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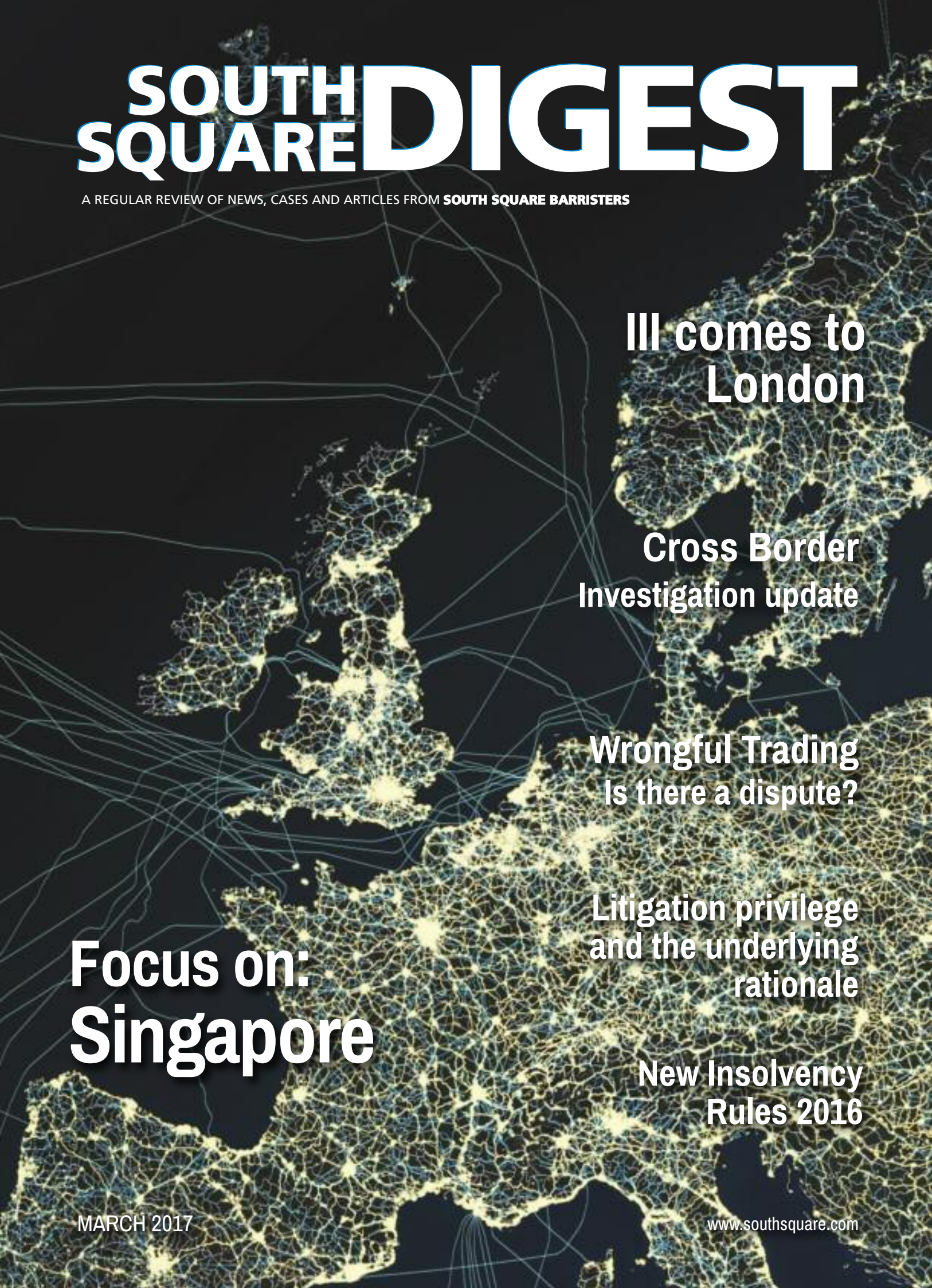

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Shopping and scheming and the rule in Gibbs

In the aftermath of the Singapore High Court's judgment in *Pacific Andes Resources Development Ltd*, **Riz Mokal** discusses the deficiencies of the 'rule in *Gibbs*'.

The Singapore High Court's decision in *Pacific Andes Resources Development Ltd [2016] SGHC 210* ('*Pacific Andes*') provides the opportunity to examine the origin, rationale, limits, and defensibility of the so-called 'rule in *Gibbs*', named after though considerably pre-dating the judgment of the Court of Appeal of England and Wales in *Gibbs v Societe Industrielle* (1890) 25 QBD 399 ('*Gibbs*'). The focus is exclusively on the rule's application to the indebtedness of distressed debtors, that is to say, those who are actually or imminently insolvent. A principled way is proposed of distinguishing objectionable from legitimate forum shopping, and the application of the rule in the context of schemes of arrangement receives particular attention.

The rule in *Gibbs*

Pursuant to what law may debts be discharged? The obvious answer is the proper law of the debt. As far back as 1726, in *Burrows v Jemino* 93 ER 815, King LC accepted that a plaintiff discharged by a Leghorn court from liability under a bill of exchange drawn in Leghorn could not be sued in England. Lord Mansfield in *Ballantine v Golding* (1784) Cooke's Bkpt Laws 8th ed 487 extended the same rule to bankruptcy: no action lay in English courts on an Irish law-governed debt discharged in Irish proceedings. The rationale, expounded by Lord Esher MR in *Gibbs*, at p. 405, rests in the assumption that the parties have agreed to the application to the debt of all elements of the debt's proper law, including that governing discharge. This reasoning ('the reasoning in *Gibbs*'), already artificial in relation to contractual debts, would be stretched to breaking point if applied to the discharge of tortious and other non-voluntary liabilities (see e.g. *Phillips v Eyre* (1870) LR 6 QB 1, 28, and compare Pt III of the Private International Law (Miscellaneous Provisions) Act 1995, and the 'Rome II' Regulation No. 864/2007).

What about a debtor bankrupted and discharged in her place of domicile or another jurisdiction with which she has a close and established connexion? The matter came to a head in November 1800 in *Smith v Buchanan* 102 ER 3. The defendants had previously petitioned for their own bankruptcy under the insolvency statute of the State of Maryland, where they lived; had duly executed a deed in favour of their trustee in bankruptcy; and had delivered up their assets to him. In return, the Maryland court had discharged them of their indebtedness. They were subsequently sued in England for payment under an English law-governed contract for goods sold and delivered. The defendants' counsel argued forcefully that just as the English court would recognise the statute's effect in divesting the defendants of what used to be their property, so it should take cognisance of the discharge, "*the benefit of the condition on which [their property] was so divested*". Lord Kenyon CJ rejected the argument on the basis that "*a contract made in one country [cannot] be*

THE SINGAPORE HIGH COURT IN *PACIFIC ANDES* SHOWS THE WAY, AWAY FROM THE RULE IN *GIBBS* AND TOWARD A MORE UNIVERSALIST APPROACH

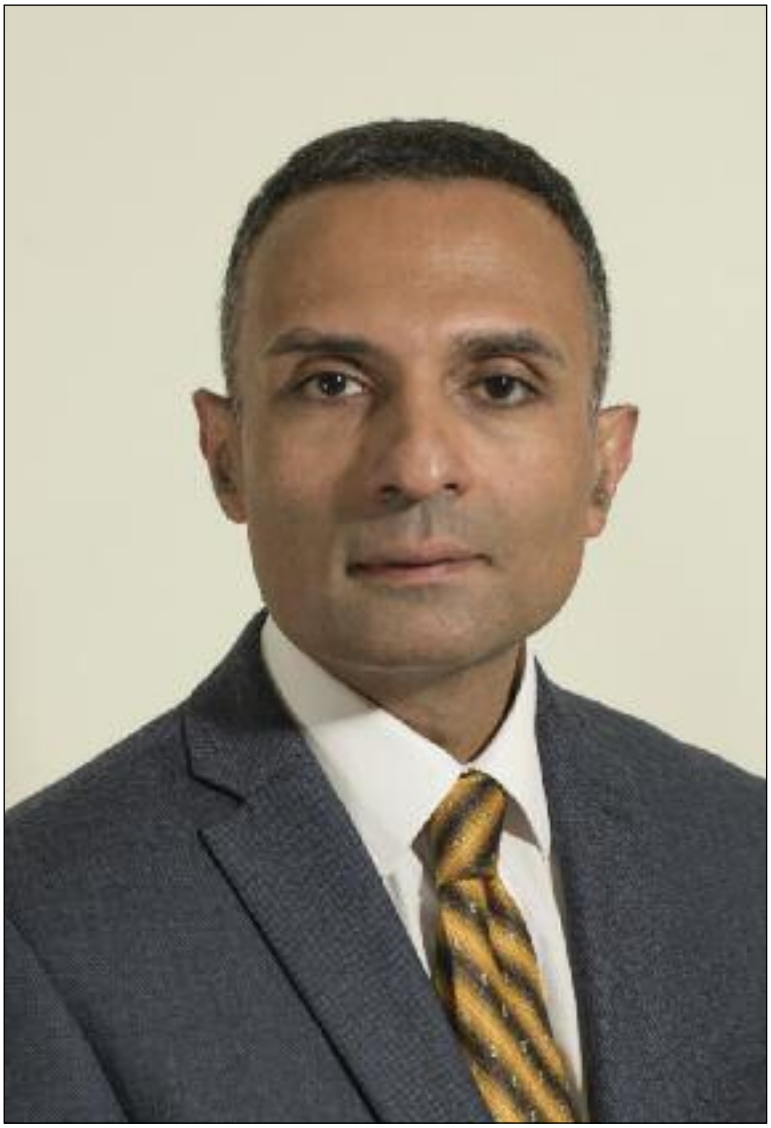
governed by the laws of another." That the English court would recognise the trustee's title to the defendants' former assets he explained on the basis that "*the right to personal property must be governed by the laws of that country where the owner is domiciled.*"

Leaps of logic over gaps in reasoning

There are at least four problems here. The first is the rational gap between the proposition that a debt may be discharged under its proper law, and the different proposition enshrined in the rule in *Gibbs*, that the debt may *only* be discharged under that law. The first rule is potentially inclusive, whereas the second is clearly exclusive. The reasoning in *Gibbs* does not justify the rule in *Gibbs*. It explains at most that some farsighted parties might reason to the conclusion that the debt's proper law would govern not merely its construction but also potentially its discharge. It does not justify restricting discharge solely to that one situation. (The difference is analogous, respectively, to that between a non-exclusive and an exclusive choice of forum.) After all, *thoughtful* farsighted parties might recognise other, potentially competing, bases for the discharge of their claims, such as the importance cost-effectively of protecting the debtor from creditor harassment and, in appropriate circumstances, of affording the debtor a chance at rehabilitation that might benefit all its stakeholders as a group.

Second and in any case, there is the substantive unfairness highlighted by the defendants' counsel in *Smith v Buchanan*. English law recognises the effect of the debtor's divestment under foreign bankruptcy proceedings while still holding her to the obligations acquittal from which was an intended consequence of that divestment, and fulfilment of which that divestment might decisively have rendered impossible.

Thirdly and relatedly is the double standard of denying to those claiming the benefit of a foreign law discharge precisely what English law confers on those able to



RIZ MOKAL

invoke its protection: "*A foreign certificate*" of discharge, states Pollock CB in *Armani v Castrique* (1844) 153 ER 185, 186, "*is no answer to a demand in our Courts; but an English certificate is surely a discharge as against all the world in the English Courts. The goods of the bankrupt all over the world are vested in the assignees; and it would be a manifest injustice to take the property of a bankrupt in a foreign country, and then to allow a foreign creditor to come and sue him here.*" The same injustice, needless to say, is manifest regardless of the nationality of an otherwise competent court ordering the bankrupt's divestment. Relatedly, there is the awkwardness of expecting recognition of English law discharges of foreign law obligations in other jurisdictions, in such cases as *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch) and *In Re Magyar Telecom BV*, Case No 13-13508 (SHL) (Bankr. S.D.N.Y. Dec. 11, 2013), while refusing that courtesy to discharges issued in those same jurisdictions.

What if the English position is not hypocritical? Just as English courts recognise the universal effect of an English discharge, it may be said, they would recognise the universal effect *from the perspective of a foreign court* of discharge under that court's law.

Even assuming the meaningfulness of this exotic scenario, we are confronted with the fourth problem. A debtor with obligations governed by the laws of more than one jurisdiction may need either to incur the expense and delay of obtaining a discharge separately in each of those jurisdictions, or else remain at the mercy of some of its creditors. This problem, though not new, is particularly acute in insolvency systems committed to affording distressed but viable debtors with the chance of trading out of their difficulties. Such rehabilitation might depend on an effective restructuring of debts governed by multiple laws, and might be sunk by the additional financial and time costs of multiple proceedings in several jurisdictions. This could be harmful not merely to the debtor, its employees and equity holders, but also to its creditors, who as a group could lose the benefit of an ongoing relationship with a rehabilitated counterpart.

Pacific Andes

This provides the context for examining the Singapore High Court's decision in *Pacific Andes*. Four members of the Pacific Andes corporate group ('the Applicants') applied pursuant to section 210(10) of the Singapore Companies Act for moratoria on any action or proceeding against any of them. Section 210 governs schemes of arrangement similar to those under the UK counterpart statute though with the added benefit of a discretionary moratorium. Each of the Applicants was incorporated outside Singapore and, at the relevant time, several were subject to foreign insolvency proceedings. The great majority of the debt of one Applicant was denominated in Singapore dollars and raised and traded on

the Singapore Exchange. This debt was, however, governed by English law, the rest of the relevant debts were subject to Hong Kong law, and none fell under Singapore law.

Unsurprisingly, the rule in *Gibbs* formed one of the bases on which the Bank of America, a lender to some of the Applicants, opposed the application. It also submitted that the Singapore court ought in any case not to sanction a scheme since Hong Kong courts, which also apply the rule (see *Hong Kong Institute of Education v Aoki* [2004] 2 HKLRD 760), would not recognise or give effect to it.

Judicial Commissioner Kannan Ramesh of the Singapore High Court was not persuaded. He adverted to the scholarly criticism to which the rule in *Gibbs* has been subject. Two of Ramesh JC's sources constitute indispensable reading on the topic. (Writing extra-judicially Ramesh JC himself has subsequently made an important contribution: 'The *Gibbs* principle: A tether on the feet of good forum shopping', *Singapore Academy of Law Journal* (forthcoming).)

The first, which received a detailed citation, is Look Chan Ho's *Cross-Border Insolvency: Principles and Practice* (Sweet & Maxwell, 2016), paras 4-096 to 4-107. Ho notes that while the rule in *Gibbs* regards bankruptcy discharge exclusively as a contractual matter, this jars with the nature of bankruptcy itself as a forum for the resolution of inter-creditor matters, not merely or even primarily creditor/debtor ones. Creditors do not characteristically have contractual relations inter se, which renders contractual analysis inapposite. Further and in any case, the reasoning in *Gibbs* attributes to parties a partial or even mistaken understanding of the law of applicable law. They are regarded as expecting the extrapolation into insolvency proceedings of the proper law of their claims, yet it is the law of the debtor's centre of main interest ('COMI') that may govern discharge under the European Union's Regulation on Insolvency Proceedings ('the Insolvency Regulation'). Ho also points out that the rule in *Gibbs* has an affinity with 'territoriality', that is, with the view that the law of a particular jurisdiction governs those

The legal corpus has outgrown the Gibbs rule limb

elements of an insolvency which have the requisite connexion with that jurisdiction, and which ought to be addressed in proceedings opened in that jurisdiction's courts. This is to contrasted with universalism, which supports universal recognition and effect for one proceeding in relation to a debtor, usually that opened in its COMI. Not only is English law committed, for the moment, to the universalist Insolvency Regulation, it has also incorporated the even more universalist Model Law on Cross-Border Insolvency ('the Model Law') promulgated by the United Nations Commission on International Trade Law. The legal corpus has outgrown the *Gibbs* rule limb.

Ramesh JC's second scholarly source is Professor Ian Fletcher's *Insolvency in Private International Law* (Oxford University Press, 2nd ed, 2005), paras 2.127 and 2.129. After subjecting the rule in *Gibbs* to penetrating criticism, Professor Fletcher proposes the development of an additional rule by which parties to a contractual relationship governed by the law of a jurisdiction adhering to the rule and reasoning in *Gibbs* would be attributed with the expectation that their claims might be discharged in proceedings in a jurisdiction with which the debtor has an established connexion of residence or business ties.

This proposal commended itself to Ramesh JC, who also noted that the English High Court in *Global Distressed Alpha Fund I Ltd v PT Bakrie Investindo* [2011] 1 WLR 2038, [14], while upholding the rule in *Gibbs*, did so only reluctantly and because constrained by precedent. Not being so constrained, Ramesh JC was minded to accept Professor Fletcher's proposal. He also took the view that if the Applicants were content to seek to restructure their liabilities in Singapore notwithstanding doubts about efficacy in Hong Kong courts, the Singapore court should feel free to assume jurisdiction so long as it has subject matter jurisdiction and sufficient nexus to justify its exercise.

Forum shopping is objectionable if it represents an attempt by some stakeholder constituencies to secure sectional benefits, when this is to the detriment or at the expense of others with accrued claims available in the exisiting forum but lost or diminished in the one being shopped for

Forum shopping

In another interesting element of his judgment, Ramesh JC noted that the rule in *Gibbs* could prove an impediment to "*good forum shopping*". He cited from *Re Codere* [2015] EWHC 3778 (Ch), [17]-[18], where the English High Court mentioned several recent attempts, all successful, to bring a company under the English court's scheme jurisdiction. These included COMI shifts on the eve of the application to convene a meeting (*Re Indah Kiat International Finance Company BV* [2016] EWHC 246); changes in the governing law of the debt to be schemed (*Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch)); and the creation of new entities and voluntary assumption of new liabilities governed by English law (*Re AI Scheme Limited* [2015] EWHC 1233 (Ch); *Re Codere* itself). In each of these cases, the attempt to shop for the English forum was "*not in order to evade debts but rather with a view to achieving the best possible outcome for creditors*" (ibid). The supplemented rule in *Gibbs* would, opined Ramesh JC, form part of and complement this global move toward value-enhancing insolvency processes.

I respectfully agree, and would venture the following principled understanding of objectionable and legitimate forum shopping.

Steps taken to facilitate the assumption of jurisdiction by a court are *objectionable* if intended or reasonably likely to secure sectional benefits to one or more stakeholder constituencies (say, the debtor's directors and shareholders) but to the detriment or at the expense of one or more categories of claimant (say, trade creditors, employees, or tax authorities) with accrued claims against the debtor that are available in the existing forum but would be lost or diminished in the forum being shopped for.

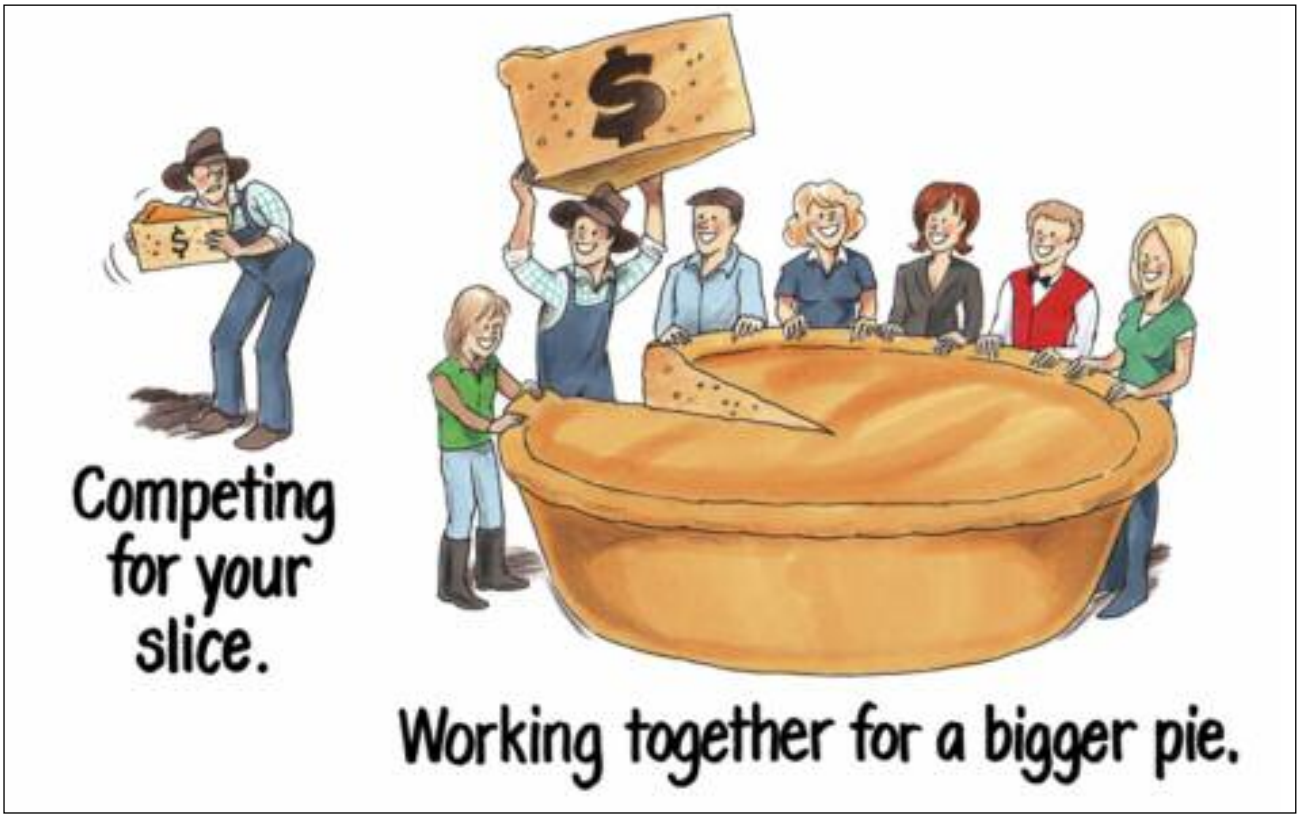
By contrast, forum shopping is *legitimate* if intended or reasonably likely to maximise the value available for the benefit of all relevant claimants considered together without resulting in prejudice to any class of accrued claim holders. Value might be maximised because of enhanced prospects for the restructuring of the debtor's liabilities and/or operations and thus its survival, or for a going concern sale of its business.

Distress, insolvency proceedings, and schemes of arrangement – Developing the law

The critique of the rule in *Gibbs* outlined above has no application to the restructuring of the liabilities of a solvent debtor. Crucially, however, the critique is not limited to the indebtedness of debtors who are in insolvency *proceedings*. What matters is whether the debtor is factually distressed in the sense defined in the Introduction. With this in mind, the following five scenarios are worth considering. The intention is to explore development of the law that is sound in principle and that advances fundamental policy objectives.

First, where the debtor is subject to insolvency proceedings in its COMI and a scheme of arrangement is proposed under the COMI court's jurisdiction, or where the scheme process itself is classified as an insolvency proceeding, the foregoing analysis applies seamlessly. Discharge and *a fortiori* variation of debt by order of the COMI court should be accepted as valid and effective by other courts worldwide.

Second, the debtor is not yet in insolvency proceedings, is unfortunate enough for its COMI to be located in a jurisdiction whose laws and/or practices would not permit value preservation, but is fortunate enough to have the resources to engineer a COMI shift. Its decision makers may legitimately facilitate assumption of jurisdiction by a court under whose insolvency law the debtor's distress could best be addressed. That court should accept jurisdiction so long as it has subject matter jurisdiction and there (now) exists a sufficient connexion between it and the debtor. Again, discharge and variation by order of such court should in principle enjoy



LEGITIMATE FORUM SHOPPING BAKES EVERYONE A BIGGER PIE, WHEREAS OBJECTIONABLE FORUM SHOPPING INVOLVES SNATCHING ANOTHER'S SLICE OF THE SAME SMALL PIE.

worldwide validity and effect.

Third, no insolvency proceedings are open in relation to the distressed debtor, none is intended, the insolvency law(s) applicable to the debtor permit(s) this, and a self-standing scheme is proposed in the debtor's COMI. That the debtor's decision-makers do not wish to open insolvency proceedings could be for any of several legitimate reasons. Paradigmatically, the decision makers might wish to avoid subjecting the debtor to the 'stigma of insolvency', that is to say, adverse responses from counterparties such as suppliers refusing discounts, buyers discounting warranties and therefore reducing what they were willing to pay, the exodus of key employees, and also adverse entries on credit history records that would make it costlier and more difficult to raise credit. Notwithstanding the absence of insolvency proceedings, it would seem appropriate for the court to consider and sanction a suitable scheme, and for courts elsewhere to recognise and give effect to this scheme. This would, by hypothesis, be in the interests of the stakeholders as a group.

Fourth, no insolvency proceedings are intended but the COMI is located in a jurisdiction lacking an efficient scheme process. Here, it may be appropriate for a different court with subject matter jurisdiction and a close and stable connexion with the debtor to permit and oversee the scheme process even in the absence of a COMI shift, and also appropriate for a resulting scheme to be accorded worldwide effectiveness.

Fifth and finally, two courts in different jurisdictions sanction mutually inconsistent schemes, and a third court is required to decide whether to give effect to either of them. In this improbable scenario, the court should make that choice by reference, first, to standard law of applicable law principles, and subject to that, to the principles of legitimate and objectionable forum shopping, so as to identify which sanctioning court had been better placed to have notified and convened creditors, ensured a fair process, and sanctioned a value-maximising scheme.

** I am deeply grateful to Look Chan Ho, Professor Irit Mevorach, Judicial Commissioner Kannan Ramesh, and Antony Zacaroli QC for discussion, comments, and advice. The views expressed here, the mistaken ones in particular, are mine alone.*

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3-4 South Square | Gray’s Inn | London WC1R 5HP | UK
Tel. +44 (0)20 7696 9900. Fax +44 (0)20 7696 9911. LDE 338 Chancery Lane. Email practicemanagers@southsquare.com.
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