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The Implications of Brexit for the Restructuring and Insolvency Industry

A Collection of Essays

Canada*

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INTRODUCTION

"Like as the waves make towards the pebbl'd shore, so do our minutes, hasten to their end;"[3] and as we hasten towards the end of Brexit negotiations, those same waves will make their way to the other side of the pond. In the case of the cross-border insolvency and corporate restructuring industries, it remains to be seen whether those waves are tiny ripples or a tsunami.

This essay addresses potential scenarios for cross-border insolvency and corporate restructuring in Canada post-Brexit. The impact of Brexit on Canada has the potential to manifest itself on the Canadian restructuring and insolvency landscape in three key ways. The first is the mix of companies that will undergo restructuring or insolvency proceedings, due largely to the disproportionate impact of the new Canadian-EU free trade agreement on certain industries. The second is the nature of the proceedings themselves for Canadian / EU companies and our speculation on the nature of future cross-border recognition and enforcement orders. The third section discusses two recent Canadian cases where recognitions orders were sought.

As with all considerations of Brexit, the extent to which these potential scenarios manifest themselves depends heavily on the particulars of the UK's withdrawal agreement. This essay also considers the above impacts in the context of a "hard" Brexit and a "soft" Brexit and the ways each will have a differing effect on the insolvency and restructuring industry in Canada.

MIX OF COMPANIES (TRADE IMPACT)

The UK is Canada's largest trading partner in Europe and its third largest export market.[4] Canada's trade surplus with the UK was CAD10.3 billion in 2016, which represented the country's second largest trade surplus. The UK thus plays an important role in the Canadian trade economy. The current tariff system in place for Canadian imports and exports with the EU varies depending on product, but is higher on average for Canadian imports than exports.[5] Of these products, nearly 500 are subject to a tariff of more than 10%.

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3 William Shakespeare, Sonnet 60.

4 The UK follows the United States (CAD392B) and China (CAD22B): http://www.statcan.oc.ca/tables-tableaux/sum-som/101/cst01/oblec02a-eno.htm.

5 See http://www.pbo-dobsoc.ca/web/default/files/Documents/Reports/2017/CETA/CETA EN.pdf.

As a result of these close economic ties and significant tariffs, the UK, along with Canada's two other largest European trade partners, Germany and France, began considering a free trade agreement in 2008.[6] Eight years later, the Comprehensive Economic and Trade Agreement ("CETA") between Canada and the European Union was ratified, and is set to come into force on September 21, 2017. The agreement eliminates 98% of tariffs between Canada and the EU, with a goal of 99% of tariffs being eliminated on full implementation.[7] While CETA is currently set to include the UK, Brexit will mean an exclusion of the UK from CETA and a loss of tariff-free trade with Canada. The disproportionate impact of this development on certain industries has the potential to create additional insolvencies and restructurings in those industries.

It should be noted that it is possible that Canada and the UK could negotiate a new free trade agreement (indeed, such negotiations have already informally begun).[8] However, given that the particulars of Brexit are not known currently, the UK cannot enter into such an agreement until post-Brexit and given the length of time CETA took to negotiate, it is likely that there will be at least some portion of time where trade between the countries would be subject to tariffs again at the rates that would apply before CETA comes into force.

As an additional factor highlighting the importance of the EU and UK as trade partners for Canada, the North American Free Trade Agreement ("NAFTA") is currently being renegotiated. Canada's largest trading partner by far is the United States, but depending on the outcome of the renegotiation, Canada might look to increase trade with the EU even more, exacerbating the disproportionate impact of Brexit on certain industries.

As a broad concept, a "hard" Brexit will mean that Canadian companies importing products from the UK will have a competitive disadvantage relative to their competitors that import from continental Europe, meaning companies that are tied to the UK exclusively could face a deteriorating economic climate. Conversely, Canadian companies exporting to the UK could face less demand, as their products become subject to tariffs again.

There is also another complexity with respect to the expected gap between the implementation of CETA this year and Brexit. There will be approximately two years between CETA coming into force and Brexit, meaning two years of free trade between Canada and the UK. The investment decisions made by companies during these two years may magnify the impact of Brexit on Canadian companies that invest heavily in UK trade during this window of free trade.

Top imports into Canada from the UK include aerospace parts and aircraft, pharmaceuticals, gems and precious metals, motor vehicles, petroleum products, and electronics.[9] Canadian companies importing these products from the UK will likely face higher costs post-Brexit and risk becoming less competitive. Additionally, multi-national UK companies with Canadian subsidiaries might shrink with a contracting UK economy.

Canadian exporters may experience a more challenging economic environment with Brexit. This changing environment will not be based exclusively on the largest exports by volume or dollar amount. Rather, exporters whose products will benefit from the greatest reduction in tariff under CETA may be subject to the greatest fluctuations in demand as a result of the duties being reinstated (on goods shipped to the UK) following Brexit. The following is an

6 Kurt Fl()loner *et al.*, "CETA: the Making of the Comprehensive Economic and Trade Agreement Between Canada and the UE", *Institut frangais des relations internationales,* April 2016 [Hubner].
See http://www.international.gc.ca/aac-amc/campaiqn-campaqne/ceta-aeca/index.aspx?lanq=enq.
See http://www.cbc.ca/news/business/brexit-trade-talks-canada-1.4049364.
9 See http://tradecommissioner.qc.ca/united-kinodom-rovaume-uni/market-facts-faits-sur-le-marche/0000978.aspx?lang=enq.

illustrative list of products that will benefit from significant reductions in duty rates under the CETA:[1°]

- Chemicals and plastics (currently subject to a 6.5% tariff);
- Machinery and equipment (currently subject to an 8% tariff);
- ICT and electronics products (currently subject to a 14% tariff);
- Wood products (currently subject to a 10% tariff);
- Agriculture and agri-food products, including wheat and Meslin flour, breads, pastries, and other baked goods, and maple syrup (tariff varies, depending on product);
- Seafood, including shrimp (currently subject to a 20% tariff) and salmon (5.5% tariff).

The temporary elimination and then subsequent reintroduction of the above tariffs may cause significant price volatility for these goods. The result may be significant negative outcomes for Canadian exporters.

Basic economics suggests that Canadian companies dependent on the most affected industries could start appearing in insolvency and restructuring proceedings more frequently over the next few years. The overlap of CETA and Brexit negotiations means that some companies may briefly enjoy the benefits of tariff reductions, before losing these benefits as tariffs return. There may be new companies that spring up during this overlap period who will be especially vulnerable to changes brought by Brexit, particularly if they are highly leveraged.

In a "hard" Brexit scenario, the companies who are unprepared, highly leveraged, or overinvested in growth opportunities, are at higher risk. It is logical to expect that such companies could be driven to seek creditor protection at a greater rate than their less-affected peers. Conversely, companies that switch to partners / suppliers and / or subsidiaries in continental Europe, may be better positioned to withstand any increased cost of doing business with the UK.

Conversely, under a "soft" Brexit or no Brexit, it is possible that products remain duty free. In such an event, companies that gamble on remaining in or moving to the UK may enjoy an advantage over their peers. At the same time, the UK has historically had a closer trading relationship with Canada than countries in continental Europe. Close political ties (including a picture of the UK Monarch on our currency), a common language and legal system (for most Canadians), and economic stability all contribute to making the UK attractive to Canadian companies (and vice versa).

To summarize, Brexit creates significant uncertainty for Canadian companies reliant on the UK market. The strategies these companies employ and the final result of Brexit could have a significant impact on the mix of companies in the Canadian insolvency and restructuring arena. CETA, which will apply to the UK only until Brexit, subsequent uncertainty over trade talks between the UK and Canada, and the results of the NAFTA renegotiation will combine to make this a very uncertain time for Canadian importers and exporters.

[1°] *Ibid.*

PROCEDURAL DIFFERENCES

The cross-border restructuring regime in Canada is governed by Part IV of the Companies' Creditors Arrangement Act ("CCAA").[11] The CCAA recognizes that main insolvency proceedings should take place under the supervision of a court in the jurisdiction that shares the greatest nexus with the company's centre of main interest (COMI).[12] Canadian courts have the authority to recognize foreign proceedings, which includes a mandatory stay.[13] Canadian courts must also specify whether a recognized foreign proceeding is the main proceeding or a non-main proceeding.

Whether a Canadian court recognizes a foreign proceeding as a main proceeding depends on the existence of a "real and substantial connection between the matter and the jurisdiction."[14] However, it is not required that an entity engage in economic activity in the foreign jurisdiction for a Canadian court to recognize proceedings, unlike the US Bankruptcy Code and the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law").

The vast majority of cross-border insolvency proceedings in Canada involve recognition under the CCAA of foreign proceedings in the United States or, alternatively, US recognition of Canadian proceedings under Chapter 15 of the US Bankruptcy Code. Both countries have substantially adopted the recognition of foreign proceedings as set out in the Model Law. This means that along with recognition of foreign proceedings, there will be an automatic stay of claims against creditors' claims if the receiving court accepts that the COMI is in the country from which recognition is being sought (which means that the foreign proceeding has been recognized as the main proceeding). Even if the receiving court does not agree that the COMI is located in the foreign country, so the foreign proceeding is considered a "non-main" proceeding, the receiving court has the discretion (but not the obligation) to grant a stay of proceedings.

Canada and the UK have adopted the Model Law and implementing legislation is in force in both countries. However, the majority of EU countries have not implemented the Model Law. The Model Law is aimed at facilitating cooperation between courts in different jurisdictions where there are companies with assets or creditors in more than one jurisdiction. Accordingly, proceedings commenced in the UK are easily recognized in Canada and offer companies protection from Canadian creditors. The same is true for proceedings started in Canada, seeking recognition in the UK.

The EU does have a series of mechanisms for creating co-operation and recognition between member states, being the European Insolvency Regulations ("EIR"), which includes the UK. (The Model Law was copied in large parts on the original EIR.) The UK therefore offers a doubly-attractive location for Canadians to do business: both as signatory to the Model Law but also as a gateway to Europe, where proceedings commenced in the UK can be recognized and companies can be afforded stays of proceedings. Additionally, Canadian proceedings commenced under the CCAA and obtaining recognition in the UK can also (theoretically) receive recognition under the EIR. This offers attractive stability for Canadian stakeholders with respect to their investments in multinational companies with operations in the UK and continental Europe.

RSC 1985, c. C-36, as amended. It should be noted that Part XIII of the Bankruptcy and Insolvency Act, RSC 1985, c. B-3, as amended ("BIA") has virtually identical recognition provisions. However, in Canada the more complex cases, including a multi-national restructuring, would be conducted under the CCAA instead of the BIA as there is more flexibility afforded under the CCAA.

[12] Section 45(2) creates a rebuttable presumption that a company's COMI will be the location of their registered office.

[13] Section 47, CCAA.

[14] *2017 Annotated Bankruptcy and Insolvency Act,* p. 1487.

For the reasons noted in the prior section, it stands to reason that a Canadian company might prefer to have its COMI in the UK to elsewhere in Europe. However, post-Brexit this may no longer be the case. Without recognition of proceedings and accessible creditor moratoriums across the EU, UK proceedings may require multiple, multi-jurisdictional court attendances for recognition and stay orders. Creditors in other European jurisdictions could attempt to seize assets or move to start proceedings domestically. This can add costs, delay and litigation risk to restructuring UK companies with assets in other parts of Europe. Post-Brexit, Canadian companies will have to become more adept at dealing with creditors in continental Europe and civil law courts.

We also expect that a "hard" Brexit will result in a loss of attractiveness of UK schemes of arrangement for Canadian companies because of the decreased jurisdiction and influence of UK courts in continental Europe. Unless there continues to be recognition of UK proceedings across the EU, it is expected that the number of UK schemes of arrangement used to compromise Canadian debts would decrease. There would be no inherent advantage to using the UK schemes over Canadian proposals under the CCAA with respect to creditors, assets, or operations elsewhere in Europe.

RECENT CANADIAN CASES

It is not expected that Brexit will have a significant impact on inbound recognition orders. Representatives seeking recognition of foreign proceedings in Canada can apply to Canadian courts under section 47(1) of the CCAA. Under that section, recognition of foreign proceedings is mandatory so long as the pre-conditions are met. That is, an application for recognition must be related to a foreign proceeding and the applicant must be a foreign representative in respect of that foreign proceeding. For recognition orders related to UK proceedings, these conditions are easily met. Where administrators are appointed by an English court pursuant to the UK Insolvency Act 1986, a Canadian court will recognize those proceedings. t[5]

Foreign states that are signatories to the Model Law are expected to continue receiving straightforward recognition orders by Canadian courts. In *MtGox Co,* Re,[16] the Court determined that the Japanese Bankruptcy Act was a law relating to bankruptcy and insolvency, and that the Japanese proceedings qualified as foreign proceedings. The definition of foreign proceedings under the CCAA is so broad that Canadian courts will likely continue to recognize proceedings in the EU whether or not UK courts are involved and whether or not a country is signatory to the Model Law.[17] Inbound recognition orders are unlikely to be affected by Brexit.

While a similar analysis would likely be undertaken regardless of where foreign proceedings had been commenced, there is an additional factor that makes Canadian courts particularly likely to recognize foreign proceedings. In *Urbancorp Toronto Management* Inc.,[18] the Court considered a co-operation protocol designed to realize upon the assets of the insolvent company. The protocol included, *inter alia,* that the Israeli representative would apply to a Canadian court for recognition that the Israeli proceedings were foreign main proceedings. Mr. Justice Newbould considered this protocol sufficient to recognize the Israeli proceedings as main proceedings, despite the fact that it was, in his words, "[n]ot clear that the COMI... is in Israel." Assuming that Canadian courts continue to take such agreements into consideration in their decisions to recognize foreign proceedings (and thus, in granting

[15] *Tucker v Aero Inventory (UK) Ltd.,* 2009 CarswellOnt 7007 (ONSC) (Commercial List) at para. 15.
[16] *MtGox Co, Re,* 2014 ONSC 5811 (ONSC) (Commercial List).
[17] For example, a similar analysis was undertaken to recognize the Cayman Islands proceedings as main proceedings: see *Centaur Litigation SPC, Re,* 2016 BCSC 1224.
[18] *Urbancorp Toronto Management Inc., Re,* 2016 ONSC 3288.

automatic stays of proceedings), then Canada will continue to be a relatively easy place to get recognition orders.

Broadly, the challenges in cross-border insolvencies and restructurings for Canadian companies are the same as those for any multi-national company. That is, protection from creditors that comes with recognition of proceedings having begun in one jurisdiction and enforcement and recognition of courts' orders. Canadian insolvency proceedings are governed by the CCAA, which contains cross-border proceeding recognition guidelines. Foreign proceedings that receive recognition orders in Canada also receive an automatic stay of proceedings for Canadian creditors. The CCAA and United States Bankruptcy Code both borrow substantially from the Model Law ideas of cross-border insolvency proceedings recognition.

The UK has adopted both the Model Law and the EIR, which means Canadian proceedings can receive a stay of proceedings in the UK. This will not change post-Brexit. However, because the EU has similar cross-border rules under EIR, proceedings in the UK are recognized across the EU. This could change post-Brexit.

Our view is that the current foreign proceeding recognition rules in the UK are attractive to Canadian businesses with operations across Europe. Establishing a COMI in London makes sense and initiating restructurings under a UK scheme of arrangement or other order makes sense for Canadian companies doing business in Europe that require formal restructuring proceedings.

Canadian companies that proceed under the CCAA and rely on a judgment from the UK court recognizing a stay of proceedings, can also theoretically rely on that judgment being recognized across the EU.[19] As with other matters involving the interplay of the Model Law and EIR, this does not affect Canada more than other signatories. However, when considered in connection with the close economic ties between Canada and the UK, this may be a factor considered by international restructuring professionals when planning a strategic solution for an insolvent Canadian company with operations in Europe. This may encourage other EU countries with close economic ties to Model Law signatories to adopt the regime and to entice international insolvency proceedings to be commenced from their financial centres. Practitioners will undoubtedly consider the potential additional costs, delay and litigation risk in determining the COMI for an international corporate group.

On a macro-economic basis, if investors and lenders believe that the post-Brexit legal regime available to UK companies to restructure their businesses or realize on collateral is now more uncertain, investment may be curtailed and / or pricing may be increased. The UK is likely to become less attractive as the main jurisdiction to run a European reorganization (particularly in the case of a hard-Brexit).

CONCLUSIONS

The impact of Brexit on the Canadian economy generally and on the insolvency and restructuring industry in particular, depends on the entity in question and how "hard" or "soft" a Brexit happens. If the UK loses the preferred tariff arrangements available under CETA, importers of British goods to Canada and exporters of Canadian goods to the UK could suffer compared to their competition who arrange to ship to and from continental Europe.

Brexit creates meaningful uncertainty for Canadian companies reliant on the UK market. The strategies these companies employ and the final result of Brexit could have a significant

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" EIR council regulation No 1346/2000, Art. 22.

impact on the mix of companies that may require insolvency and restructuring proceedings. CETA, which will apply to the UK only until Brexit, subsequent uncertainty over trade talks between the UK and Canada and the results of the NAFTA renegotiation will combine to make this a very uncertain time for Canadian importers and exporters.

Subsequent to Brexit, if the UK and Canada quickly negotiate a successful new free trade deal, the risks we identify may be short lived. Alternatively, if the result of a "soft" Brexit is that the UK continues to enjoy the benefits of CETA, the disruption to Canadian / UK trade could be minimized.

Brexit may create new challenges in cross-border proceedings for Canadian main proceedings seeking recognition in Europe. While Canada and the UK are both signatories to the UNCITRAL Model Law, few EU countries are. If the EU no longer recognizes UK proceedings under the EIR, Canadian companies would have less reason to bring proceedings in the UK. Currently an attractive centre of operations for Canadian companies, London might lose some of its luster post-Brexit for this reason. Additionally, duplicative proceedings might be necessary in the EU, which would mean additional complexity and expense for Canadian-led restructurings or those involving Canadian companies with significant European operations.

Canada and the UK are close economic partners. A "hard" Brexit will likely have an impact on Canada and on the nature of the companies that may require insolvency and restructuring expertise.