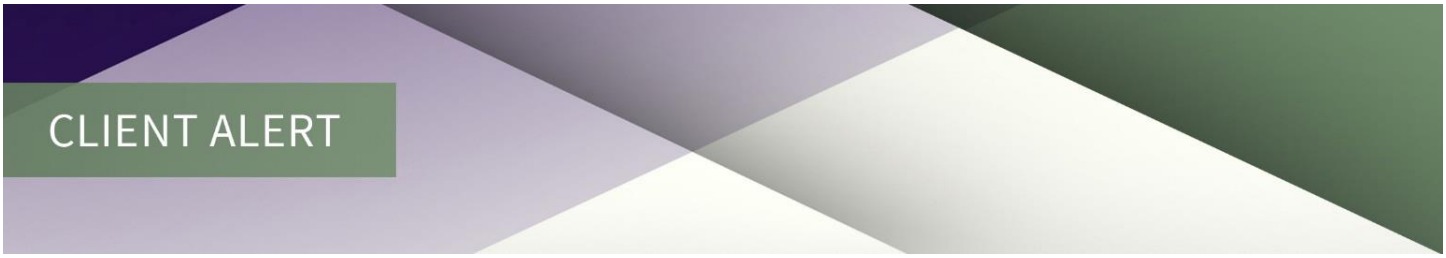

Can't Touch This: UK Supreme Court Declines Invitation to Overturn Archaic English Restructuring Law

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Introduction

The UK Supreme Court has recently refused to hear an appeal by the International Bank of Azerbaijan ("**IBA**") against a lower court's decision, which had blocked IBA from compromising the rights of two creditors with English law governed debts. The refusal by the UK's highest court to hear the appeal is a triumph for the "**Rule in Gibbs**", which holds that only English courts can compromise English law governed debts. The rule currently applies only to foreign restructurings outside the EU, but if relevant EU legislation is repealed following Brexit, then the Rule in Gibbs may become an even more powerful weapon for creditors with English law governed debt.

1. **What is the Rule in Gibbs?**

It is a long-standing rule of English common law that a foreign insolvency or restructuring process cannot interfere with, vary, modify or extinguish an English law governed debt. This rule stems from an 1890 decision of the English Court of Appeal in *Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399. It has been referred to with approval by English courts frequently over the last 129 years, although the UK Supreme Court has never been asked to decisively determine the point.

The Rule in Gibbs exists because English law regards the discharge or modification of contractual debts as a matter to be governed solely by the governing law of the contract. In this regard, it has been argued that the Rule in Gibbs provides

certainty to parties that choose to contract under English law because it gives effect to those parties' expectations as to how their contractual liabilities will be discharged.

There are two important exceptions to the Rule in Gibbs, which, if applicable, mean that an English law governed debt can be compromised by a foreign restructuring process. The two exceptions are:

a) where the creditor has submitted to the jurisdiction of the foreign proceedings (e.g. by filing a proof of debt in the foreign insolvency proceeding); or

b) where there is specific legislation in place between the foreign state and England (e.g. EU Regulation 2015/848 on Insolvency Proceedings).

2. Background to the IBA case

- IBA entered into a $3 billion restructuring under Azeri law in 2017 to compromise its debts.
- A restructuring plan was approved by a large majority of IBA's creditors and, as a matter of Azeri law, the plan was binding on all affected creditors, including those that did not vote on the plan. IBA then applied for, and was granted, recognition of the restructuring in the UK under the Cross-Border Insolvency Regulations 2006 (the "**CBIR**"), which give effect to the UNCITRAL Model Law on cross-border insolvency (the equivalent of Chapter 15 of the U.S. Bankruptcy Code).
- Sberbank and Franklin Templeton were creditors of IBA under a $20 million term loan and a $500 million notes issuance, respectively (representing 5 percent of IBA's debt in aggregate), governed by English law.
- Neither creditor had voted, or indeed participated in any way, in the Azeri restructuring process.
- IBA sought an order from the English court for an indefinite stay under the CBIR against Sberbank and Franklin Templeton to prevent them from enforcing their English law governed claims against IBA's assets in England.

3. What the English Court of Appeal decided

The Court of Appeal upheld a lower court's decision that relief under the CBIR, including a stay against creditor action, could not be granted indefinitely so as to continue beyond the date on which the relevant foreign insolvency proceeding had terminated.

The Court of Appeal also held that, in any event, the CBIR could not be used to circumvent the Rule in Gibbs: the claims of both Sberbank and Franklin Templeton were governed by English law and neither creditor had submitted to the Azeri

proceedings. Accordingly, the Rule in Gibbs applied and the English claims could not be compromised by the Azeri restructuring plan.

IBA challenged the Court of Appeal's decision in the Supreme Court, but the Supreme Court declined to hear the appeal and IBA now has no further appeals available to it.

4. What this means for debts governed by English law

Sberbank and Franklin Templeton are now free to pursue their enforcement claims against IBA in the English courts. Any creditor that holds English law governed debt and does not participate in a foreign restructuring, or otherwise submit to the jurisdiction of the relevant foreign court, may bring an action in the English courts to enforce its old debt claim. This is the case notwithstanding that the foreign insolvency law may regard the restructuring as binding on creditors worldwide, or that recognition of the foreign proceeding may have previously been granted in the UK under the CBIR (provided that any stay granted under the CBIR has now expired, e.g. if the foreign proceeding has completed such that it is no longer subject to the supervision of the foreign court).

The Rule in Gibbs remains good law for now, but it could be abrogated if the UK ever decides to enact the "New Model Law" (recently proposed by UNCITRAL), which specifically provides in Article 13 that recognition and enforcement of insolvency-related judgments are mandatory, provided that certain procedural requirements are met and subject to certain public policy exemptions.

5. Will Brexit affect the Rule in Gibbs?

It is possible that, following Brexit, the EU Insolvency Regulation and the EU Judgments Regulation will be repealed from English law. These two regulations provide for the automatic recognition of EU Member States' court decisions, including where EU courts compromise English law governed debt. If these regulations are no longer in force in England, the Rule in Gibbs will protect debt governed by English law from any restructuring process wherever located. For a consideration of the potential implications of Brexit on the recognition of cross-border restructuring and insolvencies, please see our client alert.

6. Contrast with U.S. approach

The approach of the English courts to IBA's restructuring stands in stark contrast to that of the United States. Following the English court's decision at first instance in January 2018, Judge James L. Garrity Jr. in the U.S. Bankruptcy Court for the Southern District of New York (the "**SDNY**") made IBA's restructuring plan binding in the United States on all creditors, whether or not they had agreed to be bound by the plan or had participated in the Azeri restructuring proceeding, giving the plan full force and effect in the United States.

There is no equivalent of the Rule in Gibbs in the United States. Indeed, U.S. courts have previously criticised the Rule in Gibbs as being archaic and incongruous with the principle of international comity. In Agrokor’s Chapter 15 recognition proceedings before the SDNY, Judge Glenn was highly critical of the seemingly duplicitous application of the Rule in Gibbs by English courts when the UK had also enacted the UNCITRAL Model Law, and he cited with approval English academic criticism that “*the Gibbs doctrine belongs to an age of Anglo centric reasoning which should be consigned to history*”.

One reason for the divergence in approach in this area is that U.S. judges have interpreted Chapter 15 as permitting the law of a foreign insolvency to be applied to claims in such insolvency, irrespective of the governing law of such claims, whereas to date English courts have interpreted the CBIR to permit the application of English law relief only. It remains to be seen whether any future adoption of the New Model Law will bring the UK into line with the U.S. approach.

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