7 July 2016

BREXIT: IMPACT ON RESTRUCTURING AND INSOLVENCY FOR COMPANIES

By Sonya Van de Graaff, Peter Declercq, and Howard Morris

The process of Brexit will take many years, and the implications for our clients' businesses will unfold over time. Our MoFo Brexit Task Force is coordinating Brexit-related legal analysis across all of our offices, and working with clients on key concerns and issues, now and in the coming weeks and months. We will also continue to provide MoFo Brexit Briefings on a range of key issues. We are here to support you in any and every way that we can.

Following the referendum…and after Brexit

The UK's majority vote by referendum to leave the European Union will have no immediate effect on the law or practice of restructuring and insolvency in Europe for companies. For the time being, the UK remains a member of the EU, and all existing EU-derived laws continue to apply in the UK. However, the UK's eventual exit from the EU could pose challenges for cross-border restructurings and insolvencies, depending on the future relationship between the UK and the remaining EU Member States agreed as part of the UK's exit negotiations.

Summary

UK administrations

As a result of the UK's exit, unless otherwise agreed with the EU, the UK will cease to be bound by and benefit from, the European Insolvency Regulation (the "EIR"). This will have material disadvantages for companies in administration under the Insolvency Act 1986 (UK) that have assets and/or operations in EU Member States, including:

- There will be prolonged uncertainty regarding almost every aspect of the administration (discussed in detail below). The EIR sets out detailed and transparent principles resolving questions which invariably arise in a cross-border insolvency involving assets and/or operations in EU Member States (other than Denmark which has opted out of the EIR). Unless the UK and the remaining EU Member States (other than Denmark) agree that the EIR will continue to apply post-Brexit, or separate bilateral treaties are agreed between the UK and individual EU Member States, these matters will fall to be determined by reference to the varying rules of private international law of the relevant EU Member State and the UK.

- The automatic recognition of the administrator as the authorized office-holder throughout the EU Member States and the automatic stay on litigation or enforcement of security will cease. The administrator will have to apply for recognition and a stay in each EU Member State and the application will be considered on its merits in accordance with the rules of private international law of the relevant EU Member State.

It will therefore clearly be more expensive, time-consuming and cumbersome to run a UK administration if the company has assets and operations in the EU. Companies with assets and operations in the EU may consider moving their centre of main interests ("COMI") from the UK to an EU Member State to benefit from the reciprocal automatic recognition and relief. The detailed framework for resolving conflicts of law provided under the EIR, and the reformed insolvency regimes introduced in recent years by a number of EU Member States, may thus become more popular. However, such a decision would need to be weighed up against the very real benefits – which will not change – of the UK court system and administration process, which are known for their commerciality, transparency and predictability.

Joining the European Free Trade Association ("EFTA") will not avoid these problems since the EIR does not apply to the members of the EFTA (and, in any event, the EFTA requires acceptance of the principle of freedom of movement of people, the rejection of which was a central pillar of the Leave campaign in the Brexit referendum). There is currently no precedent of a non-EU Member States acceding to the EIR, but it remains to be seen what will be agreed as part of the UK's exit negotiations.

Impact on schemes

On balance, there should be no change in the ability of an English court to sanction a scheme of arrangement (under Part 26 of the Companies Act 2006 (UK)) in respect of a (foreign) company whose COMI is in another EU Member State (but this may depend on there being no material departure by courts in the EU Member States (1) in the application of rules of their own private international law insofar as they apply them to the UK (as further discussed below) and (2) on the continued recognition of the parties' choice of jurisdiction. (See MoFo BREXIT Briefing: Recognition and Enforcement of judgments

implications for contracting parties and disputes). However, Brexit may further incentivize the EU Member States to develop alternative informal restructuring processes in competition with the ever-more popular system of schemes of arrangement.

Now for the detail

Formal corporate insolvency proceedings

If the UK leaves the EU without agreeing for the EIR to continue to apply to it post-Brexit, this is expected to have the following principal consequences.

No automatic recognition (and mismatch)

UK administrations lose automatic recognition across EU Member States.

The automatic recognition in EU Member States afforded to insolvency proceedings (such as administration) under the Insolvency Act 1986 (UK) and of the UK insolvency office holder (such as an administrator) will cease (except in those EU Member States that have implemented the UNCITRAL Model Law on Cross Border Insolvency (the "Model Law"). Only Greece, Poland, Romania and Slovenia (and the UK) have done so).

This means, for an administrator in a UK administration with assets or operations in other EU Member States, that he/she will need to make a separate application for recognition (and possibly open local proceedings) in each of those other EU Member States in order to:

- benefit from the relief (such as a moratorium, discussed below) necessary to protect those assets and operations from litigation and attachment by creditors, and
- deal with any assets or operations in that jurisdiction.

The application will fall to be determined in accordance with the laws of private international law of that EU Member State and/or judicial co-operation unless a bilateral treaty can be negotiated.

Alternatively, the administrator might have to trigger an insolvency proceeding in that EU Member State. Moreover, an insolvency proceeding in another EU Member State will not be secondary proceedings (as it is under the EIR) and confined just to the assets and liabilities of the company in that Member State. It will be, potentially, a separate independent proceeding, competing with the UK proceedings.

Mismatch: EU Member State insolvency proceedings will continue to benefit from recognition in the UK

Conversely, the UK's obligation (following a "set-piece" application without regard to the merits) to grant automatic recognition in the UK of the insolvency proceedings of a company in an EU Member State (and whose COMI is in that state) and to the officer appointed to supervise that company's insolvency, will continue (since the UK has implemented the Model Law).

No automatic relief

UK administrations will lose the right to automatic relief across EU Member States.

The reliefs and protections (such as cessation of litigation and enforcement of security) that the Insolvency Act 1986 (UK) confers on a company in administration will lose automatic recognition across the EU Member States. An application for relief will need to be made and, again, will fall to be determined in accordance with the private international law of the relevant Member State. The purpose of the relief is important – it provides breathing space for the administrator to assess and gather all of the property of the estate without creditors seeking remedies to protect their own interests. It therefore assists in ensuring the maximizing of value for all creditors.

Mismatch: EU Member State insolvency proceedings will continue to benefit from automatic relief in the UK

Conversely, EU Member State insolvency proceedings in respect of a company whose COMI is in that EU Member State will continue to benefit from relief in the UK by virtue of the Model Law (as described above).

Applicable law regime – which law applies?

The EIR establishes that the "State of opening of proceedings" determines the procedural law for the opening, conduct and closing of insolvency proceedings including the following matters:

- the assets that form part of the estate;
- the effect of insolvency proceedings on current contracts to which the debtor is party; and
- who is to bear the costs and expenses incurred in the insolvency proceedings.

The EIR also provides that other matters are to be determined otherwise than by reference to the "State of opening of proceedings". Examples are:

- set-off rights;
- rights in rem and reservation of title;

- employment rights; and
- detrimental acts.

If continued application of the EIR to the UK is not agreed as part of the UK's exit negotiations, these and other complex procedural and substantive matters will again fall to be determined in accordance with the rules of private international law of the laws of the relevant EU Member States and the UK. The determination of these issues will be time-consuming and add additional complexity to cross-border insolvencies and restructurings.

Informal restructurings: Schemes of Arrangement

On balance, we consider that the position should not change. The main area of uncertainty in relation to application of Schemes to EU Member State companies relates to the role of the Recast Judgments Regulation (EU) (which provides recognition and enforcement of judgments on civil and commercial matters within the EU). Specifically, its relevance to the question of whether there is a "good prospect" that the Scheme will take effect in those EU Member States where assets of the Scheme company are located. An English court asked to sanction a Scheme relies on expert evidence to answer that question. As recent cases show the answer has not been found in the Recast Judgments Regulation (EU), but rather in the rules of private international law as found in the relevant Member State's law [e.g. *Re Van Gansweinkel Groep B.V. and others* [2015] EWHC 2151 (Ch)]. Therefore in our view, the falling away of the Recast Judgments Regulation should have no effect.

However, it cannot be ruled out that the same expert opinions on which the English courts have relied in finding that a proposed Scheme will be recognized abroad - and which were issued when the UK was still an EU Member State – will, in practice, be more difficult to obtain post-Brexit if no appropriate replacement arrangements in place. The popularity of Schemes for restructurings over the limited solutions offered by the other EU Member States, has prompted reform of restructuring laws in some EU Member States in an effort to bring restructurings back to "home". These efforts to date have not had much practical impact. However, Brexit may lead to a change in sentiment about the attractiveness of going to London to use a Scheme.

If there were any doubt about the role of the Recast Judgments Regulation, the Lugano Convention may provide a substitute. (For more detail see MoFo Brexit Briefing: Recognition and Enforcement of judgments implications for contracting parties and disputes).

Further reading

You may also be interested in reading a briefing note that we have prepared on the impact of Brexit on restructuring ad insolvency for credit institutions:

Brexit: Impact on Restructuring and Insolvency for Credit Institutions.

Please do not hesitate to call with any question or concern you have. We're here to help.

Contact:

Sonya Van de Graaff	**Peter Declercq**	**Howard Morris**
London	London	London
+44 (207) 9204039	+44 (207) 9204041	+44 (020) 79204119
svandegraaff@mofo.com	pdeclercq@mofo.com	hmorris@mofo.com

or

Brexit@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for 12 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.