

CORPORATE MIGRATION IN CROSS-BORDER BANKRUPTCY

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Abstract

The article deals with cases of changing the national identity of an entity in order to choose a more favorable jurisdiction for conducting the bankruptcy procedure when it affects the rights and interests of parties from different countries. As a rule, cross-border insolvency is more associated with the insolvency of companies that operate in more than one country, rather than with the bankruptcy of individuals. Ideally, a country should be identified as the most appropriate jurisdiction to conduct the proceedings, and all other states will cooperate in such procedures and facilitate them (taking into account the limitations of public policy).

The legal regulation of the European Union and the USA, representing the most striking examples of legal instruments that allow to select the forum shopping for cross-border bankruptcy was chosen as the basis for this research. However, this freedom of choice affords grounds to individual countries to abuse the law. The problem of abuse of the right to choose the jurisdiction within the framework of the forum shopping requires analysis on various criteria. It is required to find the balance of protection of interests of creditors and interests of the debtor in corporate migration in cross-border bankruptcy. The analysis of the revealed advantages and shortcomings in the implementation of the considered legal norms in practice will make it possible to distinguish the main international legal trends in the formation of legal regimes for recognising foreign bankruptcies in the context of the choice of convenient jurisdiction.

In the article, the authors provide examples from normative acts of various states, as well as international legal acts, examples from law enforcement practice. On the basis of the identified issues, ways of overcoming these problems are being suggested.

The outcomes of the article may be useful for lawyer students, practising lawyers as well as legislators.

Keywords: bankruptcy procedure, law enforcement practice, cross-border insolvency, forum shopping

1. INTRODUCTION

The economic processes taking place at the present stage of cross-border trade turnover development give rise to new goals for research in the field of private international law.

In the case when the debtor has assets in several states or when the debtor's creditors have other creditors

from a state other than the one in which the insolvency proceedings are being held, then this is **cross-border insolvency**.

Based on judicial practice, problem cases of cross-border bankruptcy can be modelled on the example of a debtor carrying out economic activities in another jurisdiction outside the concentration of his finances and (or) creditors.

In recent years, many international legal instruments have been modelled, including provisions for regulating cross-border bankruptcy. However, in the absence of a single universal (global) international agreement, national law continues to play a significant role in the legal regulation of cross-border insolvency.

The development of private international law has shown the effectiveness of using model laws in order to unify or harmonise national legislation. The number of states that have passed laws on cross-border insolvency on the basis of the UNCITRAL Model Law is approaching fifty (Status (2018): UNCITRAL Model Law on Cross-Border Insolvency (1997)). In Russia, steps have recently been taken towards the legal regulation of the specifics of cross-border bankruptcy.

In the European Union, the work on the unification of legal norms in the field of cross-border insolvency was completed in 2000 with the development of the Bankruptcy Procedure N 1346/2000. This document has now become invalid due to the adoption of a new REGULATION (EU) No. 2015/848 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON INSOLVENCY PROCEEDINGS.

However, bankruptcy procedures in different countries have peculiarities that give rise to preferences for the debtor or creditor. Therefore, a change of jurisdiction to which the bankruptcy proceedings will be subject to may be decisive for legal and financial consequences.

Nevertheless, in order to eliminate the abuse of the right to choose the bankruptcy jurisdiction, the possibility of changing jurisdiction through an entrepreneur's independent actions, whose business is threatened by insolvency, by the so-called corporate migration, when artificially changing the center of the main interests of a future debtor (for example, registering it in another country) is limited by the legislator.

Thus, in paragraph (5) and (29) of the Preamble of Regulation N 2015/848, the purpose is stated as follows: ...<i>s necessary for the proper functioning of the internal market to avoid incentives for parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position to the detriment of the general body of creditors (forum shopping). This Regulation should contain a number of safeguards aimed at preventing fraudulent or abusive forum shopping.

Measures to limit forum shopping in cross-border bankruptcy are also regularly taken in the United States, as evidenced by the draft to the current regulation amended in 2018 to the Parliament.

2. METHODOLOGY

The authors note that the present research has been conducted and prepared specifically for students for educational purposes. The information is presented in the most accessible form, systematised to study at a law school, preparing for classes, making reports, as well as writing theses when receiving a higher level of education in Master's program and postgraduate studies. In modern social and economic conditions, the educational environment should be developed, erasing borders between countries in the academic environment, as indicated by lawyers in such works as Dudin M., Ivashchenko N., Frolova E., Abashidze A. (2017), Dudin M., Frolova E., Protopopova O., Artemieva Ju., Abashidze A. (2016), Dudin M., Frolova E., Kovalev S., Ermakova E., Kirsanov A. (2017).

General information on cross-border insolvency can be found in the works of such authors as Aaron M. Kaufman (2015), Bob Wessels (2004), Edward Adams and Jason Fincke (2007), Jared A. Ellias (2018), Lynn M. LoPucki (2000) , Samuel L. Bufford (2007) and others, who pay particular attention to the determination of jurisdiction in cases of cross-border bankruptcy, including the law of individual states, as well as the European Union.

The authors also used research, comments, practical guidelines and reports prepared by international organisations and law firms, in particular, the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (2010), UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective (Updated 2013), Greenhalgh Kerr. Their analysis allows us to draw up a consolidated opinion of legal practitioners regarding the advantages and disadvantages of determining the competent court for cross-border bankruptcy proceedings, as well as the choice of a convenient jurisdiction.

3. RESULTS

3.1. Jurisdiction Of Cross-Border Insolvency: Content And Theory

The development of cross-border trade and investment activities globally scale is increasingly leading to a situation when legal entities and individuals have assets in more than one state.

In the case when the debtor has assets in several states or when the debtor's creditors are from a state other than the one in which the insolvency proceedings are carried out, this is the so-called **cross-border insolvency**.

Currently, the number of cross-border bankruptcies is growing. Their international component, as a rule, can manifest itself in the following situations:

- the assets of the debtor are under the jurisdiction of a state other than where the bankruptcy proceedings are being conducted (the presence of a foreign element in the form of an object abroad);
- the debtor and its creditors or one of the creditors are foreign subjects concerning each other (presence of a foreign entity).

One of the critical issues of cross-border insolvency is to determine the competent court against the debtor. There are two models of regulation in this area of relations. **The theory of universalism (single production)** proceeds from the fact that all the main procedures and main procedural actions must take place in one state. **The theory of multiplicity of production** involves the implementation of independent territorial parallel production in several countries. The ideas, underlying these concepts are embodied both in the national legislation of individual countries and in international acts, covering the definition of court competence and other issues of cross-border insolvency.

It should be noted that problems may arise in the simultaneous handling of bankruptcy cases by courts of different countries - the so-called parallel proceedings.

For example, in the ISA-Daisytek case, parallel insolvency proceedings commenced in England and Germany. The decision of the English court that the English proceedings were the main proceeding pursuant to the EC Regulation was challenged and not recognised for over one year in Germany. As a result, there had been uncertainty as to the respective status and powers and responsibilities of the English and German insolvency representatives. After the German courts recognised the English proceeding as the main proceeding, the German and English insolvency representatives developed a "cooperation and compromise agreement" in order to resolve all outstanding issues between them and to deal with future steps in the insolvency proceedings. (UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation, 2010, p. 122)

One striking example is the insolvency proceedings of Lehman Brothers when about 75 separate and independent bankruptcy proceedings were instituted in 16 legal systems. Before the commencement of production, Lehman Brothers was one of the world's largest transnational companies with subsidiaries worldwide. Parallel bankruptcy proceedings are also known for Stonington Partners, several companies of the Swissair Group (Schweizerische Luftverkehr AG) (UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation, 2010, p. 31, 100, 123, 138), and others.

Parallel bankruptcies create legal and financial problems for both creditors and debtors. One of the trends of recent years in the field of cross-border bankruptcy can be called the development of legal regulation in order to exclude parallel production and at the same time achieve the most favourable consequences during the bankruptcy procedure for all subjects.

3.1. Determination Of Jurisdiction In Cross-Border Insolvency

At present, depending on the criteria underlying the establishment of court jurisdiction, international acts and national legislation reinforce the concepts of **primary and secondary proceedings**. Along with the place of registration of the debtor for determining the international jurisdiction, there are other criteria, such as the location of the main property of the debtor, the location of the central part of the debtor's creditors, the location of the debtor's production resources, and others.

Progressive legal regulation leads to the fact that the **main proceedings** should be carried out in the state where the centre of the main interests of the debtor is located, and **the non-main proceedings** - in the state in which the debtor's enterprise is located (Article 2 (b) (c) of The UNCITRAL Model Law, Article 3 of the EU Regulation N 2015/848). Along with the place of registration of the debtor for determining the international jurisdiction, there are other criteria, such as the location of the main property of the debtor, the

location of the central part of the debtor's creditors, the location of the debtor's production resources, and others.

Despite the attempts to reform Russian legislation (the draft law on the basis of the UNCITRAL Model Law has never been adopted), insolvency proceedings in the Russian court can only be instituted against persons incorporated in the Russian Federation. The absence in the Russian Federation of modern legal instruments for initiating insolvency proceedings in respect of companies incorporated abroad leaves Russia outside the sphere of regulating bankruptcies of cross-border business.

3.2. Forum Shopping In Cross-Border Bankruptcy

In many countries, the classification of liquidation rules due to insolvency has been formed over a long period, which is the reason why different countries choose different ways to implement the protection of parties' interests (Samuel L. Bufford, 2007, p.28).

According to Greenhalgh Kerr, whilst bankruptcy in the UK still carries severe implications for any debtor, the UK's bankruptcy provisions are relatively benign when compared with those of other EU member states, with some going so far as to label the UK a "bankruptcy paradise". The peculiarity of it is the fact that most bankrupts in the UK are discharged after 12 months, whereas in Germany for example, discharge from bankruptcy can take nine years. In Ireland, the discharge has historically taken up to a staggering 12 years, although it is intended that this will shortly be reduced to 3 years.

"As a result, there is a strong temptation for foreign debtors, when facing insolvency, to arrange their affairs in order to submit to the jurisdiction of the UK. This is, however, an issue which the Courts, the Insolvency Service, and creditors, are now well versed in". (Greenhalgh Kerr, 2018).

The most significant differences become visible when the question arises about the role of creditors and the court. French judicial authorities create special procedures in order to avoid the loss of an efficient firm and in order to maintain employment. The participation of creditors is minimal in the implementation of the bankruptcy procedure, and, as practice shows, they usually give advice. In support of these words, it is worth noting that the development of a reorganisation plan for a company does not at all require the approval of creditors. According to the English tradition, creditors can control the fate of the debtor's property, especially when it is secured creditors, and they hold the distribution of short-term government loans. The golden mean has been found in Germany: the court can take various actions concerning the debtor, while creditors also participate in controlling the bankruptcy procedure, and their confirmation is obligatory at all stages of restructuring. The varieties among legal orders prompted the emergence of the generally accepted La Porta creditors' rights assessment scale, where the state receives points ranging from 0 in France, 3 in Germany and 4 in English jurisdiction. (Bob Wessels, 2004, p. 32)

Each jurisdiction has its specifics, and with this in mind, one needs to understand that the debtor does not always want to change the centre of fundamental interests, which can entail great financial turmoil. Moreover, in the context of the consideration of this problem, one needs to understand what exactly motivates the debtor to move the centre of fundamental interests?

Forum shopping is the choice of a convenient court, a practice adopted by some participants in the process of considering their court case in a court that will most likely make the most favourable decision. For the choice of a convenient court, rules of law are used that fix the rules of jurisdiction, as well as alternative jurisdiction, if possible. For example, some jurisdictions have become known as "favourable to the "claimant," and therefore have been used even in cases where there is almost no connection between the legal issues and the jurisdiction in which they should be considered. (Edward Adams and Jason Fincke, 2007, p. 11)

3.1.1 Restriction of Forum Shopping In Cross-Border Bankruptcy

In the case of cross-border bankruptcy, forum shopping means not only the search for jurisdiction with the most favourable conditions. The implementation of the right of forum shopping is essential in order the choice of jurisdiction be made as part of a restructuring or bankruptcy procedure and meets the law-enforcement standards of the chosen state. (Aaron M. Kaufman, 2015)

In practice, all litigations can be classified as:

- forum shopping within the group of companies;
- real migration from one legal order to another.

The unfavourable trends of forum shopping coincide with the attempts already made by national legislators

and courts to find ways to restrict migration before starting a bankruptcy procedure. For example, in France, the law rejects a change in the centre of core interests that occurred less than six months prior an application for bankruptcy was filed. (Lynn M. LoPucki, 2000).

Paragraph (30) of the EU Regulation indicates that “with the same objective of preventing fraudulent or abusive forum shopping, the presumption that the centre of main interests is at the place of the registered office, at the individual's principal place of business or the individual's habitual residence should not apply where, respectively, in the case of a company, legal person or individual exercising an independent business or professional activity, the debtor has relocated its registered office or principal place of business to another Member State within the 3-month period prior to the request for opening insolvency proceedings, or, in the case of an individual not exercising an independent business or professional activity, the debtor has relocated his habitual residence to another Member State within the 6-month period prior to the request for opening insolvency proceedings.

In large US bankruptcy cases, for several decades already the majority of publicly traded companies that filed for bankruptcy did so in the bankruptcy courts of the State of Delaware and the Southern District of New York. Over 40 per cent of these companies filed in Delaware as their venue of choice. The Southern District of New York is the second busiest district court, handling 20 per cent of these bankruptcies. So-called venue options (courts that could handle a case) include the debtor's place of incorporation, its principal place of business and assets, or where an affiliate of the debtor has already filed a case under Chapter 11 U.S. Bankruptcy Code. (Bob Wessels, 2018)

As the English lawyers (Greenhalgh Kerr, 2018) note, in practice, for a debtor to establish their COMI has changed, they will need to have had the new arrangements settled for at least six months. However, there are no strict guidelines, and the Court will consider matters holistically to ensure any purported change in COMI is based on substance, rather than illusion.

Debtors are free to change their COMI; however, the Courts will be slow to accept an established COMI has been changed by activities that may turn out to be temporary or transitory.

Considerations which will be relevant to the Courts' determination of this issue may include:

- The location of the debtor's family
- Whether the debtor is financially supported by family members abroad
- The location of the debtor's legal or financial advisors
- Whether the debtor has advised creditors of the alleged move
- Whether foreign creditors correspond with the debtor in the foreign jurisdiction
- Whether the debtor is engaged in any legal proceedings in the foreign jurisdiction
- Whether the debtor's address and telephone contact details are recorded in local directories and websites
- Whether the debtor holds a local passport
- Where the debtor is registered to vote
- Where the debtor pays tax
- Whether and how often the debtor travels abroad.

On 8 January 2018 two US senators (from both the Republicans, John Cornyn, and the Democrats, Elizabeth Warren), introduced the 'Bankruptcy Venue Reform Act of 2018'. The draft bill is meant to reduce '... forum shopping and manipulation in the bankruptcy system' and it '... will strengthen the integrity, build public confidence, and ensure fairness in the bankruptcy system.' The draft bill would require companies to seek bankruptcy protection where they have their principal assets or their principal executive offices and should eliminate the possibility of filing where they are incorporated and restrict their ability to file where an affiliate's case is pending. The draft bill would in practice effectively limit access to the popular bankruptcy courts in New York and Delaware. (Bob Wessels, 2018)

At the same time, an American lawyer (Bob Wessels, 2018) notes that these innovations do not stand up to scrutiny. He explains that the US economy thrives when the bankruptcy system is fair, predictable and efficient. Experienced bankruptcy judges are critical in ensuring that companies can restructure in a way that saves jobs and preserves value under an effective U.S. bankruptcy system. Recent research suggests that

the market is better at predicting the outcomes of bankruptcy cases in New York and Delaware. In his paper 'What Drives Bankruptcy Forum Shopping? Evidence from Market Data' (November 15, 2017). (UC Hastings Research Paper no. 178., Jared A. Elias did not find evidence supporting the view that those courts are biased in favour of senior creditors. (Jared A. Elias, 2018)

Furthermore, the draft bill also provides that migration of an entity's principal place of business or assets to establish venue in a particular district – or for any other purpose up to a year before its bankruptcy filing – will not be taken into account when venue jurisdiction is considered. A new Section 1412 ('Change of venue') also proposes that notwithstanding that a case or proceeding under title 11 is filed in the correct division or district, a district court may nevertheless transfer a case or proceeding under title 11 to a district court in another district or division, in the interest of justice or for the convenience of the parties. (Bob Wessels, 2018)

Analysing the forum shopping, it is worth considering its significance and practicality. Indeed, regardless of the goals of the legislator, in the process of developing a fair bankruptcy law, it is necessary to take into account who will have the advantage: creditors and interested persons or the interests of society, because there is no perfect set of laws. The provisions of the law are focused on the proper functioning of the domestic market, where cross-border bankruptcy procedures operate effectively. Lawyers have developed the term - "effective insolvency law". Flexibility in determining the jurisdiction of the bankruptcy procedure can help achieve specific goals.

It should be noted that the question of choosing the jurisdiction for conducting cross-border bankruptcy continues to remain in the focus of the authorities. Thus, no later than 27 June 2020, the Commission shall submit to the European Parliament, the Council and the European Economic and Social Committee a study on the issue of abusive forum shopping. (para. 4 Art. 90 REGULATION (EU) No. 2015/848)

If the creditors agree to move the debtor, then from this action they will be able to gain pecuniary benefits. Consequently, forum shopping is acceptable, useful and fruitful for the sake of reducing the costs of the insolvency procedure.

4. FINDINGS

The UNCITRAL Model Law does not explicitly resolve the issue of international jurisdiction; accordingly, its mere incorporation into the national law does not sufficiently correspond to the goals of creating optimal regulation of the legal issues in question. The wording used allows flexibility in determining the competent court in a bankruptcy case, which is not always favourable for creditors.

It is assumed that the protection of the interests of creditors is ensured by the determination of the jurisdiction for conducting cross-border bankruptcy by the location of the centre of fundamental interests and the restriction of the period to change it before the initiation of bankruptcy procedure. The need for migration before initiating an insolvency procedure is undoubtedly necessary in some cases. Analysis of forum shopping from the standpoint of protecting the interests of creditors have illustrated that forum shopping is capable of having positive results for the debtor's creditors, but only if the migration was agreed between them.

American law enforcement practice shows that the choice of a convenient jurisdiction to conduct bankruptcy contributes to legal predictability, achievement of mutual benefits for the debtor and the creditor, ensuring social goals. Regulatory restrictions on the choice of jurisdiction may not always play a positive role.

Cross-border insolvency does not fall out of focus of the authorities. At the international level, the current situation is monitored, positive and negative trends are identified. Based on their analysis, solutions are proposed for reforming national legislation and international acts.

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