

# **Proving COMI: Seeking recognition under chapter 15 of the US Bankruptcy Code**

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## **At a glance**

- Only a foreign main or non-main proceeding may be recognised under chapter 15 of the US Bankruptcy Code and the court does not retain a discretion to order otherwise
- The presumption that a company has its centre of main interests ('COMI') at the place of its registered office has no special evidentiary weight and does not alter the foreign insolvency representative's burden of proof regarding the location of COMI

Central to the operation of the UNCITRAL Model Law on Cross-Border Insolvency ('Model Law') is the location of the debtor's COMI. Adoption of the Model Law has been gaining ground and a body of US case-law has been building up concerning the interpretation of the Model Law (enacted almost verbatim as chapter 15 of the Bankruptcy Code).<sup>1</sup>

This commentary reviews some of the recent US case-law applying the Model Law, in particular the COMI concept, and suggests that the US position is heading in the right direction.

## **COMI and establishment under the Model Law**

The operation of most of the Model Law provisions depends on whether one is concerned with a foreign main proceeding or a foreign non-main proceeding. A 'foreign main proceeding' is a foreign proceeding taking place in the state where the debtor has its COMI (Article 2(b)); a 'foreign non-main proceeding' is a foreign proceeding, other than a foreign main proceeding, taking place in a state where the debtor has an establishment – that is, any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services (Articles 2(c) and (f)). The mere presence of assets is insufficient to meet the definition of 'establishment'. Although COMI is not defined, there is a presumption

that the debtor's registered office, or habitual residence in the case of an individual, is the debtor's COMI.

Given that the concepts of COMI and establishment have their origin in the EU Convention on Insolvency Proceedings, which was subsequently reproduced as Council Regulation (EC) 1346/2000 on Insolvency Proceedings, there is little doubt that case law on the meaning of COMI and establishment under the EC Insolvency Regulation will serve as the most persuasive authority in this respect.

The European Court of Justice ('ECJ') in *Re Eurofood IFSC* [2006] 1 Ch 508 held, for the purposes of the EC Insolvency Regulation, that the COMI must be identified by reference to criteria that are both objective and ascertainable by third parties in order to ensure legal certainty and foreseeability concerning the determination of the court with jurisdiction to open insolvency proceedings. It follows that the presumption of the registered office of the debtor being its COMI can be rebutted only by factors which are both objective and ascertainable by third parties.

### **Finding COMI and establishment – the US approach**

Consistent with the Model Law, chapter 15 does not define COMI, but contains a presumption that '[i]n the absence of evidence to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the [COMI]' (s 1516(c)). 'Establishment' is defined as 'any place of operations where the debtor carries out a nontransitory economic activity' (s 1502(2)).

The application of these concepts is best demonstrated by two contrasting decisions discussed below.

(a) *Re SPhinX*, 351 B.R. 103 (Bankr. S.D.N.Y. 2006), *aff'd*, 2007 WL 1965597 (S.D.N.Y. July 3, 2007)

Each of the debtors in question (whose business consisted of buying and selling securities and commodities) was incorporated and went into liquidation in the Cayman Islands. Except for corporate books and records required to be maintained under Cayman Islands law, the debtors had no assets in the Cayman Islands. Most of the assets were in the United States. Corporate administration was conducted

primarily in the United States, although investor subscriptions were received in the Cayman Islands for purposes of compliance with Cayman Islands anti-money laundering requirements. The only business done in the Cayman Islands apparently was limited to those steps necessary to maintain the debtors in good standing as registered Cayman Islands companies. The debtors' auditors were an international accounting firm with a Cayman Islands address in accordance with Cayman Islands requirements, though it was not clear how much work the auditors actually performed in the Cayman Islands. There were no employees or managers in the Cayman Islands, and the debtors' boards, which contained no Cayman Islands residents, never met in the Cayman Islands.

The insolvency representatives of the debtors sought recognition of the Cayman proceedings under chapter 15 of the Bankruptcy Code.

Drain J held that the determination of COMI, whilst dependent on a number of objective factors, was to reflect the flexibility that the former s 304 of the Bankruptcy Code 'provided bankruptcy courts in handling ancillary cases in light of principles of international comity and respect for the laws and judgments of other nations' (351 B.R. 103, 112):

*'The Bankruptcy Code does not state the type of evidence required to rebut the presumption that the COMI is the debtor's place of registration or incorporation. Various factors, singly or combined, could be relevant to such a determination: the location of the debtor's headquarters; the location of those who actually manage the debtor (which, conceivably could be the headquarters of a holding company); the location of the debtor's primary assets; the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes...*

*[T]he flexibility inherent in chapter 15 strongly suggests, however, that the Court should not apply such factors mechanically. Instead, they should be viewed in light of chapter 15's emphasis on protecting the reasonable interests of parties in interest pursuant to fair procedures and the maximization of the*

*debtor's value. Because their money is ultimately at stake, one generally should defer, therefore, to the creditors' acquiescence in or support of a proposed COMI. It is reasonable to assume that the debtor and its creditors (and shareholders, if they have an economic stake in the proceeding) can, absent an improper purpose, best determine how to maximize the efficiency of a liquidation or reorganization and, ultimately, the value of the debtor, assuming also, of course, that chapter 15 requires the court to protect the legitimate interests of dissenters (even to the extent of enabling the modification of a recognition order under Bankruptcy Code section 1517(d)), particularly where other objective factors point to a different COMI. Relatedly, if the parties in interest are in a legitimate dispute over the debtor's COMI, it is probably safe to assume that promoting cooperation among courts and the parties will play a greater role than artificially choosing one proceeding as a 'primary' proceeding. At least this is what the Court takes away from the stated objectives and structure of the statute' (351 B.R. 103, 117-118).*

Accordingly, although 'important objective factors point to the [debtors'] COMI being located outside of the Cayman Islands' (351 B.R. 103, 119), the court could nevertheless find the debtors' COMI in the Cayman Islands for the following reasons:

*'[U]pon the assumption that the Cayman Islands proceedings will primarily involve the investors, who, again, have not objected to the Petition, in balancing all of the foregoing factors the Court might be inclined to find the [d]ebtors' COMI in the Cayman Islands and recognize the proceedings as foreign main proceedings ... Concededly, a simple 'location of administration of the debtor's interests test', could well result in a different outcome, particularly if there was a possibility of reorganization. But because these are liquidation cases in which competent [insolvency representatives] under the supervision of the Cayman Court are the only parties ready to perform the winding up function, and, importantly, the vast majority of the parties in interest tacitly support that approach, normally the Court would recognize the Cayman Islands proceedings as main proceedings' (351 B.R. 103, 120-121).*

Although the court did not ultimately recognise the Cayman proceedings as foreign main proceedings because the investors' tacit consent to the Cayman proceedings as foreign main proceedings was for an improper purpose, the court recognised the Cayman proceedings as foreign non-main proceedings for the following reasons:

*'where so many objective factors point to the Cayman Islands not being the [d]ebtors' COMI, and no negative consequences would appear to result from recognizing the Cayman Islands proceedings as nonmain proceedings, that is the better choice'* (351 B.R. 103, 122).

Although affirmed on appeal, Drain J's decision has been convincingly criticised by academic commentators as deviating from the structure of chapter 15:

*'[S]ince foreign proceedings are eligible for recognition only if they meet the definitional requirements of either a foreign main proceeding or a foreign non-main proceeding, there can be no recognition without the concomitant determination of qualification as a main proceeding or a non-main proceeding: If the foreign proceeding is not pending in a country where the debtor has its COMI or where it has an establishment, then the foreign proceeding is simply not eligible for recognition under chapter 15...*

*Severing recognition from the application of the definitional requirements of foreign main proceedings and foreign non-main proceedings results in the court ignoring whether the [debtors] are foreign proceedings that are eligible for chapter 15 recognition ...*

*The objective facts found by the SPhinX court, other than place of registration, put [the debtors'] COMI in the United States. The objective facts did not show any 'establishment' in Cayman Islands. This should have ended the matter. The Cayman Islands proceeding, while a foreign proceeding, is not eligible for chapter 15 recognition at all'* (Daniel M. Glosband, 'SPhinX Chapter 15 Opinion Misses the Mark' 25-JAN Am. Bankr. Inst. J. 44, 45, 84-85). See also Jay Lawrence Westbrook, 'Locating the Eye of the Financial Storm' 32 Brook. J. Int'l L. 1019 (2007).

The next decision puts the matter beyond doubt.

(b) *Re Bear Stearns High-Grade Structured Credit Strategies Master Fund* (Bankr.S.D.N.Y. September 5, 2007) (appeal to the United States District Court for the Southern District of New York pending)

The debtors were Cayman Islands exempted limited liability companies with registered offices in the Cayman Islands whose business consisted of investing in various types of securities. The debtors went into provisional liquidation in the Cayman Islands and the insolvency representatives sought recognition under chapter 15 of the Bankruptcy Code.

The objective factors connecting the debtors here with the Cayman Islands were as slim as those in *Re SphinX*, leading Lifland J to refuse to recognise the Cayman proceedings:

*‘The only adhesive connection with the Cayman Islands that the [debtors] have is the fact that they are registered there. [Footnote: The only business done in the Cayman Islands apparently was limited to those steps necessary to maintain the [debtors] in good standing as registered Cayman Islands companies, thus the [debtors] closely approximate the ‘letterbox’ companies referred to in the Eurofoods decision.] Section 1516(c) presumes that the COMI is the place of the debtor’s registered office but only ‘[i]n the absence of evidence to the contrary’ ... The ... Petitions have demonstrated such evidence to the contrary: there are no employees or managers in the Cayman Islands, the investment manager for the [debtors] is located in New York, the Administrator that runs the back-office operations of the [debtors] is in the United States along with the [debtors’] books and records and prior to the commencement of the Foreign Proceeding, all of the [debtors’] liquid assets were located in United States... The investor registries are maintained and located in the Republic of Ireland; accounts receivables are located throughout Europe and the United States; counterparties to master repurchase and swap agreements are based both inside and outside the United States but none are claimed to be in the Cayman Islands... Accordingly, the*

*presumption that the COMI is the place of the [debtors'] registered offices has been rebutted by evidence to the contrary. As noted, each of the [debtors'] real seat and therefore their COMI is the United States, the place where the [debtors] conduct the administration of their interests on a regular basis and is therefore ascertainable by third parties ... and, more specifically, is located in this district where principal interests, assets and management are located. Thus, I cannot grant recognition of the Foreign Proceedings as main proceedings...*

*[T]here is no (pertinent) nontransitory economic activity conducted locally in the Cayman Islands by the [debtors]; only those activities necessary to their offshore 'business'... [E]ven if I were to strain to find sufficient factors to satisfy the 'nonmain' eligibility status pursuant to s 1502(5), the effort does not yield a finding of a seat for local business activity (proxy for establishment).'*

Lifland J thus correctly restated the operation of chapter 15 and correctly disagreed with the *SphinX* approach:

*'[R]ecognition under s 1517 is not to be rubber stamped by the courts. This Court must make an independent determination as to whether the foreign proceeding meets the definitional requirements of ss 1502 and 1517 of the Bankruptcy Code...*

*The Petitioners basically argue that because no objections have been filed and the [debtors'] registered offices are in the Cayman Islands, this Court should recognize the Foreign Proceedings as main proceedings. In other words, the Petitioners contend that this Court should accept the proposition that the Foreign Proceedings are main proceedings because the Petitioners say so and because no[-one] else says they aren't. This contention must be rejected...*

*In so holding, I part with the dicta in the *SPhinX* decision opining that if the parties in interest had not objected to the Cayman Islands proceeding being recognized as main, recognition would have been granted under the sole grounds that no party objected and no other proceeding had been initiated*

*anywhere else... To the extent that non objection would make the recognition process a rubber stamp exercise, this Court disagrees with the dicta in the SPhinX decision...*

*I recognize that portions of this holding are at odds with the decisions in SPhinX, both the bankruptcy court's decision and the district court's affirmance. However, neither of those courts addressed the 'establishment' requirement. Instead, the district court explained that the bankruptcy court's recognition of the foreign proceeding as a nonmain proceeding was a 'pragmatic one' as no other proceedings were pending and someone had to conduct the 'winding up'...*

*The Petitioners' reliance on the discretionary and flexibility attributes of caselaw under former s 304 of the Bankruptcy Code is misplaced. While much of the jurisprudence developed under s 304 is preserved in the context of new s 1507, s 304 did not have a recognition requirement as a first step. Moreover, the eligibility requirements of s 109 of the Bankruptcy Code (entitled 'Who may be a debtor'), did not apply to s 304 but are very specific as to who qualifies for relief under each of the other chapters of the Bankruptcy Code. Section 304 simply gave the United States courts the authority to open an ancillary proceeding and grant various broad forms of relief to the foreign representative... Chapter 15, on the other hand, imposes a rigid procedural structure for recognition of foreign proceedings as either main or nonmain and thus the jurisprudence developed under s 304 is of no assistance in determining the issues relating to the presumption for recognition under chapter 15.'*

### **The weight of the COMI presumption in favour of the registered office**

While it is helpful to note that the US court attempted to align its view on COMI with the ECJ's approach in *Eurofood*, there appears to be a divergence regarding the weight to be placed on the presumption that a debtor's COMI is located at its registered office.

In the context of the EC Insolvency Regulation, the English court has said this:

*‘There seems to be no reason to suppose that the presumption that a company has its COMI at the place of its registered office is a particularly strong one [and that the presumption] is rather just one of the factors to be taken into account with the whole of the evidence in reaching a conclusion as to the location of the COMI’ (Re Ci4net.com (unreported, 20 May 2004). See also Re Parkside Flexibles [2006] BCC 589 at [9] to the same effect.*

However, the ECJ in *Eurofood* appeared to have placed much more weight on the presumption:

*‘[I]n determining the centre of the main interests of a debtor company, the simple presumption laid down by the Community legislature in favour of the registered office of that company can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect’ ([2006] 1 Ch 508, 542).*

The US approach is more akin to the English approach set out above:

*‘The legislative history to section 1516(c) further explains that the presumption that the place of the registered office is also the [debtor’s COMI] is included for speed and convenience of proof where there is no serious controversy... This presumption permits and encourages fast action in cases where speed may be essential, while leaving the debtor’s true ‘center’ open to dispute in cases where the facts are more doubtful... This presumption is not a preferred alternative where there is a separation between a corporation’s jurisdiction of incorporation and its real seat.*

*Chapter 15 changed the Model Law standard that established the presumption in ‘the absence of proof to the contrary’, to a presumption in ‘the absence of evidence to the contrary’. The legislative history explains that the word ‘proof’ was changed to ‘evidence’ to make it clearer using United States terminology that the ultimate burden is on the foreign representative... Whatever may be the proper interpretation of the EU Regulation, the Model Law and Chapter 15 give limited weight to the presumption of jurisdiction of*

*incorporation as the COMI... Accordingly, if the foreign proceeding is in the country of the registered office, and if there is evidence that the [COMI] might be elsewhere, then the foreign representative must prove that the [COMI] is in the same country as the registered office' (Re Bear Stearns High-Grade Structured Credit Strategies Master Fund (Bankr.S.D.N.Y. September 5, 2007) (original emphasis, internal citations omitted)). See also Re Tri-Continental Exchange, 349 B.R. 627, 635 (Bankr. E.D. Cal. 2006) to the same effect.*

It is submitted that both the US and ECJ approaches are correct within their own legislative compound. While the same COMI concept appears in both the EC Insolvency Regulation and the Model Law, it performs different functions in both legislations. The COMI concept controls which jurisdiction may open insolvency proceedings under the EC Insolvency Regulation, whereas it merely determines the nature of the foreign insolvency proceedings under the Model Law. The Model Law does not determine the jurisdiction to open insolvency proceedings at all.

When one is concerned with the monopoly of jurisdiction to open insolvency proceedings within the EU, the certainty of jurisdiction becomes much more important for a host of reasons. For example, creditors need to be able to assess with reasonable certainty the insolvency risks associated with a debtor before extending credit. Similarly, before acceding to the creditors' request for a warranty that the debtor's COMI will be maintained in a particular jurisdiction, the debtor's directors need to be able to assess with reasonable certainty the location of COMI. The presumption of a company's registered office being its COMI helps simplify the application of the COMI concept and reduce the risk of different conclusions being reached by different courts: M. Virgós and F. Garcimartín, *The European Insolvency Regulation: Law and Practice* (2004), p 38.

On the other hand, the Model Law may tolerate more uncertainty with regard to the location of COMI. Provided a foreign proceeding may be recognised as either a main or a non-main proceeding, there is plenty of scope for the recognising court to tailor its relief according to the circumstances of the case. 'Flexibility in granting, modifying or denying relief and in communicating and coordinating among multiple

proceedings is a hallmark of chapter 15' (Daniel M. Glosband, 'SPhinX Chapter 15 Opinion Misses the Mark' 25-JAN Am. Bankr. Inst. J. 44, 84). Accordingly, creditors should be able to provide for the impact of this flexibility of relief following recognition in the relevant jurisdictions.

### **The elements of COMI**

The elements of COMI remain elusive. The two contenders are 'head office' functions and business operations. It is submitted that there should be a general preference for 'head office' functions (cf *Re Eurofood IFSC* [2006] 1 Ch 508, 529 (Advocate General Jacobs)):

*'[T]he important factor when determining [COMI] is the place where the interests are administered, not the place where those concrete interests are located... Consequently, the 'administrative connection' (which is established in the place of management and control) must take precedence over both the 'operational connection' (which is established in the place of business or operations) and the 'asset connection' (which is established in the place where the property is located). In layman's terms, what the definition tells us is that in order to establish international jurisdiction over a debtor what matters is where the 'head' (ie the directing power) is located, not the 'muscles' (ie the assets, the factors of production, the market, etc.)...*

*'If a corporate debtor has two (or more) places of management, it must be determined which of them appears as the directing centre, denoting the place where the executive or head office functions are carried out..., as opposed to the day to day operation of the business. These are functions which, by their very nature, require a single interlocutor, such as: (i) relationships with the providers of funds (shareholders and external financiers), including the raising of capital and the publication of accounts; (ii) strategic decision-making and the establishment of policies and corporate objectives; (iii) general supervision of the business and approval of important operations; (iv) central treasury management; and (v) the provision of services which benefit from economies of scale or range for the organisation, in particular the*

*entity's external authority or legal representation'* (M. Virgós and F. Garcimartín, *The European Insolvency Regulation: Law and Practice* (2004), pp 40, 42).

The US position of treating COMI as synonymous with the principal place of business is instructive: 'an entity's 'principal place of business' in United States jurisprudence is that entity's [COMI]' (*Re Tri-Continental Exchange*, 349 B.R. 627, 634 (Bankr. E.D. Cal. 2006)).

The meaning of 'principal place of business' has been explained thus:

*'[T]wo tests are commonly employed to determine a corporation's principal place of business... The 'nerve center' test defines the principal place of business as the nerve center from which a corporation radiates out to its constituent parts and from which its officers direct, control and coordinate all activities without regard to locale, in the furtherance of the corporate objective... Under this test, courts focus on those factors that identify the place where the corporation's overall policy originates... The other test has been labeled the 'place of operations' or 'locus of operations' test. There, the effort is to identify the place in which a corporation conducts its principal operations... Courts generally apply the 'nerve center' test when a corporation's operations are geographically widespread, and the 'locus of operations' test when a corporation is centralized...*

*Regardless of which is the more appropriate test, and they are much the same, the case law makes it clear that judges should not be straightjacketed by the formal requirements of each test, but rather should adapt the tests to the facts of each case... A flexible approach is appropriate where the facts do not fall neatly within the parameters of either the 'nerve center' or 'the locus of operations' analysis' (*Phoenix Four v Strategic Resources Corp.*, 446 F.Supp.2d 205, 214-215 (S.D.N.Y. 2006)).*

## **Consequences of non-recognition under chapter 15**

Lifland J in *Bear Stearns* held that non-recognition under chapter 15 would not leave the foreign representatives remediless because they could seek to commence plenary proceedings under chapter 7 or chapter 11 of the Bankruptcy Code. There is then some potential coordination of a chapter 7 or 11 case with the foreign proceeding under ss 1525, 1526, 1527 and 1529 of the Bankruptcy Code. This aspect of the decision concerning coordination is clearly correct because the operation of ss 1525, 1526, 1527 and 1529 of the Bankruptcy Code do not necessarily depend on the existence of a foreign main or non-main proceeding – this is also consistent with the British implementation of the Model Law under the Cross-Border Insolvency Regulations 2006.

The result is therefore that in order to obtain the US court's assistance, the debtors in *Bear Stearns* would be compelled to commence plenary proceedings under chapter 7 or chapter 11.

For comparative purposes, it is perhaps helpful to note that although the Cayman proceedings in *Bear Stearns* could not be recognised in England under the Cross-Border Insolvency Regulations 2006 if the debtors had no COMI or establishment in the Cayman Islands, the Cayman proceedings could potentially be recognised under s 426 of the Insolvency Act 1986. This is because, like the former s 304 of the US Bankruptcy Code, s 426 does not contain a threshold of main or non-main proceedings. Accordingly, the foreign representatives in *Bear Stearns* could potentially seek any necessary assistance from the English court without having to commence full English insolvency proceedings.

*Re Basis Yield Alpha Fund (Master)* (Bankr.S.D.N.Y. 2007) is a case in point, which concerns a Cayman incorporated debtor (a mutual fund) conducting a similar business to that of the debtors in *Bear Stearns*. Like the debtors in *Bear Stearns*, it was also an exempted limited liability which was prohibited from engaging in business in the Cayman Islands except in furtherance of its business otherwise carried on outside of the Cayman Islands. The debtor went into provisional liquidation in the Cayman Islands and its insolvency representatives sought recognition of the Cayman

proceeding under chapter 15 of the Bankruptcy Code. Based on the documents filed with the US court, the debtor appeared to have only slightly more connection with the Cayman Islands, thus raising doubts whether the debtor had its COMI or an establishment in the Cayman Islands. At the time of writing, the decision of the US court is still pending.

However, in the meantime, the Cayman proceeding received recognition in England under section 426 of the Insolvency Act 1986, although it could not be recognised under the Cross-Border Insolvency Regulations 2006 if the debtor had no COMI or establishment in the Cayman Islands.

### **Conclusion**

Lifland J's decision in *Bear Stearns* clearly comports with the intent and structure of chapter 15 that the determination of the existence of a foreign main or non-main proceeding is a definitional matter, not a discretionary matter. If a foreign proceeding is neither main nor non-main, it is not entitled to recognition under chapter 15. The same outcome would obtain in England under the Cross-Border Insolvency Regulations 2006. Nevertheless, recognition and assistance under s 426 of the Insolvency Act 1986 remain possible.

Regardless of the position under the EC Insolvency Regulation, the presumption in chapter 15 that a company has its COMI at the place of its registered office is only meant for speed and convenience of proof where there is no serious controversy. It does not have special evidentiary value and does not shift the burden of proof. It is the foreign representative who must prove the location of COMI in all cases. It is suggested that the English court should also adopt the same approach under the Cross-Border Insolvency Regulations 2006.

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<sup>1</sup> For a detailed exposition of the enacting legislations in various jurisdictions, see L C Ho (ed), *Cross-Border Insolvency: A Commentary on the UNCITRAL Model Law* (2006).

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