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Analysis

Solving Cross-border Insolvency Issues

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Biography

Nick Hood is the Senior Business Adviser at the Opus Business Advisory Group (https://www.opusllp.com), the largest independent advisory, restructuring and insolvency firm in the UK.

Nick was a licensed Insolvency Practitioner, working in the business rescue market for 25 years. He is a committed internationalist, having created the largest global network of independent business rescue firms and having also worked overseas in Canada, Milan and Bahrain.

In his earlier career and after qualifying as a Chartered Accountant in 1970, Nick held senior executive positions in major companies in the construction, engineering and media sectors, as well as working for a boutique investment bank.

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Abstract

The insolvency world faces shapeshifting, ever more challenging examples of cases with international aspects in a commercial world, which becomes more complex and multinational with every passing year. In this article, the author considers how insolvency professionals grapple with the many different legal systems, cultures and practices they encounter in handling cross-border insolvencies and restructuring assignments.

Introduction

Decades of increasing globalization and the dominance of ever more complicated multinational corporate groups has meant that even quite small UK businesses have international interactions of one sort or another. These become far more problematic in an insolvency or restructuring scenario.

It could be a significant customer, a key supplier, a joint venture partner or a foreign subsidiary that is experiencing financial difficulties and unable to fulfil vital obligations. Tangible assets such a warehouse or a production facility might be located in another jurisdiction, held in an overseas entity and subject to local financing arrangements and creditor enforcement action. Realizing value from intangibles is likely to rely on co-operation in other countries.

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The one absolute certainty is that wherever a UK insolvency practitioner (IP) needs to engage overseas, they will find themselves navigating different legal systems and even more different insolvency regimes. Professionals they encounter will have different codes of conduct and be subject to different standards of ethics and regulation.

Sometimes these cross-border issues are predictable, and mitigation action can be planned. On other occasions, the problem can come out of the blue. A recent high profile example was a UK company with operating subsidiaries in Russia, which was crippled despite being cash rich, when it was prevented by the UK sanctions regime from making an interest payment due on a loan provided by a sanctioned financial institution also in Russia.

This triggered the defaulting of the loan and its sale to another Russian company, which threatened to foreclose on the operating subsidiaries' assets. In the ensuing insolvency, there were assets and issues in the UK, Russia, Canada, Luxembourg and the Channel Islands, not to mention creditors and shareholders all over the world.

In another multinational failure, a UK registered cryptocurrency-linked business failed after suffering a massive multi-million dollar fraud perpetrated by criminals based in Asia. It operated dozens of bank accounts in jurisdictions around the world but ultimately, the major source of recoveries by the Administrators required them to access the US bankruptcy system. Its customers and creditors were global.

How do UK IPs tackle such cross-border cases? What arrangements are there to assist them?

No harmonization but plenty of recognition

If only the world's insolvency regimes could be harmonized, international trade would be a far safer bet. Unfortunately, this laudable objective has eluded the business rescue world despite its very best efforts over many years to find a basis for it. The problem can be seen in the example of the European Union, where such an apparently coherent trading bloc linked by a political structure has found the task of bringing the very different business cultures and practices across its 27 members within one over-arching regime to be something akin to Mission Impossible. In the end, they have discovered that the level of compromise required is always too much at risk from the objections of powerful vested interests in each of the local business and political communities.

The European Commission has published a draft directive in 2022[1] harmonizing certain aspects of insolvency law, with the aim of facilitating distressed Mergers & Acquisitions (M&A) and reducing legal uncertainties for investors in cross-border opportunities. The proposal is now undergoing legislative procedure, but the only objective of this initiative is to restrict creditor avoidance tactics by unscrupulous corporates by harmonizing law on this specific aspect across the European Union.

In the absence of meaningful harmonization, the concept of recognizing foreign insolvency proceedings and the IPs concerned has developed, allowing those IPs to interact with local professionals and courts and access local legal remedies, which had previously been denied to overseas applicants.

Once UK insolvency proceedings and the status of UK IPs have been recognized, it facilitates the granting of support and the giving of assistance to them by foreign states and by overseas courts.

What mechanisms help to facilitate or cross-border cooperation?

- **Uncitral Model Law –** The start of this process was the UNCITRAL Model Law on Cross-Border Insolvency[2], which was adopted in 1997 to create some order in the chaotic world that insolvency professionals faced at that time when working on multi-jurisdictional failures or restructurings.

  This is all about recognition, nothing more. The purpose was to provide template for individual jurisdictions to enact their own cross-border insolvency laws. So far, more than 50 nations have adopted their own version of the Model Law, a relatively small number but crucially including the US (through its Chapter 15 Bankruptcy process), Canada (its Part IV), Australia (its Cross Border Insolvency Act 2008) and the UK (in its Insolvency Act S.426 and Cross Border Insolvency Regulations 2006).

- **EU Insolvency Regulation** – Notable absentees among the adopters of the Model Law are almost all European jurisdictions, except Greece and Slovenia. That is because the EU has its own cross-border arrangements under the EU Insolvency Regulation, which came into force in 2002. This operates along very similar lines to the Uncitral Model Law. It was updated in 2015[3].

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- **Group proceedings** – Both the Uncitral Model Law and the EU Insolvency Regulation applied originally only to single entity insolvency, which created practical difficulties in many situations where a failure involved groups of companies either in one foreign jurisdiction or cross-border in several countries. The result has been further cross-border legislation, this time governing the failure of groups of corporate entities.

- **Other locations** – Other countries not covered by the EU Regulation and which have not followed the Uncitral Model Law, have nevertheless developed mechanisms for cross-border recognition and cooperation, either on a formal legal basis or through informal arrangements.

How are these legal tools used in the real world?

There are three main approaches nowadays to cross-border insolvencies:

- **Main and secondary proceedings** – This is the traditional route involving a main restructuring process, which is then recognized in another jurisdiction. The classic example is a UK Scheme of Arrangement or Restructuring Plan, coupled with Chapter 15 recognition in the US. One of the best known recent examples was the Virgin Atlantic airline restructuring in 2020.

- **Proceedings in parallel** – This is where totally separate restructuring processes are deployed in two or more jurisdictions, which have similar legal systems. An example was the 2022 Hong Kong Airlines restructuring[4] in which an English Scheme of Arrangement ran alongside a Hong Kong Scheme of Arrangement.

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- **Interlocking proceedings** – This is the new kid on the cross-border insolvency block, a technique featuring separate restructuring procedures being implemented in two or more jurisdictions with different legal systems and where each process is inter-conditional upon the other. A good recent example is Cimolai[5], where an Italian Concordato procedure was paired with a UK Restructuring Plan.

Where is cross-border insolvency headed next?

The lesson of history is that new insolvency strategies and processes for effective cross-border workouts will be created as and when required to deal with changing business and financial landscapes. Where this evolutionary process takes the insolvency world and the stakeholders affected by multinational collapses next is strictly for crystal ball gazers and tea leaf readers.

Nevertheless, an area well worth keeping an eye on is brave new world of crypto currency, which is very much still bandit territory, generating not just cross-border issues but also supra-global cyber challenges. It has already forced the UK courts to redefine one of the most basic of commercial law definitions: what is ‘property’ and does the description include digital currencies?

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