Position Paper

HARNEYS

Note on the use of Parallel Schemes of Arrangement[1]

In this paper, we consider the extent to which parallel schemes of arrangement are a necessary or desirable step when effecting cross-border restructurings of companies incorporated in an offshore jurisdiction (specifically the Cayman Islands, Bermuda or the British Virgin Islands (***BVI***)) whose major operations or assets are located in an onshore jurisdiction (specifically Hong Kong or the People's Republic of China).

The question arises in the context of certain *obiter* remarks made by Deputy High Court Judge William Wong SC in *Da Yu Financial Holdings Limited* [2019] HKCFI 2531, a case concerning parallel and inter-conditional schemes of arrangement promulgated in the Cayman Islands and in Hong Kong in respect of a Cayman-incorporated entity with its principal place of business, and sole substantial asset[2], in Hong Kong.

In the course of sanctioning the Hong Kong scheme, the Deputy Judge acknowledged[3] the need to "ensure that scheme creditors cannot disrupt the smooth operation of the scheme by taking hostile action against the Company in its place of incorporation". However, he doubted[4] the appropriateness of using a parallel scheme of arrangement to achieve that outcome:

> "I am of the view that the idea that parallel schemes are needed in such circumstances appears to be an outmoded way of conducting cross-border restructuring. Requiring foreign office-holders to commence parallel proceedings is the very antithesis of cross-border insolvency cooperation. A crucial feature of cross-border insolvency cooperation is the recognition of foreign proceedings…"

The Deputy Judge appeared to endorse the idea of giving effect to Hong Kong schemes of arrangement in offshore jurisdictions through concepts of "cross-border co-operation" and "recognition"[5] of the Hong Kong scheme, specifically by reference to the decision of the Privy Council in *Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2007] 1 AC 508 and to the position under Chapter 15 of the US Bankruptcy Code (***US Chapter 15***). However, the judgment contains very little analysis of the concepts of "cross-border co-operation" or "recognition" or of how they might operate in the context of schemes of arrangement with a cross-border flavour.

As explained below, while there may be cases in which a parallel offshore scheme is not strictly necessary to give practical effect to an onshore restructuring, there are likely to be many other cases where a parallel scheme will be necessary or desirable for those purposes. We do not consider that the doctrine of "cross-border co-operation" or any rule of "recognition" (whether under the common law or under statutory regimes applicable in the offshore jurisdictions in question) presently provide an effective substitute for the use of parallel schemes. Accordingly, the use of a parallel scheme represents a sound commercial and legal choice when a scheme company is seeking to achieve execution certainty in relation to a proposed restructuring.

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1 With many thanks to David Allison QC and Henry Phillip, both of South Square, London

2 Namely its listing status on the Hong Kong Stock Exchange.

3 At paragraph [48], citing paragraph [33(d)(i)] of the judgment of Mr Justice Segal in *Re China Agrotech Holdings Limited*, unreported, 22 July 2019, sanctioning the parallel Cayman Islands Scheme.

4 At paragraphs [49] – [53].

5 See eg at paragraph [52] (with square brackets in the original): "Therefore, in my view, it would be beneficial, in the spirit of cross-border cooperation that all jurisdiction do take to heart this question (*mutatis mutandis*) posed by Lord Hoffmann in *Cambridge Gas* (at §25): "Why… should the [offshore] court not provide assistance by giving effect to the [Hong Kong scheme of arrangement] without requiring the [Hong Kong office-holders] to go to the trouble of parallel insolvency proceedings in the [offshore jurisdiction]".

Framing the issue

Underlying the issue we have been asked to consider is the question of what steps are needed to give practical effect to a cross-border restructuring of an offshore company. The risk that needs to be addressed is that of a disgruntled creditor (or member) taking steps to disrupt or undermine the restructuring in the jurisdiction where the scheme company is registered by, for example, seeking to wind-up the company or taking enforcement action against assets located in that jurisdiction (commonly, shares in a locally-incorporated subsidiary). The ability for a creditor or member to take such action will often depend on whether the variations of rights and other compromises under the restructuring are effective in the jurisdiction where the company is incorporated.

Addressing this risk is significant not only from the point of view of commercial common-sense (a scheme which does not deliver an effective restructuring spells disaster for the company) but also because the court, in exercising its discretion whether to sanction a scheme, must be satisfied that there is a reasonable prospect of the scheme having real effectiveness[6]. In cases with an international dimension, this translates into the court needing to be "persuaded that the countries in the jurisdictions where the creditors would otherwise have been likely to seek enforcement would recognise the effectiveness of the court order" [7].

The steps which may be required to give practical effect to any particular restructuring are necessarily fact sensitive and will depend on the precise nature of the compromises implemented by the restructuring process[8]. The starting point, in this regard, is the application of the so-called "rule in *Gibbs*" (or, more precisely, the rationale underpinning that rule), which helps to draw a distinction between those cases where further steps are required and those cases where further steps may not be required in order to ensure that compromises effected by a scheme promulgated in one jurisdiction are effective in another jurisdiction.

Impact of the rule in *Gibbs*

Summary of the Rule

The so-called "rule in *Gibbs*" is named after the decision of the Court of Appeal in *Antony Gibbs & Sons v La Societe Industrielle et Commerciale de Metaux* (1890) LR 25 QBD 398[9]. It refers to the general proposition that a debt governed by English law cannot be discharged or compromised by a foreign insolvency proceeding. In fact, the proposition goes further: discharge of a debt under the insolvency law of a foreign country is only treated as a discharge in England if it is a discharge under the law applicable to the contract. There is an exception to the rule where the relevant creditor submits to the foreign proceeding. The rationale for this is that the creditor will be taken to have accepted that the law governing that proceeding should determine the contractual rights he has elected to vindicate in that proceeding. The position is summarised by Professor Ian Fletcher in *The Law of Insolvency* (5th Edition) at para 30-061 as follows:

> "According to English law a foreign liquidation – or other species of insolvency procedure whose purpose is to bring about the extinction or cancellation of a debtor's obligations – is considered to effect the discharge only of such of a company's liabilities as are properly governed by the law of the country in which the liquidation takes place or, alternatively, of such as are governed by some other foreign law under which the liquidation is accorded the same effect. Consequently, whatever may be the purported effect of the liquidation according to the law of the country in which it has been conducted, the position at English law is that a debt owed to or by a dissolved company is not considered to be extinguished unless that is the effect according to the law which, in the eyes of English private international law, constitutes the proper law of the debt in question"

Significantly, the rationale underpinning the "rule" reflects the general principle of private international law that the discharge or modification of a contractual liability is treated in English law as being governed by its proper law. As

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6 As explained by David Richards J in the English decision in *Re Magyar Telecom BV* [2014] B.C.C 448 at [14]: "the court will not generally make any order which has no substantial effect and, before the court will sanction a scheme it will need to be satisfied that the scheme will achieve its purpose". We understand that the position is the same under Hong Kong law: see, for example, the cases cited at paragraph [20(g)] of *Da Yu Financial Holdings Limited ibid*.

7 *Re Apcoa Parking Holdings GmbH* [2014] 2 BCLC 285 *per* Hildyard J at [19]. See, too, *Re Noble Group Ltd* [2019] BCC 349 *per* Snowden J at [18]; *Re Syncreon Group BV* [2019] EWHC 2412 (Ch) *per* Falk J at [12]; *Re NN2 Newco Ltd* [2019] EWHC 2532 (Ch) *per* Norris J at [10]. We understand that the position is the same under Hong Kong law: see paragraphs [20(g)] and [21(e)] of *Da Yu financial Holdings Limited ibid*.

8 Other facts, such as the likely risk of adverse action being commenced in another jurisdiction, may also be relevant. See, for example, *Re PT Garuda* (unreported 4 October 2001) (upheld by the Court of Appeal [2001] EWCA Civ 1696) where parallel English and Singaporean schemes of arrangement sought to compromise the liabilities of a company incorporated in Indonesia, including a portion of debt governed by Indonesian law. No steps were taken to promulgate a restructuring in Indonesia and there was doubt over whether the scheme would be recognised in Indonesia. The scheme was nevertheless sanctioned in light of the Judge's conclusion that "in practical terms…the risk of disturbance of the scheme by an inconsistent judgment in favour of a scheme creditor in an Indonesian court seems remote".

9 In fact, the rule has a far longer pedigree stretching back further than the decision in *Gibbs* itself to a number of older authorities such as *Smith v Buchanan* (1800) 1 East 6.

explained by Lord Sumption JSC in the recent decision of the English Supreme Court in *Goldman Sachs International v Novo Banco SA* [2018] UKSC 34 at [12] (emphasis added):

> "The rescue of failing financial institutions commonly involves measures affecting the rights of their creditors and other third parties. Depending on the law under which the rescue is being carried out, these measures may include the suspension of payments, the writing down of liabilities moratoria on their enforcement, and transfers of assets and liabilities to other institutions. **At common law measures of this kind taken under a foreign law have only limited effect on contractual liabilities governed by English law. This is because the discharge or modification of a contractual liability is treated in English law as being governed only by its proper law, so that measures taken under another law, such as that of a contracting party's domicile, are normally disregarded**: *Adams v National Bank of Greece SA* [1961] AC 255".

While the "rule in *Gibbs*" has been criticised by many academics and commentators[10], it has been repeatedly applied as established law at all levels of the courts of England and Wales[11] and was recently considered and applied by the English Court of Appeal in *OJSC International Bank of Azerbaijan v Sberbank of Russia* [2018] EWCA Civ 2802, following which the Supreme Court refused permission to appeal to challenge the continued application of the "rule in *Gibbs*". The rule is recognised and applied in Hong Kong[12] and, as far as we are aware, its application has not been doubted by the courts in the Cayman Islands, Bermuda or the BVI[13].

Impact of the "rule in *Gibbs*" on the international effectiveness of schemes

The five scheme scenarios or "Schemarios" below illustrate how the operation of the "rule in *Gibbs*" can be used to distinguish between cases where further steps (in particular, a parallel scheme of arrangement[14]) are likely to be necessary to ensure the practical effectiveness of a cross-border restructuring and those cases where such steps may not strictly be necessary for that purpose. However, even in cases where further steps are not strictly necessary it may be nevertheless be desirable to take them, depending on a client's appetite for achieving commercial certainty.

Scenario 1: A Hong Kong scheme of arrangement seeks only to vary the Hong Kong law governed contractual obligations of a company incorporated in the Cayman Islands.[15]

In our view, in this scenario it is not strictly necessary to take further steps in the Cayman Islands to ensure that the restructuring has practical effect. This is because a variation under Hong Kong law of Hong Kong law governed contractual rights will be effective in the Cayman Islands by virtue of the operation of the "rule in *Gibbs*". It may nevertheless be desirable for the scheme company to take additional steps in the Cayman Islands for commercial or strategic reasons. For example, it may prefer the certainty of taking the proactive step of promulgating a parallel scheme to cut-off potential disruptive action to the less certain and more reactive approach of relying on the application of the "rule in *Gibbs*" as a defence against any disruptive action in the future. Indeed, it is often the case that the scheme company will determine that the additional costs of a parallel scheme in the jurisdiction of incorporation represent a relatively modest price to pay for the delivery of day one execution certainty for the proposed restructuring.

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10 Eg By Ian Fletcher in *Insolvency in Private International Law* (Oxford University Press, 2nd 3d, 2005) at para 2.127 and Look Chan Ho in *Cross-Border Insolvency: Principles and Practice* (Sweet & Maxwell, 2016).

11 Including in *New Zealand Loan and Mercantile Agency Co v Morrison* [1898] AC 349; *National Bank of Greece and Athens SA v Metliss* [1958] AC 509 at p.523; *Adams v National Bank of Greece SA* [1961] AC 255 at 287; *Re T&N Ltd* [2005] Pens LR 1 at [121]-[122]; *Joint Administrators of Heritable Bank plc v Winding Up Board of Landsbanki Islands hf* [2013] 1 WLR 725 at [44]; *Re Indah Kiat International Finance Company BV* [2016] BCC 418 at [11]; *Re Agrokor DD* [2017] EWHC 2791 (Ch). Teare J in *Global Distressed Alpha Fund Ltd Partnership v PT Bakrie Investindo* [2011] 1 WLR 2038 accepted that there was much to be said for developing English law to recognise and give effect to a foreign (in that case, Indonesian) insolvency process which provided for discharge of an English law governed instrument. That said, however, he held that the Court was bound by the *Gibbs* case and declined to do so.

12 See, for example, *Re LDK Solar Ltd (in Provisional Liquidation)* [2014] HKCU 2855 at [49]: "As a matter of Hong Kong law, however, a foreign composition does not discharge a debt unless it is discharged under the law governing the debt: *Hong Kong Institute of Education v Aoki Corporation* [2004] 2 HKLRD 760*; Anthony Gibbs & Sons v Societe Industrielle et Commerciale de Metaux* (1890) LR 25 QBD 399*"*.

13 This is in contrast to the position in Singapore. In *Pacific Andes Resources Development Ltd* [2016] SGHC 2010, the Singaporean High Court (Ramesh JC) held that a reformulated version of the "rule in *Gibbs*" applied, pursuant to which "if one of the parties to the contract is the subject of insolvency proceedings in a jurisdiction with which he has an established connection based on residence or ties of business, it should be recognised that the possibility of such proceedings must enter into the parties' reasonable expectations in entering their relationship, and as such may furnish a new ground for discharge to take effect under the applicable law" (at [48]). See, too, the recent decision in *Re Agrokor* (No. 18-12104), where the New York Bankruptcy Court (SD) declined to apply the "rule in *Gibbs*" (taking the view that it "mischaracterises the discharge of debt as a contractual issue, rather than a bankruptcy or insolvency issue") and thereby gave effect to the discharge of English law governed debt pursuant to a Croatian restructuring.

14 The viability of taking other steps, short of a parallel scheme of arrangement, is considered further below.

15 We have selected a Cayman-incorporated entity for illustrative purposes. Each of the scenarios is equally applicable for a BVI or Bermuda incorporated entity.

Scenario 2: A Hong Kong scheme of arrangement seeks only to vary the New York law governed contractual obligations of a company incorporated in the Cayman Islands and the company obtains recognition of the scheme in New York pursuant to US Chapter 15.

The starting point in this scenario is that the variation of the New York law governed contractual obligations by a Hong Kong scheme of arrangement will not, by itself, be effective in the Cayman Islands by virtue of the operation of the "rule in *Gibbs*"[16]. However, it is necessary to consider the effect of the US Chapter 15 recognition in New York. If the effect of such recognition, and any concomitant extension of comity[17], is to vary the New York law governed obligations as a matter of New York law, then it will not be strictly necessary to take further steps in the Cayman Islands to ensure that the restructuring has practical effect. This is because the variation of New York law governed obligations by operation of New York law will be effective in the Cayman Islands by virtue of the operation of the "rule in *Gibbs*". To the extent that there is any material uncertainty over the proper characterisation of the effect of recognition/comity as a matter of New York law, it may well be desirable for the scheme company to promulgate a parallel scheme of arrangement in the Cayman Islands as a way of mitigating risk[18]. Even in the absence of any such material uncertainty, it may well be desirable for the scheme company to take further steps in the Cayman Islands for commercial or strategic reasons (see the concluding remarks in relation to Scenario 1 above)[19].

Scenario 3: A Hong Kong scheme of arrangement includes a variation of English law governed contractual obligations of a company incorporated in the Cayman Islands.

In this scenario it will be necessary to take further steps to ensure that the restructuring has practical effect in the Cayman Islands. This is because the variation of English law governed obligations by a Hong Kong Scheme of arrangement will not be effective in the Cayman Islands by virtue of the operation of the "rule in *Gibbs*". To give effect to the compromise of the English law governed contractual obligations in the Cayman Islands it will be necessary either to promulgate a parallel scheme of arrangement in the Cayman Islands and/or England[20]. In practice, it is likely to be sufficient to promulgate a parallel scheme of arrangement in the Cayman Islands where the scheme company only has assets in Hong Kong and/or the Cayman Islands and/or in other jurisdictions which will recognise a Hong Kong law variation of English law governed rights or a variation of English law governed rights by a scheme in the Cayman Islands as the jurisdiction of incorporation[21].

Scenario 4: A Hong Kong scheme of arrangement includes a debt for equity swap in relation to a company incorporated in the Cayman Islands.

A debt for equity swap raises issues of the law of country of incorporation irrespective of the law governing the compromised debt. For example, in order to give practical effect to a debt for equity swap it may be necessary to vary or suspend certain rights (such as pre-emption rights) arising under the scheme company's constitutional documents. While it may be possible to effect such variations or suspensions through the use of

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16 A comparable situation arose in *Re Indah Kiat International Finance Company BV* [2016] BCC 418, where Snowden J held (at [15]): "So far as this court is concerned, there can be no doubt that the Indonesian Judgment would not be regarded as discharging the Notes or the security in respect of the Notes, which are governed by New York law".

17 Our understanding of the position under US law, based on our experience in cross-border restructurings, is that recognition of a foreign scheme of arrangement takes place under US Chapter 15, which gives effect to, and extends, the UNCITRAL Model law. We understand that recognition, as a procedural matter, results in the commencement of a US Chapter 15 case for the scheme, which then provides the basis for the US Bankruptcy Court to consider a request to extend comity by recognising and enforcing the compromises effected by the scheme. It is our understanding that the effect of such "recognition" and "enforcement" is a variation, as a matter of New York law, of the New York law governed rights and obligations. However, these matters should be confirmed with New York lawyers.

18 This is particularly the case where the creditor constituency is not subject to the jurisdiction of the US courts. The situation may be different where the creditor constituency is subject to the jurisdiction of the US courts. In those circumstances it becomes necessary to consider the practical likelihood of such creditors taking steps against the scheme company in the Cayman Islands in a manner which is inconsistent with the terms of the US Chapter 15 relief granted by the New York Court, particularly where (as is frequently the case) such recognition carries with it a world-wide moratorium on actions against the scheme company. See eg *Re PT Garuda* (unreported 4 October 2001) (referred to in footnote [7], above).

19 Again, the commercial/strategic steps would need to be considered in light of the creditor constituency and the extent to which its members are subject to the jurisdiction of the US courts.

20 This is because those jurisdictions will not give effect to the Hong Kong law compromise of English law governed contractual obligations and the scheme. The scheme company will want to ensure that the compromises are effective not only in the Cayman Islands (as the jurisdiction of incorporation) but in other jurisdictions where its assets are located. The most effective way of doing this is likely to be by promulgating a parallel scheme under the law applicable to the contract which, in this scenario, would result in an English scheme. A comparable situation arose in *Re Drax Holdings* [2004] 1 WLR 1049, which concerned parallel Cayman Islands, Jersey and English schemes in respect of Cayman and Jersey incorporated entities. As Lawrence Collins J explained at [30]: "In the case of a creditors' scheme, an important aspect of the international effectiveness of a scheme involving the alteration of contractual rights may be that it should be made, not only by the court in the country of incorporation, but also where (as here) by the courts of the country whose law governs the contractual obligations. Otherwise dissentient creditors may disregard the scheme and enforce their claims against assets (including security for the debt) in countries outside the country of incorporation".

21 ie jurisdictions which do not respect the "rule in *Gibbs*", such as the US and Singapore. See footnote 18 above for the relevance of the creditor constituency when considering the practical likelihood of creditors taking steps against the scheme company in the Cayman Islands following recognition in the US.

shareholder resolutions, it may well be desirable for the scheme company to take further steps in the Cayman Islands as a means of de-risking the prospect of future challenges to the validity or effectiveness of such shareholder resolutions.

Scenario 5: A Hong Kong scheme of arrangement seeks to vary or compromise the rights of members of a company incorporated in the Cayman Islands.

A scheme of arrangement between a foreign company and its members (ie a members' scheme rather than a creditors' scheme) is essentially a matter for the courts of the place of incorporation. On the assumption that a Hong Kong court would be willing to exercise its jurisdiction in relation to a scheme which purported to vary or compromise the rights of members of a Cayman-incorporated company[22], a parallel scheme of arrangement is likely to be needed to give effect to those variations/compromises as a matter of Cayman law[23].

Thus far our analysis has proceeded on the assumption that where, having regard to the operation of the "rule in *Gibbs*", it is necessary or desirable to take further steps in the country of incorporation to help give practical effect to a cross-border restructuring, the relevant and appropriate step is the promulgation of a parallel scheme.

The question raised by the Deputy Judge in *Da Yu Financial Holdings Limited* was whether concepts of "cross-border co-operation" or "recognition" could provide an effective alternative means of ensuring that a scheme of arrangement promulgated under Hong Kong law is effective in the offshore jurisdiction that is the country of incorporation. We consider this issue below.

Potential alternative steps for ensuring cross-border effectiveness

As set out below, we do not consider that there is any relevant principle of "cross-border co-operation" or rule of "recognition" (whether arising under statue or the common law) which could as a general rule be safely relied on in the Cayman Islands, Bermuda or the BVI as an alternative step to promulgating a parallel scheme of arrangement.

Recognition at Common Law

At paragraph [52] of *Da Yu Financial Holdings Limited* the Deputy Judge, having referred to speech of Lord Hoffmann in *Cambridge Gas ibid* and having remarked that "a crucial feature of cross-border insolvency cooperation is the recognition of foreign proceedings" held (with square brackets in the original):

> "… in my view, it would be beneficial, in the spirit of cross-border cooperation that all jurisdictions do take to heart this question (*mutatis mutandis*) posed by Lord Hoffmann in *Cambridge Gas* (at §25): "Why… should the [offshore] court not provide assistance by giving effect to the [Hong Kong scheme of arrangement] without requiring the [Hong Kong office-holders] to go to the trouble of parallel insolvency proceedings in the [offshore jurisdiction]".

It appears, therefore, that the Deputy Judge considered that common-law principles applicable to the "recognition" of foreign insolvency proceedings may have a role to play in giving international effect to cross-border schemes of arrangement.

The first question to ask is what "recognition" means for these purposes. In broad terms, there are two possibilities. The first is "recognition" of a foreign scheme of arrangement by giving it substantive effect in accordance with the law governing the procedure (eg by varying and extinguishing creditors' claims). The second is "recognition" in the sense of recognising a foreign insolvency process by granting relief in support of that process (eg by granting a stay on actions by creditors).

Recognition in the first sense outlined above depends on the ordinary principles of private international law. In other words, the effect of the "rule in *Gibbs*" (as described above) and the ordinary private international law rules concerning the recognition and enforcement of foreign judgments[24]. The notion that those rules can be disapplied by appealing to a

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22 *Cf Re Drax Holdings Ltd* [2004] BCC 344 at [29] *per* Lawrence Collins J: "… it is almost impossible to envisage circumstances in which an English court could properly exercise its jurisdiction in relation to a scheme of arrangement between a foreign company and its members". See, too, *Re Apcoa Parking Holdings GmbH* [2015] BCC 142 *per* Hildyard J at [216] for a statement to similar effect.

23 Relatedly, obtaining confirmation in the jurisdiction of incorporation of a capital reduction (eg under section 15(1) of the Cayman Islands Companies Law (2008 Revision)) effected by a scheme of arrangement in another jurisdiction is likely to be desirable as a means of demonstrating that the scheme will have substantial effect in the company's jurisdiction of incorporation.

24 Whether the judgment of a foreign court can be enforced or recognised at common law depends on its classification as a judgment *in personam* or *in rem*. A judgment *in personam* is capable of enforcement or recognition against the person against whom it is made if that person was present in the relevant foreign jurisdiction at the relevant time or submitted to it. A judgment *in rem* is capable of enforcement or recognition where the subject

concept of "cross-border insolvency co-operation"[25] was roundly rejected by the Supreme Court in *Rubin v Eurofinance* [2013] 1 AC 236 when it ruled that the previous decision of the Privy Council in *Cambridge Gas ibid* was wrongly decided. In this regard:

> It is undoubtedly the case that the common law recognises a principle of "modified universalism" as applying to foreign insolvency proceedings[26]. As described by Lord Hoffman in *Re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852, this means that the "… courts should, so far as is consistent with justice and UK public policy, co-operate with the courts in the country of the principal liquidation to ensure that all the company's assets are distributed to its creditors under a single system of distribution."
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> In *Cambridge Gas* the Privy Council held that a Manx Court could recognise and enforce a plan under Chapter 11 of the US Bankruptcy Code (***US Chapter 11***) involving an Isle of Man company over the objections of a shareholder of the Manx company. This conclusion was reached despite the fact that (a) the dissenting shareholder had not submitted to the personal jurisdiction of the United States (***US***) Court and (b) the Manx shares transferred by the plan were located in the Isle of Man, beyond the *in rem* jurisdiction of the US Court. In short, the Privy Council considered that the concept of "modified universalism" trumped the ordinary rules of private international law[27].
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> In *Rubin v Eurofinance ibid*, the Supreme Court held that there were no special rules for the recognition and enforcement of foreign judgments in insolvency proceedings[28] and, consequently, that *Cambridge Gas* was wrongly decided, concluding that there was "no basis for the recognition of the order of the US Bankruptcy Court in the Isle of Man"[29]. As Lord Sumption subsequently remarked in the decision of the Privy Council (Bermuda) in *Singularis Holdings Limited v PricewaterhouseCoopers* [2014] UKPC 36[30], "*Cambridge Gas* marks the furthest that the common law courts have gone in developing the common law powers of the court to assist a foreign liquidation… so far as it held that the domestic court had jurisdiction over the parties simply by virtue of its own power to assist, it was held… by a majority of the Supreme Court to be wrong in *Rubin v Eurofinance SA*".

There is, in our view, considerable reason to doubt that a Hong Kong scheme of arrangement (particularly one which is not taking place within the context of insolvency) is properly characterised as an "insolvency measure" entitled to "assistance" in accordance with the common-law principle of "modified universalism"[31]. However, in jurisdictions such as the Cayman Islands and Bermuda where there is no statutory basis for recognising foreign insolvency proceedings in relation to local companies, it is possible that a Hong Kong scheme proceeding in relation to an insolvent offshore company would receive some limited form of common law assistance. In any event, those somewhat abstract general principles of modified universalism are not capable of overriding the more specific and "hard-edged" substantive law

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matter of the judgment is property falling within the jurisdiction of the foreign court: See *Dicey, Morris & Collins on the Conflict of Laws* (15th Ed.) at 14R-054 and 14R-108.

25 Even assuming *arguendo* a Hong Kong scheme of arrangement can properly be described as a foreign "insolvency proceeding" for these purposes (see below).

26 "In the Board's opinion, the principle of modified universalism is part of the common law": *Singularis Holdings Ltd v PricewaterhouseCoopers* [2015] AC 1675 *per* Lord Sumption at [30].

27 See, in particular, paragraph [21] of *Cambridge Gas* where Lord Hoffman concluded that "these principles [ie the principles of modified universalism summarised at paragraph [16] of the judgment] are sufficient to confer upon the Manx court jurisdiction to assist the committee of creditors, as appointed representatives under the Chapter 11 order, to give effect to the plan".

28 "A change in the settled law of the recognition and enforcement of judgments… has all the hallmarks of legislation, and is a matter for the legislature and not for judicial innovation. The law relating to the enforcement of foreign judgments and the law relating to international insolvency are not areas of law which have in recent times been left to be developed by judge-made law" *per* Lord Collins at paragraphs [129].

29 *Per* Lord Collins at paragraph [132].

30 At [18].

31 We note, in this regard, that an English scheme of arrangement does not fall within the definition of an "insolvency proceeding" for the purposes of Article 1(1) of the EU Insolvency Regulation (EU 2015/848). It is, in our view, also unlikely to be a "foreign proceeding" for the purposes of the UNCITRAL Model Law on Cross-Border Insolvency. Article 2(i) of the Model Law defines "foreign proceeding" as "a collective judicial or administrative proceeding in a foreign state… pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purposes of reorganisation or liquidation". It is at the very least questionable whether a scheme of arrangement which has been sanctioned under section 670 of the Hong Kong Companies Ordinance (Cap. 622) is a "judicial or administrative proceeding" or one which is "pursuant to a law relating to insolvency". We note, in this regard, the observations of the English Court of Appeal in *OJSC International Bank of Azerbaijan v Sberbank of Russia* [2018] EWCA Civ 2802 at [79] (with emphasis added): "… there is a confusion at the heart of IBA's case between two different aspects of international insolvency restructurings. One aspect is the stay or moratorium that debtors seek in order to obtain a breathing space while they formulate a restructuring; the other is the question of how the debtor can bind dissenting parties to the proposed restructuring. **Only the former aspect falls within the scope of the existing Model Law. The latter issue depends on the jurisdiction over the dissenting creditors and/or the law which governs their debts**. In many cases, of which this is one, it may not be possible to enforce the compromise against all creditors, but the reorganisation may nevertheless be worthwhile and save a viable business. **If it is desired to go further, and bind foreign creditors who would not otherwise be bound, the long-standing practice in international restructurings of the present type has been to apply for parallel schemes of arrangement in other jurisdictions**".

provisions of the assisting court such as the "rule in *Gibbs*"[32] or the ordinary private international law rules concerning the recognition and enforcement of foreign judgments.

Accordingly, common law "recognition" is not capable of binding dissenting parties to the proposed restructuring and cannot, therefore, provide an effective substitute for the use of parallel schemes. In these circumstances, a well advised scheme company is likely to reach the view that the additional costs of a parallel scheme in the jurisdiction of incorporation represent a relatively modest price to pay for the delivery of day one execution certainty for the proposed restructuring. Where parallel schemes are implemented in relation to an insolvent company, the coordination of the proceedings by the relevant courts does, perhaps, reflect a more modest form of common law cross-border cooperation in which each court (a) recognises the other's competence to deal with its own scheme proceeding, and (b) seeks to promote the orderly administration of a "universal" insolvent estate.

For completeness, we should note that we are aware of a handful of decisions involving Bermudian companies in provisional liquidation where the Bermudian Courts have "recognised" and granted common-law relief in support of reorganisation plans effected under US Chapter 11 proceedings (see, for example, *Re Energy XXI Ltd* [2016] SC (Bda) 79 Com; *Re C & J Energy Services Ltd* [2017] Bda LR 22; *Re Seadrill Limited* [2018] Bda 39). In our view, these decisions are not inconsistent with the views we have expressed:

> **First**, it is important to note that these decisions[33] concerned common law assistance in relation to reorganisation plans taking place under the umbrella of US Chapter 11 insolvency proceedings. As noted above, there is considerable reason to doubt that a Hong Kong scheme of arrangement is a process capable of attracting such assistance.
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> **Second**, and in any event, it is clear from the various judgments that none of the orders "recognised" the relevant US Chapter 11 plan by giving it substantive effect in accordance with US law (ie by a substantive variation of rights in circumstances where the "rule in *Gibbs*" otherwise stood in the way of such variation). Rather, the recognition in each case was in the form of a stay of proceedings in Bermuda[34]. Further, the stay was framed in each case to be consistent with the ordinary principles of private international law. As explained in Kawaley CJ's judgment in *C & J Energy Services Ltd ibid* (with emphasis added):
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> > "This Court may recognise and enforce (by way of a stay of local proceedings or otherwise in accordance with local law) a foreign restructuring order extinguishing claims against an insolvent Bermudian company. **It may only properly do so as against parties who have submitted to the personal jurisdiction of the foreign court and/or as regards property which (by reason of its situs) is subject to the *in rem* jurisdiction of the foreign court**." (at [16])
> >
> > "On its face, the Recognition Order **only bound parties who were properly subject to the jurisdiction of the Confirmation Order** in full compliance with the governing principles of private international law most clearly articulated in the cross-border common law cooperation contact in *Rubin v Eurofinance*" (at [19]).
>
> **Third**, the Bermudian Court recognised and re-affirmed the utility of promulgating parallel schemes of arrangement to give practical effect to cross-border restructurings:
>
> > "A Bermuda scheme is to my mind the safest means of avoiding dissenting creditors attempting an "end run" on a foreign proceeding where they can successfully argue that they are not bound by the foreign court's orders": *Re C & J Energy Services Ltd ibid* at [14].
> >
> > "There is always a risk that a creditor or shareholder who is not party to or otherwise bound by the foreign restructuring proceedings might, absent a Bermudian parallel scheme, having standing to contend that the foreign court's order approving the foreign plan or scheme of

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32 As explained at paragraph [25] of the Judgment of Lord Sumption in *Singularis Holdings Ltd v PricewaterhouseCoopers* any order giving common law assistance to a foreign insolvency process "must be consistent with the substantive law… of the assisting court".

33 We note an earlier decision of the Bermudian Court in *Re Contel* [2011] Bda L.R. 12 granted "recognition of a scheme of arrangement entered into between the Company and its creditors in Singapore". However, (a) that case contained no analysis of whether the doctrine of modified universalism ought to apply to a Singaporean scheme of arrangement; (b) it is unclear what the consequences of "recognition" were (in particular, whether the effect of recognition was to override the "rule in *Gibbs*" or the ordinary private international rules concerning the recognition and enforcement of foreign judgments) and (c) *Re Contel* was decided before the decision in *Rubin* (subsequently affirmed as representing Bermudian law in *Singularis Holdings Ltd v PricewaterhouseCoopers ibid*) and the court appeared to rely solely on the judgment of Lord Hoffman in *Cambridge Gas*. To the extent, therefore, that *Re Contel* is inconsistent with the views we have expressed, it is in our view wrongly decided and cannot be considered good law (we note that this view appears to have been shared by Harris J in *CW Advanced Technologies Limited* [2018] HKCFI 1705 at paragraph [32(a)(i)]).

34 See *Re Energy XXI Ltd ibid* at [4]; *Re C & J Energy Services Ltd ibid* at [18]; *Re Seadrill Limited ibid* at [6].

arrangement ought not to be recognised as binding on the dissenting party under Bermudian law": *Re Energy XXI Ltd ibid* at [10].

Fourth, on the peculiar facts of those cases, the need to directly consider the application of the "rule in *Gibbs*" did not arise. All debt and equity stakeholders of the Bermudian companies had submitted to the personal jurisdiction of the US Bankruptcy Court and were apparently considered on that basis alone (by way of recognised exception to the "rule in *Gibbs*") to have become bound by the US Court's Orders.

Statutory recognition

At paragraph [51] of *Da Yu Financial Holdings Limited* the Deputy Judge referred to the steps commonly taken where Hong Kong and English schemes of arrangement "need practical effectiveness in the United States", noting that "the standard procedure is to obtain recognition of the scheme in the United States (as opposed to commencing plenary US Chapter 11 proceedings to create a parallel Chapter 11 reorganisation plan)".

Importantly, recognition in the US of Hong Kong and English law schemes of arrangement is a consequence of statutory intervention, specifically through US Chapter 15. US Chapter 15 reflects the US' enactment of the UNCITRAL Model Law on Cross-Border Insolvency (the ***Model Law***). Significantly, it departs from the text of the Model Law in certain material respects. Most notably, the US enactment of the Model Law modifies the definition of a "foreign proceeding" from "a collective judicial or administrative proceeding in a foreign state… pursuant to a law relating to insolvency" to "a collective judicial or administrative proceeding in a foreign state… pursuant to a law relating to insolvency **or adjustment of debt**" (emphasis added). This alteration facilitates the US Chapter 15 recognition of English and Hong Kong schemes of arrangement.

None of the Cayman Islands, Bermuda or the BVI has adopted the Model Law[35]. As far as we are aware, there are no provisions at all in the Bermuda Companies Act specifically directed towards cross-border assistance in insolvency. The Cayman Companies Law does contain a regime for international co-operation in insolvency[36] but it only applies to insolvency proceedings commenced in respect of "a foreign corporation or other foreign legal entity… in the country in which it is incorporated or established" (and therefore has no application in the case of a foreign proceedings in respect of a Cayman company)[37]. The position under the BVI Insolvency Act 2003 (the ***BVI Insolvency Act***) is slightly more nuanced.

Part XIX of the BVI Insolvency Act contains provisions for co-operation in bankruptcy matters between the courts of the BVI and the courts of certain other specified countries (including, relevantly, Hong Kong). Under section 467(2) a "foreign representative" may apply for an order in aid of the "foreign proceeding" in respect of which he is authorised. Pursuant to section 467(3) the BVI Court has broad powers to assist, including by making such order or granting such other relief as it considers appropriate (section 467(3)(h)). In making an order under section 467(3) the Court may apply the law of the Virgin Islands or the law applicable in respect of the foreign proceeding.

The question for present purposes is whether the provisions of Part XIX of the BVI Insolvency Act can be relied on to give substantive effect to the compromises effected by a Hong Kong scheme of arrangement, in way which could overcome the "rule in *Gibbs*". We are unaware of any case specifically considering this point[38]. The better view, in our opinion, is that it could not. Moreover, it is plain that there is, at the very least, material uncertainty in this regard with the consequence that the scheme company would be assuming a significant execution risk if it decides to proceed without a parallel scheme. In particular:

First, Part XIX defines a "foreign proceeding" as "a collective judicial or administrative proceeding in designated foreign country, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the property and affairs of the debtor are subject to control or supervision by a foreign court, for the purposes of reorganisation, liquidation or bankruptcy". It seems to us that there are likely to be considerable difficulties in characterising a scheme of arrangement which has been sanctioned under section 670 of the Hong Kong

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35 Part XVIII of the BVI Insolvency Act 2003 contains an enactment of the Model Law. However, it has not been brought into force and we understand that there are no plans to bring the provisions of Part XVIII into force in the near future.

36 See Part XVII of the Cayman Companies Law.

37 See the definitions of "debtor" and "foreign bankruptcy proceeding" at section 240 of the Cayman Companies Law.

38 The closest comparable case is the decision of Rattee J In *Re Business City Express Ltd* [1997] 2 BCLC 510. *Re Business City* concerned a scheme of composition under Irish companies legislation. The Irish Court issued letter of request to the English Court seeking assistance under section 426 of the English Insolvency Act 1986, which is similar (but by no means identical to) the provisions of Part XIX of the BVI Insolvency Act. The English Court gave assistance to the Irish Court by "apply[ing] to English creditors Irish law as to the binding effect on creditors of a scheme of arrangement approved by the court". However, the judgment does not explain how the Irish proceedings could be said to be pursuant an "insolvency law" within the meaning of section 426(10) of the English Insolvency Act, nor does it contain any consideration of the "rule in *Gibbs*" or any indication of whether the order made by the English Court had the effect of overcoming it. We note the view of the editors of *Cross Border Insolvency* (4th Ed) at 4.43 that s.426 would not be engaged by a scheme of arrangement approved in accordance with section 166 of the Hong Kong Companies Ordinance.

Companies Ordinance (Cap. 622) as a "judicial or administrative proceeding" or one which is "pursuant to a law relating to insolvency"[39] or one which is "subject to the control or supervision of the foreign court"[40].

Second, and in any event, while section 467(3)(h) of the BVI Insolvency Act confers broad powers on the BVI Court to grant "such… relief as it considers appropriate", in our view a court would be unlikely to grant relief in a manner which would, in substance, circumvent the operation of the "rule in *Gibbs*". A comparable situation arose, albeit in the context of the operation of the Model Law, in *OJSC International Bank of Azerbaijan v Sberbank of Russia ibid*. The case concerned a company which had entered into a restructuring proceeding under Azerbaijan law. A reorganisation plan was entered into under Azerbaijan law which purported to have the effect of discharging English law governed rights. The company obtained recognition of the restructuring proceedings in England pursuant to the Model Law[41] and sought to rely on an ancillary power[42] to "grant any appropriate relief" to impose a permanent moratorium against creditors enforcing their English law governed rights, thereby in substance overcoming the "rule in *Gibbs*". The English Court of Appeal held that it would be "wrong in principle to use the power under article 21(1)(a) and (b) or any other provisions of the Model Law… so as to circumvent the English law rights of the English creditors under the *Gibbs* rule" (at [95])[43].

Conclusion

For the reasons set out in this note, we do not consider that the doctrine of "cross-border co-operation" or any rule of "recognition" (whether under the common law or under statutory regimes applicable in the offshore jurisdictions in question) can provide an effective substitute for the use of parallel schemes.

While there may be exceptional cases where a parallel offshore scheme may not be strictly necessary to give practical effect to an onshore restructuring (on account of the operation of the rationale underpinning the "rule in *Gibbs*"), there are likely to be many other cases where a parallel scheme will be necessary or at least desirable for those purposes.

Accordingly, it is our view that a well advised scheme company is likely to reach the view that the additional costs of a parallel scheme in the jurisdiction of incorporation represent a relatively modest price to pay for the delivery of day one execution certainty for the proposed restructuring.

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39 *Cf* the US enactment of the Model Law, whereby US Chapter 15 recognition is available to certain proceedings "pursuant to a law relating to insolvency **or adjustment of debt**" (emphasis added).

40 The nature of schemes of arrangement under English law and, in particular, the role of the court in relation to them, was summarised by Lord Hoffmann in the Privy Council in *Kempe v Ambassador Insurance* [1998] BCLC 234 at [12] as follows: "It is true that the sanction of the court is necessary for the scheme to become binding and that it takes effect when the order expressing that sanction is delivered to the registrar. But this is not enough to say that the court (rather than the liquidators who proposed the scheme or the creditors who agreed to it) has by its order made the scheme. It is rather like saying that because Royal Assent is required for an Act of Parliament, a statute is an expression of the Royal will. Under s 99 it is for the liquidators to propose the scheme, for the creditors by the necessary majority to agree to it and for the court to sanction it. It is the statute which gives binding force to the scheme when there has been a combination of these three acts…"

41 Enacted in England under the provisions of the Cross-Border Insolvency Regulations (***CBIR***). The definitions of "foreign proceeding" and "foreign representative" in Part XIX of the BVI Insolvency Act closely follow those used in the Model Law.

42 Under Articles 21(1)(a) and (b) of the CBIR.

43 Notably, in reaching that conclusion the Court of Appeal considered (at paragraph [88]) a submission by the scheme company which has echoes of the Deputy Judge's *obiter* remarks in *Da Yu Financial Holdings Limited*: "It is also material in this context that IBA could in principle have promoted a parallel scheme of arrangement in this jurisdiction, but chose not to. Mr Bayfield says that this objection misses the point, because one of the objects of the Model Law is to avoid duplication of proceedings with all the additional expense and inconvenience which they entail. I acknowledge the force of that argument, and would accept that the Model Law is designed to increase cooperation and reduce the need for separate proceedings in relation to matters falling within its scope. But that goes only some of the way towards answering the question whether the protection of the interests of IBA's creditors really requires an indefinite stay of the English creditors' claims, when the alternative of a separate English scheme of arrangement was always available. One may surmise that the real reasons for not promulgating a separate English scheme of arrangement probably had more to do with the need which would then have arisen to treat the English creditors as a separate class, and to offer them terms which they would then be prepared to accept. That is another way of saying that the English law creditors' strongest bargaining position would have been their English law rights, protected by the *Gibbs* rule; and this brings one back to the question whether anything in the Model Law, properly construed, should be permitted to override those rights. If not, it seems to me that it could seldom, if ever, be appropriate to grant relief under the Model Law which would have the substantive effect of doing just that".