KEY POINTS

- Where a foreign restructuring process discharges a debt, the creditor may still be able to enforce its debt in England where the debt is governed by English law.
- The Cross-Border Insolvency Regulations (CBIR) cannot be used to provide an indefinite stay that would abrogate creditors' substantive rights under English law. The CBIR is intended to provide a temporary stay to give debtors a breathing-space while they formulate a restructuring.
- Where a debtor wishes to bind dissenting English creditors to a foreign restructuring, it will need to promulgate a parallel scheme of arrangement in England. The CBIR set out what are primarily procedural powers that are not intended to interfere with substantive English law rights.

Feature

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Foreign restructurings and English law debts: the limits to cross-border assistance

The recent Court of Appeal decision in *Re OJSC International Bank of Azerbaijan* gave rise to the issue of whether a debtor could obtain a permanent stay under the Cross-Border Insolvency Regulations (CBIR) to bind a creditor, whose debt was governed by English law, to a foreign restructuring. The court refused to grant a stay in circumstances where this would circumvent creditors' substantive English law rights. This article explores the effect of the decision and in particular the tension between ensuring the effectiveness of a foreign restructuring and protecting the rights of creditors whose debt obligations are governed by English law. Permission has now been sought to appeal this decision to the Supreme Court.

INTRODUCTION

The case of *Re OJSC International Bank of Azerbaijan* [2018] EWCA Civ 2802 arises out of the financial difficulties experienced by Azerbaijan's largest bank, the International Bank of Azerbaijan (IBA), in 2017. As a result of these financial difficulties, IBA entered into a restructuring process to which a number of IBA's creditors assented. A minority did not. The legal issues which arose concerned the extent to which those dissenting creditors, where their debt obligations were governed by English law, could continue to enforce claims against IBA in England. The Court of Appeal's decision confirms that the Cross Border Insolvency Regulations 2006 (CBIR) do not act as a bar to enforcement, on two levels. First, the Court of Appeal has confirmed that the relevant powers under the CBIR could not properly be exercised to circumvent the English creditors' substantive rights. Second, the court confirmed that there is no power under the CBIR to grant a permanent or indefinite stay in support of a foreign restructuring proceeding: the power to order a stay is strictly limited, in temporal terms, to the life of the restructuring proceeding itself. Both conclusions are likely to be welcomed by creditors.

BACKGROUND

IBA is an Azeri bank. It fell into financial difficulties in 2017. In April 2017, it embarked on a voluntary restructuring proceeding in Azerbaijan with a view to restructuring certain of its foreign debts. This was a rescue procedure, akin to administration or a US Chapter 11 proceeding, designed to restore the bank to financial health.

In May 2017, IBA's foreign representative applied to the English court for an order to recognise the Azeri restructuring proceeding as a foreign main proceeding under the CBIR. This was granted by Barling J in June 2017 together with a temporary stay of creditors' claims under CBIR Art 20 which was intended to give IBA a breathing-space pending its restructuring plan taking effect.

IBA's restructuring plan was approved by a majority of creditors and sanctioned by the Azeri court in August 2017. The effect of the plan, as a matter of Azeri law, was to cancel the bank's existing indebtedness and in its place provide creditors with an entitlement to take up new debt instruments.

In November 2017, IBA's foreign representative returned to the English court seeking an order under CBIR Art 21 for a permanent moratorium on creditors' claims, ie a stay that would continue indefinitely beyond the termination of the restructuring proceeding. The application was resisted by two creditors of IBA whose debts were governed by English law, Sberbank and Franklin Templeton (the English creditors).

By a judgment dated 18 January 2018, Hildyard J refused IBA's application, holding that the court had no jurisdiction under CBIR Art 21 to grant the indefinite stay sought (*Re OJSC International Bank of Azerbaijan* [2018] 4 All E.R. 964). The judge granted permission to appeal.

THE *GIBBS* RULE

Central to the issues in these proceedings is the *Gibbs* rule, which takes its name from an 1890 Court of Appeal decision (*Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399). The effect of the rule is that, as a matter of English law, any discharge of or variation to a contractual obligation is governed by the proper law of the contract. Therefore, whatever the position as a matter of Azeri law, as a matter of English law the rights of the English creditors (ie creditors whose debt obligations are governed by English law) were unaffected by the Azeri plan. (There is an

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exception where a creditor participates in the restructuring or submits to the jurisdiction of the foreign court, as to which see *Rubin v Eurofinance SA* [2013] 1 AC 236 at [167], but that did not apply in this case). It was common ground between IBA and the English creditors that the *Gibbs* rule was binding on the Court of Appeal.

THE CORE ISSUE ON APPEAL

The purpose of IBA's application was to prevent the English creditors from enforcing their claims against IBA and thereby, so it was said, obtaining an unfair advantage over the other creditors whose original debts had been discharged under the plan.

Article 21 of the CBIR provides, on the face of it, a broad power available to the English court to grant any appropriate relief, including a stay of creditors' claims, following the recognition of a foreign proceeding.

The critical question was whether there was power under CBIR Art 21 to grant an indefinite stay of creditors' claims in circumstances where to do so:

- would interfere substantively with the English creditors' rights; and
- would prolong the stay beyond the date on which the Azeri reconstruction had come to an end.

THE COURT OF APPEAL'S REASONING

In a judgment handed down in December 2018, the Court of Appeal dismissed IBA's appeal, thereby upholding the decision of Hildyard J that there was no power under CBIR Art 21 to grant the stay sought. There were two principal bases for the decision.

- First, the court held that the relevant power under Art 21 was procedural in nature which could not properly be exercised to circumvent the English creditors' substantive rights in circumstances where those rights are protected by the *Gibbs* rule. The starting point was that the CBIR, which implement the UNCITRAL Model Law, is limited to procedural aspects of cross-border insolvency and does not attempt a substantive unification of insolvency law. The court noted that, in contrast to the EU Regulation on Insolvency Proceedings (Council Regulation (EC) 1346/2000), the CBIR contains no choice of law provisions; nor, indeed, does it contain any form of reciprocity requirement. If Art 21 had been intended to override the substantive rights of creditors under the proper law governing their debts, Art 21 would have said so explicitly. It would be wrong to use Art 21 in a way that is tantamount to the application of Azeri law (see paras 86-95 of the judgment).
- Second, the court held that, in any event, there was no power for a stay to be granted on an indefinite basis that would last beyond the termination of the foreign proceeding. The main object of the relevant Art 21 powers was to provide a temporary "breathing space" to debtors while they formulate a restructuring. However, the Azeri plan had come into effect and the bank restored to financial health – whilst the proceeding (as accepted by IBA) was being kept alive artificially for the purpose of the appeal, it had as a matter of substance run its course (see paras 96-101 of the judgment).

ANALYSIS

There are two practical issues that underlie the case. The first is how a foreign debtor such as IBA is able to bind a dissenting creditor to a restructuring plan, where that creditor's debt is governed by English law.[1] The second is the temporal question: how long can any stay under the CBIR last for?

Binding creditors

In terms of the first issue, no difficulty arises where the debtor has the centre of its main interests (COMI) within the EU, since the EU Regulation on Insolvency Proceedings gives automatic effect within the EU to compositions and schemes of arrangement. Similarly, there is no difficulty where the creditor has submitted to the jurisdiction of the COMI, since in such circumstances English law holds that the creditor should not be allowed to benefit from the insolvency proceeding without the burden of complying with the orders made in that set of proceedings. However, where the debtor's COMI is outside the EU and the creditor has *not* submitted to the foreign process, the issue that a debtor in IBA's position faces is that, because of the *Gibbs* rule, a creditor whose debt is governed by English law will remain free to bring proceedings in England to enforce its debt.

There is an established way around this issue, which is for the foreign debtor to promote a parallel English scheme of arrangement so as to bind English creditors (see for example *Re Drax Holdings* [2004] 1 WLR 1049). That is not a course that IBA took. IBA sought instead to use the power to grant a stay under CBIR Art 21 as a means to align the position of the dissenting English creditors with the Azeri plan. The Court of Appeal's rejection of that approach underlines the importance of a foreign debtor promulgating a parallel scheme of arrangement where it wishes to bind English creditors who would otherwise be free to adopt a "hold out" position in reliance on their English law rights.

The Court of Appeal's decision will be welcome to English creditors who hold distressed debt in circumstances where the debtor's COMI is outside the EU. Where the debtor is subject to a foreign restructuring process, the court has held that the dissenting English creditors' substantive rights cannot be undermined by means of a procedural power under the CBIR. The court's decision therefore serves an important protection of English creditors.

The Court of Appeal did not hold that the CBIR could *never* be used to achieve the discharge or variation of an English law right (see para 95) – its decision was confined to the particular circumstances of the case and in particular the existence of English law rights under the *Gibbs* rule that would be circumvented by a stay under Art 21. It would therefore be wrong to treat the CBIR as being purely procedural in nature; as the court has held, the CBIR is capable of having substantive effects on English law rights where expressly provided for.

Whilst the correctness of the *Gibbs* rule was not in issue before the Court of Appeal (since the rule is binding on all courts below

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the Supreme Court), Henderson LJ touched at paras 29-31 on criticisms that certain commentators have made of the rule. Most recently, a New York bankruptcy decision (*Re Agrokor*, 24 October 2018) confirms that the rule does not form part of US insolvency law. Critics of the *Gibbs* rule suggest that the rule is out of step with a trend towards modified universalism, ie that a restructuring that is sanctioned by a court in a debtor's place of incorporation should be effective to bind all creditors irrespective of the law that governs the debt, when a restructuring is a collective process that is intended to benefit the body of creditors as a whole.

Yet, at least in relation to a reconstruction process, there are powerful arguments in favour of the *Gibbs* rule. As the Court of Appeal noted at para 93, there is an important conceptual distinction between a liquidation and scheme of reconstruction. The purpose of a reconstruction (unlike a liquidation) is to effect significant changes to creditors' substantive rights with a view to the debtor continuing as a going concern. There is obvious force in the proposition that a creditor's rights should only be affected if the variation is effective in accordance with the law that governs the parties' relationship. That, after all, is the bargain that the creditor and the debtor, often represented by experienced teams of lawyers, made and will typically be reflected in the cost of credit: the creditor made an English law contract and is entitled to expect that it is English law that determines whether any variation or discharge is effective. This is particularly so where the creditor and the debtor have agreed to have any disputes in relation to that debt determined by the English court.

The temporal issue

As to the second issue, the court's conclusion that a stay cannot properly be granted beyond the conclusion of the reconstruction process is also of practical relevance to commercial parties. Perhaps most importantly, the court's conclusion underlines the differing approaches to the application and interpretation of the Model Law as between the two most prominent insolvency jurisdictions: the US and the UK. Under the US Chapter 15 process, the US court may order permanent injunctive relief in order to give effect to a foreign restructuring plan. The court acknowledged that the conclusion resulted in a difference of approach as between the US and English courts (see para 100), but emphasised that the background to the incorporation of the Model Law in the US differed significantly from that in Great Britain.

Given the lack of any reciprocity requirement, it is unsurprising that different legal systems have adopted different approaches to the incorporation and interpretation of the Model Law. In the present case, the court highlighted the procedural and supportive role of the Model Law in order to limit the powers under the CBIR to the life of the restructuring process. This may provide some comfort to dissenting creditors who, whether rightly or wrongly, prefer to take the risk of waiting out the recovery process before suing to recover their debt in full. As a matter of English law (and its approach to the CBIR), there now appears to be no risk that any such right to recover will be subject to a permanent injunction.

CONCLUDING REMARKS

IBA has now sought permission to appeal the decision of the Court of Appeal and it remains to be seen whether the Supreme Court will grant such permission. Sberbank argued before the Court of Appeal that, given the delicate policy implications and the formulation of any replacement rules, any question of overruling *Gibbs* would properly be a matter for Parliament and not the courts.

It is inherent in any foreign restructuring where certain debts are governed by English law that there will be a tension between two competing interests: on the one hand, giving effect to the restructuring so that it binds creditors and restores the debtor to financial health, and on the other hand protecting the interests of creditors whose package of rights is governed by English law. The question is essentially whether the analysis should remain a strictly contractual one, or whether creditors' contractual rights should give way to a supervening rule that applies the law of the country where the restructuring took place. Unless and until *Gibbs* is overruled, the position is clear: where a creditor has English law rights, it is necessary to identify a gateway under English law to establish a variation or discharge of those rights (for example a parallel scheme of arrangement). ■

1 Broadly speaking, the *Gibbs* rule would equally protect a debt governed by a law other than English law, in circumstances where that other law similarly did not defer to the law of the COMI or place of incorporation when considering the issue of the discharge of a debt following or as the result of an insolvency process. For present purposes however (and unless stated otherwise below), the analysis proceeds on the basis of debts governed by English law given that these were in issue in the proceedings.

Further Reading:

- A further limit on modified universalism: the rule in *Gibbs* reaffirmed (2018) 5 JIBFL 301.
- Compromising English law debts: has the rule in *Gibbs* had its day? (2018) 6 CRI 206.
- LexisPSL: Restructuring and insolvency: Schemes and variation of contractual rights.