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International Insolvency Institute: Cross-Border Practice Post-Brexit

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Cross-Border Practice Post-Brexit

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Some personal remarks about the tragedy of the Brexit decision:

- Historical lessons not learned
- Generational imposition of past borders on next generation

Brexit and restructuring:

The starting point is art. 50 TFEU according to which every member state has the right to leave the Union. From then on, a clock is running for two years, cf. par. 3:

> (3) The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

Thus, the question is whether after those two years an agreement – and be it provisional – will have been reached or not. Assuming the worst case, i.e. no deal at all, not only British airplanes cannot fly any longer over the continent; there are also considerable uncertainties about the future of a so far quite prosperous legal market, i.e. the restructuring of debts of foreign debtors.

Within the last decade, the English scheme of arrangement has become something like a bestseller even for foreign (and not only continental) debtors who can manage to overcome the notorious hold-out problem in the context of an unanimity-requirement by using that English law instrument. English courts have been very innovative in extending its applicability – thereby allowing the use of a majority vote with binding effect on the hold-outs.

Always being aware that it takes two for a tango, the English practitioners courts could be quite relaxed in propelling this expansion since they could be quite sure that an English court's decision would in most cases be recognized by the other member states' jurisdictions thanks to various European legal instruments, above all the Brussles I-Regulation.

Needless to point out that this tango partner disappears from the dancing floor after those two years. Since most of the relevant instruments are no longer applicable without a respective agreement. It is heavily discussed and disputed whether at least some of the other dancing partners will still be around – e.g., the Rome I-Regulation – but the uncertainty right now is considerable.

In sight of this it is irritating to hear about plans to strengthen the English place as a dispute resolution hub. This is particularly so since competition is lurking around: The US is increasingly pushing the attractivity of its Chapter 11-proceeding. And Singapore is doing any effort to transform itself to a Asian restructuring and insolvency hub. And, strange coincidence: the European Commission is right now pushing for a Europe-wide preventive restructuring framework which is as of now still in the stage of modelling but which might turn out to become scheme substitute.

From a continental perspective, though, it is more than regrettable that Brexit in which form so ever will imply a loss of most imaginative and inspiring interpretations of law. The new European Insolvency Regulation bears witness to more than one of those innovations which Europe owes British imagination!

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This note maps the present restructuring landscape, and considers in the light of the UK government's August 2017 position papers how the landmarks might shift upon the historic act of gratuitous self-harm that is Brexit, both in the absence of a suitable deal with the UK and the EU27 and should mutually beneficial agreements be struck. In relation to both formal insolvency proceedings and the scheme of arrangement, the note considers issues of jurisdiction, applicable law, and, recognition and enforcement of judgments. It concludes by outlining how HMG might unilaterally create a strengthened restructuring jurisdiction with a view to facilitating legitimate but deterring objectionable forum shopping.

Insolvency proceedings

Current position

At present, as is well known, the EU Regulation on Insolvency Proceedings (Recast) ('**EURIP**') provides for uniform rules of jurisdiction and applicable law, and provides for recognition of judgments:

- **Jurisdiction:** EURIP permits the courts of the EU debtor's centre of main interests ('**COMI**') to open 'main' proceedings, and precludes courts of any other member state from opening competing main proceedings. The main proceedings have universal scope and extend to all of the debtor's assets. Where the debtor has an establishment in another member state, secondary proceedings may be opened in relation to local assets. Secondary proceedings may protect the interests of local stakeholders, respond to the complicity of the debtor's estate or the differences between the legal systems of the COMI and establishment states. Court in the establishment state may refuse to open proceedings if requested to do so if the insolvent practitioner representing the main proceedings undertakes that creditors in the establishment state would receive the treatment they would have if secondary proceedings had been opened. Courts in the establishment state may stay the opening of secondary proceedings in deference of a stay in the main proceedings and upon being satisfied that local creditors are protected and that they would be notified of any restructuring negotiations.

- **Applicable law:** The *lex concursus* in both main and secondary proceedings governs both procedural and substantive matters. The exceptions or 'safe harbours' relate to proprietary security rights, set-off, reservation of title, contracts relating to immovable property, employment contracts, payment systems and financial market related rights, and certain intellectual property.

- **Recognition and enforcement:** There is an immediate recognition of judgments concerning the opening, conduct, and closure of insolvency proceedings.

- **Cooperation, coordination, communication:** EURIP also facilitates cooperation, coordination, and communication in relation to proceedings, including those concerning members of a corporate group.

<u>Upon Brexit and assuming no substitute arrangements are put in place:</u>

- EURIP would remain in force in UK domestic law by virtue of Section 3 of the European Union (Withdrawal) Act (as it would then be). That means that UK courts would continue to be bound to accord recognition to EU proceedings and judgments.

- However, EU27 courts would be under no such obligation, by virtue of Article 50(3) of the Lisbon Treaty, read together with Article 288 of the Treaty on the Functioning of the European Union.

- Accordingly, UK proceedings and judgments would lose the benefit of automatic recognition. UK stakeholders would risk losing safe harboured rights in relation to proprietary security, particularly in movable assets, reservation of title, and perhaps employment relationships. And UK entities that are members of corporate groups may also lose some of the benefits of EURIP's transnational group restructuring mechanisms.

- The asymmetry of this outcome makes it virtually certain that the UK government would disapply EURIP using the 'Henry VIII powers' currently contained in Section 7(2)(c) of the European Union (Withdrawal) Act (as it would then be).

Options

The first and maximalist possibility is to recreate most of the benefits of the EURIP through a bilateral EU/UK treaty:

- **Objective:** There would be reciprocal recognition of proceedings and judgments, in principle, much as at present. It would even be possible for recognition to be automatic, as it is currently. The EC / Denmark agreement ('**the EC/Denmark Agreement**') to replicate the effects of the Brussels I Regulation ('**BIR**') on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (OJ L 299, 16.11.2005, p. 62) provides a precedent.

- **Interpretation:** In interpreting the treaty, UK courts could be required to take "*due account*" of the decisions of the Court of Justice; Protocol 2 to the Lugano Convention 2007 provides a precedent. Similarly, it might be possible for the treaty to require the Court of Justice to take account of UK judgments; a rough precedent is Article 9(1) of the Council of Europe / Iceland / Norway Agreement on the implementation of the Schengen acquis 1999, which provides for the "Mixed Committee", the dispute resolution mechanism, to "*keep under constant review the development of the case law of the Court of Justice…as well as the development of the case law of the competent courts of Iceland and Norway relation to such provisions.*" In any case, UK courts would follow their general practice of taking account of the international character of the treaty, to give regard to its purpose of according consistent and reciprocal treatment to insolvency proceedings and judgments on both sides of the Channel, and therefore to the case law of the Court of Justice.

- **Voluntary reference to the Court of Justice?** There is even the possibility of providing for the UK courts to be empowered to make a voluntary reference to the Court of Justice, as in the Moldova Association Agreement arbitration panels. Escape from the Court's jurisdiction is one of HMG's declared 'red lines', though, perhaps tellingly, the Future Partnership Papers now qualify this by reference to "*direct* jurisdiction".

- **Incorporation of amendments to the EURIP:** In response to changes to the EURIP (for example, by way of addition of a type of proceeding to Annex A), the EU/UK treaty could provide for the UK to notify the Commission of its intention to implement the change in its domestic law. The precedent here is Article 3 of the EC/Denmark Agreement provides a precedent.

- **HMG seems eager:** "*The UK will seek an agreement with the EU that allows for close and comprehensive cross-border civil judicial cooperation on a reciprocal basis, which reflects closely the substantive principles of cooperation under the current EU framework.*" HMG, *Providing a Cross-Border Civil Judicial*

Cooperation Framework: A Future Partnership Paper (August 2017), p. 6, [19]. HMG's eagerness and flexibility is also signalled by the fact that all but one of the precedents in this section draw on the "*purely illustrative…*" examples in HMG, *Enforcement and Dispute Resolution: A Future Partnership Paper* (August 2017), pp. 7 to 10, particularly [30], [49]-[50], and [58].

- **The EURIP is not a necessary incident of the single market:** This is clear from the position of Denmark, which has not adopted the EURIP, and also from the position of the UK and Ireland, which had had the option not to adopt it; EURIP, Preamble, [87] and [88]. This opens up the possibility that the hard-line position that both the UK and the EU have taken on the four freedoms (and on the free movement of workers in particular) need not extend to this domain.

Schemes of arrangement

<u>Current position</u>

A significant number of European companies have sought over the last 15 years to bring themselves under the scheme jurisdiction of the High Court in London.

- **Jurisdiction:** The English Court accepts jurisdiction so long as the debtor demonstrates "*sufficient connexion*" with England. European companies, usually acting in concert with sophisticated lenders, have in general adopted one or both of two strategies to establish sufficient connexion. The first has been a COMI shift on the eve of the application to convene a meeting (*Re Indah Kiat International Finance Company BV* [2016] EWHC 246).

- **Applicable law:** The second way in which sufficient connexion has been established is by demonstrating that the relevant obligations are governed by English law. European companies have even engineered changes in the governing law of the debt to be schemed

(*Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch)). An amalgam of the two strategies just mentioned is the acquisition or creation of English entities and voluntary assumption of new liabilities governed by English law (*Re AI Scheme Limited* [2015] EWHC 1233 (Ch); *Re Codere* [2015] EWHC 3778 (Ch)).

- **Recognition and enforcement:** That the English Court accepts jurisdiction in relation to a scheme is not sufficient; the Court must be persuaded to exercise its discretion to sanction it. English Courts generally do not issue orders that are unlikely to have substantial effect. Accordingly, where a scheme is intended to have effect in a foreign jurisdiction, the Court must be persuaded that it is likely to be recognised and enforced there. The issue of recognition and enforcement thus has a significant effect 'upstream' in the scheme process.

The English scheme has traded on ambiguity within the EU *acquis*.

- It does not fall within the ambit of the EURIP since it is not listed in Annex A, and since the debtor need not have a COMI or even an establishment in England in order to make use of it.

- The assumption, not shared by all English Courts, has been that the scheme falls within the BIR, notwithstanding that BIR does not apply to "*judicial arrangements, compositions and analogous proceedings*" (Article 1(2)(b)), with the company conceptualised as suing the creditors to be schemed. This would require either a majority of creditors to be domiciled in the UK, or at least one creditor to be so domiciled and for the company to have an English COMI or for many creditors to have submitted to the jurisdiction of the English Court; see Articles 4, 8, and 25 of BIR and *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch), [51]; and *Re DTEK Finance plc* [2016] EWHC 3562 (Ch), [17] to [19].

- Last but by no means least, the Regulation on the law applicable to contractual obligations ('**the Rome I Regulation**'), which permits parties to choose the law applicable to their contract and provides that that law governs *"the various ways of extinguishing obligations"*; Articles 3(1) and 12(1)(d). Echoing the way English courts approach the issue of whether an English scheme may vary or extinguish particular claims, the Rome I Regulation would enable EU courts to give effect to English schemes so long as the schemed rights themselves had been governed by English law. This notwithstanding that the Regulation does not apply to *"questions governed by the law of companies…such as the creation,…legal capacity, internal organisation or winding-up of companies"*; Article 1(f). While the law governing schemes is part of English company law, it is not that part which characteristically addresses questions of the company's legal capacity, internal organisation, or winding-up.

<u>Upon Brexit and assuming no substitute arrangements are put in place</u>:

- The BIR would not apply, and that possible route for recognition in EU27 jurisdictions would be closed. As noted, this would *pro tanto* deter English courts from sanctioning in the first place schemes that would be intended to have effect in those jurisdictions.

- However, the contractual route under the Rome I Regulation would remain open, since it covers choices of the laws of non-EU states; Article 2.

<u>Options</u>

- **Applicable law:** HMG intends to incorporate the Rome I Regulation into domestic law; *Providing a Cross-Border Civil Judicial*

Cooperation Framework: A Future Partnership Paper (August 2017), p. 6, [19].

- **Jurisdiction, recognition, and enforcement:** As already noted, it seems clear HMG would like to negotiate a bilateral recreation of the BIR, subject to the sorts of interpretive and amendments procedures discussed above in relation to EURIP. The EC/Denmark Agreement provides a precedent. It is worth noting that BIR is no more a necessary incident of the Single Market than is EURIP, and Denmark was permitted under the so-called Edinburgh Agreement of 1999 not to implement BIR until it chose to do so in 2005. HMG also appears ready to sign up to the Lugano Convention, that provides for jurisdiction, recognition, and enforcement in relation to Norway, Iceland, and Switzerland *Providing a Cross-Border Civil Judicial Cooperation Framework: A Future Partnership Paper* (August 2017), p. 6, [22].

Strengthened restructuring forum – 'Synthetic' proceedings

With US Chapter 11 practitioners, newly energised EU27 lawyers, and other jurisdictions led by Singapore positioning themselves to take restructuring business from post-Brexit London, relevant parts of HMG could do with ambitious thinking. A turbocharged restructuring forum could be a modest but useful shot in the arm for a jurisdiction suffering a self-inflicted wound. The outlines of the strengthened jurisdiction would draw on existing aspects of UK practice:

- **Sufficient connexion:** The test currently used by English courts to assume jurisdiction over the winding-up of foreign companies and in relation to schemes could be extended also to administrations. Foreign companies would then have access to the full range of UK restructuring tools.

- **Permit UK courts to apply foreign law:** Extending the jurisdiction currently available under section 426 of the Insolvency Act 1986 for a select group of 'cricket-playing nations', UK courts could be given power to apply foreign law including insolvency law where appropriate. Stakeholders in foreign companies would be assured of the treatment they would receive in insolvency proceedings in the COMI and/or establishment courts of the company.

- **Permit debt discharge/modification on grounds of COMI:** UK courts would assume jurisdiction in relation to the scheme regardless of the governing law of the debts to be schemed, so long as the debtor had a UK COMI. This would supplement, not replace the (in)famous 'rule in *Gibbs*', deriving from *Gibbs v Societe Industrielle* (1890) 25 QBD 399, that a debt may only be discharged or amended according to its governing law. The supplementation suggested here is consistent with the position of the Singapore High Court in *Pacific Andes Resources Development Ltd* [2016] SGHC 210. Full treatment of this is at Mokal, *Shopping and Scheming, and the Rule in* Gibbs (February 22, 2017). South Square Digest, March 2017, 58-63. Available at SSRN: https://ssrn.com/abstract=2922237.

- **Accord reciprocal treatment to similar schemes from other jurisdictions:** This would signal the principled nature of the strengthened UK process, and not merely an opportunistic jurisdiction grab.

The aim would be to facilitate **legitimate** and to deter **objectionable forum shopping**, understood thus (Mokal, *Shopping and Scheming*, supra):

> *"Steps taken to facilitate the assumption of jurisdiction by a court are objectionable if intended or reasonably likely to secure sectional benefits to one or more stakeholder constituencies (say, the debtor's directors and shareholders) but to the detriment or at the expense of one or more categories of claimant (say, trade creditors, employees, or tax authorities) with accrued claims*

against the debtor that are available in the existing forum but would be lost or diminished in the forum being shopped for.

By contrast, forum shopping is legitimate if intended or reasonably likely to maximise the value available for the benefit of all relevant claimants considered together without resulting in prejudice to any class of accrued claim holders. Value might be maximised because of enhanced prospects for the restructuring of the debtor's liabilities and/or operations and thus its survival, or for a going concern sale of its business."

Cross-Border Practice After Brexit: The Role of UNCITRAL

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A variety of corss-border bankruptcy case patterns have relied on the availability of London/UK to coordinate the case and implement relief within the EU.

London has proven important for global cases that are being coordinated outside the EU, because, by opening a case in London for the European subsidiaries, the debtor got the benefit of a market wide stay, along with the ability to provide informal synthetic treatment under English law. With the recast coming into force, formal synthetic secondary treatment would soon be available as well.

London has also positioned itself as a favored venue for coordinating global cases, either through administration or schemes of arrangement. Here too, the availability of an EU wide stay, and the insolvency regulation's recognition regime facilitated the administration of cases in the EU. For other jurisdictions, UK based cases relied on the Model Law or the special recognition regime for commonwealth countries.

Many of the attributes that make London an attractive venue for global bankruptcy cases will remain, even after Brexit. English judges will still have expertise with global restructuring, coupled with common law pragmatism and flexibility. What will be lost is the regime of automatic recognition in the EU. The question is how will practice adapt. This poses two related challenges:

- With regard to cases being coordinated outside the EU, London will lose its advantage as an EU beachhead. Since the case opened in London will not be pending in a member state, it will still be necessary to find an EU jurisdiction to gain the benefit of EU wide recognition.
- For cases based in London, recognition will have to rest on the domestic procedure for recognizing and cooperating with foreign insolvency cases.

A number of responses to these challenges are possible. For cases where the restructuring is being coordinated outside the EU, there will be a need for an EU beachhead. This may lead companies with subsidiaries registered in the UK to migrate their COMIs from London to other EU jurisdictions, such as Dublin, Frankfurt or Amsterdam. Cases coordinated in New York and London would now be on the same footing. They would need to rely on the domestic procedure for recognition. Some jurisdictions already have relatively well-developed recognition regimes, but there is little uniformity. A country that wished to provide an EU venue for global restructurings might find it advantageous to adopt the UNCITRAL Model Law on Cross-Border Insolvencies. That instrument provides a uniform and well understood mechanism for achieving cooperation, with a well-developed case law. In this regard, it might be hoped that Brexit will have the collateral consequence of encouraging uniform adoption of the Model Law.

However, a third possibility might be envisioned, and this possibility suggests an even more fundamental role for UNCITRAL instruments. As London, perhaps loses its dominance as a coordinating court for global cases, other jurisdictions might wish to step in as fora for coordinating global cases. For these purposes, there is the need to provide a pragmatic approach to standing and participation, as well as the ability to provide formal or informal synthetic treatment. These are features that are available in the US and UK, but not generally in civil law jurisdictions. In this regard, UNCITRAL again has something to offer. In particular the draft instrument on facilitating the insolvency of corporate groups may help other jurisdictions to fill the void.

The cross-border treatment of bank crises after Brexit. Possible implications for the access of UK banks to the single financial market.

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The financial sector is one of the most deeply regulated sectors, both at the EU and the international level. Since the financial crisis the intensity of regulation has increased in response to the need to improve protection of the market against cross-border risk transmission and reinforce financial stability.

A main pillar of the resulting reform process has been - along with a substantive reinforcement of prudential requirements and supervision standards - the establishment of a harmonized crisis management system, based on a common corpus of 'emergency tools' (those laid down in the Recovery and Resolution Directive – BRRD) to be used when the crisis of a financial institution may have systemic implications.

The UK, which is the home of large EU financial institutions operating across Europe and also of global non-EU headquartered banks has been one of the major actors in the harmonization process. The UK was one of the first member States, after the 2009 financial crisis, to substantially revise its national framework for the management of bank failures. This caused its regulatory approach to resolution to be particularly influential on the EU negotiations which led to the adoption of the BRRD.

Against this background, and also having in mind how crucial is the financial sector for the UK economy, a main question that arises in connection with Brexit is to what extent we can expect the UK to continue to be bound by the EU framework applicable to bank crises which it largely contributed to design.

The post-Brexit UK’s relationship with the EU has yet to be determined, but some predictions can be made in the light of the main features of the existing framework for cross-border bank insolvencies.

Directive 2001/24/EC on the reorganization and winding up of credit institutions has been implemented in the UK in 2004. This piece of legislation operates on the basis of providing recognition to insolvency and reorganization measures commenced in the financial institutions ‘home’ (member) State without any further requirements and without the opportunity to open territorially limited proceedings. On Brexit (without the UK being part of the EEA) it is very unlikely that such national rules would remain in place, as the existing regime would then operate to recognize the insolvency or reorganization of EEA financial institutions without requiring any EEA MS to recognize insolvency or reorganization measures commenced in the UK. Following repeal of the national legislation, the UK and the EU might however agree to replace CIWUD with instruments which cause recognition of UK insolvency or reorganization measures of financial institutions.

On an exit from the EU, the UK would also cease to be required to apply the BRRD framework, which has been implemented into UK law via the Banking Act 2009 and subsequent amendments to it. Thanks to intense global harmonization in this area (with the FSB having a leading role in the convergence process), it is unlikely that the UK would entirely repeal this legislation. However, UK subsidiaries of EU banking groups would be treated as third-country entities for the purposes of the BRRD, i.e. the UK resolution authority could no longer be required to automatically recognize the effects of resolution proceedings and actions taken by EU resolution authorities. Conversely, the EU MS would no longer be required to automatically recognize UK resolution proceedings and actions. The UK and the EU may however enter into cooperation arrangements under article 93 of the BRRD, whereby reciprocal recognition and enforcement of resolution proceedings could be agreed.

The feasibility of such resolution agreements, as well as that of any arrangement for the recognition of winding-up proceedings, would form part of broader discussions concerning the regulation of financial institutions post-Brexit and the type of arrangement under which UK financial institutions could be given access to the single financial market.

Given the highly regulated nature of financial services any form of access beyond the EEA model would involve some sort of 'equivalence' arrangement, with the UK seeking access as a third country to the single market. The UK has adopted the single rule book and would likely keep it, as well as it will likely maintain its resolution framework; though, meeting any equivalence assessment might be problematic in the absence of appropriate mechanisms to ensure immediate enforcement of EU resolution actions in the UK. Any determination of the equivalence of the UK regulatory regime for passporting purposes would conceivably take into account the effectiveness of the resolution regime to which financial institutions are subject, including its capacity to prevent ring fencing in a crisis scenario. Cooperation agreements for the purpose of ensuring the cross-border enforcement of resolution actions would therefore be an essential part of any post-Brexit arrangement involving some form of access to the single financial market.

Even if agreements were to be reached for the establishment of appropriate recognition mechanisms, there is however an important element that might further hinder an equivalence assessment of the UK resolution regime. It has to do with the state-aid implications of Brexit. In a non-EEA model the UK would no longer be prevented by EU law from offering aid to UK businesses on the basis that it restricts competition between EU Member States. However, allowing access to the single market to institutions from states that would not be subject to a general prohibition to provide discretionary aid to their banks would strongly affect the credibility of the bail-in regime, which is a core component of the resolution framework. Indeed, allowing UK banks to compete on equal footing with EU banks while benefitting from easier access to public funds in case of failure would be contrary to the very essence of the BRRD, which has been conceived to make banks resolvable without using taxpayer funds. This is a major impediment to any post-Brexit arrangement that might be reached to alleviate the UK third country status for the purpose of accessing the EU financial market; one that makes it highly plausible, at this stage of the negotiations, a scenario in which UK banks and banks from foreign countries would be required to obtain licenses for their branches in any EU country. This would mean, *inter alia*, the end of the UK role as the international hub for the European financial market.