International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2016 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

EDITORIAL

Continental Drift: Challenges and Possible Solutions to Cross-Border Insolvency Issues Following Brexit

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An uncertain future

There can be no disputing that the people of the United Kingdom have voted for Brexit. If, when and on what terms the UK will, in fact, leave the European Union is far less certain.

The referendum itself is merely advisory in nature. It is only the third ever UK-wide referendum, and the previous two – the 1975 vote on membership of the then European Economic Community, and 2011's AV referendum – both saw a vote in favour of the status quo. There have been a small number of other, more local, referendums, mostly related to devolution, and in one case to the Good Friday Agreement. However, the people have never voted for a change that was not actively being promoted by the government. We are in waters yet more uncharted than the seas that are the subject of EU fishing quotas.

As for the position under EU law, we are likewise in an unprecedented situation. While Greenland did leave the EEC, it did so many years prior to the coming into force of the Lisbon Treaty, with its now famous Article 50, which sets out the mechanism for withdrawal. The UK appears to be free to pick and choose when it exercises Article 50. Until it does so, it remains a member of the EU. When the button is pushed, the UK will have two years to negotiate the terms of its withdrawal, although the Council and the UK could agree to extend the period indefinitely.

There already appears to be a significant disconnect between the legal – and political – realities, and the views of some in the insolvency industry. Many view Brexit as a done deal, and in some cases there is a perception that the UK has already left the EU. It has not done so – and new Prime Minister Theresa May has said that Article 50 will not be exercised this year, but will instead be used in the 'right timescale to get the right deal for the UK.' Keeping to this timescale may require clearing the obstacle of the EU's refusal to hold any form of negotiation on Brexit prior to the invocation of Article 50, despite the EU lacking any means of forcing the UK to invoke it. It is possible that the UK keeps its finger off the trigger for many months or even years – or indeed never formally exercises Article 50.

A middle way could be for the UK instead to negotiate changes to its relationship with the EU but remaining a member. Politically, although difficult, this is possible, particularly if a new relationship were validated by a second referendum or a General Election called by a government seeking a mandate for the new arrangement. Even if Britain formally leaves, the eventual relationship may be a far cry from the vision of the future projected by Vote Leave during the referendum campaign, and could involve the UK being a member of the single market and subject to the jurisdiction of the ECJ.

What may change?

From a cross-border insolvency perspective, as with any commercial view point, uncertainty leads to loss of confidence and indecision. In the case of UK insolvency, the uncertainty is likely to be increased by the complexity of the overlapping machinery currently in force in the UK to deal with cross border insolvency issues, not all of which can or will suffer an impact from the UK's eventual withdrawal from the EU.

On the hypothesis that the UK will not, in future, adhere to or be bound by any EU regulation, the principal threat to the efficiency of cross-border insolvency procedures would be the putative withdrawal from the regime imposed by Council Regulation (EC) 1346/2000 on insolvency proceedings (the 'Insolvency Regulation'). The Insolvency Regulation has in fact been amended and Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) entered into force in principle on 25 June 2015, with the majority of its provisions applying from 26 June 2017. However, the relatively slight changes in the recast regime and the time before its entry into force make it convenient to examine the existing Insolvency Regulation and its impact on European insolvencies that touch the UK.

The Insolvency Regulation is directly effective and as such there is no enacting UK legislation incorporating its provisions into UK law. The Insolvency Regulation does not seek to harmonise insolvency law across the

EU, but rather to ensure that 'main proceedings' in most collective insolvency proceedings[1] are automatically recognised by all other EU member states. Main proceedings must only be commenced in a member state where a debtor has its centre of main interests ('COMI').

Alternative main proceedings may not be commenced in another EU member state. Any other related proceedings must be secondary to the main proceedings and are restricted to territorial or ancillary proceedings. Secondary proceedings can be opened in any member state in which the debtor has an establishment and will run in parallel to and coordinated with main proceedings and the effects of the secondary proceedings are limited to assets located in the Member State where the secondary proceedings have been opened. The insolvency office holder of the main proceedings can open the secondary proceedings in another EU member state or apply to have such proceedings stayed.

Whilst there can still be some tension under the Insolvency Regulation regime, principally controversies relating to the identification of a debtor's COMI and 'forum shopping', the regime ensures that a UK insolvency office holder in main proceedings should not need to apply to the courts of any other EU member state for recognition. Likewise an insolvency office holder from any of the other EU member states will automatically be recognised by the UK courts. If and when, however, the Insolvency Regulation ceases to apply to the UK, there will be no automatic recognition and office holders will have to make an application in each relevant jurisdiction under the local law, increasing time, cost and complexity.

Some possible effects of the Insolvency Regulation no longer applying to the UK are as follows:

– With UK insolvencies no longer automatically recognisable by EU member states and other EU member state insolvencies no longer automatically recognised in the UK, the UK may become less attractive as a primary contractual jurisdiction. Whilst it is by no means the only factor in parties agreeing to submit contractually to a UK jurisdiction (e.g. England and Wales), it is likely to be a factor for some parties that the UK currently enjoys the full benefit of the Insolvency Regulation.

– The UK (and England and Wales in particular), has a reputation for being a creditor-friendly jurisdiction and has become well-known (some would say notorious) as a destination for 'insolvency tourism', forum shopping of an aggressive kind often involving a 'migration' of a debtor's COMI, to take advantage of the UK's insolvency laws. Much of the advantage of such a shift could be negated if the UK insolvency were not to be automatically recognised as main proceedings in EU member states.

– Potential purchasers of distressed debt may choose not to invest or demand a significant discount in instances where a portfolio of distressed debt contains UK assets as well as assets located in EU member states on the basis that any collective insolvency proceeding to which the UK assets are subject may not be recognised in other EU member states. There is also the possibility that parties may seek to rely on the 'change of law' provisions commonly present in loan agreements in an attempt to avoid exposure to any uncertainty regarding insolvency recognition issues with the UK.

Whilst here we examine only the arrangements that specifically relate to cross-border insolvency, it should also be noted that there is also likely to be an impact in relation to other areas of law where EU law is directly or indirectly effective in the UK and which will have a bearing on insolvency including employment, taxation and competition. The European regime for recognition and enforcement of judgments is considered briefly below.

What will be unaffected?

Notwithstanding the importance of the Insolvency Regulation as a reciprocal mechanism for recognition of insolvency proceedings throughout the EU, there are a number of recognition and assistance mechanisms available under English law, which are separate from EU law and would (for the most part) be unaffected by the UK's departure from the Insolvency Regulation.

Model Law

The UNCITRAL Model Law on Cross-Border Insolvency (the 'Model Law'), has been enacted in Great Britain under domestic legislation (the Cross Border Insolvency Regulations 2006 ('CBIR'))[2] a relatively straightforward procedure for recognition and assistance in the UK for foreign insolvency proceedings. Applications are to a Registrar (junior level of judge) and, provided that in most cases that the foreign insolvency office holder

Notes

1 Exceptions include insurance undertakings, collective investment undertakings and credit institutions. Denmark opted out of the Insolvency Regulation and its provisions do not apply to that country.

2 A distinction is made here between Great Britain (including the jurisdictions of England and Wales as well as Scotland) and the remaining jurisdiction of the United Kingdom, Northern Ireland. Northern Ireland has separately enacted the Model Law under its devolved legislature as the Cross Border Insolvency Regulations (Northern Ireland) 2007.

can satisfy the basic requirements that the appointment is validly made in respect of foreign main proceedings, the office holder will able to obtain recognition in Great Britain and assistance including:

– staying claims against the debtor's estate in Great Britain;
– entrusting the foreign office holder with the administration of the debtor's assets in Great Britain;
– allowing the foreign office holder to examine witnesses in the Great Britain, to take evidence and force the delivery of information concerning the debtor's assets;
– giving the foreign office holder access to British anti-avoidance provisions and antecedent claims/claims against directors; and
– permitting the foreign office holder to apply his or her domestic insolvency law and procedures in Great Britain (to the extent that this is not incompatible with British law).

The regime is non-reciprocal and therefore could be used in the UK to recognise and assist office holders from any foreign jurisdiction, including, post-Brexit, the remaining EU member states. Of the current EU member states only Greece, Poland, Slovenia and Romania have implemented the Model Law. As it currently stands, therefore, the procedure would only be available to UK insolvency office holders in those EU jurisdictions.

Section 426 of the Insolvency Act 1986 and common law principles

Section 426(4) of the UK Insolvency Act 1986 provides that the courts having jurisdiction in relation to insolvency law in any part the UK shall assist the courts having corresponding jurisdiction in any other part of the UK or any relevant country or territory. This applies not only to England and Wales, Scotland and Northern Ireland, but also to the Channel Islands and the Isle of Man as well as a list of countries designated by statutory instrument, including the Republic of Ireland. As with the Model Law, the section 426 procedure could be used, for example, for an insolvency office holder from the Republic of Ireland to apply for recognition and assistance in the UK, but the converse would not be the case – an Irish court would not be bound to assist a UK office holder on the basis of a UK statute.

What could assist a UK insolvency office holder to be recognised and assisted in other common law jurisdictions is the emerging common law principle that insolvencies are (or should be) international.[3] Developed as a set of principles of comity outlined in *Cambridge Gas Transport Corp v The Official Committee of Unsecured Creditors of Navigator Holdings*,[4] the doctrine of 'modified universalism', continues to be a feature of common law jurisdictions, including those of the UK, despite having been limited by the decision in *Rubin v Euofinance*[5] and *Singularis Holdings Ltd v PwC.*[6] Neither the provisions of section 426 Insolvency Act 1986 nor common law principles will be affected by the UK's withdrawal from the Insolvency Regulation regime.

Existing exceptions to the Insolvency Regulation

As set out above, certain proceedings are in any case excluded from the regime of the Insolvency Regulation. Apart from specialist concerns such as insurance undertakings, non-collective proceedings also fall outside the regime – in particular all forms of receivership, UK Members Voluntary Liquidations and UK Companies Act 2006 schemes of arrangement. The latter in particular is a well-used international restructuring tool.

Whist these procedures would be unaffected directly by the Insolvency Regulation ceasing to apply to the UK, it should be noted that UK court orders made in respect of any of them would potentially be difficult to recognise and enforce in the remaining EU member states. Currently an order made by a court of an EU member state can be recognised efficiently pursuant to Regulation (EU) no 1215/2012 of the European Parliament of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) ('Brussels Recast'). As with the Insolvency Regulation itself, there is severe doubt whether, in a post-Brexit era, the UK would remain a part of the Brussels Recast regime or whether UK orders made in respect of, for example, a scheme of arrangement, would have to take a different route to being recognised and enforced in the remaining EU member states.

Possible solutions

There are a number of potential solutions to the problems above. There will be a significant impetus to

Notes

3 Although the Republic of Ireland is a common law jurisdiction that has declined to follow *Cambridge Gas* – see the Irish Supreme Court decision in *In re Flightlease (Ireland) Ltd* [2012] IESC 12.
4 [2006] UKPC 26.
5 [2012]UKSC 46.
6 [2014] UKPC 36.

retain the benefits of the Insolvency Regulation, which is a force-multiplier for the efficient and cost-effective administration of a European cross-border collective insolvency process. In order to avoid a proliferation of conflicts of law issues, a novel but possible solution would be to allow the UK to remain within the Insolvency Regulation without having EU membership.

However desirable this may be for the UK, other European countries may be reluctant to accommodate our wishes. All remaining member states of the EU would be required to agree and ratify any such agreement, and it is far from clear that they would do so. Brexit could be perceived in other member states as an opportunity to usurp the UK as a favoured insolvency destination, and there would be little incentive to allow the UK to retain its competitive advantage. Moreover, other member states could take comfort from the CBIR, which allow insolvency office-holders from other member states to apply for recognition in the UK.

An alternative would be for the UK to adopt the Insolvency Regulation on a reciprocal basis, but this would have the downside of precluding the UK from participating in discussions at an EU level on amendments to the legislation. There are a number of adverse changes that we can foresee. For example, there have been attempts to include UK schemes of arrangement within the prescribed list of insolvency proceedings and to remove out-of-court administrations. The UK has successfully resisted such amendments, but it may well be that, post-Brexit, EU legislation is amended in such terms and the UK would, in such an arrangement, be forced to accept the changes.

The UK could instead seek bilateral arrangements, but in the context of a failed negotiation on a broader extension of the Insolvency Regulation, the chances of such arrangements being made appear low. Not only would member states have to ensure that they complied with their existing European law obligations, but the upside for the UK would scarcely be worth the political capital and resources required to negotiate such arrangements. A proliferation of bilateral agreements would lead only to insolvency practitioners and their advisors being obliged to seek recognition jurisdiction by jurisdiction, and would raise new potential conflicts of law issues.

As for the recognition and enforcement of judgments for non-insolvency proceedings (including receiverships and schemes of arrangement), the UK presently benefits from the Lugano Convention as a result of its EU membership. It is likely that this could be preserved. If the UK does join the European Free Trade Association (which would require Iceland, Norway, Liechtenstein and Switzerland to consent) this would provide a forum for recognition and enforcement of UK judgments in both Lugano states and EU member states under the Brussels Regulation (recast) regime. The UK could, alternatively, sign the Lugano Convention in its own right, or sign bilateral recognition treaties. The principle of comity would provide some protection if the UK were unable to reach an alternative arrangement, but there would be an increase in costs and inconvenience. This is one area where we do see a workable solution as being easily achievable.

Conclusion

It seems odd that there should be business as usual notwithstanding the Brexit vote, but for now at least little has changed. The future is far more uncertain. It is unlikely that those charged with negotiating Brexit have given serious consideration to all – or perhaps any – of the issues set out in this article. We will have to wait and see if the problems we have identified come to fruition – and how they will be dealt with, if at all.

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