ALLEN & OVERY

Brexit Law – your business, the EU and the way ahead

Implications for cross-border insolvencies and restructurings

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Issue in focus

English insolvency and restructuring procedures are well regarded on the global stage, and for good reason. English law provides a flexible, comprehensive restructuring and insolvency toolkit which is supported by the speed of access to, and the commercial attitude of, English judges. Creditors lending to foreign companies have frequently utilised English procedures and structured their financings to ensure that they are able to do so (e.g. choosing English governing law and jurisdiction clauses in the finance documents or shifting the centre of main interests of the borrower to the UK).

None of this changes as a result of the UK electorate's decision to vote in favour of leaving the EU.

The UK's cross-border insolvency and restructuring regime has provided a solid, predictable backdrop for commercial counterparties when structuring cross-border deals and making investment decisions. One part of this attractiveness is the recognition afforded to certain English insolvency procedures across Europe.

Although the model and details of the way in which the UK will exit from the EU remains uncertain, it is clear that Brexit (in whatever form it ultimately will take) will have an impact on such recognition. Whether this impact will be severe enough to affect the decision to use English insolvency and restructuring procedures (i.e. the choice of England as the forum for such proceedings) is, in our view, unlikely. This is particularly the case given that one of the main tools in the toolkit (the English scheme of arrangement) is not covered by the European insolvency legislation in any event. However, the uncertainty caused by Brexit is unwelcome and it is very much hoped that the UK will put in place legislation, or will negotiate an exit, that will retain the benefits of some of the European legislation in this area.

This paper seeks to identify and analyse the potential impact of Brexit on the UK's cross-border insolvency and restructuring regime and to help clients assess whether they should be taking any immediate actions in this regard. For the reasons given in this paper, the answer to that question is no. It should be noted that, despite the outcome of the referendum, the nature and shape of the exit model remains deeply unclear. The post-exit model negotiated and adopted by the UK (and remaining EU Member States) is fundamental to the analysis, and may change certain outcomes reached, in this paper.

This paper is one of a series of specialist Allen & Overy papers on Brexit. To read these papers as they become available, please visit: www.allenovery.com/Brexit-Law.

Analysis

Cross-border insolvency law applicable in England & Wales – what is the current position?

To put Brexit in context, we have set out in Annex 1 to this paper a high level summary of the strands of cross-border insolvency law currently applicable in England & Wales. These strands are:

i) within Europe, the EC Regulation on Insolvency Proceedings (**EIR**), the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (**CIWUR**) and the Insurers (Reorganisation and Winding Up) Regulation 2004 (**IWUR**) which apply automatically if certain conditions are met;

ii) the Cross Border Insolvency Regulations 2006 (**CBIR**) which applies where an application for recognition is made by a foreign representative of a debtor with its centre of main interests or an establishment in the foreign jurisdiction (the CBIR implements the UNCITRAL Model Law on Cross Border Insolvency (the **Model Law**) in the UK);

iii) section 426 of the Insolvency Act 1986 which applies where a request for assistance is made by the courts of certain relevant countries (largely commonwealth jurisdictions);

iv) the Foreign Judgments (Reciprocal Enforcement) Act 1933 which applies to the judgments of the courts of certain listed countries; and

v) the common law.

It should be noted that the legal landscape summarised above is likely to change by the time Brexit occurs (it is assumed Brexit will be at least two years, possibly longer).

- The recast EIR will come into force on 26 June 2017. In broad terms, the recast EIR modernises the scope of the EIR by, among other things, bringing pre-insolvency "rescue" procedures within its remit.
- The harmonisation of European insolvency laws is currently on the European Commission's agenda. Building on the Commission's Recommendation of 12 March 2014 on a new approach to business failure and insolvency (which suggested certain minimum standards for restructuring proceedings) and as part of the Commission's Capital Markets Union Action Plan (and, more specifically, its aim of removing barriers to cross border investment) it is understood that the Commission had intended to publish legislative proposals for harmonisation of certain areas of European insolvency laws before the end of the year but timing may stretch into 2017. When the UK does formally leave the EU, it will lose its seat at the table to influence developments such as the recast EIR and the harmonisation project (in practical terms it is likely that, post referendum, the UK has already lost its ability to influence developments).
- UNCITRAL is currently considering an extension of the Model Law to allow, among other things, recognition and enforcement of foreign insolvency-related judgments (although any resulting legislative changes are not expected until 2017 at the earliest).

Exit models

Existing models for the EU's relations with non-Member States suggest that there are a number of arrangements that could be agreed in connection with a UK exit from the EU. Please refer to our specialist paper Potential mechanisms for a UK exit from the European Union and what follows next for a detailed analysis of the principal options that are likely to be available – these include the so-called 'Norwegian Model', the 'Swiss Model', the 'Turkish Model', the 'Canadian Model' and the 'WTO Membership Model'. It remains too early to foresee which option will be pursued by the UK in its exit negotiations with the EU. However, each option will have a different impact upon the restructuring and insolvency legal landscape.

What impact might Brexit have on the current position?

We set out in Annex 2 to this paper a high-level summary table showing the possible impact of Brexit on the existing strands of cross-border insolvency law.

Insolvency proceedings – the EIR cornerstone

The EIR revolutionised the landscape for commercial counterparties involved in cross-border insolvency cases in the EU when it was introduced in 2002. By and large, it has been a success and has operated effectively. The amendments made by the recast EIR are also considered beneficial to commercial counterparties. The EIR (and

the recast EIR) is certainly the most comprehensive strand of our cross-border insolvency regime both in terms of its application and the scope of what it governs. Crucially (particularly in the context of Brexit) it should be noted that recognition under the EIR is reciprocal and automatic in nature so the UK gets the same benefits for English insolvency procedures that it provides to the insolvency proceedings of other Member States without the need for a court order.

The EIR, as a European regulation, is directly applicable in the UK. When the UK leaves the EU, under any of the exit models highlighted above, it will (without agreement to the contrary) no longer be subject to the EIR. In this scenario, the UK would clearly lose all the benefits of the recognition of English proceedings under the (recast) EIR and would be left relying on the cross-border insolvency rules of the remaining Member States outside of the EIR. It would be piecemeal and not the uniform regime that applies (automatically) between Member States today. In this respect it is noted that very few EU Member States have implemented the Model Law – only Greece, Poland, Romania and Slovenia. Due to the lack of domestic implementation by Member States, the Model Law does not provide a comprehensive alternative to the EIR (and, in any event, provides a more limited recognition framework).

Similarly, foreign insolvency procedures seeking recognition in the UK would be forced to rely on section 426 (in the case of Ireland), the common law and CBIR which are more limited in scope. The need to rely on this 'patchwork quilt' combination of legislation and common law to obtain recognition is likely to result in delays as well as increased cost and uncertainty.

The UK could of course adopt domestic legislation imposing obligations on the UK that are equivalent to the EIR[1]. However, in order to obtain reciprocity in the remaining EU Members States, such Member States would need to agree to such reciprocity. This is likely to be some way down the list of priorities as part of exit negotiations.

The issues referred to above will apply equally to credit institutions, insurers and other financial institutions within the scope of the Credit Institutions Winding Up Directive (**CIWUD**) and the Insurers Winding Up Directive (as replaced by Title IV of the Solvency II Directive 2009/138/EC, **IWUD**) (as implemented in the UK by the CIWUR and the IWUR). These issues may be mitigated if the UK remains part of the EEA (for instance, under the Norwegian Model). In these circumstances the UK will continue to enjoy the benefits of the CIWUR and IWUR (and equivalent implementing legislation in other Member States) with respect to these types of entities and Brexit will be of no impact in this respect.

Scheme of arrangement – will it lose its popularity?

In our view, Brexit will have little impact on the popularity of the English scheme of arrangement as a European restructuring tool. The English scheme of arrangement is not a procedure listed in the annex to the EIR and will not be a "rescue" procedure listed in the recast EIR. Therefore, the potential impact of Brexit on the EIR, as highlighted above, is not applicable to schemes of arrangements.

In our recent bulletin The rise and rise of the English scheme of arrangement we highlighted the current debate surrounding the English court's jurisdiction in relation to foreign companies and the interplay between the EIR and the European Judgments Regulation - the practical effect of which means jurisdiction must now be demonstrated in respect of the scheme creditors and not just the scheme company. If, upon Brexit, the Judgments Regulation ceases to apply to the UK, there will no longer be any debate to have, potentially, leaving the "sufficient connection" test as the test for whether the court has jurisdiction to sanction a scheme of arrangement in respect of an English company[2]. English governing law is sufficient to satisfy this test. Post-Brexit, the English court will, therefore, retain its wide jurisdiction with respect to schemes in relation to foreign companies, and it is possible that jurisdiction requirements may even be simplified a little with respect to foreign scheme creditors.

However, in sanctioning a scheme of arrangement, the English court will want to ensure that its order will be

[1] For example, German autonomous international insolvency law provides an alternative (but broadly equivalent) regime for the recognition and enforcement of foreign (main) proceedings to the EIR. The main differences (compared with the EIR) are that the German courts will check whether COMI is actually in the UK and there is a formal procedure to make the foreign decision enforceable in Germany.

[2] We recognise that there is a technical debate that the UK may still be bound by the Lugano Convention (see below) or even an early predecessor to the Judgments Regulation, the Brussels Convention. In addition, in terms of enforcement of English judgments (discussed below in the context of recognition of schemes of arrangement), there may even be some bilateral treaties in place with certain jurisdictions.

effective in practice and, in doing so, will want to see evidence that the scheme would be recognised and have effect in any relevant foreign jurisdictions (including where the scheme company is incorporated and any significant assets situated). Parties have often relied upon the Judgments Regulation to provide such evidence of (automatic) recognition across the EU. If this avenue is not available post-Brexit (which absent specific agreement between the EU and the UK, it will not be), any evidence will need to rely on private international law and, if relevant, the rules in Rome I to satisfy the English court that the scheme will have effect in the relevant EU jurisdictions. In our experience, recognition can often be established via private international law but it is certainly more challenging and less of a uniform approach.

Whether another regime will fill the gap left by the Judgments Regulation following Brexit is considered in more detail in our specialist paper on jurisdiction which can be accessed here. One possibility is that the UK remains a party to the Lugano Convention 2007 (the **Lugano Convention**) (it is currently a party as a member of the EU but would likely need to separately accede post-Brexit). The Lugano Convention imposes a similar (although not identical) regime to the Judgments Regulation in relation to jurisdiction and the recognition and enforcement of judgments as between EU Member States and EFTA states other than Liechtenstein (i.e. Switzerland, Iceland and Norway). This option is probably most relevant in the Norwegian or Swiss Model where the UK becomes an EEA or EFTA state[3]. In this scenario, it seems likely that the UK would still enjoy the benefit of uniform recognition of the scheme of arrangement across EU Member States.

A second possibility could be to rely on the Hague Convention on Choice of Court Agreements 2005 (the **Hague Convention**). The Hague Convention was entered into by the EU on behalf of the Member States (other than Denmark) and came into force as between those Member States and Mexico on 1 October 2015[4]. It seems the UK itself would need to ratify the Hague Convention post-Brexit to ensure that the convention will continue to apply (as the UK is currently only party by virtue of the EU ratifying on behalf of all Member States). The Hague Convention provides a mechanism for the allocation of jurisdiction in cases where parties have agreed to an *exclusive* jurisdiction clause in favour of a contracting state and for the recognition of judgments rendered pursuant to such clauses. However, although the Hague Convention could potentially apply to scheme proceedings, the requirement for an exclusive jurisdiction clause may make it unsuitable for a typical financial creditor scheme of arrangement, where the relevant debt documents often only subject the borrower/obligors (and not the creditors) to the exclusive jurisdiction of the English Courts.

Ultimately, if there remains any concern regarding the recognition of the English scheme following Brexit, this may be a reason for choosing a restructuring process from one of the remaining Member States. For example, the Dutch equivalent of the scheme of arrangement that may be introduced in the Netherlands could be an attractive option for companies who have their centre of main interests in the Netherlands. Accordingly, it may become even more important for the full range of international restructuring options/procedures to be analysed in each restructuring situation.

Other considerations

These are simply a few of the impacts that Brexit will have on English insolvency and restructuring laws. Other areas that could be affected include:

- the enforcement of financial collateral arrangements – the UK implemented the Financial Collateral Directive by way of secondary legislation using its powers under the European Communities Act 1972. The UK will need to consider and deal with all secondary legislation passed under this Act. This will be time-consuming and could lead to uncertainties in the meantime. Furthermore, English court decisions regarding the construction of our implementing secondary legislation have often been highly influenced by the relevant European directive. Whether English judges will still consider themselves bound by these decisions (or find them relevant to their considerations) is not clear and adds to the uncertainty. For further discussion of these issues please see our specialist paper Key immediate implications of the UK's vote to leave the EU;
- bank resolution and recognition across Europe – although the UK may no longer be bound by European rules regarding resolution of UK banks, we think it is highly unlikely the UK Government will amend the Banking Act 2009 (as amended to,

[3] Although a non-EFTA state can accede to the convention.
[4] The Hague Convention has also been ratified by Singapore and it will come into force as between the relevant EU Member States, Mexico and Singapore on 1 October 2016.

among other things, implement the Bank Recovery and Resolution Directive) (or any relevant secondary legislation), so the impact on the resolution tools available in the UK may be little, if any, in practice. Automatic recognition of UK bank resolutions across Europe will be impacted if no replacement legislation is enacted. Based on recent experience with Iceland and Cyprus, it may be advantageous if the UK did not have to automatically recognise resolutions commenced in other Member States. However, on balance, a level playing field with reciprocal recognition and benefits is to be preferred;

– the choice of English law where the parties want to rely on certain safe-harbours in the EIR and the CIWUD (e.g. the transaction avoidance and, possibly, set-off and netting agreements safe-harbours) – these safe-harbours provide protections (in very general terms) for contracts governed by the laws of one Member State where insolvency or reorganisation proceedings are commenced in another Member State. For the reasons given in our specialist paper on choice of governing law (accessed here), we consider it unlikely that the parties will cease to choose English law as the governing law of their contracts simply because these safe-harbours may no longer apply - but where parties are deciding between English and New York law (as is the case with the ISDA Master Agreement), the fact that these safe-harbours may no longer apply to an English law contract might remove one of the current advantages of choosing English law;
– the choice of US bankruptcy proceedings – we have referred above (in the section on schemes) to the possibility that other European restructuring proceedings may become more popular in years to come. It is also possible that the parties will choose a US chapter 11 proceeding over any European process if the automatic recognition given by the recast EIR for European proceedings is no longer available.

Other mitigating factors

– Many (if not most) restructurings are conducted outside of a formal insolvency process and implemented by way of contract (amending existing agreements and/or entering into new agreements). They are "consensual" in the sense that the requisite creditor majorities are obtained to implement the restructuring using the amendment mechanics in existing documentation. English law, as it applies in relation to commercial contracts between parties conducting business internationally, will largely be unaffected by the uncertainty surrounding Brexit and will therefore continue to be certain, stable, predictable, commercially orientated and familiar. To the extent a "cram down" procedure is needed to bind dissenting creditors, the English scheme of arrangement will remain a useful tool for English and foreign companies (who can satisfy the "sufficient connection test") post-Brexit.
– In the context of a formal insolvency process, automatic recognition under the EIR (or lack thereof post-Brexit) may not be a concern if a creditor has taken part in the English insolvency process (e.g. by voting or proving) and by doing so submitted to jurisdiction of the English court.
– Other European jurisdictions are reforming and improving their insolvency laws and developing credible alternatives to the scheme of arrangement. It may be that, just as foreign companies have looked to the UK to utilise English insolvency and restructuring procedures, English borrowers will find European alternatives a realistic option as these reforms are implemented and new procedures are tried and tested in the market.

What does this mean for you?

Notwithstanding the clear outcome of the referendum, the ultimate exit model remains uncertain. The detailed legislative changes that result from Brexit will be driven by the exit model that is agreed with the EU. As a result, the consequential effects on clients cannot be ascertained with any certainty at this time. In the field of cross-border insolvency, the current interaction with Europe works very well. Therefore, we would hope that there will be a desire to maintain the current regime as far as possible, perhaps through the implementation of replacement legislation. The key unknown in this respect is whether the UK will enjoy the reciprocity it currently enjoys under the EIR (and other relevant European legislation) if certain Member States choose not to adopt any replacement legislation. Furthermore, agreeing to a reciprocal regime on recognition and enforcement of insolvency proceedings post-Brexit may be some way down their list of priorities.

Although there is a lot of uncertainty surrounding Brexit at this stage, one thing that can be said for certain is that, even when the UK is no longer part of the EU, UK financial institutions and commercial counterparties will want to carry on doing business with companies situated in the EU. These EU counterparties will continue to be bound by European legislation (including the EIR) when conducting their operations and business. The UK has lost its ability to shape such European legislation and any subsequent amendments or legislative developments affecting EU counterparties are now outside of its control.

There are a number of interesting questions arising out of the impact of Brexit on the UK's insolvency and restructuring offering but, in our view, none require immediate action. In particular:

- Despite any uncertainty surrounding reciprocal recognition following Brexit, commercial counterparties should continue to feel confident in their choice of English law as the governing law of their finance agreements and commercial contracts. A choice of English law to govern both contractual and non-contractual obligations is a sound one and will remain so notwithstanding the outcome of the Brexit referendum – its certainty, transparency, the speed of access to the English court system and the commercial attitude of its judges will not be impacted by Brexit. These attributes ensure restructurings and insolvencies are conducted efficiently and, for the most part, give effect to the contractual bargain struck between commercial parties. Further consideration of English governing law clauses in the context of Brexit is contained in our specialist paper on this topic, linked here.
- In our view, the potential impacts highlighted in this paper would be unlikely to have a negative impact on the credit rating of an English borrower. The toolkit of English insolvency and restructuring procedures will remain the same and they are well regarded internationally. In addition, "consensual" restructurings or a restructuring via a scheme of arrangement will be largely unaffected by Brexit.
- It is possible that an English law governing contract will not be subject to some of the safe-harbour provisions in the EIR and CIWUD which look to the governing law of the contract rather than the insolvency laws of the debtor. However, New York law governed agreements would not be subject to these safe-harbours either. We suspect that there will be little appetite to change the governing law to that of a remaining Member State, just to make use of these safe-harbours. Furthermore, there may be an advantage in choosing English law as, absent any parallel legislation replicating the effect of the EIR, the English courts will no longer be required to give effect to an EU compromise of an English law debt due to the effects of the common law rule in *Gibbs v Societe Industrielle des Metaux* (1890) 2 QBD 399.
- It is possible that currency movements, changes in regulation and changes in investor appetite could have a detrimental impact on certain businesses within and outside of the UK. This paper focuses on the legal rather than the economic consequences of Brexit and so these issues are beyond its scope. It is certainly possible, however, that in the near term Brexit could lead to a greater number of insolvencies and restructurings in certain sectors and jurisdictions.

If you would like to discuss the issues raised in this paper in more detail, please contact any of the experts below or your usual Allen & Overy contact. We also encourage clients focusing on Brexit-related issues to refer to the other specialist papers in this series, linked at www.allenovery.com/Brexit-Law.

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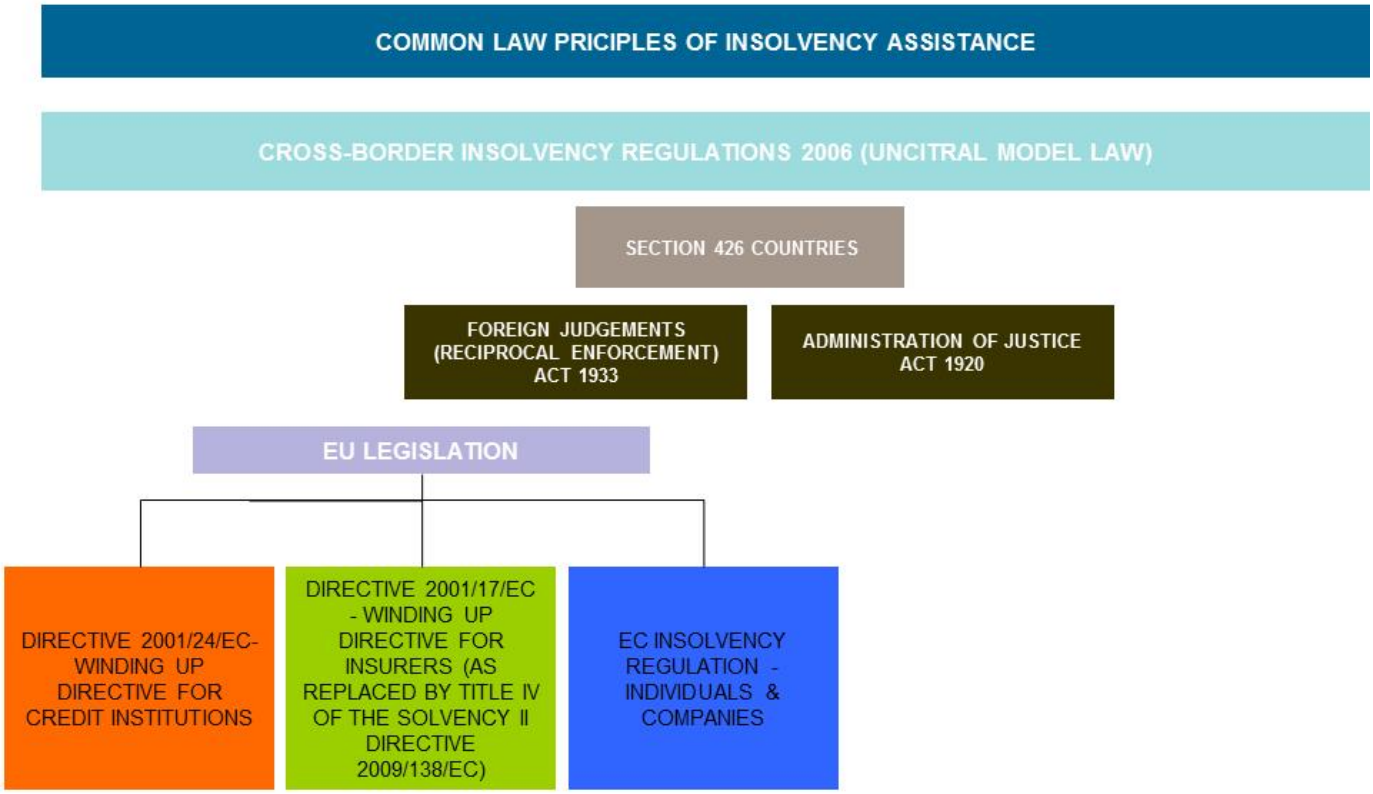
Annex 1

Strands of UK cross-border insolvency law



Annex 2

Possible strands of UK cross-border insolvency law post-Brexit

		Norwegian (EEA)	Swiss (EFTA)	Turkish	Canadian	WTO
EIR	Allocates jurisdiction for insolvency proceedings within the EU to the country where the CoMI of the debtor is located	UK will lose the benefit of this post-Brexit and recognition of English proceedings will be dependent upon the individual laws in each of the Member States – only Greece, Poland, Romania and Slovenia have implemented Model Law				
CIWUD and IWUD	Broadly, performs the same role as EIR in the EEA in relation to credit institutions and insurers. Implemented in UK by CIWUR and IWUR	UK will continue to enjoy benefit if UK becomes part of the EEA	UK will lose the benefit of this post-Brexit and be dependent on individual laws in each of the remaining Member States			
CBIR / Model Law	Implements Model Law - English courts must recognise foreign insolvency proceedings. UK gets reciprocal benefit in countries that have implemented Model Law	Will continue to apply as a means of "inbound" recognition in England for foreign insolvency proceedings –more limited recognition framework than EIR				
		Not a comprehensive alternative to EIR for "outbound" recognition of English insolvency proceedings elsewhere - of the remaining Member States, only Greece, Poland, Romania and Slovenia have implemented the Model Law				
s426	Permits English court to give assistance in relation to foreign insolvency proceedings – mainly applies to proceedings in former British Commonwealth countries	Unaffected by Brexit but the only jurisdiction that would likely benefit from within the EU would be the Republic of Ireland				
Common Law	Permits English court to provide assistance by doing whatever could have been done in the equivalent English proceedings	Unaffected by Brexit but only assists "inbound" recognition in England of foreign insolvency proceedings not "outbound" recognition of English insolvency proceedings elsewhere				
Foreign Judgments (Reciprocal Enforcement) Act	Allows enforcement of money judgments, limited number of jurisdictions (EU overlap: France, Belgium, Germany, Norway, Austria, Netherlands, Italy)	Unaffected by Brexit but only cross-over with EU/EEA is France, Belgium, Germany, Norway, Austria, the Netherlands and Italy (Administration of Justice Act 1920 provides similar regime for Cyprus and Malta)				

Key:

- = Affected by Brexit, will cease to apply
- = Unaffected by Brexit
- = Unaffected by Brexit *but* limited in scope / applicability across remaining EU (i.e. not a comprehensive alternative to EIR)