ALLEN & OVERY

Brexit – legal consequences for commercial parties

Implications for cross-border insolvencies and restructurings

February 2016

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). 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.

Brexit, in whatever form, could have an impact on such recognition. Whether this impact would 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, it is possible that the uncertainty caused by a Brexit could cause parties to consider whether another European process or a US chapter 11 plan might lead to a better outcome.

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 the post-exit model negotiated and adopted by the UK (and remaining EU Member States) is clearly 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.

Analysis

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

To put Brexit in context, we have set out in the Annex 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;

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 any Brexit occurs (if it is assumed a Brexit will be at least two years, possibly longer, following a vote to leave the EU).

- 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 for 2016. 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 will publish legislative proposals for harmonisation of certain areas of European insolvency laws before the end of the year. If the UK were to leave the EU, it would lose its seat at the table to influence developments such as the recast EIR and the harmonisation project.
- UNCITRAL is currently considering an extension of the Model Law on Cross Border Insolvency 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).

What impact might Brexit have on the current position?

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. If the UK leaves the EU, it will (without agreement to the contrary, see further below) no longer be a party 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. 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 increased time, cost and uncertainty this would create would be unwelcome.

The UK may seek to retain the benefits of the current regime under the EIR upon a Brexit – perhaps by agreeing separate bilateral legislation with as many Member States as possible. It is unclear whether, and to what extent, Member States would be willing to agree to the UK's proposals if relationships have been fractured as a result of a Brexit.

The issues referred to above would apply equally to credit institutions, insurers and other financial institutions within the scope of the Credit Institutions Winding Up Directive and the Insurers Winding Up Directive (as implemented in the UK by the CIWUR and the IWUR). These issues may be mitigated if the UK remains part of the EEA. 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 would 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 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 UK is no longer a party to the Judgments Regulation, there will no longer be any debate to have, 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. 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 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 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, 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 would remain a party to the Lugano Convention 2007 (it is currently a party as a member of the EU) which 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 Switzerland, Iceland and Norway. In this scenario, the UK would still enjoy the benefit of uniform recognition of the scheme of arrangement across EU Member States.

Ultimately, if there remains any concern regarding the recognition of the English scheme following a 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. But given the UK's decision not to list schemes in the recast EIR, this concern will arise whether or not there is a Brexit.

Other considerations

These are simply a few of the impacts that a Brexit could 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 would need to consider and deal with all secondary legislation passed under this Act which would 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 just adds to the uncertainty;

- 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 would amend the Banking Act 2009 (as amended to, 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 the set-off, netting agreements and transaction avoidance safe-harbours in the EIR and the Credit Institutions Winding Up Directive – 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 would 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 would no longer apply to an English law contract may 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 they consider that 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.

Views from around the world

We asked our colleagues in Germany, the Netherlands and New York, "*what effect do you think Brexit might have on the views of debtors/creditors when considering their cross-border restructuring/insolvency options (e.g. will the UK fall out of favour, who might reap the rewards)?*"

Peter Hoegen
Partner, Banking – Frankfurt

Oliver Waldburg
Partner, Banking – Frankfurt

"*If the EIR does not apply following a Brexit, German autonomous international insolvency law would apply in respect of the recognition and enforcement of foreign (main) insolvency proceedings. 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. In practice, following a Brexit, the German courts will continue to apply the COMI test as established by the case law under the EIR but there may be procedural delays as some more boxes have to be ticked.*

UK schemes of arrangement in respect of German companies are an established restructuring tool although there are different views of this technique in the German market. The prevailing view (not court tested) that a scheme will be recognised by the German courts. Recognition may be more difficult if neither Rome I, the Judgments Regulation nor the EIR were applicable. Recognition would be assisted if the UK became a member of EEA and joined the Lugano Convention 2007." (Peter Hoegen, Partner, Frankfurt and Oliver Waldburg, Partner, Frankfurt)

Sigrid Jansen
Partner, Banking – Amsterdam

"*Although the eventual exit route is hard to predict, Brexit is bound to result in economic uncertainty which is never good for the investment climate. It may be unclear for a while whether the (recast) EIR will continue to apply in the UK. This may result in less UK restructurings because parties may think twice before shifting the centre of main interests of the borrower to the UK.*" (Sigrid Jansen, Partner, Amsterdam)

Ken Coleman
Partner, Banking – New York

"*At the moment, there is an advantage in using an English scheme of arrangement if that gets recognition across Europe under the Judgments Regulation. But I doubt that is the decisive factor in choosing a scheme over a Chapter 11 so Brexit may make little noticeable change in this regard.*" (Ken Coleman, Partner, New York)

What does this mean for you?

Until the UK exit model becomes clearer and the legislative changes that result from Brexit are identified, the consequential effects on clients cannot be ascertained with any certainty. 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 if the UK was 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. Brexit would mean the UK is likely to lose its ability to shape such European legislation and any subsequent amendments or legislative developments affecting EU counterparties would be 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 whatever 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. Furthermore, we would expect measures to be implemented that will seek to maintain the current position as far as is possible. 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 Credit Institutions Winding Up Directive 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 would be little appetite to change the governing law to that of a remaining Member State, just to make use of these safe-harbours.
- 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 a Brexit and so these issues are beyond its scope. It is certainly possible, however, that a Brexit could lead to a greater number of insolvencies and restructurings (at least in the short term) in certain sectors and jurisdictions.

We encourage interested clients to get in touch with any questions and comments. 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.

Your Allen & Overy contacts

Ian Field
Partner
Banking – London

Contact

Tel +44 20 3088 2671
ian.field@allenovery.com

Jennifer Marshall
Partner
Banking – London

Contact

Tel +44 20 3088 4743
jennifer.marshall@allenovery.com

Lucy Aconley
Senior PSL
Banking – London

Contact

Tel +44 20 3088 4442
lucy.aconley@allenovery.com

Katrina Buckley
Partner
Banking – London

Contact

Tel +44 20 3088 2704
katrina.buckley@allenovery.com

Carolyn Conner
Partner
Banking – London

Contact

Tel +44 20 3088 4742
carolyn.conner@allenovery.com

Ken Coleman
Partner
Banking – New York

Contact

Tel +1 212 610 6434
ken.coleman@allenovery.com

Tim Crocker
Partner
Banking – London

Contact

Tel +44 20 3088 3208
tim.crocker@allenovery.com

Earl Griffith
Partner
Banking – London

Contact

Tel +44 20 3088 2635
earl.griffith@allenovery.com

Peter Hoegen
Partner
Banking – Frankfurt

Contact

Tel +49 69 2648 5905
peter.hoegen@allenovery.com

Sigrid Jansen
Partner
Banking – Amsterdam

Contact

Tel +31 20 674 1168
sigrid.jansen@allenovery.com

David Lines
Partner
Banking – London

Contact

Tel +44 20 3088 2680
david.lines@allenovery.com

Mark Sterling
Partner
Banking – London

Contact

Tel +44 20 3088 2662
mark.sterling@allenovery.com

Gordon Stewart
Partner
Banking – London

Contact

Tel +44 20 3088 2702
gordon.stewart@allenovery.com

Andrew Trahair
Partner
Banking – London

Contact

Tel +44 20 3088 2780
andrew.trahair@allenovery.com

Oliver Waldburg
Partner
Banking – Frankfurt

Contact

Tel +49 69 2648 5825
oliver.waldburg@allenovery.com

Randal Weeks
Partner
Banking – London

Contact

Tel +44 20 3088 2780
randal.weeks@allenovery.com

If you would like to discuss the issues raised in this paper in more detail, please contact Ian Field, Jennifer Marshall or Lucy Aconley or your usual Allen & Overy contact.

Annex

Strands of UK cross-border insolvency law