IAN FLETCHER INTERNATIONAL INSOLVENCY LAW MOOT 2020

Nuzilia Supreme Court
In the Matter of Apricot Corp

Appeal from: *Administrator of Apricot Corp appointed by the Companies Court of Mercuria v Blueberry Bank SA* [2019] NHC 88
Judge: Mansfield J
Date of decision: 6 September 2019

Introduction

A. This matter is being heard by the Supreme Court of Nuzilia on appeal from a decision of Her Honour Judge Mansfield of the Nuzilian High Court. The key insolvency statutes of the State of Nuzilia are its Insolvency Law of 1965; Cross-Border (Insolvency) Law of 2010 and Recognition of Foreign Judgments (Insolvency) Law of 2019. Nuzilia is a common law jurisdiction and, as such, its binding legal principles include judge-made or common law.

B. Apricot Corp ("Apricot") is a company that is incorporated in Mercuria and operates through branches world-wide, including in Nuzilia. Apricot filed for Administration in Mercuria pursuant to the Insolvency and Reorganisation Law of 2006 of Mercuria. Subsequently the Administrator proposed a compromise or arrangement (a "Plan") to its creditors, which Plan has been approved by a section 111 meeting in Mercuria and sanctioned by the Companies Court of Mercuria.

C. Blueberry Bank SA ("Blueberry Bank"), a bank incorporated in Nuzilia, is one of Apricot's creditors. Apricot is indebted to Blueberry Bank as a bank lender on a Term Loan, under which US$6 million is owing. In the circumstances as detailed in the Judgment of Judge Mansfield, Blueberry Bank itself is indebted to Apricot under an interest rate swap agreement in the amount of US$6million (the "Swap Debt").

The application at first instance

D. Apricot represented by its Administrator sought:
   1) an order recognising and giving effect to the Plan; and
   2) an order that Blueberry Bank pay the Swap Debt in full.

E. Blueberry Bank resisted the claim on two principal bases, contending that:
   1) since the Term Loan is governed by Nuzilian law, the Plan, which is an insolvency procedure under the law of Mercuria, is simply incapable of operating to discharge or modify that debt.
   2) In the alternative, Blueberry Bank is in any event not liable to pay the Swap Debt to Apricot because under the law which governs both the Swap Debt and the Term Loan, the two debts cancel each other out as a result of the operation of substantive set-off under Nuzilian law. The High Court should not recognise the judgment of the Companies Court of Mercuria sanctioning the Plan to the extent that it deprives Blueberry Bank of the right of set-off pursuant to

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Nuzilian law on the basis that this would be contrary to a fundamental public policy of Nuzilia.

Findings

F. Judgment was given by Her Honour Judge Mansfield of the High Court of Nuzilia.

G. On the effect of the Plan on Nuzilian law governed debt, Her Honour held that the Insolvency Judgments Model Law as adopted by Nuzilia rejected the Gibbs Rule and, under the new reformulated approach, the fact that the Plan discharges or modifies contractual rights of creditors governed by a foreign law, pursuant to a different (and more relaxed) majority rule principle than would be permitted under the local law governing those rights, is not a failure to protect rights of creditors within the meaning of Article 14(f) Insolvency Judgments Model Law.

H. On the issue of the rights of set-off and public policy, Her Honour again referred to the Insolvency Judgments Model Law, in particular Article 7. Based on a fundamental public policy in Nuzilia that set-off rights between banks and their counterparties are respected, and given effect to, even where one or other of the bank or its counterparty is insolvent, Her Honour held it would be contrary to that public policy to enforce the Mercurian judgment in a manner which deprived Blueberry Bank of its right of set-off.

Grounds for Appeal

I. Permission has been granted to Blueberry Bank to appeal to the Nuzilia Supreme Court on whether Article 14(f) of the Insolvency Judgments Model Law is engaged to refuse recognition and giving effect to the Mercurian judgment sanctioning the Plan.

J. Permission has been granted to Apricot to appeal to the Nuzilia Supreme Court on whether Article 7 of the Insolvency Judgments Model Law prevents enforcement of Blueberry Bank's claim under the Swap Debt.

Relevant law:

Model Law on Recognition and Enforcement of Insolvency-Related Judgments (2018)

Set-off

Gibbs & Sons v Societe Industrielle et Commerciale des Metaux (1890) 25 QBD 399

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Apricot Corp v Blueberry Bank SA

Judgment of Her Honour Judge Mansfield of the High Court of Nuzilia
Judgment given on 6 September 2019

Introduction

1. This is a claim brought by Apricot Corp ("Apricot"), a company incorporated in Mercuria, against Blueberry Bank SA ("Blueberry Bank"), a bank incorporated in Nuzilia. Blueberry Bank has, since the financial crisis in Nuzilia in the late 1990s, been 50% state owned. The other 50% is owned by public sector pension funds in Nuzilia.

2. The claim is brought pursuant to the Recognition of Foreign Judgments (Insolvency) Law of 2019 (the "ROFJIL"). The ROFJIL is a Nuzilian statute that enacts in this jurisdiction with effect from 11 January 2019 the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (the "Insolvency Judgments Model Law"). This follows on from the Cross-Border (Insolvency) Law of 2010, which enacted in this jurisdiction the UNCITRAL Model Law on Cross-Border Insolvency (the "Cross-Border Model Law") with effect from 1 January 2011.

3. Each of the Insolvency Judgments Model Law and the Cross-Border Model Law have been enacted in Nuzilia without modification from the original text. The section numbers of the ROFJIL follow precisely the article numbers of the Insolvency Judgments Model Law. For ease of reference, I shall refer in this judgment to the Articles of the Insolvency Judgments Model Law.

4. Nuzilia has chosen the first option under Article 15(1) of the Insolvency Judgments Model Law, such that an insolvency-related judgment recognized or enforceable under the ROFJIL shall be given the same effect it has in the originating State.

Background

5. Apricot has its centre of main interests in Mercuria but operates through branches throughout the world. Its business is the manufacture and installation of fibre-optic cables to provide high speed connectivity between city-based businesses and data centres situated in more remote locations.

6. Apricot generally obtains financing for particular projects by bank lending, usually from a bank located in the part of the world in which the project is established. There are currently seven bank lenders. In most cases, the bank loan is governed by the law of the place in which the relevant bank is incorporated.

7. One of those bank lenders is Blueberry Bank. Apricot is indebted to Blueberry Bank on a term loan made in 2017 which was used by Apricot to construct a fibre-optic network in Nuzilia under which US$6 million is owing (the "Term Loan"). As a result of the

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insolvency proceedings affecting Apricot, to which I refer below, this amount is due and payable.

8. In addition, Blueberry Bank is indebted to Apricot under an interest rate swap agreement (the "Swap Agreement") which Blueberry Bank required Apricot to enter as a condition of entering into the Term Loan. Interest rates have moved in favour of Apricot since the inception of the Swap Agreement, such that it is substantially 'in the money'. As a result of Apricot's insolvency, the Swap Agreement has automatically terminated. As the non-defaulting party, Blueberry Bank is entitled to calculate the sum due upon termination, and has calculated that sum to be an amount of US$6 million due to Apricot (the "Swap Debt").

9. Both the Term Loan and the Swap Agreement are governed by Nuzilian law. I will need to come back to the relevance of Nuzilian law later on in this judgment, but for now I note two important features of Nuzilian law relating to set-off.

10. First, under the common law of Nuzilia, where a debt and a cross-demand are sufficiently closely related to each other, then there is substantive set-off between the two. That means that the amount which one party is entitled to claim from the other is treated as being discharged, to the extent of the cross-claim, by that cross-claim. It is common ground in this case that the Term Loan and the Swap Debt are sufficiently closely connected that substantive set-off operates between them.

11. Second, under the Nuzilian Insolvency Law of 1965, set-off is permitted in an insolvency proceeding between mutual debts arising between a creditor and the insolvent debtor. Accordingly, an account is to be taken of debts due either way as at the date of the commencement of the insolvency and only the net balance is either provable in the insolvency of the debtor, or recoverable from the creditor (as the case may be).

12. On 15 January 2019, Apricot filed for a process in Mercuria known as "Administration". This is a procedure available for companies that are insolvent, under which an insolvency professional – called an "Administrator" – is appointed by the Court to administer the affairs of the company with a view, primarily, to seeking a reorganisation of the company's affairs. In the event that this cannot be achieved, then the Administrator is entitled to apply to the court for an order converting the Administration procedure into a liquidating procedure.

13. On 30 April 2019, and as part of a wider restructuring of Apricot's affairs, the Administrator of Apricot made a proposal to its seven lending banks. This was done pursuant to section 111 of the Mercurian Insolvency and Reorganisation Law of 2006. Section 111 provides that an insolvency professional, such as an Administrator, may propose a compromise or arrangement (called a "Plan") to the company's creditors, or one or more classes of its creditors. The creditors (or classes of creditors) vote on the Plan. If it is approved by a majority by value and in number of those creditors who vote (or those creditors in each class that vote) at a meeting ordered by the court, then the court may decide to sanction the Plan. The court is not bound to do so, but exercises a

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discretion to sanction the Plan if, in its opinion, the Plan is fair and reasonable, taking into account the interests of all stakeholders of the company.

14. It may be important to note (as I will later explain) that there is a similar procedure in Nuzilia, under which a company can propose a "Scheme" to its creditors, or one or more classes of them. There is, however, an important difference: under the Nuzilian Scheme jurisdiction, it is necessary to obtain approval of a majority in number of creditors voting (or each class of creditors voting) at a meeting, but a majority by value (in each case) of 75%.

15. In very simplified terms, the Apricot Plan provides for the debt due to each of the banks to be cancelled and replaced with New Notes, with a face value equal to two-thirds of the value of the existing debt, with a maturity date of 31 December 2025. However, in calculating the amount of debt due to the banks, no set-off is permitted. It is common ground between the parties that the banks form a class of creditors for the purposes of section 111 of the Mercurian Insolvency and Reorganisation Law of 2006, and that it is permissible under Mercurian law for the Plan to subsist solely between Apricot and the creditors within that class.

16. Accordingly, the Plan purports to extinguish the Term Loan owed to Blueberry Bank in exchange for New Notes with a face value of US$4 million, payable on 31 December 2025. But Blueberry Bank remains liable to Apricot under the Swap Debt in the sum of US$6 million.

17. Five of the bank lenders voted at the meeting convened by the Mercurian Court to consider the Plan. It was approved by a majority of 65% by value and 60% by number of those attending and voting. The Companies Court of Mercuria subsequently approved the Plan on 30 June 2019.

18. Blueberry Bank, however, played no part in the Plan proceedings or the meeting to consider the Plan. Although it received notice of the meeting and of the court hearing by email in accordance with the procedural requirements of Mercurian law, it did not respond or attend the Plan meeting or hearing. Nor has it submitted any claim in the Administration of Apricot or otherwise submitted in any way to the jurisdiction of the Mercurian Court.

19. I heard evidence from a single joint expert in Mercurian law. That evidence established that, upon the insolvency of a corporation, there is no set-off of any kind allowed as between the insolvent debtor and its creditors (irrespective of whether there would, but for the insolvency, have been any other form of set-off between them under Mercurian law or under any applicable foreign law). Instead, any creditor of the insolvent debtor, who owes a separate debt to the debtor, must prove for the full amount of its debt without deduction of the cross claim and remains liable to the debtor on the cross-claim without deduction for the debt due from the debtor.

20. I also heard evidence from an expert in Nuzilian banking practice. Her evidence was to the following effect. The financial crisis in Nuzilia to which I referred above, caused

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the almost total collapse of the Nuzilian banking system and widespread damage to the Nuzilian economy. Since that crisis, banks incorporated in Nuzilia are required by law and detailed regulations to maintain a certain proportion of their assets as capital. The regulations are complex, and I need not refer to them in detail. However, the regulations permit a bank, when calculating the value of an asset consisting of a debt due from another entity (or the value of a liability due to another entity) to take into account any right of set-off under the law applicable to that debt. For example, if a bank is owed US$1 million by an entity, X, and owes that entity US$1 million, then if the bank has the right to set-off the debt due from X against the debt it owes to X then, for regulatory purposes, the asset has no value (and there is no corresponding liability to X). This right is regarded as fundamental to the banking community since, if set-off did not apply, then it would have to account separately for an asset of US$1 million (the debt due from X) and a liability of US$1 million (the debt due to X). For this reason, many banks (and certainly those incorporated in and conducting business primarily in Nuzilia) contract on the basis of Nuzilian law, precisely because Nuzilian law permits set-off both in a solvent situation (the substantive set-off to which I referred earlier) and in an insolvent situation (the provision of the Insolvency Law of 1965 to which I also referred earlier).

21. By this claim, Apricot (represented by its Administrator) seeks (1) an order recognising and giving effect to the Plan and (2) an order that Blueberry Bank pay the Swap Debt in full.

<u>The Issues</u>

22. Blueberry Bank resists the claim on two principal bases. First, it contends that since the Term Loan is governed by Nuzilian law, the Plan, which is an insolvency procedure under the law of Mercuria, is simply incapable of operating to discharge or modify that debt.

23. Secondly, Blueberry Bank contends (if its first point is wrong) that it is in any event not liable to pay the Swap Debt to Apricot because under the law which governs both the Swap Debt and the Term Loan, the two debts cancel each other out as a result of the operation of substantive set-off under Nuzilian law. It contends that this Court should not recognise the judgment of the Companies Court of Mercuria sanctioning the Plan to the extent that it deprives Blueberry Bank of the right of set-off pursuant to Nuzilian law. That, it says, would be contrary to a fundamental public policy of Nuzilia, namely to permit set-off between debts owed to and from banks incorporated in Nuzilia.

24. I will address these two issues in turn.

<u>Effect of the Plan on Nuzilian law governed debt</u>

25. The Supreme Court of Nuzilia has held that the rule which derives from the English case of *Antony Gibbs & Sons v Societe Industrielle et Commerciale des Metaux* (1890) 25 Q.B.D. 399 is part of the common law of Nuzilia. That rule (which I will refer to as

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the "Gibbs Rule") was explained by the late Professor Ian Fletcher in his book, The Law of Insolvency 5th edn (Sweet & Maxwell, 2017), 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 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."

26. The Nuzilian Supreme Court has also concluded that the Cross-Border (Insolvency) Law of 2010, being procedural in nature only, does not permit this court to recognise and enforce an insolvency judgment of a foreign court unless the party against whom the judgment is given is – under traditional conflicts of laws principles – subject to the jurisdiction of the foreign court. The Supreme Court, in this regard, applied the decisions of the English Supreme Court in *Rubin v Eurofinance SA* [2013] A.C. 236; [2013] B.C.C. 1 and the English Court of Appeal in *Re OJSC International Bank of Azerbaijan* [2019] B.C.C. 452. As a matter of common law, I am bound by those decisions of the Nuzilian Supreme Court.

27. Apricot contends, however, that these common law principles are now wholly irrelevant, following the recent enactment of the ROFJIL. It contends that the ROFJIL provides a clear authority for this court to recognise and give effect to the judgment of the Mercurian Court sanctioning the Plan.

28. It is accepted by Blueberry Bank that the Mercurian insolvency proceedings are Insolvency Proceedings within Article 2(a) of the Insolvency Judgments Model Law. It also accepts that the Administrator is an Insolvency Representative within Article 2(b), that the judgment of the Mercurian Court sanctioning the Plan is a "Judgment" within Article 2(c), and that it is an "Insolvency Related Judgment" within Article 2(d).

29. Moreover, Blueberry Bank accepts that none of the grounds to refuse recognition in Article 14 apply, other than that contained in sub-paragraph (f). So far as sub-paragraph (g) is concerned, it is important to note that the manner in which the Mercurian Court assumed jurisdiction over Blueberry Bank in respect of the Plan was materially similar to the way in which this court assumes jurisdiction over creditors (wherever situated) under our own law relating to Schemes.

30. Blueberry Bank contends, however, that Article 14(f) provides a ground to refuse to recognise the judgment of the Mercurian Court. Article 14(f) reads as follows:

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> "The judgment (i) materially affects the rights of creditors generally, such as determining whether a plan of reorganisation or liquidation should be confirmed, a discharge of the debtor or of debts should be granted or a voluntary or out-of-court restructuring agreement should be approved; and (ii) the interests of creditors and other interested persons, including the debtor, were not adequately protected in the proceeding in which the judgment was issued."

31. Blueberry Bank contends that its interests, and the interests of any other creditors whose debts were governed by a law other than Mercurian law (which included in fact all of the lending banks subject to the Plan) were not adequately protected. It contends that it explicitly chose to contract with Apricot on the basis of Nuzilian law, in the knowledge that Nuzilian law provides a particular level of protection for creditors. In particular, while Nuzilian law contains provisions which enable contractual rights of creditors of a debtor to be varied by a majority rule principle, the relevant majority is 75% by value of all creditors (and a majority in number) who vote on a Scheme. Mercurian law subjects creditors to a fundamentally different risk – namely that their contractual rights can be varied by a simple majority in value (and number) of those creditors that vote on a Plan.

32. I reject this argument. It seems to me that one of the purposes of the Insolvency Judgments Model Law is to reject the Gibbs Rule in favour of the reformulation originally advanced by the late Professor Ian Fletcher, recently endorsed by the High Court of Singapore in *Pacific Andes Resources Development Ltd* [2016] SGHC 210 at [48]:

> "In the case of a contractual obligation which happens to be governed by English law, a further rule should be developed whereby, 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 ground for the discharge to take effect under the applicable law."

33. Under this approach, it is not a "right" of a creditor, which is deserving of "protection", that insolvency proceedings relating to its debtor shall be conducted under the law pursuant to which their contractual rights are governed. Accordingly the fact that the Plan discharges or modifies contractual rights of creditors governed by a foreign law, pursuant to a different (and more relaxed) majority rule principle than would be permitted under the law governing those rights, is not a failure to protect rights of creditors within the meaning of Article 14(f).

<u>Rights of set-off and public policy</u>

34. Blueberry Bank's alternative argument is a variation on its first. It contends that even if the overriding of its choice of Nuzilian law to govern its relationship with Apricot is

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an accepted consequence of the enactment in Nuzilia of the Insolvency Judgments Model Law, it is different when it comes to its choice of Nuzilian law to govern its entitlement to set-off. Specifically, it contends that there is a fundamental public policy in Nuzilia that set-off rights between banks and their counterparties are respected, and given effect to, even where one or other of the bank or its counterparty is insolvent. It would be contrary to that public policy to enforce the Apricot judgment in a manner which deprived Blueberry Bank of its right of set-off. This court is not prevented from taking any action otherwise governed by the Insolvency Judgments Model Law, by Article 7, "if the action would be manifestly contrary to the public policy, including the fundamental principles of procedural fairness" of Nuzilia.

35. Apricot contends that the Nuzilian law of set-off does not reflect a public policy, or a fundamental procedural fairness, but merely one of two equally valid, but policy-neutral, approaches to the conundrum thrown up by the pari passu principle which is inherent in any insolvency where those who are owed money by the insolvent estate also owe money to the insolvent debtor. One approach (that adopted in Mercuria) is to regard the claim against the person proving in the estate as an asset of the estate which is to be got in and made available for all creditors, and that it would be contrary to the pari passu principle to allow that person to treat itself as paid in preference to other creditors of the estate, by use of the cross-claim owed by it to the debtor. The other approach (that adopted in Nuzilia) is to view the pari passu principle as applying only to the net amount owing to each creditor of the estate.

36. In my judgment, Blueberry Bank is correct on this point. Set-off has been treated, by more than one jurisdiction, as a substantive principle which, as a matter of policy and justice, cannot be dis-applied in favour of the rules of a foreign insolvency law. So, for example, in *Re HIH Casualty & General Insurance Limited* [2008] 1 WLR 852 at [15]-[17] Lord Hoffmann, when commenting on the earlier decision of Sir Richard Scott V-C in *BCCI (No.10)* [1997] Ch. 213 described the rules of set-off under English law as "a matter of substantive justice between the parties". In *BCCI (No.10)* Scott V-C held that he had no jurisdiction to dis-apply English rules of insolvency set-off, and he directed funds to be withheld by liquidators in England to compensate creditors who would be disadvantaged by the fact that the law of the main insolvency proceedings in Luxembourg (where distributions were to be made) did not, as a matter of Luxembourg public policy, permit set-off. In *HIH*, Lord Hoffmann (with whom Lord Walker agreed) was of the opinion that the decision in *BCCI* was correct on the facts, because the debts in question in *BCCI* were the result of transactions having a close connection to England, and so "justice required" that the English rules of set-off should apply to them.

37. I note that the Insolvency Judgments Model Law is choice-of-law blind. In this respect it differs from the other significant international instrument designed to harmonise insolvency proceedings, the Insolvency Regulation of the European Union (the "IR"). The IR was negotiated between member states of the European Union over a long period. While it provides for automatic recognition throughout the EU of insolvency judgments entered in one member state, it does so against a backdrop of carefully negotiated choice of law provisions. Most issues arising in an insolvency are governed

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by the law of the state where the main insolvency proceedings are taking place. However, there are certain matters which the member states thought important enough to be excepted from that general rule. Set-off is one such matter. By Article 6 of the IR (Article 9 of the IR Recast), the opening of proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claims.

38. This is far from conclusive, but it demonstrates that rights of set-off were considered sufficiently important to be respected by the member states negotiating the IR, even where the law of the jurisdiction in which main insolvency proceedings are opened does not do so.

39. In this case, the debts in question were inextricably connected to a construction project in Nuzilia, and as I mentioned, I have heard evidence from a banking expert who stressed the importance of set-off to the banking community and the wider economy and people of Nuzilia. I consider that substantive justice between the parties requires the application of Nuzilian rules of set-off in this case, and that in any event it is plain that the public policy of Nuzilia requires the application of the Nuzilian rules of set-off in the banking context. The stability of the banking system is a matter of great public importance in Nuzilia. That stability is threatened if rights of set-off under Nuzilian law, which underpin a bank's calculation of its capital requirements, are thwarted.

40. Accordingly, I conclude that Article 7 of the Insolvency Judgments Model Law is engaged.

Conclusion

41. For these reasons, I will recognise the judgment of the Mercurian court sanctioning the Plan, but I dismiss Apricot's claim to recover the Swap Debt from Blueberry Bank. Under Nuzilian law, the whole of that debt is set-off against the Term Loan, such that there is no balance owing which can be the subject of a claim by Apricot. It would be manifestly contrary to Nuzilian public policy to give effect to the Mercurian judgment sanctioning the Plan insofar as it has sought to compromise Blueberry Bank's claims against Apricot without respecting Blueberry Bank's right of set-off.

Judgment of HHJ Mansfield on Permission to Appeal

Blueberry Bank seeks permission to appeal against my conclusion that Article 14(f) of the Insolvency Judgments Model Law is not engaged. Apricot seeks permission to appeal against my conclusion that Article 7 of the Insolvency Judgments Model Law applies to prevent enforcement of its claim under the Swap Debt. I recognise that these are novel points of law, on which there is no prior authority in Nuzilia. I also anticipate that the Supreme Court may have the benefit of a wider citation of case law and analysis of the UNCITRAL Model Laws

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from other jurisdictions than I had at the hearing before me. Accordingly, I consider that it is appropriate to grant permission to appeal on both points.

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