MAYER·BROWN

March 2012

Overview of the English legal framework for cross border insolvency

Introduction

In England, there are four main sources of law regarding cross border insolvency, pursuant to which the English court may recognise and give assistance to a foreign insolvency proceeding:

- The EC Regulation on Insolvency Proceedings (No. 1346/2000) (the **"EC Regulation"**);
- The Cross Border Insolvency Regulations 2006 (implementing the Model Law adopted by the United Nations Commission on International Trade Law) (the **"CBIR"**);
- s426 Insolvency Act 1986 (**"s426"**); and
- the common law.

These rules provide the legal framework for determining which country's insolvency law should apply and how the insolvency laws of different interested jurisdictions should interact. They do not contain substantive insolvency laws, as these are left to the local jurisdiction (in England, principally the Insolvency Act 1986).

The EC Regulation

The EC Regulation has direct force throughout the European Union (except Denmark) without the need for implementation in Member States. It was adopted by the Council of the European Union on 29 May 2000, with effect from 31 May 2002.

THE AIM OF THE EC REGULATION

The aim of the EC Regulation was to introduce rules to govern the administration of affairs of an insolvent entity which extend into more than one Member State. The EC Regulation does not purport substantively to change the domestic law of Member States, but rather to:

(a) ensure recognition of insolvency proceedings across Member States;

(b) encourage cooperation and assistance between Member States; and

(c) define the respective roles of office holders where more than one set of insolvency proceedings involving the same debtor have been instituted in different Member States.

APPLICATION OF THE EC REGULATION

'Insolvency proceedings' to which the EC Regulation applies must be collective proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator (or similar). In the UK, this includes compulsory liquidation, administration, creditors' voluntary winding up (where there is confirmation by the court), voluntary arrangements and personal bankruptcy. It does not include receiverships. The EC Regulation does not apply to certain types of entities including credit institutions, insurance companies and investment undertakings (for which separate regulations apply).

MULTIPLE INSOLVENCY PROCEEDINGS IN DIFFERENT JURISDICTIONS

Where there are multiple insolvency proceedings in different Member States:

(a) Main insolvency proceedings will be those opened in the Member State in which the debtor has its **"centre of main interests"** (COMI – see boxed text). Main proceedings are intended to have universal scope and encompass all of the debtor's assets, wherever situated.

(b) If the debtor has an **"establishment"** (see boxed text) in one Member State but its centre of main interests in a different Member State, ancillary insolvency proceedings can be opened in the Member State where the debtor has an establishment. If they are opened after the main proceedings, they are called **"secondary proceedings"**, and if they are opened before the main proceedings they are called **"territorial proceedings"** (although territorial proceedings can only be opened in limited circumstances). The effects of ancillary proceedings are limited to the assets located in that State and they can

run in parallel with main proceedings. Ancillary proceedings must be for winding up (not rehabilitation or rescue).

WHICH INSOLVENCY LAW APPLIES?

The insolvency law of main proceedings applies automatically and universally except where there are territorial or secondary proceedings (in which case the law of the secondary state applies in relation to the assets in that territory only). There are a number of exceptions to that rule, in order to protect parties' legitimate expectations and certainty of transactions. The exceptions to the general rule that the insolvency law of the relevant insolvency proceedings will apply include rules in relation to:

- third parties' rights in rem
- contractual set off rights
- reservation of title
- immoveable property
- payment systems and financial markets
- contracts of employment
- ships and aircraft
- community patents and trade marks

RECOGNITION OF INSOLVENCY JUDGMENTS

The judgment opening the main proceeding, as well as judgments deriving directly from the main insolvency proceeding and that are closely linked to them, are **automatically recognised** in other Member States across the EU under the EC Regulation. Judgments will generally be regarded as 'closely connected' to the insolvency proceedings if the claim is one that only an insolvency office-holder can bring (including, for example, avoidance of preferential transactions prior to the insolvency): *Seagon v Deko Martin Belgium NV* (ECJ, Case 339/07).

The Cross Border Insolvency Regulations

The CBIR were enacted in the UK to give effect to the Model Law adopted by the United Nations Commission on International Trade Law in 1997 (the **"Model Law"**).

THE AIM OF THE CBIR

The Model Law was designed to provide a template of uniform legislative provisions to assist acceding States to equip their insolvency laws with a modern, harmonised and fair framework for dealing with cross border insolvency matters.

The overall purpose of the Model Law was to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

(a) Cooperation between the courts and other competent authorities of states involved in cases of cross-border insolvency;

(b) Greater legal certainty for trade and investment;

(c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested parties, including the debtor;

(d) Protection and maximisation of the value of the debtor's assets; and

(e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

APPLICATION OF THE CBIR

The CBIR apply without the need for reciprocity (which means, for example, that the UK will recognise eligible Chinese insolvency proceedings even if China has not itself enacted the Model Law). However, the EC Regulation prevails if the other country is an EC Member State. Like the EC Regulation, the CBIR do not apply to certain types of entities including credit institutions, insurance companies etc.

The Model Law has, to date, been adopted in Australia, Canada, Colombia, Eritrea, Greece, Japan, Mauritius, Mexico, Montenegro, New Zealand, Poland, Republic of Korea, Romania, Serbia, Slovenia, South Africa, United Kingdom, British Virgin Islands and the United States of America.

MULTIPLE INSOLVENCY PROCEEDINGS IN DIFFERENT JURISDICTIONS

Under the CBIR, where there are multiple insolvencies in different countries:

(a) Insolvency proceedings opened in the jurisdiction where the debtor has its **centre of main interests** (COMI) will be the **'foreign main proceeding'**.

(b) Insolvency proceedings opened in a jurisdiction where the debtor has an **establishment** but not its centre of main interests are **'foreign non-main proceedings'**.

The 'foreign main' and 'foreign non-main' designations in the CBIR are similar to the 'main' and 'secondary' designations in the EC Regulation.

A key difference between the CBIR and the EC Regulation is that the CBIR are only relevant once foreign proceedings have been recognised in the UK (whereas recognition is automatic under the EC Regulation). Until foreign main proceedings have been formally recognised in the UK under the CBIR, in

principle any form of insolvency proceeding can be commenced in the UK where the English courts have jurisdiction, without regard to whether the debtor's centre of main interests may be somewhere else or even if main proceedings have been opened elsewhere (outside of the EU). However, once foreign main proceedings have been recognised, any English proceeding will be a non-main proceeding and will be restricted to assets in the UK.

In order for foreign proceedings to be recognised under the CBIR, the debtor must have a place of business or residence or assets situated in the UK, or the Court must otherwise consider recognition appropriate; and certain formalities must be complied with. Foreign insolvency proceedings for which recognition may be sought must be collective insolvency proceedings which are subject to the supervision and control of a foreign court.

STAY OF PROCEEDINGS FOLLOWING RECOGNITION

Once foreign main proceedings have been recognised in the UK, there is an **automatic stay** of certain types of creditor action. The stay covers:

(a) Commencement or continuation of individual actions or proceedings concerning the debtor's assets, rights, obligations or liabilities;

(b) Execution against the debtor's assets; and

(c) Suspension of the right to transfer, encumber or otherwise dispose of any assets of the debtor.

The automatic stay does **not affect** any rights to take steps to **enforce security** over the debtor's property, to **repossess** hire-purchase goods or to exercise a right of **set-off**. The Court can, however, modify and expand the terms of the automatic stay and there have been cases where the Court has ordered a stay similar to the moratorium found in an English administration - preventing the enforcement of security amongst other things - following recognition of foreign main proceedings.

Where a foreign non-main proceeding is recognised, the Court has a discretion to grant a stay or other relief, but this is not automatic. The scope of the discretionary relief is wide and is expressed as 'any appropriate relief'.

WHICH INSOLVENCY LAW APPLIES?

Upon recognition, the CBIR give the foreign representative certain rights, for example to be heard in the English courts and in some cases to commence proceedings relying on the provisions of the English Insolvency Act 1986. The CBIR do not expressly permit the foreign representative to apply foreign insolvency law directly in England. There is an argument that the English court could apply foreign insolvency law under its general powers to grant additional relief or to cooperate with foreign courts, but this argument has not yet been fully tested in the courts. This is in contrast to the position under the EC Regulation, where the insolvency law of the jurisdiction in which the main proceeding is opened will (with some exceptions) apply automatically across all Member States.

COMI and establishment

A company's centre of main interests ("**COMI**") will determine which jurisdiction will host the main proceeding under the EC Regulation or the foreign main proceeding under the CBIR.

COMI is not defined in either regulation. There is a presumption that a company's COMI is the place of its registered office, but that presumption is rebuttable by objective factors ascertainable by third parties pointing to a different jurisdiction. The COMI test is undertaken at the time it is before the Court. It always involves a factual analysis and judicial balancing of various factors.

In determining whether the presumption that a trading company's COMI is in the place of its registered office has been rebutted, the factors pointing to a different jurisdiction for the COMI must be in the public domain or be of the type that could be learned in the ordinary course of doing business with the company, without extensive enquiry by third party creditors (see *In re Stanford International Bank Ltd* [2010] 3 WLR 941). At least in the case of a trading company, the location of the company's head office functions is not, of itself, the test unless this would have been apparent to third parties doing business with the company.

Where a company's COMI is not in the jurisdiction, it must have an '**establishment**' there in order for secondary or territorial proceedings to be opened under the EC Regulation or for foreign non-main proceedings to be recognised under the CBIR.

An 'establishment' is defined as 'any place of operations where the debtor carries out a non-transitory economic activity with human means and assets or services. In layman's terms, an establishment is a place of business.

Assistance under s426

Under **s426** of the English Insolvency Act 1986, courts in the Channel Islands, Isle of Man or certain designated countries can apply to the UK courts for **assistance in insolvency proceedings**.

The designated countries are: Anguilla, Australia, the Bahamas, Bermuda, Botswana, Brunei, Canada, Cayman Islands, Falkland Islands, Guernsey (modified), Gibraltar, Hong Kong, the Republic of Ireland, Malaysia, Montserrat, New Zealand, South Africa, St Helena, Turks and Caicos Islands, Tuvalu and the Virgin Islands.

The types of assistance that can be given pursuant to a letter of request from the court of a designated country are **broad** and, in giving assistance, the UK court can apply either UK insolvency law or the relevant foreign insolvency law.

Case law on s426 shows that, although the court has a discretion regarding whether to provide assistance, and in what form, the general rule is that the court **should provide assistance unless there are powerful reasons not to**: *England v Smith* [2001] Ch 419; *In Re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852.

The common law

The common law sits alongside the CBIR and they are often seen pleaded as alternative grounds of relief. There is debate about whether the common law also sits alongside s426 (because the House of Lords was split on this issue in *In Re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852). Within the EU, however, the EC Regulation ordinarily applies to the exclusion of the common law.

The key principle of the common law on cross border insolvency is **"universalism"**. That is the idea that there should be a unitary insolvency proceeding in the court of the insolvent entity's domicile, which receives world wide recognition and should apply universally to all the insolvent entity's assets.

Mayer Brown International LLP

For further information, please contact one of the partners in the Mayer Brown London restructuring, bankruptcy and insolvency group or your usual Mayer Brown contact:

David Allen
+44 20 3130 3813
dallen@mayerbrown.com

Ashley Katz
+44 20 3130 3818
ashley.katz@mayerbrown.com

Ian McDonald
+44 20 3130 3856
imcdonald@mayerbrown.com

Devi Shah
+44 20 3130 3669
dshah@mayerbrown.com

Kristy Zander
+44 20 3130 3267
kzander@mayerbrown.com

0508fin
March 2012