

# Brexit – cross-border insolvency and restructuring

*October 2018  
(updated May 2019)*

## Introduction

One key issue that is attracting a significant amount of scrutiny is the question of what a “hard” – or “no deal” – Brexit could mean for cross-border insolvencies and restructurings, in particular, the English scheme of arrangement.

This overview and related podcast aim to help corporates, lenders and investors understand where the Brexit negotiations may be heading with regards to cross-border insolvencies and restructurings, where the impact of a “hard” Brexit may be felt most (including its impact on the popularity of the English scheme of arrangement) and what, if anything, you should be doing now.

In this bulletin we examine the following four areas:

- *Brexit negotiations – where might we be heading for cross-border insolvencies and restructurings?*
- *The English scheme of arrangement – will it lose popularity?*
- *Insolvency proceedings – the biggest impact*
- *Key takeaways*

## *May 2019 Update*

There have been a few updates since the original publication of the podcast and this accompanying bulletin in October 2018. We highlight the key updates from a cross-border insolvency and restructuring perspective on the following page.

## May 2019 Update

Key updates since the original publication of the podcast and this accompanying bulletin in October 2018 include the following.

- The form of the UK’s exit from the EU is still uncertain and “exit day” has been delayed until 31 October 2019 or such earlier date as might be agreed between the EU and the UK.
- The UK government has passed two statutory instruments particularly relevant to cross border restructuring and insolvency, the key provisions of which will only come into force in the event of a “no-deal” Brexit. These are:
  - **The Insolvency (Amendment) (EU Exit) Regulations 2019** – which largely repeal the European Insolvency Regulation 2015 and also amend the Insolvency Act 1986; and
  - **The Credit Institutions and Insurance Undertakings Reorganisation and Winding Up (Amendment) (EU Exit) Regulations 2019** – which amend the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 and the Insurers (Reorganisation and Winding Up) Regulations 2004.
- At a high level, the general approach of these “no-deal” statutory instruments is to provide for a general alignment of the treatment of EU/EEA states with that of non-EU/EEA states. Key points to note in the event of a no-deal Brexit include the following:
  - **“In-flight” proceedings** (ie those that are on-going on the day the UK exits the EU) – the statutory instruments provide that the existing (pre-Brexit) regime will apply to such proceedings subject to some (very) important safeguards which would allow the English court to intervene in certain circumstances.
  - **New proceedings** commencing after the UK exits the EU:
    - **Jurisdiction** - current EU-law driven restrictions on jurisdiction to commence English proceedings (eg COMI/establishment and “home” Member State criteria) will be lifted and we will revert to the tests set out in the (amended) Insolvency Act 1986 (for ordinary companies) and the Banking Act 2009 (for third country institutions/UK branches) – one of the consequences being that, at least on paper, it would be much easier to commence an administration in relation to a company incorporated in the EEA or for such company to propose a CVA;
    - **Recognition** – there will be no automatic recognition of EEA resolution actions or EU insolvency proceedings in the UK – recognition will be based on other (more limited) sources of recognition (eg the CBIRs or the common law and, where applicable, the Banking Act 2009); and
    - **Applicable law** – all of the choice of law exceptions under the European Insolvency Regulation 2015 are repealed – with the consequence that principles of private international law will determine issues such as the applicable law in the context of enforcement of security and claw-back actions.
- The final text of the new Model Law on the Recognition and Enforcement of Insolvency-Related Judgments has been approved by UNCITRAL and is available for adoption by states. It is not clear whether (or when) the UK will adopt the new Model Law as the potential impact on the rule in *Gibbs* will be an important point in the Brexit negotiations.
- The UK has deposited its instrument of accession to the Hague Convention on Choice of Court Agreements 2005, originally intending to accede as a contracting state on 1 April 2019 however such succession has been suspended until 1 November 2019 (currently the day after the UK is due to leave the EU).

# Brexit negotiations – where might we be heading for cross-border insolvencies and restructurings?

## Will Brexit make any difference to the way in which European cross-border restructurings and insolvencies are conducted?

The potential impact on European cross-border insolvencies should not be underestimated, even though the additional hurdles discussed below are not insurmountable. Very few cases these days are “domestic” in nature. Most, if not all, of those that come across our desks have a cross-border element – there may be multiple borrowers or guarantors in different jurisdictions; assets can be located across the world; and creditors will also be multinational. By way of an example, a recent case the firm has worked on involved 23 borrowers filing for insolvency proceedings in 16 different jurisdictions, many in Europe. That case, like many others, has demonstrated the importance of having a clear framework for conducting cross-border insolvencies.

Since 2000, the European Insolvency Regulation, recast in 2015<sup>1</sup>, has provided that framework for European cross-border cases. It is arguably the most comprehensive piece of European legislation in the field of insolvency for the past 18 years. It has provided consistent and predictable answers to a number of tricky questions that arise in European cross-border situations including: Which member state can open insolvency proceedings? Which law applies in those proceedings? And what is the effect of the opening of those proceedings in other European member states (including on creditors’ rights such as security enforcement and contractual set-off or netting)?

This consistency and predictability has made things simpler – and arguably quicker and cheaper – than they might otherwise have been, particularly in today’s “global” world. As a consequence, if the European Insolvency Regulation no longer applies post-Brexit, this could have a considerable impact on European cross-border insolvencies involving the UK. However, European cross-border cases were successfully conducted before 2000 and, today, there is no equivalent statutory framework for cases involving Asian or US borrowers and those deals are successfully restructured without too many issues. In summary, there may be more hurdles to jump in European cross-border cases, but we doubt any will be insurmountable. The real impact will depend on whether we see a “hard” or “soft” Brexit.

## If the impact depends upon the provisions that are put in place as a result of Brexit negotiations, have there been any indications as to the UK Government’s thinking in this regard?

To a certain extent, yes. The two main pieces of “Brexit legislation” – being the European Union (Withdrawal) Act 2018 and the draft EU Withdrawal Agreement – do not explicitly refer to the European Insolvency Regulation, but they do give us an idea of where things might be heading in this area.

The starting point is that the European Union (Withdrawal) Act 2018 “on-shores” EU legislation – such as the European Insolvency Regulation – as it stands at the point of exit and makes it part of UK domestic law, subject to an important power to correct “deficiencies”. One such “deficiency” is any European legislation that relies on reciprocity; the European Insolvency Regulation falls squarely in this bucket and so there is the power, under the Act, to amend or “switch off” the European Insolvency Regulation.

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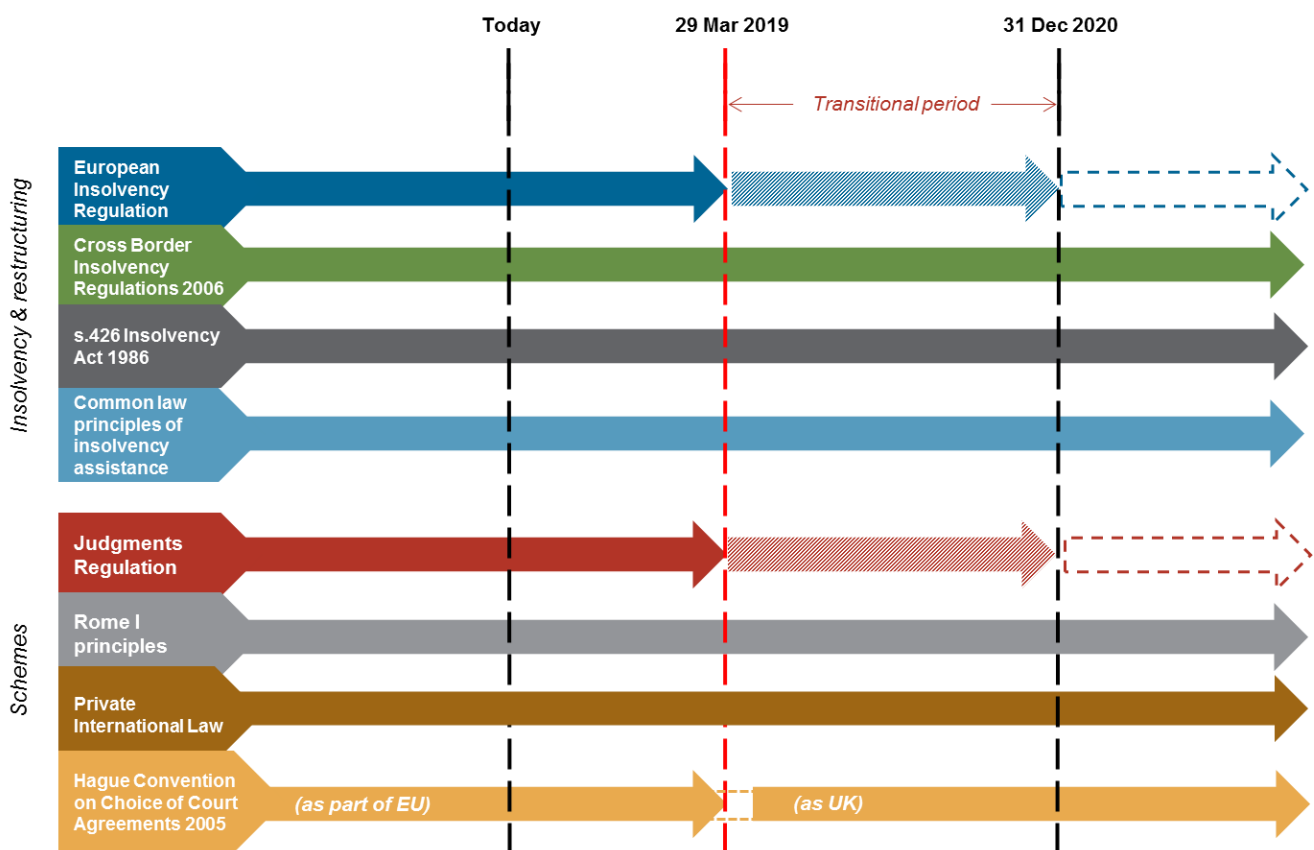
<sup>1</sup> The EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) superseding the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000)

We now know, following a recent Technical Notice issued by the UK Government in mid-September 2018<sup>2</sup>, that in the event of a “no deal” Brexit:

- Parliament will exercise its powers to correct deficiencies such that the European Insolvency Regulation and the Judgments Regulation<sup>3</sup> will not become part of UK domestic law;
- the Rome I<sup>4</sup> rules on the law applicable in contractual matters will be retained by the UK; and
- the UK will ratify the Hague Convention on Choice of Court Agreements 2005 in its own right (it is currently a “contracting state” by virtue of its membership of the EU).

In terms of what a “soft” Brexit might look like, the draft EU Withdrawal Agreement issued earlier this year provides for a transitional period where, if there is a deal and the agreement is finalised and approved by the EU and the UK, the European Insolvency Regulation may continue to apply as it does today to UK insolvency proceedings until the end of 2020 (the same would be true for the Judgments Regulation). This means it would be “business as usual” for European cross-border insolvencies and restructurings until the end of 2020.

The diagram below provides a snapshot of the potential impact of Brexit on key legislation, currently applicable in the UK and used or relied upon in cross-border insolvency and restructuring – in particular, in the context of the English scheme of arrangement. Overall, in our view, Brexit, particularly a “hard” Brexit, is going to have a greater impact on European cross-border insolvency cases than it will on the use of the English scheme of arrangement.



<sup>2</sup> Available at: <https://www.gov.uk/government/publications/handling-civil-legal-cases-that-involve-eu-countries-if-theres-no-brexit-deal/handling-civil-legal-cases-that-involve-eu-countries-if-theres-no-brexit-deal>

<sup>3</sup> Regulation (EU) No.1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast)

<sup>4</sup> Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I)

# Scheme of arrangement – will it lose popularity?

## What is a scheme of arrangement?

The scheme of arrangement is a procedure under the Companies Act 2006. It can be used to restructure solvent companies and distressed companies, and both English and foreign companies. Many say it is one of our greatest exports. For a number of years now, the scheme has been used to restructure the debts of foreign companies. Some of the reasons foreign companies are looking to the English scheme of arrangement as their restructuring tool of choice include the following:

- the speed of access to the English courts – the scheme process involves two court hearings but it is possible for the entire process, from launch of documentation to final sanction hearing, to be completed in a matter of weeks;
- the judges sitting in the English courts are incredibly commercial and familiar with the legal issues that arise in the context of a scheme – in fact, many judges were once barristers advancing the arguments on technical scheme issues (such as jurisdiction and recognition);
- the scheme is incredibly flexible and, the statutory provisions relating to the scheme are fairly short and are not prescriptive of content or structure – therefore the scheme can be used to solve a full range of issues, from a short standstill (the so-called “scheme-lite”) to amend and extend restructurings to full debt-to-equity conversions; and
- perhaps most importantly, it is a tried and tested procedure in a multitude of contexts – this leads to a certain amount of predictability for all stakeholders involved in the restructuring.

If a company wishes to use the scheme of arrangement, it must satisfy the English court that the company has a “sufficient connection” to the UK. This is easy in relation to English companies and for foreign companies it is not too difficult to establish such a connection (for example, it is sufficient if such foreign company is party to English law governed finance documents). In addition to this sufficient connection test, the English court also needs to be satisfied that the scheme will be effective in relevant overseas jurisdictions. It would certainly have been easier to satisfy the English court of this requirement if the UK had listed the scheme of arrangement in the annex to the European Insolvency Regulation. However, we did not do so, and in our view this was the right thing to do in order to retain the scheme’s flexibility (in particular, retaining the “sufficient connection” test for jurisdiction and not replacing it with a requirement that the scheme company have its centre of main interests (or **CoMI**) in the UK). Currently, there are various ways of satisfying the English court that the scheme will be effective in relevant overseas jurisdictions:

- first, if the English court order sanctioning the scheme of arrangement is considered to be a “judgment” for the purposes of the Judgments Regulation, that order will be automatically recognised in other EU Member States without any further formalities – clearly this route could be affected by a “hard” Brexit, but there is a possibility that the Hague Convention on Choice of Court Agreements might fill the gap in certain situations;
- second, if the scheme is considered to be part of contract law, the principles under Rome I (which, broadly speaking, provide that an English law governed contract can only be varied or discharged by an English law process) will provide a route to recognition in other Member States – this route will not be affected by Brexit because the principles under Rome I are not confined to Member States and do not rely on reciprocity; and
- third, principles of international law often provide another route to recognition of the scheme in overseas jurisdictions.

## What impact might Brexit have on the recognition of the scheme in other Member States?

We have been discussing this issue with a number of our European colleagues and, generally speaking, there are two camps. If the scheme of arrangement is seen as part of contract law, the principles in Rome I will likely apply and Brexit will have no impact on the recognition of the scheme via this route. However, this is not how some jurisdictions view the English scheme of arrangement, and in these other jurisdictions the basis for recognition of the scheme is much more uncertain, particularly if the company proposing the scheme is actually insolvent.

The table below provides a high-level summary of the views of our colleagues in certain Member States to two questions, each assuming the scheme of arrangement was being used to restructure English law governed finance documents:

- if the scheme company has its CoMI in England, would your jurisdiction recognise the effects of the scheme; and
- would your answer be different if the CoMI of the scheme company is in your jurisdiction, not England?

As you can see, the Netherlands, Spain and Belgium take a similar approach to recognition of the scheme, relying on Rome I or principles of private international law, whereas the route to recognition may not be as clear in Germany and Poland.

	<i>Recognition of scheme re English law finance documents if CoMI in England?</i>	<i>What if CoMI in your jurisdiction?</i>
<b>Germany</b>	Position is unclear. Some commentators say yes (under Rome I / principles of private international law). But others are more doubtful. May depend on reciprocity.	No different because based on choice of law of finance docs, not CoMI
<b>The Netherlands</b>	Most likely yes under Rome I / principles of private international law	No different because based on choice of law of finance docs, not CoMI
<b>Spain</b>	Most likely yes under Rome I / principles of private international law	No different because based on choice of law of finance docs, not CoMI (unless considered a collective insolvency proceeding)
<b>Belgium</b>	Most likely yes under Rome I / principles of private international law	No different because based on choice of law of finance docs, not CoMI
<b>Poland</b>	Unclear – depends on whether insolvency proceeding (in which case depends on terms of scheme) or part of contract law (in which case yes under Rome I)	If insolvency proceeding, no recognition; if part of contract law, no different

## Insolvency proceedings – the biggest impact

### Is the European Insolvency Regulation the only source for recognising foreign insolvency proceedings in the UK?

No, it is not the only means of recognition. We have various ways in which a foreign insolvency proceeding could be recognised in the UK. These include:

- common law principles of insolvency assistance;
- the Cross-border Insolvency Regulations 2006 (which is how the UK implemented the UNCITRAL Model Law on Cross-border Insolvency) (the **CBIRs**); and
- section 426 of the Insolvency Act 1986 (which only applies to certain designated countries).

However, these other sources of recognition are much more limited, in either their sphere of application and/or the scope of relief available, than the European Insolvency Regulation. Some of the key benefits of the European Insolvency Regulation were mentioned above. Another important practical difference is that there is no automatic recognition under these other sources – in most cases a court application is required, and this can impact structuring, timing and costs in cross-border cases.

One of the key differences between the recognition afforded under the European Insolvency Regulation and the alternative sources of recognition mentioned above is in the recognition of foreign insolvency-related judgments (for example, an order approving a composition of debt or a claw back order). Recognition of such judgments is not possible under either the automatic relief (which is, effectively, the same stay on proceedings which is available in an English liquidation) or the discretionary relief (which must be procedural in nature) available under the CBIRs. Furthermore, the Supreme Court in *Rubin*<sup>5</sup> held that the English court cannot recognise or give effect to a foreign insolvency-related judgment under common law principles unless, among other things, the party against whom the order was made was present in the foreign jurisdiction where the judgment was obtained or submitted to that foreign court. Issues of presence and submission can be incredibly complex, particularly when the rules surrounding such concepts are not consistent across different jurisdictions.

It should be noted that UNCITRAL has recently approved the text of a new Model Law on the Recognition and Enforcement of Insolvency-related Judgments (the **New Model Law**)<sup>6</sup> that could provide a statutory means for recognition of foreign insolvency-related judgments in the UK, assuming the UK chooses to adopt the text and implement it into domestic law. The New Model Law is intended to complement the existing UNCITRAL Model Law on Cross-border Insolvency, although it is a standalone law and can be adopted by states even if they have not adopted the existing Model Law. There are some questions on the scope of the New Model Law and whether its terms are sufficiently clear to provide a different result to that under the application of the common law rules following *Rubin*. If Great Britain does adopt the New Model Law, another question will be whether it can be used to give effect to a foreign law plan of reorganisation in circumstances where such recognition would currently be contrary to the common law rule in *Gibbs*<sup>7</sup>. This nineteenth century rule has been applied recently<sup>8</sup> and, at a simplistic level, provides that only English law (such as an English compromise proceeding) can alter obligations created under English law. The rule is currently disapplied by the European Insolvency Regulation in respect of European compromise proceedings but, following a “hard” Brexit, the rule in *Gibbs* could take on more significance.

<sup>5</sup> *Rubin v Eurofinance* [2012] UKSC 46

<sup>6</sup> The final text of the New Model Law has been published by the Commission, although the United Nations General Assembly has not yet approved its adoption. The General Assembly typically oversees UNCITRAL’s work and it is expected that its next resolution (amongst other items covering the New Model Law) will be published towards the end of this year. Available at: [http://www.uncitral.org/pdf/english/texts/insolven/Interim\\_MLJ.pdf](http://www.uncitral.org/pdf/english/texts/insolven/Interim_MLJ.pdf)

<sup>7</sup> *Antony Gibbs and sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399

<sup>8</sup> See *In the Matter of Agrokor DD, In the Matter of the Cross-Border Insolvency Regulations 2006* [2017] EWHC 2791 (Ch) and *Gunel Bakhshiyeva (In Her Capacity As the Foreign Representative of the OJSC International Bank of Azerbaijan) v Sberbank of Russia (and others)* [2018] EWHC 59 (Ch)

## Why doesn't the UK just "do the right thing" and continue to recognise European insolvency proceedings in the same way it does currently under the European Insolvency Regulation, regardless of any lack of reciprocity?

While this seems initially appealing, in our view it would be unwise for the UK to take this approach. The European Insolvency Regulation works so well because there are built-in safe-guards (which were heavily negotiated given that the Regulation works on the basis of automatic recognition) around choice of law. Similar European recognition regimes applying to financial institutions and insurance companies (e.g. the Credit Institutions Winding Up Directive (**CIWUD**) and the Solvency II Directive) contain equivalent safe-guards. Some of the key safe-guards are set out in the diagram below.

To take an example by way of illustration: at the moment, a French insolvency process cannot affect security over assets located in another Member State, such as the UK; and in a Greek insolvency process, rights of set-off are determined by the law applicable to the insolvent debtor's claim which, in the case of an ISDA, may be English law. Once the UK is no longer a Member State, there will be no guarantee that Europe will continue to apply these safe-guards to English secured assets or contracts governed by English law. In our view, the UK needs to have the right not to recognise insolvency proceedings where these critical safe-guards no longer apply between the UK and the remaining Member States.

	<b>EUIR</b>	<b>CIWUD</b>	<b>Solvency II</b>
<b>Rights in rem</b>	Law of Member State where assets are situated	Law of Member State where assets are situated	Law of Member State where assets are situated
<b>Set-off</b>	Law applicable to the insolvent debtor's claim	Law applicable to the credit institution's claim	Law applicable to the claim of the insurance undertaking
<b>Netting</b>	N/A	Solely by the law of the contract which governs such agreements	N/A
<b>Detrimental acts</b>	The act is subject to the law of another Member State	The act is subject to the law of another Member State	The act is subject to the law of another Member State
<b>Payment systems / financial markets / regulated markets</b>	Law of Member State applicable to that system or market	Solely by the law of the contract which governs such transactions on the regulated market	Law applicable to that regulated market



## Key takeaways

### Is there anything I should be doing now to prepare for Brexit?

In the context of restructurings and insolvencies, the short answer is probably not. We are sometimes asked questions around English governing law and English jurisdiction clauses, and whether parties should be considering moving to the law/jurisdiction of another Member State. However, we do not think this is necessary: the key advantages of English law will continue post-Brexit and we have highlighted above the advantages of an English law agreement in the context of a scheme of arrangement. The same is true for changes to your jurisdiction clauses. A move away from English jurisdiction is not necessary in light of Brexit. There may be some advantages in having an exclusive jurisdiction clause in favour of the English courts (rather than the asymmetric one that the LMA currently uses), but this decision needs to be taken as part of a broader discussion.

### Is it all bad news?

Certainly not. A number of European jurisdictions are introducing new restructuring tools, perhaps to take advantage of the perceived uncertainties surrounding the impact of Brexit on English procedures, such as the scheme of arrangement. One example is the proposed Dutch scheme which, in particular, is keenly anticipated. We expect more European alternatives to the English scheme of arrangement to appear as and when Member States start to implement the proposed EU Directive on preventative restructuring frameworks and second chance<sup>9</sup>, although this is unlikely to be finalised until 2019. We see this increase in restructuring tools as a good thing, since the additional options will create opportunities for investors and increase the chances of maximising value for all stakeholders. It is worth mentioning that the UK is also looking to add to its restructuring toolbox with a number of new initiatives that, although unlikely to get onto the statute book until after Brexit, are clearly intended to ensure UK procedures maintain their “best in class” status.<sup>10</sup> However, none of these new procedures are yet tried and tested and they will take some time to bed in and for confidence in their ability to deliver results to grow. In this sense, the English scheme of arrangement has a huge head start and, given all the strengths of the English scheme, we believe restructuring practitioners will find a way of ensuring that it is still recognised overseas.

There is likely to be a greater impact on European cross-border insolvencies involving the UK, with the possible need for parallel proceedings and the additional time and cost implications that that entails. However, again, the hurdles will not be insurmountable – European cross-border cases were successfully completed prior to 2000, when the European Insolvency Regulation came into force, and we successfully manage many non-European cross-border situations today (with US and Asia, for example).

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<sup>9</sup> Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN>

<sup>10</sup> For more information on the proposed reforms see our bulletin *UK Corporate Insolvency Reforms: What do I need to know? (October 2018)* - available at: [http://www.allenoverly.com/SiteCollectionDocuments/UK\\_Corporate\\_Insolvency\\_Reforms\\_Factsheet.pdf](http://www.allenoverly.com/SiteCollectionDocuments/UK_Corporate_Insolvency_Reforms_Factsheet.pdf)

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