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Restructuring & Special Situations

2023 Year in Review

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Key insolvency decisions in Hong Kong and PRC

Hogan Lovells provides insightful coverage on the key case law, legislative and regulatory developments specifically for lenders, asset managers and special situation investors deploying capital in the region. To receive access to our in-depth coverage, please visit www.engage.hoganlovells.com

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Nov 2022

1 – Hong Kong court calls on regulators to enhance investor protection[1]

14 – Cross-border enforcement of judgments in Hong Kong and the PRC – a new dawn?

Dec 2022

8 – Hong Kong court does away with deed of contribution requirement in sanctioning guarantor's scheme[2]

Feb 2023

21 – Hybrid jurisdiction clauses – two new English and Hong Kong cases give confidence to lenders[3]

Mar 2023

8 – Hong Kong Airlines undergoes English and Hong Kong restructuring[4]

24 – Hong Kong court orders winding up of listco already wound up in Cayman Islands[5]

May 2023

8 – Hong Kong CFA confirms primacy of exclusive jurisdiction clause in bankruptcy[6]

19 – Hong Kong court rules keepwell deeds are enforceable in first of its kind decision[7]

30 – Hong Kong court calls for debtor companies to show realistic restructuring proposals[8]

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19 – Kept-well: Hong Kong court hands keepwell trustee significant win[9]

27 – Recognition of mainland liquidation by Hong Kong court achieved through common law[10]

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4 – Hong Kong court blocks noteholder from presenting winding-up petition[11]

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25 – Do as you're told – Hong Kong court orders uncooperative former director to ratify liquidator appointment[12]

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10 – Cross-border enforcement of judgments – new mechanism comes into force 29 January 2024

13 – Arbitration agreements vs. winding up petitions – Hong Kong Court of Appeal to decide[13]

Footnotes

1. Securities and Futures Commission v Sound Global Ltd [2022] HKCFI 3025
2. Re Unity Group Holdings International Ltd [2-22] HKCFI 3419
3. Aiteo Eastern E&P Company Limited v Shell Western Supply and Trading Limited [2022] EEWHC 2912 (Comm) and China Railway (Hong Kong) Holdings Ltd v Chung Kin Holdings Co Ltd [2023] HKCFI 132
4. Re Hong Kong Airlines Ltd [2022] EWHC 3210 (Ch), [2022] All ER (D) 53 (Dec); and Re Hong Kong Airlines Ltd [2022[HKCU 6189; [2022] HKCFI 3792
5. Re Guoan International Limited (in liquidation) [2023] HKCFI 666
6. Re Guy Kwok-Hung Lam [2022] HKCFA 9
7. Nuoxi Capital Limited (諾熙資本有限公司) (in liquidation in the British Virgin Islands) v Peking University Founder Group Company Limited (北大方正集團有限公司) [2023] HKCFI 1350
8. Re Jiayuan International Group Limited (佳源國際控股有限公司) [2023] HKCFI 1254
9. Citicorp International Limited v Tsinghua Unigroup Co., Ltd (紫光集團有限公司) [2023] HKCFI 1572
10. Re Guangdong Overseas Construction Corporation [2023] HKCFI 1340
11. Re Leading Holdings Group Limited [2023] HKCFI 1770
12. Wing Sze Tiffany Wong v Wong Sai Chung [2023] HKCFI 2346
13. Shandong Chenming Paper Holdings Ltd [2023] HKCFI 2065

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The past twelve months have been a time of continuing significant developments in court-led corporate rescues in Hong Kong, all within the flexible confines of the common law and in the continued absence of a statutory corporate rescue regime.

The year saw mixed messages for holders of offshore bonds issued by Chinese issuers hoping to enforce on the mainland, good news for lenders benefitting from "hybrid" jurisdiction clauses and a degree of uncertainty being seen in the Hong Kong Court of First Instance as to whether an agreement to arbitrate should always take precedence over a winding up petition, particularly where cross-claims are involved.

Exclusive jurisdiction clauses and arbitration agreements

The Hong Kong Court of Final Appeal (CFA) confirmed a Court of Appeal finding that the court should respect the effect of an exclusive jurisdiction clause in bankruptcy proceedings, just as it does in ordinary civil actions.

In rejecting an appeal against overturning of a bankruptcy order made against the debtor in *Re Guy Kwok-Hung Lam* [2022] HKCFA 9, the Court of Final Appeal said the parties had clearly agreed by way of an exclusive jurisdiction clause (EJC) that their disputes should be determined in another forum, and that this should include the question of whether there was a *bona fide* dispute on substantial grounds.

Whether this approach should also apply where there is an arbitration agreement was considered by the Honourable Madam Justice Linda Chan, who expressed doubts as to the approach in two Court of First Instance decisions: *Simplicity & Vogue Retailing (HK) Co., Limited* [2023] HKCFI 1442 and *Re NT Pharma International Co Ltd* [2023] HKCFI 1623.

In *Shandong Chenming Paper Holdings Ltd* [2023] HKCFI 2065, the Honourable Mr Justice Harris (CFI) stayed a winding up petition presented by the company because of an agreement to arbitrate, taking the view it was clear the same principles should apply with an arbitration clause as with an EJC.

However, in October 2023, Harris J granted leave for the decision in *Shandong Chenming* to go to appeal alongside the decision in *Simplicity & Vogue Retailing*, with a view to ensuring consistency in the approach the Hong Kong courts take in determining whether an arbitration agreement should always take precedence over a winding up petition in the context of a looming insolvency. More to follow on this in 2024.

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Keepwell agreements

Two Hong Kong court decisions brought mixed messages for holders of offshore Chinese bonds using keepwell arrangements. The decisions – which concerned Peking University Founder Group Limited (PUFG) and Tsinghua Unigroup – may give confidence that bondholder rights are at least in principle enforceable in Hong Kong. However, the Hong Kong court has also laid down a strict test as to the window of time during which bondholders can hold issuers accountable.

The keepwell agreements in question required the guarantor and issuer to have sufficient liquidity and/or means to comply with their obligations in respect of the bonds at all times. The Honourable Mr Justice Harris drew a distinction between the issuer and guarantor making efforts to comply with their obligations before the onshore reorganisations took place and after they took place, noting (in respect of the PUFG ruling) that once the company was in reorganisation, there was no realistic likelihood of approvals being given for funds to be transferred out of the mainland. This finding proved fatal to the claims in three out of the four actions.

The lesson appears to be that offshore creditors need to move swiftly before any PRC reorganisation proceedings get underway and may possibly incentivise defaulting issuers to enter into a formal restructuring at an earlier stage. Bondholders need to effectively monitor the financial standing of their keepwell provider so they can move quickly in the event of a potential breach.

In *Re Leading Holdings,* the Hong Kong court also handed down a significant decision on the issue of whether an individual bondholder under a global note can present a winding up petition against a bond issuer. The court found that, under the typical global note structure, an individual beneficial holder does not have directly enforceable rights against an issuer. This was the first occasion addressing the issue of a bondholder's rights as a contingent creditor and will have implications on how holders take enforcement actions in the Hong Kong courts in the future.

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Hybrid jurisdiction clauses

Two English and Hong Kong court decisions gave some confidence to lenders that they should be able to enforce their rights against creditors under so-called asymmetric or hybrid dispute resolution clauses. In the English case *Aiteo Eastern E&P Company Limited v Shell Western Supply and Trading Limited* [2022] EWHC 2912 (Comm), Mr. Justice Foxton rejected a jurisdictional challenge to two awards under section 67 of the Arbitration Act 1996, finding that, in actively challenging the jurisdiction of a national court, a party had successfully exercised its right to refer the dispute to arbitration under a unilateral option clause; actually commencing arbitration or providing an undertaking to do so was unnecessary.

In the Hong Kong decision *China Railway (Hong Kong) Holdings Ltd v Chung Kin Holdings Co* Ltd [2023] HKCFI 132, Master Alexander Tang found that the asymmetric jurisdiction clause – which gave the right to choose the forum only to the plaintiff – was valid. The court agreed that the purpose of the clause was to ensure that the position of the plaintiff as creditor was not compromised. The court rejected the defendant's arguments that the courts in Wuhan were the more appropriate forum to hear the dispute.

Where the wording of such a clause is clear – and the intentions of the parties can be clearly determined – it seems the courts are prepared to uphold the validity of such clauses to the benefit of the lender. It is important to remember, however, that an arbitral award or judgment rendered from such a clause may be unenforceable in places such as mainland China, the UAE and Russia as a matter of public policy.

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Cross-border recognition between Hong Kong and mainland China

Insolvency practitioners in both Hong Kong and the PRC mainland are testing the limits of the new co-operation mechanism that came into force on 14 May 2021, under which liquidators appointed in Hong Kong may apply to the mainland courts (currently limited to three pilot cities) for recognition of and assistance to insolvency proceedings in Hong Kong, whilst insolvency administrators throughout the mainland may apply to the Hong Kong court for recognition of and assistance to bankruptcy proceedings in the mainland. Anecdotally, liquidators appointed in Hong Kong are not necessarily finding the pilot courts willing to hear recognition applications. With the increase in winding up orders made in 2023, this is something we will be watching with interest in 2024.

In *Re Guangdong Overseas Construction Corporation* [2023] HKCFI 1340, the Honourable Madam Justice Linda Chan recognised and provided assistance to a mainland China-appointed administrator over a mainland China company in liquidation despite the administrator's application being outside the scope of the mechanism. The Hong Kong court affirmed that its jurisdiction to recognise and assist office-holders appointed by a court of another jurisdiction derives from common law.

Insolvency-related judgments are excluded from the scope of operation of a new mechanism for reciprocal enforcement of judgments between mainland China and Hong Kong that will come into effect on 29 January 2024, although the new regime may still have some practical application in this arena (see below).

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Provisional liquidation – less of a soft touch

The past year has also been one in which the Hong Kong courts have seen fit to both clarify and qualify applications for recognition of foreign "soft touch" provisional liquidators, at the same time as reining in some of the perceived abuses.

The Honourable Madam Justice Linda Chan ordered the directors of a Bermuda-incorporated Hong Kong-listed company to be joined as defendants for the purpose of having costs awarded against them for opposing winding up proceedings in the absence of a viable restructuring proposal.

In *Re Jiayuan International Group Ltd* [2023] HKCFI 1254, Linda Chan J warned that it is not sufficient for a debtor company merely to point to commercial discussions with some of the creditors when seeking an adjournment of a petition. If the company in question is unable to demonstrate why an adjournment order should be granted and the existence of a "concrete restructuring proposal", there was no basis for the court to deny the petitioning creditor an immediate winding up order.

In a further blow to the concept of "soft touch" provisional liquidation, the Court of First Instance in *Re Guoan International Limited (in liquidation)* [2023] HKCFI 666, granted an ancillary winding up order against the company, which was listed in Hong Kong, despite it having already been wound up in its place of incorporation. The court also refused to allow the joint liquidators to recover their costs from the company's assets.

In *Wing Sze Tiffany Wong v Wong Sai Chung* [2023] HKCFI 2346, the Court of First Instance granted an order forcing an uncooperative former director of a Hong Kong listed company (who was subject to the *in personam* jurisdiction of the Hong Kong courts) to ratify the appointment of a Hong Kong liquidator over the company's four BVI subsidiaries. In doing, the Hong Kong court has shown its willingness to take the necessary steps to ensure the effective administration of a Hong Kong liquidation, even where the company is subject to ongoing proceedings elsewhere, in this case the company's country of incorporation in BVI.

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Global Restructuring Review, 2022

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Schemes of arrangement

Hong Kong's last remaining independent airline carrier, Hong Kong Airlines Limited, underwent a significant debt restructuring. In parallel proceedings (a scheme of arrangement in the UK and a scheme of arrangement in Hong Kong), both the English and Hong Kong courts sanctioned the proposed restructuring.

Both jurisdictions apply *The Rule in Gibbs*, which provides that the discharge or compromise of an obligation will only be recognised if the discharge or compromise is carried out under the law applicable to the obligation – meaning that the English scheme could not compromise Hong Kong law-governed liabilities and the Hong Kong scheme could not compromise liabilities governed by English law. The two proposals were therefore conditional upon the other as, without the approval of both schemes, liabilities would have remained outstanding such that the company would not have been able to secure new investment.

The Hong Kong court for the first time sanctioned a scheme of arrangement that released debts of third-party obligors that were guaranteed by the scheme company without requiring a deed of contribution. Giving judgment in *Re Unity Group Holdings International Ltd* [2022] HKCFI 3419, Harris J deviated from the English law approach and ruled that a deed of contribution will no longer be necessary for the release of a principal obligor's liability that had been guaranteed by the scheme company.

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Investor protection

The year saw the Honourable Madam Justice Linda Chan calling on regulators to enhance investor protections. In *Securities and Futures Commission v Sound Global Ltd* [2022] HKCFI 3025, the Securities and Futures Commission was unable to effect service for the purpose of seeking a disqualification order against directors of a listed company.

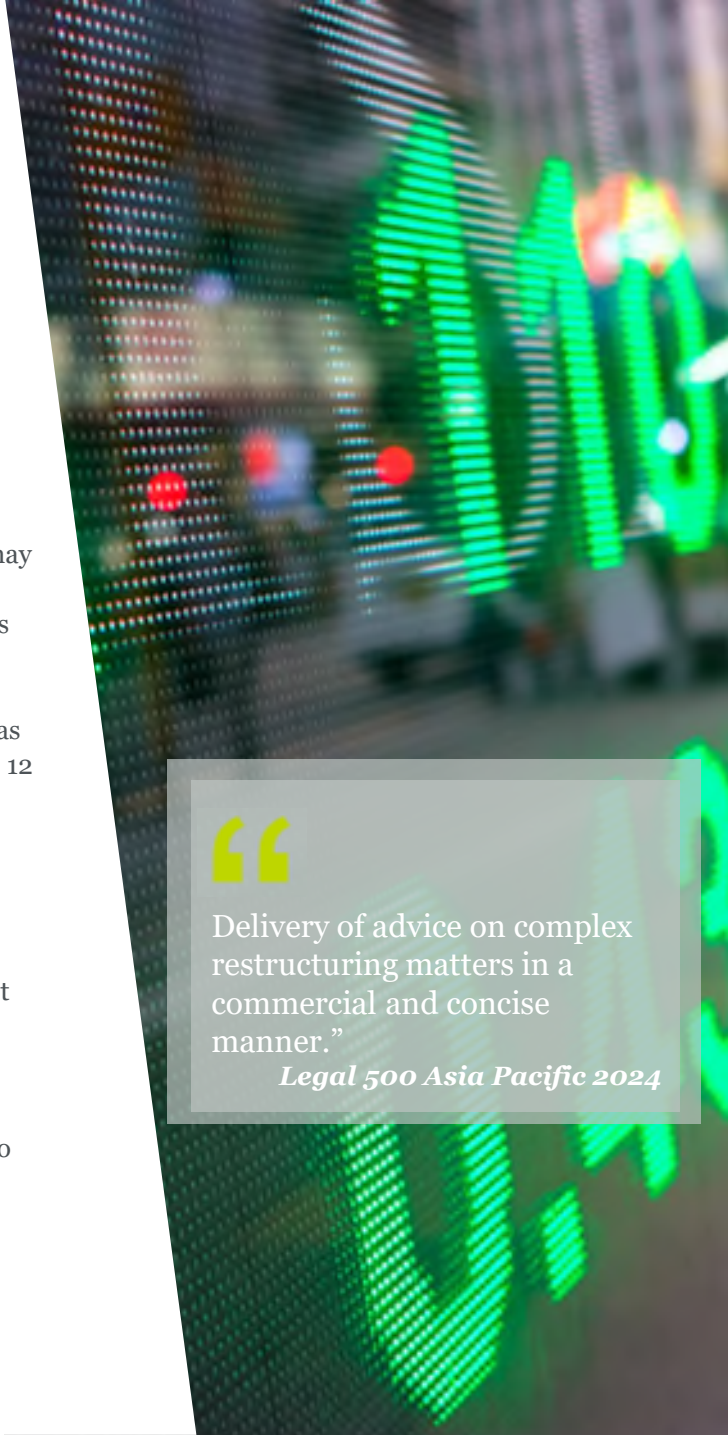
The court specifically expressed the view that regulators should step up when it comes to enforcing investor protection with mainland China-based directors of Hong Kong listed companies and it is now up to the regulators to consider putting in place appropriate measures to align with the court's view.

Bankruptcy reforms pave the way for electronic service

Changes to Hong Kong's bankruptcy laws were made to allow for easier service of statutory demands, particularly in cases where debtors may attempt to evade service. Where the debtor has agreed with the creditor to use electronic means (which include emails, WhatsApp, WeChat or similar means of communications) to receive documents relating to the debt, or the debtor has used these communication channels during the 12 months immediately preceding the date of the statutory demand, the creditor may deliver a statutory demand through such channels.

The changes also do away with the need for attendance at hearings for uncontested bankruptcy and winding up proceedings (except in the case of a just and equitable winding up). Clearer guidance is also provided in respect of urgent applications to the Companies Judge.

The changes are brought into effect through two new Practice Directions; 3.1 and 3.7, and will come into operation on 29 December 2023.



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Ahead in 2024

Given this year's uncertainty around the approach of the Hong Kong courts to favouring arbitration agreements over winding up proceedings, 2024 looks set to bring some welcome clarity as the concurrent appeals of two conflicting Court of First Instance decisions provide an opportunity for the Hong Kong courts to re-align their approach.

Hong Kong has been left without a statutory corporate rescue regime for so long that practitioners have given up hope of any reform in this area and are reliant on the flexibility of the common law, and often the ingenuity of the judiciary, to achieve pragmatic solutions. It remains unclear whether the updated Companies (Corporate Rescue) Bill will be introduced in 2024.

The continued delay in introducing any reforms to facilitate corporate rescue in Hong Kong is disappointing, particularly in light of the huge increase in defaults by property developers over the last couple of years, with the likelihood of more to follow. We do wonder if creditors and borrowers would be better served if the regime in Hong Kong offered more tools to help financially stressed corporations in the region.

The Mainland Judgments in Civil and Commercial Matters (Reciprocal Enforcement) Ordinance comes into force on 29 January 2024. The Ordinance will implement the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and the Hong Kong Special Administrative Region, which was signed on 18 January 2019. The Ordinance and the Arrangement will come into force in both Hong Kong and mainland China simultaneously.

Whilst insolvency-related judgments are excluded from the scope of operation of the Arrangement, the new regime may have practical application where a creditor obtains a judgment in Hong Kong in respect of a debt under a loan facility or keepwell deed and then uses the judgment debt to pursue an action in mainland China.

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