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Alexandra Wood



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Rare Earth and *Modern Land* Chapter 15 Recognition and the Discharge of New York Law Governed Debt

*By Alexandra Wood**

In this article, the author discusses what has been described as a “critically important issue” for foreign schemes and plans that compromise debt governed by New York law.

The Hong Kong court and the U.S. bankruptcy court have made conflicting comments regarding the discharge of New York law-governed debt by a foreign scheme of arrangement, where that scheme is the subject of recognition under Chapter 15 of the U.S. Bankruptcy Code. Obiter comments were made by Hon. Harris J of the Hong Kong court in the case of *Re Rare Earth Magnesium Technology Group Holdings Limited*¹ in the context of a wider discussion of the application of the Rule in *Gibbs*.² This rule provides that a debt is treated as discharged if it is compromised in accordance with the law of the jurisdiction which governs the instrument giving rise to the debt.

The Hong Kong court speculated that a scheme sanctioned in an offshore jurisdiction and recognized under Chapter 15 would not be treated by a Hong Kong court as compromising US\$ denominated debt for the purpose of the Rule in *Gibbs*. This was because the Rule in *Gibbs* requires the substantive alteration of contractual rights to be sanctioned by a substantive provision of the relevant law. The Hong Kong court suggested that recognition of a foreign scheme under Chapter 15 did not operate as a matter of U.S. law to discharge the debt which was the subject of that scheme. If the Hong Kong court’s analysis was correct then such a scheme would not be treated by the Hong Kong court (and possibly other courts) as binding on a creditor which had not submitted to the relevant offshore jurisdiction.

However, Chief U.S. Bankruptcy Judge Martin Glenn in the Southern District of New York rejected the comments of the Hong Kong court. In a motion (in the unrelated case of *Modern Land (China) Co. Limited*) for recognition of a foreign scheme of arrangement under Chapter 15, Judge Glenn noted that, provided that the foreign court properly exercises jurisdiction over

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¹ [2022] HKCFI 1686.

² *Antony Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux* (1890) LR 25 QBD 399.

the foreign debtor in an insolvency proceeding and the foreign court's procedures comport with broadly accepted due process principles, a decision of the foreign court approving a scheme or plan that modifies or discharges New York law governed debt is enforceable. In recognizing and enforcing Modern Land's foreign scheme, the court concluded that the discharge of the relevant notes and issuance of the replacement notes was binding and effective.

There have been many instances in which foreign schemes and plans have compromised debt governed by New York law and Judge Glenn therefore described this as a "critically important issue." The debate between the Hong Kong and U.S. bankruptcy courts is relevant to the application of the Rule in *Gibbs*, not only in Hong Kong but also in England and Wales (from where the Rule is derived) and other jurisdictions which apply the Rule in *Gibbs*.

THE HONG KONG COURT: *RE RARE EARTH MAGNESIUM TECHNOLOGY GROUP HOLDINGS LIMITED*

On June 6, 2022, Hon. Harris J handed down the reasons for his earlier decision (of May 27, 2022) on a petition for the sanction of a scheme of arrangement by Rare Earth Magnesium Technology Group Holdings Limited (the "Company") and related winding up petition, which the Company asked the court to dismiss. The Company had proposed a scheme under Hong Kong law pursuant to s673 Companies Ordinance (Cap. 622) in relation to unsecured interest-bearing bonds issued by it and governed by Hong Kong law.

These reasons included obiter comments by Hon. Harris J in relation to the recognition by the Hong Kong court of offshore schemes of arrangement which compromise U.S. law-governed debt.³ As explained below, he expressed the view that where U.S. law-governed debt has been raised by a Mainland business group listed in Hong Kong and that debt is the subject solely of an offshore scheme recognized in the United States under Chapter 15 of the U.S. Bankruptcy Code, such a scheme would not be treated in Hong Kong as binding on a creditor which had not submitted to the offshore jurisdiction.

Hon. Harris J noted that, in transnational cases, the Hong Kong court must consider whether a scheme is internationally effective in those jurisdictions which are of practical importance. Citing the Judgment of Mr. Justice Miles in *Re PGS ASA* (in an English law context), there is no requirement for a scheme to be effective in every jurisdiction worldwide, provided that it is likely to be effective in the key jurisdictions in which the company operates or has assets. Hon. Harris J highlighted the distinction between a foreign court:

³ This being a different fact pattern to the Company's proposed scheme and hence his comments were obiter.

- Treating a scheme of arrangement (or other compromise) as having the substantive legal effect of altering the legal rights of the parties to an agreement (i.e., discharging the debt which is the subject of the scheme). This is the compromise with which the Rule in *Gibbs* (referred to below) is concerned; and
- (Merely) recognizing the purported legal consequences of a foreign insolvency procedure.

He noted that Hong Kong, together with a number of offshore jurisdictions (including Bermuda and the Cayman Islands), apply what is commonly referred to as the Rule in *Gibbs*. This rule provides that a debt is treated as discharged if it is compromised in accordance with the law of the jurisdiction which governed the instrument giving rise to the debt. For example, the discharge of Hong Kong law-governed debt by a Hong Kong scheme of arrangement.

Further, if a creditor submits to the jurisdiction of a foreign insolvency process, it is taken to have accepted that its contractual rights will be governed by the law of that foreign insolvency process. For example, a scheme sanctioned by the court of an offshore jurisdiction compromising Hong Kong law-governed debt will be treated in Hong Kong as binding on a creditor which submitted to that offshore jurisdiction.

Conversely, if that creditor did not submit to the offshore jurisdiction, the scheme will not be treated in Hong Kong as binding on it.

Hon. Harris J elaborated on this latter point by reference to a US\$ debt which is the subject of a scheme sanctioned in an offshore jurisdiction and then recognized under Chapter 15 of the U.S. Bankruptcy Code. In particular, he referred to the decision of the U.S. bankruptcy court in *In re Agrokor*,⁴ specifically the explanation that “Section 1520(a)(1) provides that the automatic stay will apply to all the debtor’s property that is located within the territorial jurisdiction of the United States.”

Hon. Harris J remarked that such a scheme would not be treated in Hong Kong as binding on a creditor which had not submitted to the offshore jurisdiction because, in his view, recognition of a scheme under Chapter 15 does not constitute a compromise of U.S. law-governed debt which satisfies the Rule in *Gibbs*. Hence, that creditor would not be prevented from petitioning in Hong Kong to wind up the scheme company.

⁴ *In re Agrokor d.d.*, 591 B.R. 163, 169 (Bankr. S.D.N.Y. 2018).

THE U.S. BANKRUPTCY COURT: *MODERN LAND (CHINA) CO. LIMITED*⁵

The debtor (Modern Land (China) Co. Limited) was the subject of a foreign proceeding in the Cayman Islands concerning a scheme of arrangement between it and the holders of certain of its US\$ notes. The scheme provided for the release of claims related to these existing notes and that, in return, each scheme creditor would receive a pro rata share of scheme consideration comprising cash and new notes to be issued by the debtor. The debtor's authorized foreign representative sought, among other things, recognition of the Cayman proceedings as foreign main proceedings pursuant to Chapter 15 of the U.S. Bankruptcy Code.

In his order of July 18, 2022, Judge Glenn granted recognition of the Cayman proceedings as a foreign main proceeding. He recognized the debtor's COMI in the Cayman Islands, citing the presumption that, absent evidence to the contrary, a debtor's registered office is presumed to be its center of main interest.⁶ The totality of the circumstances before him supported a finding of COMI in the Cayman Islands.⁷

In his opinion, he addressed the obiter comments of the Hong Kong court, noting that this was a "critically important issue." The scheme of arrangement in Modern Land (as is the case in many other scheme or restructuring plan cases) modifies or discharges existing debt and related guarantees governed by New York law, and provides for the issuance of new debt and guarantees governed by New York law.

Judge Glenn said that, with great respect for the Hong Kong court in *Rare Earth*, it had misinterpreted the earlier decision in *In re Agrokor* (and other decisions in the United States which have recognized and enforced foreign court sanctioned schemes or restructuring plans that have modified or discharged New York law governed debt). Provided that the foreign court properly exercises jurisdiction over the foreign debtor in an insolvency proceeding, and the foreign court's procedures comport with broadly accepted due process principles, a decision of the foreign court approving a scheme or plan that modifies or

⁵ Case No. 22-10707 (MG).

⁶ 11 U.S.C. § 1516(c).

⁷ Factors functioning together to support a finding of COMI in the Cayman Islands included: recognition of the Cayman scheme as a foreign main proceeding would comport with the goals of Chapter 15; recognition was consistent with creditors' expectations; the prevalence of the judicial role in the Cayman scheme; the insolvency activities in the Cayman Islands; Cayman choice of law principles; and the debtor's good-faith petition for recognition.

discharges New York law governed debt is enforceable. Chapter 15 limits a U.S. bankruptcy court's authority to enjoin conduct outside the territorial jurisdiction of the United States, but it does not make a discharge of New York law governed debt any less controlling.

In recognizing and enforcing the Modern Land's scheme of arrangement in this case, the court concluded that the discharge of the existing notes and issuance of the replacement notes was binding and effective.