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# Modified Universalism in Our Time?

## A Look at Two Recent Cases in the U.S. and U.K.

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By all accounts, 1890 in the U.K. was not an exceptional year. Queen Victoria was in the last decade of her nearly 64-year reign as monarch. The Prince of Wales, the future King Edward VII, continued to be a cause for concern and embarrassment by becoming embroiled in the "royal baccarat scandal," in which he was forced to give evidence in court the following year when one of the participants in the illegal card game unsuccessfully sued one of his fellow players after being accused of cheating.[2]

In the courts, William Brett, first Viscount Esher, was the Master of the Rolls. A conservative politician, he was the solicitor-general under Prime Minister Benjamin Disraeli. He became a judge in 1868 and went on to hear many important and often-cited cases, probably the most important of which was *Foakes v. Beer*[3] on the concept of consideration in contracts. Yet rarely, if ever, will you find a mention in biographical references to him of a case that is of considerable importance in the modern era of international restructurings and insolvencies: *Antony Gibbs & Sons v. La Société Industrielle et Commerciale des Métaux*.[4]

The *Gibbs* Rule can trace its roots to even older cases.[5] It is authority for the proposition that a debt governed by English law cannot be discharged or compromised by foreign insolvency proceedings. In Lord Esher's own words, "Why should the plaintiffs be bound by the law of a country to which they do not belong, and by which they have not contracted to be bound?"

As international cases have become increasingly prominent, many writers have thought that the *Gibbs* Rule is out of step with the modern world. Indeed, one commentator[6] said that the "*Gibbs* doctrine belongs to an age of Anglocentric reasoning [that] should be confined to history."

The *Gibbs* Rule does not apply where the creditor submits to the foreign insolvency proceeding.[7] This makes perfect sense, because the creditor will be regarded as having consented to the law of the foreign proceeding determining its entitlements. However, the degree of engagement with the foreign proceedings in the *Gibbs* case was extensive.

Antony Gibbs entered a proof of debt in the foreign proceedings (albeit that it expressly reserved all of Gibbs' rights with regard to the action in the English court that was then pending) and commenced an action in the French court in relation to the liquidators' determination of it. This is mentioned for reasons that will become apparent later, but also to point out that in modern times, *Gibbs* may well have been taken to have acceded to the foreign proceeding with all that entails.[8]

Now, let's come back to the present. In January 2018, the English High Court heard the case of *Bakhshiyeva v. Sberbank of Russia*, also known as OJSC International Bank of Azerbaijan.[9] Hon. Robert Hildyard began his judgment by succinctly setting out the issue before him: "[T]he tension between what is often referred to as the [*Gibbs* Rule] and, in the context of a foreign insolvency proceeding which has been recognised in this jurisdiction, the principle of 'modified universalism.'"

In this case, the foreign representative of the Bank of Azerbaijan applied for a permanent[10] stay of enforcement to prevent a creditor from exercising its rights under a contract governed by English law in order to prevent that creditor from enforcing its rights contrary to the terms of the foreign insolvency proceeding by which all creditors were bound in accordance with the foreign law. The foreign proceedings had already been recognized under the Cross-Border Insolvency Regulations 2006 (CBIR).[11] The creditors argued, in terms, that this would prevent them from exercising their English law rights and thus went beyond the available relief in the CBIR.

In a very thorough and lengthy written judgment, Mr. Justice Hildyard, following the *Gibbs* Rule and the decision in *Fibre Celulose SA v. Pan Ocean Co Ltd.*,[12] concluded that the purpose of CBIR is not to enable the English Court to vary or discharge substantive English law rights and, more generally, that the court could not import other countries' laws without more (*e.g.*, in the form of some statutory

1 The authors thank *ABI Journal* Coordinating Editor **Tally M. Wiener** for her helpful comments and editorial assistance on this article.
2 *See* James Wilson, "A Royal Flush," *New Law Journal*, Jan. 18, 2013, *available at* newlawjournal.co.uk/content/royal-flush (last visited May 25, 2018; requires log-in credentials to view article).
3 [1881-85] All ER Rep 106.
4 (1890) 25 Q.B.D. 399 Court of Appeal.
5 This includes *Smith v. Buchanan* (1800) 1 East 6.
6 *The Law of Insolvency, 5th Edition* (2005) at ¶ 2.129.
7 Creditors who participate in a foreign restructuring plan are estopped from suing on their debts in England, a point acknowledged by Judge Nigel Teare in *Global Distressed Alpha Fund I Ltd P'ship v. PT Bakrie Investindo* [2011] EWHC 256 (Comm), [2011] 1 WLR 2038, at ¶¶ 29-32.
8 *See Global Distressed Alpha*, *supra* n.7.
9 [2018] EWHC 59 (Ch).
10 A stay that would remain in force even after the foreign proceedings come to an end.
11 CBIR is the U.K. version of the UNCITRAL Model Law on Cross-Border Insolvency (1997) and equivalent to chapter 15 of the U.S. Bankruptcy Code.
12 [2014] EWHC 2124.

remit or higher authority).[13] In the latter regard, he took note of the Supreme Court's approach to the English Courts' jurisdiction in such matters in *Rubin v. Eurofinance SA*.[14] The crux of the matter was that Mr. Justice Hildyard did not feel that he could displace the *Gibbs* Rule in favor of the principles of modified universalism as expressed in the English common law and transmitted through the Model Law, which is reflected in CBIR.

In contrast, it is probably fair to say that, in general terms, U.S. courts have been more prepared to embrace modified universalism as espoused in the Model Law than English courts.[15] The U.S. has had a long tradition of recognizing restructurings of foreign companies where the underpinning financial instruments are governed by U.S. law. This can be traced back as far as the Supreme Court's 1883 decision in the *Gebhard* case,[16] where Chief Justice Morrison Waite, while approving the recognition of a Canadian Scheme of Arrangement, said that "the true spirit of international comity requires that schemes of this character, legalized at home, should be recognised in other countries." This set forth a belief and acceptance that for restructurings and reorganizations to be effective, they have to have binding extraterritorial effect.

However, a recent case before in the Southern District of New York seemed to turn against the tide of U.S. thinking in these matters. In *In re SunEdison*,[17] Hon. **Stuart M. Bernstein** declined to grant comity to Korean insolvency law, instead citing the *Pan Ocean* case ratio, saying that "the parties selected New York Law to govern their contractual rights, and the application of Korean law ignores that choice and their presumed expectations."

The case concerned a chapter 15 application of a SunEdison joint-venture entity called SMP Ltd., which operated a plant in Korea. The joint-venture agreement between the parties contained an *ipso facto* clause entitling either party to terminate the agreement if the other filed for bankruptcy. The agreement was governed by New York law.

SunEdison and its affiliates filed for bankruptcy in New York, and SMP then filed a Korean rehabilitation proceeding. In the U.S. proceedings, the SunEdison group sold its assets, including its interest in the SMP joint venture, to a third party. SMP objected to the sale, but under a settlement agreement approved in the U.S. and Korea, SunEdison agreed to pay $5 million to SMP. The settlement agreement required SunEdison to give notice to SMP regarding the termination of the joint-venture agreement, but gave SMP a right to challenge the validity of the termination through arbitration or in the U.S. courts.

SMP chose to challenge the termination by commencing a chapter 15 proceeding and obtained recognition of the Korean rehabilitation proceeding, then sought an order declaring the *ipso facto* clause unenforceable as a matter of Korean law. SunEdison took the successful position that New York state law applied to the joint-venture agreement and *ipso facto* clauses are enforceable in the absence of fraud, collusion or overreaching.

While this is an interesting decision, it might not be more than a "fly in the ointment." It is undoubtedly a case in which, had SMP been a chapter 11 case, the Bankruptcy Code would have trumped New York state law and rendered the SunEdison *ipso facto* clause unenforceable. Furthermore, the decision could have been different had the Korean court declared the *ipso facto* clause unenforceable or if the effects of a different decision had not adversely impacted the SunEdison sale, which had already been completed.

What conclusions can be reached? The *Bank of Azerbaijan* case is in the process of being appealed, with the appeal apparently being heard sometime in October in the court of appeal. The general proposition is that the court of appeal is bound by its own decisions in civil cases, but there are exceptions. As the *Gibbs* Rule is a court of appeal decision, at its simplest the court of appeal in *Bank of Azerbaijan* should uphold it. Over the years, however, under various masters of the rolls, not the least of which was Lord Denning, the court of appeal has often found ways around established legal precedent. Whatever the outcome, it must be likely that the case will go forward to the Supreme Court.

We should perhaps not be too hasty to cast the *Gibbs* Rule into the dustbin of history. In an era that could be characterised by increased protectionism and nationalism ("America First" and "Brexit"), it will undoubtedly be of importance in order to ensure that financial instruments continue to be written under English law and New York state law if London and New York are to maintain their positions as the preeminent forums and jurisdictions for cross-border restructurings. Maintaining the territorialist proposition that only the countries of origin can discharge debts could turn out to be an important focus for professionals on both sides of the pond.

The other side of that coin is the prospective effect on English schemes of arrangement that depend on being enforced in other jurisdictions and that continue to enjoy the blessing of U.S. courts, even where they contain nondebtor releases that would not necessarily pass muster in domestic chapter 11 proceedings.[18] Modified universalism still seems to be where "it's at," in that there does not appear to be any viable new or revolutionary thinking to usurp it. There have been articles written about the deficiencies seen in the Model Law and its overly ecumenical approach to recognition, which pumps air into the fire of territorialism.

If we are truly to embrace modified universalism on the widest possible basis, we are going to need harder forms of law backed by political consensus, together with internationally agreed-upon choice-of-law principles along the lines of what is currently in place in the European Union. Moving away from automatic recognition will undoubtedly give the judges more comfort, but there has to be concerted political enthusiasm. It cannot be left to the law and the professionals who work in the sector. abi

13 The *Gibbs* case was decided in the court of appeal, therefore Mr. Justice Hildyard, sitting in the High Court, was bound by its terms.

14 [2013] AC 236.

15 *See* Adrian Walters, "Modified Universalisms and The Role of Local Legal Culture in the Making of Cross-Border Insolvency Law," *Am. Bankr. L.J.* (forthcoming), *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=3084117 (current draft); Adrian Walters and Ian Williams, "The Model Law Is Dead? Long Live the Model Law!," *R3 Recovery Magazine*, Spring 2014.

16 *Canada Southern Railway Co v. Gebhard*, 109 U.S. 527 (1883).

17 577 B.R. 120 (Bankr. S.D.N.Y. 2017).

18 *In re Avanti Commc'ns Grp. plc*, 582 B.R. 603, 605 (Bankr. S.D.N.Y. 2018) ("Recognition and enforcement of schemes of arrangement sanctioned by the U.K. courts has become commonplace in chapter 15 cases.").