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The rule in Gibbs fights another day

On 18 December 2018 the English Court of Appeal held in the case of *OJSC International Bank of Azerbaijan* that the rule in *Gibbs* is still a fundamental tenet of English insolvency law and not to be side-stepped by the Cross-Border Insolvency Regulations.

Facts

The facts in summary are these:

- International Bank of Azerbaijan (***IBA***) was in voluntary restructuring proceedings in Azerbaijan, where it has its centre of main interests.
- A debt restructuring plan was proposed and was voted on by the prescribed threshold of creditors. The plan provided for all existing debts to be extinguished and replaced with various new entitlements.
- The plan included debts which were governed by English law where the creditors did not participate in the restructuring proceedings or submit to the jurisdiction of the Azeri court. This meant that according to an English common law rule called the rule in *Gibbs* (see below) the English law debt obligations would not be treated as discharged by the Azeri proceedings.
- The Azeri officeholder successfully applied to the English courts for recognition of the Azeri restructuring proceedings under the Cross-Border Insolvency Regulations (***CBIR***) which implement the UNCITRAL Model Law on Cross-Border Insolvency in the UK. This recognition brought with it a stay of execution against IBA's assets under Article 20 of the CBIR which would remain in force until the restructuring has been implemented, but would lapse thereafter.

What is the rule in Gibbs?

In *Gibbs*, Mr Gibbs had entered into an English law governed contract to sell copper wire to a French company. Before the order was completed, the French company entered into liquidation in France. The English court held that the French insolvency was not effective to operate as a discharge of the company's obligations (here: damages payable to Mr Gibbs) because the contract was not discharged in accordance with the governing law of the debt (here: English law). The rule that debt obligations governed by English law can only be discharged by an English process has held true ever since – although the rule has come under more and more pressure in an increasingly global world with financing complexity beyond any consideration in 1890.

The question before the English courts

IBA was not content with a stay of enforcement action only until the restructuring was implemented in Azerbaijan. Two creditors had indicated that as soon as the stay expired they would seek to enforce their English law claims in the English courts, relying on the rule in *Gibbs* and arguing that their claims had not been extinguished by the Azeri proceedings. IBA therefore sought a stay that would continue indefinitely – even after the restructuring had come to an end and IBA had resumed operation as a going concern.

In addition to the automatic relief upon recognition as a foreign main proceeding in Article 20 CBIR, the CBIR provides in Article 21 that the court may, where necessary to protect the assets of the debtor or the interest of the creditors, grant any appropriate relief (which specifically includes staying execution against the debtor's assets).

The question therefore was: does the English court have the power (and if so, should it exercise this) to direct that the claims of the English law governed creditors should continue to be stayed indefinitely, even after the restructuring has come to an end? **In other words, could a stay (normally a procedural remedy) be extended to last longer than the restructuring proceeding itself and as such become a substantive remedy?** This would side-step the rule in *Gibbs* and therefore be tantamount to permitting a foreign restructuring proceeding to extinguish

English law governed debt obligations.

The decision

The Court of Appeal agreed with the High Court that the court had no jurisdiction to grant such an indefinite stay. It therefore did not need to deal with the question as to whether had there been such jurisdiction it should use its discretion to exercise it.

What were the Court's reasons?

- Under Article 21 CBIR, in order to grant appropriate relief, the relief (here: the extended stay) would need to be **necessary** to protect the interest of IBA's creditors. However, at the time of the hearing, IBA was trading again, the restructuring plan had been effected in Azerbaijan and there was no further protection which the creditors needed in order for the foreign proceeding to achieve its purpose.
- It was material that IBA could have promoted a **parallel scheme of arrangement** in England - which is the ordinary way to deal with the issue posed by the rule in *Gibbs* - but chose not to do so.
- The power to grant appropriate relief in Article 21 CBIR is **procedural** – and if the power to grant a stay had been intended to override the substantive rights of creditors under the proper law governing their debts, this should have been made explicit in the CBIR. In *Rubin v Eurofinance*, the Supreme Court expressly stated that Article 21 was concerned with procedural matters. Indeed, the court here could not find anything in Article 21 to suggest that the procedural power to grant a stay could properly be used to circumvent the *Gibbs* rule.
- IBA was asking the court to sideline or circumvent the established common law rights of English creditors by appealing to the principle of modified universalism. This line of argument was no longer open as the Supreme Court had called time on this in *Rubin*, where it held that the principle of universalism cannot be used to justify a court granting an order that disregards provisions of English law in order to assist a foreign insolvency process.
- There is an important distinction between liquidations and schemes of reconstruction. In a liquidation the prime focus is on achieving a *pari passu* distribution and the company's life will end. In a reconstruction the object is typically to change creditors' rights and to achieve a survival of the company. There could be circumstances where it was appropriate to exercise powers under the CBIR so as to achieve the discharge or variation of English law rights in a way that is tantamount to the application of foreign law, but the example given was in the context of a liquidation where it might be appropriate for the court to remit assets located in England to a foreign liquidator.
- Lastly, relief under the CBIR should only be granted to continue while the **foreign proceeding is ongoing** - it would be absurd to extend relief when the proceeding is terminated. Here it should be noted that in response to this limb the Azeri legislators had modified the Azeri proceedings to stipulate that they would be ongoing for ever. The Court did not like this circumvention: "*The reconstruction plan is being kept alive artificially, but as an insolvency proceeding it has served its purpose and run its course*."

Bringing it all back…. why is the case important?

The rule in *Gibbs* has attracted widespread criticism – the case is important as it underlines that *Gibbs* is still alive, liked or not. This means that if

> "a contract is governed by English law, then a party is not discharged from liability under that contract if there is a discharge in foreign insolvency proceedings unless the party submits to the foreign proceeding".

Here, this means that IBA's Azeri reorganisation plan did not affect the debt obligations governed by English law of creditors who had not submitted to the Azeri proceeding. The rule however would equally mean that a US Chapter 11 process does not discharge English law governed debt obligations – possibly a more common question these days than the question of Azeri restructuring proceedings.

How do you deal with the rule in Gibbs in practice?

Where a debt restructuring is taking place outside the context of the EU Regulation on Insolvency Proceeding (which is commonly thought to disapply the rule in *Gibbs* within the EU) and involves English law governed debt obligations, then parties will need to promote a parallel scheme of arrangement or some other mechanism in England. Only that mechanism will discharge the English law governed obligations – not the foreign reorganisation plan. This, of course, adds to the cost of international restructurings but provides certainty of outcome. Here, IBA had not proposed such a parallel proceeding and was therefore looking for different ways to deal with the dissenting creditors.

Comment

It may not be surprising that (even if it had authority to do so) the Court of Appeal was not minded to overturn the well established common law rule in *Gibbs* in this case.

The CBIR had generally been thought to provide only procedural (i.e. temporary and not substantive) relief. So IBA's attempt to use those rules to produce what in effect would be a substantive debt discharge of the English law governed debt obligations did not convince the Court of Appeal (or indeed, the lower court before it). The Court also noted the fact that it had been open to IBA to promote

a parallel English scheme and it had chosen not to do so.

However, despite its ruling the Court of Appeal clearly recognises the criticisms that have been levelled against the *Gibbs* rule.

- First, the rule may be thought increasingly anachronistic in a world where the principle of modified universalism has been the inspiration for much cross-border co-operation in insolvency matters. As the Court stated: "*In particular, there may now be a strong case for saying that, in the absence of a stipulation to the contrary, contracting parties should generally be taken to envisage that, upon the supervening insolvency of one party, a single law closely associated with that party should govern the rights of its creditors, wherever in the world its assets happen to be situated, and regardless of the proper law of the contract*." A point also made recently by the US courts in the matter of Agrokor where Judge Martin Glenn stated: "*The Gibbs rule remains the governing law in England despite its seeming incongruence with the principle of modified universalism espoused by the Model Law and a broad consensus of international insolvency practitioners and jurists*".
- Second, the rule sits rather uneasily with established principles of English law which expects foreign courts to recognise English insolvency or reorganisation proceedings. The most common example being a scheme of arrangement under the Companies Act modifying and/or discharging debt obligations regardless of the fact of the governing law of such obligation.

Whether the case will go to the Supreme Court and whether the Supreme Court will overrule the rule in *Gibbs* remains to be seen. In light of the uncertainty caused by Brexit, it would perhaps not be surprising if the Supreme Court viewed the decision to overturn *Gibbs* as a matter of policy and for Parliament to decide. As the rule stands, it gives primacy to English law debt obligations – forcing a parallel scheme of arrangement or other method in order to deal with English law governed debt obligations. For political reasons, now may not be the time to change this – even if Parliamentary time permitted a rethink.

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