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Comi-migration: Use or Abuse of European Insolvency Law?

by

R.J. DE WEIJS and M.S. BREEMAN*

Although the European Insolvency Regulation does not provide limitations on comi-migration, comi-migration can lead to the application of the principle of abuse of Union law. This article provides a theoretical framework to distinguish between abusive and non-abusive comi-migration. Comi-migration which seeks to overcome common pool problems and their related tragedy of the commons is in principle allowed, as is comi-migration aimed at dealing with anticommons problems and their related hold-out behaviour. Comi-migration aimed at a different ranking is, however, not allowed. If this framework is applied to failing companies migrating to England, this leads to the following. Comi-migration aimed at benefitting from the English rules on reorganisation, such as the CVA and the Scheme of Arrangements are allowed since they deal with anticommons problems and their related hold-out behaviour. Also comi-migration aimed at benefitting from a prepack and preference law is in principle allowed as these rules deal with overcoming common pool problems and their related tragedy of the commons. Comi-migration aimed at a different ranking, e.g. German, Spanish and Italian companies migrating to England in order to prevent shareholder loans from being subordinated, is not allowed. Such a comi-migration will qualify as abuse of Union law to be established by the judge of the incoming jurisdiction. Such comi-migration could therefore remain without effect, even if the comi has factually been moved. A more subtle sanction could also be applying English preference law against any upgrade of a creditor's claim, most notably an upgrade from a subordinated shareholder claim to an ordinary claim.

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1. *Introduction*

Since 2002, the European Insolvency Regulation ('EIR') provides for uniform rules on jurisdiction, applicable law and recognition in the field of insolvency law.[1] Although unintended, the EIR has created a reliable structure for parties to bring entire insolvency proceedings under the scope of a more favourable jurisdiction, simply by migrating the company's *centre of main interest* ('comi') to another country. Whether comi-migration is good or bad, and whether it should be allowed or banned, is subject to on-going debate.[2]

In 2011, the European Parliament gave its view on comi-migration when it adopted its proposal for the harmonisation of European Insolvency Law.[3] The European Parliament apparently thinks comi-migration is such a dubious practice[4] that it warrants harmonisation of substantive insolvency law throughout Europe.[5] The reasoning apparently proceeds upon the point of view that complete harmonisation of insolvency law and practice would remove incentives to migrate comi to another jurisdiction. If comi-migration would truly be the underlying problem the European Parliament seeks to

1 Council Regulation (EC) No. 1346/2000 of May 2000 on Insolvency Proceedings.

2 See amongst others H. Eidenmüller, 'Free Choice in International Company Insolvency Law in Europe', *EBOR* 2005/6, p. 423–447 and W.G. Ringe, 'Forum Shopping under the EU Insolvency Regulation', *EBOR* 2008/9, p. 609–612. See also the Heidelberg-Vienna Report, p.107 (*External Evaluation of Regulation No. 1346/2000/EC on Insolvency Proceedings*, prepared by the University of Heidelberg and the University of Vienna, presented by B. Hess e.a.) for more references.

3 See European Parliament, Resolution of 15 November 2011 with Recommendations to the Commission on Insolvency Proceedings in the context of EU Company Law (2011/2006(INI)).

4 See also M. Szydlo, 'Prevention of Forum Shopping in European Insolvency Law', *EBOR* 2010/11, p. 255, who questions the 'too generalised assumption, which seems to be accepted by the Union legislator and CJEU jurisprudence, according to which forum shopping is always and in all possible constellations harmful to the values underlying the internal market.'

5 See further § 4 below.

address, the solution of harmonisation of substantive insolvency law in all Member States is rather draconic. A far less intrusive measure would simply be changing a single provision in the EIR and banning or restricting comi-migration. In 2012, a year after the proposal by the European Parliament, the European Commission presented its long awaited proposals for the amendment of the EIR. Rather surprisingly in the light of the strong stance taken by the European Parliament *against* comi-migration, the EC proposal neither bans comi-migration nor changes the comi-criteria in any significant way. Since the EIR is, therefore, most likely not going to end comi-migration coupled with the fact that the harmonisation of insolvency law could take many years, if not decades, comi-migration is a phenomenon that is here to stay for quite some time.

This article will first of all provide a framework to distinguish between good and bad comi-migration at the level of individual cases. The analysis presented here can be used in assessing whether comi-migration constitutes an abusive practice; an assessment that may lead a national court faced with a request to open insolvency proceedings after a completed comi-migration to deny the opening of an insolvency procedure applying the abuse of law principle as a general principle of Union law. The article will first discuss the European Insolvency Regulation (§ 2). It sets out the current operation of the EIR (§ 2.1), introducing comi-migration, as well as its limitations in the EIR (§ 2.2), and discusses the recent proposals for amendments to the EIR (§ 2.3). This section will conclude with an analysis of the extent to which the principle of abuse of Union law as a general principle of Union law might provide a limitation on comi-migration (§ 2.4). After this, an analysis will be made of when comi-migration should be allowed and when it contravenes basic insolvency law principles (§ 3.1). It will be argued that comi-migration is allowed if its aim is to benefit from different rules on overcoming hold-out behaviour, most notably rules on reorganisation plans (§ 3.2). Furthermore it will be argued that comi-migration is also allowed if it is aimed at benefitting from rules on preventing a tragedy of the commons, most notably rules on liquidating assets (§ 3.3) and preferences (§ 3.4). Comi-migration, however, contravenes basic insolvency law principles if it aims to bring about a different distribution, e.g. the ranking of shareholder loans (§ 3.5). The perspective taken in § 2 and § 3 will be that of the battle between a debtor and its creditors or creditors among each other in specific cases. In § 4, comi-migration will be discussed briefly from a more general perspective, namely as a manifestation of competition between different insolvency laws at the European level.

2. Working of the EIR

2.1. Current working of EIR

The EIR provides for uniform private international law rules on jurisdiction, recognition and applicable law. It does not[6] provide for the harmonisation of substantive insolvency law.

Most importantly, the EIR contains a recognition rule in article 16 EIR, providing that if an insolvency procedure has been opened in a Member State, the opening and the effects thereof are to be recognised in all other Member States. As to which court is competent to open the insolvency proceeding, also referred to as the *forum concursus*, the rule in article 3 EIR provides the answer; it is the court where the debtor has its *centre of main interests* ('comi').[7] For legal entities, there is a rebuttable presumption that the comi is where the company has its registered office.[8] This is only a presumption and subject to proof to the contrary.[9] The test where a debtor has its comi is highly factual and subject to debate, both in practice and literature.[10]

The basic rule of the EIR as to applicable law is that the effects of opening an insolvency procedure are also governed by the law of the opening court, therefore the *lex concursus*. Without intending to be exhaustive, article 4 EIR lists topics as to which the *lex concursus* applies, e.g., the assets included in the estate,

6 There are some minor exceptions, most notable the substantive rule in article 7 EIR.

7 The comi not only provides jurisdiction to open insolvency proceedings, but also creates other jurisdiction, even though the EIR does not explicitly provide for this. Following the CJEU-case, 12 February 2009, C-339/07 (Seagon/Deko) the opening court is also competent to hear typical insolvency claims, such as transaction avoidance. In the recent CJEU-case, 16 January 2014, C-328/12 (Schmid/Hertel) the CJEU also held that the opening court has jurisdiction to hear claims on transaction avoidance against persons whose place of residence is outside the Member States.

8 The term 'registered office' is far less clear than one would expect. On the difficulties of reaching a European understanding of its meaning, see F.M. Mucciarelli, 'The Hidden Voyage of a Dying Italian Company, from the Mediterranean Sea to Albion', *ECFR* 2012/9, p. 571–579. In the case of *Interedil* (CJEU 20 October 2011, C-396/09), the Italian company Interedil Srl registered in the English Company House as an overseas company, having transferred its place of business to England. For the English Company House, Interedil was still an Italian company. From the Italian point of view, Interedil had actually transferred its statutory seat to England. See Mucciarelli, p. 573.

9 The Heidelberg-Vienna Report (2012), p. 107, suggests that in some member states the presumption is more easily rebutted than in others.

10 See M.L. Lennarts, 'The review of the EU Insolvency Regulation – Time to recognize the ties that bind company law and insolvency law?' *NACIIL Reports* 2011, Amsterdam: Ius 2012, p. 49–63 with references. She concludes that comi is necessarily a fuzzy concept and that no definition will be able to remedy this.

the powers of the court appointed administrator, the filing of claims and the ranking of claims. In some cases the EIR provides for an additional rule, in which the *lex concursus* is replaced by or complemented with a different rule.[11]

There is an important exception to the opening of an insolvency procedure having full effect throughout the European Union. In case of an establishment,[12] the opening of a secondary procedure may be requested, which will then be governed by the law of the Member State of that establishment, including the ranking of creditors. The effects of the secondary proceeding are limited to assets located within the borders of that jurisdiction.

In relatively few provisions, the EIR provides for an all-encompassing framework providing for cross-border recognition of insolvency proceedings, indicates which court is competent and provides which law is applicable.

2.2. *Comi-migration under the EIR*

One of the explicit goals of the EIR was to prevent forum shopping. Recital 4 provides the following. "It 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 (forum shopping)."[13]

Due to the factual nature of a corporate debtor's comi, parties have it within their power to transfer a company's comi to a different jurisdiction. The working of

11 See articles 5–15 EIR.

12 Establishment means any place of operations where the debtor carries out a non-transitory economic activity with human means and goods. It should not be confused with a subsidiary company being a separate legal entity. Subsidiaries are a separate legal entity and a separate main procedure will have to be opened, for which in turn, its comi needs to be determined.

13 J. Israël, 'Shopping voor een schone lei', *NTBR* 2012/19 § 3.2.3 has pointed out that preamble 4, which has been taken from the Virgos-Smith Rapport § 7, did not occupy itself with comi-migration, but with the concern of debtors moving assets out of the reach of insolvency procedures and creditors trying to foreclose on assets from an insolvent debtor located in another Member State, notwithstanding the opening of a procedure elsewhere. He concludes that those who infer from preamble 4 that it is aimed also at curbing comi-migration are mistaken. Israël's point certainly has merit and provides a better understanding of the reasons leading up to the EIR. The conclusion, however, should still be that the EIR itself has a bias against forum shopping in general, and also against comi-migration. In its predecessor, the never enacted Treaty, there was also an explicit provision against comi-migration. This provision, however, has not made it into the EIR (see Israël, § 3.2). Israël himself, however, concludes that such a broad interpretation of the preamble is difficult to reconcile with the fact that the Treaty contained a specific provision curbing comi-migration but was not adopted in the EIR.

the EIR provides that once the comi is successfully moved and an insolvency proceeding is opened, the opening is to be recognised in all Member States. The steps required to move a company's comi will depend on the nature of the debtor's business. A company with only participations in subsidiaries (e.g., a financial holding company) will have a much easier time to move its comi than a company having offices or factories with many employees.[14] It is not required that the company reincorporates or merges with a company in the inbound jurisdiction. Limitations of such kind are against the freedom of establishment contained in article 49 and 54 TFEU and its predecessors as applied in the line of CJEU-cases of *Centros*, *Überseering* and *Inspire Art*.[15]

Although there is a strong common core of insolvency law principles in the European Union,[16] the varieties as to the ways these are implemented are almost endless and regularly provide for diametrically opposed outcomes in a given case. Therefore, the reasons to move comi are not uniform,[17] nor can they be traced easily in any given case. Also the reasons provided by parties if they are pressed for an explanation should be treated with some suspicion. In insolvency, one party's gain, is often the other party's loss and win-win situations are rare.

A clear case showing the possible interests at stake in a comi-discussion is the BenQ case.[18] The Dutch company, BenQ Mobile Holding B.V., operated both

14 See for the relative ease with which the company Wind Hellas moved its comi from Luxembourg to London, *Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (Ch). Here, basically one person set up an office in London, opened a UK bank account, issued a press release of the shift of the activities and informed the creditors that the company had moved to London, where it also registered as a foreign company. The company's registered office remained in Luxembourg where it also remained liable to pay taxes. Three and a half months later the company filed for administration. The court was satisfied that the company had moved its comi, especially since in the last months all negotiations took place from London. Wessels (B. Wessels, 'COMI: Round III', *FIP* 2010/8, p. 226) writes that COMI degenerated to CANE (Centre where **A**ll **NE**gotiations took place).

15 See CJEU 9 March 1999, C-212/97 (*Centros*), CJEU 5 November 2022, C-208/00 (*Überseering*) and CJEU 30 September 2003, C-167/01 (*Inspire Art*). See about the relation between these company law cases and insolvency law, M.L. Lennarts 'The review of the EU Insolvency Regulation – Time to recognize the ties that bind company law and insolvency law?' *NACIIL Reports* 2011 (Amsterdam, Ius 2012), p. 49–50 and W.G. Ringe, 'Forum Shopping under the EU Insolvency Regulation', *EBOR* 2008/9, p. 609–612.

16 See W.W. McBryde and A. Flessner, 'Principles of European Insolvency Law and General Commentary', in: W.W. McBryde, A. Flessner and S.C.J.J. Kortmann (eds.), *Principles of European Insolvency Law* (Deventer, Kluwer 2003), p. 15–89.

17 See for possible reasons based on differences in national insolvency law W.G. Ringe, 'Forum Shopping under the EU Insolvency Regulation', *EBOR* 2008/9, p. 597–600.

18 District Court Amsterdam, 24 January 2008, *JOR* 2008/17 (*BenQ*). It can be debated, however, whether in the case at hand, there was active comi-migration or simply a

in Germany and in the Netherlands. In 2006 the company itself applied for the opening of an insolvency proceeding in the Netherlands. Known assets available for distribution amounted to €17 million. A Taiwanese shareholder claimed €70 million under a shareholder loan. According to German law, this claim would certainly be subordinated. Under Dutch law there were at the time neither statutory provisions nor decisive case law providing for non-contractual subordination.[19] If the claim of the shareholder was to be allowed, significant pay-outs were expected on this claim. German creditors argued that forum-shopping had taken place because the comi was actually in Germany and that this shift in comi would be detrimental to the creditors. The Amsterdam District Court denied appeal against the declaration of insolvency. It held that the possible detriment to the other creditors caused by the insolvency procedure being opened in the Netherlands and not in Germany, did not constitute a valid ground to reverse the opening of the procedure in the Netherlands.[20] Apart from suspicions as to the motives for comi-migration, like preferring an existing shareholder, the argument can be made that comi-migration in itself is undesirable because it creates legal uncertainty and additional costs, already because costs will arise if a foreign company needs to be liquidated under a different insolvency regime than its company law regime.[21] Also creditors will normally trade on the basis of certain expectations, and will be unpleasantly surprised if they find their dealings with their debtor to be wound up under different and unfamiliar law.[22]

Advocates of comi-migration argue that this is not what is actually driving comi-migration. Not liabilities rules and rules more favourable for existing shareholders, but better reorganisation rules are supposedly the key factors behind comi-migration. Hailed examples are Schefenacker and Deutsche Nickel.[23]

debate where the comi of a company operating in two Member States should be located. See on the case also T.M. Bos, 'Forumshopping in een Europese insolventie', in: B.E. Reinhartz e.a. (eds.), *Derden in het privaatrecht* (Den Haag, BJU 2008), p. 183–213.

19 Since then, two cases have been decided. In one case, subordination was denied; District Court Amsterdam, 17 December 2008, *JOR* 2009/171 (*One.Tel*). In another case, another court came to subordination of shareholder loans; District Court Breda, 14 October 2010, *JOR* 2010/293 (*Louwerier q.q./Oude Grote Bevelsborg q.q.*).

20 The Dutch trustees managed to negotiate some kind of subordination of intragroup claims making a 100% payment to external creditors possible.

21 H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 5. See for a discussion of actual mismatches between English insolvency law and German Company Law, B. Wessels, *International Insolvency Law* (Deventer, Kluwer 2012), nr. 10603.

22 H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 5.

23 W.G. Ringe, 'Forum Shopping under the EU Insolvency Regulation', *EBOR* 2008/9, p. 585–587.

These companies moved their comi from Germany to the UK by means of a rather complicated process, in order to complete a reorganisation plan by means of a debt for equity swap. Under the English Creditors Voluntary Arrangements ('CVA'), this could be achieved without shareholders having a blocking vote. In these cases, the creditors by and large agreed to comi-migration. Since insolvency law is primarily viewed as creditors' law, the creditors' consent has significant weight as is stressed by Ringe.[24]

The EIR does not contain a rule on comi-migration, let alone rules to distinguish between proper/good and improper/bad comi-migration. The only real limitation follows from the CJEU *Staubitz-Schreiber* case,[25] in which the court held that comi-migration effected *after* the request to open insolvency proceedings has been filed, should not be taken into account. If a creditor is of the opinion that a court has been mistaken in assuming the comi to be in its jurisdiction, the venue for appeal is the appellate court in the state of opening. In *Eurofood* the CJEU explicitly held that it is not for a court to review the decision taken by the court from a different Member State.[26] There is one possibility of escape in the EIR and that could be article 26 EIR which provides for an *ordre public* exception. The threshold for invoking this exception is, however, very high since it can only be invoked if recognising the opening of an insolvency procedure from another Member State would be manifestly contrary to that State's public policy, in particular its fundamental principles or the constitutional rights and liberties of individuals. The CJEU also stresses that in order for a regulation on the mutual recognition of jurisdiction to function, the denial of recognition with reference to public policy clauses should be reserved for exceptional cases.[27] A situation where this might particularly be the case, is according the CJEU, where the rules for a fair hearing have been violated.[28] It may, therefore, at first sight, be a stretch to argue that the liquidation of a company under a different set of rules, which on a whole provide for a fair and orderly procedure, would violate the fundamental rights of individuals. If, however, a creditor were to basically lose all or a majority of the value of its claim as a result of comi-migration, this case could come within the scope of fundamental rights.[29] This would especially be the case since the

24 W.G. Ringe, 'Forum Shopping under the EU Insolvency Regulation', *EBOR* 2008/9, p. 604 in the paragraph with the telling title 'Creditors as initiators of forum shopping'.

25 CJEU, 17 January 2006, C–1/04 (*Staubitz-Schreiber*).

26 CJEU, 2 May 2006, C-341/04 (*Eurofood*), No. 38–44, with reference to the principle of mutual trust.

27 CJEU, 2 May 2006, C-341/04 (*Eurofood*), No. 62–68, with reference to CJEU, 28 March 2000, C-7/98 (*Krombach*).

28 See CJEU, 2 May 2006, C-341/04 (*Eurofood*), No. 63.

29 This is a realistic scenario if, because of comi-migration, subordinated shareholder loans would be upgraded to normal insolvency claims (see on this § 3.5 below).

right to property is protected under the First Protocol to the European Convention on Human Rights. The problem of using article 26 EIR in case of a comi-shift is, however, that it basically second-guesses the court of another Member State. Section 26 EIR is thereby at best a second line of defence. It does not provide a remedy for the court of the host jurisdiction to deny the opening of a procedure if the comi has actually been shifted, nor does it provide criteria to distinguish between good and bad comi-migration. Therefore, any legal response to comi-migration revolving around article 26 EIR is incomplete.[30]

Depending on the nature of the company and the way comi-migration has been conducted, there is sometimes a partial remedy for creditors left behind, namely by requesting a secondary procedure. As said, for financial holding companies it is relatively easy to migrate their comi as is evidenced by the *Wind-Hellas* case.[31] For companies with production facilities this will be much more difficult. Even if such companies are successful, the remaining assets will normally qualify as an establishment,[32] providing the possibility to open a secondary procedure with respect to these assets,[33] which procedure will be governed by the laws of the land of the establishment. Most important then is the rule that the proceeds of the assets will also be distributed in accordance with the ranking provided by the laws of the Member State of the establishment.

All in all, if the comi has *actually* been moved, limitations on its effects are largely absent in the EIR. Actual comi-migration needs to be distinguished from misrepresentation. In the case of misrepresentation the comi is not moved, but the parties filing the request to open insolvency procedure present the facts to the court in a misleading manner.[34]

2.3. Suggested changes to EIR

When the EIR was enacted in 2002, it had already been decided that the EIR would be reviewed in 2012.[35] Several proposals were put forward, most nota-

30 See for the problem of second-guessing the initial court's decision, also S.M. van den Braak, 'Migratie in het zicht van insolventie: het comi nader beschouwd', *TvI* 2010/19.
31 See footnote [13] supra.
32 See article 2 h EIR.
33 See article 3-2 EIR.
34 See on the distinction H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 9. See on the issue also I Mevorach, 'Forum Shopping in Times of Crisis: A Directors' Duties Perspective', *ECFR* 2013/4, p. 547 and 548.
35 Article 46 EIR provides for an evaluation of the working of the EIR no later than 1 June, 2012.

bly with respect to altering the controversial rules on comi. Many authors have argued in favour of changing the EIR in the sense that it would change the presumption of the registered office into a non-rebuttable assumption.[36] Another line of suggested changes was to incorporate explicit rules on comi-migration.[37] The proposal put forward by the practitioners organisation INSOL Europe contained such a rule. It provided that if the company has moved its comi less than *one* year prior to the request for the opening of the insolvency proceeding, only the courts of the Member State where the comi was located one year prior to the request would have jurisdiction to open a procedure if the debtor left liabilities unpaid, unless *all*[38] old creditors agreed in writing to the migration of the comi.[39]

In December 2012 the European Commission published its draft for amendments of the EIR.[40] The proposal turned out to be somewhat of an anti-climax as far as comi is concerned since it does not contain any significant changes to the comi-rules in place. The Commission proposal only provides for the codification of the CJEU *Interedil*-case.[41] It does so by adding to the rule currently laid down in article 3 EIR, that the centre of main interests shall be 'the place where the debtor conducts the administration of his interests on a regular basis and which is ascertainable by third parties'. In addition to codifying case-law, the proposal provides in a new article 3 b under i that the court has to examine whether it has jurisdiction *ex officio.* The test cannot be seen as a real limitation on comi-migration. It could at best lead to a better distinction between misleading representations as to where the comi is and genuine comi-

36 See Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 24. See also Armour in a response to Eidenmüller in J. Armour, 'Abuse of European Insolvency Law? A Discussion', in: R. de la Feria and S. Vogenauer (eds.) *Prohibition of Abuse of Law* (Oxford, Hart Publishing 2011), p. 167 and see M.L. Lennarts 'The review of the EU Insolvency Regulation – Time to recognize the ties that bind company law and insolvency law?' *NACIIL Reports* 2011 (Amsterdam, Ius 2012), p. 50–63.

37 INSOL Europe, 'Revision of the European Insolvency Regulation, Proposals by INSOL Europe', 2012 p. 42–45.

38 As will be demonstrated below, rules requiring the consent of *all* creditors should be avoided. See also, M. Schillig, Corporate Insolvency Law in the 21st Century: State-Imposed or Market-Based? (forthcoming), who writes: "the proposal not only does not address the anti-commons problem; in fact, giving all the creditors failing within the one-year-period a veto significantly exacerbates the anti-commons problem."

39 See for a more sensible proposal, M. Schillig, Corporate Insolvency Law in the 21st Century: State-Imposed or Market-Based? (forthcoming), where he proposes a system which does require creditors' consent, without giving individual creditors a veto right.

40 EC Proposal for a Regulation of the European Parliament and the Council amending the Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings, 2012/0360(COD).

41 CJEU 20 October 2011, C-396/09 (Interedil).

migration, where the first will be filtered out better in the future.[42] Another new element in the proposed article 3 b is the rule under iii that explicitly provides that foreign creditors are entitled to challenge the opening decision, which might not have been the case in all jurisdictions.[43] Since insolvency proceedings will often be opened without hearing the creditors, it will especially be at the stage of appeal (or other means of challenge) that objections against misrepresentation and abusive comi-migration will be raised and presented to the court.[44]

The European Parliament indeed does take a more negative approach to comi-migration than the European Commission. In its subsequent 2013 amendment to the Proposal by the Commission, the European Parliament introduces a period of three months in which comi-migration basically remains without effect. The amendment provides that; "*The centre of main interests shall be the place where the debtor conducts the administration of his interests on a regular basis at least three months prior to the opening of insolvency proceedings or provisional proceedings and which is ascertainable by third parties.*" This amendment does not distinguish between different types of or reasons for comi-migration, nor does it provide for a remedy if the comi-migration is abusive, but has been conducted prior to the three months period. Whether such a three month period and its one size fits all approach will in the end become a part of the European Insolvency Regulation, remains to be seen,

42 The suggested *ex officio* test thereby addresses the argument made by Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 9, that courts insufficiently distinguish between comi-migration and misrepresentation (where he uses the stronger wordings of fraud). See further below, note [50].

43 In the 2012 Commission proposal the provision was made that these creditors should be informed either by the opening court or the appointed liquidator. In the 2013 Amendment by the European Parliament (European Parliament, *Report on the Proposal for a regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000* (..), 20 December 2013), the Commission Proposal is altered into the rule that the opening must be made public in the European register and that creditors can challenge the opening within three weeks after the publication of the opening.

44 The new rules seek to provide a procedural framework in order to curb abusive comi-migration and misrepresentation. Such a framework was suggested by the Heidelberg-Vienna Report (2012), p. 18 and 19. Although the Report is not clear on when comi-migration might qualify as abusive, it does suggest that also real comi-migration (as opposed to misrepresentation) might be abusive and should be addressed. See the Report at p. 16: "Furthermore, it seems advisable to provide for minimum procedural rules to discourage so-called abusive relocations of COMI" and p. 109 and 110. Elsewhere, the Report seems sympathetic, however, to the view that abusive comi-migration is limited to misrepresentation. See Report, p. 142: "However, several reporters emphasized that COMI shifts are not to be considered abusive of they are genuine and not merely virtual." This view however, negates the existence of abusive comi-migration. If there is a misrepresentation of comi, there is no migration to start with.

especially since the European Parliament seems much more critical as to comi-migration than the Commission, current practice and academic writing.

2.4. Comi-migration as abuse of Union law

There is yet another possible way to address *abusive* comi-migration and that is by invoking the general principle of abuse of EU law.[45] Abuse of EU law is a general principle of Union law emerging from CJEU case law.[46] The test, as first formulated by the CJEU in *Emsland-Stärke* has an objective and a subjective element. According to the CJEU, a finding of abuse requires, firstly a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved. It requires, secondly a subjective element, being the intention[47] to obtain an advantage from the Community rules by artificially creating the conditions laid down for obtaining it. There is still some debate as to whether the principle of abuse of rights exists as a general principle

45 See for yet a different approach, I. Mevorach, 'Forum Shopping in Times of Crisis: A Directors' Duties Perspective', *ECFR* 2013/4, where she is sceptic about both the possibility and the desirability of reversing a comi-shift once it has actually taken place. She proposes to tackle the issue by means of directors' liability instead, which issue can be decided by the opening court of the incoming jurisdiction. Liability would be triggered if the forum shopping would be held to be illegitimate. (See for the framework developed by her, below footnote [65]).

46 The landmark cases are CJEU, 14 December 2000, C-110/99 (*Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas*) (case where the German authorities reclaimed export subsidies for goods leaving the country only to be reimported without even being unpacked), CJEU, 21 February 2006, C-255/02 (*Halifax plc v. Commissioners of Customs & Excise*) (case where company by means of implementing a scheme involving different group companies managed to evade paying VAT on its construction works), CJEU, 12 September 2006, C-196/04 (*Cadbury Schweppes*) (case concerning the legality of Controlled Foreign Company Legislation imposing a tax charge on UK Holding companies on profits made by subsidiaries) and CJEU, 5 July 2007, C-321/05 (Kofoed v Skattenministeriet) (case concerning the application of a codified anti-abuse clause in article 11(1)(a) of the Merger Directive). See for an overview A. Lenaerts in the very readable article, 'The General Principle of the Prohibition of Abuse of Rights: A critical position on its role in a codified European Contract Law', *European Review of Private Law*, 2010/6, p. 1121–1154.

47 In CJEU, 21 February 2006, C-255/02 (*Halifax*), the CJEU uses the words 'essential aim'. See CJEU: "Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. As the Advocate General observed in point 89 of his Opinion, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages."

of Union law.[48] In CJEU *Kofoed*, the Court, however, explicitly referred to the general Community law principle that abuse of rights is prohibited.[49] Given the rather strict criteria of the abuse of law principle, the repeated use of it in CJEU case law and the explicit reference to it 'as a principle of Union law' by the CJEU, it is difficult to maintain that the principle should not be recognised and applied as such.[50]

There is, however, no current CJEU case-law applying the abuse of law as principle of Union law in the field of insolvency law. Already in 2009, Eidenmüller argued in favour of its applicability with respect to comi-migration.[51] Israël also concludes that national courts can apply the abuse of law principle in deciding on the opening of insolvency procedures.[52] In a response to Eidenmüller, Armour argues that he sees no use for the application of abuse of law in a corporate context.[53] He does not dismiss its applicability, but argues that its potential use is limited to natural persons. Armour raises several arguments against applying it in a corporate context as well. One of the arguments raised by Armour is the following:

"There are also reasons for thinking that a European law prohibition on 'abusive' comi shifts might generate significant costs. The application of any such test would be surrounded by considerable uncertainty. Given the inherent elasticity of the concept of comi, it seems likely that courts might

48 See for references A. Lenaerts, 'The General Principle of the Prohibition of Abuse of Rights: A critical position on its role in a codified European Contract Law', *European Review of Private Law*, 2010/6, p. 1139, footnotes 104 and 105.

49 CJEU, 5 July 2007, C-321/05 (*Kofoed v Skattenministeriet*), No. 38.

50 See also A. Lenaerts, 'The General Principle of the Prohibition of Abuse of Rights: A critical position on its role in a codified European Contract Law', *European Review of Private Law*, 2010/6, p. 1139 dismissing any doubts as to the existence of abuse of rights as a general principle of Union law.

51 At the same time he warns to keep some distance from the general principle, as in his view, the CJEU insufficiently distinguishes between fraud and abuse (H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 9). "For instance, the Brochier cases that were litigated in the European Courts in recent years were fraud cases and not abuse of law cases. Brochier was an English limited company that clearly had its comi in Nuremberg in Germany. However, an initial petition was supported by a distorted set of facts presented to the High Court. The facts were twisted to create the impression that Brochier's actual head office was in London, whereas on an undistorted and complete set of facts there could be doubt that the company's comi was in fact in Nuremberg."

52 J. Israël, 'Shopping voor een schone lei', *NTBR* 2012/19. In his analysis as to whether a comi-shift by natural persons would qualify as such, he concludes that this will only be so in rare cases. See on the issue also S.M. van den Braak, 'Migratie in het zicht van insolventie: het comi nader beschouwd', *TvI* 2010/19.

53 J. Armour, 'Abuse of European Insolvency Law? A Discussion', in: R. de la Feria and S. Vogenauer (eds.) *Prohibition of Abuse of Law* (Oxford, Hart Publishing 2011), p. 161–166.

be tempted to elide – and confuse – the question of whether comi has shifted at all with that of whether a prima facie shift should be struck down as being abusive."[54]

We believe it is much more likely that exactly the opposite will be the case, from what Armour fears might happen. Comi-migration is a somewhat elusive phenomenon, where questions of fact as to whether comi has shifted should indeed be properly distinguished from the question whether it is allowed. If there is no rule curbing abusive comi-shifts, doubts as to the permissibility of a comi-transfer are likely to translate themselves into the assessment that the attempt to shift comi itself has not been successful. Applying the abuse of law test, provides judges with the tools to make a proper distinction. Thereby, in all likelihood, significantly reducing the risk that any doubts as to the motives of the parties will translate themselves into a different assessment of facts.

Whatever the strength or weakness of the argument put forth by Armour against *applying* the abuse of law principle,[55] on a more conceptual level it should be noted that Armour (like Eidenmüller and Israël) does not deny the existence of the principle and the legitimacy of its application in the field of insolvency law. The discussion for insolvency law seems therefore not to be the question whether the principle exists and carries weight, but whether it could be applied in the setting of insolvency law to curb abusive comi-migration.

If comi-migration is clearly against the goals of the Insolvency Regulation and European insolvency law, and the subjective requirements developed in case-law on the abuse of law principle have been met, it can be applied and constructed as abuse of the EIR.[56] In such a case, the national court of the inbound jurisdiction can deny the opening of an insolvency procedure[57] and subse-

54 J. Armour, 'Abuse of European Insolvency Law? A Discussion', in: R. de la Feria and S. Vogenauer (eds.) *Prohibition of Abuse of Law* (Oxford, Hart Publishing 2011), p. 165.

55 This should be seen in connection with his plea for changing the EIR where the registered office would form an irrebuttable assumption (J. Armour, 'Abuse of European Insolvency Law? A Discussion', in: R. de la Feria and S. Vogenauer (eds.) *Prohibition of Abuse of Law* (Oxford, Hart Publishing 2011), p. 167). If the EIR is not changed accordingly, reconstructing the argument, there would be more use of applying the principle of abuse of Union law in a corporate context.

56 See H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 11/12.

57 From CJEU, 14 December 2000, C-110/99 (*Emsland-Stärke*), No. 59 it can be inferred that it is up to the national court to judge whether abuse has been made. This is repeated in unequivocal language in CJEU, 21 February 2006, C-255/02 (*Halifax*), No. 76: "It is for the national court to verify in accordance with the rules of evidence of national law, provided that the effectiveness of Community law is not undermined, whether action constituting such an abusive practice has taken place in the case before it." See also CJEU, 12 September 2006, C-196/04 (*Cadbury Schweppes*), No. 72.

quently the courts of the outbound jurisdiction can still open an insolvency proceeding, notwithstanding that the comi has actual been relocated. Such application of the principle of abuse of Union law by the court of the incoming jurisdiction would then be a first line of defence, which is preferable to the second line of defence approach under art. 26 EIR[58]. The court faced with the request of opening an insolvency procedure would have to deny the opening, most likely after objections raised by creditors. In case of a stealthy request in which the creditors have not been heard, the issue can be brought to the attention of the court in appeal.[59]

3. *Distinguishing between good and bad comi-migration*

The objective element from the abuse of law cases requires that despite formal observance of the conditions laid down by community rules, the purpose of those rules has not been achieved. The test is, therefore, whether comi-migration in a given case is at odds with the purpose of the EIR and, we would add, the broader field of European insolvency law. Although there is limited harmonised insolvency law at a European level, one should not view the present state of European insolvency law as being limited to the private international law rules on jurisdiction, applicable law as well as recognition and enforcement in the EIR. Already in the conclusion to the CJEU *Deko/Marty* case, Advocate General Colomer, heralded the creation of a body of European insolvency law. He writes:

> "Community action in the field of insolvency is based on the need for effectiveness and legal certainty. In order to avoid a complicated legislative framework which discourages financial transactions within the European Union, Regulation No. 1346/2000 sets out clear guidelines which provide stability and consistency in such important fields as jurisdiction, applicable law, and the recognition and enforcement of judgments. There have been other developments in the secondary legislation on the subject, all of which have the same aim and together form *the body of Community insolvency law*. In short, it is a body of law which is fully dedicated to the aim of ensuring that there is consistency in the adoption of judicial decisions."[60] (Italics are from the original)

In his 2009 article, where Eidenmüller argued in favour of applying the abuse of law principle to comi-migration, he also provides criteria when comi-migration actually qualifies as abusive. Eidenmüller first sets out to establish what the proper goals of the EIR are in order to establish when comi-migration runs counter to these goals. He concludes that the EIR contains two main goals. Firstly, the efficient and effective administration[61] of cross-border in-

58 See above § 2.2.
59 See the proposed art. 3 b under iii discussed above in § 2.3.
60 CJEU, 12 February 2009, C-339/07 (*Deko/Marty*).
61 These are explicitly mentioned in recitals 2, 8, 16, 19 and 20 in the preamble to the EIR.

solvencies aimed at maximising the net assets to satisfy creditors' claims[62] and secondly, preventing forum shopping in order to ensure predictability fostering the efficiency of credit contracts. These goals can of course conflict, in which case the first takes precedence over the second, according to Eidenmüller.[63] He concludes:

> "Everything turns on whether the COMI shift contributes to maximising the net assets available to satisfy creditors' claims. If it does, it surely cannot be considered abusive.[64] (...) COMI shifts that evidently benefit either the debtor at the expense of its creditors or some creditors at the expense of others are suspicious. Such COMI shifts are driven by *distributive considerations* and not by the goal of maximising the net assets available to satisfy creditors' claims. If a COMI shift is evidently effected in order to enrich the person(s) initiating it at the expense of other stakeholders, the shift is abusive. Speaking very crudely, it all comes down to the question of whether a COMI shift is driven by considerations of efficiency (no abuse of law) or considerations of claiming value, i.e. distributive concerns (abuse of law)."[65] (italics are from the original)

We largely agree with Eidenmüller.[66] The overall conclusion should indeed be that comi-migration aimed at bringing about a different distribution cannot be reconciled with the goals of the EIR. Furthermore, comi-migration should in principle be allowed if driven by the consideration of a more efficient insolvency regime or at least more apt to deal with the case at hand. The proposal made by Eidenmüller was, as he puts it himself, still in the stage of sketching the outlines of how the abuse of law principle could be applied to comi-migration.[67]

62 H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 14.
63 H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 15.
64 Eidenmüller does not discuss the problematic case, where a shift might do both, increasing the net assets and changing the distribution. The phrase, 'if it does (increase the net assets), it surely cannot be considered abusive', therefore lacks nuance and is too general.
65 H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 16.
66 A similar analyses is applied by Mevorach, where she develops her framework of directors' duties. She writes ('Forum Shopping in Times of Crisis: A Directors' Duties Perspective', *ECFR* 2013/4, p. 539: "While the directors' duties regime generally supports relocation, its legitimacy would depend on whether or not the relocation was predicated on a desire to improve the position of the general body of creditors. Therefore, self-serving relocations for the purpose of escaping liabilities, prolonging the entry into insolvency proceedings, retaining the managing position and so forth, as well as relocations aimed at benefiting a section of the stakeholders must be regarded detrimental (i.e. wrongful). Such relocations cannot meet the standard duty of taking steps near insolvency to avoid insolvency or minimise its affect for the benefit of the stakeholders as a whole."
67 H. Eidenmüller, 'Abuse of Law in the context of European Insolvency Law', *ECFR* 2009/1, p. 3.

In the remainder of this section (§ 3) and the following section, the argument made by Eidenmüller will be refined and provided with a theoretical basis founded in insolvency law theory. First the Creditors' Bargain Theory will be discussed as the dominant insolvency law theory. The Creditors' Bargain Theory will be expanded upon with the notion of anticommons in order to better understand the nature and goals of insolvency law (§ 3.1). Subsequently, insolvency law theory will be applied to different topics of insolvency law. As England is usually the preferred destination for comi-migration,[68] four key elements of English insolvency law will be discussed and it will be analysed whether from an insolvency theory perspective, comi-migration aimed at benefitting from English law should be considered compatible with basic insolvency law theory. These four areas are: reorganisation plans (§ 3.2), pre-packs (§ 3.3), preferences (§ 3.4) and the treatment of shareholders providing loans as normal creditors (§ 3.5).

3.1. Insolvency law Theory: overcoming common pool and anticommons problems

To understand what insolvency law is and what its scope should be, the influential Creditors' Bargain Theory provides valuable insights. The Creditors' Bargain Theory poses the question what creditors would agree upon lacking insolvency laws providing for a collective procedure. According to the Creditors' Bargain Theory, creditors would agree exactly upon such a collective procedure. In order to understand why, one only needs to realise what would happen lacking a collective procedure; in such a case it would be a free for all. In the case of distressed debtors, the moment a threat of insolvency presents itself, creditors will rush to have their claim satisfied before others, trying to seize individual assets in order to satisfy their claim. This would result in a destruction of a potentially viable business. Accordingly, the going concern value would be lost. Insolvency law seeks to maximise the value of assets through a coordinated procedure.[69] The problem insolvency law deals with

68 The preferred destination is not always England. (See for an overview of cases the Heidelberg-Vienna Report (2012), p. 100 – 151 and also B. Wessels, *International Insolvency Law* (Deventer, Kluwer 2012), No. 10603 a-c.) Depending on the circumstances and who is driving comi-migration, it might also be beneficial to move out of the UK, to for example France. (See I.F. Fletcher and B. Wessels, *Harmonisation of Insolvency Law in Europe* (Deventer, Kluwer 2012), p. 44.)

69 There are two additional reasons, besides maximisation of the value of assets, why creditors would opt for a collective procedure, according to the Creditors' Bargain Theory. Firstly, it prevents costly all-against-all litigation and secondly it reduces monitoring costs of creditors keeping an eye on each other in order not to be left out in a race against the assets.

is similar to other common pool problems, such as fishing in a lake or the grazing of lands. If all parties would act in the same self-interested manner, they would try to catch as many fish as possible, or have their cattle graze as much as possible. Even to the extent that it could mean that this behaviour would exhaust all resources. Lacking individual rights that could exclude others from use, common resources are prone to overuse, resulting in what is referred to as tragedy of the commons.[70] The Creditors' Bargain Theory, views insolvency as a common pool problem, and accordingly insolvency law as a set of rules to overcome these common pool problems.

Although the Creditors' Bargain Theory provides valuable insights as to why we have insolvency laws, it overlooks what happens once parties are locked into a collective procedure. At that stage, the tragedy of the commons is successfully overcome. Once parties are locked in, their behaviour mutates. Instead of trying to opt-out of the procedure, they might try to advance their own interest by frustrating or simply threatening to frustrate the collective process by holding out. To continue the metaphor of fishing in a lake, imagine what happens once there is a collective regime, which provides that *no one* from the village is to fish in the lake anymore, unless *everyone* in the village agrees. In such a new regime, everyone is given a veto right. The likely consequence is that quarrels and disputes will result in a situation where nobody goes fishing, until the voting problem is overcome by some kind of procedure. Such a situation fits another commons problem, namely that of the anticommons. This phenomenon is subject of more recent property law scholarly research. Basically anticommons problems are the mirror image of a common pool problem. As to a common pool, *none* of the parties has it within its powers to prevent other parties from using or even overusing a specific good or resource. In an anticommons situation *all* of the participants have it within their power to block the use by others. Where the typical effect of a common pool is overuse, the existence of an anticommons problem is likely to produce an underuse, because all parties can veto the use by the other entitled parties.[71]

70 The game-theoretical pattern explaining common pool problems and the tragedy of the commons is the prisoners' dilemma. See for an analysis of common pool problems in the terms of the prisoners' dilemma, L.A. Fennell, 'Commons, Anticommons, Semicommons', in: K. Ayotte and H.E. Smith (eds), *Research Handbook on the Economics of Property Law* (Cheltenham, Edward Elgar Publishing 2011).

71 The game-theoretical pattern explaining anticommons and their related hold-out behaviour should be understood as a game of chicken. See L.A. Fennell, 'Commons, Anticommons, Semicommons', in: K. Ayotte and H.E. Smith (eds), *Research Handbook on the Economics of Property Law* (Cheltenham, Edward Elgar Publishing 2011), p. 43: "Whereas the commons tragedy follows the strategic pattern of the Prisoner's Dilemma, the anticommons often resembles the strategic game of chicken." See more for a more elaborate application to the case of insolvency law, M. Schillig, Corporate Insolvency Law in the 21st Century: State-Imposed or Market-Based? (forthcoming).

Anticommons often better explains parties' behaviour in insolvency than the theory of the common pool. In economic terms, the debtor is expropriated for the benefit of its creditors. Here a single owner (the debtor) is replaced by multiple owners (the creditors), causing new problems of aligning these new owners.

Examples of anticommons settings in insolvency[72] are hold-out problems of creditors under composition plans or more complex reorganisation plans. Where all creditors are required to agree, a single creditor could, and most likely would, frustrate the collective process. By creating nuisance value, it could seek to receive a larger part of the pie.[73] The same dynamics of holding out and frustrating the collective process can be seen at the stage of claim filing, where some creditors file exorbitant claims and thereby create nuisance value. Here the filing of exorbitant claims targets the swift and effective liquidation of the company, which often translates itself into some kind of monetary claim. The court appointed administrator then has the choice of giving in and continue the winding down, or fighting the hold-out creditor for years. Hold-out behaviour also presents itself in case of the liquidation of a group of companies, where multiple officeholder have to consent to a going concern sale of the business operated through several legal entities, each can hold-out for a larger share of the proceeds.[74]

Although the Creditors' Bargain Theory is subject to strong criticism, the basic idea of viewing insolvency law as a way of overcoming a tragedy of the commons has strong merit. It should, however, as a conceptual model be expanded with the notion of anticommons behaviour. Together, the theory of the tragedy of the commons and the theory of anticommons explain much of what insolvency does and should do.

The central argument made in the following three sections (§ 3.2 – § 3.4) is that parties are in principle[75] allowed to look for a jurisdiction that better deals with

72 See for an analysis of insolvency law in terms of commons and anticommons and whether insolvency laws should be mandatory or mere default rules, M. Schillig, Corporate Insolvency Law in the 21st Century: State-Imposed or Market-Based? (forthcoming).

73 See for an analysis of hold-out behaviour in multi-party negotiations, J. Armour and S. Deakin, 'Norms in Private Insolvency: The "London approach" to the resolution of Financial distress', *Journal of Corporate Law Studies*, 2001, p. 21–51.

74 See on these problems R.J. de Weijs, 'Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool & Anticommons', *International Insolvency Review*, 2012/21, p. 67–83.

75 The argument made here should not be taken out of its context. It is primarily a theoretical argument made against the background of the European Union and the current situation where there are very significant differences between insolvency laws. The argument does not in any way seek to discredit the very strong arguments made

overcoming common pool problems and their related tragedy of the commons. The same is also true for jurisdictions dealing better with overcoming anticommons and their related hold-out behaviour.

3.2. Reorganisation plans: overcoming hold-out problems

Reorganisation plans normally provide for an alternative to a straightforward liquidation followed by a division of the proceeds according to the statutory rules. Throughout Europe, the rules on presenting and accepting a reorganisation plan vary considerably. Almost invariably,[76] legal systems require some kind of creditors' approval. As to the required majorities, a distinction can be made as to a majority in number of creditors[77] and a majority in value of outstanding debt.[78]

According to Dutch law, it is required that 50% of the number of unsecured creditors present at the meeting, representing at least 50% of the total outstanding debt vote in favour.[79] If adopted, also dissenting creditors are bound. Germany applies similar low thresholds. For an *Insolvenzplan* to be accepted, it is required that within each class, at least half the number of creditors vote in favour and that the creditors voting in favour represent at least half of the total amount of debt held by all creditors voting.[80] In addition to these voting rules with already rather low thresholds, both Dutch law[81] and German law provide

against comi-migration as occurs in the US for all kind of reasons, which have little to do with differences in substantive law (because insolvency is harmonised at the federal level), but more with the way bankruptcy courts deal with bankruptcy cases. See for a detailed analysis L.M. LoPucki, *Courting Failure. How competition for big cases is corrupting the bankruptcy courts* (Ann Arbor, University of Michigan Press, 2009).

76 See for exceptions to this, W.W. McBryde and A. Flessner, 'Principles of European Insolvency Law and General Commentary', in: W.W. McBryde, A. Flessner and S.C.J.J. Kortmann (eds.), *Principles of European Insolvency Law* (Deventer, Kluwer 2003), p. 73.

77 If the creditors agree, the plan usually requires court confirmation, thereby providing for a system of two decision makers, firstly the creditors and then the court. See for Dutch law, article 145 Fw for creditors' consent and article 150-153 Fw for court confirmation, and for German law articles 248 and 254 InsO. See for exceptions to a court approval, W.W. McBryde and A. Flessner, 'Principles of European Insolvency Law and General Commentary', in: W.W. McBryde, A. Flessner and S.C.J.J. Kortmann (eds.), *Principles of European Insolvency Law* (Deventer, Kluwer 2003), p. 73.

78 See for a high level comparison of different jurisdictions V. Finch, *Corporate Insolvency Law* (Cambridge, Cambridge University Press 2009), p. 291–292.

79 See article 145 Fw and article 268 Fw. See on Dutch law, Soedira, *Het Akkoord*, (Deventer, Kluwer 2011), p. 141 and 142.

80 Article 244 InsO.

81 Under Dutch law, the courts can also overrule a dissenting creditor and substitute the

cram down rules under which a court can still impose a plan on a dissenting group in case the required statutory majority has not been reached. Under German law, the provision in article 245 Insolvenzordnung ("InsO") goes by the telling name *Obstruktionsverbot* (prohibition to obstruct).[82] English law sets relatively high thresholds with respect to the creditors' consent, which might be rather surprising in the light of English law's reputation of providing a debtor and reorganisation-friendly regime. A Company Voluntary Arrangement (CVA)[83] requires the approval of a majority[84] of 75% or more in value of the creditors[85] present in person or by proxy and voting on the resolution.[86] Key difference in English law compared to current Dutch law and pre-2012 German law, is that shareholders can also be bound by a CVA. A CVA can thereby provide for a structured procedure to come to a debt for equity swap. Shareholders also get to vote at a separate meeting, but can basically be overruled by the creditors.[87] In a Scheme of Arrangement, similar provisions apply. The Scheme of Arrangements can also be made binding on shareholders[88]

creditors' dissent with a court decision. This is the case if 75% of the creditors (in terms of numbers) voted in favour and the creditors' non acceptance of the composition plan can be ascribed to one or more creditors voting against the proposal, which creditors could, given all circumstances and especially their expected pay out in case of liquidation, reasonably not have voted as they did.

82 Following from article 245 InsO there are three cumulative requirements for the court to overrule a class that voted against. Namely i) the creditors are not worse of under the plan, compared to a liquidation, ii) the debtor itself or entities related to the debtor do not retain value and iii) no creditor which would rank equally with the dissenting class creditors without the plan, would receive more under the plan.

83 A CVA can be concluded either in conjunction with a formal insolvency procedure, such as Administration and Liquidation, and also outside any formal insolvency procedure. See A. Keay and P. Walton, *Insolvency Law* (Bristol, Jordans 2008), p. 141–142. The CVA can also take another form than a straight forward composition plan, in which it is also possible that the creditors get a stake in the company (debt for equity swap).

84 There is also the proceeding of Scheme of Arrangements. Here a 75% majority in value majority is required. See V. Finch, *Corporate Insolvency Law* (Cambridge, Cambridge University Press 2009), p. 291.

85 Shareholders also get to vote at a separate meeting, but can basically be overruled by the creditors. Shareholders can however apply to the court arguing that there is an unfair prejudice or there has been a material irregularity.

86 See Insolvency Rules 1986 1.19(2). See A. Keay and P. Walton, *Insolvency Law* (Bristol, Jordans 2008), p. 148. Since this rule alone would make it possible to have creditors connected to the debtor overrule unconnected creditors, Insolvency Rules 1986 1.19(4), provides that at least 50% of unconnected creditors have to support the CVA.

87 Shareholders can however apply to the court arguing that there is an unfair prejudice or there has been a material irregularity.

88 R. Bork, *Rescuing companies in England and Germany* (Oxford, Oxford University Press 2012), p. 230, 231.

and in addition can be made binding on dissenting secured creditors.[89]

English law has been early in recognising that the scope of hold-out behaviour in insolvency is not limited to unsecured creditors. The broader possibilities to include different stakeholders among which equity holders, has been one of the reasons to move to the UK to reorganise. Over the past decade, several jurisdictions followed suit and implemented new rules on reorganisation procedures.[90] Most notable is the inclusion of shareholders in the process, facilitating a debt for equity swap. Germany introduced the debt for equity swap in 2012 when amending its Insolvency Act by implementing the Law to Facilitate Corporate Rehabilitation (ESUG or *Das Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*). Shareholders do get a right to vote under the plan. If the class of shareholders does not consent, they can be overruled by the court on the basis of the *Obstruktionsverbot*, unless they can demonstrate that they are worse off under the plan compared to normal insolvency proceedings. A rather peculiar feature of the new German rules, however, is that individual creditors cannot be forced into a debt for equity swap, because they cannot be made into a shareholder against their will.[91] In doing so, it provides individual creditors a hold-out right which will often translate itself into having to pay this individual creditor, thereby infringing on the collective nature of the insolvency process.

Hold-out problems are typical of anticommons problems and are introduced by the collective debt enforcement itself. The statutory voting rules as to a reorganisation plan can be seen as a way to overcome hold-out problems created by the collective process which parties are forced into in case of insolvency. To the extent that English law enlarges the scope of measures overcoming harmful hold-out behaviour, this can be seen as solving a collective action problem. From an insolvency law theory perspective, there is no harm in opting for a regime that deals differently with overcoming such collective problems. Therefore, if parties migrate comi merely in order to benefit from

89 R. Bork, *Rescuing companies in England and Germany* (Oxford, Oxford University Press 2012), p. 216.

90 R. Bork, *Rescuing companies in England and Germany* (Oxford, Oxford University Press 2012), p. 11–13. See also R.D. Vriesendorp, R.M. Hermans and K.A.J. de Vries, 'Herijking faillissementsrecht en het informeel akkoord; gemiste kans of opportunity voor een Nederlandse scheme of arrangement?', *TvI* 2013/12.

91 Article 225 a InsO explicitly provides that changing a creditor's entitlement into shares against the creditor's will is excluded. In the German original text; "Eine Umwandlung gegen den Willen der betroffenen Gläubiger ist ausgeschlossen." It is understood that this fosters free rider behaviour in individual cases. See P. Schäfer and A. Frischemeier, 'Debt-equity-swap – Legal "restructuring" of a restructuring instrument', *CMS Update Banking & Finance*, June 2012, p. 26.

different rules seeking to overcome hold-out behaviour in the setting of a reorganisation, this will not constitute an abuse of law.[92]

3.3. Liquidating assets: overcoming the tragedy of the commons effectively

One of the most important reasons according to the Creditors' Bargain Theory to have insolvency rules in place, is to preserve the value of assets and to capture, as much as possible, the going concern value of the business. Jackson writes:

"To the extent that a non-piecemeal collective process (whether in the form a liquidation or reorganization) is likely to increase the aggregate value of the pool of assets, its substitution for individual remedies would be advantageous to the creditors as a group. This is derived from the commonplace notion: that a collection of assets is sometimes more valuable than the same assets would be if spread to the winds. It is often referred to as the surplus of a going-concern value over a liquidation value."[93]

Ironically, it is exactly this asset and value preservation idea that is difficult to realise in practice. A court-appointed administrator will, for various reasons, find it difficult to negotiate the best price possible; there is a lack of funds to cover running expenses and the administrator has to sell quickly in order to prevent an accumulation of claims on the estate.[94]

English insolvency law and practice have tried to find a way out of the dilemma that the procedure which seeks to ensure maximum value for creditors, in and of itself reduces the changes of maximum recovery. The English way out is the pre-pack. Here the sale of the assets is prepared prior to the opening of the formal insolvency procedure and the business is sold and transferred immediately upon the company being put into an insolvency procedure. Pre-packs radically changed English insolvency practice.[95] The key element of maximising value

92 The analyses would in principle be the same if a company migrates its comi in order to become part of a reorganization of a corporate group, which chances of success will of course increase in case the reorganization of holding company and subsidiaries are governed by the same laws.

93 See T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge MA: Harvard University Press 1986), p. 14.

94 See on the difficulties of a going concern sale out of an insolvency procedure, J. Armour, 'The rise of the 'pre-pack'; corporate Restructuring in the UK and proposals for reform', in: R.P. Austin and J.G. Aoun, *Restructuring Companies in Troubled Times: Director and Creditor Perspectives* (Sydney, Ross Parsons Centre 2012) § 2.2 and also N.W.A. Tollenaar, 'Faillissementsrechters van Nederland: geef ons de pre-pack!', *TvI* 2011/23.

95 See for the leading empirical study, S. Frisby, *A preliminary Analysis of Pre-Packaged Administrations: Report to the association of Business Recovery Professionals* (University of Nottingham, August 2007).

for creditors, no longer takes place *in* formal insolvency, but *prior* to it. In practice, it is often the case that ordinary creditors will receive nothing and that they are completely excluded from the process. Pre-packs are therefore treated with suspicion, especially when the sale is concluded with a connected party such as the former shareholders and or the management of the company.[96] English law and practice have tried to deal with this, by imposing information duties on the administrator.[97]

96 According to a study conducted by Frisby (supra note [94], p. 45) and later by the Association of Business Recovery Professionals (Pre-packs' and SIS 16, March 2010) over 60% of the pre-pack sales was to a connected party. Frisby (supra note [96], p. 8 and 9) and Armour (supra note [94] at § 4.3) discuss several concerns as to the pre-pack sales, most notably as to whether the price realised is really the best one possible. In order to truly asses the practice of pre-packs and possible externalisation of costs of business failure, one, however, cannot limit the analysis to comparing pre-pack sales with asset sales out of a normal liquidation procedure, especially not when the acquiring party is formed by the previous shareholders and/or management. Take for example a company Deli Food Chain Holding Ltd (not franchise), which has start-up costs for New Deli Store Ltd of € 200.000 (debt financed). By the time the store is up and running, business is slow. The shareholder Deli Food Chain Holding Ltd is faced with the choice of providing additional funds and ensuring that all start-up costs incurred can be paid, or buying the store as a going concern by means of a pre pack. For any third party, the assets even taken together including the lease of the store space, amount to only € 30.000, also because everything is fitted with the chain logo and done in its recognisable chain style. The shareholder Deli Food Chain Holding Ltd would be willing to buy the assets out of pre-pack insolvency for € 50.000. There is no third party that will match this offer. If Deli Food Chain Holding Ltd. would have to set up an entire new store, it would again cost € 200.000. But from a value maximisation point of view, the € 50.000 is the best deal. New Deli Store Ltd is actually insolvent so the pre-pack would be a possibility. A pre-pack might be considered fair if one compares what the assets of New Deli Store Ltd would yield in a liquidation sale. If one would, however, not provide Deli Food Chain Holding Ltd with the certainty a pre-pack provides that it will be able to buy the assets out of insolvency, Deli Food Chain Holding Ltd might also chose the alternative route of ensuring that the start-up costs will be paid in full by providing additional funds and thereby quite naturally actually pay for the start-up costs as shareholders commonly do. So the full comparison of the effect of pre-packs cannot be limited to what the creditors receive in a given case with and without pre-pack. The comparison should somehow include the outcome if the law would not provide for a pre-pack at all. Concerns along these lines, cannot be taken away by having a fair value market assessment in the case at hand. Pre-packs should be a method to ensure that creditors get a maximum return and should not become a method to ensure that stakeholders are given the opportunity to hold on to the assets no matter what.

97 These are contained in the Statement of Insolvency Practice ('SIP') 16. See for an analysis of SIP 16, J. Armour, 'The rise of the 'pre-pack'; corporate Restructuring in the UK and proposals for reform', in: R.P. Austin and J.G. Aoun, *Restructuring Companies in Troubled Times: Director and Creditor Perspectives* (Sydney, Ross Parsons Centre 2012), p. 43–78.

Notwithstanding remaining doubts, which are very much justified as to the frequency of sales to connected parties, the basic idea is appealing. If insolvency procedures prove to be ill-equipped to do what they are supposed to, maximising value for creditors, alternatives should be examined. Here the problem of common pool problems which insolvency law is seeking to overcome resurfaces. If one is genuine in one's believe that insolvency laws should be there to maximise value for creditors, one should also be open to examine ways in which this can be achieved effectively. If creditors by and large consent to a comi-migration of a debtor to England to benefit from conducting a prepack sale, there are no objections to such a move from an insolvency law theory perspective and this will not constitute abuse of law. The goals of pre-packs should, however, be value maximisation for creditors. Prepacks should not turn into a device that grants shareholders and management the possibility to hold on to the assets no matter what.

3.4. Preferences

Part of the rules on transaction avoidance in insolvencies (or in German the *Insolvenzanfechtung*), is preference law. Preference law is here understood as the possibility of a court appointed administrator or trustee to reverse a payment or similar transfer to an existing creditor prior to insolvency (in German referred to as the *Deckungsanfechtung*). Preferences are all those acts that place an *existing* creditor in a better position than it would have been in without that act.[98] Preference laws display great differences throughout Europe. The question whether comi-migration with an eye to benefit from different rules on preferences should be permitted, is more controversial than the previous two questions. Voting rules and pre-packs are more procedural in nature, whereas preferences determine who gets what, or more accurate, which creditor is able to retain that which he has received prior to the opening of an insolvency procedure. Preference laws not only have their effect once insolvency proceedings are opened. They also have a strong influence on the behaviour of parties prior to insolvency, also in case where a restructuring attempt is being undertaken.

98 Excluded from the analysis here are acts that are detrimental to the debtor because they are at an undervalue or gifts. Although these acts are also detrimental to creditors in a subsequent insolvency procedure, they are very different in nature compared to preferences. Preference laws are pure insolvency laws and provide rules for creditors *among each other*. In the case of transactions at an undervalue and gifts, the counterparty is normally not a creditor. Rules governing transactions at an undervalue and gifts can therefore not be explained by the need to overcome *collective* debt collection problems.

Before answering whether comi-migration with the aim of benefitting from different preference law, should be allowed, one needs to understand the nature of preference law. Understanding insolvency law as a collective procedure seeking to overcome destructive asset grabbing, also explains the need for rules combating preferences. Jackson explains the need for and nature of preference law as follows:

> "Preference law is best viewed as a solution to this replication of the common pool problem that results from strategic planning in the pre-bankruptcy period. Preference law, therefore, is essentially a transitional rule designed to prevent individual creditors from opting out of the collective proceedings once that event becomes likely."[99]

There is also a strong case to be made for English preference law as far as restructuring cases outside insolvency are concerned. This can be seen when one turns to the question of how different legal systems deal with the issue of the extension of new credit against new security rights and how the problem should be dealt with if new securities granted at a moment of financial distress also secure old credit. English law provides for the most lenient regime compared to German and Dutch law. In so far as new credit is actually extended for new security, there is no preference according to English law, since (to that extent) no prior credit-debtor relationship exists.[100] It is important to remember that preference law deals with improving the position of an *existing* creditor: the financier that extents new loans at the moment of the crisis is not yet a creditor and the transaction is normally also not one at an undervalue.[101] English law places the entire issue outside transaction avoidance law. In so far as a floating charge also secures old credit, an existing creditor-debtor relationship does indeed partially exist. This is also subject to transaction avoidance, although *only to that extent*.[102]

German and Dutch law are much more critical, and overly so in this respect. Dutch law reasons that as far as new loans are granted at a moment of crisis against security, in a subsequent insolvency procedure the unsecured creditors

99 T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge MA: Harvard University Press 1986), p. 122.

100 See more elaborate R.J. de Weijs, E.J.R. Verweij, C. Bärenz and R. Connell, 'Financing in distress against security from an English, German and Dutch perspective: a walk in the park or in a minefield?, *International Insolvency Law Review* 2012/1, p. 27.

101 In *Re MC Bacon* [1990] B.C.C. 78 securities for new credit were held to be outside the scope of transactions at an undervalue altogether.

102 Article 245 IA provides that a floating charge created in the twelve months prior to the 'onset of insolvency' is not valid *unless* and *to the extent* that it secures certain specified forms of new value. Where the security taker is not connected with the debtor, the debtor must already have been insolvent or become insolvent as a result of the transaction. See R. Parry, J. Ayliffe and S. Shivji, *Transaction Avoidance in Insolvencies* (Oxford: Oxford University Press 2011), Chapter 17.

are prejudiced by the granting of this secured loan. If the loan is used to pay unsecured creditors, these unsecured creditors are economically replaced by a secured creditor making the remaining creditors worse off.[103] This radical different position can be easily understood if one realises that the focus of English transaction avoidance law is on unjust *benefits* gained by the counterparty, which is not the case by granting a secured loan, whereas Dutch law focuses on the *prejudice* caused to the creditors, which can be construed in case of financing with secured loans. Whatever the underlying rationale, Dutch law has on a case-by-case basis manoeuvred itself into the bizarre position that the law is more critical on granting new credit against new security (adding something to the company in distress) when compared to simply granting new security rights to cover old debt (only extracting something from the company). It is almost needless to say that such a regime does not foster restructuring attempts when insolvency is threat and that the approach is flawed in itself. German law has turned into a very technical exercise, where a bank granting additional loans against security rights, covering both old and new credit, risks losing all its security rights if it is not properly documented.[104] The English approach is, therefore, much more sensible or at least more conducive to rescue attempts, where floating charges are to be upheld to *the extent* that new value has been added.

Having said that English law provides a more sensible rule as far as (re)financing of distressed companies is concerned, strong concerns linger as to English law. To a large extent effective preference rules are missing in English law. In addition to article 245 IA on late floating charges, article 239 IA is the general provision for the avoidance of preferences. The scope of article 239 IA is very broad and seeks to cover all manners and ways in which a debtor can improve the position of a single creditor. According to English law, the avoidance of preferences depends entirely on the state of mind of the debtor. A preference can only be avoided if the debtor was influenced by a 'desire to prefer'. Furthermore, the preference must have been created within six

103 See the Dutch Supreme Court in HR 8 July 2005, *NJ* 2005, 457, (*Van Dooren q.q./ABN AMRO II*).

104 German law allows for a distinction as to the validity of a single security right in a valid part for new credit and a possible invalid part for old credit. This partial approach will, however, only be adopted if the parties differentiated clearly in the agreement as to the security right securing old and new credit. In such cases the outcome can be that the security right is subject to transaction avoidance to the *extent* it secures old credit and qualifies as an incongruent performance. To the extent the security right secures new credit, and its creation passes the test of article 133 InsO, the security right will be upheld (BGH ZIP 1993, 271, 274). However, if the parties make no such clear distinction – as in many cases – there is a high risk that an office-holder may set aside the security right in full (Braun/Riggert, InsO, § 142 at No. 3; cf. BGH ZIP 1993, 271, 274.).

months[105] prior to the 'onset of insolvency' and that the debtor was already insolvent at that time or became insolvent as a result of it. The element of desire to prefer is considerably more difficult to establish outside related ("connected") parties. Even to such an extent that this is in practice seldom if ever held to be met outside connected parties.[106] Here the 'flaw' is that English law, unlike German law, does not distinguish properly between payments in a manner and at a time in which they were due and payments that are not.[107] All in all, it should be noted that the extremely limited scope of English preference law and its reliance on strict subjective criteria are subject to criticism, often in harsh wordings,[108] and there seem to be few writers, if any, willing to defend this position. Basically, outside of the situation of related parties, English law has no working rules on preferences in place, nor on preferences where the method of fulfilling a prior existing obligation is somewhat off (e.g. so called 'in lieu of payments', where instead of paying money, a good is transferred to settle the debt).

Preference law is creditor-creditor law and pure insolvency law. It provides a rule for creditors amongst each other up the moment an individual creditor is no longer allowed to individually pursue its claim, as this will be to the detriment of the joint creditors. If one returns to the basic idea of insolvency laws as a hypothetical agreement between creditors there is little reason to force a specific rule on preferences upon these creditors. There is nothing inherently wrong with allowing the creditors to decide amongst themselves to what extent they will allow the debtor to continue making payments to existing creditors and to what extent the debtor will be able to attract new secured credit. Thus, as a starting point, the conclusion is that comi-migration with a view on preference law should also be allowed. However, this conclusion loses part of its force when the incoming jurisdiction (here England) does not really have working rules on preference. This problem is conceptually not so much a problem of comi-migration, but instead a flaw of English insolvency law. Nonetheless, through comi-migration the problem is no longer restricted to England. This effect is, it is submitted, not sufficient to discredit comi-migra-

105 Extended to two years in case of connected parties.

106 See A. Keay and P. Walton, *Insolvency Law* (Bristol, Jordans 2008), p. 559–560. "Absent the situations where the respondent is a connected person or an associate of the insolvent who is labouring under the burden of a presumption that the insolvent had a desire to give a preference to the respondent, office-holders will often have difficulty in adducing any or sufficient evidence to impugn the transaction."

107 Conceptual similar distinctions as are part of German preference law can be found in US law, where Article 547, US Bankruptcy Code treats payments that are considered to be 'within the ordinary course of business' differently from payments that are not.

108 See, for example, R. Mokal, *Corporate Insolvency Law* (Oxford, Oxford University Press 2005), p. 336, 337 and Goode, *Principles of Corporate Insolvency Law* (London, Sweet & Maxwell 2011), p. 457.

tion in itself. This is all the more so, if one brings to mind the rule from article 13 EIR, which provides that if a transaction is subject to transaction avoidance under the *lex concursus*, the transaction is to be upheld if the *lex contractus* is different from the *lex concursus* and the *lex contractus* does not provide for transaction avoidance in the case at hand. Since parties can opt for a legal regime[109] of their own likings in order to have different rules on transaction avoidance apply to their dealing, it would be inconsistent to disqualify comi-migration executed for similar reasons.

3.5. Bad comi-migration: changing the relative weight of pre-insolvency entitlements

The Creditors' Bargain Theory has formulated as its most important rule that insolvency laws should not interfere with pre-bankruptcy entitlements. One should not, according to the Creditors' Bargain Theory, introduce other interests in insolvency, which are not recognised as a creditor's claim outside of insolvency.[110] The argument is presented as follows:

> "Because the issues of who should have entitlements and how to address a common pool problem are distinct, they should be kept separate in the legal response. Nor is this simply an academic point. Bankruptcy law cannot give new groups rights and continue effectively to solve a common pool problem. Treating both as bankruptcy questions interferes with bankruptcy's historic function as a superior debt-collection system against insolvent debtors. Fashioning a distinct bankruptcy rule – such as one that gives workers' rights they do not hold under non-bankruptcy law – creates incentives for the group advantaged by the distinct bankruptcy rule to use the bankruptcy process even though it is not in the best interest of the owners[111] as a group."[112]

The argument made by the Creditors' Bargain Theory is not limited to recognising only creditors' rights in insolvency and not introducing new cred-

109 The *lex contractus* is determined not by the EIR itself, but by the Rome I regulation (Regulation on the law applicable to contractual obligations, No. 593/2008), which provides as a basic rule in article 3 freedom of choice.

110 See for a critical analysis that insolvency cannot solely deal with creditor rights, but is also there to ensure that creditors and shareholders internalise losses of a business failure and prevent the costs to be borne by taxpayers, R.J. de Weijs, 'TBTF as game of chicken with the state', *EBOR* 2013/02. The question dealt with here, deals with the relative ranking of creditors and not with externalisation of costs of business failure.

111 Owners is here understood as the creditors, see T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge MA: Harvard University Press 1986), p. 21, 22: "In bankruptcy the unsecured creditors of an insolvent debtor can be viewed as the new equity owners of the debtor and hence entitled to what the debtor was entitled to outside of bankruptcy."

112 T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge MA: Harvard University Press 1986), p. 26.

itors upon insolvency. The insolvency process, as a collective debt collection device, should also as a basic rule respect the relative weight of each claim.[113] From the perspective of basic insolvency law theory, it is clear that comi-migration violates the basic rule that insolvency law should not interfere with nor change pre-insolvency entitlements, if the goals is an alternative and more favourable ranking of creditors. The collective debt enforcement procedure should not by itself change the ranking of the creditors.

The ranking of creditors, especially the English ranking, will be one of the most interesting aspects for existing shareholders to move the comi to England. Many European[114] jurisdictions have rules on subordination of shareholder loans, most notably Germany, Italy, Spain and Austria. English law, on the other hand, has no rules on subordination of shareholder loans.[115] As was evidenced in the *BenQ*-case (discussed above in § 2.2), a shareholder-creditor will be tempted to have insolvency proceedings opened in a jurisdiction without rules that in some way treat shareholder loans as subordinated.[116]

Comi-migration conducted with a view to have some creditors benefit from a different ranking, is not allowed if analysed from a basic insolvency law theory perspective. Such a comi-migration would also qualify as an abuse of Union law. As said, abuse of union law requires first of all objective circumstances in which, despite formal observance of the conditions laid down by the community rules, the purpose of those rules has not been respected. In the case at hand, although the comi has actually been moved, the purpose of European insolvency law cannot be said to have been met. Comi-migration that has the

113 See T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge MA: Harvard University Press 1986), p. 21 and subsequent, in the paragraph titled 'The destructive effect of changes or relative entitlements in bankruptcy'.

114 Also the US have rules providing not for a per se subordination, but for equitable subordination in article 510 Bankruptcy Act.

115 There is however a rule in article 215-4 IA that allows for the subordination of loans granted by directors for wrongful trading.

116 One could also raise the question how this problem should be viewed if one were to deal with groups of companies (assuming a basic setting of a holding company and a subsidiary in a different jurisdiction). The ranking of shareholder claims will most likely *not* be an issue in case of group insolvency if the both the holding company and the subsidiaries face insolvency and the failing subsidiaries move their comi to the jurisdiction of the holding company. The idea behind an abusive comi-migration would then have to be that a shareholder loan provided to the holding company would yield more, because in turn its existing loans to the foreign subsidiaries would be treated more favorable under English law. The issue might however come up if the holding company would be German, Spanish, Italian or Austrian and would be financed by shareholder loans, and the holding company would move its comi to England to join a group insolvency in England with its subsidiaries.

effect of changing the relative weights of different claims, constitutes a violation of the body of European insolvency law since it violates basic insolvency law theory. Furthermore, if the comi-migration is conducted with a view to benefit from a different, more favourable ranking, the second, subjective element of abuse of Union law will also be met. As a consequence, an English court can apply the abuse of law principle and deny the opening, if it is satisfied that the main driver behind comi-migration is for certain creditors to benefit from the English ranking.[117]

A comi-shift, as discussed above, which is in violation of basic insolvency law principles, would however seem to provide a significant problem. Either the legal effects of comi-migration will be denied, which is an extreme sanction if the comi has actually been relocated and remains difficult to reconcile with the freedom of establishment. Alternatively, the infringement on the ranking of creditors and the violation of basic insolvency law theory is accepted as a side effect of the European Insolvency Regulation. Fortunately, there is an elegant way out at least for English insolvency law. English law could and should qualify the higher ranking of shareholders as a preference as defined by article 239 IA. In doing so, it could let shareholders' loans that had a subordinated status back home (like in Germany, Spain and Italy) keep that status. The test for a preference is whether the company 'does anything or suffers anything to be done which has the effect of putting that creditor in a better position'. If the change in ranking as a result of comi-migration is not somehow addressed, then undoubtedly, comi-migration has the effect of putting the shareholder-creditor in a better position. Article 239 IA does require that the debtor was insolvent at the time of creating the preference and requires, in addition, that the debtor was 'influenced by a desire to prefer'. Article 239(-6) IA, however, provides for a shift in the burden of proof in case of connected parties as to the subjective element of 'desire to prefer'.[118] So, in case of late comi-shifts where the company is already insolvent, the English courts could start working on the basis of the rebuttable presumption that shareholders cannot benefit from a change in ranking if the comi has been migrated just prior to the opening of the insolvency procedure.[119] The form of sanction after

117 One could argue that this is simply a consequence we should accept because the EIR determines that the ranking is governed by the *lex concursus*. Such an argument is false since the EIR did not intend on facilitating late comi-shifts, especially not with an eye to change the ranking of creditors.

118 See on the working of article 239 IA, R. Parry, J. Ayliffe and S. Shivji, *Transaction Avoidance in Insolvencies* (Oxford: Oxford University Press 2011), chapter 5 and A. Keay and P. Walton, *Insolvency Law* (Bristol, Jordans 2008), Chapter 39.

119 Applying preference law in this respect and upholding the ranking of the outbound Member State would only be a small step from the cross border insolvency cases in which the English administrators accepted a foreign ranking within an English insol-

finding a voidable preference is not in any way prescribed. Article 239(3) IA provides that the judge can make an order as he sees fit.[120] The sanction could, therefore, simply be denying the upgrade instead of denying the comi-migration and its effects entirely.

One would also not expect genuine resistance to denying foreign shareholder loans an upgrade resulting from comi-migration. The Cork Committee[121] already held the opinion that English law is defective, because it does not have a rule on the subordination of shareholder loans. It provided the following on the issue:

"The strength of the case of those who seek a change in the law – and a radical at that – can be seen if a simple and perhaps extreme example is taken. A wholly-owned subsidiary company is undercapitalised. It relies virtually wholly on moneys lent by the parent. Its affairs are conducted by and in the interest of the parent and they are mismanaged. There is a history of transactions between subsidiary and parent which, although not individually or collectively susceptible to attack at law, have, cumulatively, advantaged the parent and disadvantaged the subsidiary. All profits earned by the subsidiary have been paid up to the parent by way of dividend and the moneys needed by the subsidiary to conduct its business lent back by the parent. The subsidiary, at the instance of the parent, has obtained substantial credit by relying on its membership of the group of companies headed by the parent. The subsidiary indicates its membership on all documents and billings by showing a device or logo distinctive of the group. The subsidiary becomes insolvent and goes into liquidation. The parent company declines all liability for its subsidiary's debt to external creditors, and competes with them by submitting a proof in respect of its loan. The result is that, out of the total funds realised by the liquidator for distribution among the creditors, a substantial proportion goes to the parent company. We recognise that a law which permits such an outcome is undoubtedly a defective law."[122]

English law has thus far remained immune to this critique and still provides no rules on subordination of shareholder loans. At least by applying preference

vency procedure as to the assets located in a different Member State in order to prevent the opening of a secondary proceeding (most notably Collins & Aikman, MG Rover and Nortel Networks). The current proposal for amendment of the Insolvency Regulation (see new recital, 19 a), contains a similar rule in order to prevent the opening of secondary proceedings. Arguably, the step would be even smaller than the one made in Collins & Aikman, MG Rover and Nortel Networks, since it does not directly adopt a foreign ranking into an English insolvency proceedings but prevents shareholders from climbing the ladder by means of comi-migration. See further on the issue of applying a foreign ranking, with many references, I.F. Fletcher and B. Wessels, *Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases*, Report to the American Law Institute, 2012, principle 35 'Limits on priority'.

120 Article 239(3) IA provides: Subject as follows, the court shall, on such an application, make such order as it thinks fit for restoring the position to what it would have been if the company had not given that preference.

121 The Cork committee drafted a report, which formed the basis for the new Insolvency Act of 1986.

122 Cork Report, p. 435, 436.

law as to late comi-shifts and preventing upgrades to shareholder loans, England will not be exporting its 'defective law' to continental Europe by importing their failing companies.

4. Comi-migration as a manifestation of competition of insolvency laws

The level of analysis has thus far been at the level of individual cases and the effects comi-migration has on the different stakeholders in a specific case (i.e., micro-level analysis). In this last section, the analysis will be at a macro-level, where comi-migration can be seen as a manifestation of competition of insolvency laws throughout Europe.

In its proposal to harmonise substantive insolvency law,[123] the European Parliament has articulated the policy reasons for harmonisation as follows:

> "A) whereas disparities between national insolvency laws create competitive advantages or disadvantages and difficulties for companies with cross-border activities which could become obstacles to a successful restructuring of insolvent companies; whereas those disparities favour forum-shopping; whereas the internal market would benefit from a level playing field;
>
> B) whereas steps must be taken to prevent abuse, and any spread, of the phenomenon of forum shopping, and whereas competing main proceedings should be avoided."

In the light of the foregoing theoretical analysis, the complete disqualification of comi-migration should be considered as overly harsh and without sufficient basis. This disqualification of comi-migration by the European Parliament can probably, for an important part, be explained by a desire to achieve the further harmonisation of laws in general. Comi-migration is primarily used (or abused) as an argument to justify future legislative activities at a European level.[124] In doing so, the European Parliament has entirely dismissed the positive effects comi-migration has had at the European level as a driver behind legislative changes and harmonisation, e.g., the 2011 German government proposal to amend its Insolvency Act, where it justifies important changes to German insolvency law by referring to comi-migration out of Germany:

123 Although the European Parliament (Resolution of 15 November 2011 with Recommendations to the Commission on Insolvency Proceedings in the context of EU Company Law (2011/2006(INI)) deems harmonisation of the entire body of substantive insolvency law impossible at the moment, according to the European Parliament there are five areas of insolvency law where harmonisation is worthwhile and feasible: i) Opening of insolvency proceedings, ii) Filing of claims, iii) Avoidance actions, iv) Qualification of Liquidators and v) Restructuring Plans.

124 See on the legal basis for harmonisation of insolvency laws, B. Wessels and I.F. Fletcher, *Harmonisation of Insolvency Law in Europe* (Deventer, Kluwer 2012), p. 53–64.

"The current law places many obstacles for a company faced with the risk of insolvency, which is looking for a timely restructuring. In the past, therefore, some companies have transferred their seat to England, because it appeared to the directors and the most important creditors that the opening of insolvency proceedings under English law would be beneficial." (translation by the author).[125]

This competition triggers changes in national insolvency laws and results in the convergence of insolvency laws in Europe.[126] This convergence, in turn, has made it possible for the European Parliament to credibly adopt a motion for harmonisation, which was still deemed impossible only 10 years ago.[127] Therefore, if the ultimate goal of the European Parliament is indeed to reach the harmonisation of insolvency laws in order to create a level playing field, comi-migration can be as much a friend in this process as a perceived evil.

5. *Conclusion*

After a long period where insolvency law has been excluded from EU harmonisation projects, it now takes centre stage. Most notable is the proposal by the European Parliament to reach harmonised substantive insolvency law. One of the main reasons for the European Parliament to harmonise substantive law is to counter comi-migration. At the same time, the European Commission has presented a proposal for the amendment of the EIR, which does not contain rules to prohibit, ban or even limit comi-migration. In turn, the European Parliament made an amendment, providing for a three month period in which

125 In the original German text: "Das geltende Recht legt der frühzeitigen Sanierung insolvenzbedrohter Unternehmen zahlreiche Hindernisse in den Weg. In der Vergangenheit haben einige Unternehmen deshalb ihren Sitz nach England verlegt, da der Geschäftsleitung und den maßgeblichen Gläubigern die Eröffnung eines Insolvenzverfahrens nach englischem Recht zur Sanierung des Unternehmens vorteilhafter erschien." See *Gesetzentwurf der Bundesregierung, Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*, 23 February 2011.

126 See for further analyses of this competition, L. Enriques and M. Gelter, 'Regulatory Competition in European Company Law and Creditor Protection', *EBOR*, 2006/1, p. 417–453, G. McCormack, 'Jurisdictional Competition and Forum Shopping in Insolvency Proceedings', *Cambridge Law Journal*, 2009/1, p. 169–197 and R. Bork, *Rescuing companies in England and Germany* (Oxford, Oxford University Press 2012), p. 11–13. See for an analysis of the (limited) actual effects of such legislative changes forum shopping, W.G. Ringe, 'Corporate Mobility in the European Union – A Flash in the Pan? An empirical study on the success of lawmaking and regulatory competition', *ECFR* 2013/2, p. 230–267.

127 B. Wessels and I.F. Fletcher, *Harmonisation of Insolvency Law in Europe* (Deventer, Kluwer 2012), p. 35 in 2012 they write: "Until at least a decade ago, the combination of "harmonisation" and "insolvency law" in Europe was regarded just as impossible as a combination of fire and water."

comi-migration basically remains without effect. The question arises, therefore, whether comi-migration is necessarily something bad, as is apparently the view held by the European Parliament, or should be accepted as a feature of European insolvency law and can possibly even be seen as something good in certain cases.

The EIR itself contains no provisions that limit comi-migration, not in its current form, nor in the EC proposal for its amendment. This does not mean that there are no limits on comi-migration all together. Under circumstances, comi-migration can qualify as abuse of Union law. The general requirements for application of the principle of abuse of Union law are, firstly, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Union rules, the purpose of those rules has not been achieved. It requires, secondly, a subjective element, being the intention to obtain an advantage from the Union rules by artificially creating the conditions laid down for obtaining it.

Already in 2009, Eidenmüller argued that comi-migration might under certain circumstances run afoul of the principle of abuse of Union law. He argued that comi-migration driven by considerations of efficiency do not qualify as abuse of law, whereas comi-migration driven by distributive concerns, do qualify as abuse of law.

In order to better distinguish between abusive and non-abusive comi-migration, a theoretical framework has been formulated. Comi-migration which seeks to overcome common pool problems and their related tragedy of the commons should in principle be allowed, as should comi-migration aimed at dealing with anticommons problems and their related hold-out behaviour. Comi-migration aimed at a different ranking should, however, not be permitted.

If this framework is applied to failing companies migrating to England, then this leads to the following. Comi-migration aimed at benefitting from the English rules on reorganisation such as the CVA and the Scheme of Arrangements is in principle to be allowed since it deals with anticommons problems and hold-out behaviour. Also comi-migration aimed at benefitting from a prepack and preference laws is in principle permissible as these rules deal with overcoming common pool problems. Comi-migration aimed at a different ranking should, however, not be allowed. Such a comi-migration will qualify as abuse of Union law. The comi-migration in such a case can, therefore, remain without effect leading the court of the incoming jurisdiction to deny the opening notwithstanding that the comi has actually been moved. A more subtle sanction could also be to apply preference law against any upgrade of a creditor's claim, most notably an upgrade from a subordinated shareholder loan to an ordinary claim.

In conclusion, comi-migration should not be seen as intrinsically good or bad. Since the proposals for amendment of the EIR do not contain a ban on comi-migration, the practice will remain a feature of European insolvency law, even if the amendment of European Parliament would be adopted. Therefore, England will most likely keep on exporting its insolvency laws by importing failing companies. In this competition of insolvency laws, Germany has already moved significantly in the direction of English insolvency law. To the extent that the exported English laws are considered defective even by English standards, one would hope that the English legislature would also be willing to once again take a critical look at its own insolvency laws, most notably as to the rules on preferences and the ranking of shareholder loans. Concerns also remain as to the prevalence of sales to connected parties under an English pre-pack. A pre-pack should be a value maximisation device and not turn into a tool which provides shareholders and management to hold on to the assets, not matter what.