Comity Extended to Foreign Law that Could Modify English Law Governed Debt in Contravention of "Antiquated Rule"

In a recent decision in the Chapter 15 case *In re Agrokor d.d.*, Case No. 18-12104 (Bankr. S.D.N.Y. Oct. 24, 2018), Judge Martin Glenn held that the U.S. Bankruptcy Court for the Southern District of New York, in the exercise of comity,[1] would grant recognition to and enforce a Croatian settlement agreement (akin to a Chapter 11 plan of reorganization) approved by a Croatian court following creditor approval, notwithstanding that the settlement contained provisions that modified English law governed debt, in apparent contravention of English law.

Such modifications, Judge Glenn explained, could be in violation of "an antiquated rule" called the "*Gibbs*" rule, based on an 1890 decision of the Court of Appeal in *Antony Gibbs & Sons v. La Societe Industrielle et Commerciale des Metaux* (1890) 25 QBD 399. The *Gibbs* rule (despite its age) remains the governing law in England, and refuses to recognize a discharge or modification of English law debt approved by a court outside of England.

After discussing the principles of comity and cooperation with foreign courts, Judge Glenn concluded that the fact that England applies the *Gibbs* rule and refuses to recognize the modification of English law debt approved by a court outside of England is not a basis for the Bankruptcy Court to decline to recognize and enforce the settlement agreement within the territorial jurisdiction of the United States.

I. Background

Agrokor d.d. and its affiliated debtors comprise one of the largest companies in Croatia. Agrokor is part of a group of 77 companies headquartered in Croatia that are part of an "extraordinary administration proceeding" in Croatia under a new Croatian insolvency law passed on April 7, 2017 – the "Act on the Extraordinary Administration Proceedings in Companies of Systemic Importance of the Republic of Croatia" (the "EA Law").[2]

The EA Law was passed to prevent a wider economic fallout in Croatia and surrounding global markets through restructuring companies of "systemic importance" to Croatia.[3] As Judge Glenn noted, in effect, the new law is reminiscent of the efforts globally to deal with problems of "too big to fail."[4] Although the law was available to all companies that are determined to be "systemically important," Agrokor was the impetus for the creation of the new law (Agrokor is the largest private company by revenue in Croatia, employing more than 60,000 people, and representing approximately 15% of the gross domestic product of Croatia).[5]

Once a company qualifies for an extraordinary administration proceeding, the EA Law includes provisions for the negotiation, acceptance by creditors, and approval by the Croatian court of a settlement agreement—essentially a plan of reorganization that adjusts the debt and ownership interests of distressed companies.[6] While the Croatian proceeding of Agrokor has been recognized as a foreign main proceeding in

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[1] Comity has been described as "recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protections of its laws." *Hilton v. Guyot*, 159 U.S. 113, 164 (1895).

[2] *In re Agrokor d.d.*, Case No. 18-12104 (Bankr. S.D.N.Y. Oct. 24, 2018) at 1.

[3] *Id.* at 2.

[4] *Id.* at 26.

[5] *Id.* at 9.

[6] After a settlement agreement is created, the settlement agreement is approved either if (1) more than half of *all creditors by number* (including non-voting creditors) vote in favor of the Settlement Agreement *and* more than half of all creditors in each class *by value of claims* vote in favor of the Settlement Agreement or (2) two-thirds of *all voting creditors by claim amount* vote in favor of the Settlement Agreement. *Id.* at 31.

the High Court of England and Wales, that court had not so far been asked to recognize and enforce the settlement agreement (which modifies the English law governed debt).

Faced with a request to recognize the settlement agreement under Chapter 15 of the U.S. Bankruptcy Code (the "Bankruptcy Code"), Judge Glenn observed that this case presented "challenging issues with very practical consequences."[7] The foreign debtors (with their center of main interests in Croatia) have over €1.66 billion of debt governed by English law and over €925 million of debt governed by New York law; thus, the majority (about 64%) of the debt to be restructured under the settlement agreement is governed by English law.[8] English case law (via the 1890 *Gibbs* Rule) may not permit a court outside of England and Wales (in this case, the Croatian court that approved the settlement agreement) to approve a discharge or modification of English law governed debt, such that recognition and enforcement of the settlement agreement by the England and Wales court might not be granted.[9]

II. Opinion

As noted above, the essence of the *Gibbs* Rule is that where a debtor is a party to a contract governed by English law and to be performed in England, was declared bankrupt and its debts discharged under foreign law in a foreign proceeding, a creditor holding an English law debt claim was not bound by the discharge and could maintain an action on the contract and recover damages in an English court.[10]

Judge Glenn first noted that the Croatian proceeding was procedurally fair and, through the settlement agreement, determined the rights of all creditors to property that was subject to the jurisdiction of the Croatian court. But the Court was nevertheless concerned with the effects of a decision to extend comity to one nation if doing so could be seen as a refusal to extend comity to the laws of another—particularly where a majority of the debt to be modified is governed by the law of the latter nation (England).[11] In these circumstances, a complete comity analysis required at least consideration of, even if not ultimately lending deference to, English law. Despite the clear territorial slant of the *Gibbs* rule, it was recently followed by the English High Court.[12]

The Bankruptcy Court, in analyzing the *Gibbs* Rule, looked for guidance in a decision by Justice Kannan Ramesh of the Supreme Court of Singapore in *Pacific Andes Resources Development Ltd.*, [2016] SGHC 210. There, Justice Ramesh explained that the parties to a contractual relationship governed by the law of a jurisdiction adhering to the *Gibbs* Rule should be on notice with the expectation that their claims might be discharged in proceedings in a jurisdiction where the debtor has an established connection based on residence or ties of business.[13] This view, of course, contrasted with the *Gibbs* Rule.

In adopting the views of Justice Ramesh in *Pacific Andes*, Judge Glenn noted that a fundamental tenet of the bankruptcy system, also applied under the new Croatian law and most other modern insolvency laws, is that creditors of the same class are entitled to equality of distribution.[14] Allowing creditors with claims governed by English law to recover a greater percentage of their claims than creditors with claims governed, for example, by New York law, would violate the fundamental principle of equality of distribution.[15] And the

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7 *Id.* at 4.
8 *Id.* at 4.
9 *Id.*
10 *Gibbs*, 25 QBD at 406.
11 *Agrokor* at 47.
12 *See Bakshiyeva v. Sberbank of Russia, et al.* [2018] EWHC 59 (Ch) (refusing to recognize Azerbaijan proceeding and finding that such proceeding could not change or discharge the substantive rights of creditors holding English law governed debt where two creditors who did not participate in the foreign proceeding invoked the *Gibbs* rule).
13 *Pacific Andes*, SGHC 210 at ¶ 48.
14 *Agrokor* at 52.
15 *Id.*

settlement agreement at issue provided for equality of distribution between the holders of the English law governed and New York law governed debt.

Where a contract selects English law, choice of law principles will ordinarily dictate that a breach of contract claim should be determined under English law. Choice of law principles, according to Judge Glenn, however, should not dictate that English law applies in determining whether a claim can be discharged or modified in a foreign insolvency proceeding.[16] Put differently, although England is free to continue to adhere to the *Gibbs* rule, that does not mean a U.S. Bankruptcy Court must follow the rule in deciding whether to recognize and enforce the decision of a court of another jurisdiction, particularly where application of the U.S. ruling would be limited to the territorial jurisdiction of the United States.

In the end, Judge Glenn came to the conclusion that though the concept of comity is broad and may require overlapping considerations of the rights of several parties and nations, it is appropriate to extend comity, at least within the territorial jurisdiction of the United States, to the Croatian settlement agreement, even with respect to the modification or discharge of English law governed debt.[17] If a foreign creditor has a claim governed by English law that is modified by the settlement agreement and wants to challenge the Croatian modification of that claim, the creditor may still challenge enforcement of the claim in the English courts.[18]

III. Significance

This decision marks yet another Chapter 15 case holding that a U.S. Bankruptcy Court should and will extend comity to a foreign main proceeding and recognize and enforce foreign insolvency proceedings where creditors have a full and fair opportunity to be heard in foreign jurisdictions consistent with due process standards of the United States. *See, e.g.*, *In re Avanti Commc'n Grp. PLC*, 582 B.R. 603 (Bankr. S.D.N.Y. 2018) (modifying New York law governed debt in an English scheme of arrangement proceeding and allowing third-party guarantor releases—releases that would not be available under Chapter 11 of the Bankruptcy Code—where creditors had a full and fair opportunity to vote on and be heard in the English courts).

The Bankruptcy Court's conclusion reflects both a pragmatism of advancing well established bankruptcy principles and furthering the goal of Chapter 15 to assist foreign insolvency courts. Those reflections suggest that a U.S. court, acting in the capacity of ancillary court assisting a "foreign main insolvency proceeding, should not leave to a third court the decision whether U.S. comity principles entitle the Croatian court decision to recognition and enforcement.[19] This was particularly relevant to the Bankruptcy Court in the context of insolvency, where the basic rationale espoused *Gibbs*—that parties' consensual, contractual decisions should determine the choice of law of all future legal interactions—is inappropriate when applied in the context of insolvency or bankruptcy proceedings. The Bankruptcy Court agreed that a creditor's autonomy is relevant in the context of an insolvency proceeding only to the extent that it does not impede the underlying public policy that governs a collective insolvency or bankruptcy proceeding—equal distribution to creditors in the same class.

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16 *Id.* at 53 n. 20.

17 *Id.* at 55.

18 *Id.* at 38.

19 Interestingly, at least some of the Agrokor group sought recognition of the Croatian proceeding in six jurisdictions in addition to the United States. Only Switzerland made a final decision to recognize the commencement of the Croatian proceeding and to give effect to the "Extraordinary Administrator" to represent debtors and to deal with their assets in Switzerland under the Swiss International Private Law Act. The High Court of England and Wales also agreed to recognize the Croatian Proceeding of Agrokor, but an appeal of that decision is pending. Appeals of decisions rejecting recognition of the Croatian proceeding are pending in Slovenia, Serbia, Bosnia-Herzegovina and Montenegro.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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