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## *Cross-Border Allocation of Jurisdiction and the European Insolvency Regulation of 2000*

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# **Cross-Border Allocation of Jurisdiction and the European Insolvency Regulation 2000**

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## *Introduction*

The framework for dealing with cross-border insolvency acquires a new instrument within the European Union with the adoption on 29 May 2000 of the European Council Regulation on Insolvency Proceedings (the 'Regulation'). It will enter into effect on 31 May 2002.<sup>1</sup> The Regulation began its life as part of a proposal for a convention to supplement the treaty framework creating a common legal system within Europe following the foundation of the European Community in 1957. Fundamental principles providing for free movement of goods, services, employees and capital brought in their wake the need for the settlement of disputes and the availability of enforcement measures across the member states of the community so as to remove structural impediments to the free flow of commerce and the creation of the single market. Other treaties between the member states have in certain cases effected extensions of the treaty framework. In fact, much of the progress seen to date in the area of private international law has been achieved as a result of multilateral conventions between the member states, designed to secure the simplification of formalities governing the reciprocal recognition and enforcement of judgments.<sup>2</sup>

As part of the initial drafting work for the proposal that resulted in the Brussels Convention 1968, general questions about the nature and extent of any structure were put to the members of the working party. The conclusion was to the effect that certain fields of law were, by their nature, problematic and difficult to include in any broad-brush framework.<sup>3</sup> Although the work eventually produced was expressed to cover broad civil and commercial law, certain exclusions from its remit were felt necessary. These included areas of personal law rules, administrative law and insolvency law. The last of these areas was excluded because it was felt that a separate insolvency convention seemed to be the only method of achieving harmony in this area of the law. Work on an insolvency convention (the 'Convention') began in 1963, a draft being produced by 1970. This draft as designed ended up affecting even insolvencies without any discernible cross-border element and attracted considerable opposition. Over the years, problems were faced by successive working parties trying to complete a draft acceptable to member states. Some of these difficulties stemmed from a failure to take into account strongly held

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<sup>1</sup>OJ 2000 L160/1.

<sup>2</sup>Art. 293 (formerly 220), EC Treaty.

<sup>3</sup>See Muir Hunter, *The Draft Bankruptcy Convention of the EEC (1972)* 21 ICLQ 682 and *The Draft EEC Bankruptcy Convention: A Further Examination (1976)* 25 ICLQ 310 for views on an early text.

national views and the importance to certain jurisdictions of maintaining close scrutiny and control over the use of insolvency law as an economic tool. Despite this and a hiatus of many years while work on the convention seemed to fizzle out, a draft was produced which met with substantial agreement in the early 1990s.<sup>4</sup> This draft was approved for signature and seemed set to create a new framework for dealing with what had by then become a noticeable phenomenon: cross-border insolvencies with a consequent effect on the workings of the financial sector. It ran, as the official story would relate,<sup>5</sup> into a British Conservative Government that had withdrawn co-operation from European institutions in the wake of unresolved issues over the BSE crisis. One of the tactics used was to refuse to sign or adhere to instruments, of which the convention was one. As the signatures on the document were incomplete, the instrument failed to negotiate the final obstacle before entering into force.<sup>6</sup>

After many years of speculation over the possibility of the project being revived,<sup>7</sup> the project received a new lease of life through a joint proposal by Finland and Germany submitted to the Council of the European Union on 26 May 1999.<sup>8</sup> The proposal fell four-square with the aim of the European Community seeking to fulfil the terms of an overall initiative seeking to extend the framework for the mutual recognition of decisions in civil and commercial matters. This occurred as a result of earlier changes to the EC Treaty highlighted by the creation of a new Title IV covering judicial co-operation in civil matters. As part of the initiatives under this title, the Brussels Convention 1968 has also been updated in the form of a regulation that incidentally also streamlines the process for obtaining enforcement of judgments.<sup>9</sup> A draft programme of further measures for implementation of the principle for mutual recognition of decisions in civil and commercial matters has also been agreed.<sup>10</sup> Furthermore, since the appearance of the Regulation, there have been two further initiatives aimed at governing the reorganisation and winding up of, respectively, insurance undertakings and credit institutions.<sup>11</sup> These initiatives are necessary because of the exclusion from the Regulation of a number of bodies, also, in addition to the above, including investment undertakings holding funds or securities for third parties and collective investment undertakings.<sup>12</sup> It is probable that further instruments will be forthcoming with respect to these bodies as the view that has been taken is

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<sup>4</sup>The final draft was opened for signature in Brussels on 23 November 1995 for a period of six months.

<sup>5</sup>A different and unofficial story relates that Britain's concern at the reluctant inclusion of Gibraltar within the scope of the convention led to the failure to adhere.

<sup>6</sup>See Balz, *The European Union Convention on Insolvency Proceedings* (1996) 70 ABLJ 485; and Fletcher, *The European Union Convention on Insolvency Proceedings: An Overview and Comment, with US Interest in Mind* (1997) 23 BJIL 25.

<sup>7</sup>See Rajak, *Whither the Euro Bankruptcy Convention?* (1998) 6 IL&P 317 (editorial).

<sup>8</sup>OJ 1999 C 221/8.

<sup>9</sup>Council Regulation (EC) No. 44/2001 of 22 December 2000 OJ 2001 L12/1.

<sup>10</sup>OJ 2001 C12/1.

<sup>11</sup>Directive 2001/17/EC of 19 March 2001 OJ 2001 L110/28 and Directive 2001/24/EC of 4 April 2001 OJ 2001 L125/15 respectively.

<sup>12</sup>Preamble No. 9 and Article 1(2), Regulation.

that all the initiatives are essential to secure the proper functioning of the internal market in cross-border insolvency proceedings.<sup>13</sup>

### *The Question of Jurisdiction*

The commentators on the Convention and its successor Regulation have focused, insofar as a multiplicity of issues present themselves in the texts, on the question of jurisdiction. There are two fundamental choices that can be made in the context of proceedings, which are the choice of forum and the choice of law. There is an argument that through the selection of a forum, the second choice becomes easier to determine, since courts are more likely to wish to use the rules they are familiar with. As a result, courts will reduce the exceptions by which foreign legal orders are admitted and thus, apart from questions of renvoi and dépeçage admitted in private international law rules, seek to apply their own law to the problem. Arguably, the choice of law in a contract or through the use of the facilities offered in any legal system will often also determine the appropriate forum for the hearing of issues relating to the accomplishment of these acts. In insolvency, jurisdiction may be said to be the first issue to be determined and on this basis, understanding how national courts will use the jurisdiction rules in the Regulation is of primary importance. The work on the Regulation also represents an important part of the overall initiatives of the European Community in the area of company and insolvency law reform which are likely to continue well into the next century.

### *A Scenario for Conflict*

At a conference in 1998, organised under the auspices of the British Institute of International and Comparative Law,<sup>14</sup> one of the speakers, Gabriel Moss QC, circulated the following problem, based on the jurisdiction rules of the Convention. The problem runs as follows:

“X is incorporated in England. Its main centre of interests is in France. It has two distinct businesses. The business in France is unprofitable and can not be rescued. The business in England is profitable and could be rescued. A number of jobs and the fate of various suppliers in England depend upon the business in England being saved. If all the facts related to England, an Administration Order could be made with a view to saving the company and the profitable part of its business by a Corporate Voluntary Arrangement and/or sale as a going concern of the profitable part. If the draft European Insolvency Convention were in force and liquidation proceedings were begun in France prior to proceedings in England, it would be impossible to have an Administration Order or Corporate Voluntary Arrangement in England because of Article 3(3) of the Convention.”

Updating this example to the rules now contained in the Regulation, it is possible to put the jurisdiction rules to the test by using the problem as one of

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<sup>13</sup>Legislative Observatory Procedure Files on later instruments, available from European Union website at <[www.europa.eu.int](http://www.europa.eu.int)>.

<sup>14</sup>Held at Charles Clore House, Russell Square. London on 14 July 1998.

the possible scenarios to be encountered when dealing with the phenomenon of cross-border commercial links and incorporations.

### *The Doctrinal Conflict*

A company is required to have assigned to it a connection with a particular country in order for rights and obligations to which it is subjected to be capable of determination by the appropriate law.<sup>15</sup> Traditionally, tests used to enable the allocation of a jurisdiction include presence, often used to determine whether a company is present for the purposes of litigation, residence, of major significance in determining whether a company is subject to tax, domicil, often governing questions of status of the incorporated body, and nationality, referring most often to the location of incorporation.<sup>16</sup> These tests are confusing and often overlap in their definition. The process of determining the appropriate law is often refined through the identification of further factors, including whether business is being carried out within the jurisdiction, whether there is a registered office, branch or other presence, whether management or control is exercised from the jurisdiction and whether assets or obligations are present.

Within the European Community, a number of states, Denmark, Finland, Ireland, the Netherlands, Sweden and the United Kingdom, adhere to the 'state of incorporation' doctrine, according to which the applicable law is that of the jurisdiction where the company was incorporated. In the United Kingdom, the domicil and nationality tests both rely on the state of incorporation doctrine. Only where residence is at issue is there a difference. Here, place of incorporation is only one of the evidentiary factors to be considered when ascertaining where control of the company, defined as the seat and directing power of the affairs of the company, resides and thus where the company itself is to be regarded as resident.<sup>17</sup> This difference is justified in the case law by the need to subject the activities of the company to taxation where the exercise of management properly occurs and the real business of the company is carried out.<sup>18</sup>

By way of contrast to the state of incorporation doctrine, other European states, including Austria, Belgium, France, Germany and Luxembourg, operate the 'real seat' (siège réel or Sitztheorie) doctrine. The effects of the real seat doctrine are complex and differ between states that acknowledge its use, depending often on the precise context in which it is sought to apply the principle. In Austria, the law states that the personal law of the company is the law of the state where the company's decisions are actually taken.<sup>19</sup> In France, the Civil Code states that companies whose seat is to be found on French territory are subject to French law. The law also states that third parties are entitled to assume that the location of the statutory seat raises a

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<sup>15</sup>North and Fawcett, *Cheshire and North's Private International Law* (1992) Butterworths at 171.

<sup>16</sup>Ibid at 171-5.

<sup>17</sup>The rule in *Cesena Sulphur Co v Nicholson* (1876) 1 Ex D 428.

<sup>18</sup>The rule in *De Beers Consolidated Mines Limited v Howe* [1906] AC 455.

<sup>19</sup>Article 10, Law governing Private International Law (IPRG).

presumption of jurisdiction, although the company itself may not rely on this fact where the real seat is considered to be elsewhere.<sup>20</sup> A French court will examine whether the location of the seat corresponds to the reality of business activity. Where the seat located overseas is deemed a fiction because in reality the board of directors operates in France, this fact would give jurisdiction.<sup>21</sup> Also, French insolvency law goes beyond the real seat doctrine and states that French courts are competent to conduct insolvency proceedings, even in the absence of a seat in France and notwithstanding that the foreign seat may be real, where the company's centre of business interests is deemed to be located within the jurisdiction.<sup>22</sup>

### *The Doctrines at European Level*

The place of these apparently conflicting doctrines in European law is debatable. The view of the European Court of Justice is that “[companies] exist only by virtue of the varying national legislation which determines their incorporation and functioning. ...In defining, in Article 58, the companies which enjoy the right of establishment, the EC Treaty places on the same footing, as connecting factors, the registered office, central administration and principal place of business of a company.”<sup>23</sup> An early convention was produced in 1968 by the Council of Europe to regulate the establishment of companies across boundaries and between convention states.<sup>24</sup> This convention defined a company as any company or body constituted on the territory of one of the convention states with its registered office on the territory of that state.<sup>25</sup> Although at first sight consonant with the state of incorporation rule, the application of convention rights was to be made subject to the ‘existence of a genuine and continuing connection between the company... and the economy of [the state]...’ echoing the real seat test.<sup>26</sup> A parallel convention within the European Community, designed in 1968 to produce rules for the mutual recognition of companies and other legal entities, remains without effect due to insufficient ratifications.<sup>27</sup>

In the Brussels Convention of the same year, the question of jurisdiction is left open with the text stating that the seat of the company or other legal entity is to be treated as its domicile for the purposes of the convention. However, the determination of the seat is a matter to be left to the rules of private international law of the court in question.<sup>28</sup> Commentators have also noted that Article 2 on jurisdiction over actions does not seemingly take account of business reality in that it fails to provide for the situation where a company has

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<sup>20</sup> Article 1837, Civil Code.

<sup>21</sup> CA Paris, 9 July 1960, *Juris-Classeur Commercial* fasc 3130 para. 31.

<sup>22</sup> Article 1, Decree no. 85-1388 of 27 December 1985. See *Cassation civile*, 21 July 1987, D 1988.169.

<sup>23</sup> *R v HM Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc* (C-81/87) [1988] ECR 5483 at paras.19-21.

<sup>24</sup> European Convention on the Establishment of Companies of 20 January 1966.

<sup>25</sup> *Ibid.*, Article 1(1).

<sup>26</sup> *Ibid.*, Article 1(2).

<sup>27</sup> Convention on the Mutual Recognition of Companies, Firms and Legal Persons of 29 February 1968, adopted as a measure under Article 293, EC Treaty.

<sup>28</sup> Article 53, Brussels Convention 1968.

an economic presence in a state by virtue of its business links there. According to this view, the allowance for jurisdiction in Article 5(5) arising from the activities of a 'branch, agency or other establishment' is unduly narrow and does not form an all-encompassing definition that can take into account the myriad of methods by which businesses can transact.<sup>29</sup>

The implementation of the Brussels Convention in the United Kingdom has led to a complicated statement of the rules by which the seat is to be determined. Under this, the criteria include incorporation within the jurisdiction and location of its registered office or other official address or, alternatively, the fact that central management and control is exercised within the jurisdiction.<sup>30</sup> The same test is performed by the courts in the United Kingdom to determine whether the connection is in fact with another jurisdiction.<sup>31</sup> However, to avoid mutual renvoi leading to the company being regarded as not having the seat in either jurisdiction, the law also provides that if the foreign courts would not regard the company as having its seat there, a British court should accept this determination.<sup>32</sup> The Brussels Convention does not explicitly state what should happen to resolve a conflict where jurisdiction is simultaneously claimed by two courts, although it does provide that where actions come within the exclusive jurisdiction of more than one court, courts other than the one first seised must decline jurisdiction.<sup>33</sup> The European Court of Justice has never really expressed a preference for either doctrine under European Community law, although it has stated:

"It must therefore be held that the Treaty regards the differences in national legislation concerning the required connecting factor and the question whether - and if so how - the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions."<sup>34</sup>

The recent judgment in *Centros*, handed down by the European Court in 1999,<sup>35</sup> is being interpreted as an implicit preference for the state of incorporation doctrine. The case involved the use of an incorporation form in the United Kingdom to run, through the establishment of a branch, retail activities in Denmark. The promoters of the company made no secret of the fact they wished to circumvent Danish rules governing the paying-up of a minimum capital amount.<sup>36</sup> The Court held that they were entitled,

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<sup>29</sup>See Fawcett, *A New Approach to Jurisdiction over Companies in Private International Law* (1988) 37 ICLQ 645 at 657-9.

<sup>30</sup>s42(3), Civil Jurisdiction and Judgments Act 1982.

<sup>31</sup>*Ibid.*, s42(6).

<sup>32</sup>*Ibid.*, s42(7).

<sup>33</sup>Article 23, Brussels Convention 1968.

<sup>34</sup>*Daily Mail* case at para. 23. However, there is a proposal extant for a further Company Law Directive to regulate the terms of any cross-border transfers.

<sup>35</sup>*Centros Ltd v Erhvervs- og Selskabsstyrelsen* (C-212/97) [1999] I ECR 1459; [1999] 2 CMLR 551.

<sup>36</sup>Set at DKK 200,000 by Law no. 886 of 21 December 1991.

nevertheless, to rely on freedom of establishment provisions.<sup>37</sup> Curiously, however, no explicit mention is made in the body of the judgment of either doctrine, although commentators in Austria and Germany are interpreting it as the death-knell of the real seat doctrine.<sup>38</sup>

The move away from the real seat doctrine at European level would, it is said, have consequences for the status of what are known in Germany as 'dual-resident corporations', especially with respect to their treatment for taxation purposes.<sup>39</sup> Some commentators in Germany have argued that the real seat theory is in any event incompatible with European law.<sup>40</sup> The judgment points the way to the theory declining in utility as it clear that jurisdictions cannot seek to apply their own domestic law to foreign companies on the basis of private international law rules that would have the effect of re-qualifying the nationality of a company lawfully formed elsewhere.

The Centros case implicitly states that national legal principles, mandatory for domestic companies, cannot be imposed wholesale on companies that emanate from other jurisdictions. This view may be seen as promoting a full faith and credit system as applies in the United States to mutual recognition of the validity of laws. In light of this, the High Court in Austria has recently held, in two separate cases, that an application to be noted on the Commercial Companies Register could not be refused.<sup>41</sup> This was despite the fact that in one case, the facts involved the branch of a company incorporated under the law of a member state of the European Union, where on the evidence the company had its real seat in Austria.<sup>42</sup> However, there has been an attempt at qualifying the state of incorporation theory as an exception to the real seat rule in a case before the Frankfurt Higher Regional Court,<sup>43</sup> where the court stated that it would normally apply the real seat rule. However, on the facts, no real seat could be discerned as the articles prohibited management from meeting or conducting business in the state of incorporation. Furthermore, the company was managed from locations that changed frequently, leading the court to prefer the law of the state of incorporation to determine the issue at stake, the capacity of the company to act in legal proceedings.<sup>44</sup>

### *Jurisdiction Rules in the Regulation*

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<sup>37</sup>Article 48, EC Treaty.

<sup>38</sup>See Micheler, The Impact of the Centros case on Europe's company laws (2000) 21 Co Law 179 at fn. 2 for a list of some 20 Austrian and German commentaries published up to late 1999.

<sup>39</sup>See Looks, Dual Resident Corporations following ECJ's Centros Decision (2000) <usserve.us.kpmg.com/intlserv/intcorpt/pubs/gernews/190.html> for an outline of the currently applicable tax regime.

<sup>40</sup>See Werlauff, Using a Foreign Company for Domestic Activities (2000) <www.rws-verlag.de/volltext/centros4.htm> citing Behrens, *Rabels Zeitschrift* 1988 at 498 and Schümann, *EuZW* 1994 at 269.

<sup>41</sup>OGH 15.7.1999 (6 Ob 123/99b); OGH 15.7.1999 (6 Ob 124/99z).

<sup>42</sup>See Strommer, Freedom of Establishment as it affects the Registration of a Foreign Company's Branch (2000) <www.europeanlawoffice.com/ld.cfm?Newsletters\_Ref=1015>.

<sup>43</sup>Judgment of 23 June 1999 (ZIP 1999, 1710).

<sup>44</sup>See Looks, Place-of-Incorporation Theory applied to English Off-shore Company (2000) <usserve.us.kpmg.com/intlserv/intcorpt/pubs/gernews/193.html>.



A compromise between the conflicting doctrines has been attempted in the Regulation with the text stating that the courts of the state where the centre of the debtor's main interests is to be found will have jurisdiction. These proceedings are referred to in the convention as main proceedings, which may be both rescue and liquidation type proceedings. In the case of a company or legal entity, the location of the registered office is presumed, unless evidence is brought to the contrary, to be the centre of the debtor's main interests.<sup>45</sup> The court in whose judicial district an establishment belonging to the debtor is located may also exercise jurisdiction. However, the effect of this type of proceedings, referred to as territorial proceedings, is limited to assets situated within the jurisdiction.<sup>46</sup> 'Establishment' is defined to mean a place where the debtor carries out economic activity of a non-transitory nature with human means and assets.<sup>47</sup>

The convention provides for the maintenance of simultaneous proceedings in many states. Nevertheless, it states that where main proceedings are in existence, any territorial proceedings whether opened prior or subsequently are secondary in nature. This is an important qualification as secondary proceedings are limited to liquidation type proceedings.<sup>48</sup> Territorial proceedings may occur in time before main proceedings where the latter can not be initiated because of a legal impediment or where a creditor in a convention state initiates proceedings over a debt acquired or dispute arising in that state.<sup>49</sup> If territorial proceedings are opened before main proceedings in time and are of the rescue type, the liquidator in main proceedings is given the option to request they be converted to liquidation proceedings.<sup>50</sup>

#### *A Situation of Conflict: The 'Centre of Main Interests' Definition*

There is potential for conflict if two jurisdictions purport to open main proceedings independently in time. This is because the definition of 'centre of main interests', a term which echoes that found in French law, is not to be found in either the Convention or the Regulation.<sup>51</sup> A guide to whether the courts of a particular European Community member state will exercise jurisdiction may lie in whether the court concerned subscribes to the real seat or state of incorporation doctrines and how, in light of this, it chooses to interpret the phrase. As the above rules apply to the problem, at first sight the fact of incorporation in England would afford the courts in England jurisdiction to open main proceedings. These could then take the form of any orders that would have the benefit of allowing preservation of the business. This is, however, only a presumption in favour of exercising jurisdiction. Proof that the centre of main interests lies elsewhere could displace this and afford the

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<sup>45</sup>Article 3(1).

<sup>46</sup>Article 3(2).

<sup>47</sup>Article 2(h).

<sup>48</sup>Article 3(3).

<sup>49</sup>Article 3(4).

<sup>50</sup>Article 37.

<sup>51</sup>The *Virgos and Schmit Report*, which accompanies the Convention, does attempt a definition of the 'centre of main interests' as 'the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties (para. 75).

courts of another jurisdiction, in this case France, the opportunity of opening proceedings, which would qualify as main proceedings. On the assumption that, under the private international law rules applicable in both England and France, both countries would be prepared to exercise jurisdiction, the qualification of which proceedings are to be regarded as main and which secondary becomes quite important.

The commentary accompanying the predecessor Convention addressed this question, by stating that no express rule was provided to resolve cases of concurrent jurisdiction, as 'such conflicts of jurisdiction must be an exception, given the necessarily uniform nature of the criteria of jurisdiction used.' According to the commentary, courts faced with this question are expected to take account of Convention rules by which each court is obliged to verify its own international jurisdiction. In addition, there is mentioned the principle of Community trust according to which once the first court of a member state has made a decision, other courts are bound to recognise its competence. Furthermore, principles of procedural law that are valid in all member states or that are derived from other Community Conventions might be of application, the example given being of the Brussels Convention.<sup>52</sup> Nevertheless, a situation of conflict is potentially an issue, especially when one considers the importance of insolvency generally to national interests because of the overwhelming economic nature of insolvency and its impact on economic planning.

### *The Application of Game Theory*

Cheffins argues that an understanding of the rules applicable in any conflict situation may be achieved through the use of a model of game theory.<sup>53</sup> This would be constructed by putting in contrast the relative preferences of two opposing parties in order to ascertain how the exercise of the choices available would lead to outcomes that may be hierarchically ordered. The outcome of the interaction between participants with these opposing objectives might also be ordered in terms of a determination of preferences from best to worse on a utilitarian basis. An alternative basis would be to characterise the outcome by relation to a rational ordering of choice, in that participants are understood not to prefer or select irrational outcomes merely because they might be available as part of the range of options available. Whatever the model used for determining the result, this hierarchy of preferences is often used in economic and market theory to test predetermined preferences for choices. This would ultimately have a bearing on the outcomes that may themselves be predetermined as choices.

A summary of the game theory model might illustrate the options available in the above case:

England	
Main	Secondary

<sup>52</sup>Virgos and Schmit Report at para. 79.

<sup>53</sup>See Cheffins, *Company Law Theory Structure and Operation* (1998) OUP at 10-13.

France	Main	Conflict Situation (although the result would allow rescue of the English business and liquidation of the French business)	Liquidation of both businesses (the French because it can not be rescued and the English because secondary proceedings can only be liquidation)
	Secondary	Rescue of the English business and liquidation of the French business	Unlikely Situation (although the result would also be the liquidation of both businesses) <sup>54</sup>

From the above schematic, it can be seen that the most favourable outcomes for the English business occur when the English courts take jurisdiction and open proceedings they can qualify as main proceedings, irrespective of what the French courts may decide. However, as has already been shown by the experience of the Brussels Convention, it may well be the first court seised that has the upper hand insofar as the control and direction of proceedings is concerned. This is irrespective of any later debate, when another court comes to intervene, as to which proceedings are to be accorded priority.

In fact Johnson, in an analysis of the rescue paradigm under the Convention, conducts a similar exercise with regard to competing main and secondary proceedings. Where only assets exist in other jurisdictions, the home jurisdiction may open main proceedings, which will most approach the unity and universality paradigm. In situations where it may be necessary to agree with creditors as to the terms of their participation in main proceedings, disagreement may result in secondary proceedings being opened at a creditor's behest or indeed by the liquidator in order to gather in particular assets. However, Johnson's main concern is directed at situations where business activity in other jurisdictions may result in qualification of the status of an establishment. In this case, depending on the bias of certain jurisdictions towards or away from corporate rescue, the chances of rehabilitation may indeed depend on which court is fortuitously seised first. The most problematic situation would be where secondary proceedings are commenced as rescue proceedings and are then followed by main proceedings of a liquidation-type. In this instance, the liquidator in main proceedings may well require the conversion of secondary proceedings to liquidation, a factor that could impede the rescue of a 'marginally profitable establishment' with potential for rescue. A solution he advocated might well consist of a more

<sup>54</sup>The Virgos and Schmit Report does allow for the possibility of two or more territorial proceedings existing simultaneously without there being main proceedings in the state where the centre of main interests is located (para. 39).

flexible interpretation of the 'centre of main interests' definition to take account of the prevailing economic reality.<sup>55</sup>

### *History of Conflict*

French and English courts have often had, in the past, occasion to come into conflict over jurisdiction. Some of these conflicts can relate to questions of substantive law and understanding the differences in application these make to the proceedings afoot. A particular instance is the impact of insolvency on the crystallisation of a floating charge and the subsequent entitlement of the creditor to assets.<sup>56</sup> Other conflicts relate to the grounds for asserting jurisdiction. Still others rest on the effect that recognition would have on own interests as is shown by the case where a French company subject to insolvency proceedings was nevertheless held not to have been discharged from liability for a contract made and to be performed in England.<sup>57</sup> In fact, in a related case, the English courts have held they would not recognise the purported termination of a contract subject to English law by the fact of insolvency affecting one of the parties elsewhere.<sup>58</sup>

Some co-operation has nevertheless been evidenced in the case of a court agreeing to set aside service issued by a trustee in bankruptcy where the substance of a contract entered into between the debtor and third parties provided for submission to the jurisdiction of the Commercial Court in Paris.<sup>59</sup> The nature of relief granted under any co-operation might, however, still be subject to local considerations, as in the case where an English trustee in bankruptcy sought to exercise powers to sell assets in France. The Paris court held in principle that nothing would prevent an English judgment of this type receiving recognition through an exequatur. However, the court could not give the trustee powers that would normally only be exercised by a French insolvency administrator and would also subject the sale of assets to prior verification of the entitlement of the trustee to the assets.<sup>60</sup>

### *Testing the Hypothesis*

For the sake of testing the hypothesis exposed in the problem, it will be assumed that the French courts have been seised first and will purport to exercise jurisdiction. In light of the game theory analysis and any conclusions that may be illustrated by previous instances of conflict, an examination follows of, firstly, the traditional rules permitting the exercise of jurisdiction by French courts and, second, what procedure the courts will be likely to follow. Consideration will then be given to the likely effect of the Regulation in these areas.

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<sup>55</sup>See Johnson, *The European Union Convention on Insolvency Proceedings: A Critique of the Convention's Corporate Rescue Paradigm* (1996) 5 IIR 80 at 101-105.

<sup>56</sup>See Collins, *Floating Charges, Receivers and Managers and Conflicts of Law* (1978) 27 ICLQ 691; Dahan, *La Floating Charge: Reconnaissance en France d'une sûreté anglaise* (1996) 2 JDI 381.

<sup>57</sup>*Gibbs & Sons v Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399.

<sup>58</sup>*Tharsis Ltd v La Société des Métaux* (1889) 58 LJ QB 435.

<sup>59</sup>*Re: Jogia* [1988] 1 WLR 484.

<sup>60</sup>TGI Paris, 23 November 1989, Rev. crit. DIP 1990.741.

### *Jurisdiction before the French Courts*

As has been noted earlier, a French court is competent to exercise jurisdiction, irrespective of the nationality of the debtor.<sup>61</sup> The fact that some of the directors of a French company are of foreign nationality will not prevent the extension to them of insolvency proceedings with view to rendering them liable for company debt.<sup>62</sup> A foreign director may also be adjudged guilty of criminal bankruptcy arising out of his management of a French company.<sup>63</sup> Because nationality is not of relevance to exercising jurisdiction,<sup>64</sup> French courts use the location principle to determine their competence. This principle would allow a court to exercise jurisdiction over businesses whose seats are located outside French territory, but which have their principal interests in France. Where the business has only a branch or presence, an entity often without legal personality, a French court may still commence insolvency proceedings in France.<sup>65</sup> Where the business has no establishment or other operations in France, creditors may still petition the court to open insolvency proceedings. Jurisdiction has been accepted on the basis that the company had business dealings, possessed assets and obtained credit. The creditors or, more often than not, the successful creditor who first institutes proceedings, may choose, in the absence of a link between the business and any particular judicial district, any court in which to file their claim.<sup>66</sup> Commentators are of the opinion that pure opportunity and the desire to favour local creditors or help them more easily establish their rights are behind these jurisdiction rules.<sup>67</sup>

A further possibility, which has been canvassed in case law, for exercising jurisdiction comes from the exorbitant jurisdiction rules in the Civil Code. According to these, a foreigner may be cited before a French court to answer for any obligations pursuant to a contract with a French citizen, whether that contract was made in France or elsewhere.<sup>68</sup> Similarly, a French citizen may be answerable before French courts for obligations contracted outside France, whether with a French citizen or foreigner.<sup>69</sup> Under these rules, where a French court declares itself competent to initiate insolvency proceedings, it will apply French law. This is because insolvency law, as a law that governs commercial relations, is considered to involve principles of public order and interest and is to be preferred above all other rules to the contrary. Indeed, because of the great willingness of French courts to exercise jurisdiction, these rules were the subject of specific exclusion in the Brussels Convention.<sup>70</sup> Under the traditional rules, the existence of foreign proceedings does not place any limits on a French court being able to conduct insolvency

<sup>61</sup> Cassation civile, 4 February 1885, Clunet 1886.83.

<sup>62</sup> CA Paris, 5 July 1983, GP 1983.2.339; Juris-Data no. 27696.

<sup>63</sup> CA Colmar, 30 May 1984, Juris-Data no. 40920.

<sup>64</sup> An exception is made for litigation exclusively between foreign parties.

<sup>65</sup> CA Paris, 8 July 1992, D.1992.jur.476; RJ Com. 1993.7.

<sup>66</sup> Cassation commerciale, 19 March 1979, Bull. Civ. IV no. 104; Rev. Sociétés 1979.567.

<sup>67</sup> See Coviaux, Juris-Classeur Commercial, fasc. 3130 at para. 37.

<sup>68</sup> Article 14, Civil Code.

<sup>69</sup> Article 15, Civil Code.

<sup>70</sup> Article 3, Brussels Convention 1968.

proceedings against a foreign business. Nevertheless, where a foreign judgment exists, this may be recognised in France and enforced over assets of the debtor present within the jurisdiction.<sup>71</sup> Without formal recognition, the existence of a foreign judgment may be acknowledged by French courts as having a certain probative value. The rights of foreign insolvency officials to manage proceedings may be viewed as valid but will produce no effect on the debtor or assets in France. Creditors in France may exercise any rights against the debtor and, furthermore, a foreign judgment may not be enforced if contrary to French rules of private international law. It follows, from the principles contained in traditional French conflicts of law rules outlined above, that French courts do accept jurisdiction where any element or criterion, many of which are extremely widely defined, results in conferring legitimate reasons for French courts to consider exercising jurisdiction.<sup>72</sup> Under these rules, it will be quite unlikely that a French court, given the fact situation outlined in the problem, will refuse jurisdiction.

### *Applicable Insolvency Procedures*

The two procedures available in French insolvency are judicial rescue and liquidation.<sup>73</sup> The first is a form of rescue procedure that involves an observation period, during which business activity continues and is monitored with view to suggesting a rescue plan. The second occurs where either, during or following judicial rescue, no form of rescue plan is possible or, when the opening of proceedings are being considered, the court takes the view that the business is so compromised that liquidation of its assets is the only solution. The two options available in the context of rescue plans are generally referred to as continuation plans and sales plans.<sup>74</sup> The reality is a little more complex. Hybrid plans are not unknown and may consist of continuing business with part of the company's assets while the remainder is subject to a sales plan or liquidated. Continuation plans involve the continuation of the business of the company. The first variety of continuation plan is that which provides for the purchase by a third party of existing company shares for a nominal value. This entails the assumption of the debts by the incoming purchaser and repayment of the creditors in accordance with the continuation plan. Sales plans involve the transfer of the business for a consideration to a third party. This may be achieved by the sale of all or part of the business and is a sale of assets rather than shares. One qualification does exist, in that sales plans must involve the transfer of viable units of business. A unit may consist of a mix of assets, including property and equipment, as well as human resources but must be capable of existing independently and continuing activity autonomously. To discourage asset stripping, the law provides that for a time period, the unit may not be shut down and broken up for resale. As part of a rescue package, a

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<sup>71</sup>Article 509, New Code of Civil Procedure.

<sup>72</sup>Indeed, in North and Fawcett, *op. cit.* at 331, it is suggested that civil law systems have no power to refuse jurisdiction on the basis of *forum non conveniens*.

<sup>73</sup>For an outline of French insolvency law, see Sorensen and Omar, *Corporate Rescue Procedures in France* (1996) Kluwer.

<sup>74</sup>Rescue plans are predicated on third-party involvement as directors and members of their families are not permitted by Article L621-57, Commercial Code (formerly Article 21, Law of 1985) to make offers, except by judicial dispensation and only in the case of agricultural businesses.

court may designate certain assets, which it deems necessary for the continued viability of the unit, as key assets that cannot be sold without prior consent of the court.

In applying the above procedural rules to the problem outline, in the very likely event a French court exercises jurisdiction, it will come to the conclusion that the French business should be liquidated if no rescue plan is viable. The court will then order liquidation directly without first placing the company under judicial rescue. There is no cogent reason why the court should not, if it accepts jurisdiction, consider the fate of the English business. Indeed, French private international law posits the universality theory for insolvency proceedings and will extend these to cover assets located abroad. This is certainly the case with reference to the assets of French firms situated in other countries.<sup>75</sup> It is submitted it would also be the case for assets of foreign firms, over which jurisdiction is exercised, although in theory, the enforcement of measures over these assets will depend on the private international law rules in that jurisdiction.<sup>76</sup> This will be the case particularly where the French judgment purports to affect the status of a debtor incorporated in that jurisdiction.<sup>77</sup> The question is then whether the English courts would accept a French judgment setting out a rescue plan for an English business, which involved the continuation of business or its sale as a going concern. A further consideration, if the answer to the above was positive, would be how the English courts could best give effect to this judgment.

### *The Effect of the Regulation*

Insofar as French private international law rules are concerned, the regulation will have some impact on the exercise of jurisdiction rules, as French courts will find it more difficult to sustain arguments for exercising jurisdiction on the basis of pure exorbitant jurisdiction rules and some of the more tenuous examples of business activity. Indeed, in the negotiations preceding the original Convention, jurisdiction based on the mere presence of assets was abandoned in favour of a broader definition of the term 'establishment'.<sup>78</sup> Nevertheless, the absence of a definition of 'centre of main interests' gives wide scope for interpretation. Because the term is used in French law, it is not inconceivable that French courts faced with a question on the terminology of the convention will have regard to French usage in formulating its definition. As has been seen earlier, establishment has been qualified in France to include situations where some activity is being carried out. In the hypothetical problem, it seems highly likely even when the Regulation comes into force that the French courts would still be able to assert jurisdiction over the English company by defining establishment widely in light of their case law. The net effect would be that the French courts could order a rescue plan over the English business, which in compliance with the Regulation, an English court

<sup>75</sup>See Coviaux, *op. cit.* at para. 48 and case-law cited there.

<sup>76</sup>*Gibbs & Son v Société Industrielle des Métaux* (1890) 25 QBD 399.

<sup>77</sup>*Contra Re: Anderson* [1911] 1 KB 896, where the New Zealand trustee in bankruptcy of an Englishman was held entitled to a reversionary interest in England.

<sup>78</sup>In the *Virgos and Schmit Report*, it is stated at para. 70 that a decision was made, expressly, not to apply the definition in Article 5(5), Brussels Convention.

would be bound to enforce.<sup>79</sup> An exception relating to public policy might well apply, although it will no doubt be interpreted strictly.<sup>80</sup>

Unless territorial proceedings of a rescue type were (fortuitously) opened first, an English court in the hypothetical problem would have little option but to order liquidation if territorial proceedings were opened subsequent to French main proceedings. This may be subject to the liquidator in main proceedings agreeing they should continue as such. In theory, the liquidator has the power to sell all or part of the company's business undertakings as a going concern.<sup>81</sup> This would provide one avenue to ensure the business continued. Alternatively, if it was felt that the interests of the business required that all matters be dealt with in one set of insolvency proceedings, an English court might choose not to open proceedings at all, perhaps on grounds of *forum non conveniens*.<sup>82</sup> This is now considered a vital part of the arsenal of instruments courts must consider when deciding on the appropriateness of assuming jurisdiction in insolvency matters. It would also fulfil the judicial restraint argument propounded by Lord Justice Millett.<sup>83</sup> This holds that the failure to exercise judicial restraint potentially causes harm to judicial relations between courts in otherwise co-operating jurisdictions and would, if unchecked, lead to a diminution in faith accorded to courts.<sup>84</sup>

A further alternative would be to open proceedings and qualify these as main proceedings on the grounds that the presumption as to jurisdictional requirements was satisfied. This would enter into the possibility of conflict with the French courts. An argument might be sustained that this would be a more palatable option than risking the possibility that the French courts might ultimately decline jurisdiction or fail to order rescue proceedings in favour of the English business. In any event, the presumption may be maintained as long as no proof to the contrary is brought. It would certainly not be in the interests of the company or the English creditors to do so. It is doubtful if it would be in the interests of French creditors, given that the continued viability of the English business would satisfy, in the long run, the debt owing.<sup>85</sup>

### *Summary*

The example afforded by the hypothetical problem is a challenging one, illustrating the complexities of tailoring national law and practice to a Regulation intended to have an impact without conflict between domestic rules. It seems that the definitions are problematic because of the need to refer back to domestic rules on jurisdiction. This is especially true of the most problematic of all definitions, that of 'centre of main interests', which in French

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<sup>79</sup>Articles 16 and 25, Regulation.

<sup>80</sup>Article 26, Regulation.

<sup>81</sup>s167 and Part III of Schedule 4, Insolvency Act 1986.

<sup>82</sup>s49, Civil Jurisdiction and Judgments Act 1982 does allow this where it would not be inconsistent with the Brussels Convention.

<sup>83</sup>See Millett, *Cross-Border Insolvency: The Judicial Approach* (1997) 6 IIR 99.

<sup>84</sup>*Ibid.* at 108. The example given of a situation of failure to exercise restraint is *Felixstowe Dock and Railway Co v US Lines Inc* [1989] QB 360.

<sup>85</sup>This is assuming that the English company would not be discharged from its debts even after the liquidation of the business in France.



usage has acquired a very liberal interpretation consonant with the view of the courts in that jurisdiction being territorial as regards insolvencies with a French element. With respect to the instances of conflict hitherto seen between English and French courts, it is likely that, in an insolvency with pronounced local interests for a French court, it will seek to take jurisdiction. Justification for this position is likely to be on the basis of its understanding of the jurisdictional bases of the regulation as it interprets them in line with its practice. It remains to be seen whether French courts would accept the *forum non conveniens* argument as English courts have often done. The attempt at the answer above is, undoubtedly, one of a number of equally viable solutions. With an infinity of possible fact-situations, questions on the effect of the Regulation will continue to multiply even after it comes into effect in 2002. Ultimately, it may prove difficult to put the Regulation into practice without substantial goodwill and the willingness to put the ideal of co-operation above national interests.

The Regulation is not, in any event, the final step in what has been a long journey from the first proposals to the completed instrument. Nevertheless, the conclusion of the Regulation is an important part of the long history of the creation of a comprehensive European legal order in company and insolvency law. As witness related initiatives in the company and insolvency law field, this legal order is still in development and it is likely that the work on the Regulation will influence many of the proposals in this field. However, it is perhaps worthwhile recalling that insolvency has remained, until recently, one of the last and greatest areas of discord. This is certainly the result of insolvency being the area of law most closely identified with national interests for its economic and social importance. It may be instructive to see whether this position changes as a result of the passing of the Regulation. Nevertheless, as the most important of all the initiatives thus far, the Regulation may be seen as deserving, especially because of the very fate of its predecessor Convention and other projects in the international field, of every optimistic wish for its success.

**21 January 2002**