

## Gibbs Rule and the first Hong Kong scheme involving a PRC law governed debt



### *China Lumena New Materials Corp (in provisional liquidation) [2020] HKCFI 338 (decision made on 23 January 2020 and reasons given on 4 March 2020)*

This is the first reported scheme of arrangement in Hong Kong seeking to compromise debt governed by PRC law. Under the Gibbs Rule, a foreign composition does not discharge a debt unless it is discharged under the law governing the debt. In this case, the Hong Kong Court considered an exception to the Gibbs Rule and more generally the principles of sanctioning a scheme.

#### Background

China Lumena New Materials Corp (In Provisional Liquidation) (Company) is a Cayman incorporated investment holding company listed on the Hong Kong Stock Exchange. The Company is the parent company of a group principally engaged in the processing and sale of chemical products. The operations of the group ceased in about 2014. Provisional liquidators were appointed in the Cayman Islands and a recognition order was granted by the Hong Kong Court. The Company's listing status is its only substantial asset. The debts are governed either by Hong Kong or PRC law.

The recovery rate for creditors under the scheme is to be about 0.7%, whereas in a liquidation scenario the creditors will recover nothing. The scheme was part of the resumption proposal and the Hong Kong Stock Exchange has given its in-principle approval of the Company's new listing application.

The Court considered that the legal criteria (click [here](#) to see article which lists out the relevant legal criteria) for sanctioning a scheme was satisfied and the meeting of the scheme creditors was properly conducted. 99% in value of scheme creditors attending in person and by proxy voted in favour of the scheme. The Gibbs Rule was considered in some detail in the judgment.

#### Gibbs Rule

According to this well-established English principle laid down in *Antony Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux* [1890] 25 QBD 399, a foreign composition does not discharge a debt unless it is discharged under the law governing the debt.

This principle is followed by most common law jurisdictions including Hong Kong but not Singapore<sup>1</sup>.

In the present case, the Zhejiang branch and the Hong Kong branch of the PRC bank are both creditors. The Zhejiang branch did not vote at the scheme meeting and its PRC law governed debt represented about 42% of the Company's total indebtedness. As there is currently no mechanism for recognition and enforcement of a Hong Kong scheme of arrangement in Mainland China, a PRC Court may not treat the scheme as compromising the PRC law debt and this may call into questions the utility of the scheme.

Harris J explained that:

1. The Gibbs Rule has no effect on the Court's jurisdiction to sanction a scheme under s673 of Cap 622 as that provision is not limited to compromise of rights governed by Hong Kong law. However, the rule is relevant to the exercise of the Court's discretion to approve the scheme as the Court will not sanction a scheme which has no or limited utility;
2. An exception to the Gibbs Rule is where the relevant creditor submits to the foreign insolvency proceedings. In that situation, the creditor is taken to have accepted that his contractual rights will be governed by the law of the foreign insolvency proceeding<sup>2</sup>; and
3. The Court should not act in vain or make an order which has no substantive effect or will not achieve its purpose. However, this does not require that the Court must be satisfied that the scheme will be effective in every jurisdiction worldwide. The focus is on jurisdictions in which there are substantial assets or in which creditors might make claims.<sup>3</sup>

<sup>1</sup> *Re Pacific Andes Resources Development Ltd* [2016] SGHC 210

<sup>2</sup> *OJSC International Bank of Azerbaijan v Sberbank of Russia and others* [2018] EWCA Civ 2802

<sup>3</sup> Following *Re Lehman Brothers International (Europe) (No. 10)* [2018] EWHC 1980 (Ch)

Despite the foreign debt, the Court sanctioned the scheme because:

1. As the Hong Kong branch voted in favour of the scheme, the Court found that the PRC bank submitted to the jurisdiction of the Hong Kong Court; and
2. The Zhejiang branch had written to the provisional liquidators explaining that it supported the Scheme, but its representatives were unable to attend the scheme meeting in Hong Kong due to unexpected approval issues. The Court considered also that there is unlikely to be a creditor from Mainland China with PRC law governed debt taking enforcement action in Hong Kong.

A parallel scheme was also approved by the Cayman Court on 14 February 2020 on similar reasoning.

### Takeaway points

- The Gibbs Rule does not affect the Court's jurisdiction to compromise a foreign debt by a scheme, but it is relevant to the exercise of the Court's discretion.
- Where a foreign debt needs to be compromised, the need for parallel insolvency proceedings or recognition in that jurisdiction may often have to be considered in light of the Gibbs Rule.
- Serves as a good example of the exception to the Gibbs Rule.

## Get in touch



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