CLIENT BRIEFING

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STRATEGISE BEFORE YOU STRIKE

RECENT CASES CONCERNING HONG KONG COURT'S POWERS TO WIND UP FOREIGN COMPANIES AND RECOGNISE FOREIGN INSOLVENCIES

The Court of Final Appeal (the **CFA**) has recently clarified whether a Hong Kong court should exercise its winding-up jurisdiction over foreign companies if the petitioner would derive benefit from the invocation of the court's winding-up process but not from the making of a winding-up order[1].

The Court of First Instance has also explained the correct approach to assessing whether foreign liquidation should be recognised and whether assistance should be given to liquidators appointed overseas[2].

This client briefing discusses these recent decisions, which are important especially to creditors who are considering their options vis-à-vis debtor companies which are incorporated overseas but have some connection with Hong Kong. You are encouraged to read this in conjunction with the **Client Briefing** we published in May 2021 on what creditors should know in relation to cross-border insolvency.

Shandong Chenming Paper – the "benefit" requirement

Hong Kong court has a discretionary jurisdiction to wind up foreign companies pursuant to sections 327(1) and (3) of the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (**CWUMPO**). One of the circumstances in which a foreign company may be wound up is if the company is unable to pay its debts. The court's statutory winding-up jurisdiction is subject to self-imposed restraints that the CFA has previously articulated as three core requirements in the case of *Yung Kee*[3]. These three core requirements are:

(1) There must be a sufficient connection with Hong Kong;

(2) There must be a reasonable possibility that the winding-up order would benefit those applying for it (the **benefit requirement**); and

(3) The court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

The case of *Shandong Chenming Paper* concerned the benefit requirement.

Shandong Chenming Paper (the **Appellant**), a company incorporated in the Mainland, was (still is) listed here (and also in Shenzhen). At the material times, it was solvent though it had no assets or business operations in the territory. When the Appellant refused to pay its joint venture partner, Arjowiggins HKK2 Limited (the **Creditor**), damages as ordered in an arbitration and was then served a statutory demand, it applied for a declaration to prevent the Creditor from presenting a winding-up petition against it. Originally, the Appellant claimed that the Creditor would not be able to satisfy the three core requirements. However, it later conceded that the first and third requirements were met, so the remaining issue was whether the benefit requirement was also met.

[1] *Shandong Chenming Paper Holdings Limited v Arjowiggins HKK 2 Limited* [2022] HKCFA 11.

[2] *Provisional Liquidator of Global Brands Group Holding Ltd (In liquidation) v Computershare Hong Kong Trustees Ltd and another* [2022] HKCFI 1789.

[3] *Kam Leung Sui Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501.

The Appellant argued that there was no reasonable prospect that the Creditor would benefit from the making of a winding-up order in Hong Kong because the company's only connection with Hong Kong was its listing here and it had no assets which a liquidator could realise for the benefit of the Creditor. Further, the appointment of a liquidator by a Hong Kong court would not be recognised in the Mainland. As such, a winding-up order made in Hong Kong would be an exercise in futility.

On the other hand, the Creditor contended that the benefit requirement was satisfied by the H share listing on the Stock Exchange of Hong Kong being a valuable and realisable asset, or alternatively, by steps a liquidator might take in the winding up process. More specifically, if a winding up order was made in Hong Kong, the liquidator would have the power to investigate certain restructuring previously conducted by the Appellant which resulted in assets falling into the hands of a subsidiary.

In the first instance, whilst rejecting the arguments advanced by the Creditor, Harris J ruled that the Creditor would nevertheless benefit from a winding up order given that the imminent prospect of such a winding up order and the potential adverse consequences on the Appellant (in particular on its listed status) would create pressure on the Appellant to pay the award. This leverage created by the prospect of a winding-up petition constituted a sufficient benefit for the Creditor for the purpose of the benefit requirement. The judge considered that the core requirements which have been adopted by Hong Kong courts could be moderated in this case as otherwise the Appellant would be able to take the benefit of access to the Hong Kong's financial system without the burden of complying with the laws. Indeed, the judge considered that the Appellant had shown a disregard of the integrity of the Hong Kong legal system by refusing to honour the arbitral award.

The Court of Appeal upheld the first instance decision.

The issue put before the CFA was restricted to the nature of the benefit that will satisfy the core requirements as approved in *Yung Kee*, i.e. whether the leverage created by the commencement and existence of winding up proceedings in Hong Kong is sufficient.

The Appellant's principal argument was that as articulated by the CFA in *Yung Kee*, the benefit must arise from "the making of a winding-up order" and not from any pressure, or leverage, arising before such an order is actually made. The necessary benefit must be tangible benefit. Further, the commercial pressure on a solvent company to pay is an illegitimate form of benefit for the purposes of the benefit requirement.

The CFA refused to read the articulation of the benefit requirement in *Yung Kee* as restricting sufficient benefit only to possible benefits flowing from or consequences materialising only upon the making of a winding up order. The benefit requirement and the other two core requirements are not statutory but self-imposed constraints adopted by the courts in deciding whether to exercise winding-up jurisdiction over a foreign company. The requirements should not be construed as if they were statutory provisions and have to be applied contextually in light of the facts of the case. The courts should adopt a pragmatic approach in assessing whether it would be useful to entertain a winding-up petition.

The CFA accepted that commercial pressure to achieve the repayment of an undisputed debt is an entirely proper purpose of a creditor's winding-up petition. CWUMPO provides for a statutory demand mechanism whereby a company is deemed to be unable to pay its debts if it fails to comply with a statutory demand served on it. The company's failure to comply with a statutory demand will in turn form a proper basis for the creditor to invoke the winding-up jurisdiction, even if the company is in fact solvent. The court therefore did not see anything improper in the service of a statutory demand and the presentation of a winding up petition in order to put pressure on a debtor to pay an undisputed debt. However, this should be contrasted with the threat of issuing a winding up petition where the debt is genuinely in dispute, as that would be regarded as an abuse of process.

Since the use of winding-up process was accepted as a proper means to bring commercial pressure to bear to obtain repayment of an undisputed debt, the CFA did not see any justification for excluding the commercial pressure as a relevant benefit for the purposes of the benefit requirement.

The Appellant also sought to argue that the three requirements are jurisdictional restraints and must be interpreted in light of comity, which required the CFA to pay sufficient deference to the jurisdiction of the company's state of incorporation. It would be in breach of comity if a Hong Kong court exercised insolvency jurisdiction over the Appellant in absence of sufficient connection with Hong Kong.

The CFA determined that comity was relevant to the assessment of the first requirement (i.e. a sufficient connection with Hong Kong) but not the second requirement in the present case. Since the Appellant had already conceded on the first requirement, the court did not consider it necessary to address the comity argument at any greater length.

What the Appellant was in effect trying to contend, in the views of the CFA, was that winding up a foreign company is only justified when the jurisdiction of incorporation cannot fulfil its function so that Hong Kong is *the* most appropriate jurisdiction to fill the lacuna. The CFA however considered that there is no room for adding a further requirement.

With the clarification by the CFA on the nature of the benefit that will satisfy the benefit requirement, it seems that it will become easier to invoke Hong Kong court's jurisdiction to wind up foreign companies even if a winding up order may not be fruitful in bringing about tangible benefit to the petitioner in the form of realisable assets. The key is to show that the winding up process would serve some useful purposes.

Global Brands – modified approach to recognition and assistance of foreign insolvency proceedings in Hong Kong

Global Brands was incorporated in Bermuda and it operated in North America and Europe. It has been listed in Hong Kong since 2014.[4] When debt restructuring attempts failed, the company applied for a winding-up order in Bermuda in November 2021. Given that the company had assets in Hong Kong (namely, the proceeds of the sale of shares held by Computershare and a balance held by HSBC in the company's bank account), the provisional liquidator appointed in Bermuda sought recognition and assistance so as to take possession of the company's assets and books in Hong Kong.

The court ordered that the foreign liquidation be recognised and that the liquidator had the power to secure and obtain the company's assets and documents here. As explained in the decision, this accorded with the established principle of private international law which supports recognition of foreign office-holders' appointment in the country of incorporation as the company's lawful agents in accordance with agency theory and ordinary conflict of laws principles for corporations.

Harris J discussed at length the basis on which in future Hong Kong should grant recognition and assistance to foreign insolvency practitioners. It is particularly relevant to the insolvencies of companies which have little connection with their places of incorporation but have businesses and/or assets in Hong Kong.

Prior to this case, in absence of comprehensive statutory codes to regulate recognition and assistance of foreign insolvencies, Hong Kong courts generally followed the orthodox common law position when considering applications for recognition and assistance, namely that foreign insolvency proceedings should be recognised and assisted if they are collective insolvency proceedings and commenced in the company's country of incorporation.

Harris J considered it justified to modify the existing common law approach in view of the circumstances in which transnational insolvencies currently arise in Hong Kong. As noted by the judge, in recent years, recognition and assistance has been increasingly used to address issues arising in insolvency cases that largely result from the extensive use of holding companies incorporated in offshore jurisdictions whilst the business groups affected consist of operating and asset owning companies in Hong Kong (and the Mainland). Such a group structure is rather artificial and may lead to the tricky question as to where the home or principal insolvency jurisdiction is given that the places of incorporation are no more than a letterbox.

To better reflect the current commercial practice in Hong Kong, the court considered that a debtor's place of incorporation should not be the exclusive criterion for recognition but instead, in future, the court should first determine whether the foreign liquidation takes place in the jurisdiction of the company's centre of main interest (**COMI**) at the time of the application for recognition and assistance. If it is not, recognition and assistance should be declined unless the application falls within one of the following two categories:

(1) the application is limited to recognition of a liquidator's authority as the lawful agent of the debtor and seeking "managerial assistance" which is incidental to such authority; or

[4] Global Brands will be delisted from 25 July 2022.

(2) the assistance sought is "limited and carefully prescribed" and required by a liquidator appointed in the place of incorporation as a matter of practicality.

As to the elements of COMI (which is not defined in statutes or the UNCITRAL Model Law on Cross-Border Insolvency), the judge considered that matters similar to the following are relevant to the Hong Kong court's determination of whether or not the COMI of a company is in the jurisdiction of the foreign insolvency proceedings:

- the location of directors and board meetings;
- the location of the companies' principal officers;
- location of operations;
- location of assets;
- location of bank accounts;
- location of books and records; and
- the location in which any restructuring activities take place.

As made clear by the judge, the concept of COMI will be relevant in cases in which a foreign liquidator requires more than an order that confirms the liquidator's status and rights arising out of his appointment in the place of incorporation. As such, the judge did not decide whether Hong Kong was indeed the COMI of Global Brands before granting the orders as sought by the foreign liquidator. Therefore, if it is anticipated that asset tracing is required here (hence the need to exercise a liquidator's power to investigate the company's affairs), it might be safer to invoke the winding up jurisdiction of a Hong Kong court rather than getting a winding up order in the place of jurisdiction and then seeking recognition and assistance in Hong Kong. This question, however, will become more complicated if the liquidation process involves other countries which only recognise the appointment of liquidators in the place of incorporation.

It would be interesting to see how the concept of COMI will be applied by Hong Kong courts in future applications for recognition and assistance of foreign insolvencies. There may be difficulties in identifying the COMI of international conglomerates with operations in multiple jurisdictions, and the issue is often fact-sensitive. The COMI of a company may also change over time. It should be noted that the relevant point in time for determining a company's COMI is when an application for recognition is made, not when foreign liquidation proceedings are commenced or when the hearing of the application for recognition occurs. If there is a risk that a company's COMI may change in the life of insolvency proceedings, creditors should apply for recognition of such proceedings before the company's COMI deviates from the place of insolvency proceedings.

Cross-border insolvencies between Hong Kong and the Mainland could be less complicated given the Cooperation Mechanism entered into between the two jurisdictions in May 2021[5]. Mainland courts may grant recognition of and assistance to Hong Kong-appointed liquidators if the company's COMI is in Hong Kong. COMI is usually the place of incorporation of the company, but other factors, such as the place of the company's head office and the principal places of business and assets, will also be taken into account[6].

Takeaways

If you are a creditor and are considering options vis-à-vis your debtors, it is important to bear in mind the following:

- If there is genuinely no dispute over the debt you are owed, it is entirely proper for you to issue a statutory demand and also commence winding up proceedings (if the debtor does not comply with the statutory demand

[5] Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region.

[6] Article 4 of The Supreme People's Court's Opinion on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Insolvency Proceedings in the Hong Kong Special Administrative Region.

notwithstanding the expiry of 21 days from the date of service). No abuse of process is involved. You do not need to demonstrate that the debtor is in fact insolvent.

- If the debtor is a foreign company, you should assess which jurisdiction should have the primary jurisdiction over its liquidation.

- The place of incorporation of the debtor does not necessarily have the primary jurisdiction in the eyes of a Hong Kong court. If the debtor has significant assets in Hong Kong, you may consider commencing insolvency proceedings here if the legal advice sought suggests that Hong Kong is the COMI of the company, albeit it is incorporated elsewhere.

- There would be additional advantage of commencing winding up proceedings in Hong Kong if there are assets in the Mainland as you may be able to benefit from the Cooperation Mechanism. Having said that, currently the Cooperation Mechanism is only applicable to Shanghai, Shenzhen and Xiamen.

- If the debtor has assets in other parts of the world, you should also consider whether the insolvency commenced in Hong Kong which is not the place of incorporation would be recognised by the other jurisdictions.

- Hong Kong courts will continue to recognise and assist in foreign insolvencies based on the established principles of private international law. However, they may not be prepared to go beyond providing managerial assistance incidental to the status and authority of the foreign liquidators as the lawful agents of the debtor unless the primary insolvency jurisdiction is exercised by the courts of the COMI of the debtor.

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