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Brexit – What You Need to Know

The UK's EU Referendum on membership is looming on the horizon – What are the legal implications of a so-called "Brexit" for restructuring and insolvency professionals?

The EU Referendum Act 2015 obtained Royal Assent on 17 December 2015 and provides for the following question to be put forward for voting in a referendum in the UK until the end of 2017: "Should the United Kingdom remain a member of the EU or leave the EU?"

During the EU Council Summit of 18-19 February 2016, the Heads of State or Government of the Member States of the European Union (EU) adopted a decision concerning a New Settlement for the UK within the EU and a statement containing a draft Council Decision on specific provisions relating to the effective management of the banking union and of further consequences of further integration of the euro area, as well as an additional Declaration of the European Council and four additional Declarations of the Commission. That decision, the statement and the declarations address the four "baskets" proposed by the British Government for EU reform in its letter of 10 November 2015 to the EU Council. The four baskets deal with economic governance, competitiveness, sovereignty and immigration. The government has determined that the referendum shall take place on 23 June 2016.

What consequences would result from the UK terminating its status as a Member State of the European Union?

Article 50 of the Treaty on European Union (TEU)

Article 50 (1) TEU provides that each Member State of the EU can decide to cease to be a Member State of the EU. Article 50 (2) TEU provides that the European Council must be notified of a decision to terminate the membership in the EU. Upon receipt of such notification, the EU will negotiate with such Member State "the arrangements for its withdrawal, taking account of the framework for its future relationship". Such agreement on the effects of the withdrawal between the EU and the UK would be adopted with a qualified majority within the Council. Any potential future Association Agreement between the EU and the UK would thereafter need to be adopted with unanimity within the Council, pursuant to Article 218 (8) of the Treaty on the Functioning of the EU (TFEU).

Article 50 (2) TEU does not stipulate the contents of such a withdrawal agreement between the ceasing Member State and the EU. Theoretically, such agreement could provide, for example, for grandfathering rules applying to a specified period of time in relation to previously obtained rights, claims, titles, registrations and licenses of persons and entities domiciled in the UK within the remaining 27 Member States of the EU (and vice versa).

It might also provide for the grandfathering of approvals, listings, registrations and licenses and other rights relating to products and services or distribution channels relating to such products and services (e.g. approvals of securities and offering circulars listed at a relevant official market in a Member State) originating in either the UK or the remaining 27 Member States.

Article 50 (3) TEU provides that if no such withdrawal agreement between the ceasing Member State and the EU is entered into, then two years after the receipt by the European Council of the termination declaration, the TEU and the TFEU will no longer apply to the ceasing Member State. Accordingly, in the case of a Brexit, the UK would no longer have the status of a "Member State of the EU" and the persons and companies domiciled in the UK, and the products and services originating from or being distributed through the UK, would no longer have the status of being domiciled in, originating from or being distributed through a Member State of the EU.

Article 50 (3) TEU further provides that the European Council and the ceasing Member State can enter into an agreement which extends such two year period. The two year period would be extended if, as is likely, such extension would be required to base the future UK-EU relationship on a new contractual framework which deals with all the economic and legal consequences of the UK ceasing to be a Member State. There would be various options available for such new framework, which range from a structured and detailed Free Trade Agreement to an Association Agreement (either along the lines of the European Economic Area (EEA) or a more "individualized" version) or a "Swiss Style" bundle of sector-specific arrangements which deal with each sector's specific requirements on a case by case basis.

UK Legislation

EU Law primarily exists in the form of the TEU and the TFEU, as well as thousands of Directives and Regulations (so-called secondary EU law). In principle, Regulations are automatically and directly applicable in all Member States of the EU. If the UK ceases to be a Member State, then the existing EU Regulations would no longer be applicable in the UK, unless the UK adopts domestic legislation which provides for a continuation of the application of the relevant Regulations. Directives, however, are not automatically applicable in Member States, but must be implemented by domestic legislation. EU Directives have been implemented in the UK mainly in the form of Statutory Instruments often based on the European Communities Act 1972 or EU secondary legislation. The 1972 Act would have to be amended to ensure that the necessary existing legislation continued to apply.

Accordingly, the relevant legislative bodies of the UK would need to decide, on a case by case basis, how to deal with the relevant legislation following the Brexit, taking into account the negotiation with the EU in respect of the future UK-EU relationship. Some UK legislation provides for the current role of the EU institutions, and decisions would have to be made whether such a role should be maintained or other measures put in place.

Cross-Border Insolvency Provisions

One of the many issues that would have to be considered is how the UK would deal with cross-border insolvencies after a Brexit. As a member of the European Union, the UK has had the benefit of the EC Regulation on Insolvency Proceedings 2000 (EC Insolvency Regulation) to govern cross-border insolvencies with other EU countries. The aim of the EC Insolvency Regulation is to improve the efficiency of insolvency proceedings with cross-border aspects. It provides, within the EU, rules for determining:

- proper jurisdiction for a debtor's insolvency proceedings;
- applicable law to be used in those proceedings; and
- mandatory recognition of those proceeding in other EU member states.

After many years of discussions, both the European Commission and European Council have adopted the text of the Recast Insolvency Regulation which updates and amends the EC Insolvency Regulation. The goal of the amendments is to facilitate the rescue of European companies in distress. Ultimately, the amendments are aimed at changing the focus away from liquidation and to focus on restructurings, as well as making cross-border insolvency proceedings – especially of groups operating across multiple European jurisdictions – more efficient. Restructuring and insolvency lawyers have been eagerly anticipating these positive changes.

The changes include:

- In an attempt to prevent forum shopping which adversely affects creditors, a company's centre of main interest will be presumed to be where its head office is located but only if this has not been moved within the three months immediately before an insolvency is commenced.
- Introducing a set of procedural rules aimed at ensuring the efficient administration of insolvency proceedings relating to different companies forming part of a group.
- A requirement for member states to publish relevant information in cross-border insolvency cases in a publicly accessible electronic register to improve the information for creditors and courts involved and prevent the opening of parallel insolvency proceedings.

The Recast Insolvency Regulation comes into force on 26 June 2017. A Brexit after that date would mean that the UK was no longer be a party to the Recast Insolvency Regulation. Instead the UK may have to rely on the Cross-Border Insolvency Regulations 2006 which implement the 1997 Uncitral Model Law on Insolvency into UK legislation and are currently used for recognition of insolvency proceedings with non-EU countries such as Switzerland and the US.

It may also be necessary to widen the scope of s426 Insolvency Act 1986 which provides for the co-operation between courts exercising insolvency jurisdiction in relation to certain named countries, mostly former British Commonwealth Countries.

From the perspective of creditors and insolvency courts situated in the other 27 Member States of the EU a Brexit would mean, inter alia, (i) that insolvency proceedings commenced in the UK would not automatically be recognised in the other 27 Member States of the EU, (ii) English companies would no longer enjoy the immunity under Article 3 of the Recast Insolvency Regulation from insolvency proceedings being commenced in the other 27 Member States of the EU merely on the basis of assets (rather than the COMI or an establishment or branch) of such English companies being situated in such other 27 Member States, and (iii) that in rem rights acquired in respect of the assets of the relevant English companies would not necessarily being recognised under Article 5 of the Recast Insolvency Regulation as they would be recognised today. Whether and how this would apply in relation to insolvency proceedings which have already been commenced at the time of a Brexit is an open question.

The UK would have to negotiate alternative multilateral agreement with the EU or 27 bilateral agreements with each of the Member States to provide for continued recognition of UK insolvencies in Europe.

Enforceability of Judgments

The Brussels Regulation on the Enforcement of Judgments would also cease to apply to the UK after a Brexit. As well as meaning that English law proceedings and judgments would lack guaranteed extra-territorial effect in the other EU countries, it would be uncertain whether English Schemes of Arrangement would be recognised by the other Member States after a Brexit. The English Scheme of Arrangement has become a popular tool for European companies wanting to restructure. It is not an insolvency procedure and so is not subject to the EC Regulation on Insolvency. The English courts decide whether to allow a non-English company to propose a scheme to its creditors, depending if it considers the company has "sufficient connection" with England and whether the scheme will be recognised and given effect in the company's state of incorporation. To date English courts have generally been satisfied that the scheme will be given effect under the Brussels Regulation. After a Brexit, this will no longer be guaranteed and a new civil and commercial recognition agreement would be required.

Domestic Legislation of the Remaining 27 Member States and the European Central Bank (ECB)

Existing domestic legislation in the remaining 27 Member States of the EU would not be automatically and directly modified following a Brexit. Domestic legislation implementing EU law in the area of banks, funds, insurances, reinsurances, payment services providers and other financial services institutions regularly refers to such institutions and their products being granted mutual recognition and so-called EU Passports, provided that such institutions are situated in a Member State of the EU or the EEA.

Once the UK is no longer a Member State of the EU (and thus also no longer a Member State of the EEA), any such reference in the domestic legislation of the remaining 27 Member States of the EU would, subject to any grandfathering rules agreed upon and agreements in respect of the future relationship between the EU and the UK to be negotiated and entered into, no longer be applicable to institutions situated in the UK. In the unlikely event of satisfactory arrangements not being agreed to in the Art. 50 TEU negotiations, the domestic legislators of each of the remaining 27 Member States of the EU would be free to decide how to treat institutions from the UK, and the UK would be equally free to decide how to deal with institutions from the EU.

Contractual References to EU Persons, Companies, Products and Services

Facility Agreements and other banking contracts may contain references to certain reference entities, counterparties, debtors, obligors, guarantors or other entities, assets, products or services being domiciled in or originating from a Member State of the EU. If the UK ceased to be a Member State such existing contractual arrangements would need to be revisited. Further, other contractual provisions, like termination clauses, increased cost clauses or material adverse change clauses, may be triggered by a Brexit.

If the referendum votes in favour of a Brexit, as explained above, under Article 50 TEU there is no automatic cut-off – i.e. the UK is not immediately outside the EU. Banks and other financial services institutions would need to consider their existing contracts in respect of EU relevant trigger points and keep a close watch on how the UK's relationship with the EU develops through the negotiations and lobby, where necessary.

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22338/02/16