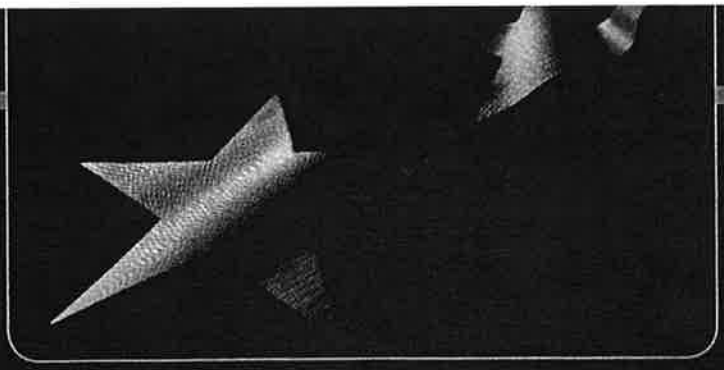

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The impact of Brexit on corporate mobility and regulatory competition

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Branches; Brexit; Business restructuring; Competition law; Cross-border insolvency; EU law; Subsidiary companies

Introduction

On 29 March 2017, and following the June 2016 UK referendum on EU membership, the UK Government triggered art.50 of the Treaty on European Union (TEU) regarding the UK's withdrawal of the EU (hereinafter "Brexit"). On 14 November 2018, following the negotiations for an agreement between the UK and the EU, a draft withdrawal agreement was published and the general trend is that the aim for the UK is to not be a part of the single market after Brexit, but to keep only some elements of free trade.

Based on art.50 of the TEU there are two scenarios regarding the withdrawal of a Member State—in this case the UK's withdrawal. First, if a withdrawal agreement is concluded, implementing Brexit involves a three-step process: the formal withdrawal on 29 March 2019, the transition period by the end of 2020, and then the future relationship between the EU and the UK from 2021 onwards.[1] Secondly, if no withdrawal agreement is concluded, i.e. in a "no deal" scenario, EU law will cease to apply in and to the UK on 29 March 2019 and following this date UK will become a "third country". As a consequence, the cross-border mobility between the UK and the EU, as well as the regulatory competition, will be severely affected.

In this article the consequences of Brexit in a "no deal" scenario are examined.

Effects of Brexit on corporate mobility

After Brexit, UK companies will become "third-party country companies", as this qualification applies to entities formed outside the EU. As of Brexit, there will be no relations between the EU and the UK, except if there have been any bilateral treaties agreed upon, or through multilateral trade treaties such as WTO, GATT and CETA. As a third party, the EU Treaty protections would no longer apply nor the companies' freedom of establishment as well.[2]

Member States will not be obliged to recognise the legal personality and limited liability of companies which are incorporated in the UK but have the central administration or the principal place of business in the EU.[3] As a result, if a UK company wants to operate within a Member State, it will be obliged to abide by the specific national laws of the relevant Member State, unless there are EU rules that apply to third-party countries.

In order to assess the effects of Brexit in cross-border mobility, a distinction between UK subsidiaries and UK branches in the EU is needed. A subsidiary is a separate legal entity that is incorporated in the country where the business operations in question take place, in contrast to a branch, which is not a separate entity, but a part of the UK entity that operates in a foreign country.

Branches

After Brexit, the UK companies will be considered as third-party country companies, and the national conditions for branches of the UK companies in the EU would apply. The access may be restricted by each national law and UK companies frequently will be denied access to the single market on the ground that they are foreign and, according to specific jurisdiction, the use of branch is against the public interest of the Member State in question, even if they will face new restrictions.[4] To be more specific, even if a UK company operates within the territory of a Member State, that company might have to apply various other regulations in regard to the public interest. For instance, companies operating in regulated businesses (such as banking) may be required to operate through a subsidiary and/or acquire a permit or licence to conduct business in their field of activity.

If UK companies want to develop their business in a Member State where the incorporation theory applies, Brexit will not affect the legal status of the UK companies, as they have to comply with the national laws of the third party in question and, as a result, they are incorporated local companies.

Subsidiaries

On the other hand, a UK company can be operated in the single market through a subsidiary. It means that the subsidiary is considered a locally incorporated company and this company will be protected as an EU legal entity, regardless of where its shareholders or management are established. This subsidiary is considered an EU entity which enjoys the EU protection under the EU rules and

[1] H. Eidenmueller, Collateral Damage: Brexit's Negative Effects on Regulatory Competition and Legal Innovation in Private Law, European Corporate Governance Institute (ECGI) - Law Working Paper No. 403/2018, 2018, *https://ecgi.global/sites/default/files/working_papers/documents/finaleidenmuellerpdf* [Accessed 1 February 2019].

[2] P. Böckli et al, The Consequences of Brexit for Companies and Company Law, University of Cambridge Faculty of Law Research Paper No. 22/2017, 2017, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926489* [Accessed 1 February 2019].

[3] European Commission, Notice to Shareholders, Withdrawal of the United Kingdom and EU Rules on Company Law, 2018, *https://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=607669* [Accessed 8 February 2019].

[4] European Commission, Notice to Shareholders, Withdrawal of the United Kingdom and EU Rules on Company Law, 2018, *https://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=607669* [Accessed 8 February 2019]. *file://dcfs01/userprofiles/k.sideri/Downloads/Noticetostakeholders_Brexitpreparedness_EUcompanylawpdf.pdf*.

other EU states will not be entitled to refuse to recognise its validity.[5] But the mother company—the UK company—as an unprotected third-party country, might also affect the status of its subsidiary in the EU. The aforementioned regime applies in Member States that implement the incorporation theory.

If UK companies want to develop their business in a Member State where the real seat theory is applied, problems might arise since it is a basic requirement for a company with its seat within a real seat country to both be registered and have its seat of management within the country. Local national law may, therefore, refuse to recognize the subsidiary as valid legal entity and may treat the entity not as a company with separate legal personality, but as a partnership, and, consequently, its shareholders may have personal liability for its debts.[6]

Effects of Brexit on regulatory competition

In the EU, regulatory competition has long been prevented by the real seat theory, which essentially required companies to be incorporated in the State where their main office was located. Following a plethora of cases from 1999 to 2003, the ECJ (e.g. *Centros*[7]) has forced Member States to reconsider the provisions related to EU regulatory competition. As a result, in 2008, Germany adopted new regulations on the GmbH (Limited Liability Company), allowing the incorporation of Limited Liability Companies without a minimum capital of €5,000.

EU Member States who were forced by the jurisprudence of the CJEU to adopt the incorporation theory as a conflicts-rule for corporations might well revert to the real seat theory for UK companies. Germany is a case in point: the real seat theory still applies vis-à-vis a third country.[8]

Once Brexit becomes effective, UK companies operating, for example, in France or Germany, will be subject to the corporate laws of their administrative seat. For these countries where the real seat theory is applied, the applicable law is the substantive law of the administrative seat. Moreover, after Brexit, the Directive 2005/56/EC on cross-border mergers will not apply any more; neither will the rules stated by the CJEU in *Cartesio*[9] or *Vale*.[10] A cross-border merger with a non-EU company would not be recognised in EU states, as their national law would require conditions and formalities to meet the directive's requirements, more specifically that the companies involved should be limited liability EU companies.[11]

In addition, the new legal forms UK companies operating abroad will choose instead of those they had in the UK is another debatable matter. Brexit could see a revival of more intense regulatory competition, seen in the early years after *Centros*[12] and *Inspire Art*.[13] They may have to be converted into another legal form. Another possibility is to transfer their registered office to another EU Member State, provided they do this before the finalisation of Brexit. Such entities incorporated in another Member State that want to migrate to the UK will no longer be able to do a simplified cross-border transfer after Brexit.[14]

With the UK leaving the EU, corporate restructurings involving UK entities might no longer be possible. Insolvency proceedings opened in the UK will no longer have to be recognised automatically, as is currently the case. In addition, the automatic transaction avoidance, set-off and netting "safe harbours" provided for in UK law-governed contracts in insolvency proceedings of other EU Member States would be lost.[15] EU Member States will decide autonomously whether and to what extent they can grant such recognition (e.g. ss.343 and 353 of

[5] L. Johnson, *EU's regulatory competition in the field of limited liability companies and the effects thereof*, Faculty of Law, Lund University, 2017, *http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=8922307&fileOId=8923779* [Accessed 1 February 2019].
[6] DENTONS, *Brexit and EU rules on company law*, Newsletter 2018, *https://www.dentons.com/en/insights/newsletters/2018/january/25/uk-corporate-briefing/uk-corporate-briefing/brexit-and-eu-rules-on-company-law* [Accessed 1 February 2019].
[7] *Centros Ltd v Erhvervs-og Selskabsstyrelsen* (C-212/97) EU:C:1999:126.
[8] Eidenmueller, Collateral Damage: Brexit's Negative Effects on Regulatory Competition and Legal Innovation in Private Law, European Corporate Governance Institute (ECGI) - Law Working Paper No. 403/2018, 2018, *https://ecgi.global/sites/default/files/working_papers/documents/finaleidenmueller.pdf* [Accessed 1 February 2019].
[9] *Szegedi Ítélőtábla (Hungary) v Cartesio Oktató és Szolgáltató bt* (C-210/06) EU:C:2008:723.
[10] *Legfelsőbb Bíróság (Hungary) v VALE Építési kft* (C-378/10) EU:C:2012:440, access to the online Reports of Cases of the CECJ. C. Thomale, "Regulatory competition in a post-Brexit EU", 2016, *http://conflictoflaws.net/2016/regulatory-competition-in-a-post-brexit-eu/* [Accessed 1 February 2019].
[11] Thomale, "Regulatory competition in a post-Brexit EU", 2016, *http://conflictoflaws.net/2016/regulatory-competition-in-a-post-brexit-eu/* [Accessed 1 February 2019]; Böckli et al, The Consequences of Brexit for Companies and Company Law, University of Cambridge Faculty of Law Research Paper No. 22/2017, 2017, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926489* [Accessed 1 February 2019].
[12] *Centros Ltd v Erhvervs-og Selskabsstyrelsen* (C-212/97) EU:C:1999:126.
[13] *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* (C-167/01) EU:C:2003:512.
[14] Lydian, "Brexit – Corporate Law", 2018, *https://www.lydian.be/brexit-corporate-law* [Accessed 1 February 2019].
[15] Clifford Chance, "Brexit: what does it mean for the restructuring and insolvency market?" 2016, *https://www.cliffordchance.com/microsites/brexit-hub/briefings/brexit-what-does-it-mean-for-the-restructuring-and-insolvency.html* [Accessed 1 February 2019].

the German Insolvency Code[16] and ss.722–723 of the German Code of Civil Procedure[17]). In addition, using the scheme of arrangement as a UK pre-insolvency restructuring tool implies the same (see, for example, ss.328,[18] 722–723[19] of the German Code of Civil Procedure).[20]

It is obvious that a competition between two jurisdictions (UK–Member State) will arise. Regulatory competition in certain fields is unavoidable and should respect market operation and protect financial stability.[21]

Conclusion

All in all, Brexit will amplify the difficulties of incorporating abroad. After Brexit, in case of a "no deal" scenario, risks and potential problems can arise if UK companies decide to operate outside of the UK and especially within the EU. In any event and for both subsidiaries and branches, it is up to the substantive law of every Member State to decide how companies from third-party countries will be treated. The main concern related to the operation of UK companies within the EU is the divergence between incorporation and real seat theory. UK companies, to which EU regulations are not applicable, will be, in general, able to exercise their activities in the EU. If they want to operate in a Member State in which the incorporation theory is applied, they will be considered fully valid legal entities and they may have to apply some additional obligations, e.g. in the field of authorisations. On the other hand, if a UK company wants to operate in a "seat" jurisdiction Member State, it has to be qualified according to the company law of the Member State in question.

After Brexit, in the case of branches, equivalence should generally be presumed as the UK regulation will normally have adopted in its local regulation the criteria and provisions laid down in the EU company law or regulation, but it will be under the final authority of the ECJ. Not to mention that equivalence may be lost due to regulatory changes in the EU or in the UK.[22] In contrast to branches, for subsidiaries, there are no conditions of equivalence, but it will take place under the form of supervisory regime.

The consequence of Brexit is obviously that cross-border merger and restructurings cannot further take place, at least on the basis of the technique laid down in the Directive. Following Brexit, the legal form of a UK company will be very difficult, due to the fact that UK companies will have to deal with the national laws of Member States. This difficulty will have a negative impact on shareholders' protection, not only in cross-border mergers, but also in cross-border restructurings. As a further consequence, there will be a reduction of the level of regulatory competition in the EU due to the fact that Member States will not be obliged to recognise the UK corporate regime when they apply jurisdiction based on the real seat theory.

[16] German Insolvency Code: Chapter Two – Foreign Insolvency Proceedings:

"Section 343 – Recognition (1) The commencement of foreign insolvency proceedings shall be recognised. This shall not apply 1. if the courts of the state where the proceedings are commenced do not have jurisdiction under German law; 2. insofar as the effects of recognition would be manifestly incompatible with material principles of German law and, in particular, incompatible with basic rights. (2) Subsection (1) applies with the necessary modifications to protective measures which are taken subsequent to the application for commencement of insolvency proceedings and to decisions issued in relation to the implementation or termination of recognised insolvency proceedings.

Section 353 – Enforceability of Foreign Decisions (1) Compulsory enforcement based on a decision handed down in foreign insolvency proceedings may be pursued only if such compulsory enforcement is ruled admissible by a judgment for enforcement. Section 722 (2) and section 723 (1) of the Code of Civil Procedure apply with the necessary modifications. (2) Subsection (1) applies with the necessary modifications to the protective measures specified in section 343 (2)."

[17] German Code of Civil Procedure:

"Section 722 Enforceability of foreign judgments (1) Compulsory enforcement may be pursued under the judgment of a foreign court if such compulsory enforcement is ruled admissible by a judgment for enforcement. (2) That local court (Amtsgericht, AG) or regional court (Landgericht, LG) shall be competent for entering the judgment on the complaint filed for such judgment with which the debtor has his general venue, and in all other cases, that local court or regional court shall be competent with which a complaint may be filed against the debtor pursuant to section 23.

Section 723 Judgment for enforcement (1) The judgment for enforcement is to be delivered without a review being performed of the decision's legality. (2) The judgment for enforcement is to be delivered only once the judgment handed down by the foreign court has attained legal validity pursuant to the laws applicable to that court. The judgment for enforcement is not to be delivered if the recognition of the judgment is ruled out pursuant to section 328."

[18] German Code of Civil Procedure:

"Section 328 Recognition of foreign judgments (1) Recognition of a judgment handed down by a foreign court shall be ruled out if: 1. The courts of the state to which the foreign court belongs do not have jurisdiction according to German law; 2. The defendant, who has not entered an appearance in the proceedings and who takes recourse to this fact, has not duly been served the document by which the proceedings were initiated, or not in such time to allow him to defend himself; 3. The judgment is incompatible with a judgment delivered in Germany, or with an earlier judgment handed down abroad that is to be recognised, or if the proceedings on which such judgment is based are incompatible with proceedings that have become pending earlier in Germany; 4. The recognition of the judgment would lead to a result that is obviously incompatible with essential principles of German law, and in particular if the recognition is not compatible with fundamental rights; 5. Reciprocity has not been granted. (2) The rule set out in number 5 does not contravene the judgment's being recognised if the judgment concerns a non-pecuniary claim and if, according to the laws of Germany, no place of jurisdiction was established in Germany."

[19] German Code of Civil Procedure (n.13).

[20] Böckli et al, The Consequences of Brexit for Companies and Company Law, University of Cambridge Faculty of Law Research Paper No. 22/2017, 2017, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926489* [Accessed 1 February 2019].

[21] E. Wymeersch, "Post-Brexit: the factors increasing the pressure to refer matters to EU law" [2018] Butterworths Journal of International Banking and Financial Law, *https://blogs.lexisnexis.co.uk/docs/default-source/loan-ranger-documents/JIBFL_2018_Vol33_Issue3_Mar_pp135-137.pdf* [Accessed 8 February 2019].

[22] Böckli et al, The Consequences of Brexit for Companies and Company Law, University of Cambridge Faculty of Law Research Paper No. 22/2017, 2017, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926489* [Accessed 1 February 2019].