# THE BANKING LITIGATION LAW REVIEW

Sixth Edition

**Editor**
Jonathan Clark

THE LAWREVIEWS

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# Preface

This year's edition of *The Banking Litigation Law Review* highlights that litigation involving banks and financial institutions shows little sign of slowing. The legal and procedural issues that arise in banking litigation continue to evolve and develop across the globe, in the context of both domestic and cross-border disputes.

The impact of covid-19 continued throughout 2022 with many of the temporary measures enacted becoming permanent features of the litigation landscape. In many jurisdictions, procedural rules have been revised to provide for the use of technology, including in the form of virtual and hybrid hearings. Nevertheless, physical hearings remain an option, especially for complex cases that involve witness evidence and large amounts of oral advocacy.

Financial institutions have also had to adapt to the increasing popularity of crypto-assets. Across the globe, regulators have made efforts to provide clarity on the regulatory framework of digital assets and this will no doubt be an evolving area in the years to come. It remains to be seen how courts will adapt to the unique challenges raised in disputes involving such assets.

Signs of the long-term economic effects of the pandemic, war in Ukraine and inflation are now visible in many parts of the world. From the perspective of the financial sector, these conditions are likely to translate into an increase in loan arrears and defaults, debt restructurings, bankruptcies and insolvencies affecting banks, their customers and counterparties. In a number of financial transactions, there will be winners and losers from the current increase in interest rates following a sustained period of historically low rates. These conditions typically presage an uptick in banking litigation and it seems likely that disputes arising from the current global economic environment will feature in future editions of this *Review*.

A continuing trend this year, as in other recent years, has been the broadening of obligations placed on financial institutions in the name of improving consumer protection. Faced with the challenge of increasing fraud, governments and courts alike have continued to develop the nature and scope of duties imposed on banks to protect their customers, including from their own susceptibility to fraudulent schemes. Claimants, and their funders, are expected to continue testing the limits of these obligations and duties in the courts.

Given the various headwinds and challenges ahead, the high volume and broad nature of litigation in the financial sector looks set to continue.

**Jonathan Clark**
Slaughter and May
London
November 2022

**Chapter 4**

# Hong Kong

*Wynne Mok, Natalie Se and Rita Kan*[1]

## I OVERVIEW

In the past year, courts in Hong Kong have consistently heard and decided cases related to the banking industry, ranging from cyber fraud cases, in which the courts granted vesting orders to allow victims of fraud to recover misappropriated funds directly from banks, to insolvency cases. The Hong Kong government has focused its efforts to ensure that the city maintains its status as a leading financial centre by updating its legislations and regulations to align with international standards. The city continues to build on and benefit from its close connection with mainland China, including mutual arrangements in relation to the enforcement of arbitral awards, availability of interim measures in aid of arbitration proceedings, and recognition of and assistance to cross-border insolvency proceedings.

## II SIGNIFICANT RECENT CASES

There is developing case law concerning recovery of funds in a cyber fraud by seeking a vesting order pursuant to Section 52(1)(e) of the Trustee Ordinance (Cap 29). The Trustee Ordinance empowers the court to make an order vesting the right to recover a thing in action in any such person as the court may appoint where the thing in action is vested in a trustee whether by way of mortgage or otherwise and if it appears to the court to be expedient. The Court of First Instance in *Wismettac Asian Foods Inc v. United Top Properties Limited*[2] held that it has jurisdiction to make a vesting order in favour of a victim in a cyber fraud, whereby the bank at which the fraudster held the funds should transfer the funds to the victim. The court took the view that a constructive trust came into existence by operation of law when the victim's funds went into the fraudster's bank account, and this is a scenario contemplated by the Trustee Ordinance. Obtaining a vesting order under the Trustee Ordinance is considered to be a faster way to recover stolen funds than the conventional way of obtaining a default judgment against the fraudster and then applying for a garnishee order. This *Wismettac* approach has recently been adopted by the Court of First Instance and the District Court.[3]

1 Wynne Mok is a disputes and investigations partner, and Natalie Se and Rita Kan are trainees within the Disputes and Investigations practice, at Slaughter and May.

2 [2020] HKCFI 1504 (Hong Kong Court of First Instance).

3 *Star Therapeutics, Inc v. Leabon Technology (HK) Ltd & Another* [2021] HKCFI 1715, *Donald Henry Case v. Profitling International Ltd and Another* [2021] HKDC 172, and *Hypertec Systems Inc v. Yifim Limited and Another* [2022] HKCFI 482.

In particular, in *Hypertec Systems Inc v. Yifim Ltd*,[4] the Court of First Instance made vesting orders pursuant to Section 52(1)(e) of the Trustee Ordinance, enabling the victim of an email fraud to recover funds stolen from him.

It has been a common practice for the Hong Kong police to issue 'letters of no consent' to banks when a suspicious transaction report is received, pursuant to the Organised and Serious Crimes Ordinance (Cap 455) (No Consent Regime). Once a letter of no consent is issued, the relevant bank account will be frozen. This has become an effective way to stop further activities in a bank account to which criminal proceeds have been transferred (e.g., funds stolen in cyber fraud) and would save banks from making their own decisions as to whether steps should be taken to freeze the relevant accounts. However, the practice of the police issuing letters of no consent was subject to legal challenge in *Tam Sze Leung v. Commissioner of Police*.[5] The court decided that the No Consent Regime is unconstitutional and *ultra vires*. While it remains unclear whether (and how) the Hong Kong police will react to the court decision, banks should exercise independent judgment as to whether to freeze the accounts that may hold proceeds of crime in accordance with the terms and conditions of the relevant account.

Hong Kong courts have defined the scope of the *Quincecare* duty narrowly. In *Luk Wing Yan v. CMB Wing Lung Bank Ltd*,[6] the Court of First Instance held that this duty on the part of a bank to exercise reasonable skill and care in executing a customer's order would only arise in circumstances where misappropriation of a customer's funds occurred due to a payment instruction from an authorised or trusted agent on behalf of a customer, instead of a customer's direct instructions. On this basis, the defendant bank was not considered as owing a *Quincecare* duty and therefore was not held liable for losses suffered by its customer when the bank acted on payment instructions from the customer, notwithstanding that the instructions were fraudulently obtained by an employee of the bank. It is notable that this legal position has been confirmed by the Privy Council in *Royal Bank of Scotland International Ltd v. JP SPC*.[7] While English cases are only persuasive in Hong Kong, this recent decision of the Privy Council will further strengthen the position that has been consistently taken by Hong Kong courts on the scope of the *Quincecare* duty.

In *Galleria (Hong Kong) Limited v. DBS Bank Ltd*,[8] the Court of Final Appeal made several important comments in relation to a bank's liabilities as a recipient or processor of misappropriated funds. First, once a court finds that a bank had no knowledge of, and therefore did not turn a blind eye to, a fraud, no question of attribution would arise. Second, the Court of Final Appeal reaffirmed the test for dishonesty in a dishonest assistance claim. The dishonesty test requires a court to first consider what the bank knew and then whether, with that knowledge, the bank could be objectively said to be dishonest. Once the court makes a factual finding that the bank lacked any knowledge of the fraud, the fact that the bank has been negligent is irrelevant as negligence is not in itself dishonest.

4 [2022] HKCFI 482.

5 [2022] 1 HKLRD 480.

6 [2021] HKCFI 279.

7 [2022] UKPC 18 (UK Privy Council).

8 [2022] HKCA 852 (Hong Kong Court of Appeal).

## III RECENT LEGISLATIVE DEVELOPMENTS

In 2021, the Financial Services and the Treasury Bureau proposed a licensing regime for virtual asset services providers. The licensing regime requires any person who is seeking to engage in the business of operating a 'virtual asset exchange' to obtain a virtual asset services provider licence from the Securities and Futures Commission. Under the licensing regime, locally incorporated companies with a permanent place of business in Hong Kong and foreign companies registered in Hong Kong may apply for a virtual asset services provider licence and will have to pass a fit-and-proper test. Applicants will also have to appoint at least two responsible officers to ensure compliance with anti-money laundering, counterterrorism financing, and other regulatory requirements. The Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 incorporating the proposed virtual asset services provider licensing regime was gazetted on 24 June 2022 and has passed first reading. Subject to the passage of second and third readings, the Bill and the licensing regime are expected to come into effect on 1 January 2023 and 1 March 2023, respectively.

Under the Financial Institutions (Resolution) Ordinance (Cap 628) (FIRO), the Hong Kong Monetary Authority has the power to temporarily suspend the termination right of a counterparty to a contract which a failing financial institution has entered into, if the Authority considers that the termination of the contract would frustrate the resolution actions taken. The Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (Cap 628C) (Stay Rules) state that any contract that is entered into by an authorised institution incorporated in Hong Kong or its holding company or related company is governed by non-Hong Kong law and that contains a termination right exercisable by a counterparty should contain a provision that the parties to the contract will be bound by any suspension of termination rights imposed by the Hong Kong Monetary Authority. On 22 December 2021, the Hong Kong Monetary Authority issued guidance on the Stay Rules, which contains further explanation and illustrative examples on the operation of the Stay Rules.[9]

The Hong Kong government has been striving to attract existing foreign investment funds to Hong Kong and strengthen Hong Kong's position as an international asset and wealth management centre. The Limited Partnership Fund Ordinance (Cap 637) and the Securities and Futures Ordinance (Cap 571), which allow re-domiciliation of foreign funds set up outside Hong Kong as limited partnership funds or open-ended fund companies in Hong Kong, came into effect on 1 November 2021. The re-domiciliation process allows existing foreign funds to set up new fund vehicles in Hong Kong and transfer their assets and shareholders to the same.

## IV CHANGES TO COURT PROCEDURE

A summary judgment is one way to expedite court processes where a plaintiff may apply for judgment against a defendant without going through a full trial on the basis that the defendant has no arguable defence. The Rules of the High Court (Amendment) Rules 2021 and Rules of the District Court (Amendment) (No. 2) Rules 2021, which came into

9 New chapter of the code of practice ST–1 'Resolution Planning – Contractual Recognition of Suspension of Termination Rights'.

operation on 1 December 2021,[10] make summary judgments available for actions begun by writ in the High Court and District Court, which includes a claim based on an allegation of fraud. As such, a victim of cyber fraud can apply for a summary judgment against the fraudster or anyone to whom the stolen funds were transferred. In *Boston Consulting Group (Brasil) Ltd v. Kaisheng Technology Co Ltd*,[11] the Court of First Instance granted a summary judgment in favour of the plaintiff, whose employees were deceived into making transfers of funds which ended up in the defendant's bank account.

With the aim of transforming the judiciary into a paperless system, in addition to the Court Proceedings (Electronic Technology) Ordinance (Cap 638) enacted in October 2021, the judiciary has issued general guidelines regarding adducing of electronic evidence and the requirements as to format and specifications of such evidence.

Apart from court procedures, since June 2012, the Financial Dispute Resolution Centre has been operating as a forum for low-value disputes between banks and other financial intermediaries on the one hand and retail customers on the other.[12] The Centre aims to provide a more economic, expeditious and amicable means of resolving disputes that would otherwise have been pursued in court. According to the Centre's latest annual report, published on 22 July 2022, it has achieved a mediation success rate of 90 per cent for the year ended 31 December 2021.

## V INTERIM MEASURES

All of Hong Kong's courts hold jurisdiction to issue various interim measures to prevent defendants from dissipating assets pending both foreign proceedings and those in Hong Kong. Such interim measures work to protect traditional assets, such as monies in a bank account, as well as digital assets. In *Yan Yu Ying v. Leung Wing Hei*,[13] the Court of First Instance granted an interim proprietary injunction to freeze certain Bitcoins pending resolution of the substantive dispute between the parties over the ownership of those digital assets.

Hong Kong remains the first and only jurisdiction outside mainland China where parties to arbitral proceedings can apply to the mainland courts for interim measures in aid of arbitral proceedings. Under the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of mainland China and of the Hong Kong Special Administrative Region (Interim Measures Arrangement), where an arbitration is seated in Hong Kong and administered by one of the designated arbitral institutions (including the Hong Kong International Arbitration Centre (HKIAC)), parties to the arbitration can apply to the mainland courts for orders to preserve property or evidence, or to prohibit a party from acting in certain ways pending conclusion of the arbitral proceedings in Hong Kong. The application, accompanied with a letter of acceptance issued by the designated arbitral institution, can be made to the Intermediate People's Court of the counterparty's place of residence, or the place where the relevant asset is located. Different procedures are applicable depending on whether the parties apply for interim measures before

10 Amendments were made to Order 14 of the High Court Rules and the Rules of the District Court (Cap 336H).

11 [2022] HKCFI 447.

12 The maximum claim is HK$1 million.

13 [2022] 3 HKLRD 270 (*Hong Kong Law Reports and Digest*).

or after acceptance of the case by an eligible arbitral institution.[14] Within three years from the implementation of the Interim Measures Arrangement, as of 24 August 2022, the HKIAC has issued preservation orders covering, accumulatively, approximately US$2.1 billion worth of assets.

On 22 June 2022, the HKIAC was included in the One-Stop Platform for Diversified International Commercial Dispute Resolution (One-Stop Platform) of the China International Commercial Court, which was set up to adjudicate international commercial cases and create an efficient legal business environment under the Belt and Road Initiative. Parties to an HKIAC-administered arbitration can apply directly to the Commercial Court for interim relief or enforcement, provided that the amount in dispute exceeds 300 million yuan, or would otherwise likely be of significant influence. In large-scale arbitrations involving multiple parties or assets scattered across different provinces within mainland China, this will be effective as a single application can be made to the Commercial Court, rather than multiple applications to different Intermediate People's Courts where the relevant parties or assets are located.

## VI PRIVILEGE AND PROFESSIONAL SECRECY

Legal professional privilege is considered fundamental in the judicial system in Hong Kong. It protects from disclosure confidential communications between a client and its lawyer for the dominant purpose of giving or receiving legal advice (legal advice privilege), and communications between parties and their lawyers and third parties for the purpose of obtaining information or advice in connection with existing or contemplated litigation (litigation privilege). Under Hong Kong law, legal advice privilege does not extend to cover legal advice given by professionals other than practising lawyers.[15]

Legal advice privilege only protects confidential client–attorney communications. In *CITIC Pacific Ltd v. Secretary for Justice (No. 2)*,[16] the Court of Appeal interpreted 'client' broadly so as to cover the client's employees, and not only employees specifically authorised to seek and receive legal advice on behalf of the client. Communications sent by an employee within the client organisation for the dominant purpose of obtaining legal advice are therefore protected by legal advice privilege. This represents a significant departure from the definition of 'client' previously adopted by the English Court of Appeal in *Three Rivers v. Governor and Company of the Bank of England (No. 5)*.[17] In a subsequent case,[18] the English Court of Appeal considered the authorities in Hong Kong (including CITIC Pacific) and acknowledged

14 Qualified arbitral tribunals under Article 2 of the Arrangement are eligible. These include, among other things, arbitral institutions that are established in Hong Kong or that have their headquarters established in Hong Kong, and with their principal place of management located within the Hong Kong Special Administrative Region. Ad hoc arbitrations would not be eligible for the Interim Measures Arrangement.

15 *Super Worth International Ltd v. Commissioner of Independent Commission Against Corruption* [2016] 1 HKLRD 281, following the decision by the UK Supreme Court (UKSC) in *R (on the application of Prudential plc & Anor) v. Special Commissioner of Income Tax & Anor* [2013] UKSC 1 (UK Supreme Court).

16 [2015] 4 HKLRD 20.

17 [2003] QB 1556 (Queen's Bench Division, High Court of England and Wales).

18 *Director of the Serious Fraud Office v. Eurasian Natural Resources Corporation* [2018] EWCA Civ 2006 (England and Wales Court of Appeal).

concerns with the narrow definition of 'client' adopted in *Three Rivers*. The issue, however, was left open and the interpretation in *Three Rivers* remains valid. The difference in the approach between English and Hong Kong courts remains.

## VII JURISDICTION AND CONFLICTS OF LAW

### i Anti-suit injunctions

Section 45 of the Arbitration Ordinance (Cap 609) and Section 21L of the High Court Ordinance (Cap 4) empower the Court of First Instance to grant anti-suit injunctions to restrain the pursuit of court proceedings in breach of an agreement to resolve disputes by arbitration. The Court will ordinarily grant permanent and interim anti-suit injunctions to restrain a party from pursuing foreign proceedings in breach of an agreement to carry out arbitration within Hong Kong, where the injunction had been sought without delay and the foreign proceedings were not too far advanced, unless the respondent demonstrates strong reasons to the contrary.[19] The principle of comity requires that the jurisdiction to grant anti-suit injunctions be exercised with caution and restraint. An applicant is required to show to a high degree of probability that the initiation of foreign proceedings constituted a breach of an arbitration agreement.[20] Delay is also a relevant consideration.[21]

### ii Stay of proceedings in favour of arbitration

An application for a stay of Hong Kong proceedings in favour of arbitration can be made under Section 20 of the Arbitration Ordinance. In *Cheung Shing Hong Ltd v. China Ping An Insurance (Hong Kong) Co Ltd*,[22] the Court of First Instance reaffirmed that it must stay the proceedings in favour of arbitration if there is a valid and enforceable arbitration agreement, a dispute exists between the parties, and the dispute falls within the scope of the arbitration agreement.

A party wishing to make an application for a stay of Hong Kong proceedings must do so before he or she submits to the substantive jurisdiction of the Hong Kong courts. This means that he or she should make an application before he or she submits his or her first statement on the substance of the dispute (e.g., his or her defence). However, Section 20(1) makes clear that a party will not be prejudiced by the mere taking of an action in relation to the proceedings that is merely protective of his or her position (e.g., acknowledgement of service of a writ). While the stay application is pending, parties can commence or continue arbitral proceedings, and any arbitral award made therefrom will be valid.

19 *Ever Judger Holdings Co Ltd v. Kroman Celik Sanayii Anonim Sirketi* [2015] 2 HKLRD 866.

20 *Capital Wealth Holdings Limited & Ors v. Nantong Jiahe Technology Investment Development Co Ltd* [2021] HKCFI 272.

21 *C v. D* [2020] *HKCU* 2374 (Hong Kong Cases Unreported) (https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=129731&currpage=T).

22 [2020] HKCFI 2269.

### iii Recognition and enforcement of foreign judgments (including mainland judgments) and awards

The Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap 597) gives effect to the Arrangement on Reciprocal Recognition and Enforcement of Judgments of Civil and Commercial Matters by the Courts of mainland China and of Hong Kong Special Administrative Region pursuant to the Choice of Court Agreements between the Parties Concerned 2006 (2006 Choice of Court Arrangement), which allows judgments made in mainland China to be enforced in Hong Kong, and vice versa.

Where a mainland court or Hong Kong court has made a final monetary judgment in a civil and commercial case, any party concerned may apply to a mainland court or Hong Kong court for recognition and enforcement of the judgment, provided that the judgment was made by the court, pursuant to a written agreement between the parties to submit their dispute to the sole jurisdiction of a mainland or Hong Kong court. A judgment so recognised shall have the same force and effect as one being made by a court of the place where enforcement of the judgment is sought. Parties to cross-border contracts can therefore confidently choose to have disputes resolved in either mainland China or Hong Kong, knowing that the judgment can be enforced in the other jurisdiction without incurring significant costs in initiating new proceedings.

Asymmetrical jurisdiction clauses are widely used in cross-border financial documents because they give lenders options as to where to enforce their rights depending on the location of the borrowers' assets while having the certainty that the borrowers can only sue in a designated jurisdiction. It is now clear, however, that such a clause does not qualify as a 'choice of Hong Kong court agreement',[23] because a plaintiff lender has the option to commence proceedings elsewhere, and the choice of forum was therefore at large.[24] This means that the judgment made by a Hong Kong court pursuant to an asymmetrical jurisdiction may not be enforced under the 2006 Choice of Court Arrangement.

The 2006 Choice of Court Arrangement, however, will be superseded upon the commencement of the Arrangement on Reciprocal Recognition and Enforcement of Judgements in Civil and Commercial Matters by the Courts of Mainland and of the Hong Kong Administrative Region (REJ Arrangement). The REJ Arrangement will expand the scope of the reciprocal enforcement mechanism to cover non-monetary judgments and remove the strict requirement of an exclusive jurisdiction clause. The Mainland Judgments in Civil and Commercial Matters (Reciprocal Enforcement) Bill, which is intended to give effect to the Arrangement via local legislation, was passed on 26 October 2022, but the commencement date of the Bill is yet to be announced.

Foreign judgments are generally enforceable under the Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap 319) or at common law.

Hong Kong is a party to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). Awards made in another contracting state to the New York Convention may be enforced in Hong Kong. The Arrangement Concerning Mutual Enforcement of Arbitral Awards between mainland China and the Hong Kong Special Administrative Region since 2000 (Original Arrangement) provides for mutual

23 It is defined under the Reciprocal Enforcement Ordinance to mean an agreement concluded by the parties in Hong Kong or any of them as the court to determine a dispute that has arisen or may arise in connection with the specified contract to the exclusion of courts of other jurisdictions.

24 *ICBC (Asia) Ltd v. Wisdom Top International Ltd* [2020] HKCFI 322.

enforcement of arbitral awards between the two jurisdictions on terms largely similar to those of the New York Convention. An applicant can apply to the Intermediate People's Court at the respondent's place of domicile. Enforcement may be refused if, under the law of the place of enforcement, the dispute is incapable of being settled by arbitration or is contrary to public policy.

On 27 November 2020, the Supplemental Arrangement Concerning Mutual Enforcement of Arbitral Awards between mainland China and the Hong Kong Special Administrative Region (Supplemental Arrangement) was signed. The Supplemental Agreement makes available interim measures available before and after the court's acceptance of an application for enforcement of an arbitral award, addressing the risk of dissipation of assets during the period after an arbitral award is made and before it is enforced. This ensures that a successful party can avail to meaningful remedy, enhancing the effectiveness of arbitration.

Furthermore, the Supplemental Arrangement has broadened the scope of mutually enforceable arbitral awards to cover any arbitral awards rendered pursuant to the Arbitration Law of the People's Republic of China[25] by making it possible to enforce an arbitral award under the Arbitration Ordinance so long as it had been made in a Chinese-seated arbitration, regardless of whether the award was made by a local arbitral authority or an international arbitration institution. Moreover, a winning party can now apply to enforce an arbitral award in the courts of mainland China and Hong Kong simultaneously (provided that the total amount recovered does not exceed the amount of the arbitral award), which was previously not possible.

Following the inclusion of the HKIAC in the One-Stop Platform, parties to international commercial cases administered by the HKIAC with an amount in dispute over 300 million yuan, or otherwise likely to be of significant influence, may also apply directly to the China International Commercial Court for enforcement of the arbitral award via the One-Stop Platform.

## VIII SOURCES OF LITIGATION

### i Bond defaults and insolvency

There have been an increasing number of bond defaults in the past year. Banks, as trustees of the bonds, could obtain judgments against the issuer or guarantor and enforce the judgment by obtaining a garnishee order.[26] A bank trustee could also petition for the winding up of the issuer.

Hong Kong courts have seen increasing attempts to wind up foreign companies in Hong Kong. In many cases, creditors sought to wind up a Hong Kong-listed company that was incorporated in offshore jurisdictions, such as the Cayman Islands, but had core business and assets in mainland China held through intermediate holding companies incorporated in another offshore jurisdiction. Such structures are prevalent among listed issuers in Hong Kong.

25 Article 2 of the Supplemental Arrangement.

26 *China Construction Bank (Asia) Corp Ltd v. Wong Sai Chung* [2022] HKCFI 2579; *Bank of Communications Trustee Ltd v. China Energy Reserve and Chemicals Group Overseas Co Ltd* [2022] HKCFI 795.

In general, the most appropriate place to wind up a company is its place of incorporation. In deciding whether to exercise its jurisdiction to wind up a foreign company, a court would consider three core requirements:

*a* the foreign company must have a sufficient connection with Hong Kong;

*b* there must be a reasonable possibility that the winding-up order would benefit those applying for it; and

*c* the court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

The second core requirement has proven to be the most problematic. In *Re China Huiyuan Juice Group Ltd*,[27] the Court held that the group that employs an offshore structure could not be wound up in Hong Kong as the petitioner could not demonstrate real benefit of doing so. This was because the company's main assets were located in mainland China, but the laws of mainland China did not recognise the Hong Kong-appointed liquidators, which meant that a winding-up order made by a Hong Kong court would not serve any meaningful purpose. The liquidators would not be able to take control of the Chinese subsidiaries and ultimately reach the assets in mainland China. However, in a more recent case, *Shandong Chenming Paper Holdings Ltd v. Arjowiggins HKK 2 Ltd*,[28] the court held that the leverage created by the commencement and existence of winding-up proceedings in Hong Kong is sufficient to satisfy the second core requirement.

Indeed, the difficulties illustrated in *Re China Huiyuan* may well be resolved. On 14 May 2021, mainland China and Hong Kong entered into an Arrangement on Mutual Recognition of and Assistance to Insolvency Proceedings (Co-operation Mechanism), which allows Hong Kong-appointed liquidators to be recognised and assisted by a mainland court, and exercise powers available to them under Hong Kong law within mainland China. Under the Co-operation Mechanism, three pilot courts (the Intermediate People's Courts in Shanghai, Xiamen and Shenzhen) will consider applications for recognition of and assistance to Hong Kong insolvency proceedings in respect of companies with a centre of main interest in Hong Kong for at least six months prior to the application, and have principal assets or business operations or representative offices in one of these pilot areas. A first letter of request was issued under the Co-operation Mechanism by the Hong Kong court to the Shenzhen Bankruptcy Court in *Re Samson Paper Co Ltd*[29] to seek recognition of Hong Kong liquidation proceedings.

Notwithstanding the above, Hong Kong courts may refuse to exercise insolvency jurisdiction if the parties have contractually agreed that this is a matter for another jurisdiction pursuant to an exclusive jurisdiction clause. *Guy Kwok Hung Lam v. Tor Asia Credit Master Fund* makes clear that winding-up proceedings must be stayed in light of an exclusive jurisdiction clause, and the question of whether there is a *bona fide* dispute on substantial grounds is secondary to that of whether the winding-up proceedings fall within the ambit of the exclusive jurisdiction clause.

Companies in financial distress may wish to effect restructuring in Hong Kong to avoid winding up. However, whereas other common law jurisdictions allow 'soft-touch provisional liquidation', whereby provisional liquidators are appointed to facilitate corporate restructuring

27 [2020] HKCFI 2940.

28 [2022] HKCFA 11 (Hong Kong Court of Final Appeal).

29 [2021] HKCFI 2151.

while the board maintains day-to-day management of the company, this mechanism is not available in Hong Kong. The approach of appointing soft-touch provisional liquidators in the company's place of incorporation and seeking recognition and assistance in Hong Kong with a view of implementing a scheme of arrangement in Hong Kong has faced scrutiny from the courts, particularly in cases where soft-touch provisional liquidators are appointed after a winding-up petition has been issued in Hong Kong and attempts are made to adjourn the insolvency proceedings in Hong Kong.[30] The Hong Kong court would consider especially the views of unsecured creditors in deciding whether to adjourn the petition in favour of restructuring. Furthermore, where the centre of main interest is in Hong Kong, the court may not give primacy to the insolvency proceedings in the company's place of incorporation (including any restructuring attempt commenced there) and, instead, order the company to be wound up in Hong Kong.

Where foreign incorporated companies seek to restructure debts through a scheme of arrangement in Hong Kong, they should avoid pursuing parallel restructuring efforts in their place of incorporation. Where the debtor company is listed in Hong Kong, whose debt is very largely governed by Hong Kong law, the debtor company should pursue a scheme of arrangement in Hong Kong only. Where parallel schemes are introduced unnecessarily, the court may refuse to sanction the Hong Kong scheme.[31]

### ii Winding-up proceedings

Traditionally, the court would only dismiss a winding-up petition if it is satisfied, on the evidence, that the debt is genuinely disputed on substantial grounds.[32] However, in *Lasmos Ltd v. Southwest Pacific Bauxite (HK) Ltd*,[33] the Court of First Instance held that a statutory demand should be set aside, or a winding-up petition should generally be dismissed, if the debtor has a genuine dispute over the debt, the dispute should be submitted to arbitration pursuant to the parties' agreement and the debtor has in fact taken steps to commence arbitral proceedings.

*Lasmos* is a departure from the traditional approach and has been subsequently doubted by the Court of Appeal. In *But Ka Chon v. Interactive Brokers LLC*, the Court of Appeal expressed that the statutory right to wind up a company, mandated by public policy, should not be fettered or precluded.[34] In another case, the Court of Appeal discouraged debtors from making opportunistic attempts to invoke the *Lasmos* approach in the future.[35]

## IX EXCLUSION OF LIABILITY

While the wording varies, anti-*Bartlett* provisions are commonly found in trust deeds for the purpose of relieving trustees from any duty to exercise control over or interfere with, or become involved in, the management or conduct of the trust-owned investment company that primarily remains in the hands of the settlors. The effectiveness of anti-*Bartlett* provisions

30 *Re China Bozza Development Holdings Ltd* [2021] HKCFI 1235; [2021] 4 HKC 560; *Li Yiqing v. Lamtex Holdings Ltd* [2021] HKCFI 622; [2021] 2 HKLRD 177.

31 *Re China Oil Gangran Energy Group Holdings Ltd* [2021] HKCFI 1592.

32 *Hollmet AG v. Meridian Success Metal Supplies Ltd* [1997] 4 HKC 343.

33 [2018] HKCFI 426; [2018] 2 HKLRD 449.

34 *But Ka Chon v. Interactive Brokers LLC* [2019] HKCA 873; [2019] 4 HKLRD 85.

35 *Sit Kwong Lam v. Petrolimex Singapore Pte Ltd* [2019] HKCA 1220; [2019] 5 HKLRD 646.

has been subject to judicial consideration in *Zhang Hong Li v. DBS Bank (Hong Kong) Ltd*.[36] The current position, as a result of the Court of Final Appeal decision, is that if an anti-*Bartlett* provision consciously agreed by contracting parties was clearly drafted to relieve trustees of any duty to interfere with the management of the company, including querying or objecting to the transactions entered into by the company, the provision would generally absolve the trustee from liability for failing to intervene. The court would not impose a high level supervisory duty on the trustee.

## X REGULATORY IMPACT

The recent years witnessed the rise of virtual assets, and regulators in Hong Kong have issued guidance on virtual asset-related activities. On 28 January 2022, the Hong Kong Monetary Authority issued a circular on the regulatory approaches to authorised institutions' activities regarding virtual assets and virtual assets service providers (the Circular).[37] The Hong Kong Monetary Authority stated that it adopts a risk-based approach in supervising authorised institutions' virtual assets activities in line with applicable international standards, and reminded authorised institutions to identify and understand the associated risks before engaging in activities involving virtual assets. In the Circular, the Hong Kong Monetary Authority identified three focus areas: prudential supervision; anti-money laundering, counterterrorism financing and financial crime risk; and investor protection. The Hong Kong Monetary Authority emphasised that authorised institutions intending to engage in virtual assets activities should discuss with the Hong Kong Monetary Authority (and other regulators where appropriate) and obtain the Hong Kong Monetary Authority's feedback on the adequacy of the institution's risk management controls prior to introducing relevant products or services.

On 28 January 2022, the Securities and Futures Commission and the Hong Kong Monetary Authority issued a joint circular on intermediaries' virtual asset-related activities (Joint Circular).[38] The Joint Circular provides guidance on issues arising from the distribution of virtual asset-related products and the provision of virtual asset-dealing services and virtual asset advisory services. There is a six-month transition period before the full implementation of the requirements in the Joint Circular for intermediaries that serve existing clients of virtual asset-related activities. Other intermediaries should ensure compliance with the requirements in the Joint Circular before introducing relevant services. Intermediaries must notify the Securities and Futures Commission (and the Hong Kong Monetary Authority, where applicable) in advance if they intend to engage in virtual asset-related activities, including the distribution of virtual asset-related products and the provision of virtual assets dealing services.

Sustainable finance continues to be a regulatory focus. In May 2020, the Hong Kong Monetary Authority and the Securities and Futures Commission established the Green and

36 [2019] HKCFA 45.

37 'Regulatory approaches to Authorized Institutions' interface with Virtual Assets and Virtual Asset Service Providers' (Hong Kong Monetary Authority (HKMA), 28 January 2022) (www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220128e3.pdf).

38 'Joint circular on intermediaries' virtual asset-related activities' (HKMA and Securities and Futures Commission, 28 January 2022) (https://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=22EC10 (PDF)).

Sustainable Finance Cross-Agency Steering Group[39] to accelerate the growth of green and sustainable finance in the city. In March 2022, the Steering Group published its preliminary feasibility assessment of carbon market opportunities for Hong Kong.[40]

## XI OUTLOOK AND CONCLUSIONS

While the global economy is facing a downturn and imminent recession, debt recovery and insolvency remain burning issues for creditors, including financial institutions. Financial institutions as creditors will need to consider what the most effective method of recovering their debts would be and which jurisdiction is best placed to deal with debt recovery and insolvency of the debtors. These issues could be complex. During the past year, Hong Kong courts have demonstrated a pragmatic approach in handling cross-border insolvency, one that is attuned to commercial realities and the protection of unsecured creditors.

Financial institutions can be assured by a number of factors. First, Hong Kong has a pro-arbitration legal system that encourages businesses to resolve disputes by arbitration. Second, Hong Kong has developed a solid legal framework for banking and insurance that has gradually extended to include virtual assets, standing the courts in good stead to navigate novel situations. Virtual assets have also taken stage in the regulatory space and Hong Kong regulators have provided welcome clarity.

39 The Green and Sustainable Finance Cross-Agency Steering Group also comprises the Financial Services and the Treasury Bureau, the Environment Bureau, Hong Kong Exchanges and Clearing Limited, the Insurance Authority, and the Mandatory Provident Fund Schemes Authority.

40 'Cross-Agency Steering Group releases assessment of carbon market opportunities for Hong Kong and next steps' (HKMA, 30 March 2022) (www.hkma.gov.hk/eng/news-and-media/press-releases/2022/03/0220330-3 (PDF)).

**Appendix 1**

# About The Authors


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Wynne Mok joined Slaughter and May in September 2018 and is a partner in the Hong Kong office's Asia-wide dispute resolution practice. Ms Mok focuses on regulatory investigations and inquiries, commercial litigation and securities investigations. She is an appointed solicitor advocate in Hong Kong and has been granted higher rights of audience in civil proceedings heard before Hong Kong's High Court and Court of Final Appeal.

Prior to joining Slaughter and May, Ms Mok was a director of enforcement of Hong Kong's Securities and Futures Commission, where her principal responsibilities included managing litigation involving the Commission's Enforcement Division, giving advice on operational issues encountered by the Enforcement Division and participating in the management of the Division.

Prior to her employment with the Securities and Futures Commission, Ms Mok was a dispute resolution partner at a global law firm where she handled cases in a broad range of areas with a particular focus on commercial litigation, securities investigations, business ethics and anti-corruption, contentious trust and probate, and employment disputes. Her previous practice focused on Chinese corporations and individuals.


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