Olympic Airlines: A first step to tighter controls in secondary insolvency proceedings?

KEY POINTS

- The definition of "establishment" applies to all kinds of secondary insolvency proceedings.
- Whether a company has an "establishment" for the purposes of the Insolvency Regulation has to be answered at the point at which the jurisdiction of the insolvency court is invoked.
- The *Olympic Airlines* decision may be seen as a first step to tighter controls in relation to secondary insolvency proceedings.

Under EU law, where the centre of a debtor's main interests is situated within the territory of a member state, the courts of another member state shall have jurisdiction to open secondary insolvency proceedings against that debtor, only if he possesses an "establishment" within the territory of that member state. Under Council Regulation EC 1346/2000 on Insolvency Proceedings (Insolvency Regulation), an establishment means any place of operations where the debtor carries out a non-transitory economic activity with human means and goods.

The recent Court of Appeal decision in *Trustees of Olympic Airlines SA Pension & Life Assurance Scheme v Olympic Airlines SA* [2013] EWCA Civ 643, considered what constitutes an "establishment" for the purposes of the Insolvency Regulation.

The appellant, Olympic Airlines (the Airline), was a Greek state-owned airline, which commenced operations in Greece in 2003. It carried on business in England from a head office in Conduit Street, London, which it leased from an associate company. It also had premises at Heathrow and Manchester Airports and employed about 27 employees in England. Most of those employees were members of the Airline's pension and life assurance scheme (the scheme).

TIMELINE OF EVENTS

- On 2 October 2009, following the decision of the European Commission that the Airline had received illegal state aid from the Greek state, it entered "special" liquidation in Greece. This constituted "main proceedings" for the purpose of the Insolvency Regulation.
- In November 2009 the ticket office at Heathrow was closed.
- On 24 March 2010, the Greek liquidator ordered the disposal of the Airline's assets at its branches outside Greece.
- In May 2010, the premises in Manchester were vacated and their contents moved to the Conduit Street office.
- On 24 June 2010, the bank manager reported to the English branch's financial and planning manager that he had insufficient funds to pay the Airline's English employees under the BACS payroll mechanism.
- On 29 June 2010, all standing orders and direct debits from the English branch were cancelled.
- On 2 July 2010, the Greek liquidator wrote to the Airline's employees in England terminating their employment from 14 July 2010. Final salary payments to English employees down to 14 July 2010 were funded by a remittance from the Greek liquidator. The English branch's financial and planning manager and former general manager were both retained on short term contracts which continued after 14 July 2010.
- The retained managers paid suppliers and utility bills, reconciled bank statements, copied and sent relevant documents and records to the liquidator in Athens and dealt with other instructions or requests from the liquidator.
- The trustees of the scheme presented a petition to wind up the Airline in England on 20 July 2010, to trigger entry of the scheme into the UK Pension Protection Fund.

The High Court held that it had jurisdiction to issue a winding up order on the trustees petition, on the basis that the Airline had an establishment in England on 20 July 2010 within the meaning of the Insolvency Regulation. The Airline appealed that decision on the basis that the Insolvency Regulation's definition of establishment required more than the High Court's findings allowed and required some more than transitory economic activity which was external and market facing. It argued that the desultory running down of a business, such as might have been indicated by the High Court's findings, did not count. The Court of Appeal allowed the appeal.

THE COURT OF APPEAL DECISION

It was common ground that the relevant time for considering whether the Airline had an establishment in England was 20 July 2010, the date the petition was presented by the trustees. It was also common ground that the Greek proceedings constituted main proceedings for the purposes of the Insolvency Regulation. The outcome, therefore, rested on the Court of Appeal's interpretation of "establishment", within the meaning of the Insolvency Regulation.

Meaning of establishment

The Court of Appeal began by examining the relationship between the Insolvency Regulation, the Model Law and the *Virgós-Schmit* Report (the *Virgós-Schmit* Report)

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on the European Convention on Insolvency Proceedings (the Convention), which preceded both the Insolvency Regulation and the Model Law. Though never adopted, Sir Andrew Morritt C in *In re Stanford International Bank Ltd* [2011] Ch 33, cited the *Virgós-Schmit* Report as an authoritative commentary on the Convention and the subsequent Insolvency Regulation derived from it.

The *Virgós-Schmit* Report states [at 71]:

> "For the Convention on insolvency proceedings, 'establishment' is understood to mean a place of operations through which the debtor carries out an economic activity on a non-transitory basis, and where he uses human resources and goods.
> Place of operations means a place from which economic activities are exercised on the market (ie, externally), whether the said activities are commercial, industrial or professional.
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> The emphasis on an economic activity having to be carried out using human resources shows the need for a minimum level of organization.
> A purely occasional place of operations cannot be classified as an 'establishment'. A certain stability is required. The negative formula ('non-transitory') aims to avoid minimum time requirements. The decisive factor is how the activity appears externally, and not the intention of the debtor.
> The rationale behind the rule is that economic operators conducting their economic activities through a local establishment should be subject to the same rules as national economic operators as long as they are both operating in the same market."

The Court of Appeal found the observation regarding place of operations of particular relevance to the appeal and concluded that the High Court had erred in overlooking the *Virgós-Schmit* Report as an authoritative commentary on the Insolvency Regulation, as well as in failing to take into account that the Insolvency Regulation is concerned with insolvency proceedings of all kinds. In this regard, the Court of Appeal observed that Art 3(3) of the Insolvency Regulation states that secondary proceedings, which follow the main proceedings elsewhere, "must be winding up proceedings" and decided it follows that secondary proceedings that precede the opening of main proceedings may be insolvency proceedings of any kind. Therefore, the definition of "establishment" applies to all kinds of secondary insolvency proceedings, under which the debtor company may seek to trade out of its difficulties.

The Court of Appeal concluded that in such cases it is simply not the case that the Insolvency Regulation contemplates that a debtor company in secondary proceedings cannot be a trading company in liquidation, with outward facing market activity. Moreover, the Court of Appeal stated that even a debtor company in liquidation may continue to trade for a while, for instance as a means of liquidating its stock and in any case, the question is not so much what the debtor company does in the period after the commencement of insolvency proceedings, but in the period immediately leading up to the commencement of such proceedings, as the issue of whether or not a company has an "establishment" for the purposes of the Insolvency Regulation, has to be answered at the point at which the jurisdiction of the insolvency court is invoked.

The Court of Appeal said that if an establishment could be provided by the desultory winding up of any business with a former "place of operations", as long as the location of such has, at the critical date, not yet been disposed of and some "human means" of activity is involved, and as long as some assets survive, perhaps no more than the worthless detritus of a defunct operation, then there would hardly ever be secondary proceedings which did not come within the definition: which is plainly not intended to be the case.

The Court of Appeal also considered the decision of Mann J in *Re Office Metro Ltd* [2012] EWHC 1191 (Ch), as the facts of that case were essentially the same. Mann J held in *Re Office Metro Ltd* that there was a "place of operations", namely a Chertsey office, and there was also some activity by "human means"; however, there was nothing which amounted to economic activity within the meaning of the Insolvency Regulation. Mann J said that at the time of the petition, the only "activity" was to sit there being liable for guarantees, sometimes paying out on them, and perhaps doing whatever else was necessary to keep itself alive in terms of compliance with formalities such as company filings. Mann J concluded that being in a state of liability, with the need sometimes to pay out on that liability and take a bit of advice, is not an economic activity for the purposes of the Insolvency Regulation.

For all these reasons, the Court of Appeal had no difficulty in giving to the Insolvency Regulation's definition of "establishment" a meaning which required more to its "economic activity" than the mere process of winding up. The Court of Appeal said the definition is clearly intended to lay down a rule that the mere presence of an office or branch, a "place" at which the debtor is located, is not sufficient. It has to be a "place of operations": human and physical resources have to be involved in those operations; and there has to be "economic activity" involving those resources.

Applying the *Virgós-Schmit* Report and jurisprudence to the facts of the case, the Court of Appeal could see no possible alternative to concluding that the definition of "establishment", as required by the Insolvency Regulation, had not been fulfilled at the critical date of 20 July 2010 and, therefore, there was no jurisdiction as of that date for the trustees of the scheme to commence secondary insolvency proceedings in England.

CONCLUSION

The Court of Appeal noted its regret that its conclusion would leave the beneficiaries of the scheme unprotected under the Pension Protection Fund and the decision will be an unwelcome one for UK final salary pension schemes of overseas companies, which need to trigger English insolvency processes to enter the Pension Protection Fund. The decision also demonstrates the importance of early presentation of a winding up petition where the entity in question is the subject of main insolvency proceedings in another member state. ■