Brexit and its consequences for the world of restructuring

Professor Christoph Paulus, of the Humbolt University, Berlin, considers what might happen with regard to cross-border insolvencies and/or insolvencies of British firms after Brexit

It has always been in the keenest interest of mankind to foresee the future. The Roman augurs watched to this end the flight of the birds, and Nostradamus compiled his collection of major, long-term predictions in his (in)famous prophecies ("Les Propheties"). Today, we want to know what happens with the markets when politician A wins the elections, and we make predictions about the UK's role in 2019 and onwards. All these efforts are as welcome as they are built on shaky grounds – suffice it to remind of the predictions about the last US-election or the one in the UK. The generally accepted right to fail with one's predictions makes participation in this business highly attractive so that it is no wonder that, as a consequence, the amount of writings alone about Brexit is exuberant and is likely to turn out to be entirely irrelevant when reading it again in the year, let's say, 2020. In Germany, one had the chance to experience a similar correlation between endless writings, discussions, and deliberations and the final outcome some 28 years ago when the re-unification fuelled the imaginations and created all sorts of proposals which, at the end of the day, in most cases turned out to be illusionary.

Given this, it should be appropriate to begin with a few observations which we can, as of today, take for granted (or, in other words, are allowed to accept as facts) and which might have an impact on or which might stem from Brexit.[1] It needs, however, to be borne in mind throughout that – even within the field of private law (being itself only a small part of the whole problem[2] to be solved) – the topic of restructuring is just a tiny little piece of a huge jigsaw puzzle that the politicians are supposed to set together for the time after. It is, thus, not an unlikely scenario that the restructuring world has to live for quite a while with uncertainty and reduced predictability.

I. Facts

The interpretation of the European Insolvency Regulation in its new version (EU 2015/848 - EIR Recast) is likely to suffer from lacking imagination and what one might call stress-tests. Looking back to the beginnings of the then (2002) new EIR the most innovative and heavily disputed actions and decisions were made by English practitioners. It was they who have – in clear contradiction to the quite explicit legislative intent[3] - introduced a way to handle group insolvencies by means of an understanding of the COMI (Centre of Main Interests) concept which, in the beginning, was strongly opposed on the continent[4] but soon later eagerly copied. Even the European Court

1/. A parallel to this scenario is dawning on the other side of the Atlantic when and if the termination of the NAFTA agreement stands to discussion.
2/. Much more burning probably problems such as the membership questions around European Common Aviation Area; i.e. in case of "no contract" (as opposed to a bad contract) it could happen that all British planes cannot fly over the continent.
3/. Just cf. Virgós/Schmit-Report, marg. No. 76.
4/. Including, i.a., the present author.

THE CJEU FIRST USED THE TERM 'CENTRE OF MAIN INTERESTS' IN ITS JUDGEMENT OF 20 OCTOBER 2011, INTERDIL SRL, IN LIQUIDATION V FALLIMENTO INTERDIT SRL AND INTESA GESTIONE CREDITI SPA

of Justice's attempt to suppress this interpretation in its Eurofood decision (and later ones) was bound to fail – not so much in terms of verbal disagreement but in terms of factual circumvention.

Another example is the ingenuity to establish a virtual secondary proceeding in order to gain a win-win-situation. The Collins & Aikman case was a teaching hour for continental Europe as to how to achieve the best possible result. And it was a sort of childish know-it-all attitude of practitioners from this side of the Channel when they afterwards wrote articles under the title: we could also have done it.

Needless to point out that both examples have made it into the EIR Recast – however, in a way that defies the Institutional Agreement between the European Parliament, the European Union and the European Commission on Better Law-Making from April 13, 2016.[5] Both set of rules in artt. 36 ff. and 61 ff. are so overly bureaucratic and complicated – metaphorically: the flexibility of the case law-approach has been put in the Procrustes bed of general applicability – that it is quite justified to predict that we will not see many cases (if any) in which they play a role.

Whereas fact no.1 brings a disadvantage to the continent, fact no.2 is negative (or at least: demanding) for the UK In her relationship with the U.S.A., the UK had the competitive advantage of automatic recognition of most (if not all) of its restructuring decisions. The European Judgment Regulation and the Rome I-Regulation worked very well as a supporter of the British restructuring and insolvency

5/. Cf. ABl. EU L 123, 1.

Some critics see a post-Brexit UK turning into a brothel of Europe

industry. Critics have seen it turning even into a brothel of Europe. This advantage is likely to fall apart after the Brexit.[6] The USA, in contrast can still offer their huge advantage – namely the effective stand-still of interfering actions worldwide thanks to its powerful global economic position.

But not only this is unfavourable to the UK. At the same time, in the far East, Singapore is increasingly and powerfully advancing itself as a restructuring hub for Asia. By enacting highly attractive restructuring tools (a mixture between the English scheme of arrangement and the U.S. Chapter 11[7]) and by setting up a "consumer-friendly" infrastructure for the professionals it is working hard on its visibility and to improve its global positioning. But since "decorating the show-case" is one thing, Singapore is very well aware that the other main trigger for the international success of its insolvency regime and hence of the state as an attractive and powerful business location is the recognisability of their courts' decisions. And here Singapore might get into direct competition with the UK. Officials are already intensely examining the possibilities – beginning with Bilateral Investment Treaties and ending at a multilateral agreement. It is fair to assume that Singapore would not mind too much if her services would also be asked for by Europeans, even if they are from the continent.

There is another twist to this competition issue, though. By an almost ironic coincidence, the member states of the European Union are confronted with the need to transform into national legislation a Directive which is, as of now, still a draft but which is very likely to get enacted rather soon. This new instrument can be described as a mixture of the French procédure de sauvegarde and the English scheme of arrangement. It introduces EU-wide a restructuring tool which is on purpose designed to avoid judge involvement to the highest degree possible. And, funnily enough, it is supposedly applicable to debtors for whom no requirement whatsoever is set up as to their centre of main interest. In other words, it can be applied to anybody no matter where this anybody is domiciled or seated. Up to now, it appears as if the continental lawyers have not yet discovered the potential of this legislative omission – at least, as far as I can see, no one has so far openly discussed this issue. However, it is to be assumed that rather sooner than later somebody will jump on the enormous potential which is connected with this instrument's openness and then the UK is in direct competition not only with Singapore and the US, but also with the member states of the EU.

II. Choosing the right way

What will happen with regard to cross-border insolvencies and/or insolvencies of British firms after a possible Brexit? The latter observations have lead us already into the realm of prediction. Accordingly, let us see which options seem to exist from the somewhat limited perspective of a German academic; what are the goals that the UK is likely to go for? – seen from the limited horizon of restructuring and insolvency law; and, finally, which of the options described before would serve best the purpose.

1/. The options

The EIR will cease to stay in force in the UK, and British insolvency proceedings/judgments will not automatically be recognized in the EU member states pursuant to the EIR. Hence, something has to be done. Following the nice and comprehensive listing, for instance, Mankowski's,[8] one can distinguish between the

6/. Cf. Burton, Insolvency and Brexit, International Insolvency & Restructuring Report 2017/18, p. 30.
7/. Cf. Sec. 211A ff. of the Companies (Amendment) Bill, Bill No. 13/2017.
8/. Mankowski, Brexit and European Insolvency Law, Hamburg Law Review 2017 (to appear in the next issue).

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"EEA" version, the "Swiss model", the "Danish model", the "Turkish model", the "Canadian model", and a tailor-made solution.

a) The "EEA" model[9] implies that the UK accedes the European Economic Area. The EEA is an extension of the Single Market to the EFTA countries Iceland, Liechtenstein, and Norway; accordingly, what would be needed is the UK also entering the EFTA group. This option carries with it the advantage of having quite unrestricted access to the European Market but comes at the price of, i.a., accepting the right to free movement.

b) The Swiss model[10] is insofar separate from the previous one as Switzerland has not joined the EEA but is a member of EFTA. However, she has not (yet) agreed to fall under the supervision of the EFTA Surveillance Authority and the EFTA Court. Instead, her relationship with the EU is based on a large number of bilateral agreements.

c) Denmark has opted out from participation in the area of judicial cooperation. Nevertheless, the EU and Denmark have entered agreements in 2005 by which an extension of the Brussels I-Regulation and the Service Regulation was agreed upon. Someway, somehow other instruments do also reach out to the northern peninsula, not, however, the European Insolvency Regulation. It is to be noted, though, that

9/. Also called "Norway model", cf. D. Paulus, Der "Brexit" als Störung der "politischen" Geschäftsgrundlage?, in: Kramme/Baldus/Schmidt-Kessel (eds.), Brexit und die juristischen Folgen, 2016, p. 101 ff.
10/. From the overboarding literature, cf. just Epiney, Die Beziehungen Schweiz – EU als Modell für die Gestaltung des Verhältnisses Großbritanniens zur EU?, in: Kramme/Baldus/Schmidt-Kessel (eds.), Brexit und die juristischen Folgen, 2016, p. 77 ff.

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Denmark is a member state of the Union.
d) The Turkish model (irrespective of its chances for further realisation) is based on Association Agreements. They do not include, however, any cooperation or alleviations regarding insolvency law but are more or less a basic tariff union.[11]
e) The Canadian model would echo the CETA bilateral free trade relationship; similar efforts are underway with Korea and Japan. These instruments, however, do not include judicial cooperation along the lines of the Brussels I- and the Insolvency Regulation.
f) A tailor-made solution could be designed as a mix of the abovementioned models or as something entirely innovative. Such innovations would have to take into account what goals the UK politics is striving for.

2/. The goals

Assuming that the UK's political will continues to be, i.a., strengthening the service and jurisdictional industry within and outside the country, recognition of decisions is key. The consequence of Brexit is that the UK is no longer a member state of the Brussels-I and the European Insolvency Regulation, thereby cutting off the recognition automatism of those two instruments within the EU. The, so far, high attractivity of, especially, London as a major economic hub relies to a great extent on the reliability of the British law (also: insolvency) system and its effects and their recognition outside of the UK, especially the EU.

This applies both to companies (and individuals) founded and registered within the UK with activities in other member states, as well as those high number of companies founded and registered in the UK but being seated in another member state where they pursue their economic activities.

What is needed, therefore, is a mechanism as close as possible – and tolerable (for both sides) – to full membership or recognisability of court decisions. And, indeed, something like that does exist.

a) To begin with the (insofar) most attractive one, the Lugano Convention 2007 has the lead – at least with regard to judgments outside of the insolvency realm. It parallels to a high degree the Brussels I-Regulation including the automatic recognition. However, access to the Convention is granted primarily in combination with either EU membership or EFTA membership. To accede EFTA (which is precondition for acceding EEA), unanimous consent is required from the existing member states (Iceland, Liechtenstein, Switzerland, and Norway), artt. 56, 43 par. 5 of the EFTA Convention.[12] It should be borne in mind that Norway is not entirely happy about such prospect, for the somewhat banal reason that she would, thereby, lose her leadership role in this group.[13] Even though this sentiment would probably not be the final word in the process, the incident reminds us that politics is not just unemotional, cool reason in progress! Once, the UK were an EFTA member, it could accede the Lugano Convention according to art. 70 par. 1 a), 71 Lugano Convention.
There is, though, another road to Lugano which, however, is thornier as it requires consent from all The Contracting Parties, artt. 70 par. 1 c), 72 par. 3 Lugano Convention. The Contracting Party is the EU, not the member states. It would take, thus, the consent of the EU to allow the UK access to the Lugano Convention. Even if that were to be granted – a step which would not be easy to explain domestic voters in a number of EU member

11/. Cf. Mayer/Manz, Der Brexit und seine Folgen auf den Rechtsverkehr zwischen der EU und dem Vereinigten Königreich, BB 2016, 1731 ff.
12/. Consolidated version, last amended on July 1, 2013.
13/. Cf. Baudenbacher, After Brexit: is the EEA an option for the United Kingdom?, European Law Reporter 2016, 134, 137.

states – the EU would still be in the position to opt out, as it were, from being bound by the access: art. 72 par. 4 allows the Contracting Parties to object the accession – with the consequence that, in relation to the EU, the Convention does not enter into force. This is a threat which is hard to imagine that the UK government would want to be confronted with.

b) On the insolvency side, the UNCITRAL Model Law could be helpful. After all, the UK has adopted it and it will be applicable with regard to the previous fellow member states of the EU since Brexit means exit also from the EIR.[14] The Model Law does not provide for automatic recognition but yet, it is based on the assumption that there is, globally speaking, just one main proceeding and that non-main proceedings are permissible but with territorial limitations.

Precondition for this somewhat improved recognition mechanism is, as a matter of fact, that there is indeed an insolvency proceeding at stake. And the question is whether this is the case at all when it comes to the British law "export hit", the scheme of arrangement. It is well known that the UK has fought fiercely[15] to get it acknowledged by the EIR Recast that it is not an insolvency proceeding[16] The somewhat delicately construed compromise in art. 1 of the Recast EIR according to which an insolvency proceeding has to be based on a "law relating to insolvency" is the badge of victory for this fight. In commentaries, we are now writing that the scheme is not covered by the EIR since it is based on the Companies Act 2006.[17] The huge advantage for the UK restructuring industry is that the scheme is applicable for entities with their COMI outside of England.

Well, under the given circumstances it is to be assumed that one judge or another will be inclined to rethink this position and to have a closer look at the elements of an insolvency proceeding as defined in art. 1 EIR Recast: there is no need of insolvency, there is no need of an all-creditors-encompassing proceeding, there is no need for any liquidation option as a last resort, etc. There is, at the end of close inspection, only this basement-requirement. But if this were the only distinguishing element – what should we say about the French insolvency law which no one ever, so far, has disputed to be a "real" insolvency tool in the sense of the EIR? It is regulated in the Code de Commerce! Shall we, therefore, save the scheme exception and give it justification post mortem (post Brexit), as it were, and tell the French that they are out of the applicability of the Regulation? Of course not! Therefore, again – it is to be feared that some may think that time would be ripe for qualifying the scheme differently from before.

However, even if we do so and accept the scheme to be an insolvency proceeding, the UNCITRAL Model Law would help only insofar as other states have also adopted it. This is strongly promoted all over the globe; but – at least with regard to the EU and for the time being – there are only few member states who have done so: Greece, Poland, Romania, and Slovenia. Therefore, the Model Law is only of limited help.

c) Some argue that the UK still is contractually bound and connected with other EU member states by the Brussels Convention 1968.[18] If this is the case, two things are to be concluded: Firstly, insolvency

14/.It is hereby supposed that the EU member states do not qualify as "relevant country" under sec. 426 par. 4 of the English Insolvency Act.
15/.Not entirely humerous, Prof. Ian Fletcher once, on a conference in Paris, stated that it could be seen as a justification for a Brexit if a scheme would be declared an insolvency proceeding by the Brussels authorities.
16/. Cf. Rinze/Lehmann, Brexit – Mögliche Auswirkungen auf Restrukturierungen und Insolvenzverfahren in Deutschland und dem Vereinigten Königreich, DB 2016, 2946, 2950.
17/. Advocating for recognisability also after Brexit Sax/Swierczork, The Recognition of an English Scheme of Arrangement in Germany Post Brexit: The Same But Different?, ICR 2017, 38.
18/. Ungerer, Brexit von Brüssel und den anderen IZVR-/IPR-Verordnungen, in: Kramme/Baldus/Schmidt-Kessel (eds.), Brexit und die juristischen Folgen, 2016, p. 297, 299 ff.; Lehmann/Zetsche, Die Auswirkungen des Brexit auf das Zivil- und Wirtschaftsrecht, JZ 2017, 62, 70. Opposing Hess, Back to the Past: Brexit und das deutsche europäische internationale Privat- und Verfahrensrecht, IPRax 2016, 409, 413.

matters are excluded; the Gourdain/Nadler decision of the ECJ[19] from 1979 indicated how far reaching this is. Secondly, apart from the UK contracting parties to the Convention are those states which acceded the then Community before 2002, thereby reducing the number of convention parties to 14. As a consequence of this limitation, the Convention has to be applied in its shape of 2002; the amendments and extensions of her successor Regulations cannot be attributed to the Convention. Nevertheless, with regard to the scheme of arrangement, the struggle for its non-insolvency-nature might continue in this regard.

d) A further recognition tool are bilateral agreements. Many of them do already exist – also with member states of the EU. It is very doubtful, though, whether they have "survived" the period of common membership until the Brexit takes effect. Everything depends here on the interpretation of the word "replace" in art. 85 EIR (Recast) and "supersede" in art. 69 of the Judgment Regulation.[20] Irrespective of the fate of those pre-existing conventions, the UK will always have the option to negotiate bilaterally or multilaterally for recognition conventions.

e) As long and insofar as this is not (yet) the case the relationship will be built on the status of common WTO membership. The consequence would be that the UK would face the same tariffs with the EU as any third country with which the EU does not have a free trade agreement or a customs union. Also, all EU free trade agreements and customs unions would no longer apply to the UK. This would immediately raise the costs of both imports and exports in the UK and severely disrupt value chains.[21]

3/. choice

At this point, when it comes to the question of which choice would be best, one is in immediate vicinity to the above-mentioned ancient Roman augurs; i.e. every statement is no more than mere guess-work.

Therefore, it must suffice to just name a few options – leaving it explicitly open that something entirely new and unforeseen might emerge from the negotiations of the coming (less than) two years. Quite interesting ideas exist and are proposed – for instance, CANZUK which would comprise a Union between Canada, Australia, New Zealand, and the UK; alternatively, a "new NAFTA" which would be the old one (assuming thereby, that it survives the present U.S. administration) plus UK; or the Continental Partnership Agreement (CPA)[22] as developed and described by the Brussels-based think tank Bruegel with very thought provoking ideas and ignoring traditional taboos.

If there is any consistency between the pre-referendum political statements and the future way to go, it seems to be precluded that the UK will join EFTA or even EEA. Irrespective of a number of quite convincing arguments and deliberations in favour of this option,[23] it is to be feared that it would be - as Allen & Overy puts it nicely in a research paper - a different name for (pretty much) the same game.[24]

With regards to schemes of arrangement the post Brexit status quo might save the day (i.e. recognition) at least with respect to 14 member states of the EU because of the so far dormant applicability of the Brussels Convention. However, a slight caveat comes from the scheme's qualification as possibly being an insolvency proceeding.

19/. From 22.2.1979 – Rs. 133/78, Neue Juristische Wochenschrift (NJW) 1979, 1771.
20/.On this, see Paulus, Europäische Insolvenzverordnung, Kommentar, 5th ed., 2017, Art. 85 marginal no. 4.
21/.On this, see, e.g, Mears/Paulus/Takagi, Global Supply Chains and Free Trade Agreements: A Suggested Vehicle for Harmonization of Insolvency and Contract-Enforcement Laws, Pratt's Journal of Bankruptcy Law 2015, 284 ff.
22/. Cf. http://bruegel.org/2016/08/europe-after-brexit-a-proposal-for-a-continental-partnership.
23/. Cf. Baudenbacher (fn. 10).
24/. Available at: http://www.allenovery.com/Brexit-Law/Documents/Macro/EU/AO_BrexitLaw_-_EEA_Membership_Jul_2016.PDF.