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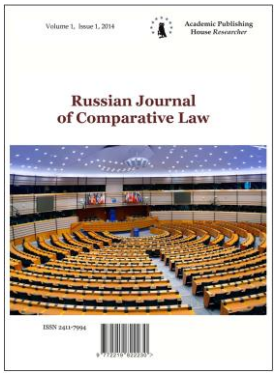

Articles

Forum-Shopping in Insolvency Law through the Example of Mr. Kekhman's Case

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Abstract

Globalization is a worldwide process, that influences peoples' lives practically in every sphere. International private law is not an exception. The article is dedicated to the problems, that may arise in cross-border insolvency cases. Namely, one of the main reasons for it is such phenomenon as "forum shopping". In other words, debtors try to find the most favorable situation for themselves and very often it does more harm than good for their creditors. The analysis of the problem is made on the decisions of the English High Court of Justice and the Russian Commercial Court on the case of Russian businessman, Vladimir Kekhman. The difference of views of two conflicting jurisdictions made the case highly debatable among scientific researchers. In this article the author shows the main points and arguments, on which the two decisions were based. Their careful examination can lead to means of solving such practical and significant problems. It should be stated, that some controversial questions are touched upon, for example reasons, advantages and disadvantages of forum-shopping; the confrontation of universality and territoriality principles; the term «Centre of Main Interests» and its interpretation in international community; ways of solving the conflict of jurisdictions problem according to the current case.

Keywords: Cross-border insolvency, forum-shopping, personal bankruptcy, V. Kekhman, case law, COMI.

1. Introduction

Insolvency is one of the classical institutes in law. As soon as the term «obligation» had been occurred, some serious questions arose: what should be done if the debtor cannot or does not want to perform his/her obligation?

One of the main goals of any insolvency procedure is to distribute the debtor's property among creditors, that are eligible for it. As very often there is more than one creditor, the urgent problem is: how to make such a distribution proper and fair? In other words, effective mechanisms for the applicable foreclosure are required.

But insolvency is not only a situation according to which the debtor does not have the ability to perform his/her obligations. First of all, it is a procedure that can be characterized as control and balance. Thus, there are certain consequences of adjudication in bankruptcy:

- Creditors become materially and procedurally bound, forming the category of «involuntary partnership»;

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- Creditors must act in good faith (Bona Fide standard);
- Creditors have fiduciary obligations towards each other.

When the insolvency procedure starts, it is clear that the debtor's property is not enough to cover all of the debts. That is why the next step of the process is to find out all of the bankrupt's assets available and to divide them equally among creditors (without any doubt, there are some exceptions in certain cases). This is the simplified version of the idea of the whole insolvency procedure. In other words, pro rata is the underlying concept of efficient asset allocation.

Unfortunately, though Bona Fide standard is an obligatory one, many debtors do not want to lose their assets and that is why they try to escape from this situation. One of the ways for doing it is «forum-shopping».

Understanding of the term «bankruptcy tourism» (or cross-border insolvency) and its international legal regulation is of a high relevance both for theory and practice. Though historically, insolvency cases were the cases of internal, local jurisdictions, now they may be subjected to jurisdictions of more than one country due to rapid globalization tendencies and multiple business trade (Chakrabarti, 2018).

It is a legal institute, according to which the debtor is deliberately trying to change the court's jurisdiction on cases of insolvency (the article will analyze only cases of personal insolvency). In order to do it, the debtor has to go to extremes, for example, to change rapidly the place of residence, which entails cross-border disputes (when the place of residence is presented by the country A; the place of property's location – the country B; and the place of creditors' location and activity – the country C). That is why such debtors are called «tourists».

This phenomenon has its own pro et contra for the participants of legal relations. Namely, it is significant when talking about practical applicability through the prism of legal cooperation between creditors and their debtors. In other words, one of the aspects of the problem is the efficiency of debt recovery procedures during personal insolvency cases.

The institute of «bankruptcy tourism» can either make such procedures more convenient or, on the contrary, deprive creditors of their reasonable expectations and leave them with nothing. Forum-shopping is mainly about finding the most favorable jurisdiction for the debtor or as it is called "pro-debtor's mechanisms" (Mohova, 2015) and that is why it can do more harm than good. In various jurisdictions such procedures as: time periods of debts' relief, full debtor's rehabilitation and etc. differ. And the debtor itself will do his/her best to avoid exacting terms. Thus, it is essential to find answers to 3 main questions:

1. The law of which county is applicable?
2. Where the insolvency procedure should be administered?
3. How and where the judgement should be enforced?

The article is nevertheless dedicated to several important issues. As the theme is rather broad and massive, it is reasonable to concentrate on one of the cases, which is an illustrative example of the phenomenon itself.

Firstly, it is necessary to find out the point of contractual obligations of JFC Group towards Russian and international creditors, as well as personal guarantees of Mr. Kekhman. Secondly, the analysis of the decisions of English courts on the case of personal insolvency is essential for basic understanding of «forum shopping» in international private law. And the last but not least issue, that is worth researching, is an attitude of Russian courts towards the English case law. In this part some reasoning will be made on the following theoretical questions: principles of universalism and territoriality; understanding of the term «Centre of Main Interests» in cross-border insolvency. It should be stated, that the conflict of 2 different jurisdictions made this case truly resonant and controversial.

2. Materials and methods

The article is made in the form of scientific research and is based, first of all, on the decision of Mr. Kekhman's case, made by High Court of Justice Chancery Division ([2015] EWHC 396 (Ch)) and on the decision of Federal Commercial Court of North-Western District (Resolution of FCC 2016/F07-9292). The problem of cross-border insolvency is popular in the legal scientific society, that is why there are some authors, the academic publications of which, were rather supportive for this article (Sobina, 2010; Mohova, 2014; Mohova, 2015; Kokorin, 2017; Morhat, 2019; Kolyada, 2018; Budylin, 2019).

The author of the work managed to select the appropriate methods for research in order to establish the basic framework of the main problem. They are mostly theoretical to be able to illustrate the cross-border insolvency in the prism of contemporary trends: analysis as a leading method to understand the nature of the main theme; the method of comparison to describe an attitude of different jurisdictions; and forecasting to predict possible ways of solving the problems encountered.

3. Discussion

3.1. Contractual obligations of JFC Group towards Russian and international creditors and personal guarantees of Mr. Kekhman

The case of Vladimir Kekhman, Russian businessman and cultural figure, attracted public attention in an unexpected way. These events have been continuing up till the moment, the author is writing this article. It is to be mentioned, that V. Kekhman is not the only businessman, who is infamous in such a situation, for example Il'ya Yurov («National Bank»), Maksim Finskij («Nornickel»), Murat Derev («Derways»), Andrej Puchkov and etc.

Speaking about V. Kekhman, it should be said, that the corporation of JFC (Joint Fruit Company) was established in 1994. In 2012 it went out of business. The activity of the company was characterized as successful and was at the peak of its tradability. JFC was believed to become the largest fruit-importer in Russia.

It is important to notice that Vladimir Kekhman was an international businessman, his holding company JFC (BVI) Limited cooperated with its partners not only in Russia, but also in Luxembourg, Panama and so on. What is more, this business was financed with the help of loan granting by such serious creditors as Sberbank, Raiffeisen Bank, VTB, etc. Most of these loans (credits) were provided by personal guarantees of Mr. Kekhman himself.

When JFC began to have difficulties with finances (the loss of the demand's market, investments and business partners), it made its creditors to feel concerned about contractual obligations of the company towards them. The extent of debts was huge (~ billions of euro) and personal guarantees of V. Kekhman were not enough. Thus in 2012 JFC was declared bankrupt, while at the same time Mr. Kekhman left Russia hurriedly. He went to Great Britain in order to open a personal insolvency case.

3.2. English case law on personal insolvency of Mr. Kekhman

The English court immediately froze the debtor's assets and took jurisdiction.

Before analyzing the line of court's thinking, it is essential to explain why Vladimir Kekhman chose British jurisdiction. To make the process cross-bordered, special conditions must be fulfilled (bankruptcy must be complicated by a foreign element). At the beginning of the article it was mentioned, that bankruptcy proceedings differ in many countries.

Great Britain, without any doubt, is a leader in providing the debtor with the most attractive insolvency relief mechanisms as soon as possible. According to the legislation, this period is about 1 year (Insolvency Act, 1986). This period is very short in comparison with other legal orders (in German Insolvency Statute – 6 years, in Ireland Bankruptcy Act – 12 years). Some specialists call this phenomenon «… an advantageous personal Insolvency regime» (Fox, Harrison, 2015), as it does not respect or protect creditors' interests.

The debtor explained his decision of choosing this very jurisdiction:

1. The Russian Federation did not have any regulation on the procedures of personal insolvency. Such a legislative gap led to the necessity of payments in full discharge, which, in his view, was impossible.

2. The character of business activities had an international nature, that is why the English jurisdiction is able to solve this case in an appropriate manner.

3. The place of economic activity (= Centre of Main Interests) is in Great Britain, as there are beneficiaries of JFC here – trusts, which are under regulation of the UK.

The English court noticed, that the case of Mr. Kekhman is a unique one and it is not about «bankruptcy tourism», the main aim of which is to change fictitiously the Centre of Main Interests of the debtor. And that is why, according to the insolvency legislation of the UK, all of the debts of Mr. Kekhman were to be discharged after the lapse of 1 year. It meant giving him social and financial rehabilitation. This turn of events made the creditors to manage to challenge the English court's decision, but the attempts were unsuccessful.

It is necessary to notice what arguments and reasons was the English court guided by, when making such a decision? The High Court of Justice came to the conclusion that the Centre of Main Interests (COMI - standard) of the debtor was in Switzerland and, as Switzerland is not the member of the European Union, the main international document about cross-border insolvency procedures (EU Insolvency Regulation 2015/848) was not applicable in this case. From this perspective, the court applied rules of national jurisdiction (Insolvency Act, 1986). The fact of place of residence (the last 3 years) in the UK was the argument of using jurisdictional authorities.

Another reason of the decision of V. Kekhman's non–extradition by the UK may lie in foreign policy. This phenomenon involves international affairs and cooperation of the two countries as ambitious actors on a global scene. Despite the fact that after the collapse of the USSR, the confrontation between the two blocs (capitalistic and socialistic) ended, the relations between the Russian Federation and its allies, as well as the countries of the Western world, remain rather tumultuous. That is why factors of exerting pressure and using force on each other are not excluded.

Indeed, one of the examples, that confirm Great Britain's «unfriendly» attitude towards the Russian Federation is the refusal to extradite Russian citizens who are prosecuted by the law of the latter. It should be noted that it is not the first such case in the modern practice of international relations between the two states. Speaking about this situation, it is sometimes called «extradition umbrella». It is a phenomenon, according to which certain personalities (citizens of the RF) can hide from system of justice in another country.

Moreover, such behavior of the British side is beneficial to it not only from the political point of view, but also from the economic one. Since most of the citizens of the Russian Federation who cannot be extradited from the territory of the Kingdom have shadow finances or offshore companies. Thus, funds can be withdrawn and used in various markets in England (for example, real estate, etc.).

3.3. The attitude of Russian courts towards the case of Mr. Kekhman's insolvency

First of all, it is necessary to mention about some important theoretical cross-border insolvency issues. Namely, there are two main forms of cross-border's insolvency recognition: full recognition (which has different variations) and full non-recognition (Wood, 1995). According to this very classification, the Russian Federation belongs to the latter one, the principle of conventional exequatur has been carrying out since the nineteenth century (Muranov, 2003). As, one of the scientists in this field, L. Sobina mentions, the most important factor is that the absence of an international treaty leads to non-recognition of insolvency international procedures (Sobina, 2010).

Sometimes such form is chosen to protect the rights of the creditors, which are on the territory of the country (before the EU Regulation, for example, Sweden supported this approach).

However, this approach cannot be called an up-to-date one for several reasons. Firstly, the rejection of an international cooperation is impossible in globalized world, where business activities operate on an international scale. Secondly, some obstacles may arise during the process of finding the bankrupt's property in foreign countries. And what is more, insolvency procedure can start in a foreign court, the decision of which won't have any legal force for the country with the non-recognition form of cross-border insolvency.

Though, there is an alternative in the Russian current legal order, which is the principle of reciprocity. Unfortunately, this principle is rather controversial and does not have any common understanding in an international society (Sobina, 2010). Thus, many states face difficult choices.

What is more, according to some scientists, the principle of reciprocity is understood incorrectly in Russian legal order (Lagarde, 1977), namely, because of its restricted approach. Following another point of view, this principle can be explained as *comitas gentium* (Sobina, 2010), which is non-binding mutual politeness and gentleness among actors. This is how reciprocity is understood in many countries, including the UK. This way of thinking helps both to keep the freedom and sovereignty of the state, and also to respect foreign courts' decisions in different situations (Kozyris, 1990).

In Russia the reciprocity cannot be presumed automatically, some evidence of foreign recognition of Russian court decisions is required. This fact makes international cooperation in the sphere of cross-border insolvency rather complicated as there is different understanding of this principle by other countries.

The main problem is, that there is no any legal act, that regulates cross-border insolvency. What is more, the country is not a member of international treaties on bankruptcy procedures. In other words, the regulation is developing only on the national level. The provisions on personal insolvency were created by the legislative power only in 2015 (Federal Law on Insolvency, 2002). And as for the international level — the question is still unsolved.

An alternative way of settling the problem is to resort to a special institute, which is called Centre of Main Interests of the debtor (COMI). It should be stated that there are also some controversial issues.

A serious gap can be found when analyzing the term COMI in international law practice. The cause lies in the existence of foreign business-partners, assets overseas, imports and exports processes and etc.

On the one hand, such business models allow its owners to gain more profit and develop overall production. On the other hand, some problems in various spheres may arise, for example, there is always a risk of insolvency for entrepreneurs and as such activities are made with the help of partners, many people are involved in this process. That is why it is important to find out the place, where this business is centralized in order to make it a starting point for insolvency procedures.

Understanding of the term «Centre of Main Interest» varies in different countries. Such multi-item interpretations entail problems in law practice. It is reasonable to make it plain and to analyze alternative points of views.

The Supreme Court of the Russian Federation has been making attempts to create a legal basis for future international regulation on cross-border insolvency's issues. For example, in one of the cases the term «Centre of economic interests of the debtor» was used (The SC Decision 2019/308-ЭС18-25635). It is impossible not to notice, that there is a similarity with the definition of COMI – standard (EU Insolvency Regulation 2015/848), which is a foundation for protecting creditors from the misconduct of the debtor.

There were also some criteria made by the Supreme Court:

1. The place where the property is located;
2. The place of business activities of the creditors and their location;
3. The location of corporate partners (legal entities).

According to international experience, COMI is compared to the «debtor's nerve center» (Rochelle, 2017). What is more, very often the debtors' headquarter or registered office is meant to be the COMI.

Nevertheless, the EU Insolvency Regulation is interpreted differently by the UK. Great Britain's regulation prefers to define the Centre of Main Interests in another way. In other words, this jurisdiction does not have a clear concept of this term. In each case objective factors, such as business operations or third parties' locations are used. It should be noticed, that it is a big problem for harmonious international regulation and unique key terms' understanding.

Sometimes the Supreme Court of the Russian Federation (The SC Decision 2019/306-ЭС19-3574) uses another argument as a ground for liability. The fictitious change of place of residence entails infliction of harm to creditors. Consequently, the aim of such actions can be called unlawful. That is why the most applicable remedy for the community of creditors is art. 10 of the Civil Code of the Russian Federation. This article is used as a special one, when there is a contravention of the principal of good faith (*bona fides*).

In 2015 there were created the provisions on personal insolvency as a result of the legislative reform. At the same time, banks and other serious creditors began their activities again in order to make Mr. Kekhman to perform his obligations towards them. The community of creditors disagreed with the English court proceedings and sued for the adjudication of personal bankruptcy in the Commercial Court of Saint Petersburg. In 2017 Vladimir Kekhman was declared bankrupt but the criminal prosecution was stopped on the reason of the expiration of the limitation period. Now this decision is being appealed by creditors.

Thus, Vladimir Kekhman is declared bankrupt both in the UK and in the Russian Federation. The main question is: what are the consequences of confrontation of the two jurisdictions? In order to answer it correctly, the line of reasoning of Russian courts (Resolution of FCC 2016/F07-9292) should be discussed.

The Russian Commercial Court cannot agree with the decision of the English High Court. There are several clear reasons for it:

1) Exclusive jurisdiction of Russian courts was established according to this very case. Therefore, the main deterrent factor of unfair conduct is to be used. It is a connecting factor, called *lex fori concursus*, which means, that bankruptcy proceedings are to be regulated by the law of the country, which is dealing with such proceedings. It seems to be a logical argument, as the exclusive jurisdiction makes this case automatically inaccessible for other jurisdictions.

In this sphere another important theoretical question arises, when talking about confrontation of universality and territoriality principles. The first one represents the idea of shared legal force of any insolvency procedure in all other countries. According to this understanding, other jurisdictions with their regulation are ignored and must comply with that one, that has already taken the decision. The second one is about strict territorial effect of insolvency procedures. However, the problem of property's plurality in various countries makes this idea not the best one.

Some scientists suppose (Israel, 2005), that both of them are quite irrelevant nowadays because of their extreme character and it is difficult to argue with this point of view. Middle-ground should be found in this case, as it is not only a theoretical issue. On the reason of its practical applicability, cross-border regulation must be elastic and adaptable as we are talking about the best ways of collection and optimization of the debtor's property. That is why, international regulation and its acknowledgment by countries is aimed at finding compromise between jurisdictions and is essential nowadays.

2) There had been made several decisions of Russian courts on the case of Mr. Kekhman before he went to the UK. Such decisions are of a preclusive effect and this fact cannot be argued with.

3) The legal and economic connection between Mr. Kekhman and the Russian Federation is much deeper, than it has been claimed by him in Great Britain. Most of debtor's business activities and his creditors are situated in the Russian Federation. For foreign court decisions to be recognized in Russia, there must be an international treaty or, if there is none, the principle of reciprocity *can* be used. And as this country is not the member of any international treaties on personal bankruptcy and cross-border insolvency, the justification for the application of principle of reciprocity has not been established yet, according to sec. 6, art 1 of the Insolvency Federal Law. If looking through the art. 244 of Arbitration Procedural Code of the Russian Federation (the procedure of courts' decisions recognition is the same as in the Federal Law №127), it can be noticed, that there are some grounds for non-recognition of foreign courts' decisions. According to one of them, the decision of the English High Court of Justice can be not recognized as there has been already a Russian court's decision on this very case. This decision is lawful and enforced.

4) The last, but not least argument is that there was an infringement of public order and all of the actions of Mr. Kekhman are aimed at doing harm to his creditors, the reasonable expectations of which are based on the civil legislation of the Russian Federation. Such interests must be protected.

4. Results

To sum it up, final outcomes of the foregoing should be outlined:

• Vladimir Kekhman, being a founder of JFC Group, had a lot of contractual obligations towards his creditors. Among them there were serious banking companies, which lent him assets for his business activities. These obligations were supported only by Mr. Kekhman's personal guarantees, which, as a result, were not enough for performing them.

• To avoid Russian jurisdiction, the debtor went to the UK, where the cross-border insolvency procedure started. The choice of British jurisdiction was not baseless: it is supposed to be the most «advantageous personal Insolvency regime» (Fox, Harrison, 2015) for the debtor, whose main aim is to become free from all of the obligations he/she cannot perform. The English court, in its turn, stated, that the actions of Mr. Kekhman were of a good faith and declared him bankrupt, applying its national legislation. The Centre of Main Interests was defined to be in Switzerland and the EU Regulation was not applicable there.

• The gap in personal insolvency's regulation in the Russian Federation made this case really difficult. Namely, it was important to justify and answer the following question: why the case must

be solved according to Russian law? After the legislation reform has been carried out, the arguments of Russian courts found their basis. Firstly, the establishment of exclusive jurisdiction can explain the connecting factor lex fori concursus, which is an important indicator for solving disputes of international character. Secondly, the preclusive effect of previous decisions of Russian courts took place, which is impossible to ignore. Thirdly, Russian legislation had not any reasons for recognizing foreign decisions of the English court. What is more, the interests of the creditors are an essential part of public order, this fact entails the necessity of their protection.

5. Conclusion

Many Russian scientists expressed their opinion on the case of Mr. Kekhman (Mohova, 2015; Budylin, 2019; Morkhat, 2019, etc.). All of them agree, that the English legal order is welcoming, when speaking about debts' relief. So does the author of the article. What is more, the negative effect of this case is that the actions of V. Kekhman can become a bad example for those, who are not going to perform their obligations. At last, he has managed to prove the applicability of foreign jurisdiction, having only little part of assets in the UK and the fictitious place of residence there.

It seems, that the applicable jurisdiction was defined incorrectly for some reasons. Namely, it is impossible to deny the fact, that, according to COMI – standards (or Centre of Economic Interests, as it is in Russia), the Centre of business activities of the creditors is situated in the Russian Federation. It can be proved by their location, business transactions, dealings and partners.

This clearly shows that the point, from which most of the processes are directed and on which they are focused, is in the country, that has an exclusive jurisdiction to protect these creditors. The second issue is that there are no legal grounds for accepting for execution of the decision of the High Court of Justice. There is a strong rule of the necessity to find evidence of the principle of reciprocity, otherwise Russian courts are not obliged to take this decision into account.

The decision of the court of the UK appears to be strongly unfair towards the creditors, who, according to insolvency regulation and common principles of equity, must be protected by law. Otherwise, (often voluntary) failures to perform obligations and absence of legal levers of pressure will be an encouragement for careless debtors.

From this point of view, «Forum-shopping» constitutes a real problem. In order to avoid such cases in the future, competent and universal regulation should be created. The European Union has already coped with this task rather successfully. But, as practice shows, unscrupulous debtors exist out of the bounds of the EU. That is why, the creation of a special document of an international character is a necessity for the international community nowadays. Moreover, for the international treaty to be successful, it is possible to adopt the experience of the EU and to create it on the basis of this regulation. In this case Russia and other countries can become its members and get rid of legislative gaps on the international level.

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