

Insolvency of an EU Company May be Declared by a Court of Another Member State

■ *by Agata Adamczyk**

In the time of crisis, facing the risk of insolvency of the contracting party, it is worth to remember that such a matter is not only regulated by domestic law, but also by the European Law.

The European Union has set out the aim of establishing an area of freedom, security and justice.

The activities of undertakings have more and more cross-border effects and are therefore increasingly being regulated by the Community law. While the insolvency of such undertakings also affects the proper functioning of the internal market, there is a need for a Community act requiring coordination of the measures to be taken regarding an insolvent debtor's assets. The proper functioning of the internal market requires that cross-border insolvency proceedings should operate efficiently and effectively.

In order to achieve the aim of improving the efficiency and effectiveness of insolvency proceedings having cross-border effects, the provisions on jurisdiction, recognition and applicable law in this area have been contained in the Council Regulation (EC) No 1346/2000 which is binding and directly applicable in member states. Provisions of the Act allow a foreign court to declare the company insolvent and to conduct these proceedings.

In case of determining that the core of the main interests of the

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insolvent company, situated within the territory of a member state (for example Poland), is located within the territory of other member state of European Union (for example Germany) and from that place the debtor's business is managed (generally in practice in the head office of the mother company), – there is a possibility of opening of the insolvency proceedings concerning such a Polish company before a foreign court. Territorial jurisdiction within Germany must be established by the Germany national law.

The issue of determining the “centre of main interests” (COMI) is of a complex character. In accordance with the provisions of the Article 3.1 of the regulation, in case of the company, the place of its registered office shall be presumed to be the centre of its main interests. This presumption however may be abolished since in parallel with the abovementioned definition, the regulation provides that the expression “centre of the debtor's main proceedings” refers to a place where a debtor conducts the administration of his interests on a regular basis and that fact is ascertainable by third parties. In practice the possibility of conducting the insolvency proceedings in other country than a country of the registered office of the company is sometimes abused by the foreign courts and the insolvency of companies was declared by foreign courts too hastily without necessary proper analysis of the debtor's activity. It shall be underlined that the Court of Justice of the European Communities in its recent judgments stressed out that the presumption may be abolished solely in a case, where it is ascertainable by the third parties that the administration of the debtor's interest is conducted in other country than a country of its registered office. The internal organization of the debtor's activity (among others the fact that the decisions are being taken by persons residing in other member state) cannot be sufficient prerequisite if it is not obvious for third parties. There is no doubt that such a prerequisite is fulfilled in case of post-box companies which are only domiciled in another member state but in reality do not conduct activity in that state as effectively their business is carried out abroad. A situation will not be that obvious if a company employs workers, carries out production or provides for services in this member state. In such a case a third party may, and probably will, perceive this company as having its COMI in this member state even though the management is being carried out from the headquarters in another member state. Therefore, the courts shall thoroughly analyze where the centre of the debtor's main interests is situated and such analysis shall be carried out from the point of view of third parties (clients, creditors).

In case of determining that COMI of a debtor is situated in another member state, the insolvency proceedings may be opened and carried out by the foreign court. It is also worth to remember that such a court

will open and carry out the insolvency proceedings in accordance with the substantive law of that foreign state (*lex fori concursus*). Essentially, the conditions for the opening of the proceedings will be determined in accordance with that law. Therefore, the German court may decide to open the insolvency proceedings of a Polish company if it fulfills the conditions of insolvency under German substantive law. It will be so even in situations, where – due to the differences between Polish and German substantive insolvency law - the insolvency conditions under Polish law are not fulfilled. It may lead to a situation where a party is not aware of the fact that its financial situation allows the foreign court to open the proceedings or even the party shall initiate the proceedings before a foreign court itself.

On the other hand, the regulation aims at avoiding a situation where a party decides to transfer its assets or judicial proceedings from one state to another due to the fact that the latter state offers the more favorable legal possibilities (*forum shopping*). In some cases it may be more favorable for the debtor to have the insolvency proceedings opened and conducted in another member state. Since the foreign courts sometimes decide to open the proceedings without a previous careful examination of the case as to the place being the debtor's centre of main interests, the aim of the Council Regulation will not be fully accomplished in that point.

Not only the procedure, but the substantive law effects of the insolvency shall be subject to foreign law. In case the insolvency of the Polish company is declared by a German court the administration of the assets of the insolvent will be conducted by the German liquidator appointed by that court. The assets of the insolvent will be capitalized in accordance with German regulations, under which, in principle, the creditors will be satisfied.

The main proceedings have universal scope, which means that they aim at encompassing all the debtor's assets, regardless of the fact in how many and in which member states the assets are located.

The liquidator may request the opening of so called "secondary insolvency proceedings" in the member state where the debtor has an establishment. The effects of secondary proceedings are limited to the assets located in that state and will be conducted by a court in this state in accordance with the substantive insolvency law in force in this state. However, it should be emphasized that opening of such proceedings is the liquidator's right, not his duty. Therefore, it is possible, in case the secondary proceedings are not opened, that the whole insolvency proceedings of a Polish company will be conducted exclusively by the German court.

In consequence, the insolvent's creditor will face the necessity

of the assertion of his rights against the insolvent before the foreign court, particularly by lodging the claims to the assets.

It shall be noted that such a lodging shall have an appropriate form, and that the time limit set out by the provisions of foreign law shall be kept. The non-compliance with such requirements results in the severe legal effects for the creditor, who finally may be satisfied in the subsequent priority or may not be satisfied at all.

It is also worth mentioning that the regulation introduces the rule of the automatic recognition of insolvency proceedings. The effects attributed to the proceedings by the law of the State in which the proceedings were opened extend to all other member states. In practice it means that in case the German court declares the insolvency of Polish company, such a judgment is automatically recognized by other member states. Therefore, for instance there is no proceedings which allow the Polish court to verify such a decision. It may be solely questioned in front of the German court in accordance with the legal instruments provided by German law.

Therefore all notices issued by the foreign insolvency courts or by the persons referring to their function as the liquidators in the foreign insolvency proceedings shall be treated with a particular attention. Disregard of them may lead in some cases to the irreversible consequences for the creditors.