INSOL INTERNATIONAL

TREATMENT OF SECURED CLAIMS IN INSOLVENCY AND PRE-INSOLVENCY PROCEEDINGS II

INSOL INTERNATIONAL

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PRESIDENT'S INTRODUCTION

Banks and other lending institutions will extend credit provided they can obtain effective security in the event of default. This results in the lender being assured that it has the right to recover its debt in a quick and efficient manner.

When a borrower defaults under a loan agreement, the lender is usually unaware of the extent of the debtor's financial difficulties. There is always a risk that the debtor may be unable to repay other creditors in addition to the lender and be forced into insolvent liquidation proceedings.

Unsecured creditors usually receive very little or nothing through the rateable distribution process employed in such proceedings. However, in most jurisdictions secured creditors stand outside the insolvency proceedings and the credit instruments would give the lender the ability to enforce its rights without utilizing the courts. A secured creditor also has the right to pursue recovery as an unsecured creditor for any balance of the debt which the security does not satisfy.

In June 2007 INSOL published the first edition of this book. The subject matter continues to be of interest and relevance to practitioners and, as a result, the INSOL Technical Research Committee decided that a second edition of this book should be published. INSOL International is delighted to present this new and updated 20 chapter book which includes seven new country chapters (namely, Brazil, BVI, Cayman Islands, Hong Kong, Mexico, Nigeria and Singapore) and 13 updated and revised chapters of previously included countries. The chapters cover a wide range of key issues that practitioners would find useful, including the types of security rights that are available, the enforcement of such rights, circumstances when the granting of secured rights may be challenged and declared void, and the impact of reorganisation of a company on secured creditors, to name but a few.

The project was led by Evan C Hollander of Orrick, Herrington & Sutcliffe LLP, New York. Evan was also involved in the publication of the 1st edition of this book and we are very grateful for his guidance, interest, and ongoing commitment to publish this book to a very high standard. Evan had a great team working on this project and we are indebted to all of them for committing their time to the editing and review process. We would also like to thank the contributors for taking the time to write / update these chapters, despite their busy schedules.

Julie Hertzberg
President
INSOL International

FOREWORD

Consistent with INSOL's mission statement to "facilitate the exchange of information and ideas", the Technical Research Committee first produced in 2007 a comparative study of the treatment of secured claims in pre-insolvency and insolvency proceedings. The template utilized in the prior edition of this guide, developed with the assistance of my predecessor Andrew DeNatale Of Counsel and Head of the Special Situations Lending Group at Stroock & Stroock & Lavan, provided a handy, accessible and well-organized reference tool outlining the issues impacting the enforcement of secured claims in the twelve jurisdictions covered in that edition. Thus, that template has been incorporated with slight modification into this new edition covering the laws in 20 jurisdictions.

The treatment of secured claims is a matter that insolvency practitioners address in virtually every case in every jurisdiction. This new volume clearly illustrates the advantages and limitations of secured status in in pre-insolvency and insolvency proceedings in each of the 20 jurisdictions covered. As more corporations have extended their presence across borders, it has become critical for practitioners and investors to understand the nuances of the treatment of secured claims in multiple locations. It is the Committee's hope that this study will enable practitioners to navigate the complexities that arise in multinational restructurings, and to provide investors with a handy guide for sound practical information regarding the risks and rewards of secured investments in different countries.

The project would not have been possible without the help and support of others. The initial acknowledgement must go to the Technical Research Committee for developing the concept and format of the project, and to my predecessor who oversaw the production of the prior edition of this volume. I also extend my thanks to the contributors, each of whom submitted excellent material for the jurisdictions covered by the project. Finally, I would like to extend my sincere gratitude to my colleagues, Scott Morrison, Vincent Yiu and Nicholas Sabatino for assisting in the editing of the chapters in this volume and Emmanuel Fua, Peter Amend and Monica Perrigino, who assisted in drafting the materials on the United States.

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CONTENTS

HONG KONG

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

Security interests over movable and immovable property in Hong Kong are typically granted by contract, including by way of deed, debenture or another form of security document. There are also certain types of security interests that arise by operation of common law or statute.

1.1 Common forms of security – movable property

The most common forms of security over movable or personal property are mortgages and charges:

1.1.1 Mortgage

For legal or equitable mortgages see sections 1.3.1 and 1.3.2 below respectively.

1.1.2 Fixed charge

A fixed charge is a security interest created over a particular asset where legal title to that asset remains with the chargor but the chargee has the right to enforce the charge following an event of default and satisfy the secured debt with the proceeds of the charged asset. The chargor may only deal with and dispose of the charged asset with the chargee's consent. If the chargee allows the chargor to deal with the asset in the ordinary course of business, the court may treat the charge as floating rather than fixed (see section 1.1.3 below).

1.1.3 Floating charge

Floating charges are created over a class of assets (present and future) and, unlike under a fixed charge, the chargor is permitted to continue to deal with the assets in the ordinary course of business until the charge crystallises upon the occurrence of an event of default or other crystallisation event. On crystallisation, a floating charge is converted into a fixed charge that attaches to the charged assets.

1.2 Other forms of security

Other available forms of security over movable property in Hong Kong include pledges and liens.

1.2.1 Pledges

Although less common than charges and mortgages, it is possible to take security over certain types of movable property by way of a pledge where possession of the asset is transferred to the pledgee who holds the asset until the secured debt is discharged, although legal title to the asset remains with the pledgor. The pledgor has the right to sell the asset upon default.

1.2.2 Liens

Common law liens are another form of possessory security interest where the lien holder has the right to retain possession of the property until the relevant obligations are discharged. Liens can also arise under contract or statute.

1.2.3 Retention of title

Although they are not necessarily security interests, retention of title arrangements can also be used in commercial transactions to give a seller of goods protection in respect of the purchase price for goods sold on credit.

While possession of the goods is transferred to the buyer, a condition of the sale is that the buyer will not acquire title to the goods until the purchase price has been paid in full. If title has not transferred to the buyer, then those assets should not fall within the buyer's estate upon its insolvency. Retention of title is typically expressed to terminate once the relevant goods have been paid for in full or when the goods have lost their identity (i.e. if they are co-mingled with other goods). A simple retention of title arrangement would not generally require registration as a security interest, provided that it is clear that title to the goods that are subject to the retention of title arrangements has not passed to the purchaser.

However, depending upon the contractual terms, retention of title arrangements can, in certain circumstances, give rise to a charge over the goods which would require registration in accordance with the Companies Ordinance (Cap 622) (CO) (see section 10 below). Examples of such circumstances include where the retention of title arrangement purports to extend to property already owned by the purchaser or to the proceeds of re-sale of the goods to a third party.

1.3 Common forms of security – immovable property

Common forms of security interests over immovable or real property include legal and equitable mortgages, although such security interests can also be taken by way of fixed charge:

1.3.1 Legal mortgage / legal charge

A legal mortgage transfers title in the asset to the mortgagee, subject to the mortgagor's equity of redemption, being the right to redeem the mortgaged property upon repayment of the secured debt obligation. The mortgagee has a right of foreclosure (i.e. to take ownership of the mortgaged assets free of the mortgagor's equity of redemption) on default. A legal mortgage over land must be created by way of a deed expressed to be a legal charge.

1.3.2 Equitable mortgage

An equitable mortgage can be created by deed, or simply by depositing title deeds or other similar documents with the mortgagee. Unlike a legal mortgage, an equitable mortgage does not transfer legal title to the mortgagee and the mortgagee has no power to sell the land on the mortgagor's default. An equitable mortgage could arise if the parties intended to execute a legal mortgage but failed to comply with the requisite formalities.

1.3.3 Fixed charge

See section 1.1.2 above.

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

Hong Kong security documents will ordinarily include a contractual right to appoint a receiver without the need for court involvement and will set out the powers of the chargee and / or the appointed receiver in respect of the charged assets. The holder of a legal mortgage or a legal charge or equitable mortgage executed as a deed will, unless contractually varied, have a statutory power of sale under the Conveyancing and Property Ordinance (Cap 219), which can be exercised without an order of the court. A court order is required for a mortgagee to exercise its right of foreclosure.

Practical difficulties can arise in the enforcement of security interests where the co-operation of the chargor is required for the chargee or the receiver to take possession and control of the secured assets. In such circumstances, assistance from the court may be required. Where practical, it is common for measures to be taken at the time the security interest is created to minimise the need for co-operation from the chargor in an enforcement scenario. For example, when taking security over certificated shares in Hong Kong it is customary for security documents to provide that the chargor must, at the time of creation of the charge, deliver to the chargee the original share certificates and, among other things, pre-executed instruments of transfer in respect of the shares and amend the company's articles of association to remove any powers of the directors to refuse to register a transfer of the shares upon enforcement. Without such documentation, co-operation of the chargor or its board of directors would likely be required to effect a transfer of ownership of the shares.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including?

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

3.1 Common pre-insolvency proceedings

As Hong Kong does not have a statutory corporate rescue regime, the most common pre-insolvency proceedings for the purpose of restructuring the debts of a company in Hong Kong are:

- informal workouts; and
- schemes of arrangement.

It is also possible to wind a company up pre-insolvency through a members' voluntary liquidation.

3.1.1 Workout

A workout is an informal out-of-court contractual arrangement between the company and its creditors for the purposes of rescheduling the company's debts. It can be initiated at any time by either the company or its creditors. The debtor's management typically remains in control during and after the workout process subject to any oversight or controls required by the creditor group, such as board observers or nominees, or cash management arrangements to which the company agrees.

Contractual and security rights may only be varied with the consent of the relevant threshold of creditors or secured creditors under the company's existing contractual documentation. Depending upon the terms of the proposed restructuring, shareholder consent may also be required to implement the workout.

3.1.2 Scheme of arrangement

A scheme of arrangement is a court-supervised statutory procedure available under the CO to enable a company and its creditors or any class of creditors to effect a compromise or arrangement in respect of the creditors' claims against the company. The scheme process is typically initiated by the company itself (or its provisional liquidators or liquidators if appointed). The scheme of arrangement procedure can be utilised by a Hong Kong incorporated company and, subject to certain criteria being met, a foreign company. The company does not need to be insolvent to be eligible to propose a scheme.

Unless a liquidator or provisional liquidator has been appointed, the debtor's existing management remains in control of the business of the company during the scheme process. The company will ordinarily appoint legal and financial advisors to formulate and negotiate the terms of the scheme, prepare the scheme documentation and make the relevant applications to the court.

To be binding on scheme creditors (or any class of scheme creditor), a majority of scheme creditors in the relevant class whose claims in aggregate represent at least 75% by value of all scheme creditors in that class who are present and voting at the scheme meeting must vote in favour of the scheme, and it must be subsequently sanctioned by the court. A copy of the court order must be registered with the Companies Registry. The scheme of arrangement can be used to compromise the claims of both secured and unsecured creditors provided the requisite majority in each class have voted in favour of the scheme. Secured and unsecured creditors would ordinarily form separate classes for the purposes of a scheme. Depending upon the terms of the scheme, shareholder consent may also be required to implement the scheme.

The initiation of a scheme of arrangement does not trigger a moratorium on creditor actions and so, in the absence of the appointment of a provisional liquidator or liquidator which would trigger a stay, co-operation from creditors will usually be required in order to avoid enforcement action during the period before the scheme becomes effective.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including?

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***

- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

As noted above, Hong Kong does not currently have a formal rescue regime. Formal insolvency proceedings in Hong Kong are limited to voluntary or compulsory liquidation and provisional liquidation. Should a liquidator or provisional liquidator wish to propose a restructuring to the company's creditors, he or she would have power to propose a scheme of arrangement (see section 3.1.2 above).

4.1 Creditors' voluntary liquidation

A creditors' voluntary liquidation can be initiated by shareholders by way of a special resolution (i.e., at least 75%) to wind up the company. A meeting of creditors must be held not later than 14 days after the date of such resolution. Notice of the creditors' meeting must be sent by post to the creditors and advertised at least seven days before the day of the meeting. A statement of affairs of the company must be tabled at the meeting of creditors, and any nomination of a liquidator by the meeting of creditors will prevail over any contrary nomination of a liquidator by the shareholders.

Alternatively, in limited circumstances, the directors (or the majority of the directors, if there are more than two) can initiate a creditors' voluntary liquidation if they have formed the opinion that the company cannot continue its business due to its liabilities and that it is not reasonably practicable to commence it in any other way. To initiate the procedure the directors must take the following key steps:

- pass a resolution which (among other things) confirms that the directors consider it necessary that the company be wound up and that the winding-up should be commenced under such procedure because it is not reasonably practicable to commence it in any other way;
- call a meeting between the company and its creditors;
- appoint a provisional liquidator with effect from the commencement of the winding-up; and
- deliver a winding-up statement to the Registrar of Companies.

Upon the appointment of the liquidator in a creditors' voluntary liquidation, the directors' powers cease, except to the extent that the creditors' committee (the committee of inspection), if any, or otherwise the creditors, agree that they can continue. There is no moratorium on proceedings against the company. However, the court has discretion to stay legal proceedings on the application of a creditor, contributory or the liquidator.

4.2 Compulsory liquidation

A compulsory liquidation is commenced by the presentation of a winding-up petition to the court. The petition can be presented by various parties, including creditors and the company itself. The party presenting the petition must satisfy certain notice, filing and advertising requirements. In the case of a

petition presented by a creditor, a statutory demand is often served first, providing a 21-day window for the company to pay the debt owed to the creditor.

There are a number of grounds upon which the court can wind up a company. The most common grounds are that:

- the company has by special resolution (i.e. at least 75%) resolved that it must be wound up;
- the company is unable to pay its debts – failure to pay a statutory demand within 21 days is an act of presumed insolvency, as is failure to satisfy a judgment debt in whole or in part; and
- the court considers that it is just and equitable that the company be wound up.

The court will not make a winding-up order if the company establishes that there is a genuine dispute on substantial grounds regarding the debt that is the subject of the petition.

The company's existing board and management will remain in control until a winding-up order is made, upon which the powers of the existing directors will cease and the liquidator will take control of the company's affairs under the supervision of the court. During the liquidation, a creditors' committee (the committee of inspection) may be appointed to supervise the liquidator in relation to certain matters. In particular, the court or the committee of inspection must approve compromises with creditors and the commencement of litigation.

At any time after the presentation of the winding-up petition and before the winding-up order is made, the company or any creditor or contributory may apply to the court for a stay of proceedings. The granting of a winding-up order will trigger an automatic stay on all actions and proceedings against the company without leave of the court.

4.3 Provisional liquidation

During the period between the filing of the winding-up petition and the making of the winding-up order, a provisional liquidator can be appointed in appropriate circumstances in order to maintain the *status quo* and preserve the assets of the company pending the making of the winding-up order. The company, a creditor or contributory can apply to the court for the appointment of a provisional liquidator if:

- there is a good *prima facie* case that a winding-up order would be made; and
- it is appropriate in all the circumstances for a provisional liquidator to be appointed, such as in the case of risk of jeopardy to or dissipation of the company's assets.

When a provisional liquidator is appointed, no actions or proceedings can be commenced or continued against the company without leave of the court, and the provisional liquidator will assume control of the company's affairs from the company's directors. The court order appointing the provisional liquidator will determine his or her powers.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

If a company enters into insolvent liquidation, a liquidator has power to examine transactions entered

into prior to the liquidation, including the grant of security interests, and may seek to have certain transactions set aside should the requisite criteria be met (see sections 5.1 to 5.4 below for further details). Similarly, a person prejudiced by a transaction entered into with intent to defraud creditors may seek to attack that transaction, although it is unlikely to be set aside if the grantee entered into the transaction in good faith without notice of the intent to defraud. Security interests can also be attacked on the grounds of a failure to register the security interest, where applicable, with the Companies Registry or other relevant asset class register (see section 10 below).

5.1 Unfair preference

A grant of security, and other transactions, made during the six months prior to the commencement of the winding-up (or two years prior if the secured creditor is connected to the company) may be set aside if it is an unfair preference. An unfair preference is any action taken by the company, influenced by a desire to prefer, that puts one creditor in a better position in the event of insolvency than it would otherwise have been in had the action not occurred. Transactions involving persons connected with the company are presumed to be an unfair preference unless proven otherwise.

5.2 Transaction at an undervalue

A security interest granted by the company within the five-year period before the company's winding-up is commenced may be set aside if it was entered into at an undervalue at a time when the company was unable to pay its debts or if the company became unable to pay its debts as a result of entering into the transaction. The company enters into a transaction with a person at an undervalue if (for that transaction) the company receives no consideration or consideration which is significantly less than the consideration provided by the company. The transaction will not be set aside if the court is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business, and there were reasonable grounds for believing that the transaction would benefit the company. The courts in Hong Kong have not yet determined whether the grant of a security interest could constitute a transaction at an undervalue.

5.3 Floating charges

Floating charges created by a company may be set aside (save to the extent of any new money provided to the company in return for the charge) if granted by the company within:

- two years before the company's winding-up commenced (if granted in favour of a person who is connected with the company); and
- within 12 months before the company's winding-up commenced (if granted in favour of a non-connected person), and the company is unable to pay its debts at the time it is entered into or becomes unable to pay its debts as a result.

5.4 Extortionate credit transactions

An extortionate extension of credit to the company within three years before the commencement of the winding-up may be set aside upon the application of a liquidator. A credit transaction is extortionate if, having regard to the risk accepted by the person providing the credit, the terms of it are such as to require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of credit, or if it otherwise grossly contravenes ordinary principles of fair dealing.

6. Is enforcement of security rights treated differently in each type of proceeding?

There is no automatic stay in a creditors' voluntary liquidation, although as noted in section 4.1 above, relevant parties can seek a stay from the court. The automatic stay on actions and proceedings against the company which is triggered upon the appointment of a provisional liquidator or the granting of a winding-up order does not prevent secured creditors from enforcing their security interests out of court, such as appointing a receiver. Should secured creditors need to commence court proceedings, such as to enforce their security interest (e.g. foreclosure over mortgaged property), they may apply to court for leave to do so and, ordinarily, the court would be expected to grant such leave to a secured creditor.

A scheme of arrangement that binds secured creditors can provide for a stay on secured creditor action, but such stay will only apply once the scheme becomes effective. As noted at section 3.1.2 above, the scheme will only become effective once it is approved by the requisite thresholds of scheme creditors and sanctioned by the court, and a copy of the court order is registered with the Companies Registry. A company may seek to enter into a contractual standstill arrangement with its creditors to prevent an enforcement prior to the scheme being launched by the company.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Upon liquidation, creditors usually rank as follows:

- *Secured creditors:* secured creditors are generally entitled to pay themselves from realisation of their secured assets, although they are then entitled to claim as an unsecured creditor for any balance that remains unpaid after realisation of the security. Expenses of a receiver incurred in realising the secured assets can be deducted from the proceeds of the assets. Where there is more than one security interest over the same asset, generally a legal mortgage will rank ahead of an equitable mortgage, and fixed charges will rank in order of date of creation.

- *Liquidators' remuneration and costs and expenses:* these are the costs, charges and expenses properly incurred in the liquidation. The liquidators are entitled to their remuneration first, followed by the costs and expenses of the winding-up.

- *Preferential creditors:* employee claims rank first in this category and can include claims for wages and salaries, severance payments, long-service payments, amounts due in respect of employee compensation and claims for holiday pay, subject to any applicable statutory caps. Government and statutory debts (such as rates and taxes) and, where applicable, claims by bank deposit holders or claims under contracts of insurance can also be included as preferential creditors' claims.

- *Floating charge holders:* where a floating charge has crystallised or a receiver is appointed under the instrument by which the charge was created, floating charge holders can be paid from the proceeds of sale of the assets, but only if the claims of all preferential creditors have been satisfied. A charge holder will be entitled to claim as an unsecured creditor for any balance that remains unpaid after realisation of the security. Any floating charges created over the same assets will rank in order of date of creation.

- *Ordinary unsecured creditors:* all remaining unsecured creditors will share the remaining surplus. If there are insufficient assets to meet the claims of ordinary unsecured creditors, they will receive a share *pro rata* to their respective claims.

- *Shareholders:* any remaining balance is distributed to shareholders in accordance with the articles of association of the company.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

As noted above, there is no automatic stay of proceedings until a winding-up order or provisional liquidation order has been made in respect of the company. The automatic stay generally does not prevent secured creditors from taking steps to enforce their security, by appointing a receiver or taking any other out-of-court action. Therefore, to the extent appropriate, these steps can be taken by the secured creditors to protect their interests in collateral during a pre-insolvency or insolvency proceeding.

Secured creditors that choose to agree to a contractual standstill or forbearance to facilitate discussions in respect of a workout or scheme of arrangement may seek to negotiate termination rights or carve-outs that would enable them to take steps to enforce their security interests and / or preserve the secured assets where necessary or appropriate.

Floating charges will typically include a crystallisation clause which will provide that, upon the occurrence of certain events such as the occurrence of a default or the presentation of a winding-up petition, the charge will automatically crystallise and be converted into a fixed charge. When the charge crystallises, it attaches to those charged assets that are at the time owned by the company which will restrict the ability of the company to deal with those assets without the secured creditor's consent.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

A scheme of arrangement between the company and its creditors can include a release of creditor claims against third-party guarantors, provided that such a release is necessary to give commercial effect to the arrangement between the company and the scheme creditors and can fairly be described as ancillary to the arrangement between the company and the scheme creditors. Generally speaking, the liquidation of a company would not prevent a creditor pursuing claims against a third-party guarantor that is not in liquidation.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

10.1 Immovable property

Registerable security interests over land and buildings must be registered with the Land Registry. Priority will be given effect from the date of: (1) execution of the security document if registered within one month of the date of execution; or (2) registration of the security document if registered more than one month after the date of execution. If a registerable security interest is not registered, it will be ineffective against a *bona fide* purchaser or mortgagee for valuable consideration. Failure to register the security interest will not affect the validity of the charge itself as between the parties to the security.

In general, a company incorporated in Hong Kong or registered in Hong Kong as a non-Hong Kong company must register mortgages over any land it owns or other registerable charges with the Companies Registry within one month after the date of creation of the mortgage or charge. A longer period applies if the document was executed overseas and secures assets which are located overseas.

The registration requirements do not apply to foreign companies that are not registered in Hong Kong as a non-Hong Kong company. If a registrable mortgage or charge is not registered by the requisite deadline, it will be void against any liquidator and creditors of the company. Failure to register the registerable charge or mortgage will not affect the obligation to repay the money secured by the charge.

10.2 Movable property

The required formalities to create and perfect a security interest over movable or personal property and the consequences of failing to take such steps will depend upon, *inter alia*, the form of security interest and the nature of the secured asset. In general, the CO requires that registerable mortgages and charges must be registered with the Companies Registry within one month of creation if the chargor is a Hong Kong incorporated company or a company registered in Hong Kong as a non-Hong Kong company. As noted above, a longer period applies if the document was executed overseas and secures assets that are located overseas. Failure to register a registerable mortgage or charge by the requisite deadline will result in the charge being void against a liquidator and other creditors of the chargor.

Certain classes of assets have separate registries and registration with the relevant registry of security interests over those assets will be required or desirable. For example, mortgages over ships must be in the prescribed form and registered with the Hong Kong Shipping Registry. Notice of security interests in aircrafts is ordinarily provided to the Civil Aviation Department in Hong Kong, although it is not strictly required to perfect the security interest. Public registers also exist in respect of certain types of intellectual property, and security interests over such assets should be registered on those registers by the requisite deadline or priority of the security interest may be impacted.

If the chargor is an individual and the security interest is over personal chattels, the security interest may amount to a bill of sale which needs to be in a prescribed form and attested and registered in the High Court Registry in accordance with the Bills of Sale Ordinance (Cap 20), or the security interest will be void to the extent of those personal chattels.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor?

As mentioned above at section 4.2, the making of a winding-up or provisional liquidation order triggers a stay of actions and proceedings against the company without the leave of the court. The automatic stay does not prevent secured creditors from taking any action to enforce their security out of court, such as appointing a receiver. To the extent the secured creditor needs to take enforcement steps that require an order of the court (e.g. foreclosure by a mortgagee), they may seek leave of the court to pursue such proceedings and the courts will generally grant such leave to a secured creditor.

A scheme of arrangement will ordinarily include a release of claims and / or stay on enforcement action which would bind secured creditors if they are scheme creditors and the scheme becomes effective. There is no stay in place prior to the scheme becoming effective. The extent to which secured creditors can take action prior to the scheme becoming effective will depend upon the terms of the security documentation and the terms of any standstill arrangements they may have entered into.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

"Free and clear" disposal of collateral by the debtor without the consent of the secured party is only possible in the case of floating charges since they do not attach to one particular asset but are created over a class of assets (present and future). In that case, the chargor can continue to deal with the assets in the ordinary course of business, including using and selling such assets, until the charge crystallises into a fixed charge. The extent to which a debtor can use "cash collateral" will depend upon whether the security interest over that cash collateral is classified as a fixed or floating charge and whether the charge has crystallised.

13. **During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?**

The Hong Kong insolvency regime does not provide for the creation of super-priority security interests without secured creditor consent. As noted above, a scheme of arrangement could be used to alter the contractual rights of secured creditors, provided the requisite scheme creditor approval is obtained and the scheme is sanctioned by the court (see section 3.1.2 above).

14. **What distribution will a secured creditor receive if a company is reorganised?**

This will be determined by the terms of the informal workout that is agreed by the secured creditors or the scheme of arrangement which has become binding on secured creditors (as applicable).

15. **Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?**

The rights of a secured creditor over the assets of a debtor will remain intact following any reorganisation of the company unless the terms of the reorganisation provided for the release of that security or alteration of the secured creditor's rights. This can only be achieved with the requisite secured creditor consent in an informal workout or scheme of arrangement.

16. **What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?**

If the creditor is over-secured, they are obliged to return to the debtor any surplus proceeds following the realisation of the secured property (see section 7 above). In a compulsory liquidation, if a secured creditor files a proof of debt which does not state that it is a secured creditor, the secured creditor shall surrender its security to the Official Receiver or, where a liquidator has been appointed, to the liquidator, for the general benefit of the creditors (unless the court is satisfied that the omission has arisen from inadvertence).

If the creditor is under-secured, it is entitled to claim as an unsecured creditor for any balance that remains unpaid after realisation of the security.

17. **Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?**

Hong Kong does not currently have a statutory regime by which foreign restructurings can be recognised and given effect to nor has it adopted the United Nations Commission on International

Trade Law Model Law on Cross-Border Insolvency (Model Law). The rule in *Antony Gibbs and Sons v La Société Industrielle et Commerciale des Métaux*, (25 Q.B.D. 399) which provides that debt obligations governed by English law cannot be discharged otherwise than under English law (save where the relevant creditor submits to the foreign jurisdiction, typically by participating in the foreign restructuring process) is good law in Hong Kong. As a result of these factors, depending upon the factual circumstances, a foreign restructuring which purports to vary a creditor's contractual rights which are governed by Hong Kong law may not be given effect to in Hong Kong. Where Hong Kong law-governed debt needs to be restructured, it is therefore common to do so by way of a Hong Kong scheme of arrangement in parallel with the relevant foreign proceeding.

The Hong Kong government is currently considering proposals to adopt the Model Law and is exploring the possibility of establishing a bilateral arrangement with Mainland China to provide for reciprocal legal assistance in respect of cross-border insolvency and debt-restructuring matters, but there are no definitive plans to enact such legislation and arrangements at this time.

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