Investor Protections in England: the Non-Recognition of the Foreign Discharge of English Law-Governed Debt

By **JAMES BRADY**

For more than 200 years, investors have relied on the fact that a debt governed by English law cannot be discharged in a foreign insolvency proceeding. This longstanding principle of English law, known as the *Gibbs Rule*[1], provides an obvious advantage to creditors with English law-governed debt: certainty in knowing that that a foreign insolvency process cannot be used to subvert their rights, and their access to the debtor's assets, in England. So long as such creditors do not submit to jurisdiction of the foreign proceeding, they will not be treated by English law as being bound by any such foreign proceeding, even if bound in the foreign jurisdiction as a matter of applicable foreign law.[2]

The Gibbs Rule—Slowly Eroding or Here to Stay?

— Historically, creditors holding English law-governed debt have long taken comfort in the Gibbs Rule, an English law principle providing that, absent consent, English law-governed debt may not be discharged in foreign restructuring proceedings.

— Notwithstanding increasing academic criticism that the Gibbs Rule is outdated and impractical, English courts recently affirmed its application in cross-border restructurings.

Notwithstanding its longstanding application by English courts, there is an obvious tension between the Gibbs Rule and core insolvency principles that elevate insolvency laws over contractual rights, such as the parties' choice of English law to govern their contract. However, despite recent academic attacks on the rationale underpinning the Gibbs Rule, recent case law in England suggests that it will remain intact, at least in the immediate future.

The Argument Against the Gibbs Rule

A number of commentators have, in recent years, criticised the Gibbs Rule and suggested that it should no longer apply. These commentators have suggested that the Gibbs Rule is inconsistent with the broader principles of recognition of foreign insolvency proceedings underpinning the Model Law on Cross-Border Insolvency and the Cross-Border Insolvency Regulations 2006 (CBIR) that are based on the Model Law and intended to facilitate effective cross-border reorganisations.

The most frequent criticism levelled at the Gibbs Rule is that it is inconsistent and contradictory for English law to provide that an English proceeding may extinguish a foreign law governed debt, but not to recognise that a foreign proceeding may extinguish an English law-governed debt. One commentator, Professor Ian Fletcher, has written that the Gibbs Rule "*should be consigned to history*", and suggested that the possibility of a foreign insolvency process concerning a party with an established connection to that jurisdiction is within the reasonable expectation of the contracting parties, and may provide a ground for the discharge of the liability to take place under the applicable law.[3]

Arguments For The Gibbs Rule	Arguments Against The Gibbs Rule
— The Gibbs Rule remains binding precedent in England. — The Gibbs Rule embodies the preservation of contractually bargained for English law rights.	— The Gibbs Rule is inconsistent with key principles (i) elevating insolvency laws over contractual relationships and (ii) that currently govern cross-border restructurings. — Foreign courts should not be barred from extinguishing English law debt where English courts are not barred from extinguishing foreign law debt.

However, notwithstanding the academic criticism, the English courts have repeatedly applied the Gibbs Rule, affirmatively declining various invitations to reject or modify it. A recent decision in *Re OJSC International Bank of Azerbaijan*[4] has reaffirmed the English courts' commitment to the Gibbs Rule.

The Decision in Re OJSC International Bank of Azerbaijan

By early 2017, OJSC International Bank of Azerbaijan (IBA) had fallen into financial difficulties and entered into a restructuring process under Azeri law to restructure its debts. IBA, through its foreign representative, applied to the English court to have the proceeding recognised in England as a foreign main proceeding under the CBIR and obtained an order recognising the proceedings and imposing a moratorium on actions against IBA by its creditors. In Azerbaijan, the restructuring plan was then approved in a creditors' meeting and by the Azeri court, and became binding under Azeri law on all creditors.

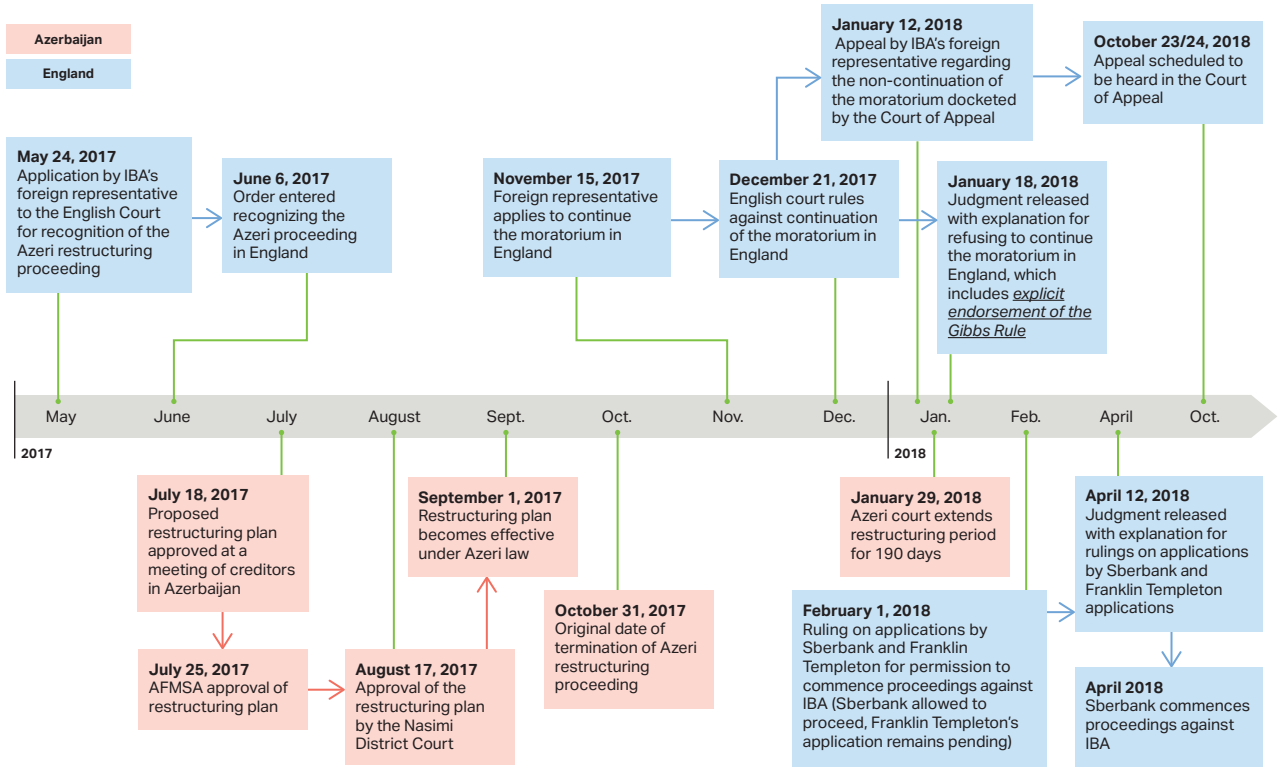
IBA's Restructuring in the United States

— IBA's restructuring, and foreign recognition of it, has not been without controversy. In the United States, a group of creditors objected to a Chapter 15 petition seeking recognition of the Azeri proceeding on the basis that it did not meet the "minimum standard of procedural and substantive fairness" required by Chapter 15 and failed to provide meaningful protections, particularly for non-Azeri creditors.

— Although Chapter 15 recognition was granted, the U.S. court did not rule on the merits of the objections in connection with IBA's petition for recognition.[5]

— Although the creditors that objected to recognition preserved their substantive objections for the time when IBA sought enforcement of its plan in the U.S. (which occurred in December 2017-January 2018), they did not ultimately re-raise such objections, and, consequently, the Chapter 15 court never ruled on the merits.

Timeline of IBA Proceedings



In the English proceedings, IBA applied to continue the moratorium in England indefinitely, beyond the termination of the Azeri restructuring proceedings, in order to permanently insulate itself from creditor actions in England. Two creditors holding English law debt who had not voted or participated in any way in the creditors' meeting to approve the Azeri process, Sberbank (a lender under a USD20 million facility agreement) and Franklin Templeton (beneficial owner of USD500 million in notes issued by IBA), made cross-applications for permission to bring claims against IBA.

In its application for a continuation of the moratorium, IBA conceded that the Gibbs Rule is binding at the High Court level in England, but argued that "*[the court] should not be afraid to depart from it*" in order to give effect to the Azeri process.[6] Recognising the Gibbs Rule was binding on the Court, the IBA relied on academic articles that advocated for the continuation of the moratorium, potentially indefinitely, so as to subvert the perceived threat of creditors with English law governed debts undermining foreign reorganisations.[7] So as to avoid forcing the court to overtly disobey established precedent, the IBA described such relief as a "procedural solution", rather than a substantive departure from the Gibbs Rule.

However, IBA's so-called "*procedural solution*" was rejected by the Judge, Mr. Justice Hildyard. The Court determined that, in substance, IBA was seeking permanently to restrain the creditors from exercising their English law rights, so as to modify their English law contractual rights to be no greater than those that they have under Azeri insolvency law. The Court held that such an approach was not permissible under the Model Law and the CBIR, and that it had no power to affect the creditors' English law rights by means of procedural relief which had the effect of, and had been designed to, limit their rights to those they would have under Azeri law.

The Judge also cast doubt on the criticisms of the Gibbs Rule, saying (*obiter*) that the principle itself is "*based on an entirely logical approach when considering the contractual rights of parties which have especially selected English law to govern their relationship*" and that, in the case of a reorganisation (as opposed to a bankruptcy or insolvency), the "*strength of the overriding argument [for departing from the Gibbs Rule] is much more debatable*".

Notably, the Judge also identified as a relevant factor that IBA had not sought to implement a parallel scheme of arrangement in England that would have been binding on creditors with English law rights if approved, which he described as the "*usual course*". The Judge rejected the contention that a parallel scheme could be expensive and time-consuming, saying "*[the Gibbs Rule] is one of the protections which a creditor has by virtue of the selection of English law to govern its debts. I do not see why a different, lesser, standard of protection would 'adequately protect' such a creditor in such circumstances*".[8]

Subsequent Developments

As a result of the Judge's refusal to allow the IBA's application to continue the moratorium, the applications by Sberbank and Franklin Templeton to commence proceedings against IBA appeared to be of lesser importance, since the Azeri restructuring process was due to end with no possibility of an extension under Azeri law as it then stood, and the English moratorium would in turn terminate by operation of law. The Judge therefore did not rule on the creditors' applications.

However, the Azerbaijan Parliament subsequently approved an amendment to Azeri restructuring law that allowed the Azeri court to extend the period of the restructuring on the mutual request of IBA and the Azeri financial market supervisory authority (AFMSA) for up to 180 days, and with no limit on the number of extensions.[9] This amendment and subsequent continuation of the Azeri proceeding resulted in the continuing effect of the moratorium in England that was granted as a result of the recognition of the Azeri restructuring, where such moratorium otherwise would have expired upon the closing of the Azeri restructuring. In response to the Azeri law amendment and extended moratorium, Sberbank and Franklin Templeton both revived their applications to bring proceedings: Sberbank seeking permission to commence litigation and Franklin Templeton to commence arbitration.

In opposing Sberbank's and Franklin Templeton's applications, IBA argued that allowing the creditors to commence proceedings would risk prejudicing its appeal against the Court's first judgment (filed in January 2018) and that preventing the creditors from commencing proceedings was an appropriate means of preserving the status quo pending the appeal.

As to the Court's general powers, the Judge accepted that there was a risk of the appeal being rendered moot, but was prepared to allow the creditors to proceed if undertakings were given that the creditors would not proceed to judgment (in Sberbank's case) or a final award (in Franklin Templeton's case). Sberbank was willing to give such an undertaking, and the author understands that it recently commenced proceedings against IBA.[10] Franklin Templeton's position was more complex because, as a noteholder, its claims were to be pursued through arbitration by the trustee, and Franklin Templeton

was not in a position to bind other noteholders to an undertaking. The Judge said that he was "*not presently persuaded*" that an undertaking from Franklin Templeton to stay an arbitration before an award was rendered was enforceable, and as a consequence, the Judge allowed Franklin Templeton and IBA further time to make representations on the appropriate course of action.

The Future of the Gibbs Rule

The Court's decision on the Gibbs Rule remains subject to IBA's pending appeal, and as the judgment recognises, it would ultimately be only the Supreme Court (or Parliament)[11] that could overturn the Gibbs Rule.

While many commentators have criticised the Gibbs Rule, the decision in *Re OJSC International Bank of Azerbaijan* brings the interplay between reorganisations and English law rights into sharp focus: Mr. Justice Hildyard was far from convinced that the Gibbs Rule has no role to play in a restructuring scenario, and the abolition of the Gibbs Rule would undoubtedly weaken the attraction of English law for emerging markets transactions and diminish the protections afforded to creditors under English law. At this stage, the Gibbs Rule remains, and should still be, a relevant consideration for creditors opting for English law.

The case is also a useful reminder that a creditor seeking to rely on its English law rights must not submit to the foreign process, by filing a proof of debt for example, since submission will subject the creditor to the outcome of the foreign process. ■

1. The rule takes its name from the decision of the Court of Appeal in *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Méteaux (1890) LR 25 QBD 399*.
2. Where a creditor does submit to the foreign proceeding they will be treated as bound by it, on the basis that they have accepted that the law governing the foreign proceeding will determine their rights.
3. Fletcher, *Insolvency in Private International Law*, 2nd ed, at para 2.217.
4. [2018] EWHC 59 (Ch).
5. See Elena Lobo and Daniel Soltman, Azeri Restructuring Could Test Limits of Chapter 15 Foreign Plan Enforcement, Emerging Markets Restructuring Journal (Issue 5).
6. *Re OJSC International Bank of Azerbaijan* at [68]. In its argument, IBA stressed principles of universalism, whereby principles of insolvency law are given primacy over bargained-for contractual rights.
7. Professor Philip Smart, *Cross-Border Restructurings and English Debts* (2009) International Corporate Rescue (Volume 6).
8. *Re OJSC International Bank of Azerbaijan* at [158(5)].
9. Section 57-11.6 of the Azeri Law on Banks.
10. Sberbank issued a Claim Form against IBA in April 2018.
11. IBA's appeal is scheduled to be heard before the Court of Appeal in October 2018 with a decision likely sometime in early 2019. Further appeals to the Supreme Court could take an additional 12-18 months.

James Brady is an associate in Cleary Gottlieb's London office, and his practice focuses on litigation and dispute resolution.

He has a broad practice including particular experience with litigation involving insolvency or restructuring situations, commercial disputes and investigations by regulatory and other law enforcement authorities, including the UK Financial Conduct Authority, the Prudential Regulation Authority and the Serious Fraud Office. He is a co-author of the UK chapter of the Global Investigations Reviews Securities and Related Investigations 'Know- How' Guide.

James has been recognised as an 'associate to watch' in the Banking Litigation rankings in *Chambers UK*, where he was described as "attracting praise for his impressive attention to detail" and as being "very intelligent, hard-working and understands the law extremely well".

James joined Cleary Gottlieb in 2014 having previously worked at another international law firm in London and Dubai from 2008 to 2014.