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EDITORIAL

Cross-Border Insolvency in Hong Kong: Will the New Cooperation and Coordination Framework with Mainland China Provide the Impetus for Broader Reform?

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Introduction

On 14 May 2021, the Government of the Hong Kong Special Administrative Region ('HKSAR') and the Supreme People's Court ('SPC') of the People's Republic of China signed a joint record of meeting on mutual recognition of and assistance to bankruptcy and insolvency proceedings between the courts of the Mainland and of the HKSAR ('Record of Meeting').

According to the Record of Meeting:

- the SPC will designate 'pilot areas' in which Intermediate People's Courts ('IPCs') in Mainland China may initiate cooperation with HKSAR courts in relation to mutual recognition and assistance in bankruptcy and insolvency matters;
- a liquidator or provisional liquidator in HKSAR insolvency proceedings may then apply to the relevant IPC in a pilot area in the Mainland for recognition of the liquidation or provisional liquidation that is being undertaken in accordance with the laws of the HKSAR, as well as recognition of and assistance in the discharge of the duties of the liquidator or provisional liquidator;
- an administrator in bankruptcy proceedings in Mainland China may apply to the High Court of the HKSAR for recognition of *either* bankruptcy liquidation, reorganisation or compromise proceedings under the Enterprise Law of the PRC ('Enterprise Law'), as well as recognition of and assistance in the discharge of the duties of the relevant administrator;
- the application procedure will take place in accordance with the process of the relevant court to which an application is made; and
- the SPC and the Government of the HKSAR will issue a guiding opinion and practical guide on mutual recognition and assistance and will also continue to work together to further improve the agreed framework over time.

This is a significant development. Indeed, apart from this specific bilateral recognition and cooperation framework with Mainland China, the HKSAR does not have in place any similar country-to-country framework with any other nation, nor does it have a broader framework for multilateral cooperation. In the latter regard, the HKSAR remains a notable exception to the 53 jurisdictions that have to date adopted the United Nations Commission on International Trade Law Model Law on Cross Border Insolvency ('Model Law').

Currently, the HKSAR, save for the Record of Meeting, relies on a common law recognition and cooperation process in cross-border insolvency matters.

Essentially, the process, as recently reaffirmed in *Re CEFC Shanghai International Group Limited*,[1] is that the Hong Kong Companies Court ('Court') will recognise a collective foreign insolvency process opened in the company's place of incorporation outside the HKSAR, with the proviso that a foreign administrator will not be able to exercise any substantive powers in the HKSAR unless those powers are both available to the administrator in his or her home jurisdiction and are also consistent with the substantive law and public policy of the HKSAR.

While the Court has shown more flexibility in granting recognition in recent times, this latter aspect of the proviso remains problematic from a policy perspective. That is because, despite ongoing calls for law reform, the HKSAR has still not adopted a formal rescue or restructuring process, whether a debtor in possession model or one under the control of an administrator.

Effectively, this means that a foreign administrator under a rescue or restructuring process, such as the Chapter 11 process in the United States, administration, a company voluntary arrangement or negotiations under the new Part A1 moratorium in the United Kingdom, or comparable administration processes in

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1 [2020] HKCFI 167.

other jurisdictions, will not be able to obtain the benefit of an enforcement moratorium, and cram-down provisions in relation to a substantive formal restructuring plan, that extend to secured creditors, owners and lessors. That is distinct to a moratorium on the enforcement of unsecured creditors' rights, which would currently be granted on the common law approach on the basis that such a moratorium is co-extensive with that which operates during the liquidation process in the HKSAR.

This is a substantial deterrent to cultivating a stronger rescue and restructuring culture in the HKSAR, and this in turn limits the prospect of viable entities being able to trade out of their difficulties and contribute to economic and financial stability and growth, as well as to activities that may be seen to be beneficial from a social and environmental perspective.

However, while the Record of Meeting represents progress for the HKSAR in adopting internationally recognised best practices in relation to both cross-border matters and the facilitation of restructuring processes, it is suggested that the focus for the HKSAR should now be on broader reform directed to the adoption of the Model Law and a local rescue and restructuring process.

Why is the Record of Meeting so important?

The Record of Meeting reflects important progress by the HKSAR in implementing two of the goals identified in the World Bank's revised edition of its Principles for Effective Insolvency and Creditor/Debtor Regimes ('World Bank Principles') launched in April 2021, specifically the need for every nation to have in place:

- clear rules in cross-border insolvency matters, particularly in light of the expansion of cross-border matters in an era of rapid globalisation (notwithstanding COVID-19) – including a clear and speedy process for obtaining recognition of foreign insolvency proceedings and providing relief to facilitate investigations and creditor claims upon the grant of recognition, and effective cooperation between courts and insolvency representatives;[2] and
- laws that support formal reorganisation processes that are timely, efficient and encourage the fair negotiation of a commercial plan for approval by an appropriate majority of creditors.[3]

Necessarily, this progress is limited to the specific bilateral arrangement with Mainland China under the Record of Meeting. The progress in relation to reorganisation is achieved insofar as China itself has substantially improved its own reorganisation processes under the Enterprise Law and three subsequent judicial interpretations issued by the SPC.

Under Chapter 8 of the Enterprise Law, there is a modified reorganisation process, so that if the court accepts a bankruptcy petition in relation to a debtor, but before the debtor is declared bankrupt, either the debtor, its creditors or those that hold more than 10% of the registered capital of the debtor may apply to the court for a reorganisation. This can take place under the control of a court appointed administrator or, if the court allows, the debtor. There is also a stay on the enforcement of rights (including by secured creditors) upon the court's acceptance of a reorganisation petition.

The Record of Meeting therefore contemplates recognition of a Mainland China-based reorganisation where assets and/or substantial creditors are located in the HKSAR. This transcends the existing common law recognition limitation in the HKSAR, under which similar rescue and restructuring processes have been refused in previous cases.[4]

Future priorities

While representing important progress on the existing common law recognition and cooperation framework, it is hoped that the Record of Meeting will now provide the necessary impetus for the HKSAR to now progress broader insolvency reform.

First, the adoption and implementation of the Model Law ought to be prioritised so that the HKSAR has in place consistent standards and a 'common language' with other nations in relation to the circumstances in which foreign insolvency processes will be recognised and the manner in which judicial cooperation will be facilitated. A bilateral, internationally accepted best practice framework of this kind is more effective than ad hoc bilateral arrangements that lack the same degree of certainty and do not allow business confidence to develop in a manner that has the potential to drive stronger foreign investment and future economic growth in the HKSAR.

Secondly, it is critical for the HKSAR to prioritise the development of a *local* framework for rescue and restructuring. The absence of such a framework places the HKSAR as an outlier in the global community. While the current process – in which any rescue attempt must necessarily take place *informally* in reliance on the private negotiation of creditors – may, if successful for a particular debtor, achieve important cost and

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2 World Bank Principles, item C15.
3 World Bank Principles, item C14.
4 See, in the context of a United Kingdom administration, *Joint Administrators of African Minerals Ltd v Madison Pacific Trust Ltd* [2015] HKEC 641.

efficiency improvements, informal workouts cannot be relied on alone in driving better insolvency outcomes in any nation.

Indeed, informal, collaborative negotiations among creditors are often difficult to achieve in practice, and creditor hold outs and the need to negotiate and document specific arrangements with individual creditors on a standalone basis (adding to the cost and complexity of the process) is common. The lack of collectivist incentives is even stronger in the current economic environment, with the individual stressors faced by creditors in multiple industries in response to ongoing demand and supply chain disruptions as COVID-19 continues to impact the global, and regional, economies.

Ideally, in implementing a best practice insolvency regime, any informal workout process should be combined with formal processes that give all corporate stakeholders the confidence that their rights can be effectively managed in the event that informal negotiations are not successful. Further, many informal workouts are themselves designed to operate in tandem with a later formal process, as in the case of pre-pack administrations and restructuring plans developed as a precursor to a scheme of arrangement. This is recognised in INSOL International's Statement of Principles for a Global Approach to Multi-Creditor Workouts, the second edition of which was published in March 2017, as well as in the new World Bank Principles.[5]

Without a formal rescue and restructuring process that incorporates broad-based enforcement moratoria and cram-down provisions capable of binding dissenting secured creditors, owners and lessors to a restructuring plan, the ability for the HKSAR to see effective corporate and business rescue outcomes for a large number of distressed but viable entities will be compromised.

In the end, the absence of a uniform cross-border recognition and cooperation framework and an effective formal local rescue and restructuring process will continue to limit the HKSAR's position globally, not only in terms of having in place effective insolvency processes but more broadly on an economic and financial level given the manner in which flexible, efficient and principled insolvency systems serve as such a critical pillar of a nation's innovation, productivity and growth.

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5 World Bank Principles, item B4.

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