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Kirkland Alert

Modern Land — Recognition of Foreign Restructuring/Insolvency Proceedings Under U.S. Chapter 15 *Does* Discharge New York Law Debt

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At a Glance

The U.S. Bankruptcy Court held in *Modern Land*¹ that a Cayman Islands scheme of arrangement recognized as a main proceeding under Chapter 15 of the U.S. Bankruptcy Code would constitute a substantive discharge of New York law governed debt.

This was so notwithstanding the recent Hong Kong decision in *Rare Earth*², in which (although not directly relevant to *Rare Earth's* case) the Hong Kong court speculated that “recognition under Chapter 15 is limited in territorial effect” – i.e., it would operate procedurally to prevent action by a creditor against a debtor’s property in the U.S., but would not constitute a compromise of debt governed by U.S. law (so as to satisfy the “rule in *Gibbs*”³).

This is a helpful clarification by the U.S. Bankruptcy Court as to the proper effect of recognition under Chapter 15.

Notably, the Court also placed significant reliance on the conduct of restructuring proceedings in the Cayman Islands, in finding that the debtor’s center of main interests was in the Cayman Islands. This case also serves as a helpful reminder of what is required to constitute an “establishment” for the purposes of recognition of a foreign nonmain proceeding.

Kirkland advised the ad hoc group of noteholders in *Modern Land* and played a key role in the successful Chapter 15 application.

Background

Modern Land (China) Co., Ltd. (the “**Debtor**”) is incorporated in the Cayman Islands, with shares listed on the Stock Exchange of Hong Kong. It is the holding company of the Modern Land group, which conducts real estate investment and development in China and the U.S.

The group experienced liquidity pressures and failed to meet repayments due in 2021, triggering events of default.

To effect a financial restructuring of its New York law governed notes, the Debtor proposed a scheme of arrangement in the Cayman Islands, which was approved by the Cayman court. It sought recognition of the Cayman scheme in the U.S. under Chapter 15 of the Bankruptcy Code, which implements the UNCITRAL Model Law on Cross-Border Insolvency in the U.S. The Debtor does not intend to seek recognition and enforcement of the scheme (or the Chapter 15 order) in Hong Kong.

Decision

The U.S. Bankruptcy Court granted recognition of the Debtor’s Cayman scheme as a foreign main proceeding, under Chapter 15.

Chapter 15 recognition constitutes substantive discharge

The U.S. Bankruptcy Court held that:

- “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 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 U.S., but it does not make a discharge of New York law governed debt any less effective; and

- the Hong Kong court’s suggestion in *Rare Earth* (that, in essence, recognition under Chapter 15 would not constitute a substantive discharge of New York law governed debt and would be limited in effect to the territorial jurisdiction of the U.S.) was – with great respect – incorrect.

The U.S. position – as we have long understood it, and now helpfully settled in *Modern Land* – contrasts with the position in the UK, where recognition⁴ of a foreign insolvency proceeding is only considered to operate as a substantive discharge of debt in certain circumstances,⁵ owing to the “rule in *Gibbs*”.⁶ This effect was recently illustrated in the *International Bank of Azerbaijan*⁷ case, when certain creditors with debts governed by English law did not participate in the Azeri restructuring proceeding and – based on the “rule in *Gibbs*” – successfully opposed the granting of a permanent moratorium (which would have effectively amounted to a permanent compromise of their claims). For further information, see our recent [Alert](#).

Assessment of Debtor’s center of main interests

The U.S. Bankruptcy Court expressed concern as to whether the Debtor’s center of main interests (“**COMI**”) was in the Cayman Islands (which is required in order for the Cayman scheme to be recognized as a “foreign main proceeding” under Chapter 15, upon which certain relief arises automatically). Absent evidence to the contrary, the debtor’s registered office is presumed to be the center of the debtor’s main interests⁸, although this presumption can be rebutted.

Following submission of further factual evidence and legal arguments, the court ultimately recognized that the Debtor’s COMI *was* in the Cayman Islands. It considered the totality of the circumstances, including:

- the statutory presumption that a debtor’s COMI is in its jurisdiction of incorporation;
- the goals of Chapter 15, in maximizing the value of the debtor’s assets, facilitating rescue and promoting co-operation between the U.S. and foreign courts;
- the scheme creditors’ expectations and intentions (that, as a Cayman company, the Debtor’s debts would be restructured pursuant to Cayman law if a restructuring became necessary – as further evidenced by overwhelming creditor support for the scheme);
- the judicial role in the Cayman scheme and activities in the Cayman Islands relating to the scheme;
- the lack of objections to recognition as a foreign main proceeding;
- Cayman choice of law principles (including that the scheme only compromised the New York law governed notes and did not seek to compromise the group’s other,

Hong Kong law governed, debt); and

- the Debtor’s good-faith petition for recognition of the Cayman scheme and the absence of any COMI shift.

Ultimately, the court found that:

- the Cayman court’s supervision of the Debtor’s scheme sufficed to conclude that the Debtor’s COMI was in the Cayman Islands, in light of the other factors explored above; and
- the fact that the restructuring was the Debtor’s primary business activity at the time of the filing of the Chapter 15 application (and was significantly conducted in the Cayman Islands) supported this finding.

Assessment of establishment

The Debtor had also argued, in the alternative, that the Cayman scheme could be recognized as a “foreign nonmain proceeding” (upon which recognition and enforcement can be granted as discretionary relief). This turned on whether the Debtor conducted a “non-transitory economic activity” in the Cayman Islands, so as to have an “establishment” there.

The U.S. Bankruptcy Court concluded that recognition as a foreign nonmain proceeding was *not* justified, because:

- recognition would be inconsistent with the goals of foreign nonmain proceedings (specifically, because foreign nonmain proceedings should relate to assets that (under U.S. law) should be administered in the foreign proceeding, and the court did not consider the existing notes to be “assets” in the Cayman Islands);
- neither the Cayman scheme proceeding nor the Debtor conducting bookkeeping activities in the Cayman Islands constituted non-transitory economic activity (so as to constitute the requisite “establishment” in the Cayman Islands); and
- the Debtor did not engage with the Cayman economy and had only a negligible effect on the local marketplace – and therefore failed to meet the U.S. standard for non-transitory economic activity.⁹

The Court’s decision not to grant recognition as a foreign nonmain proceeding was ultimately immaterial given its decision to grant recognition as a foreign main proceeding. However, the above factors are notable for future cases – for example, when seeking Chapter 15 recognition of an English scheme of arrangement or restructuring plan of a foreign company with its COMI outside the UK, compromising

New York law governed notes – particularly where the specific debtor company continues to conduct substantial activity beyond the conduct of the restructuring itself.

Implications

This case is an important clarification of the effect of obtaining recognition under Chapter 15: It is binding and effective in discharging New York law governed debt. This is so not only in the territorial jurisdiction of the U.S., but should be recognized in other jurisdictions that look to the underlying governing law of the debt in ascertaining whether the compromise is effective (i.e., including those that apply the “rule in *Gibbs*”). This reduces the risk of a dissenting stakeholder being able to successfully seek enforcement of pre-restructuring New York law governed debt in other jurisdictions.

The court’s conclusion that the very conduct of restructuring proceedings (and local court supervision) can suffice to establish the location of COMI is notable, but must be construed in light of the myriad other factors on which the court also relied.

The court’s construction of what constitutes an “establishment” (for the purposes of recognition as a foreign nonmain proceeding) is also an important practical reminder for future cases: Where the restructuring proceeding is outside the jurisdiction of the debtor’s COMI, then real, non-transitory economic activity is required for the requisite “establishment” in order for Chapter 15 discretionary relief to be available. This requires more than mere bookkeeping activities and the mere conduct of the restructuring proceeding itself.

1. *In re Modern Land (China) Co., Ltd.*, Case No. 22-10707 (MG) (Bankr. S.D.N.Y. July 18, 2022)↩

2. *In the matter of Rare Earth Magnesium Technology Group Holdings Limited* [2022] HKCFI 1686 (Harris J), June 6, 2022↩

3. The rule, stemming from the English Court of Appeal case of *Antony Gibbs & sons v La Société Industrielle et Commerciale des Métaux* (1890), that a contract can only be discharged or compromised in accordance with its governing law↩

4. Under the Cross Border Insolvency Regulations 2006, which implement the UNCITRAL Model Law on Cross-Border Insolvency in the UK↔

5. Essentially, where the compromise is a valid discharge under the underlying governing law of the debt (or rights); if the debt (or rights) are governed by English law, this would be so if the relevant stakeholder submitted to the foreign proceeding (e.g., by voting) or was present in the foreign jurisdiction when the proceeding was commenced↔

6. Further to the UK Supreme Court's decision in *Rubin v Eurofinance SA and others* [2012] UKSC 46↔

7. *Re OJSC International Bank of Azerbaijan* [2018] EWCA Civ 2802↔

8. 11 U.S.C. § 1516(c)↔

9. *In re Creative Fin., Ltd.*, 543 B.R. at 520–21, in which the court explained that recognition required “a showing of a local effect on the marketplace, more than mere incorporation and record-keeping and more than just the maintenance of property.”↔

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Suggested Reading

- 19 October 2022 - 22 October 2022 Speaking Engagement The National Conference of Bankruptcy Judges
- 09 September 2022 - 10 September 2022 Sponsored Event The Chicago Conference on Judicial Valuation
- 13 July 2022 Award The Lawyer Awards 2022

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