Protection of dissenting creditors' interests

Abbas Abbasov, winner of the Richard Turton Award 2021, writes on the direct application of the "Substantive Fairness" test in considering the recognition of foreign restructuring plans

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This article is a summary of the full paper written by the 2021 Richard Turton Award winner, Abbas Abbasov from Azerbaijan

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You can read the full version of the award-winning paper on our website: www.insol-europe.org/richard-turton-award

The protection of the dissenting creditors'[1] interests is one of the core issues to be considered in recognition of debt discharges under foreign restructuring plans. The recent restructuring case of the OJSC International Bank of Azerbaijan (IBA)[2] is a clear indication of how differently the courts in various jurisdictions deal with the issue: the English and the US courts[3] reaching contradictory outcomes in respect to analogous relief (an indefinite stay) sought by the IBA.

In refusing the relief sought,[4] the Court of Appeal (England and Wales) referred to the Gibbs rule articulated by Lord Esher MR in *Antony Gibbs* which aims to protect English-law creditors from the adverse effects of foreign insolvency proceedings and stipulates that a contract can only be discharged under a proper law governing this contract.[5,6] The court concluded that the indefinite stay would, in substance, indefinitely prevent English creditors from enforcing their English law rights, effectively meaning the discharge of the said rights. It also highlighted the possibility of the initiation of analogous proceedings under English law by the IBA.[7] By way of contrast, Judge Garrity in the US Bankruptcy Court (SDNY) granted the relief and overruled any objections thereto.[8]

Criticism of the Gibbs Rule: is the idea behind it worth preserving?

Academics and practitioners from various jurisdictions consider that the Gibbs rule is not in line with the principle of *universalism* or (its current form) *modified universalism*, which envisages a single set of insolvency proceedings with worldwide effect.[9] The late Professor Fletcher highlighted the paradox that English law does not recognize the foreign bankruptcy discharge, while expecting the English bankruptcy discharge to have universal effect.[10] Look Chan Ho argues that the rule and the CBIR (Cross-Border Insolvency Regulations 2006) are mutually exclusive.[11] In Singapore, Judge Ramesh disapproves the characterisation of debt discharge under compositions as a matter of contract law,[12] while the US bankruptcy judge, Judge Glenn, criticizes the rule by describing its essence as territorialism.[13]

It is possible to agree with these arguments (in part) that the manner of the implementation of the rule is inconsistent with modern developments in cross-border insolvency law. In cases where the plan confirmed by the COMI (centre of main interests of the debtor) court does not treat the creditors less favourably than a plan under the law of the contract would do, the necessity to initiate costly and time-consuming parallel proceedings is not comprehensible.

Having said that, one can question whether the idea behind the Gibbs rule is also completely wrong. Arguably, the answer to this question is not affirmative, as the creditors' reasonable reliance on the minimum guarantees provided for by the law governing the contract cannot be completely ignored. The US approach based on the satisfaction of procedural fairness[14] cannot be accepted as an ideal solution to that end. The US courts generally extend comity under Chapter 15, if the fundamental standards of procedural fairness have been met and US public policy has not been violated in the respective foreign proceedings.[15]

Professor Stefan Madaus makes a clear distinction between insolvency and restructuring proceedings and highlights the contract law underpinning of the latter,[16] which is also relevant to the issue of recognition of a foreign bankruptcy discharge. Accordingly, the law of the contract is to be taken into account in the recognition of debt discharges under foreign law. The problem deserves much more attention, particularly in cases where well-established substantive tests[17] dealing with the rights of the individual dissenting creditors do not exist under the foreign law governing the confirmation of the plan.

An alternative approach?

Article 22 (1) of the MLCBI (UNCITRAL Model Law on Cross Border Insolvency) and Article 14(f) of the MLREIRJ[18] are of particular importance in this regard. Both provisions highlight the need to consider whether the interests of the affected creditors have been adequately protected. The language of the latter is particularly significant, as it highlights the confirmation of a plan of reorganization and

discharge of debts. This safeguard offers an additional (and broad) layer of substantive protection for the affected creditors besides the "procedural fairness", "public policy" and "fraud" safeguards in the text.[19]

Despite the refusal to extend comity, while considering recognition and enforcement of foreign restructuring plans and foreign discharge of debts, in a limited number of cases,[20] bankruptcy courts in the US acknowledge the broad discretion given to them under section 1522[21] of the U.S Bankruptcy Code.[22] US courts define "sufficient protection"[23] as embodying three basic principles: "the just treatment of all holders of claims…, the protection … against prejudice…., and the distribution of proceeds of the [foreign] estate substantially in accordance with the order prescribed by US law."[24] The third principle mentioned needs to be further explored: it empowers the US courts to take into account the relevant substantive provisions of US law. It should also be mentioned that such direct application is only operative where the dissenting creditor opposes the recognition of the foreign restructuring plan.

As to the essence of the said test, the MLCBI does not contemplate any substantive test.[25] A viable solution could be to apply the respective tests applicable under the law governing the contract (e.g., the "best interest test" under Chapter 11 plan confirmation[26] or "unfair prejudice" challenge under an English CVA),[27] due to the contract law underpinning of the restructuring law[28].

In summary, this author proposes a two-tier test ("substantive fairness test').[29] At the first tier, the assessment should show how differently would the opposing creditor have been treated in analogous proceedings under the law of the contract by applying the respective test thereunder. Unfair treatment can be affirmed in cases where the result of such assessment indicates that the foreign plan has had a materially adverse effect on the entitlements that the opposing creditor would have received had the plan been confirmed under the law of the contract. It is also worth mentioning that the foreign restructuring law need not to be identical to the law of the contract and only the material adverse effect should be taken into consideration.

The second tier comes into operation only if the fact of unfair treatment is established. This tier comprises (i) the examination of the foreign law governing the plan to establish whether effective safeguards exist to remedy such unfair treatment and (ii) if yes, an assessment of whether the opposing creditor has exhausted all remedies available under foreign law.[30]

Concluding remarks

The purpose of this article is to reopen the discussion on the need for the development of new mechanisms to protect the substantive rights of dissenting creditors, while considering the recognition of foreign restructuring plans and bankruptcy discharges thereunder. Of note is that courts in states that have implemented the MLCBI or the MLREIRJ have broad powers under the respective provisions of those texts. ■

Abbas Abbasov (centre) receiving his award in Dublin, from (left-right) Scott Atkins (INSOL International), Christina Fitzgerald (R3), Louise Brittain (IPA) and Frank Tschentscher (INSOL Europe)

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Footnotes:

1 For the purposes of this article, "dissenting creditor" means a creditor who voted against or did not vote for the plan in question.

2 For more about the IBA case, see *Bakhshiyeva (Foreign Representative of the Ojsc International Bank of Azerbaijan) v Sberbank of Russia & Ors* [2018] EWCA Civ 2802 (18 December 2018).

3 Both jurisdictions adopted the UNCITRAL Model Law on Cross Border Insolvency (1997) (MLCBI), the UK via the Cross Border Insolvency Regulations 2006 (CBIR) and the US via Chapter 15, US Bankruptcy Code (Title 11) (Chapter 15) respectively.

4 *See Bakhshiyeva* (n 2).

5 *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399.

6 The rule does not apply in cases where the respective creditor has submitted to the foreign insolvency proceeding. This exception was not engaged in the IBA case, as the objecting foreign creditors (Sberbank of Russia and others) of the IBA had not submitted to Azeri proceedings. See Bakshiyeva (n 2), 28.

7 *Bakshiyeva* (n 2), 9 and 88.

8 *In re International Bank of Azerbaijan*, 17-11311 jlg, 23.01.2018.

9 Reinhard Bork, *Principles of Cross-Border Insolvency Law* (Intersentia, 2017), 28 (para. 2.11).

10 Ian Fletcher, *The Law of Insolvency* (5th edn) (Sweet and Maxwell, 2017), 922 (para. 29-063).

11 Look Chan Ho, *Cross-Border Insolvency: Principles and Practice* (Sweet & Maxwell, 2016), 169 (para. 4-028).

12 Kannan Ramesh, 'The Gibbs principle. A tether on the feet of good forum shopping' (2017) 29 *SAcLJ* 42.

13 *In re Agrokor d.d.*, 591 B.R. 163 (Bankr. SDNY 2018).

14 "Procedural fairness", "public policy" and "fraud" safeguards are outside the scope of this article.

15 *In re PT Bakrie Telecom Tbk*, 628 B.R. 859, 878 (Bankr. SDNY 2021), citing *Hilton v. Guyot*, 159 U.S. 113, 205-206 (1895); *JP Morgan Chase Bank v. Altos Hornos De Mexico, S.A de C.V.*, 412 F.3d 418, 428 (2d Cir. 2005); *Marcus v. Dufour*, 796 F. Supp. 2d 386, 392 (EDNY 2011).

16 Stephan Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 *Eur Bus Org Law Rev 615–647.*

17 See below (nn 26 and 27) for examples.

18 UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgements (2018).

19 These three issues are expressly or impliedly dealt by other provisions of both Model Laws. (e.g. Articles 7 and 14 (b), MLREIRJ).

20 *In re PT Bakrie Telecom Tbk* (n 15); *Ad Hoc Group of Vitro Noteholders v. Vitro S.A.B. de C.V.*, 701 F.3d 1031 (5th Cir. 2012).

21 Chapter 15 equivalent to Article 22, MLCBI.

22 *In re Intl. Banking Corp. B.S.C.*, 439 BR 614, 626–27 (Bankr. SDNY 2010), citing *Tri-Cont'l Exch.*, 349 BR at 636-37; In re Atlas Shipping A/S, 404 BR 726, 740 (Bankr. SDNY 2009), citing *Tri-Cont'l Exch.*, 349 BR at 638); *Jaffé v. Samsung Elecs. Co.*, 737 F.3d 14, 27-28 (4th Cir. 2013).

23 Section 1522 uses the term "sufficiently protected", instead of the term "adequately protected" used in Article 22, MLCBI.

24 *In re PT Bakrie Telecom Tbk* (n 15), 876, citing *In re Atlas Shipping A/S*, 404 BRn726, 740 (Bankr. SDNY 2009), *In re Artimm, S.r.L.*, 335 BR 149, 160 (Bankr. CD Cal. 2005).

25 As the MLCBI does not attempt a substantive unification of insolvency law. See Guide to Enactment and Interpretation of the MLCBI, I.A.3.

26 Rodrigo Olivares-Caminal et al., *Debt Restructuring* (2nd edn) (OUP,2016), 169-170 (paras 3.110-3.111).

27 Ibid., 220-224 (paras 3.257-3.276), citing section 6, Insolvency Act 1986; *Prudential Assurance Company Ltd & Ors v PRG Powerhouse Ltd. & Ors* [2007] EWHC 1002 (Ch) (01 May 2007) and other cases.

28 See Madaus (n 16).

29 To avoid any doubts, this article proposes applying the test as an additional (second) layer of the fairness test, the first layer being 'procedural fairness', which falls outside the scope of this article.

30 In contrast to the English law approach deterring local creditors from submitting to a foreign jurisdiction in order not to lose protection of the Gibbs rule, see above n 6.