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The International Insolvency Institute

International Insolvency Studies

2010

Forum Shopping under the Regime of the European Insolvency

Regulation

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I. Introduction - Organization and Approach of the Paper

In the light of the groundbreaking decisions *Centros*, *Überseering* and *Inspire Art*¹ the landscape of European company law changed dramatically. Under Articles 43 and 48 EC companies are now free to choose a corporate form of their liking without being restricted by the location of their actual head office (real seat). The case law of the European Court of Justice resulted in a regulatory competition within the European Union for the most flexible and business-friendly company law.²

A rather different situation can be observed in the context of international insolvency law. The European Insolvency Regulation³ (later on referred to as the EIR or the Regulation) is the central statute that governs questions concerning cross-border insolvency proceedings within the European Union. According to Recital 4 of the EIR, forum shopping is undesirable and incentives for this particular kind of conduct should be prevented. Nonetheless, in a recent series of cases the three German companies *Deutsche Nickel*, *Schefenacker* and *Hans Brochier* took steps in order to achieve the applicability of English insolvency law. Therefore, forum shopping can certainly be identified as one of the most contentious issues in the field of international insolvency law. The current paper intends to shed some light on certain aspects of the conduct in question. In general, the treatment of insolvency forum shopping under the European Insolvency Regulation will be evaluated.

In a first step a brief outline of the EIR will take place. Its legal nature and the legislative history will be analyzed and the most important provisions will be introduced (Chapter II). Afterwards, several incentives for forum shopping will be outlined in Chapter III. Therefore, a comparison of selected issues (e.g. the position of creditors and employees in insolvency scenarios) in the English, German and French bankruptcy systems will take place in order to underline the lack of harmonization of national bankruptcy laws and the resulting incentives for companies to engage in forum shopping. A brief definition of forum shopping in the context of cross-border insolvencies will follow (Chapter IV). Thereafter, the COMI concept will be explored in Chapter V as it provides the basis for forum shopping. Weak point with regard to its “fact sensitivity” will be outlined. Special attention will be paid to constellations concerning corporate groups and natural persons. Furthermore, the relevant time for the

¹ Case C-212/97 *Centros v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-01459; Case C-208/00 *Überseering v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-09919; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.* [2003] ECR I-10155.

² John Armour, *Who Should make Corporate Law? EC Legislation versus Regulatory Competition* (2005) available at Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=860444> (at June 19, 2009) at page 1.

³ Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings, [2000] OJ L 160/1.

determination of the COMI will be examined. In Chapter VI, the economic aspects of forum shopping will be examined with regard to the desirability of this particular kind of conduct. Possible “defence strategies” and countermeasures to prevent forum shopping of a debtor are debated in the next part of the paper (Chapter VII). In the further course of the investigation the question is raised, whether the EIR and its COMI concept are a case for urgent reform. Alternative approaches are discussed in Chapter VIII. Furthermore, forum shopping will be investigated against the background of the EC Treaty with special regard to the freedom of establishment (Chapter IX). The issue of a possible regulatory competition in the realm of insolvency law is addressed in Chapter X. The final part (Chapter XI) summarizes the findings and offers some conclusions.

II. The Legislative Framework of Forum Shopping in Europe - The EIR in a Nutshell

The current chapter intends to present a brief outline of the EIR as the legislative framework of forum shopping in Europe. The European Insolvency Regulation was adopted on May 29, 2000 for all EU Member States (with the exception of Denmark, which exercised its right to opt out of the Regulation⁴) and came into force on May 31, 2002⁵. As a regulation the EIR is directly applicable as part of the national law of each Member State without the necessity of national legislation to bring it into force.⁶ The Regulation intends to provide a stable framework for the treatment of cross-border insolvency proceeding in Europe and therefore contains provisions concerning the jurisdiction for bankruptcy proceedings, the recognition of foreign proceedings and the coordination of multiple proceedings with the same debtor. It was aimed at furthering the enhancement of cooperation among jurisdictions in insolvency proceedings.⁷

The EIR is widely based on a convention on the same subject that failed to come into effect in 1996.⁸ The failure of the EC Convention on Insolvency Proceedings occurred as a result of the British non-cooperation policy.⁹ As the Regulation is largely based on the original text of the failed convention the legislative history of the convention is able to grant an insight into the EIR. It is capable of providing practical guidance in matters of interpretation of the Regulation.¹⁰ In particular, the so-called “Virgos-Schmit Report” has to be mentioned in this regard.¹¹ According to the lack of any official explanatory guide for the Regulation, the value of this document cannot be overrated. Furthermore, the European Court of Justice (ECJ) has jurisdiction to interpret the Regulation in order to provide the required degree of uniformity in the application of the EIR.

⁴ See Recital (33) of the Regulation.

⁵ Article 47 of the EIR.

⁶ See Article 249 of the EC Treaty where it is stated: “A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.”

⁷ Horst Eidenmüller, *Abuse of Law in the Context of European Insolvency Law* (2009) 1 European Company and Financial Law Review 1, 3.

⁸ Gabriel Moss, *Group Insolvency – Choice of Forum and Law: The European Experience under the Influence of English Pragmatism* (2006 - 2007) 32 Brooklyn Journal of International Law 1005, 1005.

⁹ The alleged reason of the British government’s refusal to sign the Convention appeared to be its dissatisfaction with regard to the European Union’s ban on the export of British dairy and beef products due to the BSE epidemic; see Paul J Omar, *Genesis of the European Initiative of Insolvency Law* (2003) 12 International Insolvency Law Review 147. A different approach regards the unresolved “Gibraltar issue” as the underlying reason for the lapse of the Convention; for a more detailed account see Ian F Fletcher, *Insolvency in Private International Law: National and International Approaches* (2nd edition, Oxford, Oxford University Press, 2005) at 7.08 – 7.09.

¹⁰ On this important aspect see I Fletcher, above n 9, at 7.02.

¹¹ As the Convention never came into effect the Report was never officially published. Therefore, it cannot be regarded as *travaux préparatoires* with regard to these provisions of the Regulation that were directly copied from the Convention. Nevertheless, it grants valuable insights into the Regulation’s intended effects. On this point see I Fletcher, above n 9, at 7.06.

The Regulation envisions main insolvency proceedings in the country where the debtor's "centre of main interests"¹² is situated and secondary proceedings in states where the debtor has an "establishment"¹³. In this context it is important to take Recital (14) into account that limits the scope of the application of the Regulation as to proceedings where the centre of the debtor's main interests is located in the Community. Furthermore, the EIR identifies the law applicable to insolvency proceedings as the law of the Member State in which the proceedings are opened (Article 4). This rule is subject to a number of exceptions (Articles 5 - 15). However, once a court has opened main proceedings, courts in other Member States are extremely limited in their ability to challenge the validity of this decision. The automatic recognition of foreign proceedings can only be rejected in case a judgement is contrary to public policy and fundamental principles or the constitutional rights and liberties of the individual (Article 26 of the EIR).

Articles 16 – 26 govern the principle of mutual recognition of insolvency proceedings. Rules concerning the coordination of main and secondary proceedings are contained in Article 27 – 38. Articles 39 – 42 govern information rights of the creditors and the lodgement of their claims. Another important point with regard to the Regulation is that the legal instrument covers both individual and corporate bankruptcies.¹⁴ Interestingly, the EIR does not harmonize the substantial insolvency laws of the Member States¹⁵ but rather intends to provide rules on jurisdiction and conflict of law matters in the context of cross-border insolvencies.¹⁶

With regard to forum shopping the Regulation propagates a hostile attitude. It is stated that "[i]t is necessary for the proper functioning of the internal market to avoid ... forum shopping."¹⁷ This statement takes place in the Recitals whereas the main body of the Regulation remains silent with regard to this issue.

¹² Article 3 (1) of the Regulation.

¹³ Article 3 (2) of the Regulation.

¹⁴ On this point see Peter Burbidge, *Cross Border Insolvency within the European Union: Dawn of a New Era* (2002) 27 *European Law Review* 589, 590.

¹⁵ For an outline of the few harmonization attempts see Miguel Virgos and Francisco Garcimartín, *The European Insolvency Regulation: Law and Practice* (The Hague, Kluwer Law International, 2004) at 9.

¹⁶ See Recital (11) of the EIR. This is in sharp contrast to the US situation where bankruptcy law is federal.

¹⁷ Recital (4) of the Regulation.

III. Incentives for Insolvency Forum Shopping

In general, insolvency situations could be referred to as an “endgame”. As the debtor knows that he will not have future business relationships with the creditors or other third parties it was argued that his incentive to shift wealth from other parties to himself was at its maximum.¹⁸

The EIR mainly attempts to establish clear rules as to the issue of determining in which State insolvency proceedings are to be commenced in cross-border insolvency cases and what law should govern these proceedings. However, a harmonization of the differing domestic insolvency laws of the Member States did not take place. Consequently, there are still considerable differences between the domestic insolvency law regimes. These differences appear to be reason enough for companies to shift their COMI to a different Member State in order to profit from the application of a different insolvency law. A comparison of several selected aspects of English, French and German insolvency law will be undertaken in the further course of the investigation in order to highlight some of the incentives.

A first interesting point is the management’s duty to file for insolvency. In the UK there exists no such duty and consequently there is no corresponding liability of the management for late filing. The system is rather based on the creditors given the means to help themselves.¹⁹ When the manager of a company knows or at least ought to know that insolvency is unavoidable, he can avoid his liability by taking every step necessary to minimize a loss of the creditors. This concept works on the assumption that a manager does not have a duty to avoid insolvency, but when it becomes obvious that insolvency cannot be avoided he “is bound to the interests of the creditors instead of the shareholders because once all equity is lost, the creditors are the beneficial owners of the company.”²⁰ In Germany there is a rather different situation. The management is under a strict duty to file for insolvency. When a company becomes insolvent or balance-sheet over-indebted the management has to file an insolvency petition within three weeks.²¹ In case there is a breach of this duty, the management is personally liable towards the creditors for their loss. There even exists a

¹⁸ On this point see Sefa M Franken, *Three Principles of Transnational Corporate Bankruptcy Law: A Review* (2005) 11 *European Law Journal* 232, 237.

¹⁹ See Carsten Jungmann and Jan Thiessen, *Discussion Report: Restructuring Insolvent Companies in the UK and in the US* (2008) 2 *European Company and Financial Law Review* 189, 190 citing a comment of Professor Walters.

²⁰ On this point see Alexander Schall, *The UK Limited Company Abroad – How Foreign Creditors are Protected after Inspire Art (Including a Comparison of UK and German Creditor Protection Rules)* [2005] 16 *European Business Law Review* 1534, 1539.

²¹ § 64 (1) GmbHG.

criminal liability.²² Therefore, the management of a company has great incentives to file in a management-friendly jurisdiction in order to limit or even exclude claims against the directors.²³

Furthermore, different jurisdictions apply different prerequisites for bankruptcy. In certain legal systems, bankruptcy can only be declared when a company is unable to pay debts when they become due.²⁴ Other legal systems have the additional criterion of over-indebtedness which is fulfilled when the total of debts exceeds the total assets.²⁵

The differences outlined above have a great impact on the possibility of a “silent rescue” (the rescue of a firm without the open declaration of its over-indebtedness). In Germany these efforts would be under “the suspicion of an easy excuse for delayed filing”. In contrast other insolvency laws leave room for “silent rescues” as there exists no management duty to file for insolvency.²⁶ The English regime consequently appears to be more flexible as it might be in the best interest of creditors to continue trading even when the company is over-indebted. This situation explains why a company might choose the UK as an insolvency venue. The management might try to avoid the strict liability under the German law. This does not necessarily have to be detrimental, as the rescue of the firm might be for the best not only for the management but also for the creditors.

The French insolvency law regime emphasizes the importance of the preservation of the going concern and employment. The main objective of the French insolvency code to maintain the firm and thereby preserve employment had the consequence that creditors are not able to influence the restructuring process except for nonbinding recommendations. Despite this main goal of the French insolvency code, bankruptcy proceedings in France are regarded as costly and time-consuming which is underlined by the fact that most bankruptcies result in the liquidation of the insolvent firm.²⁷ With regard to this point it was stated that “European restructuring ..., with the exception of the U.K. among the major economies, is still inflexible, bureaucratic, and value destructive. For this reason international practitioners favour the U.K. as a jurisdiction should a choice be available.”²⁸ As a result of the described

²² § 15a (4) *Insolvenzordnung* (InsO).

²³ On this point see Marc-Phillipe Weller, *Forum Shopping im Internationalen Insolvenzrecht* (2004) 24 *Praxis des internationalen Privat- und Verfahrensrechts* 412, 415.

²⁴ See for example Article L.621-1 *Code de Commerce* (France).

²⁵ See § 19 *Insolvenzordnung* (Germany).

²⁶ For a more detailed account on “silent rescue” in Germany and the UK see A Schall, above n 20, 1547.

²⁷ Sergei A Davydenko and Julian R Franks, *Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany and the UK* (2008) LXIII *The Journal of Finance* 565, 603 - 604.

²⁸ Alan Tilley, *European Restructuring: Clarifying Trans-Atlantic Misconceptions* [2005] *Journal of Private Equity* 99, 102.

tendency to migrate to the UK for the purpose of restructuring, London was already regarded as the new European “restructuring capital”.²⁹ In the light of several new laws a whole new “rescue culture” developed. For example, in Section 3 (1) of Schedule B1 of the Insolvency Act 1986 (amended by the Enterprise Act 2002) it is stated that the primary goal of administration should be the rescue of the firm as a going concern. Only when this is not a viable option, administration applies. These are signs for “a shift ... towards an increased emphasis on the survival of the corporation as an ongoing concern.”³⁰ The United Kingdom has become a popular venue for restructuring companies in distress. Recent examples are the German companies *Schefenacker*, *Deutsche Nickel* and *Hans Brochier*. A major reason for this development appears to be the “Company Voluntary Arrangement” procedure (CVA).³¹ The CVA is a court-administered process and provides the company with temporary protection from the creditors’ claims.³²

A further point of interest is the position of creditors in the different domestic insolvency law regimes. The position of minority creditors in the UK seems to be rather weak and the insolvency proceeding can easily be commenced without the intervention of a court by means of the non-court appointment of an administrator to displace the existing management.³³ Consequently, the powers of the directors of a company are taken away from them. Instead, the secured creditors gain control rights and are free to sell the firm as a going concern or to liquidate it. However, unsecured creditors have few control rights. They only obtain a payout when the secured creditors’ claims have been completely satisfied.³⁴ In contrast, an administrator appointed by the court takes control of the company in France. The administrator has to “maintain the firm as a going concern, preserve employment, and satisfy creditors’ claims, in that order.”³⁵ It is in line with this order of priorities that the court is free to sell the firm for a low-value bid in case this gives the issue of employment preservation better chances. The secured creditors have a rather weak position in France. Their approval is neither required for the sale of the firm nor for the reorganization plan. Instead the court

²⁹ Gerard McCormack, *Jurisdictional Competition and Forum Shopping in Insolvency Proceedings*, (2009) 68 *The Cambridge Law Journal* 169, 180.

³⁰ Eyal Z Geva, *National Policy Objectives from an EU Perspective: UK Corporate Rescue and the European Insolvency Regulation – A Note on Hans Brochier Holdings Ltd. v. Exner and Re Collins & Aikman Europe SA* (2007) 8 *European Business Organization Law Review* 605, 609.

³¹ For a more detailed account see Ian F Fletcher, *UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – The Insolvency Act 2000, The White Paper 2001, and the Enterprise Act 2002*, (2004) 5 *European Business Organization Law Review* 119, 130.

³² S Davydenko and J Franks, above n 27, 603.

³³ G McCormack, above n 29, 185.

³⁴ S Davydenko and J Franks, above n 27, 569 et seq.

³⁵ S Davydenko and J Franks, above n 27, 569.

monitors and controls the bankruptcy process.³⁶ Under the German insolvency law regime the court appoints an administrator who monitors the bankrupt firm and advances a restructuring plan.³⁷ A majority of secured creditors is required to approve the reorganization plan. Otherwise the firm has to be sold.³⁸

There are further examples of divergences between domestic bankruptcy regimes in the realm of insolvent individuals. France appears to be a popular insolvency venue for individuals due to its discharge regime. Under the German insolvency regime a discharge can be obtained after six years. During that period the income of an insolvent person above a certain threshold is used in order to satisfy the claims of the creditors.³⁹ In comparison the French model appears to be less strict. The end of the insolvency proceedings directly leads to a discharge.⁴⁰ Furthermore, the discharge period in France (on average about 18 months) is considerably shorter than in Germany.⁴¹ This, of course, is a great incentive for insolvent individuals to migrate to France.

However, incentives for forum shopping do not only occur on a domestic level but can rather also be recognized in the EIR itself. There are possible problems with regard to conflicting decisions on the opening of insolvency proceedings. According to the underlying idea of mutual trust between EU courts a proceeding that was opened in one Member State has to be respected and recognized by courts in other Member States with the only restriction being the public policy exception in Article 26 of the Regulation. Consequently, this mechanism can enhance parties to engage in a “virtual race” to the courthouse in order to reach the opening of insolvency proceedings with the benefit of “full and unquestioned recognition throughout the EU” even in constellations where the COMI is debatable. It was cynically stated that this could provoke parties “to file first and to ask questions later”; consequently, the creditor “who hesitates is lost.”⁴²

Therefore, the conclusion can be drawn that the lack of harmonization between the domestic bankruptcy law regimes and unresolved issues in the Regulation itself are driving forces behind insolvency forum shopping. A harmonization in the field of domestic bankruptcy laws seems to be a political impossibility and therefore unlikely. Consequently, the present author

³⁶ S Davydenko and J Franks, above n 27, 569 et seq.

³⁷ Ibid.

³⁸ Wolf-Georg Ringe, *Forum Shopping under the EU Insolvency Regulation* (2009) available at Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1326964> (at June 19, 2009) at 15.

³⁹ Section 286 et seq Insolvenzordnung (InsO).

⁴⁰ For further details see H Eidenmüller, above n 7, 19.

⁴¹ WG Ringe, above n 38, 16.

⁴² On this “race to the courthouse” and the interconnected unresolved issues see G McCormack, above n 29, 186.

propagates that incentives for insolvency forum shopping will persist and future forum shopping cases will be observed. This underlines the necessity to develop a proper framework to deal with the occurring problems.

IV. Forum Shopping – A Definition

In Recital 4 of the EIR forum shopping is referred to as the “transfer [of] assets or judicial proceedings from one Member State to another” in order to “obtain a more favourable legal position”. Under the Regulation the forum and the applicable insolvency law depend on the debtor’s COMI. Therefore, forum shopping requires the debtor to move his COMI from one jurisdiction to another. As a result the forum for the main insolvency proceedings⁴³ and the *lex forum concursus*⁴⁴ will be those of the new state where the COMI is then situated.

In the academic literature the conduct was summarized as “identifying the optimal jurisdiction for ... the purpose of the restructuring or insolvency of a given company, and taking measures so that the law of that jurisdiction is applied.”⁴⁵

However, not every COMI shift has detrimental effects and should consequently be prohibited. Therefore, the current author is in favour of a reference to forum shopping as an *abusive* change of a debtor’s COMI in the vicinity of bankruptcy.⁴⁶ In this view the main criterion for an abuse is the (in-)capability of the conduct to further the maximization of the debtor’s net assets that are available to satisfy the creditors’ claims. In case the COMI shift is able to maximize the net assets it has to be regarded as non-abusive. If the conduct did not lead to a maximization of the net assets it is, in principle, abusive.⁴⁷

This finding would also be in line with recent case law. In the *PIN Group* case before a German court, a holding company moved its COMI in order to enable a proper restructuring process. Despite the vicinity of the insolvency petition the court held that the COMI shift was not abusive as it merely tried to coordinate the insolvency proceedings over the whole holding group. Therefore, it was regarded as being in the interest of the creditors as it tried to maximize the debtor’s net assets.⁴⁸

Nonetheless, it remains difficult to identify a debtor’s net assets. Therefore a restriction to evident cases should take place. Furthermore, these problems underline the necessity to take other factors into account. The motives driving a COMI shift are of the utmost importance. Therefore, COMI shifts that obviously benefit the debtor at the expense of the creditors or some creditors at the expense of other creditors are “suspicious”. In case a COMI shift intends to enrich the persons initiating it, it is abusive. Consequently, a COMI shift

⁴³ Article 3 of the Regulation.

⁴⁴ Article 4 of the EIR.

⁴⁵ WG Ringe, above n 38, 3.

⁴⁶ In the same fashion H Eidenmüller, above n 7, 16.

⁴⁷ Ibid.

⁴⁸ Local District Court Cologne, Resolution of February 19, 2008 (73 IE 1/08), [2008] Zeitschrift für Wirtschaftsrecht 423; for an endorsing comment on the finding in this case see H Eidenmüller, above n 7, 17.

undertaken in order to further efficiency considerations should not be regarded as abusive behaviour whereas COMI shifts conducted in order to claim value are abusive.⁴⁹ If a COMI shift is conducted in an abusive manner the former COMI has to remain the decisive criterion for the jurisdiction to open main insolvency proceedings.⁵⁰

Consequently, not every COMI shift is abusive. Recitals 2, 8, 16, 19, 20 explicitly underline the efficient administration of cross-border insolvencies as one goal of the EIR. With regard to these provisions it was stated that they should foster the aim “of maximising the net assets to satisfy creditors’ claims”. Another goal that is explicitly mentioned in recital 4 of the Regulation is the prevention of forum shopping. These two goals can allegedly be contradicting, as under particular circumstances a COMI shift might be required in order to assure the efficient administration of a cross-border insolvency constellation. In these situations the question arises which of the two goals obtains priority. The efficient administration of a cross-border insolvency constellation should gain priority as the rescue of a firm with resulting advantages for the creditors through a COMI shift should not be prevented.⁵¹ This is underlined by the decision *Re Ci4net.com Inc*⁵² in which it was stated that if the COMI was shifted for sound commercial reasons the policy against forum shopping should not prohibit this conduct. In contrast cynical COMI changes should be prohibited.

⁴⁹ On this line of argument see H Eidenmüller, above n 7, 16.

⁵⁰ H Eidenmüller, above n 7, 18.

⁵¹ H Eidenmüller, above n 7, 14 – 15.

⁵² [2005] BCC 277.

V. The COMI Concept - A “Breeding Ground” for Forum Shopping?

As it defines the state in which the main insolvency proceedings are to be opened, the COMI concept is of the utmost importance for the question of forum shopping. In case a firm conducts its entire business in one country the COMI is unambiguous and there is no room for forum shopping. In contrast, forum shopping becomes an option when a firm is active in several different countries and especially internationally operating corporate groups “have leeway to engineer insolvency proceedings in one of the countries in question.”⁵³ The COMI concept itself can be regarded as a means to prevent manipulations, as normally it will be more difficult to move factual criteria than legal ones.⁵⁴ Nonetheless, the COMI can possibly be shifted in the vicinity of bankruptcy in order to reach the applicability of a different national insolvency law. Furthermore, in the context of groups of companies proceedings might be filed in a jurisdiction that appears to be the most favourable choice for a particular purpose. In the further course of the investigation the COMI concept and the facts that determine it will come under closer scrutiny. Furthermore, constellations concerning groups of companies will be investigated. In this context the COMI might not factually be shifted, but it might be argued that the COMI of a particular company was situated in a certain jurisdiction. Furthermore, the COMI of natural persons and the relevant time for the determination of the COMI will be examined.

1. Weak Points of the COMI Concept and Possible Manipulations

In order to understand the COMI concept that was adopted in the EIR it makes sense to recall the differing domestic concepts that existed in Europe. The traditional approach in the UK was the reference to the place of registration. Consequently, when there were proceedings in more than one country, the main proceeding would take place in the state of registration. Proceedings in other states would be ancillary to this main proceeding.⁵⁵ The continental approach preferred to focus on the “real seat” of the company.⁵⁶ Article 3 has to be regarded as a compromise between these two approaches. On the one hand there is the rebuttable presumption of the COMI being situated at the place of registration. Nonetheless, it was

⁵³ Luca Enriques and Martin Gelter, *Regulatory Competition in European Company Law and Creditor Protection* (2006) 7 *European Business Organization Law Review* 417, 442.

⁵⁴ Henriette-Christine Duursma-Kepplinger, *Aktuelle Entwicklungen in Bezug auf die Auslegung der Vorschriften über die internationale Eröffnungszuständigkeit nach der Europäischen Insolvenzverordnung* [2006] *Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht* 177, 179.

⁵⁵ G Moss, above n 8, 1008.

⁵⁶ Gabriel Moss, Ian F Fletcher and Stuart Isaacs (editors), *The EC Regulation on Insolvency Proceedings: A Commentary and Annotated Guide* (Oxford, Oxford University Press, 2002) at para 3.11.

stated that by introducing the COMI concept, in substance the “seat” approach had won as this appears to be the idea that most likely was behind the “centre of main interests” concept.⁵⁷

Article 3 (1) of the EIR plainly states that “[t]he courts of the Member State within the territory of which the centre of the debtor’s main interests is situated shall have jurisdiction to open insolvency proceedings.” The choice of the COMI for the execution of main insolvency proceedings was regarded as the most appropriate approach, as this represented the location to which the creditors were most accustomed, where the main bulk of the debtor’s assets were located⁵⁸ and where “the business was done”⁵⁹. According to Article 3 (1) of the EIR the jurisdiction in which the debtor’s COMI is situated shall possess the exclusive competence to open main insolvency proceedings. The opening of such insolvency proceedings has an instant and universal effect in the whole European Union. The ulterior motive behind this provision was that insolvency proceedings with pan-European extraterritorial effects were expected to produce better returns for the creditors than an agglomeration of separate national proceedings.⁶⁰ Furthermore, it was regarded as more likely that a company could be rescued when the main part of the insolvency proceedings were dealt with in the same jurisdiction.⁶¹ According to Article 4 of the EIR “the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened.” So the applicable insolvency law is tied to the bankruptcy forum.

Therefore, successful forum shopping under the EIR requires that the debtor is able to move his COMI from one into another jurisdiction as both the forum and the applicable insolvency law (*lex forum concursus*) depend on his “centre of main interests”. In case of a successful COMI shift, the forum for the main insolvency proceedings according to Article 3 of the EIR as well as the *lex forum concursus* will be those of the Member State into which the COMI was transferred.⁶²

⁵⁷ G Moss, above n 8, 1008.

⁵⁸ H Eidenmüller, above n 7, 4.

⁵⁹ Miguel Virgos and Etienne Schmit, *Report on the Convention on Insolvency Proceedings*, Annex 2 to Gabriel Moss, Ian F Fletcher and Stuart Isaacs (editors), *The EC Regulation on Insolvency Proceedings: A Commentary and Annotated Guide* (Oxford, Oxford University Press, 2002), para 75.

⁶⁰ Jay L Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum* (1991) 65 *American Bankruptcy Law Journal* 457, 465: “a universalist rule would so increase values available for all local claimants in all general defaults as to offset by far the losses that particular local claimants might suffer in some cases. That assertion is persuasive because the preservation of going concern values and the maximising of liquidation values by integrated sales will likely increase returns to creditors greatly.”

⁶¹ G McCormack, above n 29, 174.

⁶² On this point see e.g. WG Ringe, above n 38, 3.

Unfortunately, the term “centre of main interests” is not defined in the main text of the Regulation. There only is a rebuttable presumption in Article 3 (1) of the EIR that in case of a company “the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.” The background of this provision is the presumption that a company’s head office is regularly situated at the place of its registered office.⁶³ However, in Recital (13) of the EIR it is stated that the COMI “should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.” This statement is rather a description than a definition. It was copied from paragraph 75 of the Virgos-Schmit report. Despite leaving several questions unresolved, the description offers a starting point for the further discussion. The decisive criterion seems to be the place where the head office functions are regularly carried out rather than the place where the head office is located.⁶⁴ It was stated that for the determination of the COMI “the attributes of transparency and objective ascertainability are dominant factors” as third parties who dealt with the debtor should be able to rely on their legitimate expectations.⁶⁵ In the *Eurofood* decision the ECJ underlined the autonomous interpretation of the Regulation and referred to Recital 13 by stating that “[t]hat definition shows that the centre of main interests must be identified by reference to criteria that are both objective and ascertainable by third parties. That ... [is] necessary in order to ensure legal certainty and foreseeability concerning the determination of the court with jurisdiction to open main insolvency proceedings.” Therefore, “empirically verifiable realities ... are capable of displacing the effects of such formal criteria as the place of registration [etc]”.⁶⁶ In order to assess the COMI a court has to take a large variety of factors into account. The most important criteria are the following locations: the place where the company’s business is managed and where the contracts are concluded; the place where board meetings take place; the place where the customers, creditors and supplier are situated and the location where the chief executive spends most of his time. These facts have to be weighed against each other in order to decide where a company’s COMI is situated.⁶⁷ However, the Regulation itself does not indicate which facts should be decisive for the determination of the COMI. The decisive facts were rather developed by courts and the academic literature than by the European legislator. Consequently, there are no guidelines

⁶³ M Virgos and E Schmit, above n 59, para. 75.

⁶⁴ G Moss, I Fletcher and S Isaacs, above n 56, 169.

⁶⁵ I Fletcher, above n 9, at 7.41.

⁶⁶ I Fletcher, above n 9, at 7.42.

⁶⁷ Roy Goode, *Principles of Corporate Insolvency Law* (London, Sweet & Maxwell, 2005), at 591.

with regard to the different weight with which particular facts have to be taken into account. This gives considerable leeway to the courts in their decisions.⁶⁸ This “fact sensitivity” leaves room for companies to strategically manipulate the relevant facts. There are several possibilities to move assets in order to choose the preferred bankruptcy forum.⁶⁹ Therefore, it was said to be of the utmost importance that a “change must have some element of permanence and must be based on substance and not on illusion.”⁷⁰ In the case law this approach was underlined by the statement that it was required “to have regard to the need, if the centre of main interests is to be ascertainable by third parties, for an element of permanence. The court should be slow to accept that an established centre of main interests has been changed by activities which may turn out to be temporary or transitory”.⁷¹ This finding is underlined by Recital (13) of the Regulation as “[t]he present tense (‘conducts’) and the requirement of the ‘regular basis’ impose conditions to the COMI that are difficult to fulfil when the debtor wants to move its COMI on a short-term basis.”⁷² Nonetheless, it has to be mentioned that even objective facts can be changed. The COMI is a “fact-sensitive criterion” and consequently these facts can be subject to manipulation.⁷³ Furthermore, the COMI concept is “capable of varying judicial interpretations.”⁷⁴ Some courts appear to be more ready than others to accept jurisdiction over a particular case and open main insolvency proceedings.⁷⁵ Therefore, the COMI concept has been described as “a highly manipulative concept” that left “ample discretion for creative judicial interpretation”.⁷⁶ It was concluded that the “highly ambiguous and manipulative concept” required “subjective and fact-intensive evaluations by judges”.⁷⁷

Consequently, there appears to be the real danger of a debtor relocating his COMI shortly before insolvency proceedings are filed in order to “organize a tactical withdrawal from the State in which creditors are taking the necessary preliminary steps with a view to seeking the

⁶⁸ On this serious omission see S Franken, above n 18, 253.

⁶⁹ Horst Eidenmüller, *Free Choice in International Company Insolvency Law in Europe* (2005) European Business Organization Law Review 423, 430.

⁷⁰ G McCormack, above n 29, 191.

⁷¹ *Shierson v Vlieland-Boddy* [2005] BCC 949.

⁷² WG Ringe, above n 38, 12.

⁷³ Bob Wessels, *The European Union Insolvency Regulation: An Overview With Trans-Atlantic Elaborations* (2003) Norton Annual Survey of Bankruptcy Law 481.

⁷⁴ G McCormack, above n 29, 185.

⁷⁵ See *Hans Brochier Holdings Ltd v Exner* [2007] BCC 127.

⁷⁶ S Franken, above n 18, 249-253.

⁷⁷ L Enriques and M Gelter, above n 53, 438.

opening of insolvency proceedings.”⁷⁸ The COMI concept appears to be too vague to provide a serious safeguard against this particular kind of conduct.

2. The COMI Concept in the Context of Groups of Companies

As already mentioned above constellations concerning company groups bear severe problems with regard to the assessment of the COMI. A group of companies can try to file for insolvency in a particular jurisdiction (in which it does not necessarily have its COMI) in order to reach the applicability of its most favourable insolvency law regime. Thereby, it might try to convince a court with legal arguments or a certain interpretation of legal terms to commence insolvency proceedings without having conducted a change in the factual scenario.⁷⁹ In these constellations the arising questions are mainly concerned with the correct definition of the COMI of the legal persons involved. The occurring problems with regard to the COMI standard will be outlined in the further course of the investigation.

Already with regard to the original Convention on Insolvency Proceedings there was no provision dealing with the treatment of insolvent groups of companies. The Virgos-Schmit report affirmed: “The Convention offers no rule for groups or affiliated companies (parent-subsidiary schemes).”⁸⁰ The same omission is true with regard to the EIR. The provisions of the Regulation are not designed to deal with corporate groups but rather refer to single corporate entities. It can be stated that despite being aware of the issue the legislator took no further steps in order to provide an appropriate solution. However, jurisdiction has to be determined separately for each legal entity, including those legal entities that are part of a group of companies.⁸¹

With regard to constellations of corporate groups, concerns were expressed that courts might show a tendency to “administratively consolidate” the insolvency of group companies. On the other hand, corporate groups could just as well try to file for bankruptcy of both the parent company and the subsidiaries in the same court.⁸²

From a practical point of view, it has to be mentioned that it would be an advantage to have a central main proceeding for an insolvent group of companies as “having separate main proceedings in each place where each subsidiary in a group is registered is wasteful,

⁷⁸ I Fletcher, above n 9, at 7.42.

⁷⁹ WG Ringe, above n 38, 5.

⁸⁰ M Virgos and E Schmit, above n 59, para 76.

⁸¹ Ibid.

⁸² On these concerns see S Franken, above n 18, 249.

duplicative, expensive, and likely to impede a rescue, reconstruction, or a beneficial realization of the business of the group.”⁸³

The question of the COMI of a group of companies is not an easy one to answer. For example, the COMI is debatable when the place(s) of incorporation, the main bulk of assets, the operations and the headquarter are all situated in different countries. It was stated that recital 13 of the Regulation, in which it is stated that the COMI “should correspond to the place where the debtor conducts the administration of his interests on a regular basis” is not really able to shed further light on these constellations.⁸⁴ Consequently, a closer look at the case law appears to be appropriate in order to gain an insight in the treatment of insolvent corporate groups through the courts.

The *Daisytek* case⁸⁵ dealt with the insolvency of the members of the Daisytek group. McGonigal J made administration orders as main insolvency proceedings for English-, French- and German-registered companies of the European company group. He held that the COMI of each of the companies was located in England. The line of argument that led to this finding was that although current operations were going on in different countries, the main part of the administrative organization was carried out in England. Furthermore, the companies needed the confirmation of ISA International to acquire anything above a certain value, most of the contracts were negotiated and entered in England, all the corporate identity and the branding was run from the Bradford office and the business of the companies had to be run in accordance with the central management strategy plan. Therefore, England was regarded as the COMI of each of the companies.⁸⁶

This approach led to “a distinction between the place from which a trading company conducts its dealings with customers in a direct sense ... and the place from which administrative control of the debtor’s main interests is systematically and transparently exercised.”⁸⁷

The judicial reasoning of the *Daisytek* case was endorsed in *Re Crisscross Telecommunications Group*.⁸⁸ The case dealt with a corporate group scenario with the companies incorporated under the laws of several EU Member States. Nonetheless, the COMI of each of the companies was found to be situated in the UK. It was argued that most of the board decisions were taken in the UK, the administration and the management were

⁸³ G Moss, above n 8, 1008.

⁸⁴ Fair point by G McCormack, above n 29, 186.

⁸⁵ *Re Daisytek-ISA Ltd* [2003] BCC 562 (Ch).

⁸⁶ *Re Daisytek*, above n 85, para 14.

⁸⁷ I Fletcher, above n 9, at 7.69.

⁸⁸ Chancery Division, May 20, 2003, unreported.

carried out from London and that despite contracts being made in other countries the accounting took place in the UK.

The cases discussed were interpreted as consolidating a “functional” test with regard to the COMI criteria – partly referred to as “command and control” test, partly called the “head office functions” test.⁸⁹ It can be stated that courts quite readily rebutted the presumption laid down in Article 3 (1) of the EIR that the COMI was situated at the place of incorporation.

Partly the “command and control” test was regarded as an infringement of the ascertainability criterion in Recital (13) of the EIR.⁹⁰ It is submitted that in the cases discussed so far, due care was taken not to infringe this requirement.⁹¹ Nonetheless, the critique should be kept in mind as a warning that the COMI has to be ascertainable by third parties such as the creditors.

In the *Eurofood* case⁹² the European Court of Justice had to decide about a further group insolvency scenario. The decision is of importance as it provides further guidelines with regard to the COMI criterion in this context. With regard to the presumption in Article 3 (1) of the EIR the ECJ stated that it could only be rebutted “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 at that registered office is deemed to reflect”.⁹³

With regard to forum shopping cases the “objective and ascertainable” criterion was said to have the implication that it would make COMI shifts more difficult as “factual and not only legal criteria ... need to be moved across the border.”⁹⁴ The “head office functions” test came under closer scrutiny in the Advocate General’s opinion which was generally endorsed by the court. It was stated that if “the centre of main interests is somewhere other than the State where a company’s registered office is located, it consequently needs to be shown that the head office’ type of functions are performed elsewhere. The focus must be on the head office functions rather than simply on the location of the head office because a ‘head office’ can be just as nominal as a registered office if head office functions are not carried out there. ... [I]n the case of groups of companies ... the head office functions for the subsidiary are often carried out at the place where the head office functions of the parent of the group are carried

⁸⁹ I Fletcher, above n 9, at 7.75.

⁹⁰ H Eidenmüller, above n 7, 24.

⁹¹ For example, in the *Daisytek* case most creditors knew that the most important functions were carried out in Bradford; see *Re Daisytek*, above n 85, 16.

⁹² Case C-341/04, *Re Eurofood IFSC Ltd* [2006] ECR I-3813.

⁹³ *Re Eurofood*, above n 92, para 34.

⁹⁴ WG Ringe, above n 38, 9.

out.”⁹⁵ The ECJ therefore appears to adopt the approach that the “head office functions” test is capable of rebutting the place of registration as the centre of main interests.⁹⁶

With regard to company groups it can be concluded that in case their holding company or entity with ‘command and control’ is based in a particular country, this country is rendered their centre of main interests for the purpose of opening main insolvency proceedings under the regime of the Regulation.⁹⁷ Nonetheless, it has to be mentioned that the problems mentioned with regard to single legal entities apply for corporate groups as well. In this context the problem of facts being manipulated might even be more severe as, due to the possible multitude of legal persons involved, there are more facts that have to be taken into account. As mentioned above the Regulation does not make a clear statement which facts have to be taken into account with which weight attached to them. In the context of corporate groups this can have the outcome that many group companies could be brought under the influence of the court in the Member State where the parent company has its headquarter, regardless of the facts where the employees are situated, where the everyday business is conducted or what expectations the creditors might have had. Debtors could “tailor the facts to their own advantage” and as the decision to open main insolvency proceedings has to be challenged before the opening court itself, this might create a further obstacle for foreign creditors intending to challenge this decision.⁹⁸ With regard to the cases discussed it can be concluded that for corporate groups it is rather easy to select the forum and thereby the law of their choice.⁹⁹

3. The COMI Concept in the Context of Natural Persons

As the Regulation also applies to natural persons the question arises where the COMI of such persons is situated. In the Virgos-Schmit report it is stated that in these constellations the COMI is the place of a natural person’s habitual residence.¹⁰⁰ Criteria like the place where the family photos are kept¹⁰¹ or the number of days spent in a particular place per annum provide the factual background against which the COMI has to be determined in this context. In this particular case a COMI shift requires the individual to move to another state in order to stay and work there.

⁹⁵ *Re Eurofood*, above n 92, Opinion of Advocate General Jacobs.

⁹⁶ G Moss, above n 8, 1017.

⁹⁷ E Geva, above n 30, 607.

⁹⁸ On this line of argument see S Franken, above n 18, 253 – 254.

⁹⁹ In the same way: L Enriques and M Gelter, above n 53, 438 – 439.

¹⁰⁰ M Virgos and E Schmit, above n 59, para 75.

¹⁰¹ An example brought forward by Professor Fletcher in the LL.M. class 2009 at the University of Auckland.

4. The Relevant Time for the Determination of the COMI

In the further course of the investigation the correct treatment of COMI shifts will be examined that are conducted between the first filing for insolvency and the moment when the proceedings are actually opened.

The *Staubitz-Schreiber* case¹⁰² dealt with a German citizen who moved her COMI to Spain after an insolvency petition had been filed but before the opening of insolvency proceedings. The question arose whether the German court still had jurisdiction over the case as, according to Article 3 (1) of the European Insolvency Regulation, the COMI was no longer situated in Germany but rather in Spain as the applicant now lived and worked there. The German *Bundesgerichtshof* referred the case to the European Court of Justice that had to decide the issue, whether it was of importance for the question of jurisdiction that the debtor had moved her COMI to another Member State before the proceedings were opened but after the filing for insolvency. The ECJ decided that the COMI at the time of the insolvency petition was the decisive criterion.¹⁰³ The court argued that acknowledging the COMI shift would invite forum shopping. Therefore, it would be “contrary to the objectives pursued by the Regulation” to acknowledge subsequent COMI shifts.¹⁰⁴ The court pointed out that according to Recital (4) incentives for parties to participate in forum shopping should be avoided. Otherwise it would also be more difficult for creditors to assess credit risks and debtors could try to escape their creditors by moving from one state to another. This could also lead to an extension of the proceeding. By not acknowledging the subsequent COMI shift, greater judicial certainty for the creditors should be ensured. Another argument that spoke against acknowledging the COMI shift was the fact, that this outcome would be incompatible with the right of a provisional administrator that was already appointed to seek protection under Art 38 EIR. The ECJ concluded that COMI shifts after the insolvency petition should never be acknowledged.

This finding of the ECJ found support in the academic literature. It was stated that the recognition of the COMI would result in less efficient insolvency proceedings. Insolvency costs in the course of the first proceedings (appointment of a provisional administrator, temporary measures) would be wasted if a COMI shift after the first petition could result in the court of another state gaining jurisdiction for the main insolvency proceedings.¹⁰⁵ It was stated that “[t]he relevant moment to establish international jurisdiction is when the

¹⁰² Case C-1/04 *Susanne Staubitz-Schreiber* [2006] ECR I-701.

¹⁰³ *Susanne Staubitz-Schreiber*, above n 102, paras 21 – 29.

¹⁰⁴ *Susanne Staubitz-Schreiber*, above n 102, para 24.

¹⁰⁵ See H Eidenmüller, above n 7, 21.

application to open insolvency proceedings is filed ... [because] [t]his is the only reference date that avoids incentives for forum shopping that the Insolvency Regulation expressly tries to eliminate.”¹⁰⁶

Therefore, it can be concluded that the relevant time for the determination of the location of the COMI is the lodging of the request to open insolvency proceedings. COMI shifts after an insolvency petition must not be recognized at all. Instead the court in the state where the COMI was situated keeps the competence to open main insolvency proceedings if the COMI is subsequently moved to another Member State. The COMI is “frozen” at the time of the insolvency petition.¹⁰⁷

However, the outcome is not self-evident as other examples in the case law illustrate. In the decision *Shierson v Vlieland Boddy*¹⁰⁸ a Registrar had made a bankruptcy order against the debtor and thereby accepted jurisdiction under the EIR. The debtor had moved his COMI from the UK to Spain after he had incurred the bankruptcy petition debt, but before the petition was heard or a bankruptcy order was made. The Registrar argued that the relevant time for the determination of the COMI was the time, when the debt was incurred. In his opinion the COMI was therefore situated in the UK. Mann J held that the relevant time for assessing the COMI was the time of the opening of proceedings, which would be the date when the relevant order was made. In the academic literature it was criticised that according to this approach, debtors would be allowed to change their COMI and that they could therefore choose the most favourable jurisdiction for them.¹⁰⁹ For the sake of clarity the approach of the ECJ seems to be preferable. Otherwise forum shopping could be abetted.

Additionally, a COMI shift immediately prior to the insolvency petition will fail to fulfil the requirement of the term “on a regular basis”.¹¹⁰ On the other hand, it can be stated that “for switches taking place with some anticipation, it might be difficult not to recognize the new COMI, provided that the longer the time lag between the switch and the filing, the more difficult to resort to general abuse or fraud exceptions to disregard it.”¹¹¹

The current chapter outlined severe uncertainties with regard to the COMI concept. Even in the context of single firms the fact-sensitivity of the standard enables manipulations. With

¹⁰⁶ M Virgos and F Garcimartin, above n 15, 49 et seq.

¹⁰⁷ H Eidenmüller, above n 7, 22.

¹⁰⁸ *Shierson v Vlieland-Boddy* [2005] EWCA Civ 974.

¹⁰⁹ Gregory Mitchell and Richard Brent, *Establishing Jurisdiction in Insolvency Cases* (2005) 155 *New Law Journal* 1819, 1821.

¹¹⁰ M Virgos and F Garcimartin, above n 15, at 41 and 50.

¹¹¹ L Enriques and M Gelter, above n 53, 439.

regard to corporate groups the uncertainties multiply. On an international level the “fuzziness” of the COMI standard might be exploited for abusive COMI shifts.¹¹² Taken into account the lack of harmonization in the domestic bankruptcy law regimes, there exists a proper “breeding ground” for insolvency forum shopping. However, as outlined above the COMI can only be shifted before the institution of insolvency proceedings.

¹¹² Joseph A McCahery, *Creditor Protection in a Cross-Border Context* (2006) 7 *European Business Organisation Law Review* 455, 459.

VI. Economic Aspects of Forum Shopping

According to Recital (4) of the Regulation “[i]t is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position”. This statement reflects a rather hostile position with regard to forum shopping in the context of cross-border insolvencies. The current chapter intends to examine, whether this view is justified. Forum shopping is investigated with regard to its possible positive and negative economic effects.

It was argued that forum shopping might be used in order to further opportunistic insolvency petitions. It is not unlikely that adjusting (sophisticated) creditors¹¹³ are well informed about a company’s financial situation and the preferences of the management. This could lead to a coalition of important creditors and the management in order to file an insolvency petition in a management-friendly jurisdiction. Due to information asymmetries this can have detrimental effects for non-adjusting creditors (e.g. tort victims or people who extend credit in such small amounts that adjusting their position would simply be uneconomical) who most likely happen to be not that well-informed. This danger especially exists as tort creditors do not have the possibility to rule out COMI shifts through a firm. On this way their interests could be undermined in case the sophisticated creditors and the management decide to file for insolvency in a country, that offers only minimal protection for smaller creditors.¹¹⁴ In contrast, sophisticated creditors can try to eliminate forum shopping opportunities on a contractual basis. Therefore, it can be hold that forum shopping can have negative effects in case sophisticated creditors force a company into a jurisdiction that is detrimental to the legal position of tort creditors.¹¹⁵

Furthermore, forum shopping could result in a discrepancy between the applicable company and insolvency law. This is the case when a company is incorporated under the law of state A and at first conducts its major business in this state but in the vicinity of insolvency shifts its COMI to state B. As a consequence the company law of state A would be applicable. In contrast, the COMI of the firm would be situated in state B which would lead to the applicability of state B’s insolvency law. Consequently, there would be a discrepancy

¹¹³ The terminology of “adjusting” and “non-adjusting” creditors was first brought forward by Lucian A Bebhuk and Jesse M Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy* (1996) 105 Yale Law Journal 857.

¹¹⁴ J Armour, above n 2, 47.

¹¹⁵ On this line of argument see J McCahery, above n 112, 458.

between the applicable insolvency and company law.¹¹⁶ This situation can have various disadvantages. The first problem could arise with regard to the issue of creditor protection. If state A decided to organize its creditor protection in its insolvency law whereas state B decided to incorporate rules of creditor protection in its company law, there would be a considerable lack of creditor protection with regard to the company described above as none of the creditor protection rules would be applicable. The combination of the company law of one Member State with the bankruptcy law of another could be exploited by shareholders and managers who might attempt to live in the best of both worlds (“cherry-picking”) at the expense of the creditors.¹¹⁷ Furthermore, there might be conflicts when creditor protection rules of different legal systems collided.¹¹⁸ It was mentioned to be another problematic point, that the dividing line between company law and insolvency law might be difficult to assess.¹¹⁹ These constellations can have the outcome of an increase of the insolvency costs.¹²⁰ It is submitted that a discrepancy between the applicable company and insolvency law can not only occur due to abusive COMI shifts, but also is a possible outcome of the legitimate choice of a company law as propagated by the ECJ in the cases *Centros*, *Überseering* and *Inspire Art*¹²¹. So if a company with its COMI in Germany decides to incorporate under English company law, this would result in the same outcome. Nonetheless, the present author acknowledges that an increase in bankruptcy costs was likely to occur in these constellations.¹²²

Another point that has to be taken into account is the fact that insolvency codes should further the ascertainability and predictability of the bankruptcy forum and the applicable bankruptcy law. This is of the utmost importance for creditors when they grant credit in order to price a loan appropriately. Forum shopping conducted in the vicinity of insolvency might lead to the application of a different bankruptcy regime than originally expected by the creditor. Debtors might be able to deliberately manipulate the facts that determine the bankruptcy forum and the applicable law. This can have detrimental effects on efficient credit contracts.¹²³

¹¹⁶ On the discrepancy between the applicable company and insolvency law regime in a more general context see A Schall, above n 20, 1536.

¹¹⁷ On this problem see Wolfgang Schön, *Playing Different Games? Regulatory Competition in Tax and Company Law Compared* (2005) 42 *Common Market Law Review* 331, 353 – 355.

¹¹⁸ A Schall, above n 20, 1537.

¹¹⁹ *Ibid.*

¹²⁰ H Eidenmüller, above n 7, 13.

¹²¹ See above n 1.

¹²² In a similar direction goes H Eidenmüller, above n 7, 25.

¹²³ H Eidenmüller, above n 69, 429.

On the other hand, the efficient administration of cross-border insolvencies is explicitly mentioned as a goal of the EIR in recitals 2, 8, 16, 19 and 20. Forum shopping could enable the selection of appropriate restructuring procedures by organizing and coordinating multiple proceedings.¹²⁴ For example, the UK restructuring regime appears to be attractive to firms seeking restructuring. Therefore, forum shopping could enable a bankrupt company to choose an insolvency venue where a fast, competent and predictable reorganization of a company in distress can take place. This could maximize the value of the reorganized firm.¹²⁵ Consequently, bankruptcy costs could possibly be minimized. Furthermore, the choice of a different insolvency forum could in some cases also lead to a firm's rescue that would not have been able to take place in the original jurisdiction. In these situations the conduct in question could further the goals of the Regulation.

A particular situation occurs when the creditors initiate a COMI shift or, at least, endorse it. It was stated that in these constellations the creditors expected certain advantages from the migration of the company. According to the principle *volonti non fit iniuria*, consenting creditors were regarded as a clear sign that the forum shopping of the debtor should not be regarded as abusive but rather "beneficial and efficient, as it will most certainly reduce the side costs of the insolvency."¹²⁶

It can be concluded that the overall economic effects of forum shopping are unclear as "[n]o conclusive empirical data exists on the total efficiency effects of forum shopping in the insolvency fields. Both positive and negative consequences can be identified on a theoretical level, but the evidence to pass a final judgement on the phenomenon is lacking."¹²⁷

¹²⁴ Marcus Cole, "Delaware is Not a State": Are We Witnessing Jurisdictional Competition in Bankruptcy? (2002) 55 Vanderbilt Law Review 1845, 1859-1871.

¹²⁵ Advocating this position in the US context Kenneth Ayotte and David A Skeel Jr, *Why Do Distressed Firms Choose Delaware? An Empirical Analysis of Venue Choice in Bankruptcy* (2004), available at Social Science Research Network <<http://ssrn.com/abstract=463001>> (at June 19, 2009).

¹²⁶ WG Ringe, above n 38, 20.

¹²⁷ H Eidenmüller, above n 7, 7.

VII. Possible Countermeasures against Forum Shopping

There are several conceivable possibilities how a debtor's abusive COMI shift might be prevented. The problem can be tackled on different levels.

Creditors could try to rule out forum shopping in the contract with the debtor. As one possibility a contract clause was proposed in which it was stated where the creditor's COMI was situated. This approach has to be rejected due to the fact that it only represents a reference to the status quo but cannot prevent subsequent COMI shifts.¹²⁸

Furthermore, the parties to a contract could agree that the debtor required the creditor to give his consent with regard to a COMI shift. A COMI shift lacking the creditor's consent could possibly be punished with a speeding up of the debtor's payment obligation. It could be argued against this solution that in most cases it might be uneconomical for the creditor to draft such a sophisticated contract and that this solution would realistically only be applicable to major lending transactions. Furthermore, it was argued that such agreements are no proper tool to deter creditors that want to misuse a COMI shift for their own good at the expense of their creditors.¹²⁹ Additionally, the approach is not helpful with regard to involuntary and unsophisticated creditors. Unsophisticated creditors do not have the know-how to negotiate an appropriate contract and involuntary creditors (such as tort creditors) do not negotiate the terms of a contract at all.¹³⁰

On a different level courts have several means to deal with forum shopping. The *Bundesgerichtshof* held that it had to be regarded as abusive behaviour when an insolvency application took place within three weeks after the migration.¹³¹ A similar approach can be observed in France where a transfer of the COMI is not recognized if it took place within half a year before the application of insolvency proceedings.¹³²

Finally, the Regulation itself provides for safeguards against forum shopping. It contains several creditor protection rules. The creditors have the possibility to challenge the opening of insolvency proceedings by judicial review. On the other hand, this has to take place before the court where the insolvency proceedings were opened, which, due to high costs, is a rather inappropriate solution for foreign creditors. Furthermore, the creditors can file for insolvency in the Member State where they think the COMI of the company in question is situated.¹³³ A further means of creditor protection is established by secondary proceedings according to

¹²⁸ H Eidenmüller, above n 7, 14.

¹²⁹ Ibid.

¹³⁰ Lynn M LoPucki, *Global and Out of Control?* (2005) 79 *American Bankruptcy Law Journal* 78, 102 – 103.

¹³¹ *Bundesgerichtshof* (Decision of March 20, 1996), X ARZ 90/96, (1996) 132 *BGHZ* 195.

¹³² Boris Dostal, *Französisches Internationales Insolvenzrecht* [1998] ZIP 969, 970.

¹³³ On these possibilities see WG Ringe, above n 38, 21 – 22.

Article 3 (2) of the EIR. The courts of another Member State have jurisdiction to open secondary insolvency proceeding, if the debtor possesses an establishment within the territory of that state. Article 28 of the Regulation states that the secondary proceedings shall be governed by the law of the Member State where the secondary proceedings are opened. Therefore, it was stated that secondary proceedings “grant creditors situated in this state the possibility to obtain insolvency protection according to their own rules and apart from the main proceedings.”¹³⁴

¹³⁴ WG Ringe, above n 38, 22.

VIII. *De Lege Ferenda* – Is the European Insolvency Regulation a Case for Urgent Reform?

As outlined above the current situation under the regime of the EIR seems to be unsatisfactory in many respects. The “fuzziness” of the COMI concept appears to be unable to prevent forum shopping and the different domestic insolvency law regimes appear to provide various incentives to engage in this particular kind of conduct. Therefore, a discussion takes place, whether the Regulation requires a fundamental reform. Various reform proposals were brought forward in the academic literature. It is especially debatable to which degree creditors should have the freedom to select their bankruptcy forum and the applicable bankruptcy law.

A first idea would be to permit a firm to select a bankruptcy forum at the time of its incorporation. On this way the company would indirectly be able to select the applicable bankruptcy law. In comparison to the current situation with the COMI concept and its uncertainties this approach would lead to an increase with regard to the predictability of the applicable bankruptcy law. This could have a positive effect on the correct evaluation of credit risks. Furthermore, the management could select an appropriate insolvency forum with regard to a possible reorganization. Especially in the context of corporate groups a central bankruptcy venue could be created in order to organize the proceedings. On the other hand, the approach might lead to the situation, that a court has to deal with the insolvency of a company in a whole different country. This might not be the best solution with regard to the aspect of efficiency. Furthermore, company and insolvency laws from different Member States could apply. The possible disadvantages of this constellation have already been discussed above.¹³⁵ Therefore, this model appears to be not too attractive.

In a different approach it was suggested that the insolvency proceedings under the Regulation should be tied to the registered office of the firm in financial distress. The COMI would be replaced by the registered office as the decisive criterion for the determination of the bankruptcy forum. Basically, this would transform the rebuttable presumption in Article 3 (1) of the EIR that a company’s COMI was situated in the state of its registered office into an irrefutable one. With regard to firms which do not have a registered office it was suggested that the bankruptcy law of the state should apply according to which the firm was organized.¹³⁶ Furthermore, the choice once made at the time of incorporation would have to

¹³⁵ On this approach in greater depth see H Eidenmüller, above n 69, 433 – 437.

¹³⁶ Horst Eidenmüller, *Der Markt für internationale Konzerninsolvenzen: Zuständigkeitskonflikte unter der EuInsVO* (2004) 57 *Neue Juristische Wochenschrift* 3455, 3458 – 3459.

be binding. Otherwise, the company could “strategically reincorporate in another state on the eve of bankruptcy in order to take advantage of debtor-protective bankruptcy laws.”¹³⁷ It would be an advantage of this approach, that in insolvency situations the company and insolvency law from the same jurisdiction would be applicable. Consequently, there could not be a gap in the protection of creditors as it could otherwise occur. A further advantage would be the legal certainty that could be reached. The creditors would be provided with an easily ascertainable bankruptcy forum. They would just have to look up the place of the firm’s incorporation in order to determine the bankruptcy forum. Therefore, creditors would be enabled to assess credit risks accurately.¹³⁸ Furthermore, firms and sophisticated creditors would not have the possibility to cherry-pick between different company and insolvency laws.¹³⁹ As a firm had to make its choice at the time of incorporation, there would not be any room to strategically manipulate the applicable bankruptcy law in order to realize a wealth shift from the creditors to the debtor. Due to the deficiencies of the current COMI concept, the model discussed bears various advantages. It has to be regarded as a serious reform proposal with regard to the status quo of the COMI concept under the EIR. On the other hand the model raises difficulties with regard to a subsequent change of the applicable bankruptcy law. If such a shift was not possible at all, even legitimate changes would not be possible any more. From the perspective of efficiency this outcome would be undesirable. However, the present author has certain sympathies for the reform proposal. Due to its clarity it seems to have clear advantages over the COMI concept currently in force. Furthermore, Article 3 (1) of the Regulation could easily be changed in order to implement the amendment.

¹³⁷ S Franken, above n 18, 245.

¹³⁸ On this line of argument see Horst Eidenmüller, *Wettbewerb der Insolvenzrechte?* (2006) 35 *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 467, 480 – 482.

¹³⁹ For a more detailed account see H Eidenmüller, above n 69, 438 – 440.

IX. Forum Shopping and the “Freedom of Establishment”

In the further course of the investigation forum shopping will be examined against the background of the EC Treaty. In this context the freedom of establishment (Articles 43 and 48 EC Treaty) plays a critical role in the examination. The EC Treaty provides the unrestricted right of establishment within the EU.

It can be stated that a company shifting its COMI from one Member State to another is generally protected under the freedom of establishment. That is also the case when the COMI shift is merely conducted for the sake of the application of a different insolvency law regime. This is justified as the migration of a company always brings along considerable changes in the regulatory environment.¹⁴⁰ In an according constellation the Local District Court in Cologne concluded, that this conduct did not constitute an abuse but rather had to be regarded as a legitimate exercise of the freedom of establishment.¹⁴¹

It is important to bear in mind that the EC Treaty is indifferent about the legal category of the obstacle that restricts the freedom of establishment.¹⁴² Consequently, every obstacle that makes it less attractive to exercise the free choice of establishment in another Member State is a possible infringement of the freedom of establishment. Justifications may apply.¹⁴³ This point suggests that there could be a possible conflict between the EIR and the EC Treaty. The hostile attitude towards forum shopping and the COMI standard that prevents a free choice of the applicable insolvency law could be regarded as an obstacle that restricts the freedom of establishment. On the other hand, fundamental freedoms can be subject to restrictions for the sake of imperative requirements in the general interest.¹⁴⁴ The protection of creditors and workers are such imperative requirements, which can justify the restrictions mentioned above.¹⁴⁵ However, it can be concluded that “exceptional circumstances” have to exist in order to regard forum shopping as an abuse of the freedom of establishment. This could be the case when a COMI shift exclusively takes place for the purpose of harming a company’s creditors.¹⁴⁶

In contrast, the EIR appears to be more critical with regard to abusive COMI shifts than the EC Treaty. Therefore, not every infringement of the EIR will be an abuse of the freedom of

¹⁴⁰ H Eidenmüller, above n 7, 11.

¹⁴¹ Local District Court Cologne, above n 48, 426.

¹⁴² See Case C-210/06 *Cartesio Oktató és Szolgáltató bt* of 22 May 2008, para 30.

¹⁴³ *Inspire Art*, above n 1, at para 133.

¹⁴⁴ *Überseering*, above n 1, at para 92.

¹⁴⁵ H Eidenmüller, above n 7, 12.

¹⁴⁶ H Eidenmüller, above n 7, 11.

establishment. On the other hand, an abuse of the freedom of establishment will regularly be a contravention of the EIR as well.¹⁴⁷

¹⁴⁷ H Eidenmüller, above n 7, 12.

X. Regulatory Competition in the Context of Insolvency Law

Prima facie, one might think that there is no room for regulatory competition between the different European bankruptcy law regimes. According to Article 3 (1) of the EIR the main insolvency proceedings are administered by the court of the Member State in which the debtor's COMI is situated. For companies there is the refutable presumption that their COMI is situated in the state where the registered office of the company is located. The applicable insolvency law is (apart from some exceptions) the law of the state where the insolvency proceedings take place.¹⁴⁸ Companies cannot freely choose the insolvency forum and consequently they cannot choose the applicable insolvency law either. Nonetheless, the “fuzziness” of the COMI concept allows forum shopping to take place. Companies have possibilities to shift their COMI to a different Member State. Thereby, regulatory competition can indirectly be triggered.¹⁴⁹

Regulatory competition implies that the Member States adapt their law to attract insolvency filings.¹⁵⁰ It is arguable whether there are sufficient incentives for Member States to engage in regulatory competition. On the one hand, it was argued that judges might be tempted by the prospect of handling an important bankruptcy case (e.g. by a prominent firm). Thereby they could try to improve the reputation and the prestige of their national courts.¹⁵¹ Furthermore, a bankruptcy regime that attracts foreign firms most likely has the outcome of an increase in the business for insolvency practitioner, lawyers and other professionals in the judicial sector. The court filing fees are an additional factor that has to be taken into account.¹⁵² Therefore, large law firms might act as proponents with regard to the required legal changes in order to accommodate such insolvency cases. Therefore, the crucial issue appears to be the degree to which certain interest groups are able to influence legislators and judges to change the law or its interpretation in order to make it more attractive and thereby attract international cases.¹⁵³ With regard to the UK it was acknowledged in the academic literature that “pan-European law firms constitute a powerful interest group in lobbying for or against legal change that is likely to affect the competitiveness of English law.”¹⁵⁴ Recent examples seem to support this finding. The German companies *Deutsche Nickel*,

¹⁴⁸ Article 4 of the Regulation.

¹⁴⁹ H Eidenmüller, above n 69, 428.

¹⁵⁰ L Enriques and M Gelter, above n 53, 442.

¹⁵¹ Lynn M LoPucki, *Courting Failure* (Ann Arbor, University of Michigan Press, 2005), 19 – 20.

¹⁵² On these aspects see G McCormack, above n 29, 180.

¹⁵³ L Enriques and M Gelter, above n 53, 449.

¹⁵⁴ J Armour, above n 2, 34.

Schefenacker and *Hans Brochier*¹⁵⁵ took steps in order to reach the applicability of English insolvency law (mainly to alleged advantages of the UK administration and company voluntary arrangement procedures).

Despite these examples it was argued that the Member States of the EU had only little incentive to engage in regulatory competition in order to attract large bankruptcy cases. However, in case regulatory competition occurred, it was stated that the possible gains would be limited by secondary proceedings. Furthermore, only a very limited number of firms could engage in forum shopping as a considerable international scope of activities was required. Another point that was made is that due to the COMI concept companies could only choose from a limited range of bankruptcy venues. It was concluded from these arguments, that it was rather unlikely “that local bankruptcy lawyers in Europe will have to fear for large portions of their business.”¹⁵⁶

It is not only the likelihood of regulatory competition to occur, but also the possible outcome of this conduct that is ambiguously evaluated in the academic literature. There are two main positions on the subject. The opponents of regulatory competition predict a “race to the bottom” whereas the advocates of this form of competition propagate a “race to the top”. On a theoretical basis there are arguments for both positions.

Judicial competition might lead to the imposition of pressure on certain courts. In case a court might try to restrict the firms’ abusive conduct, firms might just try to reach the applicability of a different jurisdiction.¹⁵⁷ It was furthermore argued that states might concentrate on the preferences of small groups (e.g. the management or certain creditors) and as a consequence forsake public welfare. Additionally, regulatory competition might have the outcome, that the legislation ignored the consequences of the laws outside their own jurisdiction.¹⁵⁸ Another aspect that has to be taken into account is the fact, that it is mainly the management that would be in control of bankruptcy filings. Therefore, states might try to attract insolvencies by enacting management-friendly provisions which could be detrimental for certain other groups such as the creditors or the shareholders.¹⁵⁹

As a positive aspect of the competition in question a possible increase in innovative and dynamic insolvency legislation is mentioned. It was argued that “[s]tates can try out different

¹⁵⁵ Only *Hans Brochier* ended up as a reported decision (above n 75). Nonetheless, all three cases caused a stir in the professional press.

¹⁵⁶ On this line of argument see L Enriques and M Gelter, above n 53, 449.

¹⁵⁷ G McCormack, above n 29, 184.

¹⁵⁸ On these points see S Franken, above n 18, 244.

¹⁵⁹ On several aspect of the “race to the bottom” view see William L Cary, *Federalism and Corporate Law: Reflections upon Delaware* (1974) 83 Yale Law Journal 663.

types of bankruptcy laws and gauge the impact of such laws on levels of bankruptcy business as well as on the cost and availability of credit” and that this innovation on a domestic level might internationally lead to “a great release of energy and creativity.”¹⁶⁰

In the last decade the discussion about jurisdictional competition changed. Most commentators (in the US debate) adopted a more empirical approach in order to support their theoretical position.¹⁶¹ Again, evidence for both positions in the debate was found. For example, recent findings underlined that firms that were reorganized in Delaware have a greater risk of failing again.¹⁶² On the other hand, it was pointed out that bankruptcy proceedings in Delaware were faster than those of other states.¹⁶³

Due to the complexity of the different factors that have to be taken into account and their weight in the equation, the overall economic outcome of judicial competition in the realm of bankruptcy is still highly contentious. Therefore, the debate appears to be far from over. Furthermore, the US experience is helpful but it cannot be directly transferred to the European situation. It has to be kept in mind, that in the United States bankruptcy law is federal law, whereas in the EU it is still domestic bankruptcy law that governs the proceedings. Therefore, the present author is hesitant to pronounce a final judgement. On a theoretical basis good arguments exist for both sides of the debate. The current cases mentioned above might well indicate that certain legislations try to attract major bankruptcy cases. On the other hand the empirical evidence is still rather limited. Therefore, it is submitted that the future developments in this field should come under close scrutiny in order to observe a clear tendency whether regulatory competition occurs, and if so, with which outcome.

¹⁶⁰ G McCormack, above n 29, 179.

¹⁶¹ For example K Ayotte and D Skeel Jr, above n 125.

¹⁶² Lynn M LoPucki and Sara D Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a “Race to the Bottom”* (2001) 54 *Vanderbilt Law Review* 231; Lynn M LoPucki and Joseph W Doherty, *Why Are Delaware and New York Bankruptcy Reorganizations Failing?* (2002) 55 *Vanderbilt Law Review* 1933.

¹⁶³ Robert K Rasmussen and Randall S Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations* (2001) 54 *Vanderbilt Law Review* 283, 295-297; Robert K Rasmussen and Randall S Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations* (1999 - 2000) 94 *Northwestern University Law Review* 1357, 1389-1390.

XI. Conclusion

Forum shopping is likely to remain a very contentious issue under the Regulation. Due to a lack of harmonization the incentives to engage in this particular conduct are manifold. This is true not only for companies but also for natural persons. The EIR itself appears to be unable to hinder forum shopping. The COMI standard lacks a clear contour and the case law is only of little help. Especially, corporate groups are able to shift their centre of main interests rather freely and thereby choose the bankruptcy law of their liking. With regard to the economical effects it has to be stated, that on a theoretical level there are good arguments for and against forum shopping. However, there is a lack of empirical data to deliver a final judgement. On several levels there are possible countermeasures to avoid forum shopping. It is submitted that the present author regards an amendment of the EIR as the best way to avoid bankruptcy forum shopping. As stated above the insolvency proceedings could be tied to the registered office. This would bear several advantages in comparison to the current situation with the COMI concept.

It is not impossible that regulatory competition will occur in the context of European insolvency law. The present case law might point into this direction. Despite all alleged negative effects, the present author regards the innovation aspects of this competition as a chance for the domestic concepts to learn from each other and develop in a positive sense.