

## **GUIDANCE NOTE**

### **Bankruptcy Tourism in England and Wales**

#### **Where Are We Now?**

**June 2014**

#### **Introduction**

This is a follow-up Guidance Note to a much longer piece co-authored in 2010 and published in *International Insolvency Review*.<sup>1</sup> Its purpose is to outline how the English<sup>2</sup> legal system has evolved in an attempt to deal with the phenomenon of bankruptcy tourism, as well as what may happen in the future. It concludes with some practical advice about what to do when confronted by a debtor who has applied to open insolvency proceedings in England.

#### **Background**

Bankruptcy tourism is short-hand for forum shopping by insolvent individuals. Debtors seek to move from one legal jurisdiction to another to utilise a more favourable bankruptcy regime. In this context more favourable usually relates to a shorter period of discharge from bankruptcy (including all of bankruptcy's legal consequences) to achieve a fresh start and/or less onerous obligations during bankruptcy, particularly in relation to future income. There is also a further practical consideration that it is harder for an officeholder to investigate a bankrupt's pre-bankruptcy affairs when those affairs are based in a foreign jurisdiction and documented in a foreign language. This is particularly so in relation to the bankrupt's assets, which may include legal claims arising from steps taken pre-bankruptcy.

Bankruptcy tourism is therefore the opposite of what happens regularly (usually with judicial oversight) in the corporate arena. There forum shopping is used for creative value-preserving purposes: if the best solution cannot be found under the insolvency laws of one jurisdiction then a move to another insolvency jurisdiction can sometimes enable a better outcome for various stakeholders, including not only creditors but also employees; value is preserved and maximised as a result of forum shopping. Conversely a bankruptcy tourist's motivations are almost always selfish: to secure a preferred outcome for them personally, which can often mean a worse outcome for their creditors. Corporate and personal insolvency forum shopping can therefore be described

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<sup>1</sup> 'Bankruptcy Tourism' under the EC Regulation on Insolvency Proceedings: A View from England and Wales - *Int. Insolv. Rev.*, Vol.19:181-208 (2010) - copy available upon request from [asmith@abg-law.com](mailto:asmith@abg-law.com)

<sup>2</sup> For the avoidance of doubt all references to England and English should be read as England and Wales or English and Welsh accordingly.

respectively as beneficial and detrimental forum shopping when viewed from the perspective of creditors.<sup>3</sup>

In a number of cases bankruptcy tourists have also been motivated by on-going civil proceedings in their home jurisdiction which they seek to frustrate or curtail through having opened insolvency proceedings in England. The civil court conducting those proceedings will usually feel obliged to defer to the English insolvency process, which contains its own dispute resolution mechanism.

In recent years the majority of bankruptcy tourists have been German nationals. There have been fewer cases involving insolvent debtors from the Republic of Ireland<sup>4</sup>, caused by the result of the severe economic downturn there. As will be seen below, despite recent reforms both countries still have bankruptcy laws which make bankruptcy under English law a more attractive option from a selfish insolvent debtor's point of view.

### **Centre of Main Interests (“COMI”)**

Council Regulation (EC) No. 1346 / 2000 of 29 May 2000 on Insolvency Proceedings (“ECIR”) introduced the concept of COMI. Which court within the EU (excluding Denmark) has jurisdiction to open insolvency proceedings in respect of an insolvent debtor is governed by the location of that debtor's COMI.<sup>5</sup>

COMI is not defined in the ECIR. Consequently case law (at national and CJEU level) has effectively given rise to a list of criteria which a court will look at in assessing where a debtor's COMI actually is at the time the request to open insolvency proceedings is received<sup>6</sup>. From a study of the cases it is possible to create a shopping list of criteria which the court will look at in assessing whether a petitioning debtor's COMI is in England or elsewhere. That can include mundane matters, such as where the debtor is registered to vote, but will primarily focus upon where the debtor is economically active in terms of income and outgoings. There are also a number of judicial decisions which frame how the court addresses the permanence of any relocation, or how readily ascertainable to creditors the debtor's COMI is, amongst other factors. A detailed discussion of those issues and cases is beyond the scope of this Guidance Note<sup>7</sup>, however suffice it to say the English court will (if the proceedings are contested) conduct a detailed enquiry and the debtor's evidence will be tested under cross-examination, translated if necessary.

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<sup>3</sup> An insolvent debtor could of course propose a solution under English law which gave a better outcome for creditors than bankruptcy, such as an Individual Voluntary Arrangement under Part VIII of the Insolvency Act 1986, but most if not all seem to opt for bankruptcy.

<sup>4</sup> Two notable examples include Sean Quinn whose bankruptcy in Northern Ireland (which has the same law as England) was annulled due to lack of COMI; and Shane Filan of the pop band Westlife who moved to England to be declared bankrupt under English law rather than the laws of the Republic of Ireland.

<sup>5</sup> See Article 3 ECIR.

<sup>6</sup> Historically there was some debate in the English case law about whether the critical date was the date of any court hearing, which could afford the debtor further time to “engineer” their COMI shift. The position is now clear: see for example *O'Donnell v Bank of Ireland* [2012] EWHC 3749 (Ch.)

<sup>7</sup> For court's approach to the analysis of COMI see, for example, *Re. Horst Benk* [2012] EWHC 2342 at paragraph [19] and for the evidential factors see, for example, *Re. Eichler (No. 2)* [2011] BPIR 1293 at paragraphs [101] to [128].

For the avoidance of doubt, while it is well established that a debtor is entitled to move their COMI (being in keeping with the enshrined freedoms under the EU's constitution) that move must not be illusory or a sham.

However, once there was effectively a check-list of criteria it did not take long for a thriving cottage industry to develop in assisting bankruptcy tourists achieve bankruptcy under English law without ever really relocating to England. Those "bankruptcy tourism agents" are easy to find on the internet, particularly from Germany. For a sizeable fee they will make all of the necessary arrangements and generate all of the necessary evidence, including sourcing accommodation, sham employer companies, contracts of employment, tax numbers, bank accounts and so on, as well as preparing the court papers and arranging for them to be filed at the relevant court. It is understood that some agents will even make regular payments into a debtor's bank account which give the appearance of a salary to support the appearance of gainful employment in England.

Once the phenomenon of bankruptcy tourism became established there was criticism of the English courts from other EU Member States. As far as they were concerned the English legal system was allowing foreign debtors to "dump" their domestic creditors through forum shopping (which Recital (4) of the ECIR addresses head-on through an expressed intention 'to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position'). A number of English newspapers were sufficiently incensed by the possibility that English insolvency procedures were apparently being abused to refer to England as a "bankruptcy brothel".<sup>8</sup>

### **The English Courts' Response**

The turning point in how English courts approach the evidence of a debtor who may have engaged in bankruptcy tourism was in *Official Receiver v Mitterfellner*.<sup>9</sup> In that case Chief Registrar Baister first equated the written evidence given by a petitioner in his bankruptcy petition and statement of affairs as being equivalent to evidence given in other *ex parte* court procedures, thereby attaching a very high standard of honesty coupled with a duty of full and frank disclosure. Those obligations, if breached, would be sufficient grounds for a bankruptcy order to be refused or set aside later on.<sup>10</sup> That exacting approach to evidence given by bankruptcy tourists has been echoed in other cases, most recently in *Sparkasse Bremen AG v Armutcu*.<sup>11</sup>

New court procedures were also introduced. Now where a debtor presents a petition to any English court and there is clearly a potential issue regarding COMI (the debtor is obliged to set out previous addresses in the petition) then the court *should* write to all of the debtor's creditors (wherever they may be and based upon information provided by the debtor) to inform them that the debtor has applied to open insolvency proceedings in England. That is then the creditors' opportunity to object if they wish to. If a creditor does so object (usually by attending at the next court hearing rather than just writing a letter to the court) then the court will give directions for both the debtor and the creditor to file further evidence on the question of COMI.

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<sup>8</sup> See footnote 3 in the previous article.

<sup>9</sup> [2009] BPIR 1075

<sup>10</sup> See paragraph [65] of the judgment.

<sup>11</sup> [2012] EWHC 4026 (Ch)

Even prior to writing to the creditors the court may also direct the debtor to file a witness statement dealing with matters relating to COMI and exhibiting documents that underpin their assertions in that regard. If any COMI shift has been well engineered (whether a sham or not) then that evidence will be readily to hand. The opposing creditor can then obtain that evidence and start to attack it.

The above procedures began in the High Court in London. They have gradually filtered out to provincial courts. Consequently the safeguards are now threefold. First, where there is on the face of the petition a potential issue as to COMI then debtor is usually required to provide further evidence on that issue to the court. Secondly, the debtor's creditors are notified of the court process and can object if they wish to. Thirdly, the court will take a very dim view of any debtor who seeks to mislead the court or omits material information in the contents of their bankruptcy petition, Statement of Affairs or written evidence and documentation.

It however should be noted that the court will not undertake any evaluation of the effect upon the debtor's creditors in the event that a bankruptcy order is made. The consequences of the bankruptcy process are not considered in terms of benefit or detriment to third parties' interests or how easy or not the bankruptcy estate will be to administer. Where the debtor's assets and creditors are located is also irrelevant. The starting point is and must be that the debtor is free to move under enshrined EU law. Consequently the only consideration is whether the debtor's COMI is properly within the jurisdiction of the English court. Accordingly the court's focus is upon whether there is jurisdiction to make a bankruptcy order based upon a *genuine* relocation of COMI and, in particular, whether any purported relocation is in fact illusory or a sham.

### **Other Responses**

A further response to bankruptcy tourism has been at quasi-governmental level based upon public policy. The Insolvency Service has powers to investigate companies and to petition for the winding up of any which are found to offend English public interest through the very nature of their business.<sup>12</sup>

In February 2009 an English company called Medicon Limited and a number of related companies were wound up on public interest grounds relating to the provision of bankruptcy tourism services to German nationals. Medicon Limited advertised its services in German newspapers and operated in Berlin, producing material that extolled the virtues of debt relief under English insolvency law.

On 4 October 2011 no less than 61 apparently dormant companies believed to be involved in bankruptcy tourism were wound up by the English court.<sup>13</sup> More recently a firm called Lovell Hill & Co. LLP (formerly known as Law Partners LLP) was wound up for offering "bankruptcy relocation services to Germans seeking to take advantage of the shorter bankruptcy discharge periods in the UK".<sup>14</sup>

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<sup>12</sup> Section 124A Insolvency Act 1986

<sup>13</sup> Insolvency Service press release dated 13 October 2011

<sup>14</sup> Insolvency Service press release dated 31 January 2014

It is clear that, in so far as resources allow and sufficiently egregious cases exist, steps are being taken to close down English companies that seek to facilitate unlawful bankruptcy tourism. Bankruptcy tourism agents based abroad are however outside beyond the reach of the English authorities.

## **The Future**

It is clear that across the insolvency laws of the EU Member States there is a gradual convergence upon 3 years<sup>15</sup> as an appropriate period of bankruptcy, with or without automatic discharge: see in particular the reforms in the Republic of Ireland (previously a 12 year discharge period) under the Personal Insolvency Act 2012. Similarly the reform of German personal insolvency law (previously a 6 or 7 year discharge period) under legislation dating from May 2013 and which comes into force in July 2014 provides for a minimum 3 year debt discharge period with various obligations regarding future income. Prior to the coming into force of the Enterprise Act 2002 it was also 3 years under English law, with no automatic obligation to pay post-bankruptcy income.

Despite moves by the legislatures of both Germany and the Republic of Ireland, England remains more attractive due to the 1 year discharge period and no automatic requirement to pay future income. For a sufficiently motivated debtor, the attractions of bankruptcy tourism remain and look set to continue. While the 1 year discharge period is generally criticised by English insolvency lawyers there appears to be no real political appetite to increase it.

Nevertheless, the steps that have been taken and are being taken, both by the courts and the Insolvency Service are making the English system harder to abuse, particularly where the debtor's creditors are moved to take action. It is understood that a number of German banks and the German tax authorities are now doing so as a matter of principle.

## **Repeat Bankruptcy Petitions**

In theory at least, despite having had a bankruptcy petition dismissed for want of COMI there is nothing to prevent a debtor petitioning again. There is no automatic bar to re-petitioning. Indeed, as a result of the contested bankruptcy petition process (which is measured in months rather than weeks) the debtor's COMI may in fact be in England by the time of the later petition, assuming that they remain resident throughout.

Arguably it is an abuse of the English court's process to keep petitioning without a change of circumstances, otherwise the same result *should* happen again. Nevertheless, there have already been a number of cases where the debtor has tried for a second time and failed again.<sup>16</sup> In future it may be the case that court orders dismissing tourists' bankruptcy petitions will require the debtor to seek the court's permission before presenting a further petition, thereby filtering out cases where nothing has changed. This is the approach that the English courts currently take *in extremis* with "vexatious litigants" who repeatedly trouble the courts with hopeless applications.

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<sup>15</sup> See Vallender, Allemand, Baister, Kuglarz, Matyhijssen, O'Neill, Collins and Potamitis in *Insolv. Int.* 2013 26(7), 97-104

<sup>16</sup> See for example *Re. Horst Benk* [2012] EWCH 2342 (Ch) and *Re. Loeffler* (unreported – Petition No. 3390 of 2013 – Registrar Derrett, 6 June 2014)

## **Costs**

A discussion of legal costs under English law is far beyond the scope of this Guidance Note. Suffice it to say that the very general rule is that the unsuccessful party in a contested court process will usually be directed to pay a contribution to the successful party's costs incurred. Contested bankruptcy petitions are not without expense, especially if the debtor fights with the benefit of legal advice. From the creditor's point of view, having lost money on the debtor already (by virtue of the fact that they are insolvent) they are more likely to be taking action as a matter of principle rather than for commercial gain.

Nevertheless, if the debtor's bankruptcy petition is dismissed then the debtor will usually be ordered to pay a proportion of the opposing creditor's legal costs. The court order providing for that can, at least in theory, be enforced in any jurisdiction where the debtor has assets for as long as the debtor is not subject to an insolvency process.

However there may be another potential target for liability in respect of the opposing creditor's costs. It is well established that the English court has a wide discretion to make an order for costs against anyone in appropriate circumstances.<sup>17</sup> It is not inconceivable that in a suitable case, where a bankruptcy tourist had professional assistance in relocating and preparing their bankruptcy petition (including the underlying factual information and supporting documentation) and the petition was found to be an abuse of the court's process, the court could order the professional adviser (be that a bankruptcy tourism agent or a firm of solicitors) to pay some of the creditor's costs as a result of having caused those costs to be incurred. It remains to be seen whether or not the court would be amendable to such a request in a suitably flagrant case. Potential liability for costs would however be potential deterrent for bankruptcy tourism agents and any legal advisers that they engage to assist their tourist clients.

## **Conclusion**

It is clear that the English courts are continuing to make life hard for bankruptcy tourists who seek to play the system and do not undergo a genuine relocation. But those processes usually require the engagement of the debtor's creditors who then need to spend money on legal proceedings in England. At the same time the under-resourced Insolvency Service is seeking to close down English companies involved in unlawful bankruptcy tourism. It remains to be seen whether the English courts would be prepared to go one step further and punish professionals assisting in the presentation of bogus petitions through the use of third party costs orders.

But while the significant differences between bankruptcy under English law and bankruptcy under the laws of either Germany or the Republic of Ireland remain, the phenomenon of bankruptcy tourism will continue.

## **Practical Steps**

Should you or your client be notified of a bankruptcy petition having been presented in England by a debtor then you need to act quickly. There is a limited window of

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<sup>17</sup> Section 51 of the Senior Courts Act 1981

opportunity to engage with the court process. That is the creditor's best opportunity to object.

Having engaged with that process the court will then allow a period (measured in weeks) for evidence in opposition to the petition to be filed, which is opportunity for a more detailed review of the merits of what the debtor has told the court.

In the event that the safeguards fail and the first notification of the bankruptcy is after it has been made, all is not lost. It remains possible to challenge the bankruptcy after it has begun and even after the bankrupt has been discharged.<sup>18</sup>

In terms of opposing a debtor's position there will usually be three lines of attack. First amassing publically available evidence of whether the debtor's COMI is still in previous jurisdiction. Secondly analysing critically all publicly available evidence of the debtor's COMI in the current jurisdiction, which can then be shown to be false or a sham. Thirdly reviewing what the debtor has told the court when petitioning and seeing whether there are any material omissions or inaccuracies that could amount to material non-disclosure or attempts to mislead the court.

In the event that the debtor is currently engaged in on-going civil court proceedings in the original jurisdiction then that court should be asked to place the proceedings on hold pending the outcome of the contested insolvency process in England. Evidence of the insolvency proceedings in England should be provided to the court in question.

*The comments in this guidance note are of a general nature only. Full advice should be sought on any specific problems or issues*

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**June 2014**

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<sup>18</sup> See section 282(3) Insolvency Act 1986