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Abuse of Law
in the Context of European Insolvency Law

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Overview

- 1) The context of the debate in insolvency law**
- 2) Abuse of law as a general concept**
- 3) Abusing freedom of establishment**
- 4) Abusing the European insolvency regulation**
- 5) Amending the European insolvency regulation**
- 6) Summary**

The context of the debate in insolvency law

- **Jurisdiction for main insolvency proceedings tied to debtor's 'centre of main interests' (COMI), Art. 3 (1) EIR**
 - Refutable presumption: registered office = COMI of a company/legal person
- **Insolvency proceedings subject to rules of the forum, Art. 4 EIR**
- **COMI after the *Eurofood* decision (2006) of the ECJ (C-341/04):**
 - “The scope of that concept is highlighted by the 13th recital ..., which states that ‘the ‘centre of main interests’ should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties’. That 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.”

The context of the debate in insolvency law

- **Nonetheless: COMI can be changed and manipulated → forum shopping and regulatory competition – is this a problem?**
- **Economic goals of (international) insolvency rules**
 - Maximizing the net assets available to satisfy creditors' claims
 - » Minimizing direct and indirect bankruptcy costs
 - Fostering the efficiency of credit contracts
 - Protecting involuntary and other “non-adjusting” creditors
- **Overall economic effects of forum shopping in Europe unclear**
- **Empirical evidence from the US (similar phenomenon) is mixed**
 - Firms reorganized in Delaware show higher refiling rates – but proceedings are faster

No conclusive empirical data exists on the overall economic effects of forum shopping in the insolvency field

Abuse of law (AOL) as a general concept

- ECJ case-law not very helpful in developing a general AOL concept
- AOL is about the correct application of the law, fraud about facts
- Elements of the AOL concept
 - Use of law contrary to its **purpose**
 - Meeting of formal requirements goes back to deliberate **action of user**
 - Specific ‘abuse intention’ not necessary
- If abuse of EC law is the issue, AOL must be a European concept
- Scope of the AOL concept: private and public actors might abuse

Abuse of European law is a European doctrinal concept on the scope of a legal position – its main element is use of law contrary to its purpose (a specific ‘abuse intention’ is not necessary)

Abusing freedom of establishment (FOE)

- **Shifting the COMI in another Member State is protected under FOE**
- **Shopping for a particular insolvency regime is in general not abusive**
 - **EIR ties main insolvency proceedings to COMI to protect the creditors**
 - **Abuse conceivable in exceptional circumstances: an abuse of the EIR (see next slides) might in some cases simultaneously amount to an abuse of FOE**
- **FOE does not mandate a “free” choice of the insolvency regime**
 - **FOE is restricted if a company faces a new insolvency regime after a COMI shift**
 - **But: the protection of workers and creditors are imperative requirements in the general interest that can justify restrictions**
 - **Arguably, these requirements are affected most strongly at the debtor’s COMI, justifying applying the insolvency law of the jurisdiction in which the COMI is located**

Shifting the COMI in another Member State is protected under the freedom of establishment and is in general not abusive

Abusing the European insolvency regulation

- **Abusing the EIR is an issue of real – not faked – COMI shifts**
- **COMI shifts problematic especially if not accompanied by a reincorporation and change in the applicable company law**
 - Creditors are protected under the 10th directive in case of cross-border mergers
 - ‘Isolated’ COMI shifts create discrepancies between company and insolvency law
- **Goals of the regulation**
 - Efficient and effective administration of cross-border insolvencies (recitals 2, 8, 16, 19, 20) → maximizing the net assets to satisfy creditors’ claims
 - Preventing forum shopping (recital 4) → fostering the efficiency of credit contracts
- **These two goals may conflict with each other**
 - An efficient and effective administration of a cross-border insolvency might require a change in COMI, e.g., in order to have the proceedings of all members of a corporate group administered in the same jurisdiction

Abusing the European insolvency regulation

- **The first goal appears to be more important**
 - EIR has deliberately chosen an unstable and changeable criterion (COMI) with respect to jurisdiction for main insolvency proceedings
 - No suspect period established by the EIR
 - AOL introduces legal uncertainty
 - Insolvency regimes of all Member States protect creditors (albeit differently)
- **AOL only if first goal apparently cannot be attained at new COMI**
 - AOL if COMI shift does **evidently not contribute to maximizing the net assets** available to satisfy creditors' claims
 - » COMI shifts that evidently benefit (i) the debtor at the expense of its creditors or (ii) some creditors at the expense of others are suspicious

COMI shifts that evidently do not contribute to maximizing the debtor's net assets are abusive

COMI shift before the insolvency petition: companies

- **Example 1: PIN group holding company shifted COMI from Luxemburg to Cologne for restructuring purposes**
 - German PIN group engaged in mail delivery business, COMI shift of holding supported restructuring plan: effective coordination of all proceedings in Germany
 - *Amtsgericht* Cologne: no abuse of law (Case 73 IE 1/08, resolution of 19 February 2008)
 - COMI shift clearly in the interest of the creditors
- **Example 2: Debtor company shifted COMI from Germany to Spain (residence of new manager) in order to ‘bury’ the company there**
 - *Bundesgerichtshof*: abuse of law (Case IX ZB 238/06, resolution of 13 December 2007)
 - COMI shift evidently not in the interest of the creditors
- **Consequence in a AOL case: the ‘old’ COMI is decisive**

Companies: COMI shift to maximize restructuring value not abusive

COMI shift before the insolvency petition: natural persons

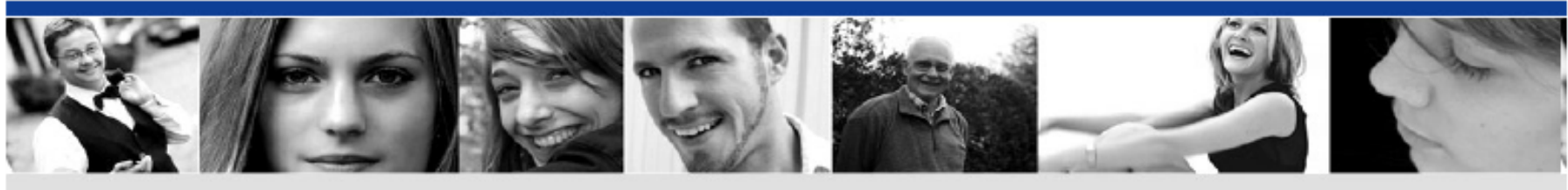
- **Natural persons: COMI conforms to habitual residence**
- **COMI can be changed quite easily, ‘professional’ help**
 - www.frankreich-insolvenz.com; www.sda-europe.de; www.bruckmann-partner.com
- **COMI shift to France: discharge within months (Germany: 6 years)**
- **Overall economic effects of shorter discharge periods unclear**
 - (1) Stimulate company formation (good), (2) encourage excessive risk taking / unprofessional management (bad), (3) preserve human capital (good)
- **In the insolvency situation, (1) and (2) are irrelevant, and (3) does apparently not ‘enlarge the pie’ but benefit (predominantly) the debtor (creditors tend to oppose COMI shift)**

French bankruptcies for German screw-ups: www.sda-europe.de

:: sda-europe ltd ::



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Guten Tag und Bonjour!

In der gegenwärtigen wirtschaftlichen Situation und den gesellschaftlichen Bedingungen gehört es mittlerweile zum Alltag – die Durchführung eines privaten Insolvenzverfahrens.

In Deutschland können bis zu 9 Jahre vergehen, ehe es zu der sogenannten Restschuldbefreiung kommt. Erst nach dieser langen Zeit kann man wieder ein gesellschaftsfähiges und schuldenfreies Leben führen. Allein die "Wohlfhaltensperiode" dauert in Deutschland ganze 6 Jahre. Dabei wird der pfändbare Teil Ihres Einkommens an einen vom Gericht festgesetzten Treuhänder abgetreten. Sollte der Schuldner dann noch in dieser langen Zeit einen "Fehler" machen, kann ihm die Restschuldbefreiung ganz untersagt werden.

Unsere Webpräsenz soll Sie davon überzeugen und anregen, Ihr Insolvenzverfahren mit Restschuldbefreiung in Frankreich durchzuführen. Der Vorteil liegt klar auf der Hand: In Frankreich dauert dieses Insolvenzverfahren mit Restschuldbefreiung nur 9 - 18 Monate.

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COMI shift before the insolvency petition: natural persons

- **COMI shift to obtain more favorable discharge regime apparently not in the interest of creditors**
- **COMI shift for other reasons unrelated to insolvency unobjectionable**
- **Distinction on the basis of the circumstances of each case**
 - **Timing of COMI shift?**
 - **Occupation in the new Member State?**
 - **Assets in the new Member State?**
 - **Magnitude of differences in the discharge provisions of old and new jurisdiction?**

Natural persons: COMI shift to obtain more favorable discharge regime abusive

COMI shift after the insolvency petition

- ***Staubitz-Schreiber* decision (2006) of the ECJ (C-1/04): the COMI at the time of the petition is decisive**
 - ECJ: COMI shift would go against goals of EIR (invite forum shopping, make it difficult for creditors to assess credit risks, force them to ‘chase’ the debtor), be incompatible with power of provisional administrator to seek protection under Art. 38 EIR
 - Most arguments equally apply to COMI shifts before the petition
- **Proceedings would be less efficient if a COMI shift were possible**
 - Costs will already have been sunk in the proceedings after the first petition
- **This is in line with the wide concept of the ECJ in *Eurofood* as to the ‘opening’ of insolvency proceedings:**
 - “... a decision to open insolvency proceedings ... is a decision ... based on the debtor’s insolvency ... that ... involves the divestment of the debtor and the appointment of a liquidator [including a provisional liquidator, HE] referred to in Annex C to the Regulation.”

COMI is ‘frozen’ at the time of the insolvency petition

Abuse by Member States / courts

- **Public actors (Member States / courts) too can abuse insolvency law**
- **Example 1: manipulative changes in procedures listed in annex A against Art. 1 (1) and recital 10 in order to ‘attract’ debtors**
 - **EIR applies only to proceedings that presuppose the insolvency of the debtor (Art. 1 (1) and recital 10)**
 - **Annex A contains a conclusive and decisive list of such proceedings**
 - **Member State X changes proceedings listed in Annex A to include restructurings that do not presuppose the insolvency of the debtor in order to become Europe’s leading restructuring venue**
- **Example 2: the ‘mind of management’ theory adopted by English courts to determine the COMI of a company**
 - **To be sure, if one finds AOL here, the opening decision nevertheless stays effective (subject to being overruled on appeal)**

Amending the European insolvency regulation

- **Forum shopping on the basis of the COMI concept creates certain significant problems**
 - Discrepancies between company and insolvency law → high bankruptcy costs
 - Possible exploitation of non-adjusting creditors
- **The AOL concept is only of limited help in solving these**
 - It requires a case by case approach and creates legal uncertainty
- **A better solution would be to tie main insolvency proceedings to the registered office of the company (irrefutable presumption)**
 - Company law and insolvency law would always go hand in hand
 - Reincorporations: creditors protected by the mechanisms under the 10th directive
- **Natural persons: establishing a suspect period makes sense**

For companies, COMI should be replaced by the registered office – for natural persons, the habitual residence (subject to a suspect period) should be decisive

Summary

- 1) **No conclusive empirical data exists on the overall economic effects of forum shopping in the insolvency field**
- 2) **Abuse of European law is a European doctrinal concept on the scope of a legal position – its main element is use of law contrary to its purpose (a specific ‘abuse intention’ is not necessary)**
- 3) **Shifting the COMI in another Member State is protected under the freedom of establishment and is in general not abusive**
- 4) **COMI shifts that evidently do not contribute to maximizing the debtor’s net assets are abusive**
 - a) **Companies: COMI shift to maximize restructuring value not abusive**
 - b) **Natural persons: COMI shift to obtain more favorable discharge regime abusive**
- 5) **COMI is ‘frozen’ at the time of the insolvency petition**
- 6) **For companies, COMI should be replaced by the registered office – for natural persons, the habitual residence (subject to a suspect period) should be decisive**