FINANCIAL MARKETS LAW COMMITTEE

The Rule in Gibbs: Exploring its value and practical use in the financial markets as a guarantor of legal predictability

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Brian Gray	**Working Group***
Chief Executive	**Tom Smith KC** (Chair), 3-4 South Square
Becky Jacombs	**Bruce Bell,** Latham & Watkins LLP
Senior Researcher	**Katharina Crinson**
Omotola Ariyo	**Radford Goodman**, Mishcon de Reya LLP
Research Coordinator	**Jennifer Marshall**, Allen & Overy LLP
	Gabrielle Ruiz, Clifford Chance LLP
	Kate Stephenson, Kirkland & Ellis International LLP
	Richard Tett, Freshfields Bruckhaus Deringer LLP
	Jo Windsor, Linklaters LLP

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1. Introduction

1.1 The role of the Financial Markets Law Committee (the "**FMLC**" or the "**Committee**") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2 In 2022, the Insolvency Service commenced a consultation[1] (the "**Consultation**") with regard to the adoption of Article X of the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments ("**MLIJ**"). Article X provides that, notwithstanding any prior interpretation to the contrary, the relief available under Article 21 of the UNCITRAL Model Law on Cross-Border Insolvency[2] (the "**Model Law**") includes the recognition and enforcement of a foreign insolvency-related judgment. The FMLC responded[3] to the Consultation, stating that the suggested implementation of Article X could create material uncertainty in the wholesale financial markets in particular in relation to its effect on the rule in Gibbs[4] (the "**Rule in Gibbs**").

1.3 In 2023, the Insolvency Service published the outcome of the Consultation[5], stating that, following the arguments made by respondents about the need for greater clarity, before implementing the MLIJ, it would undertake further work to determine how legal certainty can be maintained and to settle the UK's stance on the Rule in Gibbs.

1.4 This paper considers the Rule in Gibbs, its value and its practical use in the financial markets as a guarantor of legal predictability. It also discusses the alternatives to Rule in Gibbs*,* including Article X and how these differ to the current position under English law.

2. The Rule in Gibbs

2.1 The Rule in Gibbs is derived from the general rule of English private international law that the applicable law of a contract governs, among other things, its variation and discharge.[6]

2.2 The Rule in Gibbs reflects the application of that general principle to the particular context of a foreign insolvency or restructuring process. In Dicey, Morris & Collins[7] the rule is stated as follows:

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[1] Implementation of two UNCITRAL Model Laws on Insolvency Consultation: https://www.gov.uk/government/consultations/implementation-of-two-uncitral-model-laws-on-insolvency/implementation-of-two-uncitral-model-laws-on-insolvency-consultation.

[2] Incorporated into English law by the Cross-Border Insolvency Regulations 2006.

[3] Response to the Insolvency Service's consultation on the implementation of two UNCITRAL Model Laws on Insolvency: https://fmlc.org/publications/letter-response-to-the-insolvency-services-consultation-on-the-implementation-of-two-uncitral-model-laws-on-insolvency/

[4] Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux (1890) LR 25 QBD 399.

[5] Implementation of two UNCITRAL Model Laws on Insolvency Summary of consultation responses and Government response: https://www.gov.uk/government/consultations/implementation-of-two-uncitral-model-laws-on-insolvency/outcome/implementation-of-two-uncitral-model-laws-on-insolvency-summary-of-consultation-responses-and-government-response

[6] Goldman Sachs International v Novo Banco SA [2018] UKSC 34 per Lord Sumption at [12], citing Adams v National Bank of Greece SA [1961] AC 255. See also Lord Esher MR's speech in Gibbs itself.

[7] On the Conflict of Laws, 16th Ed., 2023, Rule 211.

"*A discharge from any debt or liability under the bankruptcy law of a foreign country outside the United Kingdom is a discharge therefrom in England if, and only if, it is a discharge under the law applicable to the contract*."[8]

2.3 In The Law of Insolvency[9], Professor Fletcher expresses the rule in the following way:

"*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*."

2.4 In the Gibbs case itself, the Court of Appeal held that, as a matter of English law, a French bankruptcy of a French company did not discharge a debt under a contract for the sale of goods governed by English law.

2.5 There is an important exception to the Rule in Gibbs if the counterparty submits to the foreign insolvency or restructuring proceeding by participating in it, such as by lodging a proof of debt. This is taken as agreement that the contractual obligations are subject to the law of the insolvency/restructuring proceeding.[10] The creditor therefore has a choice: it can choose to submit to the foreign proceeding with the result that it will be bound by any discharge or variation of its contractual obligations or it can choose not to do so and therefore not to participate in any distributions in that foreign proceeding.

2.6 For a time, the English courts appeared willing to subordinate the Rule in Gibbs to the principle of modified universalism by treating foreign insolvency-related judgments as a special category of judgment which would be more readily enforceable under English common law.[11] But in Rubin v Eurofinance SA[12] the Supreme Court signalled a return to orthodoxy, holding that foreign insolvency-related judgments were subject to the same common law rules of recognition and enforcement as other foreign judgments. The Supreme Court also held that the Model Law did not include provisions dealing with the recognition and enforcement of foreign insolvency-related judgments.[13]

2.7 More recently, in OJSC International Bank of Azerbaijan v Sberbank of Russia (the "**IBA case**")[14], the Court of Appeal declined to grant a stay under Article 21 of the Model Law in support of an Azeri restructuring plan in circumstances where the stay would have had the effect of circumventing English law rights under the Rule in

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[8] The Rule in Gibbs does not apply only to English law governed contracts: it applies equally regardless of the applicable law.

[9] 5th edition (2017) at para 30-061.

[10] See OJSC International Bank of Azerbaijan [2018] EWCA Civ 2802, per Henderson LJ at [28].

[11] Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc [2006] UKPC 26; In re HIH Casualty and General Insurance Ltd [2008] UKHL 21, per Lord Hoffmann.

[12] [2012] UKSC 46; see also Fibria Celulose S/A v Pan Ocean Co. Ltd [2014] EWHC 2124 (Ch).

[13] per Lord Collins at [133 to 144].

[14] [2018] EWCA Civ 2802.

Gibbs.[15] It was regarded as "*highly significant*"[16] that the Model Law did not contain any choice of law provisions or requirements for reciprocity.[17]

2.8 Although the Rule in Gibbs is often referred to in terms of preventing a foreign insolvency or restructuring process from varying or discharging an English law governed contract, it is also important to have in mind that the rule may also have the effect of providing a positive basis for recognition under English law of the effect of a foreign insolvency or restructuring proceeding. Thus, pursuant to the Rule in Gibbs, English law will recognise the effect of a foreign insolvency or restructuring in relation to contractual obligations where the effect of the insolvency or restructuring is recognised under the governing law of the debt. For example, English law would recognise the effect of a New York insolvency or restructuring proceeding in relation to New York law governed debt or a French insolvency or restructuring proceeding in relation to French debt.

2.9 It is therefore, in our view, incorrect to view the Rule in Gibbs as being a rule which is designed to protect the application of English law. This point was made by the Court of Appeal in the IBA case:[18]

"I would, however, observe that the charge of parochialism seems to me rather unfair, given the acceptance by this court in Gibbs that questions of discharge of a contractual liability are governed by the proper law of the contract, whether or not that law is English law. In the present case, as in Gibbs itself, the relevant contracts were governed by English law; but if they had been governed by Azeri law, the English court would have recognised the effect of the restructuring."

2.10 The Rule in Gibbs is one element of the system of English private international law, which has the capability and flexibility to recognise and take into account foreign law in appropriate circumstances.

3. Alternatives to the Rule in Gibbs

Europe

3.1 At a European level, there are various instruments designed to promote legal certainty based upon the governing law of the contract chosen by the parties. These instruments operate within the cross-border insolvency and the financial markets and services sectors.

3.2 The starting point is the European Rome I Regulation on the law applicable to contractual obligations ("**Rome I**").[19] Rome I firmly establishes that the law governing a contract, including that selected by the contracting parties, should also determine how obligations under that same contract should be extinguished.[20] In this sense, the Rule in Gibbs is not an "outlier" or unusual in favouring the contracting parties' choice of law. Under the European legislative regime, the starting point is similarly that the governing law of the contract will govern the variation or discharge of the contractual obligations contained in the contract. The position under Rome I

[15] per Henderson LJ at [88] to [95].

[16] per Henderson LJ at [89].

[17] In contrast to, for example, the EU Regulation on Insolvency Proceedings.

[18] per Henderson LJ at [30].

[19] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

[20] Article 12(1)(d) of Rome I.

is therefore analogous to the effect of the Rule in Gibbs as set out in paragraphs 2.8 and 2.9 above.

3.3 The effect of Rome I is then subject to the effect of the European instruments dealing specifically with insolvency.

3.4 In a formal insolvency scenario, the framework for cross border co-operation and recognition is embodied in the Recast European Insolvency Regulation ("**EIR**").[21] The EIR provides for the recognition of insolvency proceedings across the EU and (generally speaking) provides for the conduct of the proceedings to be governed by the law applicable to those proceedings. It also provides for the recognition of judgments which concern the course and closure of insolvency proceedings as well as compositions, without the need for any further formalities.[22] However, importantly, the EIR includes express safeguards for certain types of arrangements. These safeguards are designed to promote legal certainty. For example:

3.4.1. Article 8 provides protection for the rights of secured creditors in relation to property located in other member states.

3.4.2. Article 9 preserves and protects rights of set-off.

3.4.3. Article 12 provides that the effect of insolvency proceedings on the rights and obligations of parties to a payment system or to a financial market shall be governed by the law that is applicable to that system or market.

3.4.4. There are other exceptions for real property, intellectual property rights and employment contracts.

3.5 Another example is the European Financial Collateral Directive[23] which also operates to disapply the effects of an insolvency proceeding in relation to financial collateral arrangements. In that instrument, the restrictions on security enforcement and avoidance provisions that might otherwise negatively impact the ability to close out and rely on netting arrangements are not applicable. Similar safeguards also exist in the Credit Institutions Winding-Up Directive.[24]

3.6 The European Restructuring Framework Directive[25] includes carve-outs to exempt netting arrangements, including close-out netting, from the effects of the stay.

United States

3.7 The cross-border co-operation, recognition and relief available under Chapter 15 of the US Bankruptcy Code ("**Chapter 15**") does not have any express protections for contracts governed by the laws of one of the United States (such as New York law) and so it does not have a direct analogy with the Rule in Gibbs. However, Chapter 15 does not impinge upon a counterparty's existing rights under certain financial

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[21] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).

[22] Article 32.

[23] Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

[24] Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions.

[25] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

contracts (namely securities, forward and commodity contracts and repurchase, swap and master netting agreements) – i.e. there are "safe harbors" in respect of financial contracts. Such contracts are not subject to the automatic stay or avoidance provisions which otherwise might affect the operation of the mechanisms designed to close out and net balances.[26]

3.8 In the context of recognition under Chapter 15, the US Bankruptcy Court also has to be satisfied that due process has been followed.[27] The emphasis on due process can be compared to the similar approach of the UK Supreme Court in Rubin v Eurofinance SA, in refusing recognition of a U.S. default judgment under the Cross-Border Insolvency Regulations 2006 (the "**CBIR**") on the basis that a foreign judgment can only be enforced against entities in England which have submitted to the foreign court's jurisdiction. As the nature of the CBIR was held to be procedural only, the English Court could therefore not overlook the requirement regarding submission to the foreign jurisdiction. In contrast, the wide discretion available to US Courts under Chapter 15 (in particular, the ability to provide both procedural and substantive relief, e.g. applying a foreign law) facilitates a universal application to cross-border insolvency situations, which includes the recognition of a foreign insolvency proceeding discharging New York law governed debt. However, this is subject to the important proviso 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 discharges New York law governed debt is enforceable".[28] This means that while the discharge of New York law debt is considered effective by operation of a foreign law, this applies only where the jurisdiction has been properly exercised and due process principles observed. Accordingly, in Chapter 15, too there are constraints on the exercise of the court's discretion.

UNCITRAL project on applicable law in insolvency proceedings

3.9 UNCITRAL is in the process of developing draft legislative provisions on applicable law in insolvency proceedings. These legislative provisions envisage various exceptions to the *lex fori* concursus, e.g. for payment, clearing and settlement systems, regulated financial markets and other multilateral trading facilities, close-out netting arrangements, some aspects of employment contracts and ongoing arbitral proceedings.[29]

3.10 The highly-detailed, multi-year project at UNCITRAL clearly indicates the complexity of determining appropriate exceptions to a general *lex fori* concursus rule.

Article X

3.11 The Consultation included a proposal for the implementation of Article X of the MLIJ, which states that the recognition of insolvency-related judgments is a form of

[26] U.S. Code § 561 - Contractual right to terminate, liquidate, accelerate, or offset under a master netting agreement and across contracts; proceedings under chapter 15; see also Fairfield Sentry Ltd. v. Citibank, N.A. London (S.D.N.Y., Aug. 24, 2022).

[27] See in re Modern Land (China) Co., Ltd. (S.D.N.Y., July 18, 2022). Whilst the Bankruptcy Court was prepared to recognise the discharge of New York law governed debt effectuated by a Cayman insolvency process, this was on the premise that due process had been followed in that Cayman process.

[28] See re Modern Land (China) Co., Ltd. (S.D.N.Y., July 18, 2022).

[29] Note by the Secretariat of Working Group V, 4 September 2023.

assistance that can be granted under the Model Law (which is implemented in the UK by the CBIR).

3.12 As the Consultation notes, neither the Model Law nor Article X address the question of whether a judgment should, or should not, be recognised. The Consultation states that the Government planned to provide a non-exhaustive list of factors that the court may take into account when deciding whether or not to recognise a judgment, and that the court would retain discretion to recognise a judgment even if one of the factors applied, if that is appropriate, or to apply another relevant factor in deciding not to recognise a judgment.

3.13 As proposed, this would leave the court with a wide discretion as to whether to recognise a foreign judgement and offers no specific protections, for example for the rights of counterparties under financial contracts. This level of discretion inherently creates uncertainty, and it would likely take a number of years for sufficient case law to build up to provide people with confidence in any particular outcome.

3.14 The Consultation noted that it was not the Government's intention to override the Rule in Gibbs.[30] We note that should this be reflected in legislation there may well remain undesirable uncertainty as to the position. An adoption of Article X in conjunction with some kind of legislative statement that the Rule in Gibbs is not to be overridden is capable of creating its own legal uncertainties, particularly in relation to the intended remit of Article X, so that any legislation and accompanying explanatory statements would need to set this out very clearly in order to ensure legal certainty. In particular, there may well be a question as to whether a legislative statement of this kind could have the effect of preserving the Rule in Gibbs in the face of a clear power given to the Courts which would, on its face, permit relief to be granted which would have the effect of overriding the rule.

Conclusions on alternative systems

3.15 If it is considered that the Rule in Gibbs ought to be reformed, it will be necessary to incorporate clear parameters and safeguards such as those in other instruments explored above. Simply affording the court a wide discretion, as is appeared to be proposed in the implementation of Article X, in such cases will contribute unnecessarily to a lack of certainty and predictability and may deter parties from choosing English law to govern financial contracts as set out below.

4. Removal of the Rule in Gibbs: Impact on English Law governed financial contracts

Current position in relation to English law contracts

4.1 As is well known, English law is often selected by parties to govern financial contracts.[31] This is because English law is seen by market participants as being stable, certain, predictable and sophisticated.

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[30] See the Consultation here: "For this reason we do not anticipate, and it is not our intention, that the addition of article X will affect the application of the rule in Gibbs to the rights of creditors who have contracted with the insolvent under the law of England and Wales."

[31] See also the Law Society paper as to the value of English law (October 2023) https://www.lawsociety.org.uk/topics/research/international-data-insights-report and the underlying source paper by Oxera referred to by the Law Society: Economic value of English law, 2021: https://legaluk.org/wp-content/uploads/2021/09/The-value-of-English-law-to-the-UK-economy.pdf.

4.2 Examples of financial contracts which are often or typically governed by English law include:

- Syndicated bank debt;
- Bilateral bank debt;
- International bonds;
- Securitisations (these involve the creation of bonds and/or bank debt but should be noted separately due to the nature of the legal opinions they are associated with as described in paragraph 4.21 below);
- Leveraged and infrastructure finance;
- ISDA swaps;
- Stock lending and repo transactions;
- Insurance and reinsurance contracts;
- Commodities contracts;
- International maritime contracts;
- Export credit finance and guarantees;
- Project finance; and
- Aircraft finance leases.

4.3 To take one example, the majority of the ISDA Master Agreements entered into between counterparties based in the EU or EEA are governed by English law. English law therefore likely governed at least €661.5tn of global derivatives transactions in 2018.[32]

4.4 Similarly, to take another example, that of commodities contracts, the standard form contracts offered by the Grain and Feed Trade Association (GAFTA), the Federation of Oils, Seeds and Fats Association (FOSFA), the Refined Sugar Association (RSA) and the London Metal Exchange are governed by English law.

4.5 Likewise, a significant portion of bank debt, international bonds and securitisation transactions in the international financial markets are executed under standard English law governed documentation sponsored by the Loan Market Association (LMA) and the International Capital Markets Association (ICMA).

4.6 When parties choose English law to govern these types of contract, their expectation is that their substantive rights under the contract (including, for example, the right to exercise set-off rights or close-out netting) would be determined by English law. See for example following passage from judgment in Re Pan Ocean Ltd[33]

"in the present case, the parties had deliberately chosen English law as the law of the contract. Whereas the parties might have expected that a Korean court would apply Korean insolvency law to the insolvency of the Company, they might have been very surprised to find that an English court would apply Korean insolvency law to the substantive rights of the parties under a contract which they had agreed should be governed by English law."

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[32] https://legaluk.org/wp-content/uploads/2021/09/The-value-of-English-law-to-the-UK-economy.pdf.

[33] [2014] EWHC 2124 (Ch), Morgan J at [112].

4.7 Under European insolvency legislation (i.e. the EIR and the Credit Institutions Winding Up Directive) the legitimate expectations of the parties regarding the choice of English law were protected because such legislation contains choice of law rules for set-off and netting (which look to the applicable law of the contract) or for the enforceability of security (which look to the lex situs of the secured assets). However, no such choice of law rules were proposed in the Consultation for Article X.

4.8 Further, when selecting the law to govern a contract, it is reasonable to assume that one of the key matters which the parties will take into consideration is the susceptibility of contracts governed by particular laws to being restructured, varied or amended without the consent of the parties thereto. This is a matter which is likely to be of particular importance to financial institutions and to other creditors who advance funding to debtors.

4.9 This is because one of the key risks faced by creditors is the risk of default by the debtor. Related to that is the risk that the debt may be discharged or varied without the consent of the creditor by a foreign insolvency or restructuring process. This risk may be all the more acute in relation to debtors who are based in countries or territories with less developed insolvency and restructuring regimes or with regimes that do not conform to the usual norms in terms of due process and fair treatment of creditors. Furthermore, given that it may be possible to commence foreign insolvency or restructuring processes in jurisdictions where the debtor has only a limited connection (for example the presence of assets), it may be difficult for the creditors to identify in advance all of the jurisdictions in which insolvency or restructuring proceedings could be commenced. It is also possible for a debtor to move its centre of main interests (whether by moving the registered office or the central and financial administration of a company or both) adding to the uncertainty as to where restructuring proceedings could be commenced.

4.10 In many such cases, because of the Rule in Gibbs, the choice of English law as the governing law represents a choice by the creditor that the indebtedness arising under the relevant contract cannot be compromised, discharged or restructured outside of an English law governed process (unless the creditor consents). This no doubt represents, from the creditor's perspective, a valuable and important protection.

The IBA Case

4.11 The point is illustrated by the facts of the IBA case. In that case, the lender had selected English law to govern the relevant bank debt. (We understand that the evidence filed by the lender explained that one of the reasons it had selected English law was because of the Rule in Gibbs.) From the perspective of the lender, this meant that the debt was not capable of being varied, discharged or compromised by a non-English insolvency process without the consent of the lender.

4.12 On the facts of that case, it meant that the lender's debt was not capable of being compromised, without its consent, in an Azeri restructuring process, taking place in the domicile of the debtor (Azerbaijan). Although IBA could have proposed an English scheme of arrangement to compromise the English law debt, that debt would likely have had to form a separate class – bringing with it the protections under an English scheme of arrangement or restructuring plan.[34] The facts of the case are an example of where a creditor (and a debtor) may select English law precisely in order to avail themselves of the protection of the Rule in Gibbs.

[34] per Henderson LJ at [88].

Opinions on English law transactions

4.13 In order for the parties to various types of financial contract to get the necessary regulatory capital treatment (and to be able to carry positions on a net rather than a gross basis), the parties are required by their regulators to obtain legal opinions from all relevant jurisdictions confirming that the netting (and any collateral) will be effective including in the event of insolvency proceedings of the counterparty. Such opinions may also be required by the counterparty's credit committees or for the counterparty to assess the credit risk associated with the transaction in question.

4.14 For English law governed agreements, the parties therefore need to obtain an English law opinion on matters such as the exercise of termination rights, the validity of close-out netting and set-off and the enforceability of any collateral in the event of insolvency proceedings of the counterparty. [35] Not only will such opinions deal with the consequences of English insolvency proceedings in respect of the counterparty but they will also need to deal with the recognition in England of any foreign insolvency proceedings in respect of the counterparty, particularly where that counterparty is incorporated in another jurisdiction, and whether such recognition could have an impact on the English law governed agreement. Currently, as a result of the Rule in Gibbs, the foreign insolvency proceedings cannot vary or discharge an English law governed agreement and so the English law opinions do not need to deal in any detail with the impact of foreign insolvency proceedings.

4.15 Some of the trade associations (such as ISDA) provide industry opinions which members can rely on. An example of such an English law opinion is the Linklaters' ISDA netting memorandum dated 21 September 2022 for England and Wales (the "**ISDA English Law Opinion"**). The ISDA English Law Opinion currently deals with the question of recognition of foreign insolvency proceedings or foreign insolvency-related judgments in sections 4.3.2 and 4.3.3. In particular, the latter section deals with the question of whether a foreign liquidator in a jurisdiction that does not recognise close-out netting (a "**Non-Netting Jurisdiction**") could take any actions to disrupt close-out netting in England under an ISDA Master Agreement entered into with an English counterparty. The opinion asks, for example, whether such a liquidator could seek recognition of an order of the court of the Non-Netting Jurisdiction declaring that the netting is unenforceable under the laws of the foreign jurisdiction. The conclusion reached based on current law is as follows:

"*In our view, and depending on the facts, there is a risk that the liquidator in the Non-Netting Jurisdiction could bring an action in England that could have the effect of disrupting the netting contemplated by Section 6(e) of the ISDA Master Agreement, although we consider that an English court would strive to find ways of giving effect to the netting. Our concerns arise primarily from section 426 of the Insolvency Act 1986 and the possibility of a foreign judgment being enforced in England in certain circumstances. The risk is lessened in circumstances where the assistance or relief sought by the liquidator in the Non-Netting Jurisdiction relates to an ISDA Master Agreement that constitutes a financial collateral arrangement, or is part of an arrangement of which a financial collateral arrangement forms part, for the purposes of the FCA Regulations."*

4.16 The reason why section 426 of the Insolvency Act 1986 ("**Section 426**") is the main concern here is that this is currently the only way in which the English court could

[35] The parties will also seek legal opinions from the jurisdiction of incorporation of the counterparty on the basis that this is where insolvency proceedings are most likely to be commenced. One issue with Article X or the MLIJ is that a relevant insolvency-related judgement does not need to be handed down by the court of the place of incorporation or even the centre of main interests of the counterparty and so it is not clear what jurisdictions will be deemed to be relevant jurisdictions for opinion purposes if Article X were to be adopted.

apply the law of a foreign court (including potentially the law of a Non-Netting Jurisdiction). This will no longer be the case following the adoption of Article X because, if an insolvency-related judgment giving effect to foreign insolvency law is recognised and effective in England, the English court will (in effect) be applying the law of the foreign court when giving effect to that insolvency-related judgment. In relation to Section 426, the ISDA English Law Opinion concludes that:

"*it does not seem likely that an English court would apply foreign law under this section to overturn the effect of the close-out netting contemplated by the ISDA Master Agreement. An English court is more likely to apply foreign law, for example, to invalidate Transactions under a doctrine of foreign law comparable to our rules about preferences or transactions at an undervalue than to apply it to override a policy as fundamental to our insolvency law as insolvency set-off*."

This statement is made as a result of the case law and commentary on Section 426. Unless and until there is similar case law on Article X (and given the lack of guidance as to when a court should exercise its discretion to recognise an insolvency-related judgment), legal practitioners may well not be able to give a similar level of comfort in relation to the circumstances in which the English court would recognise an insolvency-related judgment applying foreign insolvency law under Article X.

4.17 The ISDA English Law Opinion then goes on to consider Regulation 15A of the Financial Collateral Arrangement (No 2) Regulations 2003 (SI 2003/3226) ("**FCA Regulations**") and concludes that:

"*this may mean it is not open to the court to apply foreign law under section 426(5) where the foreign law is contrary to the FCA Regulations. In any event, Regulation 15A(2) provides that a court shall not, in pursuance of section 426 of the Insolvency Act 1986 or any other enactment or rule of law, recognise or give effect to (a) any order made by a foreign court exercising jurisdiction in relation to insolvency law or (b) any act of a person appointed in such foreign country to discharge any functions under insolvency law insofar as the making of the order or the doing of the act would be prohibited by Part 3 of the FCA Regulations in the case of an English court or a relevant office holder*."

It is not clear from the Consultation whether the Insolvency Service is intending to update Regulation 15A of the FCA Regulations so as to refer expressly to an order made under Article X.

We discuss in the next section how the Rule in Gibbs is dealt with in legal opinions covering some of the other types of financial contract listed in paragraph 4.2.

Position in relation to English law contracts if Article X overturns Rule in Gibbs

4.18 Without knowing how Article X would be implemented, it is difficult to know how English law opinions on financial contracts such as the ISDA Master Agreement would need to be modified and whether this would still give parties the comfort they need for regulatory capital or credit purposes.

4.19 If Article X is adopted without any guidance being given to the courts as to how to exercise their discretion regarding the recognition of insolvency-related judgments (or with the limited guidance proposed in the Consultation), it is very likely that such opinions would need to be significantly modified. Indeed, the conclusion is likely to be that, if there is an insolvency related-judgment from the court of a Non-Netting Jurisdiction, this could have a negative impact on netting, set-off and collateral under an English law governed financial contract. This may in turn encourage the parties

to choose New York law to govern such contracts given the additional protections under US bankruptcy law (as to which see below).

4.20 In some cases the legal opinions given in respect of some of the other types of financial contract identified in paragraph 4.2 include a carve-out for insolvency laws (i.e. they are qualified by all insolvency laws). However, where transactions are secured (a significant sector of the market including leveraged, asset, project and infrastructure financings are secured) the insolvency carve out may not apply to the security (which contains a debt in the form of a covenant to pay clause) and so the terms of such opinions will need to be adjusted to address the uncertainties that would derive from the adoption of Article X, not least detailing the lack of clear parameters as to how the English court would exercise its discretion in recognising insolvency related judgments from elsewhere. Indeed, by virtue of the significant implications for legal certainty of debts owed under English contracts, occasioned by the adoption of Article X, we consider it possible that even for unsecured transactions which have a broad insolvency carve out, the implications of Article X's adoption would likely also need to be addressed in the legal opinion. In addition the impact of any insolvency or restructuring proceedings will generally be considered by those structuring those transactions and advising clients on the results as, at present, opinions are given on the basis of the Rule in Gibbs even if not expressly. If this rule were no longer to apply, this is likely to create uncertainty and it may well be that the lenders (or in case of bonds, arrangers and noteholders/investors) would consider an alternative choice of law or seek to conduct a more detailed analysis regarding the potential impact of foreign insolvency and restructuring proceedings (and not just in jurisdictions where the debtor is incorporated) which could add significantly to the costs, and potential viability, of those transactions and potentially lead the parties to choose a different governing law not prone to such uncertainty.

4.21 Moreover, the market practice in relation to customary transaction opinions given on rated securitisation transactions (given to the transaction parties, but shared with rating agencies for rating purposes) is not to include an insolvency qualification. Instead, there will tend to be an opinion from the jurisdiction of the place of incorporation of the issuer / originator which will deal with the impact of insolvency proceedings in that jurisdiction and an English law opinion (where the agreements are governed by English law) dealing with, *inter alia*, the impact of any insolvency proceedings that might be commenced in England. If the Rule in Gibbs were no longer to apply, rating agencies may well insist on a more detailed cross-border insolvency analysis, particularly if there are instances of an English law securitisation transaction being varied or discharged by a foreign insolvency law process. Again, the uncertainty created would likely add to the costs of putting together such transactions (and potentially their viability) and potentially lead the parties to choose a different governing law.

4.22 It is also to be noted specifically in relation to those financial contracts which rely on netting that, without suitable legal opinions, the amount of regulatory capital a bank or investment firm will be required to hold in respect of the counterparty exposure would be the same as if no netting agreement existed. This is likely to be much higher than the amount of regulatory capital that is required at present, significantly undermining the profitability of the banks and investment firms in question. Notably, the netting opinions required for both risk and regulatory capital purposes in the context of bilateral derivatives relationships are a matrix of opinions covering all "relevant jurisdictions" which will take into account, *inter alia*, the location of the counterparties (in addition to the governing law of the contract). Where English law is the governing law of the contract and where it could potentially recognise the discharge or change of obligations under the contract by another "relevant jurisdiction", this would need to be reflected in the English law netting opinion. This could result in the financial institution counterparty calibrating the relevant

relationship at a higher risk level, requiring it to allocate a larger amount of regulatory capital to the relationship and other consequences such as it calling for higher levels of collateralisation from its counterparty. Where neither party is located in the UK, the parties may consider changing the governing law to be a simpler method of addressing the issue.

Position in relation to New York law contracts

4.23 We have considered how Mayer Brown's ISDA netting memorandum dated 9 June 2022 for New York (the "**ISDA New York Law Opinion"**) deals with Chapter 15 which could be argued to be the US equivalent of Article X (although for the reasons given in paragraphs 4.18 and 4.19 above, we consider the analysis to be very different).

4.24 There were surprisingly few references to Chapter 15 in the ISDA New York Law Opinion. This is possibly because the opinion covers US counterparties or US branches of overseas entities and so the assumption is that these parties would be subject to substantive US bankruptcy proceedings (e.g. chapter 7 and chapter 11) rather than subject to the recognition of foreign bankruptcy proceedings pursuant to Chapter 15. However, there were a few references which show that the application of Chapter 15 is far from a box ticking exercise and that some considerable thought has gone into ensuring that the recognition of foreign insolvency law under Chapter 15 does not interfere with close-out netting:

4.24.1. In the section of the ISDA New York Law Opinion dealing with the safe-harbours in the US Bankruptcy Code regarding transaction avoidance for netting agreements, there is reference to the Fairfield Sentry Limited v Theodoor GGC Amsterdam case (SDNY 2020) where the court looked to see if the foreign avoidance provisions were similar to the avoidance powers in the US Bankruptcy Code which were the subject of the safe-harbour provisions, thus suggesting that the US Bankruptcy Court has a discretion as to whether to apply foreign avoidance provisions under Chapter 15. These safe-harbours are mentioned a few times in the ISDA New York Law Opinion.

4.24.2. In the section of the ISDA New York Law Opinion dealing with a New York branch of an overseas entity that might be subject to foreign insolvency proceedings, there is some analysis of the cases under the now repealed section 304 of the US Bankruptcy Code which suggested that counterparties may experience some delay in closing out as a result of a section 304 proceeding. However the opinion states that the Bankruptcy Abuse Prevention and Consumer Protection Act 2005 has amended the US Bankruptcy Code to make it clear both that the protective provisions of the US Bankruptcy Code would apply in proceedings under section 304 and in Chapter 15 and that branches and agencies of foreign banks with branches or agencies in the U.S. may not be the subject of Chapter 15 proceedings. Indeed, the opinion states the following:

"11 U.S.C. § 561(d) states: "Any provisions of [the US Bankruptcy Code] relating to securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements, or master netting agreements shall apply in a case under chapter 15, so that enforcement of contractual provisions of such contracts and agreements in accordance with their terms will not be stayed or otherwise limited by operation of any provision of [the US Bankruptcy Code] or by order of a court in any case under [the US Bankruptcy

Code], and to limit avoidance powers to the same extent as in a proceeding under chapter 7 or 11 of [the US Bankruptcy Code] (such enforcement not to be limited based on the presence or absence of assets of the debtor in the United States)."

4.25 In conclusion, Chapter 15 does not have a negative impact on the ability of counterparties to get a robust netting opinion in respect of a New York law governed ISDA Master Agreement but this is only because of the protections and safe-harbours that have been built into the US Bankruptcy Code in relation to swap agreements. The Consultation did not propose any similar protections when considering whether to implement Article X or the judgments model law in the UK.

4.26 Similarly, as noted above, the EIR contains important safeguards and exceptions preserving, inter alia, the effect of netting arrangements from the effects of an insolvency proceeding taking place under foreign law. Again, however, the Consultation did not propose any similar safeguards and exceptions.

Conclusion on the impact on English Law governed financial contracts

4.27 Aside from the impact which the removal of the Rule in Gibbs would have on English law governed contracts which are dependent on netting arrangements, the removal of the rule would also have a highly material impact on English law governed contracts generally.

4.28 As explained below, there is an important question concerning the retrospectivity of any alteration to the Rule in Gibbs if the present position was to be changed in circumstances where creditors and debtors are likely to have entered into arrangements and selected English law to govern those arrangements on the understanding that the Rule in Gibbs forms part of English law.

4.29 Even leaving this important point to one side, it also appears likely that any attempt to remove the Rule in Gibbs is likely to introduce legal uncertainty into future arrangements. From a creditor's perspective, it will have the new risk that its English law governed debt may be varied, discharged or compromised by a foreign insolvency or restructuring process without its consent. Moreover, in circumstances where the criteria (if any) by which the English Courts would recognise such a foreign process are unspecified and unclear, then there would be a high level of uncertainty as to when and how such a variation, discharge or compromise would be effective.

4.30 This would be highly undesirable and would introduce a high level of legal uncertainty into an important area of the law in circumstances where the present position is clear and certain because of the well known and well understood way in which the Rule in Gibbs presently operates.

4.31 Aside from the inherent undesirability of introducing uncertainty into the current legal position in this way, there may also be particular practical concerns relating to the availability and/or pricing of finance in the areas mentioned in paragraph 4.2 above if the Rule in Gibbs were removed as part of English law.

4.32 More broadly, the attractiveness of English law as a governing law of choice for the financial markets risks erosion and being prejudiced in the absence of a relative certainty of outcome for market participants.

5. Possible consequences on transactions entered into prior to the removal of the Rule in Gibbs

5.1 As explained above, lending arrangements presently are entered into by lenders knowing that, as a matter of English law, the Rule in Gibbs prevents their English law governed debt from being modified or discharged in any insolvency or restructuring process outside of England (unless, of course, they submit to the jurisdiction of the foreign court). In practice this means that lenders currently have transactional certainty that, for any discharge or modification of the debt to be effective in England, any such insolvency or restructuring process will either have to take place in England or they will have otherwise consented to it. This means that the risks of an English process can be priced into the deal at the outset. Lenders can assess this risk, as well as the timing and the predictability of outcome.

5.2 Should the Rule in Gibbs be removed without any grandfathering provisions applying to those lending arrangements already in place and entered into in reliance on the framework that the Rule in Gibbs provides, this would leave lenders exposed to the fact that, despite the legal framework upon which they took their decision to lend, there could now be a variation or discharge of their debt in a foreign jurisdiction the effects of which may be wholly unpredictable yet enforceable in England and the risk of which has not been priced into the deal. We have referred above to the potential impact on legal opinions where it is not possible to carve-out any insolvency analysis. Even where it is market practice to include such a carve-out, lenders may well want to carry out additional legal due diligence in any jurisdiction where insolvency or restructuring proceedings might be commenced. It may not be feasible to carry out the legal due diligence in all jurisdictions where such proceedings could be commenced, particularly as this may change over time.

5.3 For those financial contracts which rely on the certainty of netting arrangements for risk and regulatory capital purposes, a removal of the Rule in Gibbs with immediate effect could result in an overnight change for parties with existing trading relationships, requiring a review of risk and regulatory capital levels. Given that for parties with substantial trading relationships this could be a substantial exercise, where neither party is located in the UK, they may consider changing the governing law a simpler and more practical way to deal with the issue.

5.4 Whether this means that, if there is a possibility of a restructuring, there will be a push to file in England to prevent a filing elsewhere (so as to try to maintain the lender's preferred forum) remains to be seen. Of course, following Brexit, any such precipitous filing may also not be effective to prevent a filing within the EU in concurrence or in competition with the English process.

5.5 The impact of the introduction of Article X as proposed in the Consultation on existing transactions would be very uncertain. Post-introduction, UK courts would be given discretion to recognise an insolvency-related judgment of a foreign court. However, it is unclear how that discretion should be exercised. It is conceivable that it might be exercised to grant recognition of an insolvency-related judgment that has the effect of discharging or modifying an English law governed contract. A judge could justifiably reach such a decision through recognising the primacy of statutory provisions (in the amended CBIR) over the judge-made Rule in Gibbs. Without firm guidance as to the approach judges should take, there will be a high risk of conflicting first-instance decisions based on particular fact-patterns, which would generate great uncertainty.

5.6 By extension, because the Rule in Gibbs applies equally to contracts that are governed by laws other than English law, an English court might conclude that it should not recognise an insolvency-related judgment of a foreign court discharging

or modifying debt governed by a law other than the law governing the insolvency proceedings.

5.7 While this would have no direct impact on English law governed agreements, the outcome for a foreign insolvency officeholder seeking recognition would be uncertain where the foreign insolvency had a connection to the English jurisdiction (through the location of any assets of the debtor, for example). In making no value judgement on the correctness of the outcome, the Rule in Gibbs is at least clear.

5.8 In the absence of a clear conflicts of law regime to replace the certainty of outcome provided by the Rule in Gibbs (either following any express change to the Rule or as a result of the impact of the proposed Article X), the potential vacuum would need to be filled by new judge-made law as the parameters around the exercise of judicial discretion become established. Other legal systems have adopted strict and clear conflict of laws rules for this very reason.

6. Conclusion

6.1 This paper has described the value and practical use of the Rule in Gibbs in the financial markets as a guarantor of legal predictability. Removing it (without an appropriate alternative) is likely to introduce legal uncertainty into a large number of English law governed financial contracts.

6.2 This uncertainty would impact the risks associated with these transactions, increasing the associated costs (including in regulatory capital for certain institutions), potentially affecting the viability of the transactions or leading the parties to choose a different governing law not prone to such uncertainty.

6.3 The proposed introduction of Article X where UK courts would be given discretion to recognise an insolvency-related judgment of a foreign court would be inherently uncertain without clear statutory limits until sufficient precedent is built up (which may be difficult if parties choose to move away from English law due to the uncertainty at the outset). In our view it is not an appropriate modification or alternative to the Rule in Gibbs as proposed.

6.4 The paper highlights how other legal systems which do not have the Rule in Gibbs help to preserve legal certainty for the treatment of financial contracts in insolvency proceedings. By and large these contain strict and clear conflict of laws rules and necessary exceptions and safeguards for financial contracts.

6.5 Any further proposals to modify or remove the Rule in Gibbs should seek to contain safeguards which ensure continued certainty for financial contracts. The FMLC would urge careful consultation with the financial markets prior to any change in the law so that the consequences of any such proposals are fully understood and appreciated before implementation.

FMLC Members

Lord Thomas of Cwmgiedd (Chairman)

Andrew Bagley, Goldman Sachs International
Sir William Blair, Queen Mary, University of London
Claude Brown, Reed Smith LLP
Raymond Cox KC, Fountain Court Chambers
Simon Firth, Linklaters LLP
Kate Gibbons, Clifford Chance LLP
Jonathan Grant, Bank of England
Professor Louise Gullifer KC (Hon), FBA, University of Cambridge
Carolyn H. Jackson, Katten Muchin Rosenman U.K. LLP
Rachel Kent, Hogan Lovells (International) LLP
Peter King, HM Treasury
Sir Robin Knowles CBE
Ida Levine, Impact Investing Institute
Karen Levinge, Financial Conduct Authority
Jon May, Marshall Wace LLP
Chris Newby, AIG
Conall Patton KC, One Essex Court
Bob Penn, Allen & Overy LLP
Jan Putnis, Slaughter and May
Barnabas Reynolds, Shearman & Sterling LLP
James Smethurst, Freshfields Bruckhaus Deringer LLP
Tom Smith KC, 3-4 South Square
Sanjev Warna-kula-suriya, Latham & Watkins LLP

Brian Gray (Chief Executive)

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