# Brexit impact on insolvency avoidance actions under Italian law

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The exit of the United Kingdom from the European Union ('Brexit') has direct consequences on clawback actions which might be brought against UK creditors by insolvency practitioners of EU Member States. It also has an impact on those situations where English law comes into play as governing law and a UK entity is the beneficiary of an act, a contract or a payment which is detrimental to all the other creditors. This is particularly true in the ambit of those financial derivatives normally regulated by ISDA agreements subject to UK law as governing law, and which have often been offered by UK entities to Italian clients.
Here the author explores the details of these impacts.

When the United Kingdom of Great Britain and Northern Ireland (UK) and the European Union, as well as the EURATOM, entered into an 'Agreement on the withdrawal of the UK from EU and Euratom' (WA) on 18 October 2019, we saw the start of the transitional phase of the relationship between the two entities.

The transitional period (TP), a sort of 'interim period', is defined by article 126 of the WA as the period starting from the entry into force of the WA and ending on 31 December 2020.

As a rule, enshrined in the preamble of the WA, EU law will apply during the transition. During this time, the UK will prepare to enter into new international agreements, even in areas reserved to the EU legislation, provided that such new international agreements only come into force after the TP.

According to article 4 of the WA, the provisions contained therein have direct effects on the territory of the UK and of the EU Member States. Therefore, individuals and entities may directly invoke the provisions of the WA as if it were EU legislation.

The WA encompasses all the EU legal framework, including those pieces of legislation dealing with conflicts of law, such as the EU Regulation 593/2008 regarding the law applicable to contractual obligation, and EU Regulation 864/2007 regarding the law applicable to torts (article 66 of the WA).

With regard to matters of jurisdiction and the execution of judicial decisions or cooperation between judicial authorities, article 67 of the WA provides that for any proceeding started before the end of the transition the following regulations will apply: EU Regulation 1215/2012 on jurisdiction, as well as EU Regulation 2017/1001, (EC) 6/2002, (EC) 2100/94 and (EU) 2016/679 and 96/71/EC on jurisdiction in certain areas of law.

EU Regulation Nos 2201/2003 and 4/2009 on competence will also be applicable.

As to the subject of avoidance actions, article 67 of the WA provides that, in the UK and in EU Member States where the UK is involved, the EU Regulation 2015/848 will apply.

Therefore, provided that the main insolvency proceedings have commenced before 31 December 2020, EU Regulation 2015/848 will apply to insolvency proceedings and to actions brought pursuant to article 6, paragraph 1, of the EU Regulation 2015/848.

Article 6, paragraph 1 of EU Regulation 2015/848 provides that the courts of the Member State where the insolvency proceedings have been opened shall have jurisdiction 'for any action which derives directly from insolvency proceedings and is closely linked with them, such as avoidance actions'.

For example, in the event that an Italian company is declared bankrupt before 31 December 2020, the Italian official receiver (*curatore fallimentare)* bringing an avoidance action (*revocatoria fallimentare*) against a company located in the UK shall apply article 6, paragraph 1, of the EU Regulation 2015/848, and the competent Italian courts shall have jurisdiction over that controversy.

Based on article 7 of the EU Regulation 2015/848, the law of the state of the opening of the proceedings shall also apply to almost all the aspects of the insolvency proceedings, including 'the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors' (article 7, paragraph 2, (m).

Where insolvency proceedings have been opened in Italy, the Italian courts will have jurisdiction on any controversy regarding avoidance actions and Italian law will apply to avoidance actions brought by the insolvency practitioner against creditors.

However, there is an exception to the above general rule, set out under article 16 of the EU Regulation 2015/848, stating that the law applicable to avoidance actions (for instance, Italian law) shall not apply where 'the person who benefited from an act detrimental to all the creditors provides proof that: (a) the act is subject to the law of a Member State other than that of the State of the opening of the proceedings; and (b) the law of that Member State does not allow any means of challenging that act in the relevant case'.

As a result of the application of such exception (which mirrors article 13 of the EU Regulation 1346/2000), some decisions have been taken by the Italian courts (Rome Tribunal bankruptcy section, 07/03/2012 in an avoidance action brought by the insolvency practitioner of Alitalia against a Swiss bank) acknowledging the exemption from the avoidance actions of financial derivatives ruled by an International Swaps and Derivatives Association (ISDA) Master Agreement and the related Credit Support Annex, governed by English Law to the extent that the creditor has proved that both:

(1) the act is subject to the law of a Member State other than that of the state of the opening of the proceedings; and
(2) the law of that Member State does not allow any means of challenging that act in the relevant case.

It is widely known that financial derivatives entered over the counter are normally subject to English law or to New York law, and that many financial derivatives have been entered by Italian entities with financial counterparties located in UK, or sometimes, in the US.

The requirement under item (1) above can easily be met by pointing out to the outright choice of the English law normally enshrined in the ISDA standard contracts, and the requirement under (2) can be satisfied by providing the court with a legal opinion of an English lawyer certifying that the relevant payment could not be avoided or invalidated through any remedy under Italian law even though different from an avoidance action.

EU Regulation 848/2015 does not clearly explain the reason why a different governing law shall be regarded as a shield against avoidance actions. The reason may lie on the fact that the parties to the contract, at least when choosing a specific governing law, rely in good faith on the application of that law in any case. The bankruptcy of one of the parties may surprisingly affect the legal framework of their business arrangement, despite the choice they made. However, on the contrary, it is worth pointing out that the rule is also applied when the parties do not expressly choose a specific law.

As a result of Brexit and of the WA, any insolvency proceedings started after 31 December 2020 in a Member State – and in Italy in particular – any avoidance actions brought against a company or an individual whose seat or habitual residence is in the UK, will no longer benefit from the more lenient English law regime regarding avoidance actions in the bankruptcy context.

According to article 67, paragraph 3(c) of the WA, it is intended that the application of a governing law different from Italian law in order to paralyse an avoidance action, is still possible for UK persons when the insolvency proceedings have started before 31 December 2020, even though the avoidance action has been commenced after the end of the TP.

However, the words which state that it applies 'where the UK is involved' shall not be construed to mean that the UK is involved where English law is chosen as a governing law by two or more entities belonging to Member States other than the UK.

For instance, in the event that insolvency proceedings have been commenced in Italy, against an Italian company after the end of the TP, the insolvency practitioner may bring an avoidance action against a French or a German financial entity as beneficiary of a payment which is detrimental to all the other creditors in the context of the relevant insolvency proceedings.

To the extent that the French or German defendant, in this example, may prove that the relevant applicant contract is governed by English law and, according to such law, no remedy (not only an avoidance action) would be available under the applicable law to avoid or cancel the same contract or the payment, English law will apply and the avoidance action will be rejected by the Italian courts.

To sum up, whatever the governing law of the agreement object of the avoidance action, the governing law applicable to avoidance action against a UK entity after the end of the TP, will be Italian law.

**Giuseppe de Falco** is a partner of Ughi e Nunziante. He has considerable experience in the banking and financial sector, particularly in financial derivatives. Giuseppe also has extensive experience in capital markets transactions, securities law, and more generally, in commercial and company law assisting clients in any related litigation, including bankruptcy proceedings.