Paper Eight

Insolvency and Restructuring

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The Impact of Brexit on Insolvency and Restructuring

Summary

In general terms, the existing EU legislation governing insolvency and restructuring works well, and the amendments reflected in the upcoming Recast EUIR (Regulation No 1346/2000) have been broadly welcomed by practitioners as sensible improvements.

The UK is undoubtedly seen as a centre of excellence in this field and this can be maintained with some effort, provided that there is sufficient clarity at an early stage as to what the legal consequences of Brexit will be.

As in civil and commercial matters, and perhaps even more so in the context of insolvency and restructuring, it is generally accepted that it is essential to have a clear and consistent basis for the allocation of jurisdiction in insolvency proceedings, and the recognition and enforcement of orders made in those proceedings.

- We urge the Government to consider that there is increasing national competition in this field. Singapore is aggressively promoting its legal system in international restructuring and insolvency cases. In addition, certain EU member states (for example, the Netherlands) have adopted, or are in the process of adopting, restructuring regimes analogous to schemes of arrangement which may be an attractive alternative for businesses with a significant presence within the EU.

- We therefore urge the Government to seek a successor regime which keeps these advantages.

The Impact of Brexit on Insolvency and Restructuring

1. This note sets out the potential consequences of Brexit in the field of restructuring and insolvency law. It forms a part of a larger project being undertaken by the Bar Council intended to consider the effect of Brexit on civil justice, criminal justice and legal services. It should be read in conjunction with the papers which consider the effect of Brexit on (a) jurisdiction, and the recognition and enforcement of judgments, in civil and commercial matters[1], (b) the authorisation and regulation of banks and other financial institutions, if any, and (c) the authorisation and regulation of the insurance sector if any.

2. At present, the principal pieces of EU legislation which govern insolvency and restructuring generally (both corporate and individual) are the Council Regulation (EC) No 1346/2000 on Insolvency Proceedings ("the EUIR") and Regulation (EU) No 1215/2012 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters ("the Recast Brussels Regulation").

2.1. The EUIR determines which member state has jurisdiction to open insolvency proceedings, provides for the proper law to be applied in those proceedings and provides for EU-wide recognition and enforcement of orders made in those proceedings, with only a limited basis for refusal of recognition. So far as main proceedings are concerned, it uses the "centre of main interests" ("COMI") test for jurisdiction. COMI is a concept which has generated controversy, in particular where COMI-shifting is employed to enable a debtor to take advantage of a more debtor-friendly jurisdiction. It nevertheless appears to be accepted as a sound basis for the allocation of jurisdiction, and for the purposes of recognition and enforcement, and it was subsequently adopted as the basis for recognition of main proceedings under the UNCITRAL Model Law, which is dealt with below.

2.2. The EUIR applies only to many but not all types of insolvency proceedings (those identified in its annex) and, further, applies only to proceedings which are particularly "insolvency" in nature. A notable exception from the ambit of the EUIR are schemes of arrangement under the Companies Act 2006 ("the 2006 Act"). Complex cross-border schemes, including in respect of foreign companies, have been a notable feature of the UK legal market over a number of years. Although there remains a degree of uncertainty, the current view is that schemes fall within the Recast Brussels Regulation. So also do proceedings which, although taking place in an insolvency context, are not necessarily "insolvency" in nature; for example, proceedings against a director for breach of duty. These too fall within the Recast Brussels Regulation.

3. In relation to the EUIR, two further points should be noted:

3.1. The EUIR is shortly to be replaced by Regulation No. 2015/848 ("the Recast EUIR"), which will come into force on 26th June 2017. This followed the 10-year review of the application of the EUIR, which the EUIR itself required. It has made certain

[1] See the Bar Council's paper on this subject dated 11 November 2016.

amendments to the EUIR, in particular in relation to the COMI test, the scope of proceedings capable of falling within the EUIR, and better coordination between main and secondary proceedings, as well as in the context of group insolvencies.

3.2. Neither the EUIR nor the Recast EUIR attempt to harmonise the substantive insolvency law applicable to insolvency proceedings falling within the EUIR. However, on 22nd November 2016 (and following the EC's recommendation of 12th March 2014 and as part of the Capital Markets Union action plan of September 2015) the EC published its Proposal for a Directive on Insolvency, Restructuring and Second Chance. The focus of the proposal is very much on restructuring and rehabilitation, and current UK law is essentially consistent with much of its content (note also that the Insolvency Service is conducting a consultation, based on its consultation paper "A Review of the Corporate Insolvency Framework" published on 25th May 2016, which covers some of the same ground as the proposal). Nevertheless, the proposal represents a significant change of EU legislative intent in this area.

4. In general terms, the EUIR seems to have worked reasonably well, and the amendments reflected in the Recast EUIR were (I think) broadly welcomed as sensible improvements. As in civil and commercial matters, and perhaps even more so in the context of insolvency and restructuring, it is generally accepted that it is essential to have a clear and consistent basis for the allocation of jurisdiction in insolvency proceedings, and the recognition and enforcement of orders made in those proceedings.

5. In addition to the general EU legislation referred to above, there is "sector specific" EU legislation dealing with the insolvency and restructuring of particular types of businesses which are excluded from the scope of the EUIR, and which are subject to wider legislative regimes; namely, insurance businesses, and banking and other financial institutions.

6. Provision for jurisdiction and enforcement is made by the Insurers Winding Up Directive and the Credit Institutions Winding Up Directive "the CIWUD"), which have been transposed into UK law by the Insurers (Reorganisation and Winding Up) Regulations 2004 and the Credit Institutions (Reorganisation and Winding Up) Regulations 2004. In summary, reorganisation and winding up measures proceed only in the "home member state" (the state with responsibility for authorising the conduct of business by the relevant entity), there can be no secondary proceedings, and the proceedings are automatically recognised and given effect throughout the EU (in other words, there is no need for separate recognition and enforcement proceedings).

7. Further, and in relation to the financial sector and banking and other financial institutions, there has been an increasing trend towards harmonisation of substantive law, historically to prevent systemic risk and more recently as a response to the 2008 financial crisis.

7.1. So far as systemic risk is concerned, there is:

7.1.1. The Settlement Finality Directive, which was transposed into UK law by the Financial Markets and Insolvency (Settlement Finality) Regulations 1999

and which inter alia protects transfer orders entered on designated payment and settlement systems from specified provisions of insolvency law; transaction avoidance provisions

7.1.2. The Financial Collateral Directive, which was transposed into UK law by the Financial Collateral Arrangements (No 2) Regulations 2003 and which inter alia exempts security falling within scope from effects which would otherwise follow; for example, stays on enforcement.

7.2. The EU response to the 2008 financial crisis (or one of them) is the Resolution and Recovery Directive ("the BRRD"), which provides for a minimum degree of harmonisation of the laws of EU members states and a common approach to the recovery and resolution of banks and investment firms falling within its scope. It sits alongside the jurisdictional and recognition provisions of the CIWUD. The BRRD was transposed into UK law inter alia by way of amendments to the Banking Act 2009 and the Financial Markets and Services Act 2000.

7.3. It is difficult to form a view about the operation of these "sector specific" provisions. It is probably fair to say that the resolution of the affairs of at least some financial institutions, and therefore the operation of the CIWUD, both before and after the coming into force of the BRRD, has been controversial. However, this is perhaps inevitable, or at least not unlikely, in an area where a single business can be so critical to the stability of an economy, and where the resolution or reorganisation of its affairs is or can be a highly political endeavour (particularly where it consists of or includes the exercise of bail-in powers).

8. The potential impact of Brexit will be obvious from the brief summary of the existing position set out above.

8.1. The basis upon which the UK courts can or should assume jurisdiction in respect of the restructuring, management and winding up of the affairs of insolvent or financially distressed debtors will become uncertain and will require to be developed. Where a debtor's affairs are conducted in the UK and in EU member states, there is at least a risk of a clash of jurisdictions, which is undesirable.

8.2. Recognition, and the enforcement of orders and judgments made and given in, foreign insolvency proceedings will no longer be automatic where those proceedings are being conducted in an EU member state. The giving or recognition and assistance will be governed instead by

8.2.1. The common law doctrine of modified universalism which allows for recognition and assistance, but not the enforcement of orders and judgments: *Rubin v Eurofinance SA* [2012] UKSC 46; *Singularis Holdings Ltd v PricewaterhouseCoopers* [2014] UKPC 36;

8.2.2. Section 426 of the Insolvency Act 1986, which gives a statutory power to assist upon request for assistance by courts of designated jurisdictions, which are for the most part Commonwealth jurisdiction, but including one EU member state - the Republic of Ireland;

8.2.3. The Cross-Border Insolvency Regulations 2006 ("the CBIRs"), which enact into UK law the Model Law adopted by UNCITRAL in 1997. The CBIRs provide for recognition and the giving of assistance, but not the enforcement of orders and judgment (although UNCITRAL is currently considering the extension of the Model Law to cover enforcement); and

8.2.4. Probably, so far as enforcement is concerned, and in the absence of any other treaty or convention, the common law principles governing the enforcement of the orders of foreign courts.

8.3. In general terms, so far as UK restructuring and insolvency proceedings are concerned (including schemes of arrangement under the 2006 Act), recognition, assistance and enforcement in the EU will depend upon the domestic private international law principles applied by the courts of the relevant EU member state. In this context, it should be noted that only four EU member states (Greece, Poland, Slovakia and Slovenia) have incorporated the UNCITRAL Model Law into their domestic law. There will be, therefore, a considerable degree of uncertainty as to the extent to which UK insolvency proceedings, and orders made by UK courts, will be recognised and enforced in EU member states.

8.4. Where EU legislation provides for or contemplates "third state" or "third country" recognition (as does, for example, the Recast Brussels Regulation and the BRRD), then these provisions will take the place of the existing regime. However, recognition and enforcement is obviously less certain in the case of third country recognition.

9. It is difficult to assess with certainty what impact Brexit will have on the legal market for the provision of services in this field. The UK is undoubtedly seen as a centre of excellence in this field and, anecdotally, at least some hold the view that this can be maintained with some effort, provided that there is sufficient clarity at a sufficiently early stage as to what the legal consequences of Brexit will be. However, there is increasing national competition in this field; Singapore is aggressively promoting its legal system in international restructuring and insolvency cases, and certain EU member states (for example, the Netherlands) have adopted, or are in the process of adopting, restructuring regimes analogous to schemes of arrangement which may be an attractive alternative for businesses with a significant presence within the EU.

10. Apart from the points dealt with above, Brexit will create a very substantial task of legislative drafting and amendment. This is obvious and common across the legal sector, and so is not dealt with further.

Recommendations

Any post-Brexit arrangement with the EU should, at the very least:

(1) Ensure that, as part of the agreement between the UK and the EU governing the UK's departure from the EU, provision be made for the continuing application of the EUIR (or at least as many provisions thereof) after Brexit.

(2) In any event, and particularly if no such agreement is possible, it will be crucial to ensure that clear transitional provisions are put in place to cater for UK insolvencies which commenced before Brexit but which will be concluded after Brexit.

Chancery Bar Association

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