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Protection of dissenting creditors' interests: Direct application of the "substantive fairness" test while considering the recognition of foreign restructuring plans

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INTRODUCTION

The protection of the dissenting creditors'[1] interests is one of the core issues to be considered in recognition of the local debt discharge under foreign restructuring plans. Despite the implementation of the UNCITRAL Model Law on Cross Border Insolvency (1997) (MLCBI) and the existence of analogous statutory texts in both jurisdictions[2], the English and the U.S. courts follow different approaches while dealing with the said issue[3]. The recent restructuring case of OJSC International Bank of Azerbaijan (IBA) is a clear example in this regard: the English and the U.S. courts reached contradictory outcomes in respect to the similar orders sought by the IBA. This Paper will therefore start with the summary of the IBA restructuring case which will lead to the brief discussion of the respective English and the U.S. law approaches. Following the consideration of the pros and cons of both, the possibility of the application of an alternative rule will be examined: namely, the direct application of the substantive fairness test while considering the recognition of the foreign restructuring plans. The Paper will particularly focus on the legal-normative bases for such direct application under international texts and case law on cross-border insolvency law, which will be followed by the proposal in respect to the essence of the test.

I. IBA case

A. Azeri proceedings

The IBA launched the restructuring proceedings in 2017 to address the financial difficulties arisen from mismanagement and devaluation of local currency.[4] The main features of the restructuring proceedings in Azerbaijan (Azeri proceedings) are briefly summarized below[5]:

- The plan (Plan) put forward by IBA contemplates the restructuring of the IBA's financial indebtedness amounting to some US$3.34bn ("the Designated Financial Indebtedness").

- According to the Plan, the Designated Financial Indebtedness is classified in three main categories: "Trade Finance Liabilities", "Senior Liabilities" and "Subordinated Liabilities". The Plan provides for the Designated Financial Indebtedness to be discharged in its entirety and exchanged for various "Entitlements".

- These Entitlements consist predominantly of new debt securities (sovereign bonds issued by the Government of Azerbaijan or corporate bonds issued by IBA itself). Liabilities falling into each category of the Designated Financial Indebtedness are treated more favourably than liabilities of the inferior category in the order set above.

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[1] For the purposes of this Paper the "dissenting creditor" means a creditor who voted against or did not vote for the plan in question.
[2] the Cross Border *Insolvency* Regulations 2006 (CBIR) and the Chapter 15 of the U.S. Bankruptcy Code (Title 11) (Chapter 15) respectively.
[3] see below Parts I and II
[4] https://abb-bank.az/en/maliyye-ve-investisiya/diger-melumatlar/press-relizler/londonda-azerbaycan-beynelxalq-bankinin-xarici-kreditorlari-ile-gorus-kecirilib
[5] see the reserved judgement of Mr. Justice Hildyard J in *Bakhshiyeva v Sberbank of Russia & Ors* [2018] EWHC 59 (Ch) (18 January 2018) at 30-42 for more detailed summary of the undisputed facts of the case.

- The Plan was approved by 99.7% of those voting at the meeting, who held, in aggregate 93.9% (by value) of the total Designated Financial Indebtedness and confirmed by the Azeri Court.

- Following the approval of the Plan, a number of the dissenting creditors decided to consent to the Plan and surrender their existing claims.

B. Azeri law

The Azeri proceedings have been mainly governed by the then-recently added chapter to the Law of the Republic of Azerbaijan on Banks[6] and the Civil-Procedural Code of the Azerbaijan Republic[7]. Under the applicable Azeri law:

- A restructuring proceeding of a bank aims to provide the financially distressed bank in question with breathing space (thus, to avoid its liquidation) and the bank in question will continue to carry on its usual business during the restructuring proceeding under supervision of the financial market supervisory authority and a local court [8]. A voluntary restructuring can, therefore, be classified as a debtor-in-possession procedure[9].

- A debtor bank can restructure all or some of its liabilities, except insured deposits and is given wide powers to select which liabilities to be restructured[10]. The law sets no criteria to that end.

- The restructuring proposal shall be initially approved by the financial market supervisory authority and advertised in local media and on the website of the bank[11].

- The proposed plan must be approved by the requisite majority (two-thirds of the affected creditors by value) and confirmed by a local court. Once all these requirements have been fulfilled, the plan will be binding on all affected creditors, including the dissenting creditors[12].

- A substantive test, as to determine whether the dissenting creditors have been fairly treated under the plan, does not exist. The affected creditors, whether foreign or domestic, dissenting or non-dissenting, however, enjoy general rights, mostly procedural in nature, inter alia, to be notified of the terms of the proposed plan, the date of the meeting of creditors and a court hearing, to submit their objections and own proposals, to participate and vote at the meeting of creditors, object to the confirmation of the plan by court, to appeal the court judgement confirming the plan and, subject to certain limitations, to lodge the second appeal to the Supreme Court in case the first appeal is unsuccessful[13].

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[6] Law of the Republic of Azerbaijan on Banks dated 16.01.2004 (No: 590-IIQ)
[7] Civil-Procedural Code of the Republic of Azerbaijan (entered into force on 01.09.2000)
[8] *Bakhshiyeva* (n 5) at 28 citing the undisputed expert evidence of Mr Anar Karimov on Azeri law
[9] ibid
[10] the Law on Banks (n 6), Articles 57-11.1, 57-11.4 and 57-11.15.2
[11] ibid Articles 57-11.4-5, 57-11.7 and 57-11.9-10
[12] See above n 8
[13] the Law on Banks (n 6) Articles 57.11.7, 57.11.10-11 and Civil -Procedural Code (n 7) Articles 46, 47, 355-18.3-4, 357.1, 403.1

C. Recognition proceedings: Great Britain vs. the U.S.

The IBA restructuring proceeding has been recognized as a foreign main proceeding both in Great Britain[14] and the U.S.[15] under the CBIR and Chapter 15 respectively. The IBA then sought an order of indefinite stay (moratorium) in both jurisdictions to prevent the dissenting creditors from enforcing their claims against IBA.

The Court of Appeal (England and Wales) did not grant the sought relief [16]. The court referred to "the rule in Antony Gibbs" (Gibbs rule) articulated by Lord Esher MR in *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* which aims to protect English-law creditors from the adverse effects of foreign insolvency proceedings and clearly stipulates that a contract can only be discharged under a proper law governing this contract[17][18]. The Court of Appeal has concluded that the indefinite stay (moratorium) sought by the IBA under Article 21 of the CBIR would in substance indefinitely prevent English creditors from enforcing their English law rights, effectively meaning the discharge of the said rights and highlighted the possibility of the promulgation of analogous proceeding under English law (e.g. English scheme of arrangements) by the IBA which the latter had chosen not to do[19].

Judge James L Garrity Jr in the US Bankruptcy Court for the Southern District of New York, on the contrary, granted the analogous relief sought by the IBA and overruled any objections thereto[20]

II. Gibbs rule criticism: the idea behind is worth to 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 single set of insolvency proceedings with worldwide effect,[21] and shall be disregarded or at least reformulated. Professor Ian Fletcher highlights the paradox that English law does not recognize the foreign bankruptcy discharge while expecting the English bankruptcy discharge having universal effect[22]. Look Chan Ho argues that the Gibbs rule is no longer good law in England and Wales and the rule and the CBIR are mutually exclusive.[23] He further argues that the traditional common law rule that "an obligation can only be discharged by its proper law" with reference to which English courts refuse to recognize foreign insolvency discharge of English law governed debts should now be disregarded.[24] In his article dedicated to the harsh criticism of the Gibbs rule, Singaporean judge Kannan Ramesh specifically analyses and disapproves the characterisation of debt discharge under compositions (i.e. scheme of arrangements) as a matter of contract law

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[14] *In the matter of OJSC International Bank of Azerbaijan* [2017] EWHC 2075 Ch) (06 June 2017)
[15] *In re International Bank of Azerbaijan* 17-11311 jlg, 07.07.2017
[16] *Bakhshiyeva (Foreign Representative of the Ojsc International Bank of Azerbaijan) v Sberbank of Russia & Ors* [2018] EWCA Civ 2802 (18 December 2018).
[17] *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399.
[18] The rule does not apply in case 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 16)* at 28
[19] *Bakshiyeva (n 16)* at 9 and 88
[20] In re International Bank of Azerbaijan, 17-11311 jlg, 23.01.2018
[21] Reinhard Bork, Principles of Cross-Border Insolvency Law, (Intersentia. 2017), 28 (para. 2.11)
[22] Ian Fletcher, The Law of Insolvency, Fifth edition, 2017, 922 (para. 29-063)
[23] Look Chan Ho, Cross-Border Insolvency: Principles and Practice (Sweet & Maxwell, London, 2016), 169 (para. 4-028)
[24] ibid 215 (para. 4-094)

rather than insolvency law.[25] In *Agrokor,* US bankruptcy judge Marten Glenn also criticizes the rule by describing its essence as territorialism[26]

This Paper agrees with the aforementioned arguments in part that the manner of the implementation of the rule is inconsistent with the modern developments in cross-border insolvency law. The rule effectively requires the debtor to initiate a parallel proceeding under proper law of the debt contract in question. The issue becomes more problematic, in case where the debt contracts affected by a restructuring plan are governed with various foreign laws (e.g. English law, U.S. law and German law). If all the mentioned jurisdictions adopted the similar approach, the debtor would be required to initiate three parallel proceedings in England, the U.S. and Germany respectively. In case where the plan confirmed by a court of the state where the debtor has the centre of its main interests (COMI) does not treat the creditors less favourably than the respective three jurisdictions 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. This Paper argues that the answer to this question is not affirmative, as the creditors' reasonable reliance on the minimum guarantees provided for by the law governing the debt contract cannot be completely ignored. The problem lays not in the idea behind, rather in the manner of implementation. While departing from the Gibbs rule, its right idea to protect creditors from unfair treatment by foreign insolvency proceedings should not be completely abandoned. The U.S. approach based on the satisfaction of the minimal level of fairness, namely procedural fairness[27], cannot be accepted as an ideal solution to that end. The U.S. courts generally extend comity in recognition of foreign proceedings and/or granting the respective additional reliefs 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, as summarized in *In re PT Bakrie Telecom Tbk* : "In sum, federal courts assessing whether to extend comity look to (1) whether the foreign proceeding abided by fundamental standards of procedural fairness; (2) whether the foreign proceeding violated the laws or public policy of the United States; and (3) whether the foreign judgment was affected by fraud."[28]

Of course, this is the first step to consider in granting comity but should not be the last. More precisely, the fact that creditors have been subject to fair treatment in the foreign debt-restructuring proceeding in the procedural context and due process has been followed does and should not automatically lead to the conclusion that the creditors have been subject to fair treatment in a wider sense, which also includes the substantive fairness. Otherwise, the rights of the creditors granted by the law of the contract could be easily circumvented, which could lead to the abuse of rights.

Professor Stephan Madaus makes clear distinction between insolvency and restructuring proceedings (e.g. irrelevance of the so-called "common pool" problem in case of restructuring which lays in the core of insolvency) and highlights contract law underpinning of the latter[29], which is also relevant to the issue of recognition of the debt discharge under foreign restructuring plans. Accordingly, the law governing the contract shall be taken into

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[25] Kannan Rammesh, The Gibbs principle. A tether on the feet of good forum shopping, (29 SAcLJ 42, 2017).
[26] In re Agrokor d.d., 591 B.R. 163 (Bankr. S.D.N.Y. 2018).
[27] "Procedural fairness", "public policy" and "fraud" safeguards are outside the scope of this Paper.
[28] *In re PT Bakrie Telecom Tbk*, 628 B.R. 859, 878 (Bankr. S.D.N.Y. 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 (E.D.N.Y. 2011)
[29] Stephan Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law (Eur Bus Org Law Rev 19, 615–647, 2018).

account in considering whether the local creditors have received fair treatment in the foreign restructuring proceeding. The problem deserves much more attention particularly in cases where well-established substantive tests[30] dealing with the rights of the individual dissenting creditors do not exist under the law of the state where the debtor has its COMI.

III. Alternative approach

In view of the foregoing, there is a need to find an alternative approach. The new approach sought should avoid parallel proceedings in various jurisdictions and take into account the interests of the affected creditors from both procedural and substantive point of view. This part of the Paper will examine the possibility of the direct application of the substantive fairness test in foreign plan recognition proceedings (thus, eliminating the need for parallel proceedings), to determine whether the dissenting creditor has been fairly treated under the foreign restructuring plan. Before examining the essence of the test in question, the Paper will first look into legal-normative bases under international texts and case law on cross-border insolvency for such direct application. Article 22 (1) of the MLCBI and Article 14 (f) of the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgements (2018) (MLREIRJ) are of particular importance in that regard.

The language of both articles highlights the need to consider whether the interests of the affected creditors have been adequately protected in granting reliefs under Articles 19 and 21 of the MLCBI or in recognition and enforcement of an insolvency-related judgment under MLREIRJ respectively. The language of Article 14 (f) of the MLREIRJ is particularly significant, as it specifically highlights the confirmation of a plan of reorganization and discharge of debts. This "adequate protection of the interests" safeguard stipulated in both Model Laws offers an additional (and broad) layer of substantive protection for the affected creditors besides the "procedural fairness", "public policy" and "fraud" safeguards[31].

Despite having refused to extend comity while considering recognition and enforcement of foreign restructuring plans and foreign discharge of debts only in a limited number of cases[32], bankruptcy courts in the U.S. acknowledge the broad discretion given to them under section 1522 of the U.S Bankruptcy Code[33]: "This section is based on Model Law article 22, and gives the bankruptcy court "broad latitude to mold relief to meet specific circumstances.""[34]; "Considered together, §§ 1521 and 1522 give "the court ... ample tools for dealing with the manner in which a chapter 15 case is administered.""[35]; "the analysis required by § 1522(a) is therefore logically best done by balancing the respective interests based on the relative harms and benefits in light of the circumstances presented, thus inherently calling for application of a balancing test.[36]

The U.S. courts define "sufficient protection"[37] as embodying three basic principles: "the just treatment of all holders of claims against the bankruptcy estate, the protection of U.S. claimants against prejudice and inconvenience in the processing of claims in the [foreign] proceeding, and the distribution of proceeds of the [foreign] estate substantially in accordance with the order prescribed by U.S. law."[38]. The third principle mentioned is to be

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[30] See below n 41 and n 42 as example
[31] As these three issues are expressly or impliedly dealt by other provisions of both Model Laws. (e.g. Articles 7 and 14 (b) of MLREIRJ)
[32] *In re PT Bakrie Telecom Tbk (n* 28) and *Ad Hoc Group of Vitro Noteholders v. Vitro S.A.B. de C.V.*, 701 F.3d 1031 (5th Cir. 2012)
[33] Chapter 15 equivalent of the Article 22 of the MLCBI
[34] *In re Intl. Banking Corp. B.S.C.*, 439 B.R. 614, 626–27 (Bankr. S.D.N.Y. 2010) (citing Tri-Cont'l Exch., 349 B.R. at 636-37)
[35] *In re Atlas Shipping A/S*, 404 B.R. 726, 740 (Bankr. S.D.N.Y. 2009) (citing Tri-Cont'l Exch., 349 B.R. at 638)
[36] *Jaffé v. Samsung Elecs. Co.*, 737 F.3d 14, 27-28 (4th Cir. 2013)
[37] § 1522 uses the term "sufficiently protected" instead of the term "adequately protected" under Article 22 of the MLCBI
[38] *In re PT Bakrie Telecom Tbk (n* 28) *at* 876 (citing *In re Atlas Shipping A/S* , 404 B.R. 726, 740 (Bankr. S.D.N.Y. 2009), *In re Artimm, S.r.L.* , 335 B.R. 149, 160 (Bankr. C.D. Cal. 2005).

delved into: It does not deal with mere procedural matters, but rather empowers the U.S. courts to take into account the respective substantive provisions of U.S. law.

To sum up, there are enough grounds under the existing international texts and case law on cross-border insolvency to apply the substantive fairness test directly in proceedings for the recognition of a debt restructuring. It is also important to mention that such direct application is only operative where the individual dissenting creditor opposes the recognition of the foreign restructuring plan and burden of proof of unfair treatment lies on the latter.

As to the essence of the said test, the MLCBI does not contemplate any substantive test to assess whether the foreign restructuring plan has fairly treated the opposing dissenting creditor, as the MLCBI does not attempt a substantive unification of insolvency law[39]. The existence of universal test in this context would be an ideal solution, but there is a long way to go for it. In the meantime, a viable solution could be to apply the respective tests applicable under the law governing the contract, taking into account the contract law underpinning of the restructuring law.[40] Numerous tests have been developed in various jurisdictions to assess whether the plan has fairly treated the opposing individual creditor in domestic restructuring proceedings (e.g. "best interest test" under Chapter 11 plan confirmation[41], "unfair prejudice" challenge under English CVA[42] and etc). Summarizing, this Paper proposes a two-tier test ("substantive fairness test')[43]. As the first tier it should be assessed how differently would the opposing creditor have been treated in the analogous proceedings under the law of the contract by applying the respective test thereunder. Unfair treatment can be affirmed in case where the result of such assessment indicates that the foreign restructuring plan has had material adverse effect on the entitlements that the opposing creditor would have received had the plan been confirmed under the law of the contract. Having said that, it is also worth to mention that the foreign law governing the restructuring need not to be identical to that governing the contract. Only the material adverse effect should be taken into consideration, and it is up to the court to decide on what constitutes "material adverse effect".

The second tier comes into operation, only if the fact of such unfair treatment is established. This tier comprises (i) the examination of the foreign law governing the plan to establish whether the effective safeguards exist to remedy such unfair treatment and (ii) if yes, the assessment whether the opposing creditor has exhausted all the remedies available under foreign law. In opposite to the English law approach deterring local creditors from submitting to a foreign jurisdiction in order not to lose protection of the Gibbs rule[44], this approach requires first to exhaust all the remedies available under foreign law governing the restructuring proceedings. In other words, a wrong that can be righted in the foreign proceeding should be righted in the foreign proceeding.

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[39] Guide to Enactment and Interpretation of the MLCBI, I.A.3
[40] See Madaus (n 29)
[41] Rodrigo Olivares-Caminal and others, Debt Restructuring (2nd Edition, Oxford University Press, 2016), 169-170 (para. 3.110-3.111)
[42] ibid 220-2244 (para 3.257-3.276), citing S. 6 of the Insolvency Act 1986 and *Prudential Assurance Company Ltd & Ors v PRG Powerhouse Ltd. & Ors* [2007] EWHC 1002 (Ch) (01 May 2007) and other cases.
[43] To avoid any doubts, this Paper proposes to apply the test as an additional (the second) layer of the fairness test, the first layer being 'procedural fairness' which fall outside the scope of this Paper.
[44] See above n 18

CONCLUDING REMARKS

The purpose of this Paper is to reopen the discussions on the need for the development of new mechanisms to protect substantive rights of the dissenting creditors while considering the recognition of foreign restructuring plans and bankruptcy discharge thereunder. The Paper also aims to highlight the broad powers of the courts of the states that implemented the MLCBI or the MLREIRJ under the respective provisions thereof and to call the courts to be more creative while interpreting and applying these provisions.