

THE EUROPEAN COURT OF JUSTICE'S DECISION IN *EUROFOOD*

Introduction

The European Court of Justice ("ECJ") gave its decision on 2 May 2006 in the long running dispute between the Irish and Italian courts over which court has jurisdiction in relation to the insolvency of Eurofood IFSC Ltd ("Eurofood"), the Irish incorporated subsidiary of the Parmalat group. The ECJ's decision supports the Irish Court's jurisdiction over Eurofood. It clarifies a number of points relating to European insolvency proceedings, although because the questions put to the ECJ by the Irish Court were specific rather than general, the ECJ was disappointingly not given the opportunity to rule on various wider issues, such as a more precise definition of "centre of main interests" (or "COMI").

Summary

The EC Regulation on Insolvency Proceedings (Regulation No. 1346/2000) ("the Regulation") is intended to improve the efficiency and effectiveness of cross-border insolvency proceedings. It allows the courts of the EU Member State within which the debtor's COMI is situated to open the main insolvency proceedings (which, subject to limited exceptions, will govern the conduct of the insolvency throughout all Member States). COMI is not specifically defined, but there is a rebuttable presumption that it is the place of a company's registered office.

The ECJ's decision reinforces the principle that a decision of a court in one Member State to open insolvency proceedings must be respected by other courts. This is in keeping with the "first past the post" approach seen in cross-border insolvencies since the Regulation was introduced.

The ECJ has, however, recognised the ability of a court, in exceptional circumstances, not to recognise prior insolvency proceedings opened in another Member State on public policy grounds, specifically where those proceedings were conducted in a way which denied due process to interested parties.

The decision also addresses the situation where a subsidiary is part of a large pan-European group, and concludes that "parental control" should not of itself lead to the implementation of a single pan-European insolvency regime for the group as a whole.

Background

The following facts – and those summarised in the chronology which follows – are taken from the Advocate-General's opinion delivered in September 2005.

Eurofood IFSC Ltd ("Eurofood") is a company incorporated and registered in Ireland. It is a wholly owned subsidiary of Parmalat, a company incorporated in Italy which operated through subsidiary companies in more than 30 countries worldwide. Eurofood's principal objective was the provision of financing facilities for companies in the Parmalat group.

Eurofood's registered office is at the International Financial Services Centre, Dublin ("IFSC"). The IFSC was established to provide a location for internationally traded financial services to be provided only to non-resident persons or bodies. Eurofood carried on business at the IFSC as required by law.

Bank of America NA ("Bank of America"), a bank established in the United States with branches in Dublin and Milan, managed the day-to-day administration of Eurofood in accordance with the terms of an administration agreement.

Eurofood engaged in the following three large financial transactions:

- (a) on 29 September 1998 Eurofood issued notes by way of private placement in an aggregate amount of USD 80,000,000 (to provide collateral for a loan by Bank of America to Venezuelan companies in the Parmalat group);
- (b) on 29 September 1998 Eurofood issued notes by way of private placement in an aggregate amount of USD 100,000,000 (to fund a loan by Eurofood to Brazilian companies in the Parmalat group);
- (c) there was a "Swap" agreement with Bank of America dated 10 August 2001.

Eurofood's liabilities under the first two transactions were guaranteed by Parmalat.

Eurofood's creditors under the first two transactions ("the Certificate/Note Holders") are now owed in excess of USD 122 million. Eurofood is unable to pay its debts.

Chronology of the insolvency proceedings in Ireland and Italy

Italy

Parmalat was discovered in late 2003 to be in deep financial crisis, which led to the insolvency of many of its key companies.

On 23 December 2003 the Italian Parliament passed into law decree No 347 providing for the extraordinary administration of companies with more than 1,000 employees and debts of no less than EUR 1 billion.

On 24 December 2003 Parmalat was admitted to extraordinary administration proceedings by the Ministero delle Attivite Produttive (Italian Ministry of Productive Activities). Dr Enrico Bondi was appointed as extraordinary administrator.

On 27 December 2003 the Civil and Criminal Court at Parma ('the Parma court') confirmed that Parmalat was insolvent and placed it in extraordinary administration.

Ireland

On 27 January 2004 Bank of America presented to the High Court of Ireland ('the Irish court') a petition for the winding up of Eurofood, alleging that Eurofood was insolvent and claiming a debt due to it of in excess of USD 3.5 million.

On the same date Bank of America also applied ex parte for the appointment of a provisional liquidator. On that date the Irish court appointed Mr Pearse Farrell as provisional liquidator of Eurofood with powers to take possession of all of its assets, to manage its affairs, to open a bank account in its name and to retain the services of lawyers etc.¹

Italy

On 9 February 2004 the Italian Ministry of Productive Activities admitted Eurofood, as a group company, to the extraordinary administration of Parmalat.

¹ Lovells' Rome and Milan offices act for the Irish liquidator of Eurofood.

On 10 February 2004 the Parma court made an order in which it acknowledged the filing of a petition to declare the insolvency of Eurofood and set 17 February 2004 as the date for the hearing of that petition.

Mr Farrell was legally represented before the Parma court at that hearing. However, despite an order of the court and what Mr Farrell has described as "repeated written and verbal requests" to Dr Bondi, he had not received any of the documents filed with the Parma court, including the petition and the papers upon which Dr Bondi proposed to rely.

On 20 February 2004 the Parma court gave judgment opening insolvency proceedings concerning Eurofood, declaring it to be insolvent, determining that the centre of its main interests was in Italy - and not Ireland - and appointing Dr Bondi as extraordinary administrator. (See the Appendix for a summary of the arguments before the Parma court.)

Ireland

Bank of America's petition for the winding-up of Eurofood was heard in the Irish court from 2 to 4 March 2004. Bank of America, Mr Farrell, the Certificate/Note Holders and the Director of Corporate Enforcement² were represented. On 23 March 2004 the Irish court ruled that:

- "(1) Insolvency proceedings had been opened in Ireland at the date of the presentation of the petition.
- "(2) Eurofood's centre of main interests was in Ireland and therefore the proceedings opened in Ireland as of 27 January 2004 were main insolvency proceedings within the meaning of the Insolvency Proceedings Regulation.
- "(3) The purported opening of main insolvency proceedings by the Parma court was contrary to recital 22 and Article 16 of the Regulation and could not alter the fact that main insolvency proceedings were already extant in Ireland.
- "(4) The failure of Dr Bondi to put Eurofood's creditors on notice of the hearing before the Parma court despite that court's directions on the matter and the failure to furnish Mr Farrell with the petition or other papers grounding the application until after the hearing had taken place all amounted to a lack of due process such as to warrant the

² The Office of the Director of Corporate Enforcement was established in November 2001 pursuant to the Company Law Enforcement Act, 2001. Under that Act, the Director of Corporate Enforcement is responsible for encouraging compliance with company law and investigating and enforcing suspected breaches of the legislation.

Irish courts refusing to give recognition to the decision of the Parma court under Article 26 of the Regulation."

In the light of those conclusions and in circumstances where Eurofood was "grossly insolvent", the Irish court made a winding-up order in respect of Eurofood and appointed Mr Farrell as liquidator. The Irish court did not recognize the decision of the Parma court of 20 February 2004.

Dr Bondi appealed against the Irish judgment, and the Irish Supreme Court referred a number of questions to the ECJ. On 2 May 2006 the ECJ delivered its judgment in support of the Irish Court's jurisdiction, following, as expected, the opinion of the Advocate-General delivered in September last year.

The appeal and the questions referred

The principal subjects of argument on the hearing of Dr Bondi's appeal to the Irish Supreme Court were whether insolvency proceedings had been first opened in Ireland or Italy, whether Eurofood's COMI was in Ireland or Italy and whether there had been such an absence of fair procedures leading to the decision of the Parma court that that decision should not be recognised by the Irish court.

The Supreme Court decided to stay the proceedings and to refer the following questions relating to those three areas of dispute to the ECJ:

"(1) Where a petition is presented to a court of competent jurisdiction in Ireland for the winding up of an insolvent company and that court makes an order, pending the making of an order for winding up, appointing a provisional liquidator with powers to take possession of the assets of the company, manage its affairs, open a bank account and appoint a solicitor all with the effect in law of depriving the directors of the company of power to act, does that order combined with the presentation of the petition constitute a judgment opening ... insolvency proceedings for the purposes of Article 16, interpreted in the light of Articles 1 and 2, of Council Regulation (EC) No 1346 of 2000?

"(2) If the answer to Question 1 is in the negative, does the presentation, in Ireland, of a petition to the High Court for the compulsory winding up of a company by the court constitute the opening of insolvency proceedings for the purposes of that Regulation by virtue of the Irish legal provision (section 220(2) of the Companies Act, 1963)

deeming the winding up of the company to commence at the date of the presentation of the petition?

"(3) Does Article 3 of the said Regulation, in combination with Article 16, have the effect that a court in a Member State other than that in which the registered office of the company is situate and other than where the company conducts the administration of its interests on a regular basis in a manner ascertainable by third parties, but where insolvency proceedings are first opened has jurisdiction to open main insolvency proceedings?

"(4) Where,

(a) the registered offices of a parent company and its subsidiary are in two different Member States,

(b) the subsidiary conducts the administration of its interests on a regular basis in a manner ascertainable by third parties and in complete and regular respect for its own corporate identity in the Member State where its registered office is situated and

(c) the parent company is in a position, by virtue of its shareholding and power to appoint directors, to control and does in fact control the policy of the subsidiary,

in determining the 'centre of main interests', are the governing factors those referred to at (b) above or on the other hand those referred to at (c) above?

"(5) Where it is manifestly contrary to the public policy of a Member State to permit a judicial or administrative decision to have legal effect in relation [to] persons or bodies whose right to fair procedures and a fair hearing has not been respected in reaching such a decision, is that Member State bound, by virtue of Article 17 of the said Regulation, to give recognition to a decision of the courts of another Member State purporting to open insolvency proceedings in respect of a company, in a situation where the court of the first Member State is satisfied that the decision in question has been made in disregard of those principles and, in particular, where the applicant in the second Member State has refused, in spite of requests and contrary to the order of the court of the second Member State, to provide the provisional liquidator of the company, duly appointed in accordance with the law of the first Member State, with any copy of the essential papers grounding the application?"

“Parental Control”

A perceived deficiency in the Regulation is its failure to provide a practical means of dealing with the cross-border insolvency of a group of companies. The English court has nevertheless been willing, in recent cases, to take a fairly pragmatic approach in taking jurisdiction over several companies within a group, on the basis that an English parent has exercised management and control over that group.

The Eurofood decision is a reminder that COMI must still be assessed on the basis of each individual company and not on a group-wide basis. In considering COMI, the ECJ takes as its starting point the provision in the Regulation that COMI shall be presumed to be the place of the registered office of a company. The ECJ cites the rule that 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. The court concludes that the presumption can only therefore be rebutted if factors which are both objective and ascertainable by third parties enable it to be established that COMI is somewhere else. The court makes it expressly clear that where a company carries on its business in the country of its registered office (as was the case with Eurofood), the mere fact of "parental control" by a parent located in another Member State is not enough to rebut the presumption.

The ECJ held:

“...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.

In those circumstances, the answer to the fourth question must be that, where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different Member States, the presumption laid down in the second sentence of Article 3(1) of the Regulation, whereby the centre of main interests of that subsidiary is situated in the Member State where its registered office is situated, can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect. That could be so in particular in the case of a company not carrying out any business in the territory of the Member State in which its registered office is situated. By contrast, 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.”

Opening of Insolvency Proceedings

This question arose because of the chronology of the early stages of the Irish and the Italian proceedings. On 27 January 2004 Bank of America presented to the Irish court a petition to wind up Eurofood and that court appointed Mr Farrell as provisional liquidator on the same date. On 20 February 2004 the Parma court declared Eurofood to be insolvent and appointed Dr Bondi as extraordinary administrator. On 23 March 2004 the Irish court ruled that insolvency proceedings had been opened in Ireland at the date of the presentation of the petition. If the appointment of Mr Farrell in conjunction with the presentation of the petition on 27 January 2004 was a "judgment opening insolvency proceedings" within the meaning of Article 16 of the Regulation, the Parma court would be bound by that provision to recognise that judgment.

One of the other questions referred to the ECJ by the Irish court was whether the order appointing an Irish provisional liquidator, pending the making of a compulsory winding up order, constituted a judgment opening insolvency proceedings for the purposes of the Regulation. The ECJ decided that it did.

The ECJ sought to define a general principle as to what sorts of decision will amount to a "judgment" for the purposes of the Regulation. The obvious starting point was the list of proceedings as set out for each Member State in the Regulation. The list includes the appointment of provisional liquidators in Ireland (and, since an amendment to the Regulation introduced in May 2005, in England also). The ECJ highlighted that a key factor common to such proceedings is the fact that the debtor loses the power of management over his assets.

The ECJ unfortunately did not rule on whether or not the "relation-back" principle - that the winding up of a company is deemed to commence, not at the date the winding up order is ultimately made by the court, but at the date of the presentation of the petition - should be recognised under the Regulation. The ECJ did not need to do so, because its answer to the question about the provisional liquidation order had rendered the issue irrelevant for the purposes of Eurofood. Although this was also true in relation to the Advocate-General's opinion in September, the Advocate-General had suggested that "relation-back" should be recognised. Given the importance that the ECJ attached to the appointment of an office-holder taking over the management of the debtor's assets in determining what is a

"judgment" for the purposes of the Regulation, the way the ECJ would rule on "relation-back" in a situation where it actually matters remains open to doubt.

The ECJ held

“... a "decision to open insolvency proceedings" for the purposes of the Regulation must be regarded as including not only a decision which is formally described as an opening decision by the legislation of the Member State of the court that handed it down, but also a decision handed down following an application, based on the debtor's insolvency, seeking the opening of proceedings referred to in Annex A to the Regulation, where that decision involves divestment of the debtor and the appointment of a liquidator referred to in Annex C to the Regulation. Such divestment involves the debtor losing the powers of management which he has over his assets. In such a case, the two characteristic consequences of insolvency proceedings, namely the appointment of a liquidator referred to in Annex C and the divestment of the debtor, have taken effect, and thus all the elements constituting the definition of such proceedings, given in Article 1(1) of the Regulation, are present.

"In view of the above considerations, the answer to the first question must be that, on a proper interpretation of the first subparagraph of Article 16(1) of the Regulation, a decision to open insolvency proceedings for the purposes of that provision is a decision handed down by a court of a Member State to which application for such a decision has been made, based on the debtor's insolvency and seeking the opening of proceedings referred to in Annex A to the Regulation, where that decision involves the divestment of the debtor and the appointment of a liquidator referred to in Annex C to the Regulation. Such divestment implies that the debtor loses the powers of management that he has over his assets.”

Mutual Recognition

On 9 February 2004 the Italian Ministry of Productive Activities admitted Eurofood, as a group company, to the extraordinary administration of Parmalat.

On 10 February the Parma court made an order in which it acknowledged the filing of a petition to declare the insolvency of Eurofood and set 17 February 2004 as the date for the hearing of that petition.

Mr Farrell was legally represented before the Parma court at that hearing. However, as noted above, despite an order of the court and what Mr Farrell has described as "repeated written and verbal requests" to Dr Bondi, he had not received any of the documents filed with the court, including the petition and the papers upon which Dr Bondi proposed to rely.

The ECJ confirmed that where a court in one Member State has purported to open main proceedings, that decision must be recognised by other Member States, without the latter being able to review the jurisdiction of the court of the opening state. This should only be challenged in the courts of that Member State or, where appropriate, in the ECJ.

The ECJ accepted that the Regulation does not require a Member State to recognise a decision purporting to open insolvency proceedings in respect of a company, where to do so would be contrary to public policy. Specifically, this could be the case where the decision to open the proceedings was taken in flagrant breach of the fundamental right to be heard, which a person concerned by such proceedings enjoys. The ECJ held that in relation to Eurofood, the question whether or not the Italian proceedings had breached this requirement would be a question for the Irish court.

As to the right to be notified of procedural documents and, more generally, the right to be heard, referred to in the referring court's fifth question, the ECJ held that these rights occupy an eminent position in the organisation and conduct of a fair legal process. In the context of insolvency proceedings, the right of creditors or their representatives to participate in accordance with the principle of equality of arms is of particular importance. Though the specific rules concerning the right to be heard may vary according to the urgency for a ruling to be given, any restriction on the exercise of that right must be properly justified and there must be procedural guarantees ensuring that persons affected by such proceedings actually have the opportunity to challenge the relief sought, whatever the urgency may be.

In the light of those considerations, the ECJ's answer to the fifth question was that, on a proper interpretation of Article 26 of the Regulation, a Member State may refuse to recognise insolvency proceedings opened in another Member State where the decision to open the proceedings was taken in flagrant breach of the fundamental right to be heard, which a person concerned by such proceedings enjoys.

The ECJ explained that it was for the Irish court to establish whether, in the main proceedings, that has been the case with the conduct of the proceedings before the Parma court. But the Irish court should not confine itself to transposing its own conception of the requirement for an oral hearing and of how fundamental that requirement is in its legal system, but it should assess, having regard to all the circumstances, whether or not the provisional liquidator appointed by the High Court was given a sufficient opportunity to be heard.

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APPENDIX - ARGUMENTS BEFORE THE PARMA COURT

Dr Bondi attempted to stretch the concept of COMI to incorporate a group rationale deriving from Article 9 of the Italian Bankruptcy Law, which employs the **main seat (“sede principale”) concept**, and the case-law developed thereunder.

Taking advantage of the lack of any specific definition of COMI, Dr Bondi construed Article 3 of the Regulation using Italian principles of construction. Dr Bondi did not focus on concepts applicable to the Regulation when tendering evidence to refute the presumption the Eurofood’s COMI was in Ireland (he should have attempted to show that Eurofood’s COMI was actually situated in Italy and that such was ascertainable by third parties). Rather, he sought to argue “substance over form” based on the alleged correspondence of Eurofood's “real seat” with Parmalat's, where its management and administration were carried out.

To support his position, Dr Bondi asserted the following features of Eurofood:

- A. the actual management of the company was entrusted to the so-called executive directors only, who had always been Parmalat's employees;
- B. the two major transactions carried out by Eurofood were "managed" by the directors employed at Parmalat;
- C. Eurofood had neither employees nor premises in Ireland and its registered office was at a law firm;
- D. the Italian directors allegedly attended the board meetings via telephone, and went to Ireland only on rare occasions;
- E. Eurofood's corporate objects included the possibility of granting loans to companies belonging to the Parmalat group;
- F. Eurofood was a wholly-owned subsidiary of Parmalat; and
- G. the private placement transactions carried out by Eurofood were guaranteed by Parmalat.

Mr Farrell challenged each of these arguments on the merits.

As to A, all directors were given the same management and representative authority pursuant to the articles of association.

As to B, the Italian directors always acted in such a way that third parties could ascertain that the company's administrative centre was located in Ireland - if for no other reason than with a view to enabling Eurofood to continue benefiting from the Irish tax regime.

As to C, the administration agreement with [Bank of America] was greatly underestimated as Eurofood did not need any premises or employees; the day-to-day administration had been outsourced.

As to D, the "Italian" directors were physically present in Ireland at 5 at least of the 13 board meetings but all the board minutes certified that the meetings were held in Ireland.

As to E, it is common practice, and not just within Italian groups, to establish subsidiaries abroad, especially in countries having more favourable tax regimes.

Above all, however, Mr Farrell insisted on the irrelevance of these matters for the purpose of identifying the COMI as ascertainable by third parties. He maintained that none of A to E above was in any way capable of refuting the presumption under the Regulation that Eurofood's COMI was in Ireland. Dr Bondi could not prove that third parties might have thought that Eurofood's main centre (ie the place where the company conducted the administration of its interests on a regular basis) was situated in Italy and not in Ireland.

Mr Farrell argued that *the basic principle underpinning his approach was that EU instruments must be strictly interpreted by means of the relevant interpretation rules, not by relying on the case law developed in the various Member States, since there is otherwise a serious risk that the aims of the Regulation will be jeopardised by the attempted application of conflicting national laws.*

With specific reference to points E, F and G (which directly relate to the issue of group of companies), Mr Farrell pointed out:

1. The mere fact that a company is a wholly-owned subsidiary is not sufficient to prove where the administration of a subsidiary's interests is conducted.

2. On the other hand, neither the concept of "total control" of the corporate capital nor the group concept is used by the Regulation. Rather, according to the Virgos/Schmit Report, in the event of companies belonging to groups, jurisdiction must always be ascertained in respect of each company, which is deemed to be a separate legal entity.
3. Just as it is normal for international business to be conducted in a group structure, the mere fact that a parent company guarantees the obligations undertaken by its subsidiaries is standard international corporate practice and does not displace the presumption under the Regulation as to the location of COMI.

The Parma court wrongly upheld Dr Bondi's arguments by applying the Italian law criterion of substance over form. The Court neglected the fact that the only basis for displacing the presumption as to the location of COMI is the one provided for by in the Regulation, ie the place where a company conducts the administration of its interests on a regular basis in a manner ascertainable by third parties. That is not necessarily the place where management decisions are taken; it is **exclusively** the place from where such decisions are made known outside the company and can therefore be ascertained by third parties.

In respect of these matters, the ECJ made the following fundamental findings:

Para 30, confirming the Virgos/Schmit approach to groups, see above;

Para 31, confirming the basic interpretative principle invoked by Mr Farrell (see the italicised section above); and

Paras 33 and 36, rejecting the principle of substance over the form with respect to the ascertainment of COMI.