

Duplicate officeholders – too many cooks spoil the broth?

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Speed read

- English administrators of a German registered company cannot delegate their responsibilities (owed to the English court) to a German preliminary administrator appointed by the German court to the same company outside the regime of the EC Insolvency Regulation.
- There may be a duplication of expense in respect of the remuneration of main and secondary officeholders, but a successful cooperation between the officeholders can produce benefits for creditors.
- The appointment of a German preliminary administrator may open secondary proceedings under the EC Insolvency Regulation. This will turn on the facts of each individual case.
- Where main proceedings are already opened there may be no need for a preliminary insolvency proceeding in a jurisdiction where the opening of secondary proceedings is contemplated.

Introduction

The EC Insolvency Regulation (1346/2000) (the **Regulation**) has caused considerable debate since it came into force across the EU (with the exception of Denmark) in May 2002. This debate has primarily concerned the interpretation of the centre of main interests concept and the recognition of insolvency proceedings commenced in one EU Member State by other EU Member States. However, as the Regulation has now been in force for some time, its impact on other issues arising in insolvency proceedings is now being seen.

By way of background, Article 3(1) of the Regulation allows the courts of the EU Member State within the territory of which the debtor's "centre of main interests" is situated to open main insolvency proceedings. The expression "centre of main interests" is not defined in the Regulation but there is a rebuttable presumption, in the case of a company, that it is the place of its registered office. Article 3(3) of the Regulation provides that once main insolvency proceedings have been opened in one Member State, any insolvency proceedings opened in another Member State under the Regulation (on the basis of an establishment¹ there) must be secondary proceedings of a winding-up nature. However, secondary proceedings are restricted to the assets of the debtor situated within the territory of the Member State that has opened the secondary proceedings². One concern that has frequently been expressed in relation to the commencement of main and secondary insolvency proceedings under the

¹ Article 2(h) of the Regulation provides that "establishment" shall mean any place of operations where the debtor carries out non-transitory economic activity with human means and goods.

² Article 27 of the Regulation.

Regulation is that the appointment of two sets of officeholders may result in a duplication of expense, which may reduce the return to creditors.

Articles 4 and 28 of the Regulation provide that, once insolvency proceedings are opened, subject to certain exceptions in Articles 5-15 of the Regulation, the law applicable to the main or secondary insolvency proceedings and their effects is the law of the Member State within the territory of which such proceedings are opened. In particular, this law will determine who is to bear the costs and expenses incurred in the insolvency proceedings³.

In relation to the costs and expenses incurred in insolvency proceedings, the effect of the choice of law rules in the Regulation has recently been considered by the English court in relation to the administration of a German registered company within the MG Rover Group (**MG Rover Germany**).

The factual backdrop

In 2005, the English court placed companies within the MG Rover Group, including MG Rover Germany, into administration in England. This decision was reached on the basis that each individual company's centre of main interests was in England. Accordingly, the English administration proceedings were main proceedings under the Regulation. A creditors' committee dominated by the German car dealers was established in relation to MG Rover Germany. The creditors' committee approved a 50% payment on account of the administrators' fees, calculated on a time cost basis, but refused to sanction an agreement beyond that.

At the request of German creditors, the German court appointed a preliminary administrator over MG Rover Germany⁴. This appointment was held not to commence secondary proceedings in Germany⁵. The order appointing the German preliminary administrator provided that the disposal of any asset by MG Rover Germany should only be effective if made with the German preliminary administrator's approval and that his task was to supervise MG Rover Germany so as to secure and maintain its assets. The order contained no express power allowing the German preliminary administrator to control the assets or manage the business of MG Rover Germany. Following the German preliminary administrator's appointment, the creditors' committee suggested that the English administrators reduce their involvement in the administration of MG Rover Germany, in effect leaving this to be conducted by the German preliminary administrator. The English administrators did not reduce their involvement but did attempt to negotiate a protocol with the preliminary administrator as to how the two sets of officeholders should communicate and cooperate⁶. Four months later, the German court opened secondary proceedings in relation to MG Rover Germany appointing the preliminary administrator as liquidator in those proceedings⁷. The English administrators applied unsuccessfully under Article 33(1) of the Regulation⁸ to the German court for the liquidation process in the secondary proceedings to be stayed⁹.

MG Rover Germany's creditors' committee refused to approve the level of remuneration claimed by the English administrators. The English administrators applied to the English court, under Rule 2.106 of the Insolvency Rules 1986¹⁰, for an order that their remuneration be fixed on a time basis and for a specified sum. The creditors' committee and the German liquidator in the secondary proceedings raised a number of objections to the sum claimed by the English administrators.

³ Article 4(2)(l) of the Regulation.

⁴ Unreported, Düsseldorf Court, 22 June 2005.

⁵ There is some indication that the German court viewed this appointment as one opening preliminary secondary proceedings.

⁶ A final agreement for a protocol was never reached.

⁷ Unreported, Düsseldorf Court, 7 November 2005. The English administrators unsuccessfully opposed the opening of secondary proceedings.

⁸ Article 33(1) of the Regulation provides that "the court, which opened the secondary proceedings, shall stay the process of liquidation in whole or in part on receipt of a request from the liquidator in the main proceedings... Such a request from the liquidator may be rejected only if it is manifestly of no interest to the creditors in the main proceedings". Article 33(1) of the Regulation allows the liquidation process to be stayed for a period of up to three months. Should a further stay be required, after the period of the initial stay has expired, a further court application will be needed.

⁹ Unreported, Düsseldorf Court, 8 November 2005. There is no written copy of this decision – accordingly, we do not know the reasons for the German court's refusal.

¹⁰ Rule 2.106 of the Insolvency Rules 1986 provides that English administrators' remuneration is fixed either as a percentage of the value of the property with which the administrators have to deal or by reference to the time properly given by the administrators and their staff to matters arising in the administration. If a creditors' committee does not agree to the level of administrators' remuneration (and it is not possible to secure a resolution of a meeting of creditors) then the administrators' remuneration is fixed by the court.

Norris HHJ held¹¹ that as the administration was large, complex and novel and was made more difficult by a large number of disaffected creditors who preferred to look to their local court, it involved the exercise of special expertise by the English administrators. Furthermore, the cooperative approach of the English administrators and the German preliminary administrator would result in a substantial dividend being payable to MG Rover Germany's creditors. Accordingly, Norris HHJ assessed the English administrators' remuneration on a time basis¹² and approved the payment of approximately 97% of the remuneration sought by the English administrators.

Two officeholders, two sets of remuneration?

The overarching objection of the creditors' committee and the liquidator in the secondary proceedings was that it was not reasonable for the creditors to pay for two sets of officeholders or, worded in another way, that because work had been done by the German preliminary officeholder, work done by the English administrators was not necessary. Norris HHJ emphatically rejected this objection as to do so would "stand the Regulation on its head". Applying Article 4 of the Regulation, Norris HHJ held that English law applied to the questions of how the administrators' remuneration should be assessed and whether the administrators could delegate their powers to the German preliminary administrator. As a matter of English law, the English administrators could not delegate to the German preliminary administrator the responsibility which they owed to the English court for the due and proper administration of the affairs of MG Rover Germany. The English administrators' decision to cooperate with the German preliminary administrator could not convert the English administration (opened under Article 3(1) of the Regulation) into a German preliminary insolvency process under the jurisdiction of the German court, nor could such a decision confer the English administrators' powers upon the German preliminary administrator. Accordingly, it was unrealistic to suggest that the English administrators should have reduced their staff or involvement in the administration so as to save on their remuneration. Any duplication of work was due to the decision of the German creditors to seek the appointment of the German preliminary administrator

and then open secondary proceedings in Germany. Furthermore, the German creditors had full knowledge of the English administrators' view that the opening of secondary proceedings would lead to additional costs that would fall on the assets before distribution as this view was contained in the English administrators' initial proposals.

Did the appointment of the German preliminary administrator fall within the Regulation?

Before the English court it appeared to be accepted by all parties that the appointment of the German preliminary administrator was outside the regime envisaged by the Regulation and Norris HHJ's judgment was based on this proposition. However, the question of whether the German preliminary administrator's appointment fell under the Regulation was not analysed in detail in the written decisions of the English or German court. The view of the German court was that the appointment of the German preliminary administrator opened "preliminary secondary proceedings". The Regulation does not provide for "preliminary secondary proceedings". Therefore, perhaps the question to ask in order to establish whether the appointment of the German preliminary officeholder fell under the Regulation is whether the appointment opened secondary proceedings or resulted in the appointment of a temporary administrator under Article 38 of the Regulation.

THE OPENING OF SECONDARY PROCEEDINGS?

A preliminary administrator is usually appointed in Germany to protect a company's assets and investigate a company's financial position pending the hearing of the application to open winding-up proceedings. It could be argued that the German court's appointment of the preliminary administrator opened secondary proceedings. The guidance from the European Court of Justice (ECJ) in *Eurofood*¹³ would support this argument. In *Eurofood* the ECJ held that the appointment of an Irish provisional liquidator, pending the hearing of an application to wind up the Irish registered Parmalat subsidiary, opened main proceedings under the Regulation. While the

¹¹ *In the matter of MG Rover Deutschland GmbH (in administration)*, unreported, Chancery Division (Birmingham District Registry) 14 August 2006.

¹² It was appropriate to assess the English administrators' remuneration on a time basis – from the outset it was clear to MG Rover Germany's creditors that the English administrators proposed to charge on this basis and the creditors had previously raised no clear objection to this.

¹³ C-341/04, 2 May 2006.

German court's decision to appoint the preliminary administrator was handed down prior to the ECJ's decision in *Eurofood*, the ECJ in *Eurofood* gave the following comprehensive guidance on whether the appointment of a provisional officeholder will open main insolvency proceedings for the purpose of the Regulation.

- Based on the wording of Article 1(1) of the Regulation, for the Regulation to apply, insolvency proceedings must have four characteristics: (i) they must be collective proceedings (listed in Annex A to the Regulation); (ii) based on the debtor's insolvency; (iii) which entail at least partial divestment of that debtor; and (iv) prompt the appointment of a liquidator (listed in Annex C to the Regulation). Such divestment implies that the debtor's directors lose the powers of management that they have over the company's assets.
- It was necessary for the automatic recognition principle in Article 16 of the Regulation to be capable of being applied as soon as possible. In light of this, a "decision to open insolvency proceedings" must be regarded as including not only a decision which is formally described as an opening decision by the legislation of the Member State of the court that handed it down, but also a decision arising out of an application, based on the debtor's insolvency, seeking the opening of proceedings referred to in Annex A to the Regulation where that decision involves divestment of the debtor and the appointment of a liquidator listed in Annex C.

The ECJ's decision concerned the opening of main proceedings. However, the ECJ's guidance could be applied by analogy to the question of whether the appointment of a provisional officeholder opens secondary proceedings by substituting references to Annex A to the Regulation for Annex B to the Regulation¹⁴. Accordingly, the appointment of a provisional officeholder will open secondary proceedings only if both: (i) the conditions for opening secondary proceedings (as set out in the Regulation); and (ii) the conditions set out above by the ECJ in *Eurofood* (above) are satisfied. This results in the following set of conditions which must be satisfied for the appointment of a provisional officeholder to open secondary proceedings under the Regulation.

1. Main proceedings have already been opened in a Member State other than the Member State where the provisional officeholder has been appointed¹⁵. In relation to MG Rover Germany, this condition was satisfied as main proceedings had been opened in England prior to the appointment of the German preliminary administrator.
2. The debtor possesses an establishment within the territory of the Member State where the provisional officeholder is appointed. There is no detailed consideration in the German judgments as to whether MG Rover Germany possessed an establishment in Germany. However, the fact that MG Rover Germany was a national sales company distributing vehicles produced by MG Rover Group Ltd almost certainly fulfilled the requirement of "non-transitory economic activity with human means and goods".
3. The provisional officeholder must be listed in the list of liquidators for the relevant Member State in Annex C to the Regulation. In relation to the appointment of the German preliminary administrator to MG Rover Germany, this condition was fulfilled as a German preliminary administrator is listed in the German entry in Annex C to the Regulation¹⁶.
4. The provisional officeholder must be appointed pursuant to an application which is based on the debtor's insolvency and seeks the opening of insolvency proceedings listed in Annex B to the Regulation. In relation to the appointment of the German preliminary administrator to MG Rover Germany, this condition was fulfilled as the German preliminary administrator was appointed to investigate the solvency or otherwise of MG Rover Germany on the basis of an application seeking the opening of liquidation proceedings listed in the German entry in Annex B to the Regulation¹⁷.
5. The appointment of the provisional officeholder involves the divestment of the debtor. In this case the appointment could not divest MG Rover Germany of the powers of

¹⁴ Insolvency proceedings which are available as secondary proceedings under the Regulation are listed in Annex B.

¹⁵ Article 3(3) of the Regulation.

¹⁶ Volaufiger Insolvenzverwalter.

¹⁷ Das Insolvenzverfahren.

management it had over its assets as:
 (i) practically such divestment had already taken place when the English administrators had been appointed; and (ii) more importantly, the order appointing the German preliminary administrator conferred no power on him to control the assets or manage the business of MG Rover Germany.

As, in this case, condition 5(ii) was unfulfilled, it is highly unlikely that the appointment of the German preliminary administrator resulted in the opening of secondary proceedings under the Regulation. However, in future cases, whether the appointment of a German preliminary administrator opens secondary proceedings under the Regulation will turn on the individual facts of each case and, in particular, the terms of the appointing order.

TEMPORARY ADMINISTRATOR UNDER ARTICLE 38 OF THE REGULATION?

Article 38 of the Regulation provides for the appointment of a temporary administrator to ensure the preservation of a debtor's assets. However, the appointment of a provisional officeholder will only fall under Article 38 of the Regulation (and thus within the scope of the Regulation) if the debtor's centre of main interests is within the territory of the appointing Member State. As the English court had already decided that MG Rover Germany's centre of main interests was in England, the German preliminary administrator could not be classed as a temporary administrator under Article 38 of the Regulation.

Was there any need for a German preliminary officeholder?

There has to be considerable doubt as to whether the German court needed to appoint a German preliminary officeholder prior to the opening of secondary proceedings. There was no need to secure and maintain MG Rover Germany's assets as the

English administrators would have already done this. Furthermore, there was no need to investigate the financial position of MG Rover Germany as under the Regulation there is no need for a separate examination of the debtor's insolvency by the Member State's court considering an application to open secondary proceedings¹⁸. It would appear that, in relation to MG Rover Germany, the only reason to open a German preliminary insolvency proceeding was to check that MG Rover Germany's assets, which would fall within the secondary proceeding, would be enough to cover the costs of such a proceeding. Accordingly, it could be argued that the German court should have simply opened secondary proceedings at the outset and that it was unnecessary to appoint a preliminary officeholder.

Did the appointment of the German preliminary officeholder breach the English moratorium?

Paragraph 43 of Schedule B1 to the Insolvency Act 1986 provides for a moratorium on other legal processes being initiated once administration proceedings are opened¹⁹. In particular this moratorium provides that no legal process (including legal proceedings, execution, distress and diligence) may be instituted or continued against a company or its property without the consent of the administrator or the consent of the court²⁰. Once the English administration proceedings were opened the effect of the Regulation was that the English moratorium applied across the EU and, in particular, in the German jurisdiction²¹. If the appointment of a German preliminary administrator constituted "a legal process" that was outside the regime of the Regulation²² then the English moratorium should have prevented the German court appointing a German preliminary administrator. Given that the application was one in a foreign country's court the question of whether the appointment was a "legal process" is difficult to assess.

¹⁸ See Article 27 of the Regulation which provides that the Member State's court opening secondary proceedings is entitled to rely on the determination of insolvency made by the Member State's court which has opened main proceedings.

¹⁹ There is also a moratorium, under Paragraph 42 of Schedule B1 to the Insolvency Act 1986, on the commencement of certain insolvency proceedings but this is drafted to refer to UK insolvency proceedings and, in any event, clearly would not prevent the commencement of secondary proceedings under the Regulation.

²⁰ Paragraph 43(6) of Schedule B1 to the Insolvency Act 1986.

²¹ Article 17 of the Regulation provides that the judgment opening main proceedings shall, with no further formalities, produce the same effects in any other Member State as under the law of the State of the opening of proceedings, unless the Regulation provides otherwise and as long as no secondary proceedings have been opened in the other Member State. At the time the German preliminary administrator was appointed no secondary proceedings had been opened in Germany and there was no other provision in the Regulation which prevented the general rule in Article 17 from applying. Accordingly, the English moratorium was effective in Germany when the German court came to consider whether or not to appoint the preliminary administrator.

²² See above for a discussion on whether the appointment of the German preliminary administrator fell outside of the Regulation.

Case law on the forerunner to Paragraph 43 (Section 11 of the Insolvency Act 1986²³) is aimed at domestic applications and we are yet to have any substantive body of cases on Paragraph 43 as this provision came into force in 2003.

Officeholders' duty to cooperate and communicate

Norris HHJ held that the English administrators were entitled to claim remuneration for negotiating a protocol with the German preliminary administrator notwithstanding that a final agreement was never reached. This was on the basis that an administrator is entitled to be remunerated for work even if the outcome of the particular action is not successful. Furthermore, Norris HHJ was of the view that, notwithstanding the fact that at the time the protocol was sought the German preliminary administrator was not a secondary officeholder appointed under the Regulation, there was still the same duty on the English administrators to communicate and cooperate with the German provisional administrator as there was when he was appointed liquidator in the secondary proceedings²⁴. While Norris HHJ's decision on this point is eminently sensible from a commercial and practical viewpoint no legal basis was asserted for the existence of the duty to cooperate. However, there are two legal grounds under which the English administrators could be said to be under a duty to communicate and cooperate with the German preliminary administrator even if he had no status under the Regulation. The first is under the international principle of comity which encourages the courts and court-appointed officeholders to respect other countries' courts and their court-appointed officeholders. Secondly, an English administrator must perform his functions in the interests of the company's creditors as a whole²⁵. It could be argued that it was in the interests of MG Rover Germany's creditors as a whole that the English administrators communicated and cooperated with the German preliminary administrator to obtain the most efficient realisation of MG Rover Germany's assets.

Reduction of the English administrators' remuneration

Norris HHJ held that there should be a small reduction in the overall level of the English administrators' remuneration to take into account the time (or part of the time) spent by the English administrators in relation to the following matters: first, in opposing the opening of secondary proceedings in Germany and seeking a stay of the liquidation process in these proceedings; second, in seeking to prevent the payment of the balance of a bank account with HSBC Trinkhaus & Burkhardt AG (belonging to MG Rover Germany) to the liquidator in the secondary proceedings²⁶; and third, in negotiating a claim against another MG Rover entity. These steps were held to have been taken by the English administrators to protect the value of their statutory charge in respect of their remuneration over the assets of MG Rover Germany, rather than being in the interests of MG Rover Germany's creditors as a whole.

Norris HHJ accepted the argument of the German creditors that the English administrators, in opposing the opening of secondary proceedings and seeking to stay the liquidation process in these proceedings, were motivated by a desire to protect the value of their statutory charge. However, it could be argued that this opposition was motivated by a desire to save costs and thus retain a greater part of MG Rover Germany's estate for distribution to creditors²⁷. Furthermore, it is unfortunate that the German court did not hand down a written decision giving reasons for its refusal to stay the liquidation process in the secondary proceedings. An application to stay the liquidation process in secondary proceedings on the request of the liquidator in the main proceedings may only be refused if such a stay is manifestly of no interest to the creditors in the main proceedings²⁸. If the liquidation process in the secondary proceedings was unlikely to provide extra value to the creditors in the main proceedings, when compared to the extra costs that the liquidation process would entail, then it is arguable that the German court should have acceded to the English administrators' request and stayed the liquidation process. In another

²³ Paragraph 43 has substantially the same effect as the previous Section 11.

²⁴ Article 31 of the Regulation places a duty on the liquidator in the main proceedings and the liquidator in any secondary proceedings to communicate and cooperate with each other.

²⁵ Paragraph 3(2) of Schedule B1 to the Insolvency Act 1986.

²⁶ At the commencement of the secondary proceedings the English administrators had sent a letter to HSBC Trinkhaus & Burkhardt AG requesting that money held in accounts for MG Rover Germany should not be released to the German liquidator without the consent of the English administrators.

²⁷ This is especially the case as the English administrators had made clear that, in their view, the opening of secondary proceedings would occasion additional costs which would fall on the assets available for distribution.

²⁸ Article 33(1) of the Regulation.

recent topical administration, the English administrators of the Austrian registered Collins & Aikman company successfully obtained an order from the Austrian court to stay the liquidation process in the secondary proceedings which had been opened in Austria²⁹. This was on the basis that the Austrian court agreed with the English administrators that the Austrian registered company's creditors would be better served if the English administrators were able to realise the goodwill of the entire group without secondary proceedings interfering with this process. However, it is unknown if, in the Collins & Aikman administrations, there was the same resistance from the Austrian creditors to the English administration as there was from the German creditors in the MG Rover administration.

The English administrators' argument that they sought to prevent the payment of the balance of the bank account to the liquidator in the secondary proceedings in order to protect themselves in the event that the German court granted a stay on the liquidation process in the secondary proceedings was rejected by Norris HHJ. This was on the basis that an attempt to freeze a bank account was not consistent with such a stay. Given that the arguments centred on the stay of the liquidation process in the secondary proceedings it would seem to have been agreed by all parties that the bank account was an asset which fell within the secondary proceedings. A bank account represents a claim by the holder of the account against the bank for the repayment of the balance of the account. For the purpose of the Regulation, a claim is situated in the territory in which the third party required to meet it has its centre of main interests³⁰. The result of this rule is that if for example the account was held with a German branch of a bank which had its centre of main interests in London, the location of the claim would be England and thus the asset would be one to be dealt with in the English main proceedings. However, given that the bank account in question was held by MG Rover Germany with HSBC Trinkhaus & Burkhardt AG (a bank registered in Germany) it would seem that it was correct to assume that the bank account was an asset situated in Germany and thus fell within the secondary proceedings.

Conclusion

The issues that arose in respect of the remuneration of the officeholders in the main and secondary proceedings in relation to MG Rover Germany indicate that the concerns that have been expressed in relation to any duplication of expense that the appointment of two sets of officeholders may incur were well founded. The English court confirmed that such duplication may be necessary as a matter of the applicable insolvency law under the Regulation, but that a successful cooperation between officeholders can produce benefits for creditors.

The authors understand that the quantum of the German preliminary administrator's and liquidator's remuneration is yet to be approved. It is understood that the sum sought is a similar amount to that sought by the English administrators and it may be that objections will be raised as to the level of remuneration claimed. Any comments the German court may make on this issue are awaited with interest.

²⁹ Higher Regional Court of Graz (3 R 149/051 – the decision is not officially published).

³⁰ Article 2(g) of the Regulation.

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