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Back to the future – but no idea when

What Brexit could mean for the Anglo-European restructuring industry

What happens now?

On 23 June 2016, the UK voted to leave the European Union. The nature of the UK's relationship with the EU and the rest of the world, post-Brexit (if and when Brexit happens), is uncertain. So what do we know?

Actually, we do know several things:

– Legally speaking, the referendum result has no immediate effect. It is only advisory. The UK continues to be a member of the EU and is still bound by the EU Treaties and subject to the jurisdiction of the Court of Justice of the European Union.

– The only legal mechanism for withdrawal is that set out in Article 50 of the Treaty on the European Union (TEU). This requires the UK to issue a formal notice to the European Council (an "Article 50" notice) which will then trigger a two-year period. At the end of that period the UK will automatically stop being an EU Member State whether or not a withdrawal agreement has been reached. It is up to the UK when and if it notifies the European Council of its decision to leave; no timeframe for notification is provided under Article 50.

– Given the current political situation in the UK and the possibility that the act of triggering Article 50 will have to be brought before Parliament and debated, it may be that an Article 50 notice will not be served until the Autumn at the earliest – and possibly even later. However, the remaining 27 Member States, the European Commission and the European Parliament may be unprepared to engage in informal negotiations until notice has been given. Thus, the UK can expect to come under growing pressure to serve notice sooner rather than later.

So where does that leave us? The UK has its own legal system which is enforced by its own independent court systems. However, a great deal of law which currently applies in the UK is derived from EU law in two ways:

- Directly, without the need for any domestic implementing legislation, in the form of EU Regulations; and
- Indirectly, in the form of EU Directives which have to be implemented by Member States through domestic implementing legislation.

If Brexit requires a repeal of the European Communities Act (ECA), then secondary legislation which is incorporated into UK law by the ECA would be likely to fall away. However, any primary legislation (which has been implemented through a freestanding UK statute to incorporate EU rules into UK law) would still stand. This would cause inconsistencies and gaps in the UK's legislation which would need to be addressed in the transition period. Post-Brexit, the UK will need to decide how much, if any, EU law it wishes to retain. There is a range of possibilities from a clean break through to mirroring EU law in UK law.

One of the key unknowns when looking at the impact of a Brexit on restructuring and insolvency laws, is what sort of relationship the UK will have with the rest of the EU once its divorce has become final. Will the UK join the EEA? Will it become a member of EFTA but otherwise negotiate bilateral agreements with Member States? Or will it go it alone, negotiating a bespoke solution with each jurisdiction? Hogan Lovells has produced a note on the various options which can be **accessed here**.

It's life, Jim, but not as we know it

The flexibility and pragmatism of the English courts, combined with the creativity of restructuring professionals in this jurisdiction, has gone a long way towards making England a forum of choice for the implementation of numerous complex restructuring transactions. That success could be placed in serious jeopardy unless the post-Brexit world includes means, by which access to the mutual recognition and cooperation provisions in the various European insolvency provisions can be preserved.

In the rest of this piece we consider the impact that Brexit might have on restructuring and insolvency transactions, keeping in mind the different models that the UK might follow when negotiating its future relationships with EU Member States.

Cross-border recognition and assistance – background

- Those involved in cross-border restructuring and insolvency transactions before 2002 (and indeed those who are involved in cases today involving jurisdictions with little or no formal recognition or assistance laws in place) will recall the legal and practical issues that such cases presented. Each EU Member State had (and still retains) its own insolvency laws. The likelihood of a court in (for example) Luxembourg recognising insolvency proceedings started in the UK depended on Luxembourg recognition laws (and in some jurisdictions, the mood of the court at the time).
- Matters were eased in 2002 for corporates and individuals with the introduction of the EU Regulation on Insolvency Proceedings (EIR). However, the EIR does not apply to credit institutions or insurers, and it was not until 2004 that recognition legislation was passed for those entities.
- Some of the issues which flowed from the lack of a formal recognition system for insolvency proceedings are mentioned below, but in all cases it led to increased uncertainty in terms of outcomes (both for the creditors of the company and the company itself), time and costs, even where practical steps (such as agreeing and implementing an insolvency protocol, as used on the liquidation of BCCI) were taken to try to resolve some of those issues

EC Regulation on Insolvency Proceedings 2000

- The EIR came into force in 2002 and was significantly amended in 2015 (the "Recast EIR"). The Recast EIR is in force but will apply to insolvency proceedings started after 26 June 2017. Despite its relatively recent arrival on the scene, the EIR has become the foundation for cross-border insolvency recognition across the EU.
- The EIR does not change the domestic insolvency laws of each EU Member State; instead, it sets out a framework of rules governing the administration and recognition of insolvency proceedings which involve more than one EU jurisdiction. By way of example, insolvency proceedings started in an EU Member State where the insolvent person or company has their centre of main interests or Centre of Main Interest

COMI must be recognized throughout all other EU Member State (note that Denmark falls outside the EIR). The EIR also sets what laws apply to certain matters arising in insolvency proceedings, such as antecedent transactions, set-off and security matters.

- As an EU Regulation, the EIR is directly effective in the UK and will cease to have effect on Brexit, unless the UK and the EU have agreed otherwise. This will be the case whatever model the UK chooses to adopt, including whether or not the UK joins the EEA. Three of the obvious consequences are as follows:
  - The courts in EU Member States will not have to recognize proceedings started in the UK as main proceedings. Unless the UK has negotiated bilateral recognition agreements with each EU Member State (which at this stage might appear unlikely), recognition would depend upon local recognition rules. This may lead to a patchwork of different (and not necessarily consistent) decisions on the same issue, depending upon the jurisdictions involved;
  - Under the EIR, once main proceedings have been started in one EU Member State, only secondary proceedings can be started in other Member States, effectively giving precedence to the main proceedings. This concept of main and secondary proceedings will disappear, and it would be open to courts in other jurisdictions to bring conflicting proceedings once proceedings had been started in the UK, leading to delay and increased costs as conflicts are resolved.
  - Without the framework of the EIR, where insolvency practitioners are appointed in different jurisdictions we may see a return to the use of insolvency protocols, which can take time to negotiate and will inevitably increase the costs of the proceedings.

Cross-Border Insolvency Regulations 2006

- The Cross-border Insolvency Regulations 2006 (CBR) implement the UNCITRAL Model Law, which means that they should remain unaffected on any repeal of the ECA. Neither the CBR nor the Model Law requires the UK to be a member of the EU for the CBR to be effective.
- Under the CBR, an insolvency practitioner appointed under foreign main or foreign secondary proceedings, can apply for recognition and assistance by the UK Courts. It is possible, therefore, that insolvency practitioners appointed in EU Member States will be able to gain recognition in the UK, whereas recognition of insolvency proceedings commenced in the UK would depend upon the local recognition rules of each relevant EU jurisdiction. Where an EU Member State has implemented the Model Law, this may not be an issue. However to date only Greece, Poland, Romania and Slovenia have implemented the Model Law.

Credit Institutions Winding-Up Directive (CIWD) and the Credit Institutions (Reorganisation And Winding-Up) Regulations 2004 (CIRWR)

- The CIWD is an EU Directive and therefore not directly applicable in England and Wales. However, it was implemented as a matter of English law under the Credit Institutions (Reorganisation and Winding-up) Regulations 2004. Unless confirmed by Parliament before Brexit, the CIRWR will fall away as and when the ECA is repealed. The rest of this section assumes the continuation of the CIRWR post-Brexit.
- The effect of Brexit on the CIRWR and the CIWD will depend on what model the UK adopts for its relationship with the EU:
  - **UK joins the EEA:** the CIWR and the CIRWR apply to EEA states as well as EU Member States. If the UK becomes a member of the EEA, there will be little change to the current position;
  - **UK does not join the EEA:** the CIRWR would continue to apply as a matter of English law, meaning that the UK would have to give effect to and recognize any reorganization or winding-up measures affecting an EEA credit institution, and which were applied to any branch of that credit institution, any of its property or other assets and any of its debts or liabilities. However, similar action by the UK resolution authorities in relation to a UK credit institution would not be recognised or given effect to in the same way by EU Member States.

Insurers Winding-up Directive 2001 and the Insurers (Reorganisation and Winding up) Regulations 2004

The position and outcome in relation to insurers will be the same as that for credit institutions, summarized above

albeit in relation to a different directive and implementing regulations. The winding up and reorganization of insurers in EEA states is currently governed by Directive 2001/17/EC on the reorganization and winding up of insurance undertakings. This has been implemented in the UK by the Insurers (Reorganisation and Winding Up) Regulations 2004.

Bank Recovery and Resolution Directive 2014 (BRRD) and the Banking Act 2009 (BA)

- As a Directive, the BRRD should have been implemented by each EU Member State by 1 January 2015 (with a later date for certain provisions such as the bail-in provisions). The BRRD was implemented in the UK by amendments to the Banking Act 2009. As this was primary, as against secondary legislation, the BA will be unaffected by a repeal of the ECA. However, as with the CIRWR, the effect of Brexit on the resolution and recovery regimes set out in the BA will depend upon which post-Brexit model the UK ultimately ends up following.
- If we become a member of the EEA: the Directive applies to EEA states which implement the Directive, which the UK has already done. If the UK joined the EEA we would be treated as a Member State for the purposes of the Directive and the BA, and so there should be little change to the current position. However, cross-border recognition of resolution actions is achieved through the CIWD/CIRWR; the UK would therefore need to take the appropriate steps to ensure the continuation of that legislation.
- If we do not remain in the EEA:
  - The BA is primary legislation and is already in force. It will therefore remain in place unless or until it is repealed or amended by Parliament. As the principles contained in the Directive are derived in part from wider global steps taken to ensure the end of "too big to fail", it is perhaps unlikely that the UK government would seek to change significantly the resolution and recovery regime that now applies. However, amendments will be needed to deal with the separation of the UK from the EU.
  - Upon Brexit, the UK would become a "third country" for the purposes of the Directive (and EU Member States will become "third countries" for the purposes of the BA). One of the consequences of the UK being a "third country" is that, in accordance with Article 55 of the Directive, financial institutions regulated in the EU which incur liabilities under English law contracts will have to seek the inclusion of contractual recognition of bail-in clauses in those English law contracts – thereby extending what is already an onerous obligation.
- Certain provisions already exist under the Directive and the BA for the recognition (or not) of third country resolution actions:
  1. The European Commission may submit proposals to the Council for agreements with third countries on co-operation between EU resolution authorities and the relevant third country authorities in respect of resolutions affecting banks with operations in EU Member States and in third countries.
  2. The following paragraphs set out the position under the BA regarding recognition of resolution action taken by third countries. It is possible that similar third country provisions will exist in other EU Member States to the extent the provisions are derived from the Directive, but each Member State will have implemented the provisions slightly differently. This could lead to resolution action taken by the UK resolution authorities being treated differently across the EEA.
  3. For significant UK subsidiaries and branches of non-EEA banks, it is likely that resolution action will be led by the resolution authority where the bank is located. However, it may be necessary for the Bank of England to take actions that recognize or facilitate those resolution proceedings. Where the Bank of England is notified that a third country resolution authority has taken a resolution action, the objective and results of which are comparable to the exercise of a stabilization option in the special resolution regime, the Bank of England is obliged by the BA to make a "third country instrument" which either recognizes the action, refuses to recognize it, or recognizes some parts of the action but not others.
  4. In addition to recognizing a third country resolution action, the Bank of England may exercise one or more of the stabilization powers

in respect of an entity or branch in the UK of a third country banking institution in order to support third country resolution with a view to promoting objectives which, in the third country, correspond to the special resolution objectives in the BA.

5. The Bank of England may only refuse to recognize a third country resolution action, and instead take independent resolution actions if appropriate, if both the Bank of England and the Treasury are satisfied that one or more specified conditions are met, including where recognition would have an adverse effect on financial stability in the UK or the action treats creditors located or payable in the UK less favorably than creditors with similar rights located or payable in the third country.

(6) When exercising resolution tools and powers, the Bank of England must take into account the interests of other relevant jurisdictions, and the potential effect on that jurisdiction's financial stability.

The Insolvency Act 1986 (IA)

The IA is the key piece of insolvency legislation in the UK. Although not derived from EU law, it was amended in certain respects following the coming into force of the EIR (for example, the definition of "company" in paragraph 111(1A) of Schedule B1). If the UK does not join the EEA, the IA should be reviewed to ensure that, on Brexit, there are no further references to EU legislation which might, in the future, prove to be a bear trap for the unwary.

Financial Collateral Directive and the Financial Collateral Arrangements (No.2) Regulations 2003 (FCR)

– The aim of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, better known as the Financial Collateral Directive (FCD), was to create a Community regime for the provision of securities and cash as collateral under both security interest and title transfer structures. It was felt that such a regime would "...contribute to the integration and cost-efficiency of the financial market as well as to the stability of the financial system in the Community, thereby supporting the freedom to provide services and the free movement of capital in the single market in financial services" (Recital 3 of the FCD).

– The Directive was implemented under English law through the FCR. The FCR applies to financial collateral arrangements between non-natural persons. A financial collateral arrangement is (in summary) a security financial collateral arrangement or a title transfer financial collateral arrangement. Both arrangements have to involve "financial collateral", defined as cash, credit instruments or credit claims. There are a number of advantages to having a financial collateral arrangement:

  – Certain formalities will not apply to the arrangement, so for example there is no need to register a security financial collateral arrangement at Companies House;

  – A number of insolvency provisions are disapplied, so for example a receiver appointed under a security financial collateral arrangement cannot be required to vacate office by an administrator;

  – Appropriation was introduced as a new way of enforcing a security financial collateral arrangement in certain circumstances, which would allow the security holder to take ownership of the collateral.

– However, doubt has been cast on the way in which the FCR has been implemented. There is a concern that the FCR has been implemented more widely than the FCD, and that Parliament should therefore have enacted primary legislation and not secondary legislation under the ECA. Because of this doubt, a provision was inserted into the Banking Act 2009 giving the Treasury the power to make additional regulations relating to the FCD and the FCR. In particular, the regulations can provide for the FCR or anything done under or in reliance on the FCR to be treated as having had effect despite any lack of vires. In other words, the Treasury now has power under primary legislation to address any issues that might arise as a consequence of any improper implementation of the FCR. No regulations have yet been made by the Treasury.

– As secondary legislation, the FCR will fall away on any repeal of the ECA unless steps are taken by Parliament to affirm the legislation. Given the powers given to the Treasury under the Banking Act

2009, this may be easier than with other secondary legislation. Given the aims of the FCD, it would seem likely that the Government would want to retain either the FCR or something similar post-Brexit.

Schemes of arrangement

- The extent to which the European Judgments Regulation (EU 1215/2012) (EJR) applies to English schemes of arrangement remains a matter of debate. Schemes fall outside the scope of the EIR. There is an argument that the EIR and the EJR are intended to dovetail neatly so that to the extent a proceeding doesn't fall for recognition under one, it must fall under the other. However, it can be difficult to reconcile schemes and the scheme process with the language used in the EJR. When considering jurisdiction, the courts in recent English scheme decisions have considered jurisdiction both on the basis the EJR did apply, and on the basis it did not, looking at whether all creditors have submitted to the jurisdiction of the English courts, and to the extent there is no such submission whether at least one creditor is domiciled in England and whether it is expedient to deal with all the creditors in the same proceeding. To date the English courts have satisfied themselves that they have the necessary jurisdiction both under the EJR and otherwise.
- This uncertainty would disappear on Brexit, as the EJR would no longer have effect in this jurisdiction. However, that may merely replace one uncertainty with another.
- If the UK leaves the EU but joins the EEA, the 2007 Lugano Convention on jurisdiction and the enforcement of judgments in civil and commercial matters (LC) will have to be considered. The LC governs issues of jurisdiction and the enforcement of judgments between EU Member States and certain of the EFTA countries (Iceland, Switzerland and Norway but not Liechtenstein). As the terms of the LC are similar in many ways to the EJR, English courts would therefore have to carry out a similar exercise to the one now carried out under the EJR.
- If the UK leaves the EU but does not join the EEA, consideration will have to be given to 2005 Hague Convention on Choice of Court Agreements (the Convention). Every EU Member State (other than Denmark), including the UK, is currently subject to the Convention by virtue of its membership of the EU. If and when the UK comes to leave the EU, it will undoubtedly accede to the Convention as an independent contracting state. The UK's ability to do so is not dependent on the consent or cooperation of the EU. The Convention should guarantee that exclusive jurisdiction clauses in favor of UK courts will continue to be respected in the EU in most civil or commercial disputes of an international nature, and that UK judgments can be enforced in the EU with relative ease, whatever the outcome of the negotiations with the EU. However, this will depend in practice on the approach of courts in the EU to the interrelation between the Hague, the EU, and national jurisdiction rules.
- There are two further points worth keeping in mind:
  - The Convention is subject to exceptions, one of which is that it does not apply to "insolvency, composition and analogous matters". Whether that would include or exclude schemes of arrangement remains to be seen;
  - The Convention applies to jurisdiction agreements entered into after the date on which the Convention came into force for that contracting state. The EU (and therefore the UK) acceded to the Convention on 1 October 2015; however, the UK will have to accede as a separate nation upon leaving the EU. This gives rise to two questions: (1) will the Convention apply to jurisdiction agreements entered into after 1 October 2015 or the later date that the UK acceded to the Convention; and (2) in the case of a scheme, what is the "jurisdiction agreement" that has to be considered – is it the submission to the jurisdiction of the English courts in the debt documents, or is it the submission to the English courts as part of the scheme process?

  The answer to both these issues may have significant consequences for the recognition (or otherwise) of English law schemes of arrangement used to deliver international restructurings.
- So what is the position where none of the EJR, the LC or the Convention applies? Again, the answer is fraught with uncertainty, but it may be that concepts of private international law would have to be considered, and the English courts, when considering whether the scheme would be effective in relevant jurisdictions in the EU, would need to be satisfied that domestic conflict of laws rules would enable the courts in the relevant jurisdictions to

grant recognition of the scheme and give effect to it. However, recent cases have considered questions of recognition both under the EJR and as a matter of private international law, and concluded that the schemes in question would be recognized in the relevant jurisdictions on both bases, so it may be that the scheme success story will continue relatively unchanged.

Capital Markets Union (CMU) and the EU consultation on insolvency harmonization

If the CMU Action Plan proceeds along the currently proposed timetable, a Directive concerning the harmonization of certain insolvency laws across EU Member States may be in force before Brexit occurs. The UK may have very little influence on or input in the negotiation of that Directive. EU Member States may take the opportunity to develop EU insolvency laws which are more in line with their current regimes, rather than follow a UK or U.S. type approach. If the Directive comes into force with an implementation date which is earlier than Brexit, the UK will have to consider whether to implement the Directive or breach EU laws by failing to do so.

Conclusion

The task facing the UK government is Herculean and should not be under-estimated. If and when Brexit happens it will require perhaps the most significant review and revision of UK legislation ever undertaken. There is a risk that, in the process, little attention will be paid to this country's insolvency laws, resulting in a loss of that flexibility and cross-border recognition that has made the UK an epicentre for restructuring and insolvency. Those involved in restructuring and insolvency need to make sure that the Insolvency Service, the Treasury and the regulators are lobbied to ensure the insolvency laws are amended appropriately. Otherwise, we risk taking a significant step backwards in time.

We end this article on the following quote from Benjamin Franklin, which although not meant for Brexit nevertheless sums up the current position

"...but in this world nothing can be said to be certain, except death and taxes."

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