The importance of a strong insolvency and restructuring regime for the UK economy

Christina Fitzgerald writes on the implications of Brexit for the insolvency profession in the UK

Since 31 May 2002, the European Insolvency Regulation ("EIR") has had direct effect in England and Wales.

This allows for the automatic recognition across Europe of insolvency proceedings in EU Member States. This means that Licensed Insolvency Practitioners ("IPs") can take control and realise the assets of an insolvent company or of an individual who is bankrupt in another EU Member State quickly, cheaply and efficiently. This avoids the need for IPs to apply to the Court in the relevant jurisdiction to ask for recognition of their powers to act and then to apply for the repatriation of assets to the UK. In summary, it provides for rules on the choice of law, the recognition and enforcement of judgments and co-operation between IPs.

On 5 June 2015, the European Insolvency Regulation (recast EIR) was published and is now due to apply to this jurisdiction from 26 June 2017. It extends to all EU Members, except Denmark. The recast EIR contains a codification of the method of determination of centre of main interest (COMI) designed to curb forum shopping. Courts are positively obliged to examine COMI and determine whether proceedings are main or just territorial. The scope is widened to include rescue and pre-insolvency proceedings as well as liquidation. The recast EIR introduces a new definition of "establishment", it introduces "synthetic" secondaries and creates national electronic searchable databases linking them up to create a central European database.

The concern is that the UK government, once Brexit becomes formal, will not reach any agreement which would have the effect of maintaining the benefits afforded by the recast EIR. R3, the UK's insolvency and restructuring trade body, has called on the UK government to ensure that the benefits of the EIR and the recast EIR are preserved in negotiations via an equivalent treaty between the UK and the EU. This would ensure that the UK's insolvency proceedings are automatically recognised across the EU, helping to maintain the UK's status as an attractive place to do business.

Areas of concern

The UK's preparations to leave the EU coincide with the publication of the Directive on "Insolvency Restructuring and Second Chance". As sponsors of The Academic Forum of INSOL Europe, we know that this will be the focus of the conference being held in Warsaw in October 2017.

One area of concern which has been identified by our European colleagues (and with all due respect to Rolef Weijs of the University of Amsterdam and our intellectual debates on this issue) is the risk of abuse that the contemplated preventive restructuring schemes could bring. We have seen the "loan to own" scams experienced in America under Chapter 11 and in Australia. Such strategies involve opportunistic and sophisticated financial investors acquiring debt in financially distressed companies, generally at a fraction of its face value. Member States will be asked to consider these issues when implementing the Directive.

New tools

Brexit may not have such a detrimental effect from the UK's perspective as regards this Directive. The government launched a consultation in the summer of 2016 on the "Corporate Insolvency Framework" and proposed the introduction of new tools to support business rescue, including a "moratorium" and a new restructuring tool.

The UK is considered to be an excellent restructuring hub and we have an excellent framework within the combined insolvency and company legislation. However, other jurisdictions are developing and reforming, including the EU countries, Singapore and the US with the ABI review of Chapter 11. The UK has also suffered in the World Bank rankings (following a switch in the ranking's methodology to favour US-style frameworks), moving from 6th position in 2012 to 13th position in 2017 and the consultation and

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sufficient funding to trade during the moratorium, being insolvent or in financial distress, not having been in administration in the previous twelve months and having a reasonable prospect of compromise or arrangement with creditors.

Under the Directive, Member States will be permitted to afford grantors of new and interim financing priority in the context of any subsequent liquidation compared to other creditors who would otherwise have superior or equal claims to money or assets. The Directive requires Member States to rank new and interim financing senior to ordinary unsecured claims. Unlike the Directive, the UK proposals to not consider the implementation of "super-priority" as it was considered that there were sufficient private equity investors in the industry without having to introduce this.

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recommendations are considered to be a determined effort to boost the UK's position in these rankings.

According to the UK proposals, the new moratorium would be available to all businesses and would last for up to three months with the possibility of an extension. This would provide a "gateway" for a business to consider its options for a rescue plan. An authorised Supervisor would be involved in the application process and would monitor the company's compliance, ensure that the company's management is not abusing the moratorium and to bring the moratorium to an end if there is evidence of abuse. Fundamentally the directors would retain control of the affairs during the moratorium. The Supervisor would be prevented from taking any subsequent formal insolvency appointment as an IP.

Under these proposals, instigation of these new tools was mooted to be undertaken by qualified IPs, suitably experienced accountants and solicitors acting as the Supervisor. There has been no final determination on this point. However, the feedback has been that only IPs could be effective undertaking the role and that they alone are properly regulated. Commentators suspect that it will be restricted to IPs but will leave the door open for other suitably regulated professions in the future. That is not what the Directive above provides. It introduces the terms "managers" and "supervisors" who are not necessarily qualified IPs and this has given rise to concerns of having unethical, untrained or unregulated "Supervisors".

Eligibility tests

Under the UK proposals, in order to benefit from the protection of the moratorium, a company will have to satisfy a set of eligibility tests and qualifying conditions. These will include having

Reducing costs

Another driver behind the UK proposals was to reduce restructuring costs. It should be noted that trading debts and the Supervisor's costs incurred during the moratorium would be paid first as an expense. Any unpaid debts would benefit from a first charge if the company were to enter into a formal insolvency process.

As regards the moratorium, how will this affect creditors and suppliers? In relation to creditors, the proposals provide that they will be sent a copy of the application for the moratorium and they will have a right of challenge during the first 28 days. Creditors will have the right to request information from the Supervisor and to apply to Court and to challenge unfairly prejudicial acts of the company's directors in Court. Suppliers of essential supplies may be forced to continue to supply the company, provided that the supplies are paid for. Questions still remain as to the definition of "essential supplies" and what safeguards should be put in place to protect suppliers.

The proposals are designed to

introduce a flexible restructuring plan in which companies will be able to bind all creditors to that plan. It is intended that "cram down" provisions will be introduced allowing for a plan to be imposed on a junior class of creditors even if they vote against the plan, as long as they are no worse off than in a liquidation. In relation to the voting mechanism, for a class to vote in favour 75% of creditors by value, and more that 50% by number must agree to the plan.

Feedback

There has been no official feedback on these proposals in the UK so far, and the government was continuing to consult on proposals at the start of 2017. The announcement of next steps has been further delayed by the Government's decision to hold a surprise general election in June. The UK's unique reputation for insolvency and restructuring work will be fiercely guarded by R3 and we will make sure the profession's views on the proposed reforms are heard by policy makers.

The Directive contemplates a moratorium which can be renewed for up to four months. In complex matters the stay may be extended for up to twelve months. Which suppliers can afford not to be paid in that time period? What if the supplier is unable to supply the goods ordered and cannot terminate the contract? Member States may well seek to adopt the approach suggested in the UK.

The Directive also introduces rules to allow entrepreneurs to benefit from a second chance as they will be fully discharged of their debts after a maximum period of three years. The government in the UK has not needed to focus on this aspect of the Directive because in the UK, a bankrupt is usually fully discharged after just 12 months.

The COMI migrations in the past led other EU countries to change their legislation in line with UK law. From a European insolvency perspective, it would be very disappointing if ties were cut which have grown over the years. The UK should appreciate that it can benefit from future close ties and the continent should understand that the UK can remain a source of inspiration for the future direction of European insolvency law.

Brexit presents a challenge for the UK's insolvency and restructuring profession and it is important that the profession's concerns are taken on board by the government as part of its negotiations with the EU. As chair of R3 in London and the South East, I will be working with the profession and government to mitigate some of the challenges posed by Brexit and maximise potential opportunities. ■

BREXIT PRESENTS A CHALLENGE FOR THE UK'S INSOLVENCY AND RESTRUCTURING PROFESSION AND IT IS IMPORTANT THAT THE PROFESSION'S CONCERNS ARE TAKEN ON BOARD BY THE GOVERNMENT

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