Brexit: Opportunities, Challenges and the Road Ahead

Britain in Europe Policy Report
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INTRODUCTION

The British people have spoken and the Government is now committed to following through with Brexit, but where does this monumental decision leave us as a nation? No sector can be viewed in isolation, so we are putting this seminal question to thought leaders in their fields, asking them to explore the challenges and opportunities facing the UK at this historic crossroads for the country.

This policy report is looking for answers about the way forward, so that we, as a think tank, can address the fundamental dilemmas that the EU referendum has created for us, in relation to immigration, the free market, our constitutional system, businesses and the free movement of labour, our financial institutions, human rights, the internationalisation of higher education and research, judicial cooperation in Europe, security and national defence, culture and environmental protection; the list is endless.

But Brexit is so much more than just seeking solutions to (the numerous) practical problems that disentangling ourselves from the EU will naturally create. It is also, much more importantly, about looking back again into the elements that make our society's fabric, and redefining the UK's role in Europe and the world.

I would like to thank all the contributors to this report. Here they provide expert, evidence-based, diagnosis of some of the flaws of (parts of) the UK legal, political and socio-economic frameworks that have come to the surface with Brexit (while at the same time pinpointing many of their inherent strengths), and insightfully prescribe remedies that will help transform challenges into opportunities as we navigate uncharted waters ahead.

Our appreciation as a think tank also goes to Brunel University and Brunel Law School for fully supporting this collaborative research effort.

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THE POSSIBLE EFFECTS OF BREXIT ON CROSS-BORDER INSOLVENCY ISSUES

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Brexit impact on the recognition of insolvency officeholders

The key uncertainty from the perspective of cross-border insolvency is the applicability of Council Regulation (EC) 1346/2000 on insolvency proceedings and its successor, Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), which entered into force in principle on 25 June 2015, with the majority of its provisions applying from 26 June 2017 to UK insolvency procedures in the post-Brexit world.

The Regulation, which we will refer to in both its current and amended form, simply as the "**Insolvency Regulation**", is directly effective in EU member states (with the exception of Denmark, which we will not include as a member state for the purposes of this article) and to a great degree represents an astonishing level of supra-national legal cooperation and reciprocity across the very different legal systems of the EU. Whilst not a harmonization of the insolvency law of the member states, the Insolvency Regulation guarantees automatic recognition of most collective insolvency proceedings commenced in one EU state by the other states, without the necessity of opening proceedings in those other states.[1]

The premise of the Insolvency Regulation is that main insolvency proceedings may only be opened in the state in which the debtor has its centre of main interests ("**COMI**"). The rebuttable presumption is that COMI will be located in the jurisdiction in which the debtor's registered office is located, but should in any case be ascertainable to third parties as the place where the debtor administrates his interests (for example the jurisdiction of the location to which creditors habitually send their invoices). Once a main proceeding has been opened in a state, there can be no alternative main proceedings.

Instead any related proceedings must be secondary to the main proceedings and are restricted to territorial or ancillary proceedings, which can be opened before or after main proceedings are opened. Such secondary proceedings can be opened in any member state in which the debtor has an establishment 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 officeholder of the main proceedings can open the secondary proceedings in another EU member state to run in parallel with the main proceedings or apply to have such proceedings stayed. The Insolvency Regulation therefore adopts the principle of universality, but with concessions to protecting local interests.

Although there are controversies relating to the identification of a debtor's COMI and concerns about debtors engaging "forum shopping" to select the most favourable jurisdiction in which to file (of which see more below), the Insolvency Regulation provides automatic recognition of a UK insolvency officeholder in main proceedings in any other EU member state and vice versa. Likewise an insolvency officeholder 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 as a result of Brexit, there will be no automatic recognition and officeholders will have to make an application in each relevant jurisdiction under the local law, increasing time, cost and complexity. At a stroke, a UK insolvency officeholder will face a considerably harder task in identifying, securing and realizing a company's assets outside of the UK. The obvious loser in this scenario is the creditors, who will ultimately carry the burden of the additional time and cost.

The ultimate effects of the Insolvency Regulation ceasing to apply in relation to the UK are multi-faceted and potentially far-reaching. The UK (and England and Wales in particular), is currently perceived as a jurisdiction in which creditors can more easily control or influence the course of an insolvency than in other, more debtor-friendly states within the EU. Procedures available in the UK such as out-of-court administration appointments and schemes of arrangement under the Companies Act 2006 (although strictly a corporate rather than an insolvency procedure) have historically provided both the debtor and creditors with more flexibility to deal with distressed situations without needing to enter a formal liquidation process. Partly as a result the UK has become an attractive primary contractual jurisdiction as well as a popular destination for "insolvency tourism" or forum shopping to take advantage of the UK's mature and flexible insolvency regime, although this has been the subject of considerable criticism, particularly where a company "shifts" its COMI, in what can sometimes be regarded as an artificial manner, to the UK.

Not only might the UK become a less attractive jurisdiction in which to do business within Europe generally, but more niche issues could also arise. For example, 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. With London being a well-established marketplace in debt trading, the trades are frequently subject to English law. This market position could be under serious threat in a post-Insolvency Regulation UK. Another example is 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.

Brexit impact on the recognition and enforcement of judgments

A second EU regulation that is of importance for the purposes of cross-border insolvency and restructuring is 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**").

Brussels Recast contains the "insolvency exception", precluding the regime from application to "bankruptcy proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings". Brussels Recast does however apply (at least in some circumstances) to the following procedures, which are important procedures in the UK restructuring sphere, however characterized:

- All forms of receivership including Law of Property Act and fixed charge receiverships (administrative receiverships have to a very large extent been replaced by administration, which is subject to the Insolvency Regulation);

- Members' Voluntary Liquidations (a form of solvent voluntary liquidation initiated by special resolution of the company); and

- Schemes of arrangement of foreign companies in England and Wales under the Companies Act 2006 in circumstances where the company is not otherwise the subject of insolvency proceedings (see for example *Re Codere Finance (UK) Ltd*).[2]

Once Brussels Recast ceases to be directly effective in the UK, insolvency officeholders seeking to have judgments relating to such proceedings in the UK recognised or enforced in other EU member states will no longer be able to rely on the automatic recognition provided by Brussels Recast and will instead need to apply for such recognition and enforcement in each member state according to its domestic laws on recognition and enforcement of foreign judgments. As with recognition under the Insolvency Regulation, there is huge potential for a massive increase in process, time and cost.

Possible management of the impact of Brexit on UK insolvency law

One way to maintain the status quo post-Brexit, at least in theory, would be for the Insolvency Regulation to continue to apply to the UK, despite no longer being a member of the EU. In practice, it would be a mammoth task (if indeed possible) to achieve the required consensus between all the member states to agree and ratify such a step. There is likely to be little sympathy amongst the remaining EU member states to minimize the effect of Brexit on the UK's position as a leading destination for forum shopping and debt trading and indeed some states may see an opportunity to usurp the UK as a favoured insolvency destination.

Even if the UK were to seek to adopt the Insolvency Regulation on a reciprocal basis, one major factor would be a lack of control regarding future amendments to the Regulation. To date, the UK has been in a position to resist amendments to the Insolvency Regulation to which it takes exception, including as recent examples, attempts to include UK schemes of arrangement within the prescribed list of insolvency proceedings and to remove the UK out-of-court administration procedure from the list of insolvency proceedings. Once it is no longer a member of the EU club, the UK will be likely to have to accept the legislation as it is amended from time to time by the remaining members.

There is at least a more obvious path in relation to the recognition and enforcement of judgments for non-insolvency proceedings, including as discussed above, receiverships, members' voluntary liquidations and schemes of arrangement. Currently three of the four members of the European Free Trade Association (Iceland, Norway and Switzerland, but not Liechtenstein) are signatories to the 2007 Lugano Convention, which governs issues of jurisdiction and enforcement of judgments as between those EFTA states and the member states of the EU, providing a reciprocal regime materially the same as the 2001 Brussels Regulation (forerunner to Brussels Recast).

The Lugano Convention is already incorporated into law by the Civil Jurisdiction and Judgments Regulations 2009. The Convention could form an alternate framework for recognition and enforcement of judgments for the UK in place of Brussels Recast, provided that the UK became a signatory to it in its own right. Whilst consensus would again be required, not only from the remaining EU member states, but also Iceland, Norway and Switzerland, it does seem likely that the solution would be a positive outcome for all states concerned.

Alternative recognition regime - the Model Law

An alternative recognition framework to the Insolvency Regulation is that provided by the UNCITRAL Model Law on Cross-Border Insolvency (the "**Model Law**"). States that are signatories to the Model Law are subject to a standardized regime that provides a relatively straightforward procedure for recognition and assistance for foreign insolvency proceedings. Great Britain (both the jurisdiction of England and Wales and the jurisdiction of Scotland) has incorporated the Model Law under domestic legislation (the Cross Border Insolvency Regulations 2006 ("**CBIR**").[3] Provided that a foreign insolvency officeholder can satisfy the basic requirements that the appointment is validly made in respect of foreign main proceedings, any foreign insolvency officeholder should be able to obtain recognition in Great Britain as well as assistance including:

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

However, aside from the UK, 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 officeholders in those jurisdictions, rather than across the EU creating an obvious imbalance. There is no obvious sign that the other EU member states are likely to adopt the Model Law in the near future, either as individual states or by general application of a new insolvency regulation with the same effect as the Model Law regime and reaching the consensus that would be required is highly unlikely. The imbalance could be corrected if the UK, like Romania, were to make the CBIR reciprocal (whether positively or negatively), but it seems counter-intuitive that the UK would seek to make its recognition of insolvency proceedings less rather than more universal.[4]

The current availability of the Model Law to allow insolvency officeholders of remaining EU member states to seek recognition and assistance in the UK militates against the notion that the UK could negotiate a series of bilateral agreements with individual remaining members of the EU. After all what could those other states stand to gain more than is already available under the Model Law? UK insolvency officeholders will be at a disadvantage, but there is no obvious solution to the imbalance short of reversing the common-law principle of modified universalism, which holds that insolvency proceedings in relation to one debtor should apply worldwide.

Possible future effects of Brexit on UK insolvency

As it stands, the UK is a more open jurisdiction than most when it comes to recognizing and assisting foreign insolvency officeholders, whether they be from an EU member state or otherwise. Whilst there is obvious advantage in negotiating an arrangement with the remaining EU member states to continuing a regime identical or similar to that provided by the Insolvency Regulation, for the reasons discussed above, the bargaining positions are unequal and it is likely that the UK will have to accept whatever terms, if any, the remaining EU member states can agree to offer. Even in this context, the possibility of the Insolvency Regulation morphing into a different regime with the UK powerless to influence any changes, make the permanence of any agreement, or its fitness for purpose as far as the UK is concerned, questionable.

The current attractiveness of the UK as a destination for corporate and financial restructurings reflects the maturity of the laws and the flexibility of the courts in the UK to facilitate restructuring. This world-leading position is already under threat as a number of European jurisdictions have amended or introduced legislation in recent years that in due course could provide a more popular environment for insolvency and restructuring. In addition the UK's advantage over other existing market hubs such as New York, or emerging jurisdictions such as Singapore, is likely to diminish if and when UK insolvency office-holders lose the right to automatic recognition across the EU. It is likely that in ten years' time the geographical spread of cross-border insolvency work will be much changed, with the UK losing its pre-eminent position especially if a "Hard Brexit" is pursued.

Notes

1. Exceptions to the Insolvency Regulation include insolvency proceedings relating to insurance undertakings, collective investment undertakings and credit institutions.

2. 2015 EWHC 3778 (Ch).

3. The remaining jurisdiction of the United Kingdom, Northern Ireland has enacted the Model Law separately under the Cross Border Insolvency Regulations (Northern Ireland) 2007.

4. For more on the topic of reciprocity see "*Should reciprocity be a part of the UNCITRAL Model Cross-Border Insolvency Law*?" K.D.Yamauchi, University of Calgary, International Insolvency Review Vol 16, Issue 3, 29 Oct 2007.

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