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Letterbox Entities Under Attack!

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Introduction

The recent developments in Cyprus have stirred up a discussion in The Netherlands concerning the many letterbox (i.e. holding) entities we host. Some politicians say these entities do not pay enough taxes and new rules should me made to discourage incorporation in The Netherlands of these "letterbox" companies.

As professionals we know there are many valid reasons for incorporating holding companies in a group structure. Obviously businesses are placed in separate companies to avoid recourse, the holding company linking the other companies together in one group. The holding company's activities are often limited to holding shares in the capital of foreign subsidiaries. The Dutch tax system is beneficial for holding companies because no taxes are levied on profits of foreign subsidiaries. The assumption is that taxes will be paid in the relevant foreign country. An additional benefit is that the Dutch tax authorities are prepared to issue rulings on tax structures so that there is certainty in advance about the amount of taxes to be paid.

Speaking as Dutch insolvency lawyers and practitioners, the use of Dutch holding companies provides for interesting cross-border insolvency work. The European Insolvency Regulation ("Regulation") sits on the corner of our desks.

Both the tax and the bankruptcy consequences of the use of letterbox entities are the subject of discussion. As insolvency administrators of Dutch holding companies, we encounter much resistance from foreign colleagues, creditors and foreign courts against main insolvency proceedings regarding Dutch holding companies. The professionals involved often consider that it is inappropriate for a Dutch insolvency administrator to wind up foreign activities vested in either or both of the holding company and its subsidiaries. Sensitivities about sovereignty still seem to play a role here, even though the Regulation was introduced more than 10 years ago.

In the last few years, our appointment insolvency administrators have been challenged in multiple court proceedings in Germany, Italy, France and The Netherlands. People who know us – and as you can see from the photo – can tell we are not particularly aggressive people; on the contrary, we dare say that we continuously seek ways to cooperate. The CoCo guidelines and examples of cooperation protocols also sit on the corner of our desks.

We know that resistance to a restructuring is not personal and that it reflects professional necessity as against being evidence of acting in bad faith. It is nevertheless a matter of conflicts of interest between the creditors of the respective group companies. Stakeholders, i.e. creditors, directors, shareholders and/or foreign insolvency practitioners manoeuvre to maximize their financial and legal position. They exploit the lack of clarity in the Regulation towards centre of main interests ("COMI") in the context of group structures. Our experience reveals, broadly speaking, a three-step approach in the making of any challenge to the main insolvency/administrator:

1. challenge COMI in country where proceedings are opened,
2. challenge the main proceeding administrator on grounds of public policy,
3 devising a creative alternative to challenge or at least frustrate the proceedings.

Below we give an example of a recent case in which 1. the Dutch courts ruled COMI of Dutch holdings/letterbox entities to be in The Netherlands despite head office functions in France. 2. the French court ruled that the public policy exception did not apply. 3. the French court, however, approved the French subsidiary's administrator's seizure of the Dutch holdings' assets.

1. COMI of a letterbox entity

The group structure comprised two Dutch holding entities, Jemnice B.V. and En Sof Property Fund I B.V. ("Dutch Holdings") which hold the shares in a French subsidiary, Continental Property Investment S.A. ("French subsidiary") owning real estate companies in France and Spain. The French subsidiary was already subject to French insolvency proceedings (*redressement judiciaire*). First, Dutch Holdings applied for insolvency in France, but the Paris Commercial Court denied the request because a French COMI had not been established. Subsequently, the main creditor filed bankruptcy petitions against the Dutch Holdings with the Amsterdam District Court.

Both the director of Dutch Holdings and the French administrator of the French subsidiary argued before the Amsterdam District Court that the COMI of Dutch Holdings was in France, because – in short – the actual head office functions of the Dutch Holdings were carried out in Paris and that consequently the COMI-presumption of Amsterdam as the 'place of the registered office' (article 3(1) Regulation) should be rebutted. Nevertheless the Amsterdam District Court in the first instance opened Dutch bankruptcy proceedings. The parties lodged an appeal. As trustees we confirmed before the Amsterdam Court of Appeal that head office functions were indeed carried out in Paris, and that if that were the test then main

proceedings should indeed be opened in France instead of in The Netherlands, although there were other factors supporting the establishment of COMI in The Netherlands.

With an emphasis on the requirements of transparency and predictability of the applicable law regarding the opening of insolvency proceedings, the Amsterdam Court of Appeal ruled that COMI was in The Netherlands.[1] The Court argued that key factor was the view of potential creditors of the debtor's COMI, to be judged on the basis of objective aspects. What was important was the fact that the activities of Dutch Holdings, being a letterbox entity, were limited in nature. The activities only involved: holding the shares in a French company, paying taxes in The Netherlands (on the basis of declarations made by a Dutch auditor), publishing annual accounts in The Netherlands, and pursuant to the articles of association shareholders' meetings had to be held in The Netherlands.

The Court considered that the following factors – each supporting the mind of management in France and group centre approach – were not sufficient to rebut the presumptions: (i) the director lived and worked in France, (ii) the actual visitors' address was in France (according to the Court this was irrelevant because such an address is unnecessary for shareholders), (iii) the Dutch tax authorities communicated with the French address, (iv) the shares were held in a French company, and (v) the annual accounts were also prepared by a French administration office. The Court also considered it relevant that the main creditor had lent money to Dutch Holdings. these funds were lent onto the French subsidiary. Additionally this creditor had asserted that it intended to deal with Dutch Holdings in accordance with Dutch tax and bankruptcy law. For these reasons, the Amsterdam Court of Appeal confirmed the COMI was in The Netherlands taking into account the limited activities of the letterbox entity and the fact the few creditors knew they were dealing with a Netherlands-registered company, despite the fact that the director was resident in France. This showed a clear entity-by-entity approach, as against instead of looking for a group centre, as had been the case with previous well known UK decisions.

In our view this decision of the Amsterdam Court of Appeal reflects existing European Court of Justice case law.[2] It is clearly essential that potential creditors should be able to ascertain in advance the legal system that would resolve any insolvency affecting their interests. The starting point is the rule that transparency and objective as certain ability are key prerequisites in the determination of COMI.[3] Any party seeking to rebut the presumption that insolvency jurisdiction follows the registered office must demonstrate that the factors relied on satisfy these pre requisites, taking into account the nature of the particular entity, and notwithstanding its strong connection with group companies.

2. Public policy

After main insolvency proceedings had been opened in France, the French administrator of the French subsidiary and the director of Dutch Holdings invoked the public policy exception (article 26 Regulation) in an appeal before the Paris Court of Appeal against the rejection of the request to open French main insolvency proceedings (*redressement judiciaire*) to the Dutch Holdings.

The public policy exception is known as a general principle, which operates to exclude certain results from a given legal system where the effects would be 'manifestly' contrary to the other State's public policy.[4] In the above mentioned case the French administrator of the French subsidiary argued that the nature of Dutch insolvency proceedings could prevent recognition of those proceedings in France. The Dutch proceedings (*faillissement*) are liquidation proceedings, whereas *redressement judiciaire* aims for rehabilitation.

Some procedures are more intrusive than others. However, the Regulation itself is neutral in the sense that it respects national diversity and acknowledges different insolvency proceedings throughout its Annexes.[5] Public policy does not require a general review of the correctness of the foreign proceedings, but it does seek certain procedural safeguards.[6] 'Manifestly' means that the provision should only operate in exceptional cases, where its contrary nature is obvious or unequivocal.[7]

The Paris Court of Appeal ruled that the nature of the Dutch insolvency proceedings concerned (*faillissement*, included in Annex A) was considered to be an insolvency proceeding within the meaning of the Regulation.[8] Hence, the public policy exception was denied. The Paris Court of Appeal ruled that it was unable to open French proceedings, and considered that Dutch proceedings were automatically recognized in conformity with article 16 of the Regulation.
It was helpful that the Supervisory Judge of the Amsterdam District Court had given notice of the Dutch main proceedings by sending a letter directly to the Paris Court of Appeal. It was stated that main proceedings in The

1 Amsterdam Court of Appeal 20 December 2012, LJN: BY6980 (paragraph 3.3).
2 CJ EU 2 May 2006, case C-314/04 (Eurofood); CJ EU 20 October 2011, case C-396/09 (*Interedil*).
3 Virgós-Schmit Report, No. 75; Case C-341/04, Opinion of Advocate General Jacobs, 27 September 2005, par. 118 (*Eurofood IFSC*).
4 Virgós & Garcimartín, *The European Insolvency Regulation: Law and Practice*, Kluwer Law International 2004, p. 214.
5 Idem, p. 73.
6 Idem , p. 215.
7 Virgós/Schmit Report, No. 205.
8 Paris Court of Appeal 26 February 2013, RG no 12/19669, p. 7.

Netherlands and the authority of the Dutch trustee had to be recognized automatically in France. We have no doubt that such court-to-court communications can be very useful in giving explanations of the status of pending proceedings to foreign courts in another Member State. In our view a digital European insolvency register showing court decisions opening insolvency proceedings as recently proposed by the European Committee is essential to the proper functioning of the Regulation.

3. Upstream seizures

A third – and we must admit 'creative' – alternative to challenge the opening of Dutch insolvency proceedings was the action initiated by the French administrator before the Paris Commercial Court regarding the application of the French subsidiary's insolvency proceedings to the assets of Dutch Holdings. Such application was based on the French Commercial Code and substantiated by, among other things, the 'fictitious character' of the Dutch Holdings being letterbox entities.

The Paris Commercial Court approved an 'upstream' seizure of the assets of the Dutch Holdings, i.e. the Dutch estates.[9] It was considered that such seizure was a matter of great urgency because the risk assets, i.e. shares in the French subsidiary, could be disposed. Pursuant to the 'new' French *Petroplus* legislation,[10] it is possible to impose interim relief in respect of the assets of the defendant pending the decision in the substantive proceedings. As a result, Dutch Holdings' 100% shareholdings in the French Subsidiary as well as the 100% shareholdings *in* the Dutch Holdings were seized in order to prevent us as trustee from performing any irreversible actions. The Amsterdam District Court is expected to render a judgment in this respect.

Conclusion

These matters show that not all professionals are ready to accept insolvency proceedings of letterbox entities. We dare say that the issue of sovereignty still plays a role in the sense that there is reluctance to let a foreign trustee or court decide what should happen to the assets of a subsidiary. Apparently it is difficult to put the principle of mutual trust between Member States into practice. However, the main issue is creditors' separate recourse against individual companies which causes substantial conflicts of interest. Why share the assets of your debtor with creditors of empty group companies?

In itself, the ambition to concentrate the COMIs of group companies in the same place – in this case Paris – is not bad. It would lead to the appointment of one administrator, who would take into account the interests of the entire group in supervising the proceedings. However, the decisions of the European Court of Justice – and in the matter at hand from the Amsterdam Court of Appeal – show that separate recourse against individual companies is still the starting point when dealing with groups. Creditors should be able to rely on who their debtors are.

The conflicts of interest between group companies make it difficult to find a unified approach, except when synergy benefits are clear. In our view the European Commission's initiative to extend the coordination powers of a parent company's main administrator to other group entities is an essential step towards the further integration of cross-border insolvency proceedings.

[9] Paris Commercial Court 29 January 2013, 13_169, 13_6220.
[10] No 2012-346, article L 621-2 al. 4 Code de Commerce (Petroplus).