

practical solutions to avoid them. The decisions in *McKay* and *Re SE Services* show a continued commitment by the courts to the rescue culture and a realistic attitude to striving to ensure that professionals involved in corporate recovery are dealt with even-handedly. Given that it appears accepted that the insolvent company should be responsible for paying for professional advice received by it, it difficult to see how such advice could not come within the definition of "costs and expenses of the appointor" for the purposes of r.2.67(1)(c) in the

case of a company or directors' appointment. Until such time, however, as a clear court or legislative statement is made to that effect, practitioners will need to continue relying on other means—such as the discretion contained in para.13—to secure payment of their fees.

1 [2006] All E.R. (D) 266

2 [2005] EWCA Civ 115

3 *Re A Company No.005174 of 1999* [2000] B.C.C. 698 at 708

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MYSTERY OF THE SPHINX—COMI IN THE US

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LT Allocation of jurisdiction; Centre of main interests; Cross-border insolvency; Groups of companies; United States

Introduction

The judgment of Judge Drain in *Re Sphinx Ltd*, a case in the Southern District Court of New York on September 6, 2006 appears to be the first in relation to a contest over the location of the "centre of main interests" of a debtor in the context of Ch.15 of the US Bankruptcy Code, the US enactment of the UNCITRAL Model Law.

The case concerned a Cayman registered group of companies in liquidation in the Cayman Islands. The outcome was that the US court declined to recognise the Cayman liquidations as "main" proceedings and recognised them as "non-main"¹ proceedings.

The Cayman companies operated hedge funds, tracking certain indices. The companies were established offshore to take advantage of Cayman tax and regulatory benefits. However, the companies did not conduct any trade or business in the Cayman Islands, had no employees and no physical offices in the Cayman Islands. The only "assets" in the Cayman Islands were the corporate books and records required to be maintained under Cayman law. The real assets and the conduct of the business were in the United States. Approximately \$500 million of assets were located in the United States.

The hedge fund business of the companies was actually conducted under a fully discretionary investment management contract by a Delaware company carrying on business in New York. The companies' auditors were PWC at their Cayman office, a requirement of Cayman law. It is not clear, however, how much of the actual auditing work was performed in the Cayman Islands. None of the directors resided in the Cayman Islands and there was no evidence of any board meeting taking place there. The directors were Irish, Bahamian and US residents. The investors were located throughout the world, with only about 14 per cent in the United States. The investors apparently qualified as creditors for the purposes of Cayman Islands' winding up proceedings.

The Cayman companies had been Defendants to proceedings relating to the Refco collapse, seeking the repayment of an alleged preference. The preference

claim was settled and the settlement funds put in escrow pending the claimants getting court approval in their own insolvency proceedings for the settlement. Certain investors in the Cayman companies' hedge funds objected in the insolvency proceedings of the claimant on the basis that the settlement was too favourable to the claimant. This was obviously not a good objection in the estate of the claimant and the objection was disallowed but the investors appealed, thereby holding up both the settlement and the resolution of the claimants' insolvency proceedings.

The Cayman companies went into liquidation and the liquidators tried to hold up the appeal relating to the settlement on the grounds that they needed to investigate whether the settlement was proper from the Cayman companies' perspective. This application was rejected.

The proceedings, the subject of the judgment being considered, were applications for recognition by the liquidators of the Cayman companies of the Cayman proceedings as main proceedings, thereby creating an automatic stay under Ch.15 the US Bankruptcy Code, with the goal of staying the appeals in relation to the settlement agreement. It seems there was no other reason for applying for recognition.

One would have thought the short answer on these facts was that since the companies carried on no business in the Cayman Islands and since everything was run from the United States, the presumption as to the centre of main interests being in the place of registration was plainly rebutted and, using the "head office functions" test,² the centre of main interests was plainly in the United States. That in turn would mean that the Cayman proceedings could not be recognised as main proceedings. Moreover, there was no "establishment" in the Cayman Islands as defined by s.1502 of the US Bankruptcy Code, i.e. "any place of operations where the debtor carries out a non transitory economic activity", since there was no such place of operations in the Cayman Islands and no economic activity was carried on at the registered office in Cayman. Thus recognition as a non-main proceeding was not possible either.

The actual result of the case was a refusal to recognise the Cayman proceedings as main proceedings, but not on the basis that the COMI was not there. Moreover, there was recognition of the Cayman proceedings as non-main proceedings but with no attempt to deal with the need to show an "establishment" or any recognition that the facts failed to show any place of operations in Cayman where economic activity was carried out.

Whilst the decision of Judge Drain not to recognise the Cayman proceedings as main proceedings must be

entirely correct, his reasoning is, with all due respect, difficult to follow.

COMI

In considering the approach to the concept of "centre of main interests", Judge Drain considered that the statutory presumption would be of "less weight" in the event of a serious dispute, since the presumption was included for speed and convenience of proof where there was no serious controversy.³

So far, so good. However, the next principle mentioned by Judge Drain, that of deferring to the creditors' acquiescence in or support of a proposed centre of main interests cannot be right, since the location of the centre of main interests must be an objective judgment by the court on the basis of the evidence.

Judge Drain referred to the *Eurofood* decision of the European Court of Justice and observed, accurately, that the question put to the European Court of Justice by the Irish Supreme Court:

"assumed that the only evidence offered to rebut the place-of-registered-office presumption was that management for the holding company that owned the debtor made decisions on the debtor's behalf in the alternative proposed COMI."

That situation was completely distinguishable on the facts of the present case. Again, a good point.

Judge Drain concluded that there were important objective factors pointing to the centre of main interests being located in the United States, since the only business done in the Cayman Islands was limited to those steps necessary to maintain the companies in good standing as being registered Cayman Islands' companies. Pragmatic considerations also pointed to the United States since there were no assets in the Cayman Islands and therefore liquidators in the Cayman Islands would have to seek assistance from other courts. Moreover, most if not all of the creditors and investors were located outside the Cayman Islands and the Cayman court would have to rely on orders of other courts to bind them.

Judge Drain commented that the Cayman courts themselves had not made a finding as to the centre of main interests and in any event he would not have been bound by any such finding.

The only extant proceedings

At this stage the judgment takes a peculiar turn. Judge Drain considered and placed weight upon the fact that the Cayman Islands winding up proceedings were the only extant proceedings and that they were capable of winding up the affairs of the debtor, notwithstanding the fact that the relevant activities and assets were in the United States. He also referred to the fact that the Cayman companies had held themselves out in their offering memorandum as offshore Cayman Island entities. Judge Drain then considered that in principle and but for one additional consideration he would have been inclined to find that the debtor companies' centre of main interests was in the Cayman Islands and to recognise the Cayman proceedings as foreign main proceedings. In doing so he took into account that these

were liquidations and not reorganisations which might better take place at the place where the debtors' interests were administered—a reference to the "definition" (in reality, "description") of centre of main interests in recital (13) to the EC Regulation on Insolvency Proceedings. He considered that the liquidators and the Cayman court were the only parties ready to perform the winding up function and the vast majority of the parties with a relevant interest tacitly supported that approach.

With the greatest of respect to Judge Drain, this is an extraordinary dictum. The centre of main interests is plainly an objective concept which is unrelated to the question of which jurisdiction is ready, willing and able to perform the winding up function and to the tacit (or indeed express) support of interested parties. Moreover, on the facts of this case, the choice, in principle, of the Cayman Islands went directly against the evidence, which plainly showed that the presumption based on the place of the registered office was rebutted by the evidence that the companies' affairs were run and managed outside the Cayman Islands and in particular in the United States. The United States plainly had the strongest claim to be the centre of main interests, since the companies did no business in the Cayman Islands and were simply registered there for tax and regulatory purposes.

Fortunately, the reasoning as to where the centre of main interests might have been found to be was only a dictum, because the choice "in principle" was overridden by Judge Drain's view that the application was abusive, because it was for an improper collateral purpose. The only reason for the application for recognition as a main proceeding was to get an automatic stay of the appeal from the order sanctioning the settlement agreement and the application was thus a mere tactic to try and sabotage the settlement and obtain a better payment for the investors of the Cayman companies. These tactics were described by Judge Drain as "improper forum shopping". It is respectfully suggested that a better description would be an "abuse of process", on the grounds that the application was being made for a collateral and improper purpose—the proper purpose of seeking recognition would be to protect the assets or other proper interests of the creditors and not in order to extort a better settlement.

Recognition by the US Bankruptcy court

The next stage in the reasoning is also very odd. Judge Drain considered that the US legislature had separated the concept of "recognition" under the Bankruptcy Code from the concept of "recognition as a foreign non-main proceeding". With respect, this does not seem to be correct: the UNCITRAL Model Law provides for recognition either as a foreign main or nonmain proceeding but not recognition in the abstract. Moreover, the wording of s.1517 of the US Bankruptcy Code,⁴ enacting the Model Law, gives the same limited choice.

Judge Drain then went on to recognise the Cayman proceedings as non-main proceedings. He referred back to the "main objective factors" pointing to the Cayman Islands not being the debtors' centre of main interests and therefore considered that, since "no negative consequences would appear to result from recognising the Cayman Islands proceedings as non-main

proceedings, that is the better choice". With the greatest respect to Judge Drain, this is not really a question of "choice" but of whether the proceeding being considered falls within the concept of main or non-main proceeding. In particular, to be able to recognise a proceeding as a non-main proceeding, the definition in s.1502 of the US Bankruptcy Code requires the proceeding to be "pending in a country where the debtor has an establishment".⁵ The same section defines "establishment" as "any place of operations where the debtor carries out a non-transitory economic activity".⁶ The difficulty with Judge Drain's recognition of the Cayman proceedings as non-main proceedings is that, on the evidence set out by Judge Drain, there was no "place of operations" in the Cayman Islands and no "economic" activity being carried out there.

Judge Drain did hold that one can have a foreign non-main proceeding even though there is no other pending proceeding—a concept which, of course, is very familiar under the EC Regulation, which expressly refers to the ability to open independent territorial proceedings prior to the opening of any main proceedings in certain conditions: see Art.3.

Conclusions

Whilst it was plainly right for Judge Drain to reject the application for recognition of the Cayman proceedings as main proceedings, the reasoning, with all due respect to him, is wholly unsatisfactory. The only European case that he mentions, the *Eurofood* decision, was of little assistance and was distinguished by him. However, he does not refer to and perhaps was not referred to the wealth of national case law in Europe on this subject. Nor does he mention any of the writings of numerous commentators who have dealt with this subject in the European context.⁷ It was plain on the facts as recited by Judge Drain that on an objective basis the Cayman Islands had no real claim to be the centre of main interests, since no "head office functions"⁸ were being carried on there and the registration in Cayman was purely for tax and regulatory purposes. Since no business was carried on in Cayman, the dicta of the European Court of Justice decision in *Eurofood*⁹ provided an additional basis for holding that the presumption based on registered office was rebutted and the COMI was in the United States.

Since the presumption of the place of the registered office was plainly rebutted on the facts, the remaining question was: which other jurisdiction had the best claim to be the centre of main interests? Given that the business of the company was controlled and directed in the United States under contract, the best candidate was plainly the United States. The fact that the majority of interested parties either wanted or acquiesced in the Cayman Islands being treated as the centre of main interests should not have been of any relevance. Since the application for recognition as a main proceeding was abusive, it could and should have been dismissed on that ground alone in any event. Although s.1517 of the US Bankruptcy Code is in mandatory terms¹⁰ requiring recognition, this must be read subject to universally accepted principles, for example that the court's jurisdiction may not be abused. Alternatively, the public policy exception in s.1506¹¹ can be used to prevent an abuse of process, since an abuse would violate fundamental procedural norms of any jurisdiction and

lead to an unfair process: see the principle set out at [65] of the *Eurofood* judgment.

As far as recognising the Cayman proceedings as non-main proceedings is concerned, this is not in accordance with Ch.15 or the UNCITRAL Model Law and cannot be justified in terms of the facts, since there was no "establishment", as defined by Ch.15, in the Cayman Islands.

As a matter of speculation, the difficulty felt by Judge Drain in this case may stem from the thought in the United States, arising from the legislative history, that Ch.15 is the only mode of seeking assistance for foreign proceedings. Unfortunately, this view, if correct, creates a serious gap in a case where there is a proceeding in the place of registration (and therefore recognised in most parts of the World) but where the centre of main interests is elsewhere and there is no "establishment" in the place of registration. If, perhaps for reasons of inconvenience and expense, no main proceedings are started in the place where the centre of main interests is located, there is a serious difficulty recognising the proceedings in the United States, if the view is taken that Ch.15 is the only route.

It is possible that this type of problem lies behind the awkward reasoning in the *Sphinx* case, with its attempt to find a practical solution that unfortunately does not fit the language or provisions of the statute or indeed the case law in Europe. It is respectfully suggested that a better route, that does not do violence to the language of the statute would be to hold that Ch.15 is not exclusive, since it does not expressly purport to be, and that the US courts can in cases such as *Sphinx* follow the lead of the Privy Council in the *Cambridge Gas and Navigator* case [2006] 3 All E.R. 829 in applying common law judicial assistance to foreign proceedings irrespective of the location of the centre of main interests. Judge Drain refers to the *Cambridge* decision at fn.21 of his judgment and it is a great pity that he did not hold that he could use the common law jurisdiction instead of Ch.15 to assist the Cayman proceedings, since that would have provided both a principled and practical solution. His reasoning, with all due respect to him, leaves the interpretation of Ch.15 in a mess, leaving it uncertain what the correct approach in the United States is to both the centre of main interests and the concept of establishment.

1 "Non-main" is the US version of secondary proceedings: once again Great Britain and the US are two countries divided by a common language.

2 As approved by the Advocate General at [111] and [112] of his Opinion in *Eurofood* [2005] B.C.C. 1021

3 This is consistent with the approach in the English case of *C14net* [2005] B.C.C. 277

4 In Great Britain, Art.17 of Sch.I to the Cross-Border Insolvency Regulations 2006 is to the same effect.

5 Art.2(h) of Sch.I to the The Cross-Border Insolvency Regulations also defines "non-main" proceedings so as to require requires an "establishment" to exist in the relevant country.

6 Compare Art.2(e) of the Regulations which add: "...with human means and assets or services."

7 For example, the leading work in English, Moss Fletcher and Isaacs, *The EC Regulation on Insolvency Proceedings* (OUP, 2002).

8 The "head office functions" test pioneered in the case law in the UK and subsequently followed in Germany, Italy, Hungary and France was approved by the Advocate General in *Eurofood*, reported at [2005] BCC 1021 at [111] and [112].

9 Paras 34 and 35 of the judgment of the ECJ reported at [2006] B.C.C. 397 cites as a typical example of the rebuttal of the presumption

a case where the company does not carry on business in the jurisdiction where it is registered.
10 As is Art.17 of Sch.I to The Cross-Border Insolvency Regulations

11 Art. 6 in the Regulations

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ADDRESSING THE REFORM OF THE INSOLVENCY REGULATION: WISHLISTS OR FANCIES?

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LT Centre of main interests; Creditors; Cross-border insolvency; EC law; Jurisdiction; Priorities

Introduction

The European Regulation on Insolvency Proceedings 2000¹ is the successor text to the European Insolvency Convention 1995. It is the result of a project nearly four decades long in the making and forms part of an overall jurisdiction, recognition and enforcement allocation initiative that also brought into being the Brussels Convention 1968.² The history of the project included a number of drafts whose remit moved gradually away from including elements of substantive harmonisation towards simple procedural harmonisation and choice of laws. There were a number of false starts, including the suspension of work after a failure to reach a consensus on a second draft in 1985, reversed following the initiation of a rival project by the Council of Europe which saw the conclusion of the Istanbul Convention 1990.³ Although the Council of Ministers approved the text that became the European Insolvency Convention 1995, it did not enter into force because the United Kingdom failed to adhere within the time period open for signature.⁴ Following a proposal co-authored by Germany and Finland in 1999, the Insolvency Regulation revived this project without major amendment to its provisions and the text entered directly into force on May 31, 2002 in all of the member states in the European Union subject to Title IV of the EC Treaty, then 14 in number (Denmark being excluded as it had secured opt-out provisions during negotiations for the Treaty of Maastricht). As part of preparations for the European Union being joined by 10 new Member States on May 1, 2004, the Insolvency Regulation was amended by the relevant Act of Accession, signed on September 23, 2003, with effect from the date of accession. There have also been some updating amendments to the lists of insolvency proceedings and officials in the annexes to the Insolvency Regulation.⁵ It is likely there will be further amendments consequent on the Act of Accession, signed on April 25, 2005, providing for the accession of Romania and Bulgaria to the European Union on January 1, 2007.

Reform Challenges

Since the enactment of the Insolvency Regulation, there have been calls for reforms to the text. Some of the relevant issues were raised in a 2005 conference paper

authored by Gabriel Moss Q.C. and Professor Christoph Paulus and published in this journal in early 2006.⁶ This paper dealt with concerns surrounding the definition of the "centre of main interests", the phenomenon of forum shopping through debtors moving prior to the initiation of proceedings as well as the race to court highlighted by decisions such as *Eurofood*.⁷ It also noted other related issues such as a possible framework for court-to-court communications, whether there should be a central register of insolvency judgments, perhaps together with publication through an official website, as well as difficulties attendant on the amendment process. The paper also questioned whether a special regime or default presumption for corporate groups should be created and the consequent impact on prospects for corporate rescue through the Insolvency Regulation by the maintenance of the limitation to winding up procedures in the case of secondary proceedings. A number of cogent points were made in the article, some of which have also been addressed by other authors,⁸ explaining why reforms may be necessary. Many of these could usefully be taken on board during any amendments that may be made as the Insolvency Regulation is reviewed, a process to which the authors say consideration is already being given.⁹

More Reform Challenges

Although it is not the purpose of this piece to respond directly to the Moss-Paulus paper, there are other issues that would merit consideration were reforms to be initiated that are germane to concerns raised in that paper. These include the issue of priorities and the possible interference of doctrines of public policy, the use of avoidance strategies aimed at preventing the proliferation of proceedings as well as the overall relationship of the Insolvency Regulation to other international instruments regulating cross-border insolvency, in particular the UNCITRAL Model Law on Cross-Border Insolvency 1997.¹⁰

(i) Priorities and Public Policy Issues¹¹

The basic principle in the Insolvency Regulation is that the rules governing the admission and content of claims, the special position of debts arising after the institution of insolvency proceedings as well as proof and verification of all these claims are all matters for the substantive law of the jurisdiction where proceedings are opened (the *lex concursus* principle).¹² Similarly, the same substantive law also governs the distribution of proceeds when assets are realised, the ranking of claims as well as the rights of creditors who have obtained partial satisfaction after insolvency proceedings are opened (for example through the use of quasi-security). Because the Insolvency Regulation paradigm allows for the possibility of multiple proceedings subject to the threshold test of an "establishment" existing in the case of secondary or territorial proceedings,¹³ the possibility of multiple