



Restructuring & Insolvency in Hong Kong

Recent Key Cases Update March 2021

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Introduction



In light of the global economic dislocation and significant challenges faced by many businesses in Asia over the past year, the Hong Kong Companies Court has recently been grappling with multiple cross-border corporate insolvencies, including many that relate to Mainland China-based businesses. In this context, judicial attention has focused on a number of interesting and novel issues leading to some important legal developments and key practice points for market participants and practitioners alike.

In this update, we highlight a selection of key Court decisions which focus on cross-border recognition and assistance, restructuring and schemes of arrangement, the winding-up of foreign companies in Hong Kong and other insolvency-related issues.

These decisions mark, among other things, the first time insolvency officeholders appointed in Mainland China were recognized in Hong Kong, provide clarity on the scope of judicial assistance in Hong Kong that may be granted to foreign insolvency officeholders, illustrate a new focus on a company's center of main interest when weighing up the primacy of competing insolvency proceedings, revisit the circumstances in which a scheme of arrangement in Hong Kong may compromise foreign-law-governed debt and shed light on why widely held expectations about the centrality of Hong Kong in the winding-up of certain Mainland Chinese business groups may be misplaced.

The corporate insolvency landscape in Hong Kong continues to evolve, and may do so even more rapidly if and when important statutory reforms which are expected to be progressed this year, not least the long-awaited corporate rescue regime, materialize.



A framework for Reciprocal Cooperation between Mainland China and Hong Kong?

The Hong Kong Government has for some time been considering a cross-border arrangement or framework between Hong Kong and Mainland China in relation to cross-border insolvency and restructuring matters. In June 2020, the Hong Kong Government published a consultation paper setting out details of a proposed framework. Under that framework, it is proposed that Hong Kong would continue to rely on the common law principles developed by the Courts (some of which are discussed below) to underpin recognition of Mainland Chinese “collective insolvency proceedings” in Hong Kong and new Mainland Chinese legislation based on the UNCITRAL Model Law on Cross-Border Insolvency would be enacted in Mainland China to facilitate recognition of Hong Kong insolvency proceedings.

It is not yet precisely clear when a cross-border arrangement between Hong Kong and Mainland China will be entered into but it is anticipated that this will occur in the near future and hopefully sometime in 2021. As the implementation of such an arrangement would further reinforce Hong Kong’s position as a major financial center and cement its status as the gateway to Mainland China, developments in this area will be keenly watched.

A refresher on the principles underlying the recognition of ‘soft-touch’ provisional liquidators in Hong Kong

***Re Moody Technology Holdings Ltd* [2020] HKCFI 416**

The Hong Kong Companies Court helpfully revisited the following principles underpinning the jurisdiction to recognise and grant powers to foreign ‘soft-touch’ provisional liquidators (in this case, appointed in Bermuda over a Hong Kong-listed company):¹

- Soft-touch provisional liquidation is impermissible in Hong Kong (*Re Legend International Resorts Ltd* [2006] 2 HKLRD 192). In this respect, “the present Hong Kong position is an uncommon and peculiar one in the common law world.”
- Nonetheless, the doctrine of modified universalism means that the Hong Kong Court may recognise a foreign insolvency proceeding notwithstanding the absence of an identical proceeding in Hong Kong.
- Soft-touch provisional liquidation and provisional liquidation in Hong Kong differ only in degree, not in kind. Both are species of collective insolvency proceedings and where circumstances warrant it, provisional liquidators in Hong Kong may be granted powers to explore and facilitate a restructuring of the company.
- A refusal to recognise soft-touch provisional liquidation in Hong Kong may create discriminatory consequences – for example, provisional liquidators often have the same need to investigate the debtor’s affairs, whether or not appointed on a soft-touch basis.
- Recognition of soft-touch provisional liquidators in Hong Kong merely recognises their status as agents of the company and gives effect to their management and governance powers under the law of the company’s incorporation.

¹ The essence of ‘soft touch’ provisional liquidation is described in the decision as being where “a company remains under the day-to-day control of the directors, but is protected against actions by individual creditors. The purpose is to give the Group the opportunity to restructure its debts, or otherwise achieve a better outcome for creditors than would be achieved by way of liquidation”.

A long-awaited milestone: recognition of Mainland China-appointed administrators

***Re CEFC Shanghai International Group Ltd* [2020] HKCFI 167**

***Re Shenzhen Everich Supply Chain Co Ltd* [2020] HKCFI 965**

CEFC Shanghai International represents the first occasion on which administrators of a company in liquidation in Mainland China (appointed in this case by the Shanghai No 3 Intermediate People's Court) were recognised and granted assistance in Hong Kong. The Hong Kong Companies Court noted that the application was of considerable importance given the financial problems increasingly faced by Mainland businesses with assets located overseas.

The core criteria for recognition, which are the same for officeholders appointed in common law and civil law jurisdictions, were satisfied. The Mainland insolvency proceedings under the PRC Enterprise Bankruptcy Law were by nature collective insolvency proceedings opened in the jurisdiction of the company's incorporation.

The Court also re-confirmed that the power of assistance which follows recognition is not a tool to enable foreign officeholders to do something which they could not do under the law by which they were appointed. The order must also be consistent with the substantive law and public policy of Hong Kong. These requirements were satisfied too since the powers sought by the administrators were consistent with Mainland insolvency law and the Hong Kong Companies Court's standard recognition order (about which, we say more below).

While common law recognition and assistance is not conditional on reciprocal treatment on the part of the jurisdiction in which the foreign insolvency officeholders were appointed, the Court observed that the extent to which greater assistance should be provided in Hong Kong to Mainland administrators in the future is likely to be influenced by the extent to which the Mainland, like Hong Kong, promotes a unitary approach to transnational insolvencies.

A second case involving recognition in Hong Kong of a Mainland administrator (appointed by the Shenzhen Intermediate People's Court) followed fairly swiftly in *Re Shenzhen Everich*.

Deviations from the Court's standard recognition and assistance order: tread lightly

***Re Agritrade Resources Ltd* [2020] HKCFI 1967**

***Re China Oil Gangran Energy Group Holdings Ltd* [2020] HKCFI 825**

The Hong Kong Companies Court has developed a standard form of recognition and assistance order – part of an established practice to facilitate the efficient handling of recognition and assistance applications without the need for a hearing in many cases.

In *Re Agritrade Resources*, the soft-touch provisional liquidators of a Bermudan-incorporated Hong Kong-listed company applied for recognition and assistance in Hong Kong on terms that deviated materially from the standard order. The applicants explained that they were seeking to avoid any confusion caused by differences with the terms of the Bermuda order.

The Hong Kong Companies Court insisted on recognition and assistance in accordance with the standard form of order. While there will be situations which require the standard terms to be amended, the Court's preference is to stick to them in order to facilitate a uniform practice and quick, cost effective and, so far as possible, uncontroversial recognition and assistance. Letters of request from foreign appointing courts should therefore be sought on terms that are consistent with the Hong Kong standard recognition and assistance order.

On the other hand, the slightly earlier decision in *Re China Oil Gangran Energy* serves as an example of a deviation from the standard order being upheld, consistent with the idea that the standard terms continue to be developed as practitioners and the Court encounter different situations and identify improvements. In that case, the deviation concerned powers proposed to be granted to the Cayman Islands-appointed provisional liquidators focused on restructuring. They were held to be unobjectionable given the purpose of recognising and assisting soft-touch provisional liquidators in the first place.

The limits of assistance

***Re FDG Electric Vehicles Ltd* [2020] HKCFI 2931**

In recognising and granting assistance to the provisional liquidators of a Bermudan-incorporated Hong Kong-listed company, the Companies Court took the opportunity to clarify two important issues:

- The first is that assistance granted to offshore insolvency officeholders to facilitate their control over the debtor’s assets is restricted to assets situated in Hong Kong, including subsidiaries incorporated in Hong Kong. A broader power—which had been sought and would have purported to empower the officeholders to take control of the debtor’s subsidiaries in the British Virgin Islands (BVI)—would constitute “*impermissible judicial overreach*.”
- The second clarification is that it is not necessarily accepted that a foreign soft-touch provisional liquidation is for all purposes a ‘collective insolvency process’ (given the restructuring objective). Accordingly, it is to be questioned whether a general stay of proceedings in Hong Kong as part of the package of assistance typically ordered in favour of foreign soft-touch provisional liquidators is justified. It was noted that the ‘Rule in Gibbs’, about which we say more below, might for instance require a Hong Kong creditor to establish a right of payment in Hong Kong in support of a foreign insolvency process.

Accordingly, the Hong Kong Companies Court signaled a new direction. Rather than an automatic and blanket stay of court proceedings in Hong Kong, the recognition and assistance order would enable provisional liquidators to take steps to apply separately for a stay or other directions in respect of particular proceedings before the High Court of Hong Kong. This would then give the party affected by such a stay an opportunity to argue the alternative.

The judgment has the effect of amending the standard form recognition and assistance order, at least for the purpose of applications concerning soft-touch provisional liquidators.

A step closer to the recognition of Hong Kong insolvency proceedings in Mainland China?

***Re Ando Credit Ltd* [2020] HKCFI 2775**

The Hong Kong Companies Court was asked, for the first time, to appoint provisional liquidators over a Hong Kong company so that they could then seek recognition in Mainland China to facilitate the recovery of very substantial receivables believed to be owed to the company by its debtors in Mainland China. The Court agreed and made provisions for the appointment order to include a power permitting the provisional liquidators to make an application for recognition by the Shenzhen Bankruptcy Court (subject to the approval of the Hong Kong Court at various stages).

Noting that Mainland-appointed administrators have now been recognised and granted assistance in Hong Kong (see above), the Court observed that there is no precedent yet of Mainland reciprocation.

This will likely change soon. The Court referred to the expectation that a proposed protocol for mutual recognition of insolvency proceedings will be agreed in the near future between the Mainland Supreme People’s Court and Hong Kong. Furthermore, the Court appended to its decision an article authored by three Mainland judges expressing the view that a basis already exists, according to the doctrine of reciprocity, for Mainland courts to hear applications for recognition and assistance by Hong Kong liquidators.

Recognition of insolvency proceedings in a place other than a company’s jurisdiction of incorporation

***Re Lamtex Holdings Limited* [2021] HKCFI 622**

In this significant decision, the Hong Kong Companies Court accepted that it had become desirable, if not essential, for the Hong Kong Court to be able to address recognition of insolvency officeholders in a manner which is consistent with commercial practice in Hong Kong and Mainland China where a company’s jurisdiction of incorporation is often not the same as its center of main interest. The Court also confirmed that there is no doctrinal reason why the common law in Hong Kong could not extend to the recognition of insolvency proceedings in a place which is not the company’s jurisdiction of incorporation.

We explore this decision in more detail later in this update.

Restructuring and Schemes of Arrangement



Will a corporate rescue regime finally be implemented?

As readers will be aware, there are currently no statutory corporate rescue procedures in Hong Kong. In the absence of a voluntary agreement between the company and all of its creditors (or with the requisite approval of creditors under the amendment and waiver provisions of its debt documents), under Hong Kong law a company in Hong Kong only has recourse to a scheme of arrangement to restructure its debts and cram down dissenting creditors.

The Law Reform Commission of Hong Kong issued a report in 1996 that made detailed proposals to implement a form of provisional supervision. Supervision was intended to be through an independent third party, namely a provisional supervisor, who would take temporary control of the company and work towards a voluntary proposal for creditors with minimal supervision from the Court. There would also be a moratorium on creditors' claims during the provisional supervision process.

Such proposals have been considered several times since then but to date, have not progressed to legislation. The latest position (as of November 2020) is that the Hong Kong Government intends to present the Companies (Corporate Rescue) Bill (the "**Bill**") (the legislation which would implement provisional supervision in Hong Kong) to the Hong Kong Legislative Council in early 2021. As there have been no further public updates on the progress of the Bill since that time, the precise legislative timetable remains unclear at the time of writing.

A proper level of disclosure on restructuring and other costs

Re Da Yu Financial Holdings Ltd [2019] HKCFI 2531

In the context of a sanction hearing for a proposed scheme of arrangement, the Hong Kong Companies Court expressed concern about the quantum of the liquidators' restructuring and liquidation costs as compared to the disclosed rate of return to scheme creditors. The Court noted the need to determine in every case, by reference to all prevailing circumstances, including the rate of return to scheme creditors, whether a scheme is propounded for a permissible purpose for the general benefit of scheme creditors.

In this context, the Court observed that the explanatory statement for the proposed scheme contained scant information about key costs, including any form of breakdown. The Court observed that the available information was inadequate to enable scheme creditors and the Court to assess the reasonableness of such costs and noted that in the future, a more detailed breakdown would be a useful guide.

Notwithstanding this deficiency, the Court was keen to avoid a nil recovery for scheme creditors as a consequence of not sanctioning the scheme. The Court therefore did sanction the scheme but on the condition that all restructuring and other expenses would be taxed by the Court, with any cost savings resulting from that process to be distributed to scheme creditors.

A scheme compromising foreign law governed debt may be sanctioned if the evidence demonstrates it will achieve its apparent purpose

The 'Rule in Gibbs' is a long-established common law rule that applies in Hong Kong.² It provides that a foreign composition does not discharge a debt if the creditor does not consent and/or submit to the relevant foreign proceeding, unless the discharge occurs under the law governing the debt.

On the other hand, the fact that a part of the debt subject to a scheme of arrangement in Hong Kong is foreign law governed does not prevent the Hong Kong Court from sanctioning the scheme. The fundamental

² *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* ((1890) 25 QBD 399).

question is whether the scheme can achieve its apparent purpose and has utility. Two recent cases have underscored this important principle.

No invariable rule that chapter 15 recognition is required for a scheme compromising New York law governed debt

***Re China Singyes Solar Technologies Holdings Ltd* [2020] HKCFI 467**

The Hong Kong Companies Court was prepared to sanction a scheme of arrangement to compromise, amongst other things, debts arising under New York law governed notes, even though not all noteholders voted on the scheme and there was no plan to seek recognition of the scheme under chapter 15 of the United States Bankruptcy Code.

The Court accepted that recognition under chapter 15 was not necessary on the basis that:

- More than 99% of the relevant noteholders had voted in favour of the scheme.
- While chapter 15 recognition was sought in other cases involving a very high percentage of votes in favour of the relevant scheme, there is no invariable rule that such recognition is required.
- The Court is entitled to take a robust approach and worldwide effectiveness is not required. The Court's focus is scheme effectiveness in jurisdictions where the company has substantial assets that may be subject to creditor claims.
- The scheme must achieve a substantial effect and, in the present case, would do so without chapter 15 recognition because the company did not know the identity of the non-voting scheme creditors and had no reason to believe that any of them would seek to enforce their rights against the company in the United States.

In this decision, the Court also re-confirmed that a Hong Kong scheme may compromise claims against third parties (in this case guarantor subsidiaries) provided that such claims are merely ancillary to the arrangement between the company and its creditors. Further, underlying beneficial holders of the notes were properly to be characterised as contingent creditors of the company based on existing precedent and practice.

Evidence of scheme utility

***Re Freeman Fintech Corp Ltd* [2021] HKCFI 310**

The scheme in question purported to compromise Macanese law-governed debt held by an individual creditor with whom the joint provisional liquidators of the debtor company had previously liaised, but who had not returned a proxy form, notice of claim, or made any contact concerning his debt or the scheme. The debt represented approximately 1.5% of the total unsecured debt of the company. Nonetheless, the Hong Kong Companies Court held that the scheme could be sanctioned since:

- The company had no assets in Macau.
- Enforcement in Macau was "not of concern" to the company.
- Once sanctioned, the creditor in question would be prevented from taking enforcement proceedings against the company in Hong Kong.

In the decision, the Court referred to its earlier decision in *Re China Lumena New Materials Corp* [2020] HKCFI 338, which was the first reported case in Hong Kong involving a scheme of arrangement purporting to compromise PRC law-governed debt. The Court sanctioned the scheme even though a Mainland branch of a Chinese bank, which held PRC law-governed debt representing approximately 42% of the total debt of the company, had not voted in favour of the scheme on account of unexpected administrative complications.

The Court found that the creditor bank in question had likely submitted to the jurisdiction in any event through its Hong Kong branch (an exception to the Rule in Gibbs, as mentioned above), but even if that had not been the case, the scheme would probably still be found to serve its purpose and have utility since there appeared to be no reason to think that a Mainland creditor would try to enforce its claim (based on PRC law-governed debt) in Hong Kong on the basis it was not bound by the scheme.

Winding-Up of Foreign Companies in Hong Kong



Significant enforcement barriers created by the typical Mainland business group structure

***Re China Huiyuan Juice Group Ltd* [2020] HKCFI 2940**

***Shandong Chenming Paper Holdings Ltd v Arjowiggins HKK 2 Ltd* [2020] HKEC 2290**

The Hong Kong Companies Court has a discretionary jurisdiction to wind-up a company located in a foreign jurisdiction based on three core requirements (*Kam Leung Sui Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501). They are: (i) a sufficient connection with Hong Kong, but not necessarily consisting in the presence of assets in the jurisdiction; (ii) a real possibility that the winding-up order would benefit those applying for it; and (iii) the Court being able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

The first and third core requirements are usually satisfied if a company has a listing in Hong Kong. *Re China Huiyuan Juice* concerned a winding up petition in respect of such a company — a Cayman Islands-incorporated, Hong Kong-listed holding company of a Mainland Chinese business group. In its noteworthy decision, the Court focused on the second core requirement, which it described as being of much greater significance now in light of the significant increase in winding-up petitions—accounting for the majority of the corporate insolvency caseload before the Companies Court by November 2020—in respect of Hong Kong-listed offshore companies of Mainland Chinese business groups, which have no or few assets in Hong Kong.

The Court referred to an earlier judgment of the Hong Kong Court of Appeal in *Shandong Chenming Paper* concerning a Mainland-incorporated company with listings in Shenzhen and Hong Kong. The company refused to pay a judgment debt and was threatened by the judgment creditor with a winding-up petition in Hong Kong. The company's only connection with Hong Kong was its listing, which gave rise to a benefit to the defendant (the proposed petitioner) capable of satisfying the second core requirement. This was explained by the pressure that a liquidation in Hong Kong, or the prospect of a liquidation, would put on the company to settle the relevant debt.

The judgment in *Shandong Chenming Paper* had not been handed down prior to the hearing in *Re China Huiyuan Juice*, but was referred to in the *Re China Huiyuan Juice* decision. It did not, however, assist the petitioner in *Re China Huiyuan Juice* when it came to the second core requirement. In *Shandong Chenming Paper*, the only reason the company had refused to pay the debt was recalcitrance, such that the pressure of a liquidation may have forced payment. In *Re China Huiyuan Juice*, the debtor was insolvent and the value of the realised listing was questionable. The Court observed that the value of listings in Hong Kong seemed to have dropped to approximately the costs of a conventional restructuring. Accordingly, the Court would require evidence—from a witness familiar with the practice of the Stock Exchange of Hong Kong (“SEHK”) — to demonstrate that there is 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.

Other potential avenues to satisfy the second core requirement were also rejected. In particular, the evidence suggested that liquidators appointed in Hong Kong would neither be recognised in Mainland China, nor in the Cayman Islands (except for the purpose of introducing a scheme of arrangement), such that they would not therefore be in a position to assume control of the group's intermediate BVI holding companies, which would in turn give them a means of assuming control of the Mainland business. As such, a Hong Kong winding-up order would not itself enable the petitioning creditor to recover assets located in the Mainland.

The Court noted that the types of considerations that had emerged in *Re China Huiyuan Juice* gave rise to a need for caution—observing that the typical Mainland China business group structure “...creates a significant barrier to steps being taken by creditors and shareholders to enforce rights using the courts of Hong Kong, which is the legal system that they have probably assumed they will be able to access if they need to take steps to enforce their legal rights against a company listed here.”

The relevance of COMI versus jurisdiction of incorporation

***Re Lamtex Holdings Limited* [2021] HKCFI 622**

***Re Ping An Securities Group (Holdings) Ltd* [2021] HKCFI 651**

In *Re Lamtex*, the Hong Kong Companies Court ordered the winding-up of a Bermuda-incorporated Hong Kong-listed company that had already been placed into ‘soft-touch’ provisional liquidation in Bermuda. The decision represents an important evolution in cross-border insolvency law and practice in Hong Kong and was followed just one day later by the decision in *Re Ping An Securities Group*, which concerns another company in the same situation.

The common law doctrine of ‘modified universalism’ guides the Hong Kong Court when determining cross-border issues arising in transnational insolvencies. Applying this doctrine, the established practice has been to stay local winding-up proceedings in Hong Kong in favour of foreign proceedings opened in the company’s place of incorporation, which is thereby afforded primacy.

The question for the Court in *Re Lamtex* was whether this approach should be adopted with the result that the Hong Kong winding-up petition (which was presented before the filing in Bermuda) should be adjourned so that a restructuring could be pursued under the Bermudan soft-touch provisional liquidation.

The Court held, on the facts of the case, that a greater emphasis should be placed on the centre of main interest (“**COMI**”) of the company and set out the following framework to address questions of primacy with respect to competing insolvency proceedings in future cases:

- “1. Generally, a company should be liquidated in its place of incorporation.
2. However, if the company’s COMI is elsewhere, regard should be had to other factors:
 - (a) Is the company a holding company and, if so, does the group structure require 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.”

The focus on a company’s COMI in the context of assessing the primacy of competing insolvency proceedings is likely to have a significant impact given that many Hong Kong and Mainland Chinese corporate groups are structured under a Hong Kong-listed offshore holding company with little connection to the businesses of the group. It is also pertinent in Hong Kong where the UNCITRAL Model Law on Cross-Border Insolvency has not been adopted and there is currently no statutory framework for dealing with cross-border insolvency matters.

The decision also casts a spotlight on the tactical use in certain cases of soft-touch provisional liquidation as a means of avoiding a winding up in Hong Kong and/or obtaining a de facto moratorium. The Court observed in *Re Lamtex* that this was a questionable use of soft-touch provisional liquidation that would encourage it to view with care similar applications in the future. Indeed, in the future, unless the agreement of a petitioner and supporting creditors have been obtained in advance, the Court confirmed it would not deal with recognition and assistance applications made by soft-touch provisional liquidators on the papers (i.e. without a hearing) after a winding-up petition has been presented in Hong Kong.

A shareholder dispute should be resolved in a jurisdiction which can grant either a buy-out order or a winding-up order

***Scanty Investment Company v Brilliant Functions Ltd* [2020] HKCFI 498**

This decision concerned a shareholder's winding-up petition in respect of a company incorporated in the BVI with no establishment in Hong Kong. The company was solvent and carrying on business.

The Hong Kong Companies Court held that it was consistent with the philosophy underlying Hong Kong's legislation that a shareholder dispute ought to be resolved in a jurisdiction which could grant a buy-out order (the usual remedy for unfair prejudice) or a winding-up order. In a situation where, as here, the company is incorporated in a jurisdiction (the BVI) with an unfair prejudice regime similar to that in Hong Kong, is solvent and has no place of business in Hong Kong, the petitioner is behaving unreasonably in seeking exclusively a winding-up.

Key issues surfacing in the context of a shareholder's petition on the just and equitable ground

***Champ Prestige International Limited v China City Construction (International) Co Ltd & Anor* [2020] HKCFI 355**

The Hong Kong Companies Court considered a winding-up application, on the just and equitable ground, in relation to a BVI-incorporated Hong Kong-listed joint venture vehicle whose sole business activity was the development of land in the United States.

A dispute arose between the joint venture partners in the context of which the petitioner argued that the joint venture vehicle could no longer fulfil its business purpose. A key question was whether the first core requirement was met, namely a sufficient connection between the company proposed to be wound up and Hong Kong.

The Court observed that, for a shareholder's petition on the just and equitable ground, one looks to see whether management and ownership of the company proposed to be wound up have a sufficient connection with Hong Kong — a question to be considered in general and common sense terms to determine whether the company is fairly viewed as a Hong Kong business entity. The answer was yes in this case: four out of five of the company's directors were resident in Hong Kong. Further, one joint venture partner was incorporated in Hong Kong, while the other was wholly owned by a Hong Kong-listed company.

The Court was also invited to consider a stay of the petition on the basis that one of the key joint venture agreements contains an arbitration clause. It was held that, for a shareholder's petition, the correct approach is to identify the substance of the dispute between the parties and ask whether or not it is covered by the arbitration agreement. While there may be cases where a part of the dispute can be hived off to arbitration and the balance of the complaints stayed until the arbitration has concluded and the petition continues, the complaints in this case all formed part of one continuing narrative. The Court observed that it was reluctant to exercise a discretion to stay a petition on the grounds that some, but not all of the factual matters in dispute are subject of an arbitration clause unless it is clear and obvious that a dispute the subject of an arbitration clause would be central and probably determinative of the factual matters raised by the petition.

Other Recent Developments



Impact of an arbitration agreement on a creditor's winding-up petition

***Dayang (HK) Marine Shipping Co, Ltd v Asia Master Logistics Ltd* [2020] HKCFI 311**

A company, the subject of a winding-up petition in Hong Kong, did not dispute the relevant debt owed to the petitioner. However, the company sought to stay the petition on the basis that it had a counterclaim against the petitioner, which arose under a charterparty containing an arbitration agreement. The Hong Kong Companies Court had no difficulty on the facts dismissing the counterclaim as lacking a credible basis and making a winding-up order.

However, the Court took the opportunity to review in detail the principles of law relevant to the following question: when a contract from which a debt arises contains an arbitration agreement covering any dispute relating to the debt, is the Court obliged to stay or dismiss winding-up proceedings in favour of arbitration?

In a detailed decision, the Court questioned the underlying rationale for the approach previously adopted to relation to this matter in Hong Kong, as reflected in the decision of *Lasmos Limited v Southwest Pacific Bauxite (HK) Limited* [2018] HKCFI 426. Having traversed through an "analytical journey", the Court expressed the view that where a debtor-company wishes to dispute the existence of a debt, it must show that there is a *bona fide* dispute on substantial grounds. It would not be enough simply to deny the debt. As for the existence of an arbitration agreement, this should be regarded as irrelevant to

the exercise of the Court's discretion, although if the debtor had commenced arbitration proceedings or such proceedings would be commenced, then this may be relevant evidence of a *bona fide* dispute.

This is an evolving area of law in Hong Kong, and *Dayang* is a first instance decision which is out of step with the position in England and in Singapore (following the noteworthy decision last year in *AnAn Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Company)* [2020] SGCA 33).

Matters for a liquidator's commercial judgment

Two recent decisions caution insolvency practitioners to tread carefully when seeking Court sanction of proposed steps that are properly within a liquidator's authority and his or her commercial judgment to take.

Litigation funding agreements

***Re Patrick Cowley and Lui Yee Man, Joint and Several Liquidators of the Company* [2020] HKCFI 922**

An application was made under section 255 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance, Cap 32 ("**WUMPO**")³ by Hong Kong-appointed liquidators in the context of a voluntary winding-up of a company for a direction confirming the appropriateness of a proposed litigation funding agreement to be entered into by the company, and that such agreement be approved. The proposed funding agreement contained a condition precedent requiring sanction by the Hong Kong Court.

The liquidators' position was that, while they did not have concerns about any particular provision of the funding agreement, certain recent Hong Kong Court decisions (one relating to a trustee in bankruptcy and a funding agreement) had created uncertainty in the market about the need to obtain the Court's blessing of a funding agreement in an insolvency context. In any event, a direction was required in this case in order to satisfy the condition precedent in the agreement.

³ This provision, among other things, entitles a liquidator or any contributory or creditor to apply to the court to determine any question arising in the winding-up of a company, and provides that the court may determine the question if just and beneficial.

The Court confirmed that, while liquidators may seek directions, this does not mean they may do so about any decision being contemplated just because there may be some uncertainty about the appropriateness of the decision. Assignments of choses in action and the taking of steps to pursue litigation are matters liquidators are authorised by statute to pursue and within the range of decisions concerned with the conduct of a liquidation which involve liquidators exercising their professional expertise and judgment.

Furthermore, it was noted that the form of order sought did not involve the formulation of an issue requiring a legal judgment. As it transpired, the issue that required determination was whether or not it was necessary to obtain the Court's sanction before causing the company to enter into a funding agreement. The Court's decision helpfully clarifies that, as a starting point at least, the answer to this question is no.

Directions concerning possible distributions

***Joint and Several Provisional Liquidators of Hsin Chong Construction Co Ltd (Provisional Liquidators) Appointed v The Chinese University of Hong Kong And Others* [2020] HKCFI 2434**

Provisional liquidators in the context of an insolvent creditor's winding-up made an application for directions under section 200(3) WUMPO (which provides that a liquidator may apply to the court in relation to any particular matter arising under the winding-up). In essence, the provisional liquidators sought confirmation whether the debtor, as main contractor under a building contract, should make certain payments to various sub-contractors out of funds received from the employer under the contract, and the amounts of any such payments.

The application was dismissed. The thrust of the Court's decision was that liquidators cannot ask the Court to make, or absolve them from responsibility for making, a difficult commercial decision. Directions should be reserved for situations where a genuine difficulty arises, such as where a decision is criticised by a creditor as being unreasonable or evidence of bad faith. The proper approach is for liquidators to seek legal advice and then decide themselves on the appropriate course of action.

Common practice is not always correct

***Re China Ocean Industry Group Ltd* [2021] HKCFI 247**

The mere presentation of a winding up petition in Hong Kong often results in a number negative consequences for a debtor company. The driving force behind those consequences is section 182 WUMPO which provides, relevantly, that any disposition of property of a company or any transfer of shares or alteration in the status of the members after the commencement of winding-up proceedings (i.e. the presentation of a winding-up petition) is void. Section 182 does, however, provide that courts are able to grant validation orders to allow those actions to occur in certain circumstances.

In *Re China Ocean*, the Court took the opportunity to correct a commonly held view in Hong Kong (including by the SEHK) that a validation order was required for a company the subject of a winding up petition to issue new shares. In the context of an application by an insolvent listed company for a validation order to allow it to issue new shares and convertible bonds as part of a debt restructuring (the application was made to meet the (existing) requirements of the SEHK), the Court found that neither act resulted in any transfer of shares or alteration in the status of (existing) members of the company. As such, the Court held that it had no jurisdiction to grant a validation order as the prohibitions in section 182 WUMPO were not engaged.

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Our Asia practice, with offices located in Beijing, Hong Kong and Singapore, serves both Asia-based clients seeking international representation and U.S. and international clients interested in initiating or expanding enterprises in any Asian jurisdiction. Akin Gump's Asia practice offers clients advice and counsel in more than 85 practices linked across offices in Europe, the Middle East, the Commonwealth of Independent States (CIS) and the United States, while focusing on its own core strengths: pan-Asian M&A, energy, transactions, private equity, finance and financial restructuring, investment fund formation and international trade.

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Akin Gump Strauss Hauer & Feld is a leading global law firm providing innovative legal services and business solutions to individuals and institutions. Founded in 1945 by Richard Gump and Robert Strauss with the guiding vision that commitment, excellence and integrity would drive its success, the firm focuses on building lasting and mutually beneficial relationships with its clients. Our firm's clients range from individuals to corporations and nations. We offer clients a broad-spectrum approach, with over 85 practices that range from traditional strengths such as appellate, corporate and public policy to 21st century concentrations such as climate change, intellectual property litigation and national security.