CHAPTER 13

INSOLVENCY

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INTRODUCTION

The UK is widely regarded as a global centre for restructurings, something evidenced by the number of non-UK companies that take measures to bring themselves within the jurisdiction of the courts so they might restructure, principally using the scheme of arrangement. In addition the UK is an important capital market with so many banks, investors and the specialist hedge funds that are active among distressed companies, based in the country. English law is commonly the governing law of a material part of debtor companies' obligations so the UK is the obvious and convenient venue for consensual restructurings hammered out between the debtor and its stakeholders. It is not simply UK insolvency laws (some would say 'in spite of') which are, again, the subject of reform proposals, that make the UK so attractive as a place to restructure but the respect felt internationally for the quality of professional advisers, the flexibility and predictability of English law and the sophistication and reliability of the UK courts. A number of these critical factors will be unaffected by Brexit and so, notwithstanding leaving the EU, the UK can remain a hub for international restructurings, even following Brexit.

However, it is clear that the loss of EU membership and the disapplication of EU laws will have some negative effect on the perceived attractiveness of conducting a cross-border restructuring in the UK. The UK recently slipped in the World Bank's annual Doing Business league table which suggests that perception of the UK's insolvency laws are not as favourable as they once were. By removing the added advantage of EU-wide automatic recognition of judgments and proceedings and cooperation between insolvency office-holders – that perception may fall even further.

Conversely, the US rose ten places in the same World Bank league table. American restructuring tools, and in particular, the Chapter 11 process are being increasingly viewed as best practices by organisations such as the World Bank and UNCITRAL. In the absence of measures modernising the insolvency processes in the UK (which remain at consultation stage[1]), there is a risk that following Brexit, companies may seek to find a nexus which allows them to conduct their restructurings in the US rather than in UK and credit institutions may seek to create establishments in other EU member states in order to retain access to the EU-wide tools available to them currently. A significant effort

1 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf

towards harmonisation of EU insolvency laws to establish a framework across the community that would, like the UK's reform proposals, bring the EU closer to the World Bank and UNCITRAL ideals, as well as competition from Singapore and other nations aspiring to be international restructuring centres, means that there is no guarantee the UK will remain such a powerful hub.

13.1 CORPORATE INSOLVENCY AND RESTRUCTURINGS

Currently, the main operative piece of EU legislation that affects UK restructuring/insolvency proceedings is the European Insolvency Regulation (Council Regulation (EC) 1346/2000 (the 'EIR'). The EIR is aimed at increasing cooperation and establishing common rules on cross-border insolvencies and has direct effect in the UK (as well as in every other EU member state except Denmark). For companies, it applies to compulsory winding up proceedings, creditors' voluntary winding up proceedings, administrations and company voluntary arrangements. It does not include schemes of arrangement or any type of receivership.

The EIR provides clarity over the effect of the location of insolvency proceedings:

- the courts of the member state in which the debtor has his centre of main interests (COMI) have jurisdiction to open insolvency proceedings, which are referred to as the 'main insolvency proceedings';
- once main proceedings have been opened, 'secondary insolvency proceedings' may also be opened, which run in parallel in one or more other member states in which the debtor has a place of operations where it carries out a non-transitory economic activity with human means and goods (an 'establishment');
- before main proceedings have been opened in an EU member state where the debtor has its COMI, local insolvency proceedings can be opened anywhere the debtor has an establishment. Such proceedings are referred to 'territorial proceedings' and are restricted to the assets located in that member state. This can apply to either winding up or reorganisation proceedings.

The EIR creates a duty for office holders in main proceedings and secondary proceedings to communicate information with each other and to cooperate with each other in general. The office holder in secondary proceedings has to give the office holder in the main proceedings an early chance to submit proposals on how the assets in the secondary proceedings should be used. This had been seen as a fairly radical development in cooperation in cross-border insolvency provisions but appears to have been hampered by the lack of a central database of court orders made in insolvency proceedings located in the EU.

13.2 BREXIT EFFECT

On leaving the EU the UK will cease to benefit from the EIR. The country will be going back in time to before the EIR but with a significant difference, the mismatch described below. The following will be the principal consequences:

- No automatic recognition (and mismatch):

  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 yet done so).

  This means, for an administrator in a UK administration with assets or operations in other EU member statess, she or he 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 is put in place between the UK and that state. 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.

  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 COMI from the UK to an EU member state so as to benefit from the reciprocal automatic recognition and relief and 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). There is currently no option for non-EU member states to accede to the EIR.

  - 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:

  The reliefs and protections (such as cessation of litigation and enforcement of security) that the UK's Insolvency Act 1986 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 maximising 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 any entity 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).

- Which laws apply?

  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.

Following Brexit, 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 difficult to predict.

13.3 SCHEMES OF ARRANGEMENT

As already mentioned the scheme of arrangement, not a creature of UK insolvency legislation but a venerable procedure from the Companies Acts that has enjoyed a surge of popularity in recent years as an effective tool to restructure companies notwithstanding up to 25% of the stakeholders with an economic interest in the company, vote against the proposal, is an important reason why non-UK debtor companies make their way to the UK to achieve a deal.

The main area of uncertainty in relation to application of schemes to EU member state companies relates to the role of the EU Recast Judgments Regulation. Specifically, the regulation's bearing on 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. And that is an issue for a non-UK company or a UK company if they have assets in other jurisdictions. An English court asked to sanction a scheme relies on expert evidence to answer the 'good prospect' question. As recent cases show the answer has not been found in the Recast Judgments Regulation, but rather in the rules of private international law as found in the relevant member state's law (eg *Re Van Gansweinkel Groep BV and others*[1]). Therefore on this basis, the falling away of the Recast Judgments Regulation should not affect the sanctioning of Schemes.

However, it is a possibility that it will prove in practice to be more difficult to obtain the same expert opinions on which the English court have relied if the UK has exited the EU on acrimonious terms and with 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 'home'. These efforts to date have not had much tangible impact. However, as mentioned above, the loss of automatic cross-border recognition for the UK could also see an increase in the number of companies who seek out alternative restructuring solutions. Brexit may lead to a change in sentiment about the attractiveness of going to England to use a Scheme.

(If there were any doubt about the role of the Recast Judgments Regulation, the Lugano Convention may provide a substitute.)

13.4 CREDIT INSTITUTIONS

Formal reorganisation and winding up proceedings under the Credit Institutions (Winding Up) Directive (2001/12/EC) ('CIWUD')

CIWUD provides rules for mutual recognition and effectiveness of reorganisation and winding up measures in respect of a credit institution taken by EEA States. It assists in ensuring that the measures will be applied to branches of an institution located in another EEA State.

1 [2015] EWHC 2151 (Ch).

- No automatic recognition:

  Following Brexit, the UK authorities would lose automatic recognition across EU member states (as well as members of the EFTA) as CIWUD would cease to apply to the UK. The relevant UK authority may be required to apply for the opening of local proceedings for branches of the institution that are located in an EEA State. The benefits of the single proceeding facilitated by CIWUD would therefore be lost.

  For UK measures to be granted recognition in relation to branches in other EU member states the following options apply:

- the UK could negotiate bilateral arrangements with the relevant EEA States individually, or
- the UK could seek to become a member of the European Free Trade Association ('EFTA') (as CIWUD applies to the EFTA members).

  – potential mismatch of recognition**.**

  On the other hand, unless and until the UK amends or repeals its equivalent domestic legislation implementing CIWUD, measures taken in EEA States would continue to benefit from recognition in the UK.

13.5 RECOVERY AND RESOLUTION MEASURES UNDER THE BANK RECOVERY AND RESOLUTION DIRECTIVE (2014/59/EU) (THE 'BRRD')

The BRRD grants powers to 'resolution authorities' in EU member states in respect of banks and certain other investment firms in their jurisdiction. These powers allow them to intervene at an early stage of a failing institution (including to use the controversial 'bail-in powers' on creditors). The BRRD provides harmonisation of those powers and mutual recognition and enforcement across all EU member states of their exercise. For example, if a Portuguese Resolution Authority exercises a 'bail in power' in respect of English law bonds issued by a Portuguese bank, this will be recognised in the UK; absent 'supra-national' authority such as the BRRD, there would be limited ability for a foreign government to interfere with rights and obligations governed by an English law instrument.

- No automatic recognition: The UK authorities lose automatic recognition across the EEA

  The principle of automatic mutual recognition of resolution measures will cease to apply and the issues noted above in relation to CIWUD would apply equally here also.

  In order for UK measures to be granted recognition in other EU member states, in addition to taking the steps referred to in the CIWUD section above, it may be possible to negotiate a 'third country' agreement. The BRRD allows the EU Council to negotiate agreements with countries outside of the EEA to facilitate the establishment of principles of cooperation and recognition between the EEA countries and these third countries.

– potential mismatch of recognition.

As with CIWUD, domestic legislation implementing the BRRD would not cease to be in effect if the UK was to leave the EU. On that basis, automatic recognition of resolution measures imposed by EU resolution authorities should continue to apply in the UK unless and until such legislation is amended or repealed.

13.6 CONCLUSION

Depending on a deal the UK and the EU negotiate, and which the Prime Minister has asserted is not guaranteed to be agreed at all, UK insolvency and restructuring may find itself outside of the EU system completely. The Great Repeal Bill may tackle the domestic issue of which EU laws continue to apply in the UK, but it will not in itself be able to resolve the mismatch issues described above or coerce cooperation in insolvency proceedings from the remaining EU member states. There are a range of possible outcomes. It is possible that the UK and the EU negotiate and agree a multilateral treaty effectively recreating the effect of the EIR and similar measures are agreed in respect of the other Brexit consequences. However, certainly in the short term, this is widely considered as unlikely, not least because restructuring and insolvency are not seen by either the UK or EU negotiators as critical issues.

Conducting restructurings in the UK following Brexit is unlikely to substantially change or experience significant short-term decline. However, Brexit is set to intensify the need for modernisation of UK insolvency procedures to remain attractive in the spectre of the growing popularity of US methods and the attempts of other EU nations to revamp their procedures.

To summarise, the likely effect of Brexit on UK restructurings are as follows:

13.6.1 Companies

- UK administrations: the UK will cease to be bound by and benefit from, the European Insolvency Regulation. This means material disadvantages for companies in administration 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). Unless separate bilateral treaties with individual EU Member States are negotiated 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 authorised 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.

- Schemes: as it stands, there should be no change in the ability of an English court to sanction a scheme of arrangement 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 in the application of rules of their own private international law insofar as they apply them to the UK (as further discussed. However, Brexit may further incentivise the EU Member States to develop alternative informal restructuring processes in competition with the ever-more popular scheme.

13.6.2 Credit institutions

- Formal winding up tools: a UK financial institution that undergoes a formal reorganisation or winding up proceeding will be disadvantaged if it has branches or assets in other EU member states or has issued securities under the laws of another EU member state.

  This is because the proceedings will cease to benefit from automatic recognition and relief across all EU member states provided by CIWUD. Joining the EFTA would, however, solve this.

- Recovery and resolution tools: similar disadvantages will be experienced by UK credit institutions and other relevant firms in relation to so-called recovery and resolution tools (such as bail-in and good bank/bad bank arrangements). However, the UK may be able to negotiate a ‘third country’ agreement with the EU Council as regards some matters covered by the BRRD. Joining the EFTA would also solve this.