of Enron Energie Espana SL ("**EEE**"), which already operated as an Enron business in Spain. By using the Company as the agent of EEE, EEE's business was widened using the Enron Direct model. (Witness Statement of Mr Cooke, paragraphs 3.1.2, 3.2.1, 3.2.2)

(2) The nature of the Company's business

9 At the time of the incorporation of the Company, it did not hold a licence from the Spanish electricity regulator which would allow it to supply electricity to end user customers. EEE did hold an appropriate licence. The Company therefore contracted with customers as the agent for EEE. Customers paid by direct debit to the Company's pesetas bank account which was with a Madrid branch of Citibank International plc, a UK registered company. The agreement between EE and the Company is at pages 9 to 14 of "CKCC2". The exact relationship between the Company and EEE is unclear. (Witness Statement of Mr Cooke, paragraphs 3.2.1, 3.2.2, 3.2.4.)

10 The business relationship between EEE and the Company was managed by Jose Luis Gomez-Banovio ("Senor Banovio") on behalf of the Company and Paul Mead, an Enron employee based in London on behalf of EEE. (Witness Statement of Mr Cooke, paragraph 3.2.3.)

11 The Company eventually employed approximately 25 sales staff and EEE provided an accountant and an analyst. The Company also hired sales agents to identify and obtain business from, new customers. At the conclusion of trading in December 2001, the Company had approximately 450 customers and a turnover of approximately €12 million. (Witness Statement of Mr Cooke, paragraph 3.2.4.)

D The Centre of Main Interests of the Company ("COMI")

12 This administration petition is one to which the EC Regulation applies, since administration is within Annex "A" and the company is not an excluded entity within Article 1(2): see Article 2(a).

13 Any doubt as to the English court's domestic law jurisdiction to make administration orders in respect of Member State (any state within the EU except for Denmark) companies was removed by Regulation 5 of the Insolvency Act 1986 (Amendment)(No.2) Regulations 2002, which adds section 8(7) to the Insolvency Act 1986.

14 To establish international jurisdiction for a main proceeding within the Regulation, it is necessary to show that the COMI of the Company was in the UK (Article 3(1)). In

the case of a company, Article 3(1) establishes a fall-back presumption that, in the absence of evidence to the contrary, the COMI is the place of the registered office.

15 There is no definition of COMI in the EC Regulation itself. Recital 13 provides as follows:-

> "The 'centre of main interests' 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."

This is lifted almost word for word from the Virgos-Schmit Report referred to below.

16 The EC Regulation was originally intended to be a Convention in terms, for present purposes, nearly identical form to that of the EC Regulation. In that context, a report was prepared by Professor Miguel Virgos and Etienne Schmit, commenting on the provisions of the draft Convention and intended to be agreed between parties to the Convention. It is submitted that, although never agreed by the Member States and not binding, this Report gives an indication of the intentions behind the text negotiated by the parties to the Convention. Paragraph 75 of the Virgos-Schmit Report addresses the meaning of the concept of the COMI. That paragraph states:-

> "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.
>
> The rationale of this rule is not difficult to explain. Insolvency is a foreseeable risk. It is therefore important that international jurisdiction (which, as we will see, entails the application of the insolvency laws of that Contracting State) be based on a place known to the debtor's potential creditors. This enable the legal risks which would have to be assumed in the case of insolvency to be calculated.
>
> 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 (e.g. consumers). The expression 'main' serves as a criterion for the cases where these 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.
>
> Where companies and legal persons are concerned, the Convention presumes, unless proved to the contrary, that the debtor's centre of main interests is the place of his registered office. **This place normally corresponds to the debtor's head office.**" [emphasis added]

17 It can be seen that Recital 13 has simply taken the first, general wording of paragraph 75, which deals with all types of debtors. The part of paragraph 75 which deals specifically with corporate debtors is the last sub-paragraph. This in turn explains the fall-back presumption of the registered office as being the place which "….normally

corresponds to the debtor's head office." Accordingly, the "proof" required to show that the COMI is not the place of the registered office will usually be evidence to show that head office functions were performed, not at the registered office, but elsewhere, in another Member State. That is precisely the position here.

18 In the present case the evidence before the Court shows that the headquarters functions were carried out in England and therefore it is submitted that the COMI is in England.

19 No reported cases have decided the question of the COMI of a company, so far as researches have indicated. The only case we are aware of in relation to COMI is an unreported Dutch personal insolvency case, an unofficial translation of which is provided in the bundle of authorities.

20 The day to day operations of the Company were carried out by employees based in the UK, but also in Spain. As set out further below, and in detail in paragraph 6 of the Witness Statement of Mr Cooke, all of the principal executive, strategic and administrative decisions in relation to the financial and economic activity of the Company were conducted in London. The directors and head office decision makers were also based in London. In addition:-

20.1 The Company's main creditors, EEE and EPOL, knew that the Company was administered from London.

20.2 The employees were under local management, but would have been aware that local management reported to the director in London and that important human resources issues were dealt with in London.

20.3 The commercial agents responsible for dealing with customers negotiated their employment agreements with the central legal department in London.

20.4 Customers dealt with Spanish employees of the Company on a day-to-day basis. All customers (in particular those who were large in size) would have been subject to credit authorisation from London.

21 On a day-to-day basis, the Company was managed by two employees (Witness Statement of Mr Cooke, paragraph 3.3):-

21.1 Senor Giminez was responsible for commercial activity such as hiring sales agents. Senor Giminez was employed by Enron Europe Limited ("**EEL**"). Whilst Senor Giminez was employed in the business of the Company he was based in London but commuted regularly to Spain. In April 2001 Senor Giminez ceased his involvement with the Company and was appointed as a director of Enron Direct Limited ("**EDL**").

21.2 The general manager, Senor Banovio, was located permanently in the offices in Spain which the Company shared with EEE. Senor Banovio was employed by EEE. Day-to-day business decisions were taken by him in Spain.

21.3 Mr Cooke was based in London. He was involved in all high level decisions. There were no formal board meetings, but Mr Cooke met regularly with Mr Banovio in Spain or London. These meetings were conducted in English.

21.4 The reporting lines for these three officers of the Company are set out in paragraph 3.3.2 of the Witness Statement of Mr Cooke. In essence, all three reported to and were responsible to more senior employees who were either based in the US or in the UK.

22 As set out in paragraph 3.4.1 of the Witness Statement of Mr Cooke, the Enron business structure was slightly unusual.

22.1 The group was operated on global business lines. All business activity domiciled in Europe was controlled by EEL from Enron House in London.

22.2 When a local operation such as that conducted by the Company was set up, a limited element of power and responsibility was delegated to local management who were resident in the relevant jurisdiction.

22.3 The individuals appointed as directors, with executive responsibility, such as Mr Cooke in the case of the Company, were principally resident either in the UK or the US.

22.4 Mr Cooke states that in the case of the Company, the head office or headquarters function was exclusively based in London.

22.5 Local managers and business line directors, such as Mr Cooke, were required to acquire all of the administrative services such as human resources, finance and treasury from the administrative centre in London.

22.6 The purpose of this structure was to enable the Enron Group to ensure that it maintained uniform standards within all its business operations globally and to maintain central control of its operations.

22.7 As set out in further detail below, key functions involving human resources issues, regulatory affairs and finance and treasury functions were all handled at Enron House in London. Local management of the Company dealt with all the day to day affairs of the operation of the Company, motivating, managing and monitoring staff and negotiating contracts with new customers, generating bills, collecting revenue and monitoring performance. All higher level executive functions and administrative functions involving important business or strategic decisions or financial matters were exclusively controlled by directors or Enron Group staff based at Enron House in London.

23 As set out more completely in paragraph 3.4.3 of the Witness Statement of Mr Cooke, the following high level matters were dealt with at the head office in London while the lower level matters were dealt with in Spain.

24 In personnel matters, lower level decisions were taken in Spain, but administrative and higher level decisions were taken in England (Witness Statement of Mr Cooke, paragraph 3.4.3(i)):-

24.1 The recruitment and dismissal of junior staff was dealt with directly by Senor Banovio in Spain with the agreement of Mr Cooke, who was based in England.

24.2 If a prospective member of staff were being recruited at mid or senior level he or she would be interviewed in Spain by Senor Banovio and then proceed to a second interview, often over the telephone to the UK, with the central human resources team based in London.

24.3 At whatever level of employment, all procedural matters such as compensation, benefits, performance reviews and data management would be dealt with in London.

24.4 The Company's employment contracts were dealt with by Enron Europe's central legal team in London.

25 In relation to treasury management, the central treasury team was based in London. No financial authority was based in Spain. In addition (Witness Statement of Mr Cooke, paragraph 3.4.3(ii)):-

25.1 Until August 2001 the local Company management had authorisation to sign off invoices for payment in respect of sums up to £5,000. When Senor Gomez approved such invoices they were then sent to London for payment to be processed.

25.2 Any invoice involving a sum over £5,000 was sent to London for both approval and payment.

25.3 Therefore, for example, all employees of the Company and all major suppliers to the Company were paid on authorisation from London.

25.4 No financial authority was given to Senor Banovio or Senor Giminez in Spain.

25.5 The signatories on the bank account mandate of the Company were members of the central treasury team in London. Neither Mr Cooke nor the other directors of the Company were authorised to sign.

26 In relation to accounting procedures, most of these were dealt with in the UK (at least in part) (Witness Statement of Mr Cooke, paragraph 3.4.3(iv)):

26.1 Monthly management accounts were prepared by the Company's accountants in conjunction with an Enron financial controller based in London with responsibility for the Enron Direct business as a whole.

26.2 The main entries in the accounts (gross margins and operational expenses) were calculated by Graham Dunbar in London.

26.3 Mr Cooke, who was based in London, reviewed the monthly management accounts to monitor such things as gross margin levels and the level of operating costs of the Company.

26.4 Operating costs such as salaries and other overheads were re-charged from other Enron companies, usually EPOL, the Petitioner.

27 In relation to Spanish compliance issues, all Spanish regulatory and compliance issues were dealt with in London. For example, EEL dealt with the application to the Spanish regulator for a licence to supply electricity on the part of the Company (Witness Statement of Mr Cooke, paragraph 3.4.3(vii)).

28 The general administration of all Enron European companies was centralised in London and carried out by EPOL, which paid all costs in the nature of payroll, travel, some information technology. professional fees, stationery and entertainment, before recharging them to group companies. The Company was part of this system. (Witness Statement of Mr Cooke, paragraph 3.4.3(viii))

29 In relation to general supervision, all targets, budgets and margins were set initially in London. The performance of Senor Banovio, the general manager, was monitored by Mr Cooke from his base in London (Witness Statement of Mr Cooke, paragraph 3.4.3(ix)).

29.1 Mr Cooke, travelled to the Madrid office once every three to four weeks to review the business of the Company generally. Once a quarter Mr Cooke went to Madrid to discuss performance of the Company against budgets in a more formal manner.

29.2 Senor Banovio visited London on a more regular basis in order to review such matters as finance, human resources and other head office functions.

29.3 Mr Cooke was also directly involved in the authorisation of all sales contracts with a value in excess of €100,000.

29.4 Mr Cooke also arranged for the performance and approval of the credit checks required for all customers.

30 For the sake of completeness, and bearing in mind the obligation of full and frank disclosure, the Petitioner draws attention to the following facts which, it might be argued, affect the question of the COMI:-

30.1 The pricing policy in relation to contracts and the specific information technology systems were derived by using a software model which had been developed by Enron Direct (Witness Statement of Mr Cooke, paragraph 3.4.3(iii and v)).

30.1.1 even though the models had been developed in London the Company was effectively given permission to use them and adapt them for a Spanish model;

30.1.2 all the data in respect of the pricing model was inputted by employees of the Company in Spain and the ultimate prices were established form data obtained locally;

30.1.3 the specific information technology systems were migrated to a server in Spain;

30.1.4 the pricing activity was therefore dealt with in Spain, although the pricing policy was dealt with exclusively in London.

30.2 From the point of view of the customers the business of the Company was a Spanish business serving Spanish customers with Spanish goods - in this case electricity. The local Spanish management dealt with the hiring of the sales agents. Once a customer had been signed up, the local management dealt with arranging for the installation of an appropriate meter which it would later arrange to have read, recorded and monitored. The local employees then inputted the relevant data into the relevant software to generate an invoice which was then sent out from Spain. All of this activity was carried out from premises which the Company shared with EEE. EEE re-charged a cost element back to the Company. (Witness Statement of Mr Cooke, paragraph 3.4.3(vi))

Notwithstanding these facts and matters, it is submitted that the COMI was located in the UK.

31 In summary, most, if not all, high level decisions were taken by the directors of the Company in London. The head office functions were carried out in London.

E Insolvency of the Company

32 Following the worldwide failure of the Enron Group, EEE became insolvent under Spanish law solvency tests. A suspension of payments in Spain in relation to EEE began in December 2001, under the supervision of the Spanish courts. The licence of

EEE was suspended, and, as a result, the Company ceased trading. (Witness Statement of Mr Cooke, paragraph 4.1)

33 Upon ceasing to trade a number of customers had claims under the electricity supply agreement. The Spanish regulator settled such claims using the deposits which had been paid to it by EEE and the Company as a pre-requisite for obtaining a licence. (Witness Statement of Mr Cooke, paragraph 4.2)

34 There is a balance of the licence fee remaining with the regulator following settlement of all outstanding liabilities to customers by each of EEE and the Company. (Witness Statement of Mr Cooke, paragraph 4.2)

35 All but one of the Spanish staff were made redundant in January 2002. (The remaining employee is a junior IT manager, who is maintaining the Company's IT system and records.) (Witness Statement of Mr Cooke, paragraph 4.3)

36 The Company is insolvent on a balance sheet basis, with net liabilities of about €7 million (based on book values as at 31 May 2002). The solvency position is addressed in section 2 of the 2.2 Report (page 5) and section 5 of the Witness Statement of Mr Cooke. A summary balance sheet is at Appendix C to the 2.2 Report.

36.1 The Company's only assets are:

36.1.1 Cash at bank - €2.7 million, deposited in a Spanish branch of Citibank International plc, a UK registered company.

36.1.2 Fixed assets (intellectual property rights to software developed by EDL and adapted by the Company) of €46,000.

36.1.3 Contingent asset realisation of the Spanish regulatory deposit of €1.3 million

36.1.4 Inter-company receivables of €2.6 million (in respect of which minimal recoveries are expected).

36.2 The book value of the liabilities of the Company are:

36.2.1 Balance due to EEE - €10.7 million

36.2.2 Balance due to EPOL for central services - €1.5 million

36.2.3 Inter-company balances with other members of the Enron Corp totalling €0.3M

36.2.4 Trade creditors and employee claims €39,000

As a result, the Company is or is likely to become unable to pay its debts (within the meaning given to that expression in section 123 of the Insolvency Act 1986), and is also insolvent under its Spanish law equivalent.

F Urgency

37 As set out in section 7 of the Witness Statement of Mr Cooke:-

37.1 Although the directors of the Company presently remain in office, they wish to resign as soon as possible, as they no longer have full time involvement in the affairs of Enron, and are not in a position to deal effectively with the affairs of the Company. Further, under Spanish law, significant personal liabilities can attach to the directors of insolvent companies. The directors are concerned about their ongoing position and wish to see an appropriate insolvency process initiated as soon as possible.

37.2 In addition, the balance of the regulatory deposit which is due to be repaid to the Company from the Spanish regulator (some €1.3 million), needs to be dealt with. The Petitioner is concerned to realise these assets as soon as practicable.

G The purposes of the proposed administration

38 The statutory purposes for which the administration order in respect of the Company is sought are:-

38.1 a more advantageous realisation of the Company's assets than would be effected on a winding up, and

38.2 the approval of a voluntary arrangement under Part 1 of the Insolvency Act 1986.

39 These purposes are set out in sections 3 and 4 of the 2.2 Report. The proposed administrators intend to take steps to put a CVA to the creditors immediately after the granting of the administration order. In addition, the proposed administrators intend to:-

39.1 Realise any value in the Company's intellectual property rights.

39.2 Deal with the cash deposit held by the Spanish authorities.

39.3 Make the final member of staff redundant and agree all employee liabilities.

39.4 Arrange a fast-track and inexpensive dissolution of the Company in Spain.

40 In essence, the proposed Administrators believe that the most effective and expedient means of distributing value to the creditors and closing the affairs of the Company are for an administrator to realise the cash assets and make distribution through a CVA in England. In addition, an administration:-

40.1 Holds out the real prospect that there are available tax losses within the Company which an administrator may be able to surrender to other Enron Group companies, thereby increasing the funds available for distribution to creditors. This value would not be able to be realised in a liquidation.

40.2 Would avoid the extra burden of ad valorem fees.

40.3 Would be faster than a liquidation in England or in Spain.

41 The alternatives to an administration in England are as follows:-

41.1 A liquidation in Spain which, as set out above, is not the COMI and could therefore only be an Article 3(2) proceeding, having only territorial effect. In addition, such a procedure:-

41.1.1 Would take more time than an administration in England;

41.1.2 Would damage the prospect of realising value from the tax losses.

41.2 A liquidation in England which:-

41.2.1 Would damage the prospect of realising value from the tax losses;

41.2.2 Would lead to the imposition of ad valorem fees.

42 It is submitted that the best alternative, bearing in mind that the COMI is in England, would be for the administration to take place in England.

43 EEL is holding funds of approximately €2.7 million which will be available to the proposed administrators to finance the realisation of the remaining assets of the Company and the approval of the CVA. It is intended that the expenditure of those sums will achieve a more advantageous realisation of the tax losses which are assets of the Company, and that therefore, on balance, the creditors will be better off than they would be in an administration. (Witness Statement of Mr Cooke, paragraph 9)

44 No winding-up petition has been presented against the Company. There is no sheriff or other officer who is charged with an execution or other legal process against the Company or its property. No person holds a debenture which would enable them to appoint an administrative receiver of the Company. As far as the Petitioner is aware, there are no other proceedings pending in any Member State. (Witness Statement of Mr Cooke, paragraphs 10 to 11; Witness Statement of Mr Lomas, paragraphs 4 and 5)

45 The consent of the proposed administrators is at "CKCC 4". Those proposed administrators waive service of the petition on them and the requirement for the period between service of the petition and the date fixed for the hearing of the petition to be as specified in Rule 2.7(1) of the Insolvency Act 1986. (Witness Statement of Mr Cooke, paragraph 12; Witness Statement of Mr Lomas, paragraph 6.)

46 In the circumstances, the Court is requested to make an order in the terms of the draft Minute of Order.

4 July 2002

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SKELETON ARGUMENT ON BEHALF OF THE PETITIONER

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