Brexit Update: A European Perspective

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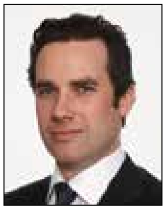
The International Scene

By Adam Gallagher and Katharina Crinson

Brexit: Where Are We Now, and What Does It Mean for Restructurings?



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Editor's Note: *In 2016,* ***Graham Bushby*** *and* ***Ian Williams*** *of RSM Restructuring Advisory LLP updated ABI members on Brexit development and what this means for restructuring and insolvency.*[1] *Since then, a lot has happened. In this article, we recap on where the U.K. is politically as of the date of this article and what we can already say will be the impact for bankruptcy and restructurings.*

To recap, on June 23, 2016, the U.K. held a public referendum — a vote in which everyone (or nearly everyone) of voting age can take part — to decide whether the U.K. should leave or remain in the European Union (EU). Voters wanted by a very narrow margin to leave (with 51.9 percent in favor of leaving and 48.1 percent in favor of remaining). On March 29, 2017, the U.K. government submitted a so-called Article 50 notice (named after Article 50 of the Treaty on European Union) to the EU, formally triggering the legal departure process.

Article 50 required the EU to negotiate an agreement setting out the arrangements for the U.K.'s withdrawal, taking into account the framework for its future relationship with the EU (the "withdrawal agreement"). Under Article 50, the U.K. had two years to negotiate the withdrawal agreement, during which time it remained a member of the EU. If two years expired without the conclusion of a withdrawal agreement, then the U.K. would leave the EU without any further arrangements (the so-called "no-deal scenario") on March 29, 2019, being two years after the Article 50 notice had been delivered.

The U.K. government proceeded to negotiate a withdrawal agreement with the EU, but under U.K. domestic law, it was still necessary for the withdrawal agreement to be approved by the U.K. parliament. So far, this has proved to be impossible. The U.K. government proposed the passing of the withdrawal agreement a total of three times, but each time it was voted down by members of the U.K. parliament.

Given this impasse, U.K. Prime Minister Theresa May asked the EU for an extension to the firm deadline of March 29, 2019. At this point, the EU granted a short extension: If the U.K. parliament passed the withdrawal agreement by April 12, 2019, then the deadline for the U.K. to leave the EU would be May 22. If the U.K. could not pass the withdrawal agreement by April 12, then this would be the date that the U.K. leaves the EU without a deal. However, April 12 came and went, and Prime Minister May returned to the EU to ask for a longer extension. The new agreed-upon final deadline for the U.K. to pass the withdrawal agreement or leave the EU without a deal is Oct. 31, 2019.

If the withdrawal agreement is passed, a transition period would begin on the day of exit and end on Dec. 31, 2020 (unless this is extended given the extensions to the current exit day). During this period, the U.K.'s current economic relationship with the EU would remain largely unchanged. The U.K. would effectively remain in the EU single market and customs union, continue to contribute to the EU budget, be obliged to apply EU law in full and be subject to the jurisdiction of the European Court of Justice. However, it would not have any formal role in the EU's institutions and decision-making bodies (notably the council, parliament and commission). The U.K. would be a rule-taker.

The No-Deal Situation

So, amidst the political uncertainty, what do we know and what can we say will be the impact on bankruptcy and restructurings? Well, at the moment, all we know is what would happen if there is a no-deal situation — whether this be at the end of the transition period or on a no-deal situation (on Oct. 31).

The U.K. government has drafted (and the U.K. parliament has passed) a number of statutory instruments (essentially, secondary legislation) that deal with the impact of a no-deal Brexit on various sectors. One such statutory instrument deals with the impact of cross-border insolvency. The instrument is snappily entitled the "Insolvency (Amendment) (EU Exit) Regulations 2018" (the "Insolvency Exit Regulations").[2]

The Insolvency Exit Regulations are live — even though they will only enter into force on exit day. Broadly, the Insolvency Exit Regulations are divided into two parts. The first part deals with proceedings that are already pending on exit day (so-called "in-flight proceedings"), where recognition will still be available subject to a "handbrake." The second part deals with proceedings opened after exit day, where there is no longer recognition under the Insolvency Regulation.

1 Graham Bushby and Ian G. Williams, "Inside the 'Brexit Bubble': What's Next for the U.K.?," XXXV *ABI Journal* 9, 32-33, 63-64, September 2016, *available at* abi.org/abi-journal.

2 Statutory Instrument (SI) 2019/146.

EU Regulation on Insolvency Proceedings

The EU Regulation on Insolvency Proceedings (the "Insolvency Regulation") was introduced in 2000 and became effective in 2002. It provides a framework within the EU (with the exception of Denmark) that governs where insolvency proceedings might be opened, what laws will apply to matters arising out of those proceedings, and how such proceedings are to be recognized in other EU member states. The Insolvency Regulation is based on a principle of reciprocity. It applies only as between EU members (save for Denmark) and does not extend to third countries.

Prior to Brexit, as a member state of the EU, the U.K. was part of this framework of cross-border insolvency. After a transition period (if any), the Insolvency Regulation will cease to apply to the U.K. and insolvency proceedings commenced in the U.K.

What Does the Loss of the Insolvency Regulation Mean for Proceedings that Are Already Opened on Exit Day?

Regarding in-flight proceedings, where main proceedings under the Insolvency Regulation have been opened before exit day, the U.K. will treat them as if the U.K. had not left the EU. Any reference to the EU and its members is to be read as if that still included the U.K. This means that the U.K. will continue to provide the mutual recognition provided for in the EU Regulation to insolvency proceedings opened in EU member states. For example, the U.K. would continue to recognize a German *Insolvenzverfahren* or a French *sauveguard* opened in accordance with the provisions of the Insolvency Regulation in the place where the debtor has its center of main interests (COMI), just as it recognized these proceedings prior to exit day.

There is a caveat, however. Broadly speaking, if a U.K. court decides that an EU member state where main proceedings are opened does not treat the U.K. like it was still a member state and that the interests of a creditor, the debtor or the shareholders are *materially prejudiced* or that it would be *manifestly contrary to public policy* to continue to apply the Insolvency Regulation, then the court may instead apply other U.K. insolvency laws. This is what could be called the "handbrake" option open to the U.K. courts. The drafting of the handbrake option was criticized by the Joint Committee on Statutory Instruments, and as a result, the government provided further examples of when the U.K. government will consider the handbrake option to be used.

Prejudice to U.K. Creditors

A U.K. creditor might be prejudiced if it is not given the same notice within an insolvency in another EU member state opened before the exit date and it therefore misses a deadline for the filing of proofs. The foreign officeholder will not be obliged to send notice to the U.K. creditors anymore under the EIR. Assume that U.K. creditors apply to the court for an injunction to freeze assets in a bank account in the U.K. Because the foreign proceedings were opened before the exit date, the U.K. courts would apply the Insolvency Regulation as-is. If the foreign insolvency proceeding contains a moratorium on enforcement, this would mean that they would have to dismiss the action to freeze the account. However, if the court considers that the interests of U.K. creditors are materially prejudiced because they did not have notice and therefore missed the claims deadline, the court could make the freezing order and require that U.K. creditors are paid out of the assets in the U.K. bank account.

Prejudice to U.K. Tax Authorities

If the foreign insolvency proceeding does not pay HM Revenue and Customs (HMRC) (but does pay other EU member state tax authorities, in accordance with the Insolvency Regulation), then HMRC could apply to the U.K. courts to have assets in the U.K. frozen and used to pay HMRC.

Honoring an Obligation to a Debtor

Once main proceedings are opened, a person owing money to the insolvent should pay it to the officeholder for distribution amongst all creditors. However, the Insolvency Regulation provides that if the person honors an obligation for the benefit of the insolvent by making a payment on its behalf in good faith without knowing of the insolvency, then the person is discharged from its debt obligation. Here, if a U.K. person has paid in good faith on behalf of a foreign insolvent but the foreign officeholder does not treat the U.K. person as discharged as the Insolvency Regulation does not apply, then the U.K. courts could refuse to allow the foreign officeholder to sue the U.K. person.

Undertaking to Creditors to Avoid Secondary Proceedings

A U.K. liquidator in a main proceeding can give an undertaking to creditors in an EU member state in order to avoid secondary proceedings, but the creditors in that member state might, post-Brexit, apply to the court in that member state for secondary proceedings to be opened, and the foreign court would not consider itself bound by the Insolvency Regulation and therefore could open main proceedings. If this means that there is a less favorable outcome for U.K. creditors (as local assets are used to pay local creditors), then the court can order a distribution of U.K.-based assets that remedies that otherwise less favorable treatment.

What Does the Loss of the Insolvency Regulation Mean for Proceedings Opened After Exit Day?

There is no provision providing recognition to insolvency proceedings opened in EU member states after exit day. Any recognition will need to follow other avenues open in the U.K., such as an application by a foreign officeholder under the Cross-Border Insolvency Regulations (which implement the UNCITRAL Model Law on Cross-Border Insolvency in the U.K.). Officeholders from the Republic of Ireland could also rely on § 426 of the Insolvency Act of 1986, which provides for recognition for a finite list of countries.

Looking Out: Will U.K. Insolvency Proceedings Be Recognized in the EU?

In regards to U.K. insolvency proceedings looking for recognition, there is no indication that the EU is adopting

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a similar approach to the U.K., or that individual EU member states will continue to provide recognition to proceedings opened before exit day. Regarding proceedings opened after exit day, the U.K. officeholder will need to look to the domestic law of the EU member state where recognition is required and/or rely on the UNCITRAL Model Law on Cross-Border Insolvency Proceedings provisions in those member states that have adopted the Model Law (this applies to Greece, Poland, Romania and Slovenia).

Will a U.K. Scheme of Arrangement Be Recognized in the EU?

The Insolvency Regulation does not apply to schemes. However, other legislation has been commonly assumed to (at least arguably) apply to schemes, namely the Judgments Regulation. This has been relied on, at least in part, to argue that a U.K. scheme should be recognized in other EU member states. On exit day, the Judgments Regulation will no longer apply to the U.K. However, there is a solution.

It is intended that the U.K. will join the Hague Convention in its own right from exit day, which will facilitate recognition and enforcement of schemes in the EU. However, there is one caveat: The Hague Convention only applies where the finance documents contain an exclusive jurisdiction clause in favor of the English courts. This is currently not the norm for finance documents where the jurisdiction clause is often asymmetrical (*i.e.*, allowing the creditors to sue the debtor anywhere and the debtor being restricted to suing the lenders in a certain jurisdiction). It will assist where finance documents do provide for such exclusive jurisdiction. In any event, the Hague Convention is not the only remedy to counteract the Brexit effect. The Rome Convention on choice of law will continue to apply (as its effect is not limited to EU member states). Thus, where parties have chosen English law to govern the contract, there is an argument that the discharge or compromise of such contract should also be governed by English law and as such respected across the EU.

Conclusion

Brexit has not gone smoothly, but the future for U.K.-based restructuring is much more positive. The U.K. has already made provisions to join the Hague Convention in its own right, which will assist where finance documents contain an exclusive jurisdiction clause in favor of the English courts for schemes of arrangement. For schemes, there are many strings to the bow of recognition in other EU member states, so we can remain positive that U.K. schemes will continue to be afforded recognition in EU member states — even after Brexit.

We also welcome the U.K. government's approach to continue to provide recognition to in-flight proceedings, and we hope that this sets the tone in the EU so that U.K. insolvency proceedings that are ongoing on exit day will also benefit from the continued favorable treatment that used to be afforded to them under the Insolvency Regulation. However, it is a real shame that the automatic recognition of insolvency proceedings, which has worked so well since its introduction in 2002, will be lost — but the U.K. has centuries of private international law to rely upon. abi