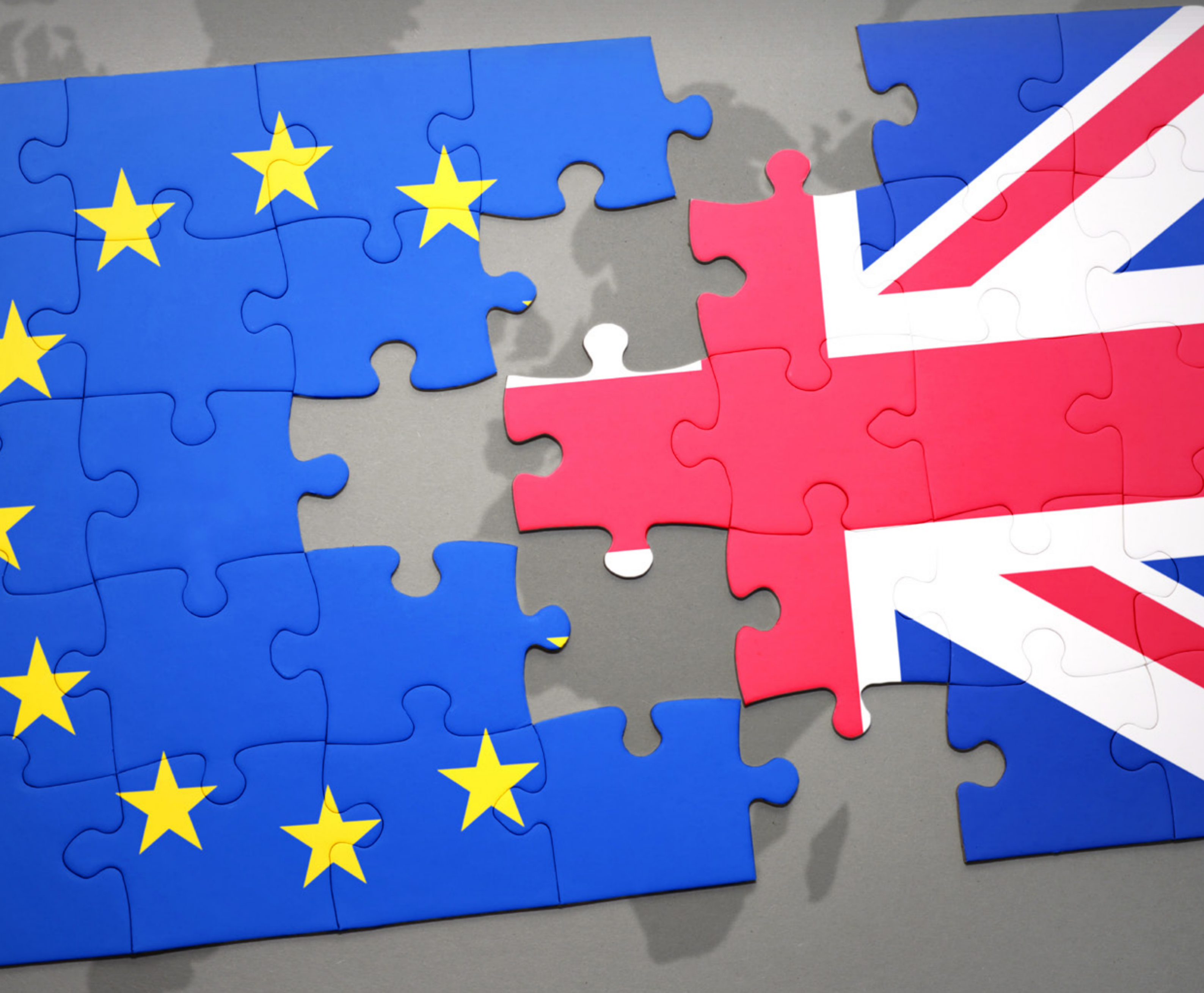
Association of Business Recovery Professionals
R3
Rescue
Recovery
Renewal

Brexit and the UK's insolvency and restructuring regime: The impact on the wider economy



R3 (the UK's insolvency and restructuring trade body) is calling on the government to protect the UK's reputation as an attractive place to do business by preserving the benefits of two EU regulations: the European Insolvency Regulation and the Recast Brussels Regulation.

These regulations allow automatic recognition of UK insolvency procedures and judgments across the EU and form a vital part of the UK's strong, world class insolvency and restructuring regime. If the benefits of these regulations are not preserved, jobs, growth, inward investment and productivity will be harmed and the cost of borrowing is likely to increase. According to 62% of R3 members[1], the prospect of leaving the EU diminishes the UK's reputation as an international centre for restructuring work.

The UK's preparations to leave the EU coincide with efforts by the bloc to improve Member States' insolvency and restructuring regimes. In November 2016, the European Commission published a proposed Directive on 'Insolvency, Restructuring, and Second Chance', which will eventually see the EU-27 develop insolvency and restructuring tools similar to those currently available, or planned to be introduced soon[2] in the UK. At the same time that 'Brexit' risks making UK-based cross-border insolvency and restructuring procedures more inefficient, the rest of the EU will be closing the gap on the advantages that the UK regime currently enjoys.

This briefing provides evidence of the benefits of the regulations through findings from an R3 member survey and case studies of recent cross-border business insolvencies.

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

A strong insolvency regime:

- Encourages cross border investment and increases the overall efficiency and attractiveness of a country as a place 'to do business'.
- Encourages the timely restructuring of viable companies in financial difficulties.
- Encourages entrepreneurship.
- Improves access to credit.

The UK's insolvency regime is one of the best in the world, according to the World Bank, returning more money more quickly to creditors than other countries including Germany, France and the USA.

The regime provides predictable, cost-effective, and fast outcomes for creditors and consequently encourages investment, which in turn promotes entrepreneurship, helps create and preserve jobs, and boosts the economy. The regime and the professionals who work within it, are a vital part of the UK's position as an international centre for financial and professional services.

The UK's domestic insolvency regime (i.e. corporate insolvency procedures such as administration and liquidation, and personal insolvency procedures such as bankruptcy and Individual Voluntary Arrangements) is governed by UK law and will not be directly affected. However, the strength of the UK's insolvency and restructuring regime depends, in part, on its pan-European effect[3] and unless mechanisms are put in place to maintain the benefits of the European Insolvency Regulation and the Recast Brussels Regulation, there will be a significant detrimental impact on the economy.

1. European Insolvency Regulation: Automatic recognition of UK insolvency procedures

In 2002 the European Insolvency Regulation (EIR) was introduced to allow for the automatic recognition across Europe of insolvency proceedings in EU Member States. The EIR allows insolvency practitioners to quickly and easily take control of, and realise, an insolvent company or individual's assets that are situated in another EU country. The EIR has provided speed, clarity and predictability in cross-border work. It significantly reduces the cost of pan-European insolvency proceedings and helps to maximise value for creditors. Prior to the introduction of the EIR, insolvency practitioners needed to make a court application (or a series of applications) in each jurisdiction where assets belonging to the insolvent party were situated, asking the court to recognise their authority to act and to represent the insolvent company or individual in question, and then had to apply for permission to repatriate their assets. Such recognition applications were costly and slow.

[1] R3 member survey on Brexit carried out in November 2016 (364 responses - 15% response rate)

[2] "A review of the Corporate Insolvency Framework, May 2016" consultation proposed the introduction of new tools to support business rescue, including a 'moratorium' and a new restructuring tool. Legislation is expected in 2017

[3] Around 60% of R3 members' work involved cross-border EU work (up from 49% in 2015)

If the UK were to leave the EU without putting in place a mechanism which provides the same benefits as the EIR, insolvency practitioners would be forced to return to the expensive and time-consuming practice of making separate applications for recognition in every jurisdiction in which an insolvent party has assets. By definition, funds are limited in an insolvency and time can be short. Recognition applications would delay proceedings and increase costs, while reducing returns to creditors; in some cases, recognition applications may not be feasible at all, leaving creditors completely out of pocket. The costs and delays involved in such applications would act as a deterrent to investment in UK companies, and would deter companies from having their European centre of main interest in the UK - with all consequent detrimental effects on the economy. R3's member survey found that respondents fear leaving the EU and losing the EIR would have the following impacts:

- 83% believe there would be a negative impact on the speed with which insolvency procedures involving European work are resolved.
- 79% believe there would be a negative impact on the cost of insolvency procedures involving European cross-border work.
- 67% believe there would be a negative impact on the amount of money returned to creditors after insolvency procedures involving cross border work.
- 61% believe there would be a negative impact on the insolvency profession's ability to tackle fraud.
- 49% believe there would be a negative impact on the number of businesses with a Centre of Main Interest (COMI) in the UK.
- 46% believe there would be a negative impact on the amount of cases UK insolvency practitioners are asked or willing to take on.
- 43% believe Brexit will have a negative impact on the fee revenue of the UK insolvency and restructuring profession.
- Across the nine impact areas surveyed, a maximum of 10% said that Brexit would have a positive effect (in relation to fee revenue). Survey respondents were most likely to have a negative outlook in seven of the nine areas.

It is worth noting that the benefits of the EIR are reciprocal. If the UK were no longer part of the EIR, insolvency practitioners dealing with insolvencies in other Member States which have assets in the UK would need to apply to the UK court for recognition. There is therefore a strong incentive for all Member States to find a solution to this potential problem.

Recommendation for Brexit negotiations:
R3 is calling on the UK government to ensure that the benefits of the EU Regulation on Insolvency are preserved in negotiations via an equivalent treaty between the UK and the EU. This would ensure that the UK's insolvency procedures are automatically recognised across the EU, helping to maintain the UK's status as an attractive place to do business.

2. Recast Brussels Regulation (the Judgments Regulation): Automatic recognition of court judgments

The Recast Brussels Regulation (the Judgments Regulation) facilitates the automatic recognition and enforcement of court judgments across the EU. This applies to all types of cross-border civil and commercial judgments, including insolvency. The Regulation is used by the UK's insolvency and restructuring profession to tackle cross-border fraud and collect debts due to insolvent parties whose affairs they are seeking to resolve. The Judgments Regulation extends the reach of insolvency practitioners across Europe. It is an essential tool in not only maximising returns to creditors but also in monitoring and upholding the highest standards of business governance. Like the EIR, it is an intrinsic part of the reason the UK is perceived as such an attractive place to do business. Without the regulation, the UK's insolvency and restructuring profession will need to rely on local law opinions and principles of private international law to determine whether they are entitled to exercise their powers and to recover debts due from creditors in other EU Member States, thus slowing down restructuring procedures, and increasing costs. It is vital that the benefits of the Judgments Regulation be retained.

The benefits of the Judgments Regulation are also important for the English 'Scheme of Arrangement', a world-renowned restructuring tool used by large multinational companies. Regardless of where they are based in the world, such companies come to the UK to take advantage of the sophisticated market of restructuring and insolvency professional advisers and the specialism of our judges, and to use the UK's Scheme of Arrangement procedure as a tool to restructure their financially distressed business. The UK Scheme of Arrangement arguably now rivals the attractiveness of the world-renowned US 'Chapter 11' procedure. Debt write-offs achieved by a Scheme may depend on the Judgments Regulation to be enforceable against affected creditors based in other EU jurisdictions. Losing the benefits of the Judgments Regulation could make Schemes a less attractive restructuring tool for international companies, which would have a detrimental impact on the UK's insolvency and restructuring regime and its status as an international centre of excellence for fast, cost-effective restructuring solutions. According to the R3 member survey, 62% of respondents say that the prospect of leaving the EU diminishes the UK's status as a centre for international restructuring work whereas just 9% think it is enhanced.

Recommendation for Brexit negotiations:
The benefits of the Judgments Regulation must be retained to ensure that the UK remains an attractive place to do business. The UK government could either enter into a similar agreement to the Brussels Recast Regulation, or it could join the 'Lugano Convention 2007', which imposes a similar regime to the Judgments Regulation in relation to enforcement of judgments between EU Member States, Switzerland, Iceland, and Norway.

CASE STUDY Alkor-Venilia

Alkor-Venilia GmbH (AK) is a German self-adhesive manufacturer. It is a single company with a presence across Europe, including factories or warehouses in Germany, the UK, France, Spain, Belgium, and Italy. AK ran into financial difficulty in 2011 and German insolvency proceedings were started.

By this point, the company's 80 Northumberland-based UK staff had not been paid for two months but had not had their contracts terminated; staff members were unwilling to resign and lose access to redundancy pay to which they would have been entitled.

Extra options

Without the Insolvency Regulation, options would have been limited. The German insolvency practitioner, who had limited resources, would only have been able to petition to have the UK operations wound up as a foreign company, which would have been an uncertain and drawn-out process. Employees would have been left in limbo, while the need to opt for a winding-up process would have made business and job rescue less likely and reduced the value of assets available to creditors.

Thanks to the Insolvency Regulation, the German insolvency practitioner was able to seek the urgent appointment of UK administrators to handle the UK operations. Within 24 hours of their appointment, the administrators had helped UK staff start claiming redundancy payments.

Joining the dots

Although a sale of the UK operations could not be achieved and the administrators became liquidators, the Insolvency Regulation continued to aid the company's employees and other creditors. For example, while there were not enough assets available to make distributions from the UK operations, the UK liquidators were able to have the employees' preferential claims paid out by distributions from the liquidation of the Italian operations. Without the Insolvency Regulation this would not have been possible.

The liquidation is ongoing and the UK liquidators are waiting for the German insolvency practitioner to make a distribution from the German estate; the UK liquidators will then be able to make a distribution to UK creditors (including the company's former employees). Without the presence of a UK liquidator to act as an intermediary – made possible by the Insolvency Regulation – the UK creditors would have to deal directly with the German insolvency proceedings in order to make their claims. This would be time-consuming, expensive, and potentially a barrier to some creditors pursuing claims.

CASE STUDY Nortel

Global telecoms giant Nortel entered insolvency proceedings in January 2009. The Canadian company employed tens of thousands of workers across the world, owed billions of dollars to creditors and possessed billions in assets.

While 80% of the company was based in the US and Canada, much of the rest was spread across Europe, with its centre of main interest in the UK. Thanks to the European Insolvency Regulation and Judgments Regulation, the same UK administration covers 19 companies in 18 European jurisdictions. Globally, $7.5bn has been realised to repay creditors, including approximately $1.5bn for creditors in Europe.

Without the Regulations, there would have been up to 19 separate local European insolvency proceedings, which would have been much more disjointed, costlier, and far less beneficial to creditors.

Nortel's structure

Nortel was structured around product teams which were spread worldwide. As a result, the various businesses would not have been as valuable to a potential buyer unless that buyer could purchase relevant operations in every country. Having one European vendor (rather than 19) made selling Nortel's various businesses much simpler and maximised the value of the assets.

Intellectual property – a key asset – was also licensed around the worldwide group. The value of intellectual property assets owned would have been worth much less to a buyer had it been possible for a standalone officeholder elsewhere in Europe to attempt to sell the same intellectual property to another buyer.

Similarly, having one point of contact for suppliers and customers across Europe helped maintain confidence in Nortel at the outset of the administration and allowed operations to continue and be wound down or sold in an orderly fashion.

Different insolvency procedures

Insolvency procedures are different across the EU: without the Regulations, some officeholders may have been left trying to save local Nortel operations while other officeholders were limited to simply winding Nortel up. This would have reduced the sale price of assets across Europe and would have meant less money returned to creditors.

There would also be 19 different sets of insolvency costs (rather than one) for creditors to pay – and costs would have been created by the need for 19 different officeholders to communicate with each other.

Avoiding competitive insolvencies

While it is possible for officeholders in different jurisdictions to cooperate with each other, there is also the risk that some officeholders may seek to undercut others and ensure 'their' creditors are repaid first, or hold other procedures to 'ransom' unless things are done their way. This situation would be unfair to creditors who find money owed to them has already been repaid to creditors elsewhere.

This situation arose with Nortel: the officeholder in a small entity not covered by the European Insolvency Regulation 'broke ranks' with the global disposal process.

About R3

R3 is the trade body for the UK's insolvency and restructuring profession. From senior partners at global accountancy and legal firms to practitioners who run their own small and micro-businesses, our members have extensive experience of helping businesses and individuals in financial distress.
Please contact R3's Senior Public Affairs & Policy Manager if you would like any further information georgina.waite@r3.org.uk • 020 7566 4214

Key facts about the UK's insolvency and restructuring regime

- The UK's insolvency regime is one of the best in the world according to the World Bank. It has one of the highest rates of returns to creditors, returning money more quickly and cheaply than regimes in the US, Germany and France. UK Insolvency Practitioners (IPs) return more than £4bn a year to creditors (including HMRC and businesses).
- There are approximately 1,750 IPs in the UK and around 12,000 professionals who work in insolvency.
- Most insolvency practitioners are accountants or lawyers. They are all qualified and regulated (by one of four regulatory bodies).
- In 2013-14 UK IPs:
  - Rescued approximately 6,700 (41%) of insolvent businesses, saving around 230,000 jobs.
  - Advised 135,000 people about their finances and helped individuals repay £5bn of personal debt within five years.