GRR Global Restructuring Review

Cross-border restructurings and the post-Brexit UK regime

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Brexit threatened to make the UK a less competitive cross-border restructuring market, McDermott Will & Emery's co-head of finance, restructuring and special situations **Aymen Mahmoud** in London and partner **Darren Azman** in New York write – but the accelerated enactment of the Corporate Insolvency and Governance Act during covid-19 has ensured English law will continue to be a key international player.

As we look back to June 2016 and the close of the British referendum in which 52% of the electorate voted to leave the European Union, the world looked on with uncertainty and a host of unanswered questions: would Britain continue to be an effective trading nation? Would Sterling be heavily impacted as a currency? Would the UK become less competitive as an economic power and in turn, how would this impact foreign direct investment?

These were just some of the questions posed by market participants. For many distressed players – some of whom drive value by delaying market uncertainty – this dislocation and unpredictability was viewed as being potentially positive. Until then, government intervention by way of quantitative easing and the like had made it very difficult for distressed players to take short positions synthetically forcing those investors to bet against the deep pockets of nation states and supranational financial institutions.

We can put to one side the far-reaching, non-economic aspects of Brexit for the purposes of this discussion, but it is very clear that the potential economic impact was both far-ranging and significant in 2016 and it is possible that certain issues that were masked by the subsequent pandemic as being driven by that pandemic were the direct result of the Brexit decision.

What then of the world of cross-border restructurings? Prior to the UK's formal withdrawal from the EU in January 2021, recognition and enforcement of insolvency procedures and judgements across Europe and the UK was governed by an umbrella regulatory regime.

Brexit, however, left a regulatory void and gave rise to a series of questions that to date have not been fully answered. For example: How effective would the legal framework for recognition be, both from EU Member States to the UK and vice versa? How would European credits respond to a changing economic and regulatory landscape? Would the UNCITRAL Model Law on

Cross-Border Insolvency be sufficiently detailed to provide coverage? These are all fair questions.

However, what became most strikingly clear shortly after the June 2016 decision is that other European countries quickly accelerated the modernisation of their own restructuring regimes. In the years that followed, there were changes across legal systems dealing with restructurings in the Benelux region, France, Germany and the UK, to name only a few.

From afar, these developments were indicative of a growing concern that the UK (and in particular, London) would not remain the pre-eminent European hub for adjudicating cross-border restructurings, something widely accepted as the norm in prior years. It was this market sentiment that led to trepidation from market participants in the aftermath of Brexit.

Restructuring tools that had previously been their first port of call became tools of last resort, only to be used when strictly needed. This resistance to traveling down the cross-border restructuring path was made easier by the general economic success of both Britain and the EU between the Brexit announcement and the onset of covid-19.

By March 2020 (some nine months prior to the UK's withdrawal from the European Union), the world had been rocked by covid-19. What was viewed with more certainty at that stage became subject to uncertainty, and the global economic outlook shifted significantly.

Alongside this, the market looked closely at the restructuring toolkits available to them and even through their modernisation, there were gaps. World events therefore precipitated the accelerated enactment of the Corporate Insolvency and Governance Act 2020 (CIGA), but not without some fortuitous timing that allowed consideration to be given to the impact of covid-19.

It is strange to think that enacting legislation at such a time could be considered "advantageous," but that is very much the case here. Lawmakers were able to think further about measures needed to support going concerns, while ensuring regulatory and public policy messaging was in sync with legislative design.

At the same time as governmental and supra-national support made its way to businesses (e.g., through state-backed low-interest rate loans) and individuals (e.g., through state-backed furlough schemes), the messaging from the Prudential Regulatory Authority, the Financial Conduct Authority and the Bank of England was carefully crafted to encourage patience.

Alongside this, corporate treasurers rushed to secure liquidity, drawing on revolving and other credit lines to maximise their chances of survival during a covid timetable that nobody could meaningfully see the end of. Not only was global public policy aligned with seeing enforcement as a matter of last resort, but there were also massive logistical issues with enforcement (e.g., buyers could not easily go and see what they were buying, conducting diligence was fraught with challenges and buying a business without understanding when your workforce would return gave even the boldest investors a reason to pause).

Through 2020, there were fewer corporate insolvencies than in 2018 and 2019 combined – a statistic that gave investors and commentators worry: it was not a matter of if, but when the insolvency/ distressed cascade would begin because that statistic simply did not make sense.

Surprisingly (and moving further through the chronology) the immediate aftermath of covid-19 seemed to suggest it was "business as usual", with highly liquid markets and a record 2021 by reference to most metrics, including M&A activity. Could it really be the case that there would be almost no impact from such a significant world event? It would be – and was – very hard to accept for many, and seemingly there has been a more precarious piling up of world events that could easily tilt between growth and recession.

For the small number of court cases that were heard in the UK in 2020 and 2021, these were very carefully adjudicated. The world was watching the behaviours of the UK and the US very closely, and for cross-border restructuring this would mean the need for efficiency, a focus on going concern protection and the nullification of nuisance or ransom hold-out players.

Liquidity was of course driving a significant aspect of this behaviour – the *type* of liquidity in particular. For example, many capital structures had been financed by private credit – a less regulated method of financing, one which is more structurally patient and able to conjure creative solutions for difficult situations.

For a significant number of transactions, both in the middle market and large-cap space, this likely led to restructurings being carried out more cordially and less publicly. In addition, the last year saw an increase in "covenant lite" deals in the market and the simultaneous softening of covenants in those covenanted deals – so much so that a breach likely meant irretrievable damage.

This liquidity, coupled with the lack of "canary in the coal mine" early-warning mechanisms that played strongly in the immediate aftermath of covid-19, were both hallmarks of the relative absence of the need to restructure until the last minute.

Into 2022, the context for current economic behaviours, restructuring types and financial outcomes became much more structural. Supply chain issues and inflation have become mainstream areas for economic focus, politically. Energy prices and the impact of conflict in Ukraine have each also garnered not just economic attention but significant social attention. This volatility may well impact the foundations of cross-border restructurings and possibly the timescales for a more widespread restructuring environment.

Turning to the specifics of some restructurings, those before the UK courts have largely been as well-thought out as they have been slick. Looking at the 2021 restructuring plans of Premier Oil, Gategroup, DeepOcean, Virgin Active and others, these were all (bar one) approved, in an important demonstration of the limits of cross-class cramdowns (otherwise invoked four times, twice against at least one unanimously dissenting creditor class).

The English law restructuring plan has been used by English, European and non-European groups to carry out financial and, in some cases, operational restructurings. On the one hand, the restructuring plan gives effect to achieving what would have taken a longer and more drawn-out scheme of arrangement and CVA (*Virgin Active*), and on the other, it can be used for a more traditional going concern administration exit (*Amicus Finance*).

Judges have sensibly opposed excessive force or precipitant action (*Hurricane Energy*), and the absence of an absolute priority rule as is common in other jurisdictions, was shown not to have stifled this upgraded insolvency regime under CIGA. Instead, new legislation has worked well with the UK's traditional restructuring regime and continued to highlight the flexibility of the English law restructuring market – a strong feather in the cap of the English courts.

The certainty afforded by cross-class cramdowns will be a critical path to future restructurings, even if there is some guidance still to be sought (e.g., on the treatment of equity holders).

The UK insolvency service published its interim report in June 2022, accepting that the advent of the restructuring plan had assisted in company rescue while conceding that there were various areas for improvement. The chief identified improvement zone was cost.

Accessing the tools available under the CIGA was seen to be potentially too costly for use in the SME market in the initial period of use. Whilst this may be the case, one must consider that the efficiency often associated with legal change takes time to achieve and requires carefully constructed advice, which is expensive. Indeed, among the most well-regarded systems in the world, Chapter 11's considerable expense is an accepted norm.

Separately, some commentators have argued that the moratorium made available under CIGA may be used to alter pre-existing priorities and that the use of a moratorium monitor may add both cost and inefficiency to its use. Again, the need for a monitor may subside as time goes on as the ability to solve issues considered by that monitor becomes more feasible.

As part of this discussion, it is important to consider the move in July 2022 by the UK Insolvency Service to open consultation on the implementation on the two Model Laws from UNCITRAL to further develop the cross-border insolvency framework.

If we accept that Brexit may have driven certain European businesses, courts and other participants away from any pre-held fondness towards the UK system, this may go some way to restoring some of that faith. The two Model Laws deal with, on the first hand, recognition of insolvency-related judgements and, on the second hand, group insolvencies.

The initial indication from the UK government is to adopt the first rule only and the second partially, to preserve what is commonly known as the r*ule in Gibbs*. This rule broadly states that the contractual choice to govern a contract by a particular law cannot be undermined, compromised or discharged by insolvency proceedings under a different law. As a practical matter, this can lead to some odd or inefficient results, such as debts governed by English law not being capable of giving effect to a restructuring from another jurisdiction. The rule does, however, continue to guide non-English users towards the English court where flexibility can then be applied by the presiding judge.

This combined outward facing approach in being an early adopter of the Model Laws is likely to increase the UK's exposure and its continued reputation as a key restructuring hub.

Where, then, can we expect to see more issues and activity around restructuring in the coming period?

Sectors susceptible to high inflation are the obvious candidates today. Typically, this means industrial companies that struggle to deal with rising input costs and reduced demand. Businesses that specialise in materials or industrials often see an initial uptick, but continued periods of economic growth-concern can weaken them, particularly in economies that are driven by those businesses.

Of course, consumer discretionary industries are most susceptible to being hit by diminishing purchasing power and a decrease in discretionary spending, particularly when those companies face fluctuating costs and supply chain issues as they would today.

In any of these circumstances, the UK will remain a very strong proponent for restructuring matters for the foreseeable future. It has demonstrated a willingness to be flexible, to tackle problems and not to be afraid of moving first, as seen recently by changes to the laws facilitating the rectification of any abuses of government support that was taken in bad faith.

The English courts, their history and their sophistication are known worldwide, and in some legal systems of significant business influence, remain formally adopted. This global level of respect is hard to ignore as a standalone matter, but combined with the modernisation of the English law insolvency toolkit to bring it closer to the world-renowned US bankruptcy code, we can expect English law to continue to be a key player within cross-border restructurings, both domestically and internationally.

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