EFFECT OF BREXIT ON PART 26A ARRANGEMENTS AND RECONSTRUCTIONS

COMMENTARY BY DANIEL LEWIS, 9TH FEBRUARY 2021

1. It is one of the ironies of Brexit that the UK has effectively implemented many of the features of the 2019 EU Restructuring Directive[1], providing for restructuring plans with cross-class cram down and moratoria, before all of the remaining EU member states (although the Corporate Insolvency and Governance Act 2020 was avowedly *not* the implementation of EU law). The EU member states are required to implement the Restructuring Directive by 17 July 2021, although to date only Germany, the Netherlands and Greece have done so and many more are expected to seek an extension of the deadline to July 2022.

2. Already and increasingly, a company in financial distress looking to restructure has a variety of fora within Europe within which to shop. The Restructuring Directive itself allows member states a relatively free hand as to the form that its implementation may take, leading to a wide range of similar but different restructuring solutions depending upon the jurisdiction chosen, to which the provisions of Part 26A of the Companies Act 2006 are but one addition. Depending upon a company's choice of jurisdiction between Germany or the UK, for instance, it might benefit from a moratorium in support of a restructuring of up to 11 months in the former case or only 40 business days in the latter.

3. In the eight months since the introduction of Part 26A where the UK courts have most obviously departed from the EU has been in their readiness to accept

[1] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132. The text is available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L1023

jurisdiction in cases that have limited connection to the UK. It is another irony that the jurisdictional basis for this departure has been the application of EU law and the Recast Judgments Regulation[2] to non-UK creditors. Contrast this with Germany, where jurisdiction is based upon the debtor's COMI being in Germany and restructuring recognised as such under the EU Recast Insolvency Regulation[3]. In its extra-territorial effect the application of Part 26A has been much closer to US Chapter 11 than the EU scheme.

4. In several cases where the debtor has had marginal connection to the jurisdiction, the UK courts have accepted that the restructuring would be recognised and therefore effective in EU member states. After 1 January 2021, that conclusion does not necessarily follow. The Recast Judgments Regulation no longer applies, and what is left is the more flexible (or, to the European critic, arbitrary) test of sufficient connection. The relegation of COMI to only one of many factors in the application of that test is antithetical to the EU ideal of uniformity and the primacy of the debtor's 'home' court. The reception of a UK Part 26A restructuring plan in this new environment has yet to be tested. A less-than-warm welcome might be anticipated in those jurisdictions where the debtor has its COMI and which have also implemented their own restructuring schemes. This will ultimately affect the international effectiveness of restructuring schemes and, in turn, the readiness of the UK courts to sanction them.

5. The question of international jurisdiction under Part 26A of the Companies Act 2006 arises in three ways:

   (1) Is the company liable to be wound up under the Insolvency Act 1986?

   (2) Does the English court have jurisdiction over the plan creditors (referred to as the test of "sufficient connection")?

   (3) Is there a reasonable prospect that scheme will be recognised and given effect in other relevant jurisdictions so as not to be capable of being undermined by action by dissenting creditors (referred to as the test of "international effectiveness")?

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[2] Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.
[3] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings.

(1) Company liable to be wound up

6. This is a jurisdictional requirement under section 901A of the Companies Act 2006. A company to which Part 26A may apply is defined in section 901A(4)(b) as "any company liable to be wound up under the Insolvency Act 1986 or the Insolvency (Northern Ireland) Order 1989."

7. The English court has jurisdiction to wind up any unregistered company[4] and this includes foreign companies. In *DAP Holding NV* [2006] B.C.C. 48 at [6] [5], Lewison J accepted that the words of section 221 IA86 relating to unregistered companies "do not on the face of them carry any restriction on the theoretical jurisdiction of the court to wind up a company on territorial grounds". All that is required is that the entity in question falls within "the juridical concept of a company".

8. The first test is therefore easily met. The court does not consider here questions of COMI. Nor does the court consider whether there is or is likely to be (i) sufficient connection or (ii) international effectiveness, which are not questions for the existence of jurisdiction but for its exercise[6].

(2) Sufficiency of connection

9. At the time of writing, the courts have yet to consider their jurisdiction over plan creditors in cases commenced after the 1 January 2021.

Pre-Brexit

10. Until 1 January 2021 the question of the Court's jurisdiction over plan creditors was determined in accordance with the Recast Judgments Regulation. The approach of the courts to Part 26 schemes was applied to Part 26A restructuring plans, it being accepted that both were "a civil or commercial matter" to which the Regulation applied[7].

11. The courts adopted the pragmatic expedient of assuming that the Recast Judgments Regulation applied to the proceedings and that if the court had

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[4] Which includes "any association and any company, with the exception of a company registered under the Companies Act 2006 in any part of the United Kingdom" (section 220(1) IA86).
[5] In relation to Part 26, applied to Part 26A in *Re Virgin Atlantic Airways Ltd* [2020] B.C.C. 997, at [36].
[6] *Colouroz Investment 2 LLC* [2020] B.C.C. 926, at [57].
[7] *Re Virgin Atlantic Airways Ltd* [2020] B.C.C. 997 at [58].

jurisdiction based on that assumption, then there was no need to determine whether the assumption was correct. Although never finally determined, the working assumption was that plan creditors were being sued by the debtor company for which purpose they were to be treated as defendants. The plan creditors were therefore to be sued in their member states of domiciled under article 4, unless an exception applied[8].

12. The usual exceptions relied upon were:

    (1) Article 8, by which "anchor" creditors in the jurisdiction were relied upon to join creditors domiciled outside the jurisdiction to the proceedings; and

    (2) Article 25, where there was a jurisdiction agreement conferring jurisdiction on the English court[9].

13. Reliance has been placed in several cases on variations of the financing documents constituting the debts to substitute English law and English jurisdiction clauses. These variations are entered into to confer (often temporary) jurisdiction on the English courts for the purposes of the scheme, and may be short-lived and changed soon after sanction is obtained. The *Colouroz* case was a striking example of this, where sanction was obtained notwithstanding the fact that none of the companies were incorporated in England or had any material operational or business connection with the jurisdiction. The only connection was the very recent amendment of the credit agreements to provide for exclusive jurisdiction in favour of England.

<u>Post-Brexit</u>

14. For any proceedings for approval of a restructuring plan commenced after 1 January 2021, the Recast Judgments Regulation no longer applies. Jurisdiction will be determined in cases where there is an exclusive jurisdiction agreement under the Hague Convention on Choice of Court Agreements 2005 and in all other cases in accordance with common law.

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[8] *Virgin Atlantic* at [59]-[61].

[9] However, in the *Virgin Atlantic* case the fact that some trade creditors were subject to English jurisdiction clauses was not a basis to assume jurisdiction against those for whom there was no evidence that they had agreed to English jurisdiction, at [62]. *Colouroz* is an example of successful reliance on article 25.

15. In the case of exclusive jurisdiction agreements in favour of the English courts, the Hague Convention will apply in the same way as article 25 of the Recast Judgments Regulation, making possible the sort of temporary jurisdiction agreement used and accepted in *Colouroz* and *Re KCA Deutag UK Finance Plc* [2020] EWHC 2977 (Ch). There may now, however, be doubt as to international effectiveness in these cases (see below).

16. In cases where there is no exclusive jurisdiction agreement, the common law rules lack the uniformity and certainty previously offered by the Recast Judgments Regulation. It seems quite possible that this may result in a less exorbitant approach and a greater need to establish sufficiency of connection. If, for instance, a bare majority of trade creditors domiciled in England was "amply sufficient" to satisfy article 8 in the *Virgin Atlantic* case, the same might not be said in determining sufficiency of connection under the common law absent other connecting factors.

17. The 'rules' of the Recast Judgments Regulation might be said to have provided pegs on which to hang jurisdiction in marginal cases. It is likely that greater emphasis will now be placed upon the COMI of the company and the domicile of a majority of the scheme creditors. Concerns about international effectiveness are now likely to promote a more cautious application of the test of sufficiency of connection.

(3) International effectiveness

18. The requirement of international effectiveness (or "substantial effect"[10]) was summarised by Snowden J in *KCA Deutag* at [32]:

> *"The final point is that the court will wish to be satisfied that it is not acting in vain when it sanctions a scheme, especially one which has an international aspect. The concern arises where a significant number of scheme creditors and assets of the scheme company are located in other jurisdictions. In such a case the court should be alert to ensure that there is at least a reasonable prospect that scheme will be recognised and given effect in other relevant jurisdictions so as not to be capable of being undermined by action by*

[10] In *Re Magyar Telecom* [2014] B.C.C. 448 at [16], David Richards J said: "The court will not generally make any order which has no substantial effect and, before the court will sanction a scheme, it will need to be satisfied that the scheme will achieve its purpose."

dissenting creditors (or indeed any creditors who participated under the scheme), who might fancy a second bite at the assets of the company."

19. There are three obvious ways of demonstrating that the restructuring plan is likely to have substantial effect in EU member states:

    (1) The support of a large - or better, overwhelming - majority of scheme creditors;

    (2) The fact that a large number of scheme creditors have entered into lock-up agreements, not only demonstrating their support but also being likely to restrict their ability to subsequently challenge the scheme in other jurisdictions by enforcing against the assets of the company;

    (3) Expert evidence that the schemes are likely to be recognised in the jurisdictions in which the company is incorporated or holds assets.

20. After 1 January 2021, the recognition of UK restructuring plans in the EU (and therefore their international effectiveness) is likely to prove more difficult. It is likely that the EU member states will compete as attractive venues for restructuring, and the Restructuring Directive certainly promotes that aim. Such EU schemes have the advantage of automatic recognition within the EU not afforded to UK restructuring plans.

21. With the increasing availability of alternative regimes in EU member states (having the same and in some cases more favourable essential features as the UK regime), it is more difficult to see cases of limited connection such as *Colouroz,* for instance, being recognised in member states and therefore being internationally effective. In this context, lock-up agreements effective in the jurisdictions where the company is incorporated and its assets located may have a more important role in securing recognition and in turn demonstrating effectiveness.

22. Schemes under Part 26 and 26A have been long been recognised as a form of forum shopping, albeit of the "good forum shopping" kind[11]. The preparedness of the courts of EU member states to accept such forum shopping (even if considered by the UK courts to be of the "good" kind) is now open to serious

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[11] *Re Codere Finance* [2015] EWHC 3778 (Ch), referred to in relation to Part 26A in *Re Colouroz Investment 2 LLC* [2020] EWHC 2464 (Ch) at [20].

doubt, particularly in the absence of a reciprocal framework requiring them to do so. This is an area where rapid development can be expected in the coming months.

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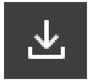 *icon in the top-right-hand corner when in full screen view.*