Mayday

#Interview: The impact of Brexit on cross-border insolvency

09 MARS 2020

Brexit brings a lot of questions, notably about the legal regime applicable to cross-border insolvency proceedings. Therefore, Mayday interviewed Pierre-Emmanuel Fender, French partner in the law firm Gibson Dunn, and his counterpart in London, Gregory A. Campbell, to better understand its implications on the restructuring market.

Mayday: So far, the EU Insolvency Regulation has determined the jurisdictional rules and applicable law of cross-border insolvencies in the EU. With Brexit, could you tell us which law is now applicable and which tribunal is competent to deal with a cross-border restructuring operation involving a UK company?

Gregory A. Campbell: Actually, at the moment everything stays the same for European cross-border restructurings. We are currently in a transition period until the end of December 2020. During this period, an insolvency case opened in England or elsewhere in Europe will continue to operate under the EU Insolvency Regulation. The bad news is that the transition period comes to an end in December 2020. The Withdrawal Agreement says that this recognition only applies with respect to proceedings opened during the transition period. The regime after the transition period is still to be negotiated and nobody quite knows what's going to happen.

Mayday: In your article "Brexit and the cross-border conundrum", you refer to what it is called the 'COMI' concept (ie. Center Of Main Interest) that exists both in common law and civil law. Do you think this rule may be satisfactory to settle the potential conflicts of law or jurisdiction?

GC: As you know, the 'COMI' is a fused and negotiated concept. It came about as a compromise between the English law concept of the 'state of incorporation' doctrine[1]and what the civil law countries call the 'Siège Réel' concept. So, in the UK we normally look at the state of incorporation as a determinative feature of which insolvency law should apply to a company. The 'COMI' test, however, is presumed to be the state of incorporation, unless you can rebuild the presumption and prove that the actual activity of the company is really somewhere else. Although in the UK there is generally a strong preference for the state of incorporation test. I think 'COMI' has become part of our legal vocabulary for cross-border restructurings. In particular, 'COMI' now forms part of the UNCITRAL Model Law which will remain law in the UK as well as being incorporated into the US bankruptcy code as Chapter 15. So I think that this 'COMI' concept is probably here to stay.

Mayday: As far as you're concerned Mister Fender, can you measure the impact of Brexit on insolvency law and practice?

Pierre-Emmanuel Fender: As Gregory Campbell just mentioned it, from a legal standpoint there is no immediate impact and the situation will remain the same until the end of this year. What happens next is the real issue. The great paradox is that, for the moment, we have actually a better visibility on the impact of Brexit on the domestication of French insolvency judgements in Great Britain than the other way round: with the European Union Withdrawal Act passed in 2018 during the tenure of Theresa May, Great Britain did cut off the source of EU law in the UK but, in order to provide legal continuity, it also enabled the transposition of directly-applicable existing EU law into UK law and created this way a new category of domestic law for the United Kingdom, the so-called "retained EU law". The current insolvency framework based on the Regulation 2015/848 on insolvency proceedings is part of this "retained EU legislation" and shall therefore continue to apply in the UK notwithstanding any notion of reciprocity. By contrast, for the domestication of insolvency judgements in France, the Brexit will bring us back to the state of law which preexisted to the EU Regulation or which prevails outside of its scope. This state of law does essentially rely on case law, which by itself is a source of uncertainty given the absence of rule of precedent and the relatively casuistic approach of French judges. Two EU regulations facilitated greatly the circulation of judgements within the European Union: the Regulation 2015/848 on insolvency proceedings, which expedited enormously the recognition of insolvency proceedings, and the Regulation No 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. Outside of their scopes we can only rely on the jurisprudence of the Cour de cassation since, contrary to the UK, France has not adopted the Uncitral model law on cross-border insolvency. French judges may of course be influenced by the notions and the legal concepts which have been used over the years and derive from the EU Insolvency regulation. Nonetheless, on both sides of the Channel, we can only hope that the pending negotiations will give birth to a legal instrument which will bring back the certainty and the efficiency which the said regulations did provide. From a French perspective, the importance of the regulation is not only the substantive rules which it contains, but above all the speedy and efficient way of dealing with all the questions raised by cross-border insolvencies. Taking for example the simple recognition of insolvency judgements (which can trigger the stay of individual enforcement proceedings against assets located in France), in the context of the EU Regulation, this recognition is automatic. When the Brexit will be effective, in order to domesticate a UK insolvency judgement, we will have to go through the standard exequatur process. This process shall start with the tedious service of claim forms filed before civil courts and raises a number of practical issues. Neither the pace of these civil proceedings nor the general practice of these courts, are consistent with the speed and pragmatism required to address swiftly the urgent needs of an insolvent business. Coming back to these time-consuming procedures will starkly contrast with the speed to which we have now been used to when dealing with the domestication of foreign decisions coming from any other neighboring country. Of course, in order to expedite the domestication of a UK insolvency judgement in the EU and in France, we will try to use every possible short cuts. There is, for example, some European countries which have also adopted the Uncitral model law on cross-border insolvency, namely. Poland, Romania and Slovenia. These countries having adopted the same model law as the UK, it may be easier and quicker to domesticate there a judgment coming from the UK. Once the decisions would have been recognized in these countries, they might in turn be quickly recognized and become enforceable in the whole EU and in France. This would be a rather complicated substitute in order to obtain a result which is currently automatic. So, obviously there will be an impact, unless an agreement can be found to maintain the current state of affairs, before the deadline of the end of this year.

Mayday: In a cross-border restructuring operation, if the holding company based in UK owns a French subsidiary to be restructured, how could the insolvency practitioners coordinate their action within the group? Which one of these two practitioners should lead the operation?

GC: Obviously it’s going to be the English one! I’m joking. In your example, I’m assuming that the companies are part of a private equity structure and that the financial debt is located both in the holding company and in the operating company. If that debt is governed by English law, English law remains ptentially very relevant. For example, that debt could be restructured using a law for a scheme of arrangement[2]to be available and allows the majority creditors (majority in number and 75% in value) in a class (with the court’s blessing) to impose the reorganisation plan over the objection of minority creditors (up to 25% in value) in that class. Restructuring of course is not always simply reorganising the debt. There can be significant employees’ issues, operational and trading issues and such like the things that impact a real business and where a moratorium is important to protect the business. As a scheme isn’t a formal insolvency procedure (it is more of a debt restructuring tool), recourse to the French insolvency toolbox seems appropriate, perhaps combined with a debt restructuring workstream. In international cases, it is so important to have legal and financial advisors working seamlessly together across the different jurisdictions, and cooperating in a pragmatic way with office holders, management and other stakeholders to get the best outcome for the company, its creditors and employees.

Mayday: And in your opinion, Mister Fender?

PEF: Schemes of arrangement are outside of the scopes of the two EU Regulations I’ve mentioned earlier. They are still relevant and very useful to resolve the situation of debtors which control cross border businesses all-across Europe. This isn’t going to change: it has been possible, it will be possible. Everything is driven by pragmatism. The importance of cooperation and collaboration will not change either. It is in the habit of practitioners to consider putting in place protocols between the various insolvency practitioners when a cross-border situation requires a smooth coordination between various jurisdictions. This practice should persist, even outside of the legal frame provided by the EU regulation. Nevertheless, it will be more complicated for us to convince the court that it is worth entering into this kind of protocol if we have absolutely no guidelines. These pragmatic solutions will appear riskier, legally speaking; therefore it might be more complicated to convince the judges that this is the right thing to do. I can only hope that in the context of the discussion between the UK and European Union, some time will be left to anticipate these issues.

Mayday: Last question but not least…Do you think Brexit will impact the economic and legal attractiveness of the UK? If so, do you think Paris will benefit from this decline? And maybe any other European city?

GC: I think that the UK is a very pragmatic nation and Brexit does provide a lot of opportunity. I think that UK has the most sophisticated restructuring laws and practices in Europe. We have been developing restructuring laws for over a hundred years. For example, the scheme of arrangement is a very old notion. The Framework Directive is having an impact on Europe and will drive EU member states to reform their internal laws to match some of the practicalities that the UK enjoys and to adopt concepts such as cram down and other concepts similar to Chapter 11. I think, though, for the moment, the UK leads Europe in terms of the effectiveness of restructuring laws and the sophistication of insolvency professionals that operate in the UK market. I think we are going to have competition not from Brexit, not from Europe, but from the US, given the importance of US dollar / NY law financing made available to European companies in recent years under NY-law documented high yield bonds and TLB financing structures. The two main capital markets are New York and London, and most high value financings are documented under NY or English law. So I think the UK will continue to be an important jurisdiction irrespective of Brexit, but will face pressure – from the US and from an increasingly sophisticated European restructuring model. But I don’t think Paris is set to usurp London as an attractive jurisdiction for the origination of financial transactions and their restructuring.

PEF: I’m glad you’ve brought the topic of the Framework Directive because indeed the big paradox is that the UK will leave EU just when we eventually manage to have an embryo of actual substantive legislation on insolvency. This Directive aims at making a sort of synthesis of all the good points of every system. Notions such as enterprise value, class of creditors, cram down[3], which are all very relevant in the finance industry across the world and which were difficult to domesticate in France will now be imported in our French legislation. In this respect, more than ever, France and every European country will be more welcoming *vis à vis* Anglosaxon financial institution. It is therefore indeed a paradox that, at the same time, the UK and its financial ecosystem are losing access to the EU. On the other hand, the Framework Guideline is a compromise, which is also implementing across Europe, pre-insolvency proceedings which do not exist in all these jurisdictions…

Mayday: Even in the UK?

PEF: They don’t have translation and I think there is no similar safeguard proceeding. Correct me if I’m wrong…

GC: We’ve got it through another way. We will get to it through administration where you don’t have to be insolvent but we also have it historically through receivership…

PEF: I also agree with Gregory Campbell that there is a lot of French debtors which are raising debt in the US and for some of these operations, there will hardly be any difference between doing it in New York or in London. What really matters is where the financial market is and it is not the insolvency regulation applying in Europe that will change that. I do not think that it will have an immediate effect. It makes things easier, it simplifies the circulation of the money and facilitates investment decision but the impact of Brexit on insolvency law will not significantly change the role of financial centres overnight. It is definitely not the insolvency legislation that will be the key driver which leads to Paris, Frankfurt or any other city being actually competing on the same foot with London as a key financial hub...

GC: London is certainly under pressure. Paris is definitely competing with London to take finance market share. It is one of the unpredictable outcomes of Brexit. Paris and Frankfurt have always competed with London and Brexit only changes the game and orients the fight in favour of the continent. But the London financial market is extremely old, and extremely well established and it operates in English. The London market is set to last, regardless of Brexit.

Par Pauline Vigneron

[1] Refers to the state in which a company is incorporated

[2] A scheme of arrangement is a court-approved agreement between a company and its shareholders or creditors. Schemes of arrangement are used to execute arbitrary changes in the structure of a business and thus are used when a reorganisation such as, rescheduling a debt, cannot be achieved by other means. In the UK, the relevant provisions for implementing a scheme of arrangement are found in the Companies Act 2006, Parts 26 and 27.

[3] A cram down is the involuntary imposition by a court of a reorganization plan over the objection of some classes of creditors. A cram down reduces the amount owed to the creditor to reflect the fair market value of collateral that was used to secure the original debt. A cram down provision is primarily used on certain secured debts, such as a car or furniture.