Introduction of a Statutory Corporate Rescue Procedure and Insolvent Trading Provisions – Non-Hong Kong Companies

Comments of the Hong Kong Bar Association

1. On 13 July 2016, the Hong Kong Bar Association ("**HKBA**") provided its comments on certain issues in relation to the Administration's proposals to introduce (1) a new statutory corporate rescue procedure ("**CRP**") and (2) insolvent trading provisions. By letter dated 1 August 2016, the Financial Services and the Treasury Bureau ("**FSTB**") invited the HKBA to provide further comments on whether the proposed CRP should be extended to non-Hong Kong companies registered under Part 16 of the Companies Ordinance (Cap.622) or a former Companies Ordinance.

2. In sum, the HKBA **supports** the extension of the CRP to non-Hong Kong companies[1] – in respect of which the Hong Kong court already has jurisdiction to wind up (under Part X of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32) and sanction arrangements or compromises (under Division 2 of Part 13 of Cap.622), and considers that the CRP should also extend to "unregistered company" which is "liable to be wound up under [Cap.32]"– for the following reasons:-

   2.1. CRP is designed to be an alternative to liquidation and there is no legitimate reason, whether as a matter of principle or policy, as to why the court cannot put a non-Hong Kong company and an unregistered company which is liable to be wound up in Hong Kong (together "**foreign company**") into CRP;

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[1] A non-Hong Kong company is defined in Cap.32 and Cap.622 as a company incorporated outside Hong Kong that either establishes or has established a place of business in Hong Kong, which is required to be registered under Division 2 of Part 16 of Cap.622. Once registered, it becomes a "registered non-Hong Kong company"

2.2. Given the prevalent use of foreign companies as a matter of business practice, the exclusion of such companies from CRP would seriously undermine its legislative purpose, *viz*. to facilitate companies with viable long-term business prospects but are in short term financial difficulty to turn around or restructure;

2.3. The extension of CRP to foreign companies is consistent with the current statutory scheme governing winding-up and scheme of arrangement, which apply to both non-Hong Kong companies and unregistered companies liable to be wound up in Hong Kong; and

2.4. The "obstacles" identified by the Administration are by no means insurmountable, and any practical difficulties associated therewith are unlikely to outweigh the benefits which CRP would confer.

3. First, there is no principle or policy reason against the extension of the CRP to foreign companies. On the contrary, such extension would be consistent with, and in furtherance of, the stated policy objective of the CRP.

4. The policy objective of the CRP is stated by the Administration as maximizing the chance of existence of the company or as much as possible its business, and if this is not attainable, achieving a better return for the creditors of the company than in the case of an immediate insolvent winding-up: see letter from the FSTB to the HKBA dated 10 June 2016, Appendix A, §(b).

5. The purpose of the CRP is to serve as an alternative to liquidation, with a view to achieving better return for the creditors. One of the possible outcomes of CRP – probably its primary target – is the proposal of a voluntary arrangement by an independent professional for creditors' consideration and approval.

6. Under the current statutory regime, the Hong Kong court already has jurisdiction to:-

   6.1. wind up an "unregistered company", which is defined to include a "registered non-Hong Kong company" (Cap.32, s.326(2)); and

   6.2. sanction arrangements and compromises of a company that is "liable to be wound up under [Cap.32]" (Cap.622, s.668(1)). This includes non-Hong Kong company and unregistered company liable to be wound up in Hong Kong.

   In other words, a foreign company has the same options as a Hong Kong company in the face of insolvency.

7. As such, there is no reason why (and **none** has been identified by the Administration) the policy considerations that underlie the CRP do not apply with equal force to foreign companies.

8. Second and significantly, it has been recognized that unlike the position in other jurisdictions such as the United Kingdom and Australia, the business practice in Hong Kong is heavily inclined towards the use of corporate structures involving foreign companies: see the observations of the Court of Final Appeal in *Kam Leung Sui Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501, §28 (*Yung Kee*) and Harris J (the current companies Judge) in *Re Gottinghen Trading Ltd* [2012] 3 HKLRD 453, §25. Indeed, it was recognised by the Law Reform Commission in as early as 1999, that a "large proportion" of companies listed in Hong Kong were registered abroad: *Law Reform Commission of Hong Kong: Report on the Winding-up Provisions of the Companies Ordinance* (1999) §26.1. The number of foreign companies listed in Hong Kong now is even larger than the time considered by the Law Reform Commission.

9. In these circumstances, the exclusion of foreign companies would mean that a substantial number of companies that are active in Hong

Kong – including those which have the highest value, both from the perspective of financial value and also value to the Hong Kong economy and community as a whole – cannot take advantage of this valuable option to weather short-term financial difficulty and turn around. This is particularly so when such foreign companies are already subject to the jurisdiction of the Hong Kong court for the purposes of winding-up and scheme of arrangement. This is most undesirable.

10. In this regard, the HKBA is of the view that the benefit to be derived from case law and operational experience in the United Kingdom and Australia should not be over-stated, given the significantly different business practices and realities between those jurisdictions and Hong Kong. Ultimately, the Hong Kong regime should be designed to meet local needs.

11. Third, the HKBA considers that the "obstacles" identified by the Administration in §6 of its letter to the HKBA dated 1 August 2016 are by no means insurmountable. In any event, they are not valid reasons for not extending the CRP to non-Hong Kong companies and companies liable to be wound up in Hong Kong.

12. In respect of the suggestion that the company law of the place of incorporation may not be directly comparable with that of Hong Kong and that is said to give rise to uncertainty:-

    12.1. The HKBA notes that the discrepancies between the company law of the different jurisdictions have **never** been regarded as an obstacle to the Hong Kong court exercising its jurisdiction to wind up foreign companies or sanction their arrangements or compromises. As explained by the CFA in *Yung Kee*, at §§19-24, while the most appropriate jurisdiction in which to wind up a company is the jurisdiction where it is incorporated, the courts have adopted some necessary self-imposed restraints on the making of a winding-up order against a foreign company by laying down the so-called 3 core-requirements, which **must** be

satisfied before the court will exercise its statutory jurisdiction to wind-up a foreign company. In the case of a creditor seeking to wind-up a foreign company in Hong Kong, he needs to satisfy the court that there is a sufficient connection between the company and Hong Kong, and that there is a reasonable prospect that the petitioner will derive a sufficient benefit from the making of a winding-up order.

12.2. In practice, once a foreign company is put into liquidation in Hong Kong, the liquidator can administer the liquidation in Hong Kong. Whether the liquidation in Hong Kong will be the primary or ancillary liquidation depends on where its creditors and assets are located. It is not uncommon that after foreign companies are wound up in Hong Kong, the primary liquidation are to be conducted in Hong Kong. For example, the liquidation of Akai Holdings Ltd (a Bermuda company listed in Hong Kong) and China Metal Recycling (Holdings) Ltd (a Cayman company listed in Hong Kong).

12.3. Thus, so long as a foreign company has the requisite connection with Hong Kong and satisfies the 3 core-requirements, there is sufficient justification for such company to take advantage of the CRP. The CRP will be binding on the foreign company in Hong Kong, including all the officers and creditors present in Hong Kong. The fact that it may be necessary to seek similar moratorium or CRP in the jurisdiction in which the foreign company was incorporated (or, indeed, in other jurisdictions in which the company has operated or has assets) is something which the company and its creditors would need to decide in the circumstances of the company. For example, where the overwhelming majority of the foreign company's creditors are present in Hong Kong, and therefore, bound by the CRP, it is difficult to see why it is necessary to commence similar CRP in its place of incorporation at all.

12.4. Similarly, in the context of scheme of arrangement in respect of a foreign company, the established practice has been for the company to apply for sanction of the scheme **both** in the jurisdiction in which the company was incorporated and in Hong Kong where the company has assets or creditors in Hong Kong. The application in Hong Kong would be regarded as ancillary to the same, thereby removing any such uncertainties: see eg *Re LDK Solar Co Ltd* [2015] 1 HKLRD 458, §§49-57.

12.5. As such, the HKBA is of the view that the risk of uncertainty identified is more fanciful than real, and that in practice it will most likely be mitigated by insolvency practitioners taking corresponding steps in the different jurisdictions anyway.

12.6. As to the Administration's suggestion of overcoming such issue by requiring a non-Hong Kong company to obtain the sanction of the court before it commences provisional supervision, the HKBA believes this is a viable alternative as it will give certainty on the question whether the foreign company is a company which is liable to be wound up in Hong Kong, which is necessary for the company to avail itself of the CRP. The advantage of certainty will likely outweigh the costs associated with the application.

13. In respect of the alleged uncertainty concerning the identity of the major secured creditors ("**MSCs**") of the foreign companies:-

13.1. The HKBA does not see why there would be any perceived uncertainty. It must be borne in mind that the CRP is proposed to be initiated by either the company, its provisional liquidator or liquidator. These parties would be in the best position to ascertain the identity of the MSCs, and to provide or call for documentary proof as to the secured indebtedness.

13.2. In any event, even if there were to be any error in respect of the identity of the MSCs such that the provisional supervisor ("**PS**")

appointed pursuant thereto is subsequently found to be unsuitable or detrimental to the interests of the creditors as a whole, the creditors would be protected in that (a) at the first creditor meeting the creditors can replace the PS; and any of their number can (b) apply to court to remove the PS; (c) apply to court to challenge the conduct of the PS; or (d) commence misfeasance action against the PS (see HKBA's comments dated 13 July 2016).

13.3. The proposal to introduce a requirement for the appointor of the PS to make certain statutory declarations can provide additional safeguard, although for the reasons in §13.2 above the vice it seeks to address is likely to have been catered for under the existing CRP proposals already.

14. In respect of the perceived difficulty arising from the inability of a foreign company to be wound up voluntarily, the HKBA does not consider this to be a serious obstacle, for the Hong Kong court indisputably has jurisdiction to wind up a foreign company compulsorily. It has been considered that the availability of this jurisdiction is sufficient to achieve the purpose of the CRP: see Sheldon, Cross-Border Insolvency, 4th ed., §5.80. The fact that foreign companies may not have the facility to initiate voluntary liquidation is not a reason to deny them of CRP altogether.

15. Finally, the HKBA considers that it is viable to explore the suggestion that in addition to the primarily "self-help" nature of the CRP, there should be express powers conferred on the Hong Kong court to appoint a PS over a foreign company and place it into CRP upon application. This is necessary, as the Court of Appeal in *Re Legend International Resorts Ltd* [2006] 2 HKLRD 192 at §§25-27, 35-37, 49-50 held that the court has no jurisdiction to appoint provisional liquidators over a company for the purpose of considering or implementing a debt restructuring, as the purpose of the appointment is to protect the company, such that some danger to the assets must be shown before the court can make the appointment.

16. In the premises, the HKBA considers that it is beneficial and necessary to extend the CRP to foreign companies. The HKBA is of the view that such extension is consistent with the purpose of the CRP and addresses the practical needs associated with the unique business practices in Hong Kong.

Hong Kong Bar Association

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