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Forum shopping and filing insolvency proceedings in a global legal world

Insolvency Commission

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National Report of Germany

Michael Pauli, LL.M.

Heuking Kühn Lüer Wojtek
Georg-Glock-Straße 4
40474 Düsseldorf
Germany
+49 211-600 55 268
m.pauli@heuking.de

Giuseppe Scotti, Studio Scotti, Parma, Italy
Stephanie Reed Traband, Levine Kellogg Lehman Schneider + Grossman
LLP, Miami, Florida USA

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1. Proper place for commencement of insolvency proceedings and centre of main interests.

- a. In your jurisdiction which is the proper place for commencement of insolvency proceedings? Is the applicable law determined separately than the venue?

Insolvency proceedings in Germany are governed by the Insolvency Act (*Insolvenzordnung*, henceforth “**InsO**”). According to sec. 2 (1), sec. 3 (1) InsO, the proper place for commencing insolvency proceedings is the local court for insolvency at the debtor’s place of general jurisdiction. The general jurisdiction is determined by the registered seat/domicile of the debtor according to sec. 12 of the Code of Civil Procedure. If the debtor’s main business activity is located elsewhere than the registered seat/domicile, the insolvency court of that place has exclusive jurisdiction.

The applicable law for German insolvency proceedings is the InsO, which does not change with another national venue. Yet, for certain entities, namely financial institutions, banks and capital investment companies, there are additional provisions set forth in e.g. the Banking Act (*Kreditwesengesetz*).

- b. Is there in your country a notion or definition of the debtor’s centre of main interests (“COMI”)?

The COMI applicable in Germany is regulated in Article 3 (1) European Council Regulation (EC) No 1346/2000, (henceforth “**EUInsReg**”). It has not been directly implemented into German insolvency provisions nor is there a binding legal definition. However, court proceedings concerning issues of cross-border insolvencies are governed by the COMI of the EUInsReg. Cross-border insolvencies are given whenever a debtor’s assets or liabilities are placed in more than one Member State, or if the debtor is subject to the jurisdiction of courts from two or more states.

- c. Which are the factors relevant to the determination of centre of main interests?

First of all, according to Article 3 (1) sentence 2 EUInsReg, it is presumed that the COMI is the place of the registered office or habitual residence. This presumption can only be rebutted by substantiating a different location for the COMI. Generally, there are two different theories defining the factors for the determination of the COMI, which are the mind-of-management-theory and the business-activity-theory.

According to the mind-of-management-theory, the COMI is located at the place of the debtor’s head office or strategic management. Office functions pointing towards a COMI under the mind-of-management-theory could be:

- Internal accounting;
- Internal purchasing control;
- Internal treasury management;

- Strategic control;
- IT systems;
- Board meetings and domicile of the directors.

In contrast, the business-activity-theory establishes the COMI where the debtor actually operates his business. Hence, it focuses mainly on external factors which are visible for third parties not involved in the debtor's business structure.

Factors could be:

- Commercial appearance;
- Location of bank accounts used for payments to creditors;
- Location of business productions sites and warehouses;
- Choice of law in contracts with creditors;
- Local advertising of products.

In Germany both theories were used to determine the COMI for cross-border insolvencies until the European Court of Justice ("ECJ"), which is the highest court of the European Union and tasked with interpreting EU law, rendered the landmark judgment of *Re Eurofood IFSC Ltd* [2006]. It ruled that COMI must only be determined based on factors which are ascertainable by third party creditors and objective from the viewpoint of other parties of interest. Thus, although the ECJ did not literally refer to the business-activity-theory, it leaned towards its COMI-deciding factors.

- d. Is this essential in determining the jurisdiction?

Yes, according to Article 3 (1) EUInsReg, the determination of the COMI decides which jurisdiction is applicable for the cross-border insolvency proceedings.

It reads:

The courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.

- e. Are there international or supranational regulations regarding the proper place for commencement of insolvency proceedings and/or the determination of the centre of main interest applicable in your country?

Yes, the abovementioned EUInsReg is directly applicable in the Member States of the European Union (without Denmark), which is the reason why there is no German regulation as to what factors are decisive for the establishment of the COMI.

- f. Is the debtor's centre of main interests the place where an insolvency proceeding concerning the debtor is likely to commence? Why or why not?

As referred to above, the German legislator did not transpose the rule of COMI directly to national insolvency proceedings. It is only applicable for cross-border insolvencies. Yet, according to sec. 3 (1) clause 2 InsO, even if the debtor is registered somewhere else, the exclusive jurisdiction is established where the center of his business activity is located. In consequence, there is no difference between the COMI according to the business-activity-theory and the location for exclusive jurisdiction according to the business activity in sec. 3 (1) clause 2 InsO.

- g. Please discuss the issues of timing and procedure with respect to the determination of centre of main interests, including when or if a judicial determination on this issue is required or made?

In German courts, the issue of timing is important in relation to national and cross-border proceedings.

If several German courts have possible jurisdiction over an insolvency proceeding, sec. 3 (2) InsO states that the court where the first request to open the proceeding is filed shall have exclusive jurisdiction. The courts will ex officio verify if they have jurisdiction for a specific insolvency procedure. Where the insolvency petition is filed at an incompetent court the judges will give order to the debtor or creditor who requested the proceeding. The party requesting the procedure then has the chance to file their request at the competent court at a different location. If the party requesting the procedure is reluctant to file a new request at the competent court, the original court will dismiss the request entirely.

For cross-border issues Article 3 EUInsReg differentiates between main proceedings, secondary proceedings and territorial proceedings. This is imperative for the issue of timing and procedure, because main proceedings, once commenced, have priority over secondary proceedings and have to be recognized by all other Member States and their courts. After commencement of primary proceedings, creditors in other Member States can file for secondary proceedings in order to protect their rights within the Member State. Secondary proceedings run parallel to main proceedings and are subordinated to them, Article 3 (3) EUInsReg. They can only be winding-up proceedings and any surplus has to be passed on to the main proceedings.

Territorial proceedings, as third possible option, are basically secondary proceedings petitioned in a Member State in which the debtor has no COMI, however substantial assets. They can only be opened prior to primary proceedings. In contrast to secondary proceedings, territorial proceedings can be rehabilitation proceedings as well as winding-up proceedings. They are limited to two possible cases: (i) the conditions for opening the insolvency proceedings, as set out by the law of the State where the centre of a debtor's main interests is located, do not allow main proceedings to be opened, and (ii) where the opening is requested by a local creditor or whose claim arises from the operation of that local establishment of the debtor, within the meaning of Article 3(4)(b)

EUInsReg. Once primary proceedings commence, territorial proceedings convert to secondary proceedings.

Therefore, if there are several possible COMI and jurisdictions, the first one to be requested for insolvency proceedings has exclusive jurisdiction.

2. Movement of the place of registration (or habitual residence) of centre of main interest.

- a. Is it possible for the debtor to move its place of registration (or habitual residence) prior or after the commencement of insolvency proceedings? Will such a move affect the decision as to centre of main interests and the determination about the commencement of the proceedings?

In general, the debtor may change the place of registration or habitual residence prior to commencement of insolvency proceedings. Yet, it depends on his business activity if the move affects the COMI and place of proceedings.

In cases where the debtor lacks a business activity, i.e. is a natural person or company without any business activity, the move of registration or habitual residence will also change the jurisdiction of insolvency proceedings if completed prior to the commencement of insolvency proceedings.

If the debtor has a business activity, and then merely changes the place of registration without moving the center of the business activity, the move will not change the venue for the insolvency proceeding due to the exclusive jurisdiction of business activity according to sec. 3 (1) sentence 2 InsO. Within Germany, jurisdiction by business activity has priority over any jurisdiction by seat/registration.

Since the *Re Eurofood* decision of the ECJ (see above 1.c.) the result for changes of registration within Germany is the same as for cross-border moves, because the COMI (applicable only for cross-border insolvencies, see above) will only change where the factors determining the business-activity-rule transfer as well. Hence, if the company's bank accounts, commercial appearance and choice of law remain in a Member State, the COMI will not relocate with a new registration in a different Member State, nor will the place for commencement of insolvency proceedings. As a result, the German centre of business activity according to sec. 3 (1) sentence 2 InsO and the COMI of Article 3 (1) EUInsReg share most of the deciding factors.

Yet, it has to be noted that for German companies the cross-border move of registration and/or habitual residence out of, or into, German legislation may be difficult. This is mainly due to corporate law issues relating to the incorporation theory and the real seat theory. In short, some company forms have to liquidate and wind up before they can transfer into another cross-border jurisdiction.

Hence, though it may be possible for companies to change their registration across borders, it might not be practicable due to corporate law.

The move of registration or habitual residence after the commencement of insolvency proceedings is possible, but will not affect the jurisdiction.

- b. Is it possible to move a debtor's centre of main interests prior to commencement of insolvency proceedings?

Yes, it is possible to move debtor's COMI prior to commencement of insolvency proceedings. Yet, it is very difficult for a company to do so.

As mentioned above, the German insolvency courts only apply the COMI if cross-border proceedings are at hand. After the *Re Eurofood* decision, the factors of the business-activity-theory apply for the determination of the COMI (see 1.c.). Hence, a company would have to change most of the factors of the business-activity-theory in order to move its COMI; in short, giving up most of the business in Germany and open up shop in another country.

- c. Is it possible to move a debtor's centre of main interests between the time of the application for commencement and the actual commencement of those proceedings?

In national German proceedings the time of the request for insolvency proceedings is relevant. Once established, changes of registration or habitual residence do not affect the jurisdiction.

For cross-border border issues the same principle applies. This was established in *Re Staubitz-Schreiber* [2006], where the ECJ ruled that the first request for insolvency proceeding establishes the main jurisdiction. Later requests can only institute secondary proceedings with reduced capacities.

- d. If there is evidence of such a move in close proximity to the commencement of the proceeding, in determining whether to recognize those proceedings, will the court scrutinize more closely such a move?

German courts carefully verify their jurisdiction *ex officio* in order to eventually decline jurisdiction and prevent the work load. A move of registration in close proximity will not be scrutinized more closely.

- e. Is forum shopping allowed under domestic or supranational law which applies in your jurisdiction?

Generally speaking, forum shopping is not forbidden, but as soon as the debtor abuses the law, the courts will prevent the change of venue. If the debtor is a company, a possible approach to prevent forum shopping is the director's liability. The director of an insolvent company is required to file the petition for insolvency proceedings at the right court in due time. Once he tries to file the

request at the wrong court, in order to go forum shopping, he might be liable of a delayed insolvency petition according to sec. 15a InsO.

However, where an insolvent debtor has multiple COMI, he is permitted to petition at a jurisdiction of his choice within the COMIs. Once a national or international jurisdiction is established, further main proceedings in other jurisdictions are not applicable.

- f. What are factors in your country that may influence a debtor to choose one forum over another, e.g. judges, favorable laws, case law precedent, etc.?

In national German insolvency proceedings forum shopping is not necessary, because the relevant laws, especially the InsO, apply in all federal states. Due to the codified insolvency proceedings, case law precedents play a smaller role than in Anglo-American proceedings. Yet, where the supreme court of Germany (*Bundesgerichtshof*) has not set a binding precedent, one higher regional court (*Oberlandesgericht*) might be favorable over another due to their case law precedents.

Germany, in contrast to the UK, is not popular for creditors in cross-border insolvency proceedings. English insolvency law is considered to be flexible and to prioritize reorganization, whereas German insolvency laws are considered to be more punitive for the debtor. Additionally, the German liquidator is chosen by the insolvency court with limited influence by the creditors or debtors. Finally, if the debtor is a natural person, the residual debt is discharged in Germany after a vast seven years, whereas in the UK the discharge is achieved in only one year. However, employees of insolvent companies might be in favor of a German forum: Under certain circumstances German social laws provide for state funding of salaries for up to three months before the commencement of insolvency proceedings (*Insolvenzgeld*).

- g. Is it possible for a creditor or other party to force or cause a debtor's insolvency proceedings to be moved (rather than dismissed), as a result of a challenge to the debtor's definition of its centre of main interests?

For German insolvency proceedings, yes: According to sec. 281 Code of Civil Procedure, the creditor is entitled to petition for referral to another court due to lack of jurisdiction. The motion is directed at challenging the debtor's choice of insolvency court and forcing the debtor to commence proceedings at another court. If the court finds that the motion is valid, it will order the insolvency proceedings to be held at the competent insolvency court. If several courts have jurisdiction, the insolvency proceedings are referred to the court of the creditor's choice.

In cross-border matters it is not possible to move an insolvency proceeding once it commenced, because Article 16 (1) EUInsReg provides a priority

principle for the first proceedings against all subsequent proceedings. Yet, there are chances to challenge the recognition (see below).

3. Recognition of foreign proceedings, main and secondary proceedings

- a. Is the recognition of foreign proceedings allowed in your country? What are the requirements? Is this recognition affected by the notion of centre of main interests?

Due to the harmonization of the European insolvency proceedings through the EUInsReg the recognition of foreign proceedings in Germany is divided into two parts.

EU insolvency proceedings are directly recognized according to Article 16 EUInsReg. The requirements are those laid down above, especially the COMI.

According to sec. 343 InsO, non-EU insolvency proceedings are also recognized in Germany. The recognition is only declined if the foreign court does not have jurisdiction in accordance with German law; also, where the recognition of proceedings leads to a result which is incompatible with major principles of German law, in particular with the basic rights of the constitution (*Grundgesetz*). The result is that if i.e. a Chapter-11 (US-Insolvency Proceeding) proceeding did not commence in the right jurisdiction according to sec. 3 (1) InsO, the recognition is declined in Germany.

- b. Does your relevant domestic or supranational legislation have the notions of main and secondary proceedings or otherwise distinguish between the concepts?

Main and secondary proceedings (explained under 1.g.) are only relevant for cross-border insolvency proceedings. In Germany there is no such concept.

- c. Does your legislation permit secondary proceedings to be opened to run in parallel with the main proceedings? Are the effects of secondary proceedings limited to the assets located in that State where secondary proceedings are opened?

German legislation only permits secondary proceedings opened in parallel with main proceedings for cross-border insolvencies according to Article 3 (3) EUInsReg. These proceedings are limited to assets located in the Member State where they are opened and can only be winding-up proceedings. They run parallel with main proceedings (see 1.g.).

- d. Does your jurisdiction allow a challenge to proceedings being designated as secondary? If so, please explain in greater detail.

Generally, decisions to open insolvency proceedings or the decline thereof can be appealed at the competent courts. For example, a creditor requests secondary

proceedings in Germany because the debtor supposedly has assets in Berlin. If the debtor now lacks a habitual residence in Germany, he will appeal the opened secondary proceeding according to sec. 34 InsO (*Rechtsbeschwerde*) on the grounds that Article 3 (2) EUInsReg, which requires a residence, is not established. Thus, the challenge of secondary proceedings is possible.

4. Abuse of process

- a. In your jurisdiction, is a court able to take account of abuse of its processes as a ground to decline recognition?

In EU proceedings the priority principle of Article 16 (1) EUInsReg usually trumps abuse of process. The result is that once proceedings are commenced in one Member State, courts of other Member States have to recognize its jurisdiction. This rule stands even if the decision to commence proceedings was wrong or the results of an abuse of process.

However, Article 26 EUInsReg presents a corrective for the recognition of foreign proceedings in form of a public policy (or *ordre public*) clause. Public policy clauses are commonly used in European Regulations and constitute a safeguard to the national autonomy of the Member States. Article 26 EUInsReg states that if the commencement of the foreign proceeding is incompatible to an unacceptable degree with the legal order of the State in which recognition is sought, the recognizing State may decline the proceeding. Yet, due to the incompatibility “to an unacceptable degree”, the public policy clause remains an exception to the general priority principle of Article 16 (1) EUInsReg.

For non-EU cross-border insolvencies sec. 3 (1) InsO and sec. 343 (1) InsO apply which set a higher standard than the EUInsReg. Therefore, insolvency proceedings will only be recognized if the jurisdiction was established in accordance with German law. In essence, unlike the EUInsReg, there is no primary principle allowing a minor form of abuse of process.

- b. What happens if the applicant falsely claims the centre of main interests to be in a particular State?

Article 16 (1) EUInsReg applies and the proceedings commence in the wrong state if the court assumes its jurisdiction. Yet, where the commencement of the insolvency proceedings is in breach with the public policy of Germany, the diligent creditor, whose rights have been violated to an unacceptable degree, may invoke Article 26 EUInsReg and ask German courts to decline the recognition of the insolvency proceedings. If the German court rules in favor of the creditor the foreign insolvency proceeding is not recognized in Germany nor is it enforceable.

In case the applicant is a director of a company in Germany he might even be criminally liable for delaying the insolvency petition according to sec. 15a InsO which is punishable by imprisonment for up to three years or a fine.

- c. Are those issues governed by international or supranational regulations or only by domestic law?

The issues are generally governed by the European EUInsReg. Yet, where criminal charges apply, the regulation is domestic law and part of the InsO.