

“Center of Main Interests” Finally Becomes the Center of Main Interest in the Case Law

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In the realm of cross-border insolvency law and policy, as modified universalism has become ascendant over territorialism, the key concept of “center of main interests” has remained stubbornly undefined. Now, however, with the flap over Eurofoods in the European Union and the filings of a couple of hedge funds in the Cayman Islands, courts are finally beginning the task of fleshing out the concept. Predictably, these early-stage forays are somewhat less than satisfying, though the recent effort by Judge Burton Lifland seems to offer promise for developing a standard that others might follow.

A little background helps to set the stage for a discussion of the most recent decisions. The concept of modified universalism counsels cooperation among two or more jurisdictions that might find themselves presiding over the insolvency proceeding of an enterprise, with one jurisdiction functioning as the “main” proceeding and the other jurisdictions functioning in a “helper” or “ancillary” mode. The United Nations Commission on International Trade Law (UNCITRAL) gave the previously aspirational concept a huge practical push with its promulgation of the Model Law on Cross-Border Insolvency in 1997. Practical applications quickly gained traction, with the European Union adopting its EU Insolvency Regulation and a number of nations enacting close versions of the UNCITRAL Model Law. The United States was relatively late to the party for unrelated reasons; the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was finally enacted in 2005 and contained a new Chapter 15 that closely tracked the Model Law.

The Model Law’s purpose is to provide effective mechanisms for dealing with cases of cross-border insolvency by advancing cooperation between jurisdictions involved in such cases (there are other objectives, as well, but we focus only on this one here). One mechanism for achieving that end is “recognition.” A foreign representative of a foreign proceeding commences an ancillary case by filing a petition for recognition of the foreign proceeding in the intended jurisdiction, and the latter jurisdiction (usually via a court) grants recognition. Both the Model Law and its attendant Guide for Enactment emphasize that the recognition process should be relatively simple, making access by the foreign representative as easy as possible—a change from the territorialist approaches of the past, when simply getting through the door was often the most daunting and difficult task for the representative of a foreign proceeding seeking assistance in the local jurisdiction.

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And here is where “center of main interests” comes to the fore. Under Chapter 15 of the U.S. Bankruptcy Code (and under the EU Regulation, for that matter), the level of assistance a foreign representative may expect in the U.S. turns in part on whether the foreign proceeding in question is a “main” or a “non-main” proceeding. The U.S. court’s role is more circumscribed if the foreign proceeding is the main proceeding, as opposed to the non-main proceeding (again, this is also the case under the EU Regulation). By the same token, the level of immediate relief in the U.S. that is accorded to a main proceeding is greater. So it is important to know whether or not the foreign proceeding is the ‘main’ proceeding.” Indeed, as we shall see shortly, it may be all that matters.

A proceeding is recognized as a foreign main proceeding, says Section 1517, “if it is pending in the country where the debtor has the *center of its main interests*.”¹ The proceeding may still be recognized as a foreign non-main proceeding even though it is not pending in the country where the debtor has its center of main interests, but in that event, the country in question must at least be one in which the debtor, at the very least, has an establishment, that is, a “place of operations where the debtor carries out a nontransitory economic activity.”² Thus, one could imagine a situation in which a foreign representative might have been appointed in a country that is host to *neither* the debtor’s center of main interests (or COMI, as it has come to be called) nor any place of operations where the debtor carries out nontransitory economic activity—a letterbox company, for example.

What normally comes to mind when one thinks of an enterprise’s “center of main interests”? The question is a fair one, but the Model Law declined to comment in any great detail. There were good and practical reasons for doing so, of course, including the likelihood that no consensus would likely be reached on the point. For example, should the concept focus on management operations or on manufacturing operations? What of corporate operations spread across a number of jurisdictions? Which one is the center?³

Fortunately (at least at first blush), Chapter 15 follows the lead of the Model Law (as well as the EU Regulation) by adopting a presumption that a debtor’s registered office is the debtor’s COMI in the absence of evidence to the contrary. The House Report to Section 1516(c), where this presumption is found, explains that this presumption is included “for speed and convenience of proof where there is no serious controversy.”⁴ Yet the reality is that if there is any question regarding what a debtor’s COMI might be, and if that determination must be made before recognition can be given, then the recognition process will not be speedy or efficient.⁵

1. 11 U.S.C. § 1502(4) (2006) (emphasis added).

2. 11 U.S.C. § 1502(2) (2006).

3. See generally AM. LAW INST., TRANSNATIONAL INSOLVENCY: COOPERATION AMONG NAFTA COUNTRIES: PRINCIPLES OF COOPERATION AMONG THE NAFTA COUNTRIES, Reporters’ Note 1 (2003).

4. H.R. REP. NO. 109-31, at 1516 (2005).

5. See *In re Basis Yield Alpha Fund (Master)*, 2007 WL 4723359, at 10–11 (Bankr. S.D.N.Y. Jan. 16, 2008) (observing that when there is reason for serious dispute, the court should look past the presumption, mindful that the burden of proof remains on the party seeking recognition); see also *In re Tri-Continental Exchange, Ltd.*, 349 B.R. 627, 635 (Bankr. E.D. Cal. 2006) (discussing the role of presumptions under the Federal Rules of Evidence).

This is the point highlighted by the competing decisions of the bankruptcy court for the Southern District of New York, *SPhinX* and *Bear Stearns*.⁶ *SPhinX* pays closer attention to the purpose of the chapter, as perceived by the court from its review of the policy statements and presumptions incorporated in Sections 1501, 1508, and 1516. *Bear Stearns* attends to the structural integrity of Section 1515, in effect counseling that only in this way can the door be closed on opportunistic filings designed to subvert the cross-border insolvency regime. Reasonable persons may differ about which approach makes more sense in terms of statutory construction. They may also differ regarding how best to balance the need for efficiency against the need to minimize abuse.

In *SPhinX*, the court concluded that the structure of Chapter 15, coupled with the statute's stated purpose, demanded that the court conduct a two-step process. First, the court needs to determine whether the foreign representative should be accorded recognition. It viewed this task as nearly mechanical and found support for that approach in the statute's reference to speed and efficiency in assuring the foreign representative access to the local court. Second, if recognition is given, the court needs to determine whether the foreign proceeding is a main proceeding or a non-main proceeding. The court suggests that this task, though important, may not make that much of a difference in the long run because even a non-main proceeding may obtain substantial benefits, albeit subject to much greater discretion on the part of the court.

In *Bear Stearns*, Judge Burton Lifland, writing for the court, parts ways with his colleague, concluding that under Section 1515, the foreign proceeding *must* be either a main or a non-main proceeding as a prerequisite to recognition. Thus, it is conceivable that a foreign proceeding might fail to qualify as *either* kind of proceeding, in which case the foreign representative would not be granted recognition. The door will be closed on that representative's plea for relief under Chapter 15. In addition, the foreign representative would not be able to initiate either a voluntary or an involuntary case under Title 11 in the U.S. While agreeing that, in the usual case, recognition should be relatively simple and speedy, Judge Lifland notes that if a foreign proceeding does not qualify as either main or non-main, then it is better that the foreign representative be denied access altogether, an outcome in fact consistent with the Model Law and its attendant Guide.

From a policy point of view, it is hard to argue with Judge Lifland's analysis. Opportunistic filings in jurisdictions perceived to be friendly primarily because of their local rules, but not necessarily appropriate given the lack of any real presence in that jurisdiction, certainly look like efforts to "game" the system, and judges are rightly suspicious of such tactics. The real question, however, is whether the statute in fact gives the judge the ability to cut off such maneuverings. It appeared to Judge Drain in *SPhinX* that the statute's structure broke the process down into two steps, all but assuring the foreign representative access to the local jurisdiction (because the process for application for recognition set out in Section 1515 is procedurally simple and straightforward). Once access is granted, following this two step process, the foreign proceeding *must* be either a foreign main proceeding or a foreign non-main proceeding. Judge Lifland in *Bear Stearns* concluded that the process is unitary—that a proceeding must be either a foreign main proceeding or a foreign

6. *In re SPhinX, Ltd.*, 351 B.R. 103 (Bankr. S.D.N.Y. 2006), *aff'd*, 371 B.R. 10 (S.D.N.Y. 2007); *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, Nos. 07-12383 (BRL), 07-12384 (BRL), 2007 WL 2479483 (Bankr. S.D.N.Y. Aug. 30, 2007).

non-main proceeding in order for its foreign representative to qualify for recognition (focusing on Section 1517 for support). If a proceeding is *neither*, then under Judge Lifland’s analysis, recognition cannot be granted at all.

Commentators—especially those who were very close to the drafting and design of both the Model Law and Chapter 15—have sided with Judge Lifland’s approach.⁷ They note that both the Model Law and Chapter 15 impose a fairly rigid structure for recognition, such that a foreign proceeding—main or non-main—should only be eligible for recognition if they meet the definitional requirements spelled out in the law. The backdrop to their comments is the vigorous debate that preceded the formulation of the Model Law regarding whether the kinds of proceedings available in some countries should qualify as the sorts of insolvency proceedings that ought to be accorded recognition. Those debates of course included criticisms of some proceedings as less in the nature of a true insolvency proceeding and more in the nature of an administrative winding up of corporate affairs. They also included criticisms of proceedings in which the debtor operated with apparently unfettered freedom, without a trustee. And they included concerns about proceedings in jurisdictions in which the debtor had little more than a registered name and a letterbox.

The upshot of those vigorous debates was a series of carefully crafted compromises. As enacted by the United States in Chapter 15 of the Bankruptcy Code, those compromises included a specific definition of what constitutes a foreign proceeding, a definition of foreign representative sufficiently broad to accommodate proceedings similar to the U.S. Chapter 11 debtor-in-possession model, a simplified procedure for proving up a foreign representative’s authority to act (designed to counter the difficulties that such representatives routinely encountered in many civil law countries), and a mechanism for recognition designed to promote speed. At the same time, one compromise, designed to answer the concerns about letterbox jurisdictions, gave the court sufficient flexibility to cut off access while still preserving concerns about speedy recognition.

And here, at last, is where the competing policies of speed and preventing abuse must collide. It is a fact of judicial life that, when abuse rears its head, speed is the abuser’s friend. Ferreting out abuse invariably slows the process down because it requires consideration of evidence. The commentators noted above both realized this. The process *should* slow down when the process is serving only as a tool for abuse. Requiring a proceeding to pass muster as either a foreign main or a foreign non-main proceeding is a screen designed to protect against abuse. When it catches an abuser, the process must slow down. On the other hand, the process should not end up bogged down in frivolous disputes over recognition when there is little real cause to question the legitimacy of the proceeding. Thusly are compromises crafted, and invariably are they thrust on the courts to police the margins. It is up to the courts, then, to assure that the process is not undermined by either kind of abuser.

Which brings us full circle to the question of COMI. Under Judge Lifland’s approach, COMI becomes vitally important to the recognition process. Under Judge Drain’s approach, it becomes all but irrelevant. Chapter 15 follows the lead of the

7. See Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 BROOK. J. INT’L L. 3, 6 (2007); Daniel M. Glosband, *SPhinX Chapter 15 Opinion Misses the Mark*, 25 AM. BANKR. INST. J. 44, 45 (2007).

Model Law in deferring to a debtor's place of registration as the presumptive locus of its COMI, a compromise struck in the drafting of the Model Law. But the Model Law also incorporates a *caveat*. There might be evidence to rebut this presumption, and if there is, then the foreign representative ought to be made to demonstrate that the foreign proceeding in question *is* the debtor's COMI for reasons in addition to the place of registration. Of course, the foreign representative is free, in the alternative, to prove that the debtor has an "establishment" in that jurisdiction, a place of operations where the debtor carries out a non-transitory economic activity, though if there have been serious questions about COMI, it will likely be because the debtor does *not* have an establishment in that jurisdiction.

Thus, at the end of the day, the importance of *Bear Stearns* is not limited to Judge Lifland's analysis regarding whether the debtor in question had its COMI in the Cayman Islands. Judge Drain's approach to this issue in *SPhinX* does not differ significantly in its evaluation of the relevant factual considerations. Perhaps, as the case law develops, we will have increasingly clear determinants that practitioners can use to predict the outcome of future COMI fights. If these decisions are any indication of that development, common sense will tend to prevail over technicalities. That is a good thing. The real importance of *Bear Stearns*, however, is its appreciation of the ultimate centrality of the concept of COMI to the legitimacy of a foreign representative's access to the local jurisdiction. Better development of the factors that ought to decide COMI is all-important, given its centrality to the process. *Bear Stearns*—and *SPhinX*, for that matter—are an important start.⁸

For that, at least, this author is very glad.⁹

8. Since the original draft of this article, there have been a number of important developments. Judge Drain's decision in *SphinX* was upheld by the district court. See *In re SphinX, Ltd.*, 371 B.R. 10 (S.D.N.Y. 2007). Judge Lifland's decision in *Bear Stearns* is currently pending on appeal—ironically assigned to the same district judge who ruled on *SphinX*. Judge Robert Gerber has issued a decision in which he follows *Bear Stearns*. See *In re Basis Yield Alpha Fund (Master)*, 2007 WL 4723359 (Bankr. S.D.N.Y. 2007). In that decision, the attorneys for the foreign representative, placing the minimal amount of evidence before the court (evidently having learned from what had happened in *Bear Stearns*), moved for summary judgment, relying on the statutory presumption. Of course, no one filed any objections (though one creditor filed a "comment"). Judge Gerber denied the motion nonetheless. Here is what he had to say:

In this case, however, and significantly, none of the papers filed by the JPLs to date have addressed, in any meaningful way, any of those factors. The silence is deafening. The JPLs' conspicuous failure to try to establish, or even plead, facts supporting the existence of a main proceeding, even after the Citigroup submission and the Court's own questions in this regard, makes any reasonable observer wonder why. As importantly or more so, the failure of Citigroup ultimately to file an objection does not make the issues Citigroup noted go away—and, as noted, the issues were obvious in any event.

Id. at 7. If Judge Drain's approach in *SphinX* is correct, then it was error to deny the motion. If Judge Lifland's approach in *Bear Stearns* is correct, then it is at least arguable that Judge Gerber did the right thing.

One other interesting thing to note is that, under Cayman Islands law, in essence, an entity that is registered as an exempted company is free from local taxation—but is also prohibited from carrying on its business on the Islands. See Cayman Companies Law § 193. This was one piece of evidence that Judge Gerber said justified his denying the motion for summary judgment. It is also evidence that suggests that the entity in question could not qualify as either a foreign main or a foreign non-main proceeding within the meaning of Chapter 15.

9. In the interests of full disclosure, the author is the source of Reporters' Note 1 in the ALI guide.