Hong Kong Corporate Insolvency and Restructuring Law 2019 Review

Produced in partnership with ***Ludwig Ng of ONC Lawyers***

In this Hong Kong Corporate Insolvency and Restructuring Law 2019 Review, I would like to highlight several recent Hong Kong cases which I believe would be of particular interest to insolvency practitioners.

In recent years, the Hong Kong Court, relying on its inherent power under the common law principle of modified universalism, has shown great willingness to assist the effective implementation of cross-border insolvency and restructuring regimes. After the ground-breaking *Re Mr Kaoru Takamatsu* [2019] HKCFI 802, where the Hong Kong Court recognized non-common law insolvency proceedings for the first time, the Hong Kong Court has recently delivered its judgment in *Re CEFC Shanghai International Group Limited* [2020] HKCFI 167, granting recognition and assistance to Mainland liquidators for the very first time. It however remains to be seen how far this collaboration between the Mainland and Hong Kong judicial authorities in insolvency matters will go. Another case of interest is *Re Da Yu Financial Holdings Limited (formerly known as China Agrotech Holdings Ltd) (in liquidation)* [2019] HKCFI 2531, where the Hong Kong Court held that it will take into account the rate of return to scheme creditors and the amount of the restructuring and liquidation expenses in considering whether a scheme of arrangement is propounded for a permissible purpose for the general benefit of the scheme creditors. Lastly, in the recent cases of *But Ka Chon v Interactive Brokers LLC* [2019] HKCA 873 and *Sit Kwong Lam v Petrolimex Singapore Pte. Ltd* [2019] HKCA 1220, the Hong Kong Court of Appeal was asked to consider the correctness of the approach laid down in the case of *Lasmos Limited v Southwest Pacific Bauxite (HK) Limited* (2018) HKCFI 426 in dealing with winding-up/bankruptcy petitions involving arbitration clauses. The Court of Appeal, in both cases, though did not find it necessary to decide on the correctness of the Lasmos approach, expressed its reservations on the *Lasmos* approach and warned against debtor's opportunistic attempts to invoke the *Lasmos* approach in the future to stay winding-up/bankruptcy petition by invoking arbitration agreement. Insolvency practitioners should give careful consideration to the Court of Appeal's comments before issuing statutory demands or insolvency proceedings for debt recovery where the parties to a contract have agreed to arbitration for dispute resolution.

Hong Kong Court recognized and assisted Mainland liquidators for the first time: *Re CEFC Shanghai International Group Limited* [2020] HKCFI 167

Facts

CEFC Shanghai International Group Limited (the "**Company**") was in insolvent liquidation in the Mainland and had substantial assets in Hong Kong, including a claim against its Hong Kong subsidiary ("**HK Subsidiary**") which amounted

to some HK$7.2 billion ("**HK Receivable**"). However, prior to the Company's liquidation, one creditor of the Company had obtained a default judgment in Hong Kong and a garnishee order nisi in respect of the HK Receivable. In order to prevent the creditor from obtaining a garnishee order absolute, the Mainland liquidators applied to the Hong Kong Court for recognition and assistance urgently.

Decision

It is now well-settled that the Hong Kong Court will recognize foreign insolvency proceedings that are collective in nature and are commenced in the company's country of incorporation: *Re Joint Provisional Liquidators of China Lumena New Materials Corp* [2018] HKCFI 276; *Re Joint Liquidators of Supreme Tycoon Ltd* [2018] 1 HKLRD 1120. Provided these criteria are satisfied, the Court may recognize insolvency proceedings opened in a civil law jurisdiction: *Re Mr Kaoru Takamatsu* [2019] HKCFI 802. Upon the foreign insolvency proceedings being recognised, the Court will grant assistance to the foreign officeholders by applying Hong Kong insolvency law. In the case of liquidators appointed in jurisdictions with similar insolvency regimes to Hong Kong, the assistance may extend to granting orders that give the foreign liquidators substantially similar powers: *Re Joint Liquidators of Supreme Tycoon Ltd* [2018] HKCFI 277.

Harris J was satisfied that the Company's Mainland liquidation is a collective insolvency proceeding, which is demonstrated by the fact that the liquidation proceeding encompasses all of the debtor's assets. Further, the powers sought by the Administrators are consistent with Mainland insolvency law and the standard recognition order as set out in *Re Joint and Several Liquidators of Pacific Andes Enterprises* (unrep, HCMP 3560/2016, 27 January 2017) and *Re Joint Provisional Liquidators of Hsin Chong Group Holdings Ltd* [2019] HKCFI 805.

Harris J thus granted the recognition and assistance sought by the Mainland Administrators and held that the garnishee proceedings ought to be stayed as it violated the *pari passu* principle and the principle of collectivity.

This is the first time where the Hong Kong Court recognized and assisted Mainland liquidations. As to the extent to which greater assistance should be provided to Mainland administrators in the future, Harris J commented – "development of recognition is likely to be influenced by the extent to which the Court is satisfied that the Mainland, like Hong Kong, promotes a unitary approach to transnational insolvencies."

Know more about the case here.

Hong Kong Court recognized non-common law insolvency proceedings for the first time: *Re Mr Kaoru Takamatsu* [2019] HKCFI 802

Facts

Japan Life Co, Ltd (the "**Company**"), a company incorporated in Japan, was ordered to be wound up in Japan on the grounds of insolvency. The trustee in bankruptcy applied for recognition in Hong Kong in order to enable him to deal with the Company's affairs in Hong Kong. He obtained from the Tokyo Court a letter of request seeking an order for recognition and assistance in substantially the form commonly granted by Hong Kong Court.

Decision

This is the first application by a trustee in bankruptcy appointed in Japan over a Japanese incorporated company in compulsory liquidation in Japan for a formal order recognizing the Japanese winding up and providing assistance.

Harris J noted that Japan has a civil law system. However, he considered that it was clear from the affirmation of a Japanese lawyer in support of the application explaining elements of the Japanese bankruptcy code that the Company was in collective insolvency proceedings in its place of incorporation. Hence, the proceedings should be recognized. Further, upon analyzing various provisions in Japan's Bankruptcy Act, Harris J noted that although not

identical, the status and powers of a trustee in bankruptcy appointed in Japan are similar to those of a liquidator appointed in Hong Kong.

The Court therefore granted the trustee in bankruptcy the powers in the standard order set out in *Re Joint and Several Liquidators of Pacific Andes Enterprises (BVI) Ltd* (unrep, HCMP 3560/2016, 27 January 2017). The standard order in paragraphs 2(a), (b) & (c) confers on a foreign liquidator general power to administer a company's assets and seek documents and information, which are powers that a trustee has under the Japanese insolvency regime. However, the standard order in paragraph 2(e) confers include the right to apply for certain orders, such as under s286B of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) for an order for examination of a person concerning the affairs of a company or to seek documents from a third party concerning a company's affairs. Harris J emphasized that if such an application were to be made, it would be necessary for Mr. Takamatsu to demonstrate that a like power exists in the Japanese regime and that it is appropriate to grant such an order on the evidence.

Know more about the case here.

In considering whether a scheme of arrangement is propounded for a permissible purpose for the general benefit of the scheme creditors, the Court will take into account the rate of return to scheme creditors and the amount of the restructuring and liquidation expenses: *Re Da Yu Financial Holdings Limited (formerly known as China Agrotech Holdings Ltd) (in liquidation)* [2019] HKCFI 2531

Facts

Da Yu Financial Holdings Limited (formerly known as China Agrotech Holdings Limited) (in liquidation) (the "**Company**") is a Hong Kong listed company incorporated in the Cayman Islands. It was in liquidation in Hong Kong.

Pursuant to leave granted by the Hong Kong Court, the Company convened a Scheme Meeting where an overwhelming majority of the Scheme Creditors voted in favour of the Hong Kong Scheme. Later, the Cayman Court sanctioned a parallel scheme of arrangement (the "**Cayman Scheme**"). The Company sought the Hong Kong Court's sanction of the Hong Kong Scheme.

Decision

The only concern of the Court was the quantum of the liquidators' restructuring and liquidation costs as compared to the rate of return to the Scheme Creditors – save for that, the Court was satisfied to sanction the Scheme. In every case, the question is, taking into account all the circumstances of the case, including the rate of return to scheme creditors and the amount of the restructuring and liquidation expenses, whether the relevant scheme is propounded for a permissible purpose for the general benefit of the scheme creditors.

On the facts, the Court noted that there was insufficient information or meaningful disclosure for the Court and Scheme Creditors to assess the reasonableness of the restructuring costs and expense.

However, the Court also considered that it would not be just to withhold sanction of the Scheme as the failure of the Scheme would leave the Scheme Creditors with nil recovery. Accordingly, the Court sanctioned the Scheme on the condition that all of the restructuring and other expenses will be subject to taxation. Any cost savings resulting from the taxation process should be distributed to the Scheme Creditors.

Know more about the case here.

The Court of Appeal warned against debtor's opportunistic attempts to invoke the Lasmos approach in the future to stay winding-up/bankruptcy petition by invoking arbitration agreement: *Sit Kwong Lam v Petrolimex Singapore Pte. Ltd* [2019] HKCA 1220

Facts

Petrolimex Singapore Pte Ltd (the "**Petitioner**") presented a bankruptcy petition in the Court of First Instance against Sit Kwong Lam (the "**Debtor**") in respect of a debt of over US$30 million (the "**Debt**"). A bankruptcy order was made against the Debtor by Ng J.

The Debtor appealed against the bankruptcy order, raising two broad issues, namely first whether the Debt is covered by an arbitration clause, and secondly, if there is at least a good *prima facie* or reasonably arguable case on the first issue, whether the judge should have exercised his discretion to stay or dismiss the petition on the basis that the Debt is not admitted. Before Ng J, the Debtor had opposed the petition, and argued the Court should exercise its discretion to dismiss and stay the petition, invoking the approach in insolvency liquidation in *Re Southwest Pacific Bauxite (HK) Ltd* [2018] 2 HKLRD 449 (the "***Lasmos* case**") because the disputed debt ought to be resolved by arbitration.

Decision

In the *Lasmos* case, in which Harris J departed from previous authorities at first instance and held that save for exceptional cases, a creditor's petition to wind up a company should "generally be dismissed" where three requirements are met:

(1) if a company disputes the debt relied on by the petitioner;

(2) the contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and

(3) the company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process (which might include preliminary stages such as mediation) and files an affirmation in accordance with rule 32 of the Companies (Winding-Up) Rules (Cap 32H), demonstrating this.

The Court of Appeal agreed with Ng J's findings that the Debt is not covered by an arbitration clause. The discretion issue thus does not arise for consideration. Nevertheless, in view of the challenge mounted by the Debtor to the necessity of the third requirement of the *Lasmos* approach, the Court of Appeal made the following observations, to discourage debtors from making opportunistic attempts to invoke the *Lasmos* approach in future.

The Court of Appeal considered that it is not necessary that arbitration has been commenced by the time the insolvency proceedings are heard. All that is required of the debtor is that he has taken the steps required under the arbitration clause to commence the process of arbitration, which may include preliminary stages such as mediation, and file an affirmation in accordance with rule 32 of the Companies (Winding-Up) Rules (Cap 32H), demonstrating this. This sensible requirement is to demonstrate to the Court that the debtor has a genuine intention to arbitrate and could hardly be considered onerous.

Further, the fact that the debtor has no substantive claim against the creditor is immaterial. It is entirely possible for the debtor to refer the dispute to arbitration and seek a declaration of non-liability in respect of the debt alleged by the creditor.

On the evidence, the Court of Appeal did not consider that the third requirement of *Lasmos* approach is satisfied. The Court found that the Debtor was aware of the requirements in *Lasmos*, as this case was mentioned in the skeleton submissions he filed for the first hearing before the judge. However, no mention was made in the subsequent affirmation he filed of any steps taken to commence the process of arbitration. In the skeleton submissions filed for the substantive hearing of the petition, the Debtor challenged the need for the third requirement and contended that "all that should be required is that the arbitration clause remains operable and capable of being performed", and "if necessary,

[the Debtor] can undertake to commence arbitration within a prescribed period since the arbitration clause is still operable". The Debtor had ample opportunity to take steps to commence the arbitration process. He did not suggest there was any obstacle in taking the necessary steps. The belated and conditional assertion in the skeleton submissions of his counsel can hardly be regarded as indicative of a genuine intention to arbitrate. The Debtor's appeal was thus dismissed with costs.

Know more about the case here.

Is arbitration clause an absolute bar to winding-up petition? - The latest position after the Lasmos case: *But Ka Chon v Interactive Brokers LLC* [2019] HKCA 873

In *But Ka Chon*, the Court of Appeal agreed with the trial judge that *Lasmos* was inapplicable as there was no genuine dispute to be arbitrated. Even if *Lasmos* was applicable, the third requirement (which is to actually commence arbitration) was not satisfied by the debtor in *But Ka Chon*. The Court of Appeal nonetheless made the following important observations in *obiter*:

- Insolvency petitions do not come within the wording of article 8(1) of the UNCITRAL Model Law (which has effect by virtue of section 20 of the Arbitration Ordinance (Cap 609)). It follows that there is no automatic, mandatory or non-discretionary stay under that provision.
- Pre-*Lasmos*, there was a discretionary power to be exercised under the insolvency legislation whether to dismiss or stay a petition where the alleged debt arises out of a transaction containing an arbitration agreement. In exercising its discretion, the Court will consider all relevant circumstances, including the financial position of the company, the existence of other creditors, and the position taken by them.
- *Lasmos* decided that the discretion under the insolvency legislation should be exercised only one way: the petition should "generally be dismissed" save in exceptional circumstances, upon satisfaction of the three requirements.
- It is contrary to public policy to preclude or fetter the exercise of the statutory right conferred on a creditor to petition for bankruptcy or winding up on the ground of insolvency. Even though the *Lasmos* approach may not be regarded as totally precluding a creditor from invoking the insolvency jurisdiction of the Court, it is a substantial curtailment of his statutory right.
- However, the Court of Appeal did acknowledge that considerable weight should be given to the factor of arbitration in the exercise of the Court's discretion and such discretion should not be exercised in a way that would inevitably encourage parties to an arbitration agreement to seek to bypass the arbitration agreement/legislation by presenting a winding up petition.

Know more about the case here.

Hong Kong Court granted restructuring power to provisional liquidators appointed in Bermuda by way of assistance: *Re The Joint Provisional Liquidators of Hsin Chong Group Holdings Ltd (Provisional Liquidators Appointed) (For Restructuring Purposes Only)* [2019] HKCFI 805

Facts

Hsin Chong Group Holdings Ltd (the "**Company**") is incorporated in Bermuda and listed on the Main Board of The Stock Exchange of Hong Kong Limited. The Company was in provisional liquidation in Bermuda and soft-touch joint provisional liquidators ("**JPLs**") had been appointed. The JPLs applied for recognition and assistance by the Hong Kong High Court pursuant to a letter of request. The order sought contains some provisions in relation to a proposed restructuring intended to be carried out in Hong Kong.

Decision

Harris J considered that the recognition of the Company's proceedings in Bermuda is consistent with the existing Companies Court's practice. In relation to the order sought for the purpose of the restructuring, Harris J referred to his own decision in *Re China Solar Energy Holdings Ltd (No 2)* [2018] 2 HKLRD 338, in which his Lordship explained that it is not permissible to appoint provisional liquidators in Hong Kong in order to restructure the debt of the company. It is however permissible to appoint provisional liquidators for orthodox reasons and, after the provisional liquidators have familiarized themselves with the affairs of the company, for an interested party (commonly the provisional liquidators) to apply to Court if it is thought desirable for restructuring powers to be granted to the provisional liquidators. His Lordship held the view that it is not inconsistent with Hong Kong law for restructuring powers to be granted by way of assistance to a provisional liquidator appointed over a foreign company by the Court of its place of incorporation, in which a soft-touch provisional liquidation is permissible, as such powers can be granted, albeit in the more limited circumstances as discussed in *China Solar*, to a Hong Kong provisional liquidator. For the benefit of the practitioners, the order is appended to the reasons.

Know more about the case here.

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Ludwig's major area of practice is insolvency and corporate restructuring. Under his leadership, the firm has a thriving practice advising and representing insolvency practitioners in Hong Kong and overseas in all aspects of their practice, particularly on investigation of corporate fraud, assets tracing and recovery, actions against former company officers, cross-border insolvency and corporate restructuring. The firm also represents banks, financial institutions and substantial creditors in protecting their rights in the insolvency of their customers. Apart from insolvency, Ludwig is also experienced in the whole spectrum of civil and criminal matters, particularly shareholder disputes, corporate fraud, media law and intellectual properties. Outside the firm, Ludwig is an examiner of the Overseas Lawyers Qualification Examinations. Ludwig is one of the few solicitors in Hong Kong awarded the Higher Rights of Audience, which entitles him to appear as an advocate in all Courts up to the Court of Final Appeal. Ludwig is selected by AsiaLaw Profiles and Chambers and Partners as a leading lawyer in the fields of Dispute Resolution and Restructuring & Insolvency.
