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Insolvency Forum Shopping

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What is 'insolvency forum shopping'?

Insolvency forum shopping, also known as 'forum shopping' or 'bankruptcy tourism', refers to the situation where an insolvent company or individual relocates to another jurisdiction, or seeks access to the law of a jurisdiction other than their own, in order to allow them to access insolvency and restructuring processes there.

There may be a variety of reasons why an individual or company may choose to use insolvency processes in the UK rather than in their home countries. A company may, for example, genuinely relocate to the UK in order to use UK insolvency or restructuring processes which, in instances where the company can restructure, give it the best chance of surviving as a going concern, thereby saving jobs and ensuring an ongoing contribution to the economy. On the other hand, if the company is insolvent, relocating to the UK may enable it to undertake an insolvency process which will unwind its affairs in a fair and structured way, ensuring the maximum possible returns to that company's creditors.

Individuals may also choose to relocate to the UK in order to declare themselves bankrupt. As with companies, this can be for a variety of reasons, including the fact that their home jurisdictions may have less beneficial or accessible personal insolvency regimes or, for example, there is no real insolvency regime in that country which would enable the individual to deal with their debts within a structured, uniform and highly regulated process, such as that available in the UK.

Is 'bankruptcy tourism' or 'forum shopping' permissible?

There is nothing unlawful about insolvency forum shopping in itself; its merits or otherwise will depend on the circumstances of the individual case. The main question is whether it is a purely opportunistic and self-serving attempt by the company or the individual to avoid their domestic insolvency regime with no perceptible benefit to their creditors, or whether it serves a legitimate purpose of taking advantage of another jurisdiction to achieve a better outcome for creditors than would be possible under domestic insolvency law. In the case of the latter, there must also be a sound legal base for the foreign courts to assume jurisdiction.

The UK courts have recognised that there can be 'good' and 'bad' forum shopping, and are prepared to permit forum shopping provided that it is legitimate and beneficial.

Jurisdiction to start insolvency proceedings

The law governing the jurisdiction where an individual or company can start insolvency proceedings is complex, and depends on a number of factors. In the case of the UK, there are three possible sets of circumstances in which the question of forum shopping might arise:

- The individual or company is based in another EU country which is subject to the European Regulation on Insolvency Proceedings ('the Regulation'). In this case, jurisdiction will depend on the provisions of the Regulation.
- The individual or company is based in another country which is not a party to the Regulation. In this case, jurisdiction will depend on the provisions of UK legislation and case law developed by the UK courts.
- A company based outside the UK seeks to restructure without using a formal insolvency process by making use of a scheme of arrangement under UK companies legislation. In this case, jurisdiction will depend on the provisions of UK legislation and case law developed by the UK courts.

1. The European Regulation on Insolvency Proceedings – the individual or company is based in an EU country subject to the Regulation

'Forum shopping' is permissible under European law. The Regulation, which applies to all EU member states, is intended to improve coordination and cooperation in cross-border insolvencies, where companies or individuals may have operations or assets in one or more member states.

Whilst the Regulation established common rules on deciding which court the insolvency proceedings should be started in, which country's law would apply to those proceedings and mutual recognition of courts' decisions across the EU, it is important to note that it did not harmonise the insolvency law of member states, which vary in many ways from state to state.

In order to determine whether an individual or company may start insolvency proceedings in a particular country, the court must ultimately decide in which country the individual or company has their 'centre of main interests' ('COMI'). Under Article 3 of the Regulation, it is the courts of the member state in which either the company or the individual has their COMI that have jurisdiction to start insolvency proceedings.

In the case of a company, the location of its registered office is presumed to be the COMI, from which the company is presumed to administer its commercial and professional activities, unless it can be shown to be elsewhere. In the case of individuals, the COMI is likely to be the country in which they live as this is where they are likely to run their financial affairs or, in the case of professional people, the COMI may be their main place of business, if they are carrying on business in their own right.

'COMI' and relocating to the UK

A company's or individual's COMI is not fixed – both a company and an individual can move their COMI depending on their circumstances. This is consistent with the central principle of the European Union – free movement of people, goods and services.

If a foreign company or individual wishes to start insolvency proceedings in the UK, the company's or individual's COMI in the UK forms the basis of the UK court's jurisdiction to make a winding-up order in relation to a company or a bankruptcy order in respect of an individual. The UK court would therefore need to make a decision on where the COMI is based on the facts of the case – it is not a matter of discretion for the court.

Fundamental to the decision on COMI is the fact that the court must be satisfied, and it can be proved, that the company or individual has genuinely relocated to the UK. This requirement helps to prevent abuse of the UK's insolvency processes. By way of example, in the case of individuals, the court may request that they supply bank statements, utility bills, payslips and a tenancy agreement or other evidence of a place of residence in the UK for a specified period of time leading up to the date of the court hearing. This is to demonstrate to the court that the individual genuinely lives and works in the UK. The court must therefore be satisfied that the relocation is not merely an 'illusion' to enable the company or individual to circumvent less favourable laws in their home country.

If the company or individual cannot produce sufficient evidence to satisfy the UK court that their COMI is based in the UK, their application to start insolvency proceedings will be refused on the basis that the move to the UK is not a genuine relocation. The courts have emphasised that COMI should be identified by means of objective factors that are identifiable by third parties.

Robust judicial processes therefore exist to enable a high level of scrutiny by the courts in order to ensure that only companies or individuals who have genuinely relocated their business or home to the UK are able to benefit from the UK's insolvency regime.

2. Where the Regulation does not apply – the individual or company is based in a country which is not covered by the Regulation

In cases where jurisdiction is not determined by the Regulation (i.e. where the individual or company is based outside of those countries covered by the Regulation), it will depend on domestic law and the principles developed by the courts.

Personal insolvency

Under English bankruptcy law, an individual can be declared bankrupt in England and Wales if they –

- are domiciled in England and Wales; or
- are personally present in England and Wales on the day on which the bankruptcy petition is presented; or
- have carried on business or been resident in England and Wales in the preceding three years.

The law therefore allows an individual to present their own bankruptcy petition even if they are not based in England and Wales, or are present only very briefly, and their centre of main interests is elsewhere.

These provisions are subject to the discretion of the court to refuse to make a bankruptcy order if there is some impropriety in the individual's application, or an order would serve no practical purpose.

Case studies

1) A UK citizen who lived and carried on his business activities primarily in the United States was made bankrupt on his own petition presented in the English court, and an English Insolvency Practitioner was appointed as his Trustee in bankruptcy, even though his COMI was not in the UK (a fact later confirmed by the US court).
2) A prominent Russian businessman who fell into financial difficulties, largely as a result of guarantees given in relation to debts incurred by his various businesses. He lived in Russia, but travelled to England for four days, during which time he presented his own bankruptcy petition. The court made the bankruptcy order, and refused to annul it on a subsequent application, on the grounds that:
    - The fact that his visit to England was only fleeting did not fetter the court's jurisdiction.
    - There was no personal bankruptcy regime in Russia which could have provided an alternative vehicle for dealing with the insolvency.
    - The individual had assets outside Russia which could be dealt with in the English bankruptcy in an orderly manner, avoiding the otherwise inevitable disorderly 'asset grab' by competing creditors.
    - Some of the individual's guarantee obligations were expressly subject to English law.
    - There was no suggestion that the bankruptcy was sought for an improper purpose.
    - The English bankruptcy enabled thorough investigation of the individual's affairs by the Trustee in bankruptcy.
    - The English bankruptcy was unlikely to be recognised in Russia, and was therefore not prejudicial to the creditors there.

Corporate insolvency

The UK courts may also wind up a foreign company as an unregistered company, but in order to do so the court must be satisfied that there is sufficient connection with the UK.

Sufficient connection may be indicated by the presence of assets or commercial dealings within the UK, and there must be some benefit from the making of the winding-up order. The need for investigation of the company's affairs by an Insolvency Practitioner acting in their capacity as liquidator of the company may also be a relevant factor.

3. Schemes of arrangement outside formal insolvency – a company based outside the UK seeks to restructure using UK companies legislation

Part 26 of the Companies Act 2006 provides a mechanism for company arrangements and reconstructions with the sanction of the court. The Part 26 procedure enables a company to make a compromise or arrangement with its members or creditors. These are generally referred to as 'schemes'.

Most schemes are used in circumstances that have nothing to do with insolvency, such as reconstructions of share capital, or to give effect to takeovers. However, schemes can also be used to restructure financially distressed companies, including a reconstruction of a company's debts.

A recent development has been an extension of schemes to non-UK companies. Companies Act schemes are not covered by the provisions of the European Regulation, so the problems presented by a company having its COMI in another EU member state do not arise. However, as in the case of winding up, the UK court must be satisfied that it has jurisdiction to sanction a scheme in relation to a foreign company, and it must also be persuaded that the scheme is reasonably likely to achieve its purpose.

Examples of schemes which have been sanctioned by the UK courts in relation to foreign companies are:

- An Indonesian company which entered into a scheme under English and Singaporean law because there was no equivalent mechanism available under Indonesian law, and the creditors were overwhelmingly in favour.
- In two separate cases, companies based in Germany, where the relevant loan agreements were expressly subject to English law. This provided sufficient connection with the jurisdiction.
- A company based in the Netherlands which was part of a group operating in Hungary. Its COMI had been moved to England before the application, and this meant that, although the company was not in liquidation, any insolvency proceedings which might be started would be subject to English law, and the sufficient connection test was therefore satisfied. The relevant debts affected by the scheme were subject to New York law, and the scheme was recognised by the New York courts. This was important in establishing that it would achieve its intended effect.
- Dutch and Belgian companies where the relevant loan facilities were governed by English law and subject to the exclusive jurisdiction of the English court. This was sufficient to give the English court jurisdiction to sanction the scheme.
- A French company which was part of a Polish group. The debts concerned were subject to New York law. The company wanted to avoid restructuring in France or New York, and moved its centre of operations to London in order to establish its COMI there. It was held that the move to London was sufficient to give the English court jurisdiction. Although the European Regulation did not apply and COMI was therefore not relevant for that purpose, the move of COMI to London was significant for the purposes of obtaining recognition of the scheme by the New York court, which was a crucial factor in establishing that the scheme would achieve its desired effect.

The principles adopted by the courts

In the case of the Russian individual referred to previously, the judge summarised the principles which the courts will adopt when considering an application to start insolvency proceedings by a foreign company or individual:

- The courts will act to fill gaps in foreign jurisdictions when it is proper to do so.
- The existence of insolvency proceedings in another jurisdiction is a relevant consideration, but is not a bar to making an order.
- In determining whether there is a sufficient connection with the jurisdiction, the real test is the existence of some commercial subject-matter on which the process can operate. The presence of assets or claims in the jurisdiction may be, but is not necessarily, a factor.
- There is a need to show some benefit – the court will not make an order which will be of no effect or which will serve no purpose.
- The presence of debts and the individual in the jurisdiction may be a consideration.
- Submission to the jurisdiction appears to be relevant.
- The need for investigation is also a relevant factor.
- The rehabilitation of the individual or preservation of something for their benefit may be taken into account.

The UK insolvency profession's view

There has been significant debate about the desirability of forum shopping and the relocation of companies and individuals to the UK jurisdiction in order to use insolvency processes which may be viewed as more lenient than insolvency laws in other countries. Reference is made to the fact that the UK, for example, has a bankruptcy period of 12 months, compared to longer periods of bankruptcy in Germany (seven years) and Ireland (three years), which appear, at least on the surface, to be harsher regimes for indebted individuals.

R3 believes that the fact that companies and individual debtors prefer to use the insolvency procedures in the UK rather than elsewhere tells us something about the perception of the UK insolvency regime as a world leading regime, as demonstrated by World Bank data[1].

R3 further believes that there is nothing inherently objectionable about companies having a choice over where to restructure, or individuals having a choice about where to deal with their debt problems; rather the choice to relocate to the UK, or to use UK procedures, in order to resolve a company's or individual's insolvency demonstrates the effectiveness of the UK's insolvency regime and the competence of the UK's Insolvency Practitioners in delivering restructuring, rescue and insolvency solutions for companies and indebted individuals alike.

R3 does, however, recognise that the ability of companies and individuals to access UK procedures must be balanced against cases where there may be an abuse of process, such as instances where a relocation of COMI takes place immediately prior to the winding up or bankruptcy petition in order to create an 'illusion' of a relocation merely to allow the company or individual to circumvent laws or creditors in their home country.

R3 believes that the UK courts have robust processes and evidential requirements in place to ensure that such abuses are minimised and supports the courts' consistent scrutiny of winding up and bankruptcy petitions presented by foreign companies and individuals.

1 http://www.doingbusiness.org/data/exploretopics/resolving-insolvency

Standard three year term of bankruptcy

In March 2014, the European Commission issued a report on a 'new approach to business failure and insolvency'[2] which, amongst other recommendations for the harmonisation of insolvency procedures across EU countries, suggested that there should be a standard bankruptcy term of three years across all member states. The Commission believes that such harmonisation of bankruptcy terms across the member states would encourage entrepreneurs and support them in starting again after a business or personal financial failure, albeit it is recognised that the same discharge period may not be appropriate in all circumstances, including those where the individual has acted dishonestly or in bad faith.

R3 has long held the view that the bankruptcy term in England and Wales needs to be reviewed and suggests that the term should return to three years, as it was prior to 2004. The term was reduced to 12 months on the grounds that doing so could help to promote entrepreneurship by allowing entrepreneurs whose initial business ventures had failed to be swiftly rehabilitated and in a position to try again. Whilst it is unclear what effect this has had on entrepreneurship, the number of trading-related bankruptcies as a proportion of overall bankruptcy case numbers has fallen significantly since 2004.

According to Insolvency Service statistics, in 2002, bankruptcies associated with trading or self-employed individuals accounted for just over 36% of all bankruptcies during the year, totalling 8,854 compared to 15,438 other bankruptcies. By 2007, three years after the Enterprise Act was introduced, the number of trading-related bankruptcies accounted for only 10.9% of all bankruptcies (a total of 7,058 compared to 57,422 other bankruptcies).

Even though the figures for 2011 and 2013 show a slight increase in the percentage of trading or self-employed individuals going bankrupt, (accounting for 21% and 25% respectively of all bankruptcies in those years), this is due to the decline in the number of consumer bankruptcies in recent years. As with previous years, it remains the case that the vast majority of bankruptcy cases continue to be consumer bankruptcies, (for 2011, 8,893 trading-related bankruptcies compared to 32,983 consumed-related bankruptcies and for 2013, 5,999 trading-related compared to 18,572 consumer-related bankruptcies) for which no attempt was made to justify a reduction in the original three year term.

R3 believes that revising the standard term of bankruptcy in England and Wales back to three years would restore the balance between debtors and creditors to the situation before 2004, on the basis that the vast majority of bankruptcies continue to be amongst consumers.

Summary

- **R3 believes that there is nothing inherently objectionable about companies having a choice over which country to restructure in or individuals having a choice about where to deal with their debt problems.**
- **The choice of the UK jurisdiction as a place in which to deal with a company's or individual's insolvency demonstrates the effectiveness of the UK's insolvency professionals and the UK's position as a world class insolvency regime.**
- **R3 welcomes the UK courts' scrutiny of cases where foreign companies or individuals seek to utilise UK insolvency processes in order to prevent abuses of process and supports the courts' consistent approach to, and reasoned decisions on, such cases.**
- **R3 believes that the standard term of bankruptcy in England and Wales should return to three years in line with the European Commission's recommendation of harmonisation of bankruptcy terms across member states.**

About R3:

R3, the insolvency trade body, represents the UK's insolvency practitioners. R3's full members are all regulated by their recognised professional bodies, they can be licensed insolvency practitioners, solicitors, chartered accountants or certified accountants. They have extensive experience of helping businesses and individuals in financial distress.

2 European Commission – Commission Recommendation of 12.03.14 on a new approach to business failure and insolvency, Brussels 12.03.14 C(2014) 1500 final