

CORPORATE

Hong Kong SAR cross-border insolvency landscape evolves for Chinese corporates

Naomi Moore, Daniel Cohen and Jeremy Haywood of Akin Gump explain the implications of recent Hong Kong SAR court rulings on cross-border insolvency cases concerning HKEX-listed mainland Chinese corporate groups

The Hong Kong Companies Court has made a number of rulings concerning mainland Chinese corporate groups listed in Hong Kong SAR which illustrate the evolving landscape of cross-border insolvency law. These cases may, in some instances, cause creditors and debtors to re-evaluate some of the enforcement and defensive strategies traditionally used in the insolvencies of such companies.

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Hong Kong SAR has long been an international finance centre and investment gateway for mainland China. Not surprisingly, there are a significant number of mainland Chinese corporate groups listed on the Stock Exchange of Hong Kong (HKEX). As of December 31, 2020, there were 1,319 mainland enterprises listed on the HKEX, comprising 52% of the total number of listed companies and 80% of the total market capitalisation.

Many of these listed companies are incorporated in offshore jurisdictions such as the Cayman Islands, the British Virgin Islands or Bermuda and have issued substantial amounts of foreign law governed debt (often New York law governed bonds). Most have their principal operations in mainland China. In the context of an insolvency scenario, these group structures often spawn many complex cross-border issues which need to be solved.

The utility of winding up proceedings in Hong Kong SAR

Hong Kong SAR, as the place of a mainland Chinese group's listing and given its proximity to the mainland, is



often a jurisdiction of focus for creditors of a mainland Chinese corporate group in a default and enforcement scenario. The primary enforcement tool available in Hong Kong SAR to unsecured creditors of an insolvent company is a winding-up petition which, if successful, will result in the appointment of liquidators to take control of, and realise, the assets of the company.

As a starting point, a foreign-incorporated HKEX-listed company is capable of being wound up in Hong Kong SAR provided that the following three core requirements can be satisfied: (i) the company has a sufficient connection with Hong Kong SAR, but not necessarily consisting of the presence of assets in the jurisdiction; (ii) there is a real possibility that the winding-up order would benefit those applying for it; and (iii) the Court is able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

However, while the first and third core requirements are usually satisfied if a company has a listing in Hong Kong SAR, the Hong Kong Companies Court in *Re China Huiyuan Juice Group Ltd* expressed

significant doubt about whether the same is true of the second core requirement.

In that case, the debtor company was insolvent and the value of its listing (once realised) was thought to be questionable. The Court observed that the value of listings in Hong Kong SAR seemed to have dropped to approximately the cost of a conventional restructuring. Accordingly, the Court said that it would require evidence to demonstrate a real (not hypothetical) prospect of a material financial benefit to creditors from the realisation of a listing in order to satisfy the second core requirement.

This may not always be required. In the earlier case of *Shandong Chenming Paper Holdings Limited v. Arjowiggins HKK2 Limited*, the Court found that the second core requirement was satisfied by reason of the listing in Hong Kong SAR. The Court was of the view that the company had refused to pay the debt in question out of intransigence, so that the pressure of a liquidation – and the threat to the listing – were likely to provide the petitioner with leverage and force payment.

Nevertheless, it appears that going forward the Hong Kong SAR Courts will

apply closer scrutiny to the economic and strategic value of the listing in assessing whether the three core requirements have been met.

Offshore provisional liquidation as a debtor response

A common strategic approach for offshore-incorporated HKEX-listed companies faced with a local winding-up petition in Hong Kong SAR is to take defensive action in the company's place of incorporation.

This usually takes the form of a "soft-touch" provisional liquidation application in the offshore jurisdiction. Soft-touch provisional liquidation is a restructuring tool that allows a company to remain under the day-to-day control of the directors but with the protection from actions by individual creditors afforded by the provisional liquidation process. Upon the appointment of soft-touch provisional liquidators over the company for the purposes of facilitating a financial restructuring, the provisional liquidators are then able to seek recognition and assistance at common law in Hong

Kong SAR, including a stay of any existing local winding-up proceedings.

The effect of any such stay would essentially be to subordinate the Hong Kong SAR winding-up proceedings to the soft-touch provisional liquidation in the company's place of incorporation.

For context, Hong Kong SAR does not have a statutory cross-border insolvency and restructuring recognition and assistance regime. In lieu of one, the Hong Kong Court has developed and expanded a common law framework for cross-border recognition and assistance. Since the landmark decision of *Joint Official Liquidators of A Co v B*, common law recognition applications have become commonplace in Hong Kong SAR with recognition so far having been granted by the Court in respect of foreign insolvency proceedings commenced in Australia, Bermuda, the Cayman Islands, the British Virgin Islands, Japan and mainland China.

The applicable principles are as follows:

1. The Court may recognise a foreign collective insolvency proceeding (including a voluntary liquidation). So far, this has been limited to 'collective' insolvency proceedings commenced in a company's place of incorporation. However, the Court has recently observed that there is no doctrinal reason why the common law in Hong Kong SAR could not extend to the recognition of insolvency proceedings in a company's centre of main interests (COMI), which is not the jurisdiction of incorporation.
2. The Court may then grant assistance in Hong Kong SAR to the relevant overseas insolvency officeholders appointed in the context of the recognised proceeding.
3. Such assistance may extend only to what is necessary in the performance of the overseas officeholder's functions. It cannot enable the officeholder to do something that he or she could not do under the law by which he/she was appointed.

The recent decision in *Re FDG Electric Vehicles Limited* called into question a debtor's defensive and tactical use of an offshore soft-touch provisional liquidation in response to a creditor's winding-up petition in Hong Kong SAR.

In *FDG Electric Vehicles*, the Hong Kong Companies Court was asked to recognise and grant assistance, including by way of a general stay of proceedings in Hong Kong SAR, to the provisional liquidators of

a Bermuda-incorporated Hong Kong SAR-listed company.

In recognising the provisional liquidators and granting a modified form of assistance from that originally sought, the Court held that, while it is well established that the Court in Hong Kong SAR has the power to assist foreign liquidators by ordering a stay of proceedings in Hong Kong SAR under the doctrine of modified universalism, this power only existed to aid foreign collective insolvency proceedings.

As soft-touch provisional liquidators are typically appointed to facilitate the restructuring of a company's debts (rather than for the purpose of collecting in a company's assets and distributing them to its creditors under a single system of distribution), the Court held that it was not yet accepted that a soft-touch provisional liquidation was for all purposes to be treated as a collective insolvency proceeding.

Moreover, where the debt the subject of a creditor's winding-up petition is governed by Hong Kong SAR law, then the 'Gibbs rule' is relevant. This provides that the discharge or compromise of liabilities under a contract is to be governed by the laws of that contract. The Court observed that a stay of local proceedings in aid of a foreign insolvency proceeding should not be granted in respect of proceedings in Hong Kong SAR to establish a right of payment under a contract governed by the laws of Hong Kong SAR.

Consequently, with the above points in mind, the Hong Kong Companies Court signalled a new direction in *FDG Electric Vehicles*. Rather than provide for an automatic, general stay of all Court proceedings in Hong Kong SAR (which had been the norm before the *FDG* decision), the standard recognition and assistance order in the future would enable an offshore-appointed soft-touch provisional liquidator to apply separately for a stay or other directions in respect of a particular set of proceedings (including a winding-up petition). In other words, no general stay. This would give the parties impacted by a stay of particular proceedings (e.g. a creditor petitioner) an opportunity to seek to resist this outcome.

Further scrutiny of tactical soft-touch provisional liquidation

FDG Electric Vehicles did not address the broader and highly important matter of which insolvency process is to be afforded

primacy where a creditor petitions the Court in Hong Kong SAR for the winding-up of an HKEX-listed offshore-incorporated company, which is also subject to soft-touch provisional liquidation proceedings commenced defensively by the debtor in its place of incorporation.

This question was addressed in the subsequent Hong Kong SAR decision of *Re Lamtex*.

The facts involved a creditor's winding-up petition in Hong Kong SAR in respect of a Bermuda-incorporated HKEX-listed company. Following the presentation of the Hong Kong SAR petition, the debtor applied to appoint soft-touch provisional liquidators in Bermuda. Once appointed, the provisional liquidators then sought recognition and assistance in Hong Kong SAR and an adjournment of the Hong Kong SAR petition to give the company breathing room to progress a restructuring. This tactical manoeuvre failed.

The common law doctrine of 'modified universalism' guides the Hong Kong SAR Court when determining cross-border issues arising in transnational insolvencies, such as a request for recognition and assistance of a foreign insolvency officeholder. The application of this doctrine in Hong Kong SAR had traditionally afforded primacy to the company's place of incorporation in situations where there were competing foreign and local insolvency proceedings.

The question for the Court in *Re Lamtex* (and in the context of another case, *Re Ping An Securities Group*, which was decided around the same time) was whether this approach required the Hong Kong SAR winding-up petition to be adjourned so that a restructuring could be pursued under the Bermudan soft-touch provisional liquidation.

The Court held that in a contest for primacy between insolvency proceedings opened in the jurisdiction of incorporation (i.e. Bermuda) and in the company's COMI, which was Hong Kong SAR, on the facts of *Re Lamtex*, there was less reason to give primacy to the place of incorporation than had been the practice historically. In particular, the Court observed that local Hong Kong SAR proceedings should not be stayed in favour of a foreign proceeding if the foreign proceeding comprises a soft-touch provisional liquidation being managed out of Hong Kong SAR and used to circumvent the problems created by the absence in Hong Kong SAR of a formal corporate rescue procedure.

The Court also observed that, if the three core requirements for the winding up a foreign company in Hong Kong SAR are satisfied then, “it is not...sufficient for the Company simply to point to insolvency proceedings commenced sometime after the Hong Kong Petition was presented in its place of incorporation and request in the face of objection from local creditors this court simply to defer to that of the place of incorporation. It seems to me unrealistic to expect the court not to have regard to the fact that companies such as the present conduct business in the People’s Republic of China which commonly is also the location of a high proportion of their shareholders, creditors and assets.”

In dealing with these issues moving forward, the Court proposed the following framework to address questions of primacy with respect to insolvency proceedings opened in different jurisdictions:

1. Generally, the place of incorporation should be the jurisdiction in which a company should be liquidated; in practice, this means it will be the system for distributions to creditors.

2. However, if the company’s COMI is elsewhere, regard is to be had to other factors:

- a. Whether the company is a holding company and, if so, whether the group structure requires the place of incorporation to be the primary jurisdiction in order effectively to liquidate or restructure the group
- b. The extent to which giving primacy to the place of incorporation is artificial having regard to the strength of the COMI’s connection with its location
- c. The views of creditors

What’s next on the horizon in an evolving landscape?

These recent decisions illuminate a number of the cross-border challenges and complexities that arise in the insolvency of HKEX-listed mainland Chinese corporate groups and indicate that the Hong Kong SAR Court is beginning to adapt its approach to navigating some of these key issues. Evolution in this area will no doubt continue if the framework between

mainland China and Hong Kong SAR on cross-border cooperation in corporate insolvency matters, which is currently being discussed, comes into play.

Similarly, if Hong Kong SAR’s long awaited corporate rescue (provisional supervision) regime finally becomes law this year, as was the last indication from the Hong Kong SAR government in November 2020, it will give debtors a new strategic option in the tool kit and the Hong Kong SAR Court a new set of issues and complexities to navigate.



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