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The International Comparative Legal Guide to:

Lending & Secured Finance 2014

2nd Edition

A practical cross-border insight into lending and secured finance

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Hong Kong



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1 Overview

1.1 What are the main trends/significant developments in the lending markets in Hong Kong?

It has been reported that syndicated lending activity in 2013 increased by more than 80% compared to the previous year. This was a product of, among other things, increased demand from borrowers in Mainland China. The increase in lending activity in Hong Kong was consistent with a material increase in lending activity across the Asia Pacific region generally, involving larger average loan sizes and more multibillion dollar loans.

In July 2012, the Legislative Council in Hong Kong passed the New Companies Ordinance (Cap. 622) (“CO”). The majority of the provisions of the new legislation took effect on 3 March 2014 and they have several implications for financing transactions, including with respect to the registration of charges and the rules relating to the giving of financial assistance, among other things.

1.2 What are some significant lending transactions that have taken place in Hong Kong in recent years?

Significant transactions by loan size in 2013 included the US\$8 billion loan to Alibaba Group Holding Ltd by a large syndicate reported to consist of over 20 institutions, and the US\$6 billion syndicated term loan to CNOOC Canada Holding Ltd., in connection with the widely reported acquisition by China National Offshore Oil Corporation (one of China’s largest oil companies) of the Canadian energy company, Nexen Inc. Other significant deals included the US\$1.525 billion loan to Focus Media Holding Ltd. by a syndicate of lenders in connection with the private equity buy-out of Focus Media by a consortium, including Carlyle Group LP.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Subject to the prohibition on giving financial assistance (addressed in section 4 below), there is, in principle, nothing to restrict a company guaranteeing the borrowings of other members of its corporate group, provided that it is in the guarantor’s best interests to do so (see question 2.2).

It should be noted that section 500 CO prohibits, subject to specified exceptions, a company giving a guarantee in connection with a loan made to a director of the company, a director of the company’s holding company or to another company controlled by one or more such directors.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A guarantee must serve the guarantor’s own commercial interests rather than just the interests of its corporate group as a whole. The directors of the guarantor have a fiduciary duty to act *bona fide* in what they consider to be the best interests of the company and for a proper purpose.

Whether or not the guarantee does benefit the company is a question of fact to be determined by the directors having regard to the circumstances surrounding the transaction and the guarantor. Corporate benefit may be more difficult to demonstrate in the case of a proposed upstream or cross guarantee.

If the directors breach their duty to act in the best interests of the company they can be personally liable. In certain circumstances, if the creditor had actual or constructive knowledge of such breach, a liquidator of the guarantor may be able to apply to court to set aside the guarantee and recover any benefits conferred on the creditor, such as payments made under the guarantee.

2.3 Is lack of corporate power an issue?

A Hong Kong company formed on or after 31 August 1984 has the power to give guarantees, subject to any limitation or restriction in its articles of association. It should be noted that by virtue of section 98 CO, Hong Kong companies no longer have a memorandum of association although the provisions of any pre-existing memorandum are deemed to be incorporated into the articles of association.

Subject to certain exceptions, the power of the directors to bind the company is regarded as free of any such limitation or restriction under the articles in favour of a person dealing with the company in good faith. However, it is still best practice to check the guarantor’s constitutional documents to ensure that there are no relevant restrictions or limitations on the company’s power.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

As a general rule, no, although the directors of a company giving a guarantee may wish to seek shareholder approval in circumstances in which they have corporate benefit concerns (see question 2.2 above). A valid and enforceable guarantee will also need to adhere to the principles of contract law.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such limitations, although the greater the potential value of the guarantee, the more important it will be for the directors of the guarantor to be able to demonstrate corporate benefit to the guarantor (see question 2.2).

In addition, if the guarantor was or becomes (within the requisite statutory clawback periods) insolvent after entering into the guarantee, the guarantee may be vulnerable to being set aside if it can be shown to constitute, for example, a transaction defrauding creditors (see further question 8.2).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, although controls do exist in Mainland China, which may be relevant if the guarantor is a Chinese company.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A large variety of different types of assets and interests, whether tangible or otherwise, are available to secure lending obligations under Hong Kong law. The following types of assets are most commonly used as collateral in Hong Kong.

- Real estate, which includes land, any right, interest or easement in or over land, the whole or part of an undivided share in land and any fixtures that are permanently fastened to land such as buildings (see Conveyancing and Property Ordinance (Cap. 219) (“CPO”).
- Receivables and claims, which are rights under contracts and include book debts and receivables in the form of loans, notes and other types of financial receivables. Examples of financial receivables include trade receivables and future toll road receivables.
- Financial instruments such as listed and unlisted shares, bonds, exchange-traded funds and other forms of securities, whether they are directly held by the owner or held indirectly through a clearing system (e.g. the Central Clearing and Settlement System (“CCASS”) operated by the Hong Kong Securities Clearing Company Limited (“HKSCC”).
- Cash deposits in bank accounts.
- Tangible movable assets such as ships, aircraft, inventory and machinery.

Other common collateral asset classes include insurance and intellectual property.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to grant security over different types of assets by

means of a general security agreement. In practice, however, a separate security agreement is typically used for each type of asset as the perfection requirements are likely to vary. Perfection may involve complying with certain registration formalities, such as a security interest created over land in Hong Kong (registration with the Land Registry); a ship registered under the flag of Hong Kong (registration with the Marine Department); or a trade mark registered in Hong Kong (registration with the Intellectual Property Department). Failure to comply with applicable registration formalities may result in a loss of priority over claims from subsequent secured creditors with security over the relevant asset.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Land and Plant

Security can be taken over land (which, as defined in the CPO, includes any permanent fixtures attaching to the land such as a plant in the form of a building) and is most commonly created by way of a statutory legal charge (typically referred to as a mortgage in Hong Kong) or an equitable mortgage. A statutory legal charge over land should be in writing, executed as a deed, and expressed to be a legal charge under the CPO. The mortgagee under a legal charge has the powers, rights and protections given to it under the CPO which include, among other things, the power to sell and the right to possess the property in the event of a default by the mortgagor. An equitable mortgage is an informal, but enforceable, security arrangement that may arise where the title deeds of a property are deposited with the lender. If the equitable mortgage is executed as a deed, the lender will benefit from most of the powers and protections of a mortgagee under a legal charge, except in relation to the power to sell the property.

Any instrument that gives effect to the creation or transfer of a security interest in land in Hong Kong should be registered with the Land Registry within one month from the execution of the instrument in order to preserve the priority of the security interest over any subsequent interests (see section 5 of the Land Registration Ordinance (Cap. 128) (“LRO”). An unregistered instrument will be void against any subsequent purchaser in good faith or mortgagee for valuable consideration (see section 3 LRO).

If the mortgagor is a Hong Kong incorporated company or, in the case of a mortgage over property situated in Hong Kong, a non-Hong Kong company that maintains a registered place of business in Hong Kong (registered with the Companies Registry under Part XVI CO), particulars of the security interest (including a certified copy of the security instrument) must also be registered with the Companies Registry within one calendar month from the date of its creation (see sections 335 and 336 CO) in order to perfect the security interest.

Machinery and Equipment

Security can be taken over machinery and equipment, which generally constitute movable property not permanently attached to land and, therefore are not considered as land within the meaning of the CPO. The most common methods of granting security over machinery and equipment in Hong Kong are by way of a fixed or floating charge for the benefit of a secured party. Security can also be created over machinery and equipment by way of a mortgage (legal or equitable), pledge or lien.

A charge provides the secured party (or chargee) the right to appropriate the charged property, i.e. the machinery and equipment, to discharge the debt in the event of a default by the chargor (the collateral provider). It creates an encumbrance over the machinery

and equipment but does not transfer ownership or possession of it to the chargee (although a document creating a charge will usually grant the chargee with a power of attorney to compel a transfer of ownership in the event of a default by the chargor).

A charge may be fixed or floating. In the case of a fixed charge, the encumbrance attaches to specifically identified property – in this case machinery and equipment – immediately upon the creation of the fixed charge (or, in the case of a fixed charge over future machinery and equipment, immediately upon the relevant machinery or equipment coming into existence as the chargor’s assets). The fixed charge deprives the chargor of the right freely to deal with, or maintain control over, the charged assets without the consent of the chargee. In contrast, a floating charge is a charge over unascertained assets within a defined category, which crystallises into a fixed charge upon the occurrence of a specified event, at which point the charge attaches to the specific assets then constituting the property in existence within the defined category. Applied here, the chargor, as owner, retains control over the charged machinery and equipment and has the right to deal with, use and dispose of the machinery and equipment in the ordinary course of business. New and replacement machinery and equipment would automatically become subject to the floating charge. Notwithstanding the label the parties may give a charge, whether a court would regard it as floating or fixed will depend upon, among other things, the extent to which the chargor can in fact deal with, and exert control over, the charged property.

While a chargor typically will prefer a floating charge (as this preserves its ability to freely deal with the property), a secured party typically will prefer a fixed charge given certain disadvantages of a floating charge, including the fact that, in a liquidation of the chargor, the claim secured by a fixed charge ranks above the liquidator’s expenses and certain statutorily preferred claims, such as certain claims of employees. A floating charge, on the other hand, ranks below such claims and expenses.

In addition, a person who acquires an interest in property subject to an uncrystallised floating charge will generally acquire the interest free of the charge. On the other hand, the rights of a chargee under a fixed charge will only be defeated by a third-party purchaser of the charged property who acquires it in good faith without notice of the fixed charge. If the fixed charge has been duly registered, a purchaser will in any event be deemed to have knowledge of the charge.

In the event of a liquidation of the chargor, section 267 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (“**CWMP**O”) provides that a floating charge created within the 12 months preceding the commencement of the winding-up may be void unless the debtor was solvent immediately after the creation of the charge.

Alternatively, security over machinery and equipment can be taken by way of a legal or equitable mortgage. Under a legal mortgage, legal title to the collateral is held by the lender (the mortgagee), subject to a condition requiring the lender to transfer title back to the borrower (the mortgagor) upon full performance or redemption of the secured obligations (e.g. on discharge of the debt in full). An equitable mortgage may exist where the parties intended to create a legal mortgage but there was no transfer to the lender of legal title to the secured property.

Finally, it is also possible to create security over machinery and equipment by way of a pledge, which requires a constructive or actual transfer of possession of the property, or by way of a lien, which involves the retention of possession by the lien holder in order to secure a debt in the form of, for example, unpaid servicing fees on the relevant machinery or equipment. A lien may arise by express agreement or by operation of law.

Where the security is given by a Hong Kong incorporated company or, in the case of security over property situated in Hong Kong, a non-Hong Kong company that maintains a registered place of business in Hong Kong (registered with the Companies Registry under Part XVI of the CO), registration requirements under sections 335 and 336 CO are applicable (see above).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security can be taken over receivables. Where the receivables in question are governed by Hong Kong law, perfection requirements and rules relating to priority will be governed by Hong Kong law, regardless of the governing law of the contract creating the security interest. The most common methods of granting security over receivables in Hong Kong are through an assignment by way of security or a charge.

An assignment of receivables by way of security to a secured party will typically provide for reassignment of the receivables once the secured obligations have been performed or redeemed (e.g. when the debt has been fully discharged).

An assignment may be a legal assignment or an equitable assignment. A legal assignment is an assignment that complies with the requirements under section 9 of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23) (“**LARCO**”). An assignment will be an effective legal assignment if:

- it is an absolute assignment whereby the assignor’s entire legal interest in the receivables is transferred to the assignee;
- the assignment is in writing signed by the assignor, or by an agent authorised by it;
- the subject matter of the assignment is legal debts; and
- express written notice of the assignment is given to the obligor.

An assignment which does not meet one or more of the above criteria will be an equitable assignment. Equitable assignments, which are enforceable in the name of the assignor, are common as assignors often prefer to avoid providing written notice to obligors, especially where it is commercially impractical to do so (e.g., where large volumes of receivables involving multiple obligors are continuously created and assigned).

An assignment is perfected once the requirements specified under section 9 LARCO have been satisfied (see above). Where competing claims to the same receivables exist among multiple assignees, the order in which notices of assignment were given to the obligor will determine priority. A perfected assignment where notice of the assignment has been given to the obligor will take priority over an earlier assignment with respect to which notice either was not given to the obligor or was given, but subsequent to the perfection of the later assignment (unless the assignee of the later assignment had knowledge at the time of the assignment of the existence of the earlier assignment).

The purchaser may alternatively create a charge over receivables for the benefit of a secured party (see question 3.3 above for details of the features of these types of charges).

Security created over receivables of a Hong Kong incorporated company or, in the case of receivables situated in Hong Kong, a non-Hong Kong company that maintains a registered place of business in Hong Kong (registered with the Companies Registry under Part XVI of the CO) is registrable under sections 335 and 336 CO (see above).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security may be taken over a bank account (including the cash deposited in the account) situated in Hong Kong by way of a fixed or floating charge (see question 3.3 above for details of the features of these types of charges).

While the Hong Kong court generally will recognise security governed by a foreign law over a Hong Kong bank account, Hong Kong law perfection requirements are still applicable. Charges over bank accounts are not strictly registrable under the CO, although it is common practice to register such security interests that are granted by a Hong Kong incorporated company or a non-Hong Kong company that maintains a registered place of business in Hong Kong (registered with the Companies registry under Part XVI CO) as if such security interests were required to be registered under sections 335 or 336 CO.

3.6 Can collateral security be taken over shares in companies incorporated in Hong Kong? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security can be taken over shares in a Hong Kong incorporated company by way of a mortgage or charge. Shares in a Hong Kong company may be in certificated form or in scripless form held indirectly through a clearing system such as the CCASS operated by the HKSCC.

Security over shares in certificated form may be created by way of a legal mortgage, where the shares are transferred to the mortgagee (or its nominee) who becomes the registered holder, with an agreement by the mortgagee to transfer the shares back to the mortgagor on repayment of the debt by the mortgagor. Alternatively, the mortgagor may create a security interest over the shares by way of a charge or equitable mortgage whereby the mortgagor remains the legal owner of the shares at the time the security is created, but the share certificates are physically deposited with the secured party together with other relevant supporting documents (such as a signed blank share transfer form and contract notes) so that a transfer of ownership of the shares to the secured party may be effected if the security becomes enforceable. If a charge or equitable mortgage is created over a company's shares, the company is usually notified of the security interest.

If shares are held in scripless form with CCASS, then security is usually created by way of a charge over certain rights of the chargor relating to the shares, such as rights against CCASS and the relevant participant of CCASS. Notice of the security interest must be given to the participant.

It is common practice for a security interest over shares to be registered with the Companies Registry if the collateral provider is a Hong Kong incorporated company or a non-Hong Kong company that maintains a registered place of business in Hong Kong (under sections 335 and 336 CO – see above). Although a security interest over shares is not specified as a registrable charge under the CO, declared dividends relating to the shares may be considered as book debts, which fall within one of the categories of registrable charges under the CO.

Security over shares can be granted under a New York or English law governed security document (as Hong Kong courts will generally give effect to the contracting parties' choice of foreign law provided certain conditions are satisfied – see question 7.1

below). However, irrespective of the choice of law, perfection requirements under Hong Kong law would apply where the *lex situs* of the shares is Hong Kong.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security can be taken over inventory, usually in the form of a floating charge. A floating charge is usually more appropriate than a fixed charge or a legal mortgage as a form of security over inventory, given the need for the chargor to deal with the charged assets in the ordinary course of business and the turnover of inventory (see the response to question 3.3 above for a detailed discussion about charges and mortgages). New inventory may automatically become the subject of a floating charge and, upon the occurrence of an enforcement event, the floating charge would crystallise into a fixed charge which attaches to the specific inventory items then constituting the charged property. A floating charge must be perfected by registration at the Companies Registry under sections 335 and 336 CO, where applicable (see above).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A Hong Kong company may grant a security interest to secure its obligations as a borrower under a credit facility. The secured obligations may include not only payment obligations but also other types of obligations (e.g. an obligation to comply with covenants and undertakings). In general, a company may grant a security interest in order to secure its obligations as a guarantor of the obligations of other borrowers or guarantors of obligations under a credit facility. However, there are restrictions in certain circumstances, as discussed in response to section 4 below.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty

Stamp duty is generally not payable on the creation or enforcement of a security interest, unless it involves a transfer of title, whether in a legal mortgage or upon enforcement, with respect to certain types of assets. Stamp duty is chargeable in Hong Kong under the Stamp Duty Ordinance (Cap. 117) for transfers of interests in land, debt instruments in bearer form and shares (subject to certain exemptions where shares are transferred pursuant to a stock lending and stock borrowing transaction).

Registration fees

Registration fees are payable with respect to each instrument that is registered with the relevant registry. The relevant registries (and the registration fees currently applicable) in Hong Kong are the Companies Registry (HK\$340), the Land Registry (HK\$200 to HK\$450 depending on, among other things, the nature of the instrument being registered and the value involved), the Trade Marks Registry (HK\$800), the Patents Registry (HK\$325) and the Designs Registry (HK\$590).

Notarisation fees

Security documents are not required to be notarised in Hong Kong.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No. Registrations and filings at various registries in Hong Kong generally take several weeks. See question 3.9 regarding registration fees.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are required in order to create a security interest in Hong Kong, except in certain circumstances involving the transfer of shares (in a legal mortgage) in, or an assignment of, assets of a telecommunications company that holds a carrier licence (such as a 3G licence), in which case an approval from the Office of Telecommunications Authority (“OFTA”) is required. It is common practice to seek a comfort letter from the OFTA even if the creation of a security interest does not involve a transfer of shares or assets (such as where a charge or equitable mortgage is created). The comfort letter ideally should state that the creation of the security interest does not violate any laws or regulations and the terms of the relevant licence.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. In Hong Kong, priority depends on various factors relating to the creation and perfection of the security interest (such as the form of security created and the timing of perfection or registration of a security interest) and not on the nature of the obligations which are being secured.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

With respect to land, as discussed in question 3.3 above, a statutory legal charge or an equitable mortgage (executed as a deed) must be created under the CPO in order for a mortgagee to be entitled to take advantage of the protections and rights under the Ordinance. A statutory legal charge over land must be in writing, executed as a deed and expressed to be a legal charge under the CPO.

A mortgage over a ship registered under the flag of Hong Kong is required to be in a prescribed form and registered with the Hong Kong Marine Department. The prescribed form requires only basic information about the relevant transaction and details of the parties involved. Supplemental agreements between the parties may be filed using the prescribed form.

Where an instrument contains the grant of a power of attorney, it is required under the Powers of Attorney Ordinance (Cap. 31) to be executed as a deed. A Hong Kong law governed charge typically includes the grant of a power of attorney by the chargor to the chargee and is therefore typically executed as a deed. Furthermore, where it is unclear whether valuable consideration is given, a security agreement should be executed as a deed as it is generally binding and enforceable despite the lack of consideration. To be validly executed as a deed, a document must comply with certain formalities applicable to deeds, including a clear marking on the face of the document that it is intended to be a deed.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes. Under Hong Kong law, where a person has acquired shares in a company and any liability has been incurred (by that or any other person), for the purpose of that acquisition, it is (subject to certain limited exceptions) not lawful for the company or any of its subsidiaries to give financial assistance directly or indirectly for the purpose of reducing or discharging the liability so incurred (section 275 CO). The term “financial assistance” is a broadly defined term that includes a guarantee, security, indemnity and loan, among other things. A company that guarantees or grants security to support a loan incurred by the borrower to acquire shares of the company would fall within the general prohibition of the law. However, financial assistance may be given in certain circumstances (broadly, if the financial assistance does not exceed 5% of the paid up share capital and reserves of the company or is pre-approved by shareholders) if the detailed requirements of certain statutory authorisation procedures in sections 283 to 285 CO are met. Such requirements include the need for the directors of the company giving the assistance to make a solvency statement in respect of the company.

(b) Shares of any company which directly or indirectly owns shares in the company

Yes. The general prohibition discussed in (a) above and the relevant exceptions may also apply where a direct or indirect subsidiary of a holding company (other than a holding company incorporated outside Hong Kong) provides financial assistance to support a loan incurred by the borrower to acquire shares of the holding company.

(c) Shares in a sister subsidiary

Although the prohibition does not expressly prohibit a company from providing financial assistance for the purpose of acquiring shares in a sister subsidiary of the company, it is important for the directors of the company to ensure that, by providing such financial assistance, they are not acting in breach of their fiduciary duty to act in good faith in the best interests of the company and that the transaction is for the commercial benefit of the company. Whether commercial benefit exists is a matter of fact and should be determined in light of all the surrounding circumstances. Directors may seek shareholders’ approval to support their position.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will Hong Kong recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The concepts of agency and trust are well recognised in Hong Kong. In syndicated lending in Hong Kong, it is common for the agent bank to act as security trustee and, thus, hold security as trustee for the secured lenders. A security trustee can enforce its rights in a Hong Kong court.

5.2 If an agent or trustee is not recognised in Hong Kong, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable, as the agent and trustee concepts are recognised in Hong Kong.

5.3 Assume a loan is made to a company organised under the laws of Hong Kong and guaranteed by a guarantor organised under the laws of Hong Kong. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The loan and guarantee can be transferred in one of two key ways: by assignment, or by novation.

Assignment:

Provided that the loan agreement does not contain any restrictions on assignment, Lender A can assign the benefit of the loan to Lender B without the need for the consent of the borrower although only the benefit, and not the burden, of an agreement can be assigned. To ensure that the loan can be enforced by Lender B in its own name, a legal assignment will be required. The assignment will only be a legal assignment if: (i) it is in writing signed by the assignor; (ii) it is absolute (and not conditional or revocable); (iii) notice is given to the assignee (who is usually a party to the assignment contract); and (iv) written notice of assignment is given to the borrower. If the loan agreement prohibits assignments, the consent of the borrower will be required.

To ensure that Lender B can enforce the guarantee in its own name, it will also be necessary for the guarantee to be legally assigned to Lender B. To avoid any argument that the guarantee is discharged as a result of the assignment of the loan, the guarantor's consent to the assignment should be obtained.

Novation:

Alternatively, Lender A could novate the contract to Lender B. In a novation, both the benefit and burden of the contract are transferred to the transferee. The consent of each of the borrower, Lender A and Lender B would be required. A novation would have the effect of extinguishing the original contract between the borrower and Lender A and replacing it with a new contract between the borrower and Lender B. This would have the effect of releasing the guarantee given in respect of that contract. It will therefore also be necessary for the guarantee to be transferred to Lender B with the guarantor's consent or alternatively for Lender B to enter into a new guarantee agreement with the guarantor.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Hong Kong does not levy withholding tax on either interest payable on loans, proceeds of a claim under a guarantee or proceeds of enforcing security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Tax advantages for foreign investors and creditors

There are no incentive regimes in Hong Kong that are offered only to foreign investors or creditors. However, Hong Kong maintains a favourable tax regime with low profits tax rates, and the absence of capital gains, interest and dividend taxes makes it an attractive jurisdiction to potential investors and creditors. Furthermore, there are certain tax facilities available in Hong Kong to encourage investments in general. These include accelerated depreciation allowances on plant and machinery and, provided certain conditions are met, availability of special deductions for certain expenses such as capital expenditure on the provision of certain fixed assets (such as manufacturing machinery and computer hardware and software) and expenditure for building refurbishment. Preferential profits tax treatment may also be available, including a preferential profits tax rate or an exemption for certain profits derived from investments in a select list of bonds and other debt instruments, and a preferential profits tax rate for qualifying reinsurance business on profits from insuring offshore risks.

While not limited to foreign entities, authorised companies that participate in insuring offshore risks receive an exemption of 50% on their profits tax.

Taxes which apply especially to foreign investors

Since October 2012, Hong Kong has applied a special Buyer's Stamp Duty of 15% (of the stated consideration paid or market value, whichever is higher) on real estate acquisitions for purchasers who are companies and foreign individuals who are not permanent residents of Hong Kong. The special stamp duty is imposed on top of the required stamp duty payable on all real estate transactions.

6.3 Will any income of a foreign lender become taxable in Hong Kong solely because of a loan to or guarantee and/or grant of security from a company in Hong Kong?

Hong Kong operates on a territorial, source-based taxation basis. In general, a company carrying on a business in Hong Kong is subject to tax on profits derived from and arising in Hong Kong. Interest income of banks will therefore normally be taxable if the income is derived from a source in Hong Kong. The general rule for determining whether interest income of a financial institution is taxable in Hong Kong is that if the interest income received by or accrued to a financial institution arises through the carrying on by the financial institution of its business in Hong Kong, the income will be taxable in Hong Kong. This is the case even if the loan that is being made is available only outside of Hong Kong.

As regards the granting of security from a company, whether the grant gives rise to tax implications depends on the collateral involved and the form of the grant. A grant of shares as security may give rise to stamp duty at the time of the grant if it involves a transfer of title such as in a legal mortgage of shares, except where the shares are transferred pursuant to a stock lending and stock borrowing transaction. See question 3.9 above.

The existence of a guarantee ordinarily would not give rise to any tax implications. However, if the guarantee is provided by the borrower by way of a deposit or another loan, then the interest

payable to the lender by the borrower may not be deductible for the borrower unless the interest on the other loan or deposit is also taxable in Hong Kong.

Hong Kong has entered into double tax agreements with a number of jurisdictions. Where a double tax agreement applies, taxes payable outside of Hong Kong may be credited against Hong Kong profits taxes on the same profit.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

See question 3.9 relating to various costs involved.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences to the borrower in such a scenario. There are no thin capitalisation rules that apply in Hong Kong, although anti-tax avoidance rules may apply under certain circumstances to disallow the deduction of interest expenses by the borrower (see, for example, question 6.3 relating to guarantees).

7 Judicial Enforcement

7.1 Will the courts in Hong Kong recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in Hong Kong enforce a contract that has a foreign governing law?

Subject to limited exceptions, the Hong Kong court will recognise, and give effect to, the contracting parties' choice of foreign law, where that choice is made in good faith and is legal and sufficiently certain. The court may refuse to apply a foreign law if doing so would be contrary to Hong Kong public policy and/or if the foreign law was chosen with the intention of evading the laws of the jurisdiction which has the most real and substantial connection with the subject matter of the contract.

Hong Kong mandatory rules and legal principles will apply in some circumstances, such as those relating to a transfer of an interest in land in Hong Kong.

7.2 Will the courts in Hong Kong recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Judgments given by the courts in New York and England and Wales are capable of being recognised and enforced in Hong Kong at common law, subject to compliance with certain requirements. The requirements include, among others, that the judgment is final and conclusive and was rendered by a court, which had competent jurisdiction. The limited grounds on which enforcement of a foreign judgment may be challenged do not allow a re-examination of the merits of the judgment.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in Hong Kong, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in Hong Kong against the assets of the company?

Obtaining a judgment from the Hong Kong court

Timing will largely depend on whether or not the defendant attempts to defend the claim, or takes other steps that would slow the progress of the proceedings, such as contesting the jurisdiction of the Hong Kong court to hear the claim.

If the defendant does not seek to defend the claim, it may be possible to obtain default judgment (which is administrative in nature and does not involve a consideration of the merits of the case) within around one month of the proceedings being served on the defendant.

If the defendant does file a defence which has no legal merits, it may be possible to obtain summary judgment (i.e. a judgment on the merits but without a full trial) in around 3 to 6 months. A plaintiff may also consider seeking the early determination of its case on a point of law or a strike-out of the defence.

Enforcing a judgment of the Hong Kong court against the assets of the company

There are several methods of enforcing a judgment against assets located in Hong Kong; the method(s) used will depend upon, among other things, the type(s) of asset in question. It would ordinarily take approximately two months or more to complete one of the available enforcement procedures.

Enforcing a foreign judgment

The entire process from registering, or commencing an action on, the foreign judgment (as applicable) to enforcing it over the assets of the judgment debtor by one of the available enforcement procedures would ordinarily take around four to six months (but could take materially longer if the judgment debtor seeks to resist enforcement).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

There are no significant restrictions, although the exact steps that will need to be taken and the consequent timing of the process (and need for any regulatory consents) will depend upon the nature of the security interest and property in question, as well as the proprietary remedies pursued by the secured creditor.

If court intervention is necessary, the enforcement process may take longer and be more expensive. In addition, a creditor exercising a power of sale will ordinarily owe the debtor (and surety) certain duties, which may require reasonable precautions to be taken to obtain the full market value of the property. While this may dictate in favour of a public auction, there is no general requirement that a sale of the secured assets should be conducted in this way.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in Hong Kong or (b) foreclosure on collateral security?

In general, there are no such restrictions specifically applicable to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in Hong Kong provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Compulsory winding-up

Once a winding-up order has been made or following the appointment of a provisional liquidator, no action or proceeding may, except with the leave of the court, be proceeded or commenced against the company. This does not, however, prevent a secured creditor from appointing a receiver pursuant to the terms of its security agreement, although if the receiver needs to take possession of assets of the company, he or she will need leave of the court to do so. Such leave is ordinarily granted as a matter of course.

Voluntary winding-up

Unlike a compulsory winding-up, there is no statutory moratorium, although the court has a discretion to stay particular creditor actions and proceedings. However, the court will ordinarily be very reluctant to exercise its discretion to prevent a secured creditor from enforcing its security.

Schemes of arrangement

If a moratorium is agreed as part of the terms of a scheme of arrangement, it will take effect once the scheme becomes effective and will bind all creditors subject to the scheme. There will be no stay of proceedings prior to the scheme becoming effective unless the court has appointed a provisional liquidator or a liquidator to the scheme company.

7.7 Will the courts in Hong Kong recognise and enforce an arbitral award given against the company without re-examination of the merits?

Hong Kong is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards by virtue of China's accession to that treaty. The Hong Kong Arbitration Ordinance (Cap. 609) ("AO") is largely based on the UNCITRAL Model law.

The AO stipulates that both Hong Kong and foreign awards will be enforceable in the same manner as a Hong Kong court order. Enforcement may only be refused if the respondent proves that one or more of the limited grounds set out in the AO applies. These relate to matters such as procedural fairness and the status of the award, but not to questions of fact or law (although, if the award was made in a non-New York Convention country, the Hong Kong court has a discretion to refuse enforcement for any other reason the court considers it just to do so).

Parties to an international arbitration with its seat in Hong Kong may choose to preserve a right to appeal to the Hong Kong court on a question of law. Such a right will apply automatically if the arbitration in Hong Kong is domestic rather than international.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

See the response to question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In certain circumstances, a security interest can be challenged by a liquidator or other relevant parties. An overview of the key grounds for such challenges is set out below:

Unfair preference:

Pursuant to section 266 CWMPO, if an insolvent company does something or suffers something to be done that puts a creditor in a better position in the event of an insolvent liquidation than they would otherwise have been and the company was influenced by a desire to prefer that creditor, an unfair preference occurs. A liquidator may apply to set aside such a transaction if it occurred within six months prior to commencement of the liquidation or, in the case of a transaction with an associate, two years prior to such commencement.

Floating charge:

Pursuant to section 267 CWMPO, a floating charge granted by a company within 12 months prior to the commencement of the company's liquidation is invalid if the company was insolvent at the time of granting the charge or became insolvent as a consequence, except to the extent of any new money advanced to the company at the same time as or after the charge was created.

Extortionate credit transactions:

Pursuant to section 264B CWMPO, any credit transaction entered into within three years prior to the commencement of the liquidation may, on the application of a liquidator, be set aside or varied by the court if it involves grossly exorbitant payments or otherwise grossly contravenes ordinary principles of fair dealing. There is a presumption that the transaction is extortionate unless the presumption can be rebutted.

Fraud – transactions to defraud creditors and fraudulent trading:

A transaction may be set aside pursuant to section 60 of the CPO if it can be proven that it was entered into with the intent to defraud creditors. There is no time limit or insolvency requirement for such a claim.

In addition, if in the course of the winding up it appears that any business of the company has been carried out with intent to defraud creditors or for any fraudulent purpose, the court may, on the application of a liquidator, Official Receiver, creditor or contributory, declare pursuant to section 275 CWMPO that any persons who were knowingly parties to the carrying on of the business in that way are personally liable for all or any of the company's debts (as the court may direct).

Similarly, if an officer of the company is guilty of misfeasance or breach of duty, pursuant to section 276 CWMPO, the court may, on the application of a liquidator, Official Receiver, creditor or contributory, compel the officer to repay or restore the money or property of the company.

Preferential creditors:

Secured creditors are generally entitled to recover out of the proceeds of their security in priority to all other claimants.

However, if the security is by way of a floating charge, the claims of preferential creditors will rank ahead of the claims of the floating charge holder. Preferential creditors in Hong Kong are primarily: (i) employees with certain claims in respect of, for example, unpaid wages, severance, long service and other relevant leave entitlements; and (ii) the Hong Kong Government in respect of unpaid taxes falling due in the 12 months immediately prior to the commencement of the liquidation. In a winding up of a bank or insurance company, certain other categories of claim are also given preferential status.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Voluntary liquidation is not available to unregistered companies or banks in Hong Kong. Such entities can only be wound up by order of the court. Unregistered companies include any company, partnership or association which has more than eight members and is not registered under the relevant Companies Ordinances or the Limited Partnerships Ordinance. Foreign companies registered under Part XVI of the CO are also considered “unregistered” for the purposes of winding-up.

The winding-up provisions of the CWMPO are also varied in some respects in the case of a winding-up of a bank or insurance company, by virtue of the provisions of the Banking Ordinance (Cap. 155) (“BO”) and Insurance Companies Ordinance respectively.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

A secured creditor may in certain circumstances be in a position to exercise a power of sale over secured property which is already in its possession, or take other out-of-court steps such as to appoint a receiver or exercise rights of set-off. However, a creditor, or an office holder in the context of insolvency proceedings, that is not in possession of the assets of the company, would require the assistance of the court to forcefully take possession of such assets, if the party in possession of the assets refuses to surrender them.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of Hong Kong?

If the parties have agreed that a foreign court is to have exclusive jurisdiction in relation to any disputes between them, the Hong Kong court will ordinarily respect that agreement and should grant a stay of any proceedings commenced before it. If, on the other hand, the parties have agreed that the foreign court is to have non-exclusive jurisdiction, that is likely to be one of a number of factors the Hong Kong court will take into account on an application by one of the parties for a stay of the Hong Kong proceedings on the basis of *forum non conveniens*.

The fact that parallel proceedings may already be afoot in a foreign jurisdiction will not of itself cause the Hong Kong court to stay proceedings but will be a relevant consideration on a stay application.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of Hong Kong?

The Hong Kong Court of Final Appeal (in *Democratic Republic of*

the Congo & Ors. v. FG Hemisphere Associates LLC [2011] 5 HKC) has held that the doctrine of absolute sovereign immunity applies in Hong Kong. This means that an entity entitled to immunity will be able to assert immunity in relation to all transactions and in respect of all assets, regardless of their commercial or sovereign nature.

Whilst it is possible for a state to waive immunity, such a waiver must be express, unequivocal and made at the time when the court is being asked to exercise jurisdiction against the state in question. This means that pre-dispute contractual waivers of sovereign immunity will not be enforced by the Hong Kong court.

The absolute doctrine of state immunity should not impact the ability of an arbitral tribunal with its seat in Hong Kong to assume jurisdiction over a foreign state because arbitration is a consensual process. It is widely considered that an arbitration agreement will also operate as an effective waiver of immunity from the supervisory oversight of the Hong Kong court in relation to an arbitration seated in Hong Kong.

Finally, it would appear that the doctrine of sovereign immunity has no application to a claim before the Hong Kong court against the People's Republic of China (the “PRC”) on the basis that, since 1997, the Hong Kong Special Administrative Region has been a part of the PRC. It may be, however, that the PRC could seek to claim immunity under the related doctrine of crown immunity.

10 Other Matters

10.1 Are there any eligibility requirements in Hong Kong for lenders to a company, e.g. that the lender must be a bank, or for the agent or security agent? Do lenders to a company in Hong Kong need to be licensed or authorised in Hong Kong or in their jurisdiction of incorporation?

Any individual or company that carries on the business of making loans is required to be licensed as a money lender under the Money Lenders Ordinance (Cap. 163) (“MLO”). The Licensing Court is responsible for the determination of applications for and granting of money lenders' licences, and will therefore consider whether an applicant is a suitable person to be granted a licence. There are exemptions available under the MLO that exempt certain persons from being required to hold a money lenders' licence. Exempted persons include any authorised banking institution that holds a Hong Kong banking licence under the BO and any bank incorporated or established outside of Hong Kong that is regulated by an overseas banking supervisory authority and that carries on banking business in the place where that banking supervisory authority is located. Certain types of loans are also exempt from the licensing requirement of the MLO. Exempted loans include any loan made by a holding company to its subsidiary or by a subsidiary to its holding company, any loan made to a company that has a paid up share capital of not less than HK\$1,000,000 or an equivalent amount in any other approved currency and any loan made to a company secured by a mortgage, charge, lien or other encumbrance registered, or to be registered, under the CO.

There are no eligibility requirements for any person to be an agent or a security agent, although if the agent engages in any regulated activities in Hong Kong under the Securities and Futures Ordinance (Cap. 571), it may be required to obtain the relevant licence or licences depending on the nature and scope of the activities involved.

10.2 Are there any other material considerations which should be taken into account by lenders when participating in financings in Hong Kong?*Excessive Interest*

There are regulations in Hong Kong aimed primarily at protecting consumers from being subject to excessive rates of interest. Any person (other than an authorised banking institution regulated by the Hong Kong Monetary Authority) who lends or offers to lend at a rate of interest exceeding 60% *per annum* commits a criminal offence under section 24 MLO, and could be subject to a substantial fine and imprisonment. Any such agreement and any security provided by the borrower will not be enforceable. In addition, any agreement for the repayment of a loan or for the payment of interest on a loan in respect of which the effective rate of interest exceeds 48% *per annum* will, having regard to that fact alone, be presumed to be a transaction which is extortionate, as provided under section 25 MLO. A Hong Kong court may give directions to alter the terms of an extortionate agreement. However, the presumption could be rebutted if the court is satisfied that the rate of interest is not unreasonable or unfair given the surrounding circumstances. The factors the court would consider include, without limitation, the debtor's age, experience, business capacity, market rates for similar transactions and the degree of risk faced by the lender. The regulations discussed above do not apply to loans made to a company with a paid up share capital of HK\$1,000,000 or more.

As a general rule, a party is not permitted to impose a penalty on another party, including a penalty for late payment. However, an exception to the rule is that contracting parties are free to agree on a default interest rate for late payment so long as it reflects a

genuine estimate of the loss that would be suffered by the non-defaulting party.

Consumer Protection

Where a party to a contract deals as a consumer under the Unconscionable Contracts Ordinance (Cap. 458) (the "UCO"), the contract, or the part of the contract that is held by a court to be unconscionable, will not be enforceable. A consumer is one who neither makes the contract in the course of a business nor holds himself out as doing so (see section 3 UCO). It should be noted that in determining whether a contract or a part of a contract is "unconscionable", the Hong Kong court would consider the circumstances relating to the contract at the time the contract was made. For example, it has previously been decided by the Hong Kong court that the costs provisions in a credit card agreement were unconscionable because of the relative strengths of the bargaining positions of the credit card company or bank.

Where a lender is an authorised banking institution regulated by the Hong Kong Monetary Authority, the lender will be subject to the Code of Banking Practice issued by The Hong Kong Association of Banks, which governs, among other things, the proper conduct of authorised banking institutions in dealing with individual customers.

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