

**For discussion on  
22 June 2020**

**Legislative Council Panel on  
Administration of Justice and Legal Services**

**Proposed Framework for Co-operation with the Mainland in  
Corporate Insolvency Matters**

**PURPOSE**

This paper seeks to consult Members on a suggested framework for co-operation between the Hong Kong Special Administrative Region (“**Hong Kong**”) and the Mainland on recognition of and assistance in corporate insolvency matters.<sup>1</sup>

**BACKGROUND**

***A. Legal framework in Hong Kong for cross-border insolvency***

*Insolvency proceedings under Hong Kong law*

2. A winding up under Hong Kong law purports to have worldwide effect. All assets of the company, wherever situated, are subject to Hong Kong insolvency law. Creditors worldwide have the same right to assert their provable claims under Hong Kong law.

3. In cases where debt restructuring is feasible, the practice in Hong Kong is for the provisional liquidator appointed to the company to propose and seek sanction of a scheme of arrangement for compromising the company’s debt. If

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<sup>1</sup> Personal bankruptcy would not, for the time being, be included in the suggested framework.

a scheme of arrangement covers debt which is not governed by Hong Kong law, it would be prudent to seek recognition of the scheme of arrangement in the jurisdiction of such debt's governing law, unless the relevant creditor agrees to act in accordance with the terms of the scheme of arrangement.

4. In reality, whether another jurisdiction would recognise (1) the purportedly worldwide effect of a Hong Kong winding up; or (2) a scheme of arrangement in Hong Kong covering debt governed by that jurisdiction's law would depend on the law of that jurisdiction and whether there exists any co-operation mechanism between Hong Kong and that jurisdiction.

#### *Insolvency proceedings commenced outside Hong Kong*

5. As regards a company subject to insolvency proceedings in another jurisdiction, there is no statutory provision in Hong Kong providing for the **recognition** of the appointment of that company's insolvency office-holder (who may be known as, for example, a trustee in bankruptcy, a liquidator, a provisional liquidator or an administrator) or **assistance** to them. Be that as it may, the Hong Kong courts have developed a set of **common law principles** in this area.

#### *Common law mechanism on cross-border insolvency*

6. A body of case law in recent years has established that the Hong Kong court can **recognise** collective insolvency proceedings (including voluntary liquidations) commenced in a company's place of incorporation outside Hong Kong. In the case of an insolvency office-holder appointed in such jurisdiction with a similar insolvency regime to Hong Kong, the court can further **grant assistance** in the form of an order similar to one available to a Hong Kong provisional liquidator or liquidator.

7. The rationale underlying the court's power to grant recognition and assistance is **modified universalism**, which requires that Hong Kong courts should, so far as is consistent with justice and Hong Kong's public policy,

co-operate with the courts of the place of the principal liquidation to ensure that all the company's assets are distributed to its creditors under a single system of distribution.

8. Since the court's power to grant assistance exists for the purpose of giving effect in Hong Kong to a winding-up order made by a court outside Hong Kong with purported worldwide effect, the court's power would only be available to the extent **necessary** for the performance of an insolvency office-holder's functions. It would **not** be available to enable the office-holder to do something that he or she could not do under the law by which he or she was appointed. Moreover, an order granting assistance must be consistent with the substantive law and public policy of Hong Kong.

9. A provisional liquidator may be appointed in another jurisdiction to represent the creditors' collective interests for the purpose of exploring a **restructuring of debts**. In this situation, the company remains under the day to day control of the directors, but is protected against actions by individual creditors. The Hong Kong court can grant powers for exploring and progressing a restructuring by way of giving assistance to a provisional liquidator appointed in such other jurisdiction even though a similar appointment of a provisional liquidator in Hong Kong may not succeed.

10. The principles governing common law recognition and assistance do **not** require reciprocity between the relevant jurisdictions to be demonstrated.

11. Procedurally, the Court of First Instance ("**CFI**") of the High Court of Hong Kong has developed a **standard practice** on applications for recognition and assistance briefly outlined as follows:

- (1) The insolvency office-holder must first obtain, from the court which appointed him or her, a **letter of request** addressed to the Hong Kong court. The letter of request would typically set out the terms of the order to be sought in Hong Kong. The application for the letter of request is effectively an occasion for the appointing court from outside

Hong Kong to be satisfied, from the perspective of the law of the appointing court and the facts of the case, that recognition and assistance should be sought and the terms of the proposed order are appropriate.

- (2) Having obtained a letter of request, the insolvency office-holder can then apply to the CFI by originating summons with affidavit / affirmation evidence, on an “*ex parte* on paper” basis, for a **standard-form order**<sup>2</sup>.
- (3) In sum, the standard-form order would:
  - (a) empower the insolvency office-holder to **take possession and control** of the company’s property in Hong Kong, investigate its affairs in Hong Kong and bring proceedings in Hong Kong to facilitate these processes; and
  - (b) provide for a **stay of the commencement or continuation of proceedings** against the company or its assets in Hong Kong save with the leave of the Hong Kong court. The purpose of the stay is largely to provide a mechanism enabling the court to regulate creditor actions in Hong Kong with a view to promoting an orderly liquidation or restructuring as in the case of a domestic liquidation under section 186 of the **Companies (Winding Up and Miscellaneous Provisions) Ordinance** (Cap. 32) (“**CWUMPO**”).
- (4) If in addition to the standard-form order, the insolvency office-holder applies for substantive orders affecting a specific party (for example, orders for production of documents and oral examination), that party should be identified as a respondent and served with the application in accordance with general litigation principles.

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<sup>2</sup> The terms of the standard-form order are set out in a number of cases such as *Re Pacific Andes Enterprises (BVI) Ltd* [2017] HKCFI 663.

12. To date, apart from insolvency proceedings commenced in common law jurisdictions (including Bermuda, the Cayman Islands and the British Virgin Islands), there have also been recent cases in which insolvency office-holders appointed in the civil law jurisdictions of Japan<sup>3</sup> and the Mainland have obtained the Hong Kong court's orders of recognition and assistance in the standard terms as discussed in paragraph 11 above. The court granted those applications after considering the evidence adduced on the legal regimes applicable to the respective insolvency proceedings.

*Recognition of and assistance to Mainland insolvency proceedings*

13. So far as insolvency proceedings in the Mainland are concerned, the first relevant case is *Re CEFC Shanghai International Group Ltd (Mainland liquidation)*<sup>4</sup>. The salient features of the case of *CEFC* are as follows:

- (1) The debtor company was incorporated in the Mainland and put into insolvent liquidation by the No. 3 Intermediate People's Court of the Shanghai Municipality ("**Shanghai Court**").
- (2) Seeking to enforce a default judgment against the company, a third party obtained a garnishee order *nisi* in respect of the company's claim against its Hong Kong subsidiary. The company's administrators applied to the CFI for recognition and assistance so as to prevent the third party from obtaining a garnishee order absolute.
- (3) Having referred to the Shanghai Court's letter of request as well as the relevant articles of the **Enterprise Bankruptcy Law of the People's Republic of China** (中華人民共和國企業破產法) ("**EBL**"), the CFI held that the debtor's liquidation in the Mainland was a set of collective insolvency proceedings. It also concluded that the powers sought by the administrators were consistent with both the Mainland insolvency law and the standard-form order discussed in paragraph 11 above. In

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<sup>3</sup> See the case of *Re Takamatsu* [2019] 5 HKC 505.

<sup>4</sup> [2020] 1 HKLRD 676

January 2020, the application was granted accordingly.

(4) Separately, the court remarked as follows:

*“The extent to which greater assistance should be provided to Mainland administrators in the future will have to be decided on a case by case basis and the development of recognition is likely to be influenced by the extent to which the court is satisfied that the Mainland, like Hong Kong, promotes a unitary approach to transnational insolvencies.”*

14. Another relevant case is *Re Shenzhen Everich Supply Chain Co, Ltd (in liquidation in the Mainland)*<sup>5</sup> which involves a company incorporated in the Mainland and ordered by the Intermediate People’s Court of the Shenzhen Municipality to be wound up on the ground of insolvency. The company’s administrator applied to the CFI for recognition and assistance primarily for the purpose of gaining control of the company’s subsidiaries in Hong Kong which held very significant external trade receivables. The CFI granted the application in June 2020 following the principles established in the *CEFC* case.

***B. Lack of a mechanism under Mainland law for recognition of and assistance to Hong Kong insolvency proceedings***

15. The EBL, which came into force in the Mainland on 1 June 2007, is the main piece of legislation that governs the Mainland’s insolvency regime. Under **Article 5 of the EBL**, an application may be made to a Mainland court for recognition and enforcement of a ruling made by a foreign court against the foreign company’s assets in the Mainland. The Mainland court may recognise and enforce it according to the relevant international treaties that the People’s Republic of China (“**PRC**”) has concluded or acceded to or on the basis of the principle of reciprocity. If the court finds that the said judgment or ruling does not violate the basic principles of the laws of the PRC, does not jeopardise the

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<sup>5</sup> [2020] HKCFI 965

sovereignty and security of the State or public interests and does not undermine the rights and interests of the creditors within the territory of the PRC, the court may recognise and enforce such foreign court's ruling.

16. Article 5 of the EBL does not appear to apply to the recognition of a winding up order given by a Hong Kong court. In September 2011, the SPC indicated in an official reply in a case<sup>6</sup> involving an application to a Mainland court for recognition of a winding up order made by the CFI that there was **no** legal basis for the Mainland courts to recognise the relevant winding up order. Specifically, the SPC stated that the “**2006 Choice of Court Arrangement**”<sup>7</sup> did **not** apply to the recognition of a winding up order and further, a winding up order did not constitute a foreign judgment for the purpose of Article 5 of the EBL and the then applicable Article 265 of the *Civil Procedure Law of the PRC* (中華人民共和國民事訴訟法) (2007)<sup>8</sup>.

### ***C. The need for a co-operation mechanism between Hong Kong and the Mainland on corporate insolvency matters***

17. A modernised, effective and efficient insolvency regime is favourable for doing business and investment. When businesses show early signs of unsustainability, the restructuring of debts would facilitate a company to regain its momentum; whereas when businesses are no longer viable, they should be orderly and efficiently liquidated thereby gaining an expeditious fresh start for another business venture.

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<sup>6</sup> 《關於北泰汽車工業控股有限公司申請認可香港特別行政區法院命令案的請示的覆函》(2011)民四他字第 19 號

<sup>7</sup> The Chinese title of the “2006 Choice of Court Arrangement” is 《關於內地與香港特別行政區法院相互認可和執行當事人協議管轄的民商事案件判決的安排》 and its English translation is “*Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned*”.

<sup>8</sup> Under Article 265 of the then applicable *Civil Procedure Law of the PRC* (2007), a party may directly apply to the intermediate people's court of the PRC that has jurisdiction over the case to seek recognition and enforcement of a legally effective judgment or ruling made by a foreign court, or the foreign court may, according to the provisions of the international treaties concluded or acceded to by the PRC or on the basis of the principle of reciprocity, request a people's court for recognition and enforcement.

18. Hong Kong has always been one of the Mainland's largest source of foreign direct investment<sup>9</sup>. Likewise, Hong Kong has also been one of the top destinations for direct investment from the Mainland<sup>10</sup>.

19. In light of the increasingly close economic ties between Hong Kong and the Mainland, the current lack of a co-operation mechanism for recognition of and assistance in corporate insolvency matters is uncondusive to the **promotion of an orderly and efficient insolvency regime** and the **facilitation of the rescue of financially troubled businesses**.

20. The need for such a co-operation mechanism has been highlighted in the consultation exercise relating to the “**2019 REJ Arrangement**”<sup>11</sup> which was signed between Hong Kong and the Mainland in January 2019 but does **not** cover certain specific matters including insolvency and restructuring:

- (1) At the meeting held in November 2017, Members as well as the Hong Kong Bar Association (“**Bar Association**”) pointed out the need for a bilateral mechanism with the Mainland for recognition of and assistance in insolvency and restructuring matters.
- (2) At the meeting held in November 2018, Members and the Bar Association reiterated the need for a legal mechanism to address issues relating to cross-border insolvency and restructuring between Hong Kong and the Mainland.

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<sup>9</sup> For example, in 2018, Hong Kong was the largest source of foreign direct investment in the Mainland, accounting for 65.0% (US\$89.9 billion) of the Mainland's total Foreign Direct Investment stock of that year (US\$138.3 billion). See the Statistical Bulletin of Foreign Direct Investment in China 2019 published by the Ministry of Commerce of the PRC (at page 6), available at <http://images.mofcom.gov.cn/wzs/201912/20191226103003602.pdf> (last access: 10 June 2020).

<sup>10</sup> For example, in 2018, Mainland was the second largest source of foreign direct investment in Hong Kong, accounting for 26.8% (HK\$4,121.6 billion) out of Hong Kong's total FDI stock of that year (HK\$15,380.6 billion). See the External Direct Investment Statistics of Hong Kong 2018, Census and Statistics Department of the Hong Kong SAR Government (at page 16), available at <https://www.statistics.gov.hk/pub/B10400032018AN18B0100.pdf> (last access: 10 June 2020).

<sup>11</sup> The Chinese title of the “2019 REJ Arrangement” is 《關於內地與香港特別行政區法院相互認可和執行民商事案件判決的安排》 and its English translation is “*Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region*”. This Arrangement was signed in January 2019 and would take effect after both sides have completed the procedures for implementation. In the case for Hong Kong, the 2019 REJ Arrangement would need to be implemented by local legislation.

- (3) Separately, stakeholders from the legal, accountancy and business sectors commented that there was an imminent need for a bilateral arrangement with the Mainland on matters relating to insolvency and restructuring, given the current practical problems arising from a legal lacuna for mutual recognition of insolvency proceedings and assistance to the exercise of powers by insolvency office-holders.

21. The Hong Kong courts have also indicated in various cases that it would be highly desirable to introduce a formal mechanism for recognition of and assistance in insolvency matters between Hong Kong and the Mainland. For example, the CFI in *Re CW Advanced Technologies Ltd* has referred to “*the urgent need to enact a statutory cross-border insolvency regime*”<sup>12</sup>. Similar remarks were expressed in other cases including, for example, *Re Da Yu Financial Holdings Limited (in liquidation)*<sup>13</sup>.

22. It is hoped that with a framework in place for co-operation between Hong Kong and the Mainland, the insolvency office-holders could utilise the framework as an **additional tool** for the **better protection of the assets of the debtor company** as well as the **interests of the creditors**. The existence of a co-operation framework would **minimise the need for parallel proceedings**, enhance the **recovery rate** and where appropriate, **facilitate the successful restructuring or rescue** of the debtor company. A co-operation framework in corporate insolvency matters would be advantageous for investment and trade in both places.

23. Further, since the Mainland has to date not established any specific co-operation mechanism on insolvency matters with any other jurisdiction, such a new framework between Hong Kong and Mainland would enhance Hong Kong’s competitiveness as a regional insolvency and debt restructuring hub. Professional co-operation between the insolvency office-holders and other stakeholders in Hong Kong and the Mainland would also create new

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<sup>12</sup> [2018] 3 HKLRD 552, at 563.

<sup>13</sup> [2019] HKCFI 2531, at paras. 46 to 53.

opportunities and synergy for cross-fertilisation.

## **KEY FEATURES OF A SUGGESTED FRAMEWORK FOR CO-OPERATION**

24. There has been on-going discussion between the DoJ and SPC with a view to reaching consensus on a framework for co-operation in corporate insolvency matters. Members' comments on the following possibilities as suggested are invited. They would be taken into account when we take forward this initiative.

### *D. The suggested framework for recognition of Hong Kong insolvency proceedings in the Mainland*

#### *Overview*

25. It is suggested that “insolvency proceedings” commenced in Hong Kong may be recognised by the Mainland court either as **main** or **non-main** proceedings.

- (1) Where a debtor company's “**Centre of Main Interests**” (“**COMI**”) is in Hong Kong, insolvency proceedings commenced in Hong Kong may be recognised by a Mainland court as **main** proceedings upon which a variety of assistance may, in principle, be granted by the Mainland court to “insolvency office-holders” appointed in such proceedings.
- (2) Where a debtor company's COMI is **not** in Hong Kong, insolvency proceedings commenced in Hong Kong may be regarded by the Mainland court as **non-main** proceedings, in which case the relevant “insolvency office-holders” may only be granted such power as the court decides in its discretion.

*“Insolvency proceedings”*

26. It is suggested that “insolvency proceedings” would refer to:

- (1) **compulsory winding up** commenced pursuant to the **CWUMPO**;
- (2) **creditors’ voluntary winding up** commenced pursuant to the **CWUMPO**; and
- (3) **“schemes of arrangement”** for restructuring debt, sanctioned by the Hong Kong court under **section 673 of the Companies Ordinance** (Cap. 622).

*“Insolvency office-holders”*

27. It is suggested that “insolvency office-holders” would refer to **liquidators** and **provisional liquidators**.

*Determination of COMI*

28. The definition of COMI is suggested to be formulated along the lines as provided under **Article 16 of the UNCITRAL Model Law on Cross-Border Insolvency (“Model Law”)** interpreted in light of the comments set out in the *Guide to Enactment and Interpretation of the Model Law*<sup>14</sup>. The COMI of a company incorporated in Hong Kong would be **presumed** to be in Hong Kong.

29. The presumption may be **rebutted** if, having **holistically** considered a **non-exhaustive** list of factors, the Mainland court is satisfied that the place of central administration of the debtor is **not** in Hong Kong. The list of factors would include:

- (1) the location of the debtor’s books and records;

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<sup>14</sup> Paragraphs 145 to 147 of the *Guide of Enactment and Interpretation of the Model Law*.

- (2) the location where the debtor's financing was organised or authorised, or from where the cash management system was run;
- (3) the location of the debtor's principal assets or operations;
- (4) the location of the debtor's employees;
- (5) the location of the debtor's primary bank; and
- (6) the location in which commercial policy was determined.

*Legal effect of recognition by the Mainland court*

30. Upon recognition of the insolvency proceedings commenced in Hong Kong as well as the appointment and status of the insolvency office-holders, the Mainland court may in principle grant the following assistance<sup>15</sup>:

- (1) order that **no action or proceedings shall be proceeded with or commenced** against the debtor or its assets or affairs, or their property in the Mainland, except with leave of the Mainland court and subject to such conditions as that court may impose; and
- (2) grant the insolvency officer-holders with the following **powers**:
  - (a) to locate, protect, secure and take into their possession and control the books, papers and records of the debtor including accounts and also seals and chops;
  - (b) to take possession and control of all the debtor's assets and property in the Mainland;
  - (c) to represent the debtor in legal proceedings in the Mainland and bring legal proceedings on behalf of the debtor, including any applications to the Mainland court for necessary orders to facilitate their investigations into the assets and affairs of the debtor and/or the protection and recovery of assets;

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<sup>15</sup> In case of a scheme of arrangement, it is suggested that recognition by the Mainland court should have the effect of recognising its validity in compromising and discharging debts governed by Mainland law.

- (d) to retain and employ lawyers and/or other agents or professional persons for the purpose of advising or assisting in the execution of the above powers and duties; and
- (e) such further or other assistance as the Mainland court may consider appropriate.

31. The insolvency office-holders, upon recognition by the Mainland court shall exercise the powers granted by the Mainland court according to Mainland law and in this connection, the sale and repatriation of assets of the debtor out of the Mainland for distribution would be subject to approval of the Mainland court.

#### *Refusal Grounds*

32. It is suggested that the Mainland court may **refuse** to recognise the relevant insolvency proceedings and/or grant assistance to the insolvency office-holders on the following grounds:

- (1) If the Mainland court is satisfied that the debtor's COMI is not in Hong Kong (subject to the discussion in the paragraph 33 below);
- (2) If recognition or grant of assistance would manifestly violate the social and public interests of the Mainland;
- (3) If recognition or grant of assistance would seriously prejudice the lawful interests of Mainland creditors.

#### *Assistance for non-main proceedings*

33. It is suggested that **if** the Mainland court is satisfied that the debtor's COMI is **not** in Hong Kong, it may, at its **discretion**, grant such assistance as necessary to protect the assets of the debtor in the Mainland or the interests of the creditors. It is further contemplated that suitable reference would be made

to **Article 21 of the Model Law**<sup>16</sup> and paragraph 30 above.

***E. The suggested framework for recognition of Mainland insolvency proceedings in Hong Kong***

34. It is suggested that Mainland insolvency proceedings should continue to be recognised in Hong Kong under existing common law mechanism as outlined in paragraphs 6 to 14 above. This suggestion reflects the existing legal framework in Hong Kong and taking it forward would not require enabling legislation. Without statutory underpinning, however, the existing framework offers less certainty and stability, given that the relevant common law principles might evolve over time.

***F. Procedural issues***

35. It is suggested that an application to the requested court for recognition and assistance should be supported by a **letter of request** issued by the requesting court. In this regard, reference may be made to the existing practice as outlined in paragraph 11 above.

36. It is suggested that, similar to the case of the 2019 REJ Arrangement, an application to the Mainland for recognition and assistance may be filed with an Intermediate People's Court of the place where the property of the debtor company is located or where the debtor's representative office is located.

37. In the case of a request to Hong Kong, it is suggested that reference may be made to the existing practice that the insolvency office-holder in

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<sup>16</sup> With reference to Article 21(1) of the Model Law, the following assistance may be granted at the *discretion* of the requested court to assist a set of proceedings regarded as "non-main proceedings" where necessary to protect the assets of the debtor or the interests of the creditors: (a) staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities; (b) staying the execution against the debtor's assets; (c) suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor; (d) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities; (e) entrusting the administration or realisation of all or part of the debtor's assets located in the requested place to the foreign representative or another person designated by the court.

Mainland would apply to the CFI on the strength of, among others, a letter of request issued by the relevant Mainland court seized of the insolvency proceedings.

## **SUMMARY OF ISSUES**

38. In sum, we would like to invite Members' views and comments on the following issues:

- (1) the need for a co-operation mechanism between Hong Kong and the Mainland on matters of corporate insolvency (including restructuring) (as discussed in paragraphs 17 to 23 above);
- (2) the key features of the suggested framework for recognition of Hong Kong insolvency proceedings in the Mainland (as set out in paragraphs 25 to 33 above);
- (3) the suggestion that the common law mechanism in Hong Kong continue to be employed for the purpose of recognition of and assistance to Mainland insolvency proceedings in Hong Kong (as set out in paragraphs 34 above); and
- (4) the procedural matters as discussed in paragraphs 35 to 37 above.

