德輔 DES VOEUX CHAMBERS

Recent Case Law from the INSOLVENCY domain

Vol. 2 (2018-)

Insolvency

For restructuring and insolvency practitioners in Hong Kong, 2018 has been a year of fast-paced developments and landmark judgments, thanks in no small part to the hard work of the Companies Court. A series of landmark decisions have clarified or altered the direction of Hong Kong's restructuring and insolvency practice - from the use of provisional liquidation to achieve a restructuring, to the recognition of foreign insolvency proceedings, to innovative schemes of arrangement, and to the interaction between arbitration and liquidation, just to name a few. This booklet summarises and offers a snapshot of these key developments to date.

What the directories say:

One of DVC's Silks is characterised as "one of the best operators at the Bar," "a force of nature" and "the man to go to for company matters." Soures are also quick to emphasise his "ability to explain really complex issues in very plain language and with really clear examples"... He is also noted for his specific command of insolvency issues and was one of the counsel acting for the petitioning shareholder in the widely reported Re China Solar Energy Holdings High Court case.

Another of DVC's Silks is pinpointed as "definitely a go-to counsel" for company law and insolvency issues, an area in which he is both "very much an academic guru" and a "fantastic, very quick operator with a lot of commercial sense." "very good strategist and often thinks ahead of the other side."

Chambers & Partners Asia Pacific (2019)

One of DVC's members stands out for being a "fantastic, first-class advocate with a lot of commercial common sense" and "a rare combination of flair, wit, incisiveness and fairness." Credited with possessing "best in class" client management skills, he was recommended for being a "go-to- Silk for company insolvency matters."

Another one of DVC's members was singled out for his "in-depth knowledge of companies litigation and for being a tough opponent [able] to fight vigorously for clients."

Chambers & Partners Asia Pacific (2018)

DVC's Insolvency Practitioners

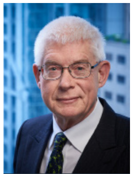
Silks (Senior Counsel)


Patrick Fung SC


John Scott
QC, SC, JP


Charles Sussex
SC


Simon Westbrook
SC


Clifford Smith
SC


Chua Guan-Hock
SC


Winnie Tam
SC, JP


Johnny Mok
SC


Barrie Barlow
SC


Anthony Houghton
SC


William M.F. Wong
SC


Anson Wong
SC


Douglas Lam
SC


José-Antonio
Maurellet SC


John Litton
QC

Over 12 years' call


Liza Jane Cruden


Mairéad Rattigan


Alfred Liang


Lawrence K.F. Ng


Pat Lun Chan


Richard Leung JP


Richard Zimmern


Patrick Chong


Janine Cheung


Johnny Ma


Teresa Wu


Jenkin Suen


Yang-Wahn Hew


Rachel Lam


Calvin Cheuk

Between 5 and 12 years' call


Frances Lok


Gary Lam


Adrian Lai


John Hui


Benny Lo


Alvin Tsang


Alan Kwong


Christopher Chain


Sabrina Ho


Connie Lee


Patrick Siu


David Chen


Alexander Tang


Ebony Ling


Jason Yu


Kerby Lau


Justin Lam

Over 5 years' call


Martin Kok


Jacqueline Law


Michael Lok


Eva Leung


Joseph Wong


Jonathan Chan


Kaiser Leung


Ross Li


Vincent Chiu


Tom Ng


Stephanie Wong


Cherry Xu


Terrence Tai


Tommy Cheung


Lai Chun Ho


Sharon Yuen


Kevin Lau

Tenants called to the Bar in 2018


Michael Ng


Jasmine Cheung


Rosa Lee


Tiffany Chan


Howard Wong


Look-Chan Ho

Case Reports

Case Reports

Case Reports

Hong Kong Provisional Liquidation Meets Singapore Moratorium: *Re CW Advanced Technologies Limited*

20 July 2018

In a ground-breaking decision, the Hong Kong Court in ***Re CW Advanced Technologies Limited*** [2018] HKCFI 1705; [2018] 3 HKLRD 552 explains:

(a) the interface between the Hong Kong provisional liquidation regime and Singapore's new insolvency regime; and

(b) how both regimes could work in tandem to help restructure a Singapore-based pan-Asian business group.

Background

The matter concerns the CW Group which is a precision engineering solutions provider. The CW Group is headquartered and has its principal place of business in Singapore. The material corporate and debt structures are as follows:

The holding company, CW Group Holdings Limited ("CWG"), is incorporated in the Cayman Islands and listed on the Hong Kong Stock Exchange.

There are operating subsidiaries in various jurisdictions, including CW Advanced Technologies Limited ("Company") which is a Hong Kong incorporated company.

The CW Group's financial indebtedness consists primarily in bank and bond debts, governed by Singapore and Hong Kong law.

All of the Company's bank debt is governed by Hong Kong law.

The CW Group's management's intention was apparently that the restructuring would be managed primarily through the Singapore Moratorium and Singapore schemes of arrangement, with recognition and assistance given by other jurisdictions in which the CW Group members were located.

Thus in late June 2018, the Company also applied for provisional liquidation in Hong Kong with a view to implementing the CW Group's restructuring efforts in Singapore.

However, because the Bank of China (Hong Kong) Limited ("BOC") (the CW Group's largest creditor) was apparently not consulted prior to the application for the Singapore

Moratorium, BOC opposed the Company's plan in Hong Kong.

In the meantime, CWG applied for provisional liquidation in the Cayman Islands. Afterwards, the Company withdrew its provisional liquidation application in Hong Kong. BOC then applied for the Company's provisional liquidation in Hong Kong.

The Hong Kong Court's Decision

The Court (Harris J) granted BOC's provisional liquidation application because the Company was clearly insolvent and BOC had produced evidence showing the need for asset preservation and independent investigation into the Company's affairs. Although the provisional liquidators were not given restructuring powers to begin with, they could apply for an extension of their powers when the circumstances would justify it.

Despite the significant cross-border background leading to BOC's provisional liquidation application, the parties took the position that they would not need to address the Court's cross-border concerns, such as the impact and relevance of the Singapore Moratorium. As a result, the Court did not have to determine the cross-border issues.

Nevertheless, the Court provided a helpful list of issues for future applicants to consider when faced with similar cross-border situations, including:

(a) whether the Singapore Moratorium would be eligible for recognition in Hong Kong; and

(b) if the Singapore Moratorium was eligible for recognition, whether the Court could grant assistance by way of appointing provisional liquidators in Hong Kong.

The Court also set out some of the key questions that need to be addressed regarding the recognition of the Singapore Moratorium, such as whether it could constitute a collective insolvency proceeding.

Although the matters had not progressed in the way originally envisaged by the CW Group's management, the Court noted that the CW Group's restructuring could be achieved through schemes of arrangement in Hong Kong, coupled with recognition and assistance in Singapore under the new Singapore insolvency regime.

Finally, Harris J repeated his call for an urgent statutory cross-border insolvency reform in Hong Kong.

Comments

In many respects, this is a landmark decision on the development of cross-border insolvency law in Asia. It is also the first ever decision reflecting on the possibility of assisting the new Singapore insolvency regime and its interaction with the Hong Kong provisional liquidation regime.

From the practitioners' viewpoint, the decision provides a useful roadmap to the conduct of cross-border restructuring in Asia. In particular:

(a) It reaffirms the Hong Kong Court's pragmatic approach to cross-border restructuring.

(b) It provides a checklist of the issues to consider concerning the recognition of Singapore insolvency proceedings under the new Singapore insolvency regime.

(c) It explains how the Hong Kong provisional liquidation regime and the new Singapore regime may complement each other to achieve a group restructuring

José-Antonio Maurellet SC and **Alexander Tang** acted for the Company.

Anson Wong SC and **Patrick Siu** acted for the Bank of China (Hong Kong) Limited.

William Wong SC and **Tommy Cheung** acted as *amicus curiae.*

William Wong SC and **Look-Chan Ho** co-authored this case report.


William M.F. Wong SC


Anson Wong SC


José-Antonio Maurellet SC


Patrick Siu


Alexander Tang


Tommy Cheung


Look-Chan Ho

View the announcement in the Newsletter

Provisional Liquidators' Restructuring Powers Clarified: ***Re China Solar Energy Holdings Ltd (No 2)*** [2018] HKCFI 555; [2018] 2 HKLRD 338

The Court of Appeal decision in ***Re Legend International Resorts*** [2006] 2 HKLRD 192 had caused many to doubt if provisional liquidators appointed in Hong Kong could play a restructuring role at all. Twelve years later, in ***Re China Solar Energy Holdings Ltd (No 2)*** [2018] HKCFI 555, Harris J has clarified that provisional liquidators need to be appointed on such conventional grounds as asset preservation. But where the circumstances warrant it, the provisional liquidators may be given restructuring powers and may pursue the company's restructuring exercise to fruition.

The China Solar facts and decision

China Solar Energy Holdings Limited ("**Company**") was incorporated in Bermuda and listed on the Hong Kong Stock Exchange ("**HKSE**"), but trading in the Company's shares had been suspended since August 2013.

Since January 2015 the Company had been in various stages of the delisting procedure because of the Company's failure to comply with the listing requirements. In August 2015, on the Company's application, provisional liquidators ("**PLs**") were appointed to the Company on the basis that the PLs were needed to: (a) safeguard the Company's assets (including the Company's listing status) which were in jeopardy, and (b) investigate certain suspicious transactions entered into by the Company.

The PLs' terms of appointment included a power to pursue the Company's restructuring. Thus from the outset, the PLs intended to procure a restructuring with a view to the Company resuming the trading of its shares. Together with a potential investor, the PLs had been working on various re-listing proposals to be submitted to HKSE.

In February 2017, however, the petitioner (a shareholder of the Company), who in fact supported the Company's application for provisional liquidation and intended to invest in the Company's restructuring, applied to the court to remove the PLs. The petitioner argued that, because the PLs had finished their asset preservation tasks, the PLs' primary remaining role would be to pursue the Company's restructuring. That, according to the petitioner, would not be permissible under Legend because Legend held that provisional liquidation must be for the purpose of a winding-up, and not for the purpose of avoiding a winding-up. A successful restructuring of the Company would avoid a winding-up.

Harris J dismissed the petitioner's application. His Lordship reasoned and explained the effect of Legend as follows. The court may appoint provisional liquidators only on conventional grounds, such as the need to preserve the company's assets. In other words, provisional liquidators may not be appointed solely for the purpose of restructuring.

Where the circumstances so warrant, however, the provisional liquidators may be given restructuring powers. The provisional liquidators will be permitted to complete the company's restructuring, even if they have completed their other tasks, such as asset preservation. Terminating the provisional liquidators just because their remaining primary task concerns restructuring would be detrimental to the creditors' collective interest. This would not be consistent with the statutory purpose underlying the appointment of provisional liquidators.

Comments

This decision is a much welcome clarification of Legend. For practitioners, the decision stands for the following propositions:

1. The Hong Kong court may appoint provisional liquidators only on conventional grounds, such as asset preservation and investigation.

2. In the right circumstances (such as the existence of strong creditor support), provisional liquidators may be given powers to restructure the company's business and indebtedness.

3. Provisional liquidators with restructuring powers may focus on restructuring even if they have completed their other tasks for which they were appointed.

4. Thus the Hong Kong provisional liquidation regime may sometimes help a foreign company achieve a restructuring, as the facts in China Solar demonstrate.

José-Antonio Maurellet SC, **John Hui** and **Jonathan Chan** acted for the petitioner.

John Scott SC, QC, JP acted for the Company.

Clifford Smith SC and **Alexander Tang** acted for the provisional liquidators.

Patrick Chong acted for an investor.

William M F Wong SC and **Look-Chan Ho** co-authored this Case Report.

This case won the GRR Award for Most Significant Insolvency or Restructuring Related Litigation at the 2nd Annual GRR Ceremony held in London on 26th June 2018.


John Scott
SC, QC, JP


Clifford Smith
SC


José-Antonio
Maurellet SC


John
Hui


Alexander
Tang


Jonathan
Chan


William M.F. Wong
SC


Look-Chan Ho

HK Landmark Judgment: Arbitration Trumps Winding-Up Petition
Re Southwest Pacific Bauxite (HK) Ltd [2018] HKCFI 426; [2018] 2 HKLRD 449

On 2 March 2018, Harris J handed down a landmark judgment holding that, where a creditor presents a winding-up petition based on a disputed debt which is covered by an arbitration agreement between the creditor and the company, the court would generally dismiss the petition.

In so holding, Harris J brought Hong Kong law in line with the position in England, Singapore and the Cayman Islands. The decision offers compelling reasons for developing Hong Kong law in this direction.

The position is to be contrasted to a situation where the petition debt is disputed and there is no arbitration provision. In such a case, the court's general approach is to dismiss the petition only if the debt is subject to a bona fide dispute on substantial grounds.

Comments

The Lasmos case arose out of the petitioner's unsatisfied claim for fees under a management services agreement, which contained an arbitration clause. The petitioner issued a statutory demand and then a winding-up petition against the Company. The Company's position was that the fees had not been agreed.

Because the Company required the dispute to be resolved in accordance with the arbitration clause, the Court dismissed the petition. In any event, the Court also found that the petitioner's claim was disputed on bona fide substantial grounds

Prior to this decision, it was generally assumed that, once a winding-up petition was issued, the existence of an arbitration clause covering the petition debt would be irrelevant to the court's exercise of its winding-up jurisdiction.

The decision to develop Hong Kong law here seems eminently sensible in principle because it gives primacy to the party's agreed dispute resolution method. If a petition debt is subject to an arbitration clause, it is not appropriate for the Companies Court to try the dispute, even for the mere purpose of determining the existence of bona fide substantial dispute. Otherwise, a creditor could essentially repudiate the arbitration agreement by merely presenting a winding-up petition to collect a disputed debt.

Upholding the parties' arbitration agreement, however, does not mean that the Companies Court's insolvency jurisdiction is ousted. The Court emphasised that, where exceptional circumstances exist, the Court could still exercise its insolvency jurisdiction (such as appointing provisional liquidators), despite the presence of an arbitration clause covering the disputed petition debt.

Summary of the Companies Court's practice

After this landmark decision, the Companies Court's practice when dealing with a disputed petition debt may be summarised thus:

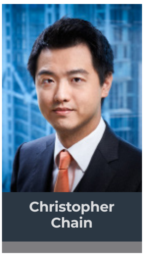
1. If there is no arbitration clause, the court will generally dismiss the winding-up petition only if there is a bona fide dispute on substantial grounds.

2. If there is an arbitration clause and the company wishes to refer the dispute to arbitration, the court would generally dismiss the winding-up petition.

3. The court retains the ultimate discretion to exercise its insolvency jurisdiction in exceptional circumstances, despite the presence of an arbitration clause.

Christopher Chain represented the Company in this case.

Look-Chan Ho authored this Case Report.



Cross-Border Scheme of Arrangement for Secured Noteholders: *Re Mongolian Mining Corporation* [2018] HKCFI 2035

In ***Re Mongolian Mining Corporation*** [**2018] HKCFI 2035**, the court sanctioned a scheme of arrangement which was part of a larger restructuring exercise involving a Cayman scheme of arrangement and scheme recognition in the US under Chapter 15 of the US Bankruptcy Code.

This decision is a useful reminder of a number of scheme practice points, some of which have no previous Hong Kong authority:

- a scheme of arrangement may be used to restructure purely secured debts governed by non-Hong Kong law;

- foreign expert evidence about the scheme's effect abroad may be needed to satisfy the court that the scheme will achieve its practical objectives; and

- where the bonds are issued in the form of a global note, the underlying beneficial holders may participate directly in the scheme as creditors.

The facts and decision

The scheme of arrangement in this case concerned the debt restructuring of Mongolian Mining Corporation ("**Company**"), a Cayman-incorporated and Hong Kong-listed company. It was an investment holding company with operating subsidiaries in Mongolia carrying on the business of producing and exporting high quality coking coal.

Due to financial distress, the Company went into Cayman provisional liquidation in July 2016. The Company's financial indebtedness comprised:

- US$600,000,000 senior secured notes, governed by New York law, listed in Singapore, and secured by charges over shares in the Company's subsidiaries in Hong Kong and Luxembourg ("**Old Notes**");

- a secured loan facility of US$150,000,000; and

- two promissory notes in the aggregate original principal amount of US$52,500,000.

The secured loan facility and promissory notes were restructured bilaterally and consensually. The Old Notes were to be restructured through inter-conditional parallel schemes of arrangement in Hong Kong and the Cayman Islands. The effect of the schemes was that debts owed to the Scheme Creditors would be released and discharged; in return, the Scheme Creditors would obtain new notes and shares in the

Company. The effectiveness of the Hong Kong scheme was conditional on the Cayman scheme being sanctioned by the Cayman court and recognised in the US under Chapter 15 of the Bankruptcy Code.

As the Old Notes were held in a global form or global restricted form through the clearing systems, the Scheme Creditors were defined in the scheme as the beneficial holders of the Old Notes who had a right, upon satisfaction of certain conditions, to be issued with definitive notes in accordance with the terms of the Old Notes.

The court was satisfied that the court had scheme jurisdiction over the Scheme Creditors because, while there was statutory definition of 'creditor' for scheme purposes, the scheme jurisdiction would extend to contingent and secured creditors, consistent with English case-law. Here because the Scheme Creditors were entitled, upon satisfaction of certain conditions, to be issued with definitive notes in accordance with the terms of the Old Notes, they were contingent creditors for the purposes of the scheme jurisdiction. The court was also satisfied that the Scheme Creditors were properly put in a single class.

As the Company was a foreign company, the court had to be satisfied that there was sufficient connection between the scheme and Hong Kong. Sufficient connection was established because of a number of factors, including the Company being registered as an overseas company in Hong Kong and listed in Hong Kong; one key security agreement securing the Old Notes being governed by Hong Kong law; and approximately 30% of the Scheme Creditors being based in Hong Kong.

The Company produced expert evidence that the Cayman parallel scheme would be granted recognition in the US and thus the Hong Kong scheme would achieve its practical purpose.

The court sanctioned the scheme accordingly.

Comments

This decision is a welcome addition to the scheme authorities in Hong Kong. It serves as a useful reminder of how schemes in Hong Kong can be used to restructure foreign companies' foreign law-governed debts, including notes issued in the form of a single global note.

José-Antonio Maurellet SC and **Jason Yu** acted for the Company.

Yang-Wahn Hew acted on behalf of the Company and obtained leave for a court sanctioned scheme of arrangement.

Look-Chan Ho authored this Case Report.

José-Antonio Maurellet SC

Jason Yu

Yang-Wahn Hew

Look-Chan Ho

Novel Single-Member Scheme of Arrangement: ***Re Enice Holding***

In ***Re Enice Holding Co Ltd*** [2018] HKCFI 1736; [2018] 4 HKLRD 736, the Court sanctioned a novel privatisation scheme of arrangement and explains:

(a) the Court's jurisdiction over a scheme of arrangement involving just one member;

(b) the possibility of split voting; and

(c) the management of the Court's timetable especially in the case of an urgent application.

The facts and decision

The scheme of arrangement in this case concerned the privatisation of Enice Holding Company Limited (**"Company"**) which, though incorporated in Hong Kong, was listed on the Australian Securities Exchange (**"ASX"**).

While privatisation schemes are commonplace, this scheme contained some novel features because the Company had only one shareholder which held all the issued shares on trust for the underlying investors.

The reason for the Company having only one shareholder was that, being a Hong Kong incorporated company, its shares could not be directly traded on Australia's financial markets. Thus, in order to facilitate electronic trading on ASX, the Company's shareholding structure had to be altered as follows: All the Company's issued shares were transferred to CHESS Depositary Nominees Pty Ltd (**"CHESS"**). CHESS then issued Chess Depositary Interests (**"CDIs"**) to the holders of CDIs. CDIs were developed by ASX to facilitate the clearing and settlement of transactions in securities through CHESS where the listed entity is incorporated outside of Australia.

The legal effect of these changes to the Company's shareholding structure was as follows:

(a) CHESS became the only shareholder of the Company.

(b) CHESS held all the issued shares on trust for the CDI holders, with one CDI unit representing the beneficial ownership of one share.

(c) CDIs (as opposed to the issued shares) would be listed and traded through the ASX trading platform.

(d) The CDI holders would enjoy all the economic benefits of the issued shares. Although the CDI holders, not being the legal owners, could not vote at the Company's general meeting, they could direct CHESS on how to vote.

The scheme contained the following key steps:

(a) The Company's issued share capital would be reduced by cancelling and extinguishing ordinary shares (**"Scheme Shares"**) beneficially held by the CDI holders who were not connected with Tech World Limited (**"Offeror"**).

(b) In consideration of the cancellation and extinguishment of the Scheme Shares, the Offeror would pay CHESS a cancellation price which CHESS would hold on trust for the CDI holders.

(c) Subject to and immediately upon such reduction of capital taking effect, the Company's share capital would be increased to its former amount by the creation of such number of new shares as was equal to the number of the Scheme Shares cancelled.

(d) The Company would apply the credit arising in its books of account as a result of the capital reduction in paying up the newly created shares, which would be allotted and issued, credited as fully paid, to the Offeror.

On completion of the scheme, the entire issued share capital of the Company would be held by the Offeror and parties associated with it. The Company's listing on ASX would be withdrawn accordingly.

The Court undertook some research, provided guidance to the Company on the scheme structure, and was satisfied that the scheme should be sanctioned. The Court reasoned as follows:

(a) The Court had jurisdiction over a single-member scheme, supported by precedents of such scheme in England and Australia.

(b) Where the single member was a trustee (such as CHESS in the present case), the trustee's vote could be split for the purposes of determining the value of votes for and against the scheme, according to the beneficial owners' wishes.

(c) As the scheme was a "takeover offer" within the meaning of section 674(2) of the Companies Ordinance, the headcount test was inapplicable.

(d) As the scheme would operate to bind CHESS (as the sole shareholder) and the ASX rules would operate to give reflexive effect to the scheme vis-à-vis the CDI holders such that the scheme in practice would become binding on the CDI holders, this would be a proper scheme to sanction.

In explaining the operation of a single-member scheme, the Court also explained how the single member-cum-trustee's vote would be counted for headcount purposes. In brief, depending on the beneficiaries' wishes, the trustee's vote could be counted as (i) one vote for, (ii) one vote against, or (iii) zero, for headcount purposes.

Finally, the Court provided practical timetable guidance for practitioners seeking to launch an urgent scheme of arrangement:

"[T]he Companies Court expects solicitors to proceed as follows when acting for parties introducing schemes or capital reductions. As soon as they are instructed to proceed with a scheme or capital reduction they should approach the Companies Judge's clerk to obtain dates, which it is reasonable to expect the company to meet. Counsel should be instructed who are available on the allocated dates and the Company should work towards those dates. The Companies Court should not be expected to fit in with the convenience of companies and solicitors should make this clear to those instructing them."

Comments

Although this is a solvent privatisation scheme, most of the Court's reasoning and remarks apply equally to a debt restructuring scheme.

The decision stands for the following scheme practice points:

(a) the Court has jurisdiction over a scheme of arrangement involving just one shareholder or creditor;

(b) where the single shareholder or creditor is a trustee, his vote could be split for the purposes of determining the value of votes for and against the scheme, according to the beneficial owners' wishes;

(c) depending on the beneficial owners' wishes, a trustee's vote could be counted as (i) one vote for, (ii) one vote against, or (iii) zero, for headcount purposes; and

(d) if a scheme needs to be sanctioned urgently, advanced planning and timely communication with the Court is crucial.

William Wong SC and **Michael Lok** acted for the Company.

Terrence Tai acted for the Offeror.

Look-Chan Ho authored this Case Report.


William M.F. Wong SC


Michael Lok


Terrence Tai


Look-Chan Ho

Scheme of Arrangement and Bondholders' Votes – Split Voting and Voting as Contingent Creditors

Recent Hong Kong, Singapore and English cases have converged and re-confirmed how bondholders vote in schemes of arrangement where the bonds are issued in global form. The position in summary is as follows:

(a) if the bond trustee votes, a split-vote approach respecting the underlying beneficial bondholders' wishes is to be adopted such that:

(i) for the purposes of the headcount test, the trustee's vote will be counted as one vote for, one vote against, or zero;

(ii) for the purposes of the majority-in-value test, the trustee's vote will reflect the beneficial bondholders' wishes as if they were voting directly themselves;

(b) alternatively, instead of the bond trustee voting, the underlying beneficial bondholders may vote directly as creditors on the basis that they are contingent creditors, provided the beneficial bondholders can acquire direct rights against the company in some (even remote) circumstances.

Scheme voting requirements and bond issuance structure

Under Part 13 of the Companies Ordinance (Cap. 622), the court may sanction a scheme of arrangement between a company and its creditors provided the two pre-conditions set out in section 674(1) are satisfied. First, a majority in number of the class of creditors present and voting must agree to it ("headcount" test), and secondly, 75% in value of the class of creditors present and voting must agree to it ("majority-in-value" test).

The Companies Ordinance does not define "creditor, but case-law has established that "creditor" means anyone who has a monetary claim against the company which, when payable, will constitute a debt. Contingent claims are included for this purpose.

The application of the scheme voting requirements to bonds issued in global form have given rise to some potentially complex issues which have now been resolved by case-law.

When bonds are issued in global form, legal ownership of the bonds rests with the nominee of a common depositary ("bond trustee"). The direct creditor of the bond issuer is thus the bond trustee while he holds his interest on trust for the underlying beneficial bondholders.

This bond issuance structure gave rise to a concern that the underlying bondholders beneficially interested under a trust might not be considered to be creditors for the purposes of the scheme jurisdiction. If so, only the bond trustee could vote in a scheme of arrangement.

However, bond documents typically contain a mechanism whereby the beneficial bondholder can upon request become a direct creditor of the bond issuer. Typically, on the occurrence of an event of default, there is a provision that the global note is to be transferred to the beneficial owners in the form of definitive notes upon the request by the beneficial owners. Because of the existence of this mechanism, the ultimate beneficial bondholders may be regarded as contingent creditors of the bond issuer. The beneficial bondholders may thus vote as creditors in the bond issuer's scheme of arrangement.

If the beneficial bondholders are not called upon to vote, the bond trustee may of course vote as he is the legal creditor of record in any event.

Where the bond trustee votes, case-law has established that his single vote is to be calculated using the split vote analysis. The split vote analysis produces the following consequences.

First, if all the beneficial bondholders accept or reject the scheme proposal, the bond trustee's vote will be treated as one vote for or against the scheme, for headcount purposes.

Second, if the beneficial bondholders do not speak in one voice, then for headcount purposes, the bond trustee's vote will be treated as one vote for and one vote against the scheme, thus cancelling each other out.

Third, for the majority-in-value test, the trustee's vote will simply reflect the value for and against the scheme according to the beneficial bondholders' wishes.

The recent cases confirming the above approach are *Re Enice Holding Company Ltd* [2018] HKCFI 1736; [2018] 4 HKLRD 736, *Re Mongolian Mining Corporation* [2018] HKCFI 2035, *Re Swiber Holdings* [2018] SGHC 211, and *Re Noble Group Ltd* [2018]

HK Court's Jurisdiction to Wind Up Foreign Companies: The Test is Sufficient Connection

China Medical Technologies, Inc.* v. *Samson Tsang Tak Yung [2018] HKCA 111

On 28 February 2018, the Court of Appeal reaffirmed that "sufficient connection" is the overarching criterion for the Hong Kong court's exercise of its jurisdiction to wind up insolvent foreign companies.

Generally speaking, when considering whether to exercise its discretion to wind up a foreign company, the Hong Kong court has to be satisfied that three core requirements exist, namely:

> (1) there must be a sufficient connection with Hong Kong which may, but does not necessarily have to, consist of assets within the jurisdiction;
>
> (2) there must be a reasonable possibility if a winding-up order is made, of benefit to those applying for the winding-up order; and
>
> (3) one or more persons interested in the distribution of the assets of the company must be persons over whom the court can exercise a jurisdiction.

The Court of Appeal held that the ultimate overarching question is whether there is a sufficient connection between the company and Hong Kong that would justify the winding-up of the company in Hong Kong. Thus the three core requirements above may be best understood as aspects of the sufficient connection enquiry. It follows that in some circumstances the third core requirement may be dispensed with.

The facts in ***China Medical*** serve to illustrate this conclusion. China Medical Technologies, Inc., incorporated in the Cayman Islands, was insolvent and wound up in the Cayman Islands. The Cayman liquidators then petitioned for the Company's winding-up in Hong Kong. Their purpose of seeking a Hong Kong winding-up was to use the HK insolvency legislation to obtain information from various people, including the opposing contributory.

The Cayman liquidators could not satisfy the third core requirement because the available evidence suggested that there was only one Hong Kong creditor, with a debt of just over US$4,000. But the Court of Appeal agreed with the first instance judge (Harris J) that the strength of the first two core requirements alone was already sufficient to justify the making of a winding-up order.

Key takeaways

The Court of Appeal decision stands for the following propositions:

1. Before the Hong Kong court will exercise its jurisdiction to wind up a foreign company, the overarching criterion to satisfy is sufficient connection with Hong Kong.

2. The three core requirements developed by case law are to test the sufficiency of connection. Thus in most cases all three requirements need to be satisfied.

3. Because the ultimate issue is sufficiency of connection, in exceptional cases the third core requirement may be dispensed with.

Anson Wong SC acted for the opposing contributory.

Look-Chan Ho authored this Case Report.

Anson Wong SC

Look-Chan Ho

Recognition of Foreign Restructuring Plan: Bermuda Pushing the Common Law Envelope in Seadrill

In ***Re Seadrill Drilling*** [2018] SC (Bda) 30 Com (5 April 2018), the Bermuda court recognised and enforced a US Chapter 11 reorganisation plan in relation to Bermuda-incorporated companies. The court's reasoning appears to sit somewhat uncomfortably with the UK Supreme Court decision in ***Rubin v. Eurofinance*** [2012] UKSC 46; [2013] 1 AC 236 and the Privy Council decision in ***Singularis Holdings v. PricewaterhouseCoopers*** [2014] UKPC 36; [2015] AC 1675. It is doubtful if the Hong Kong court would follow the Bermuda court's approach.

The facts and decision

On 12 September 2017, Seadrill Limited, North Atlantic Drilling Ltd, and Sevan Drilling Limited ("**Companies**"), together with other affiliates, commenced US Chapter 11 proceedings to pursue the group's debt restructuring.

On 13 September 2017, the Companies applied for provisional liquidation in Bermuda in order to coordinate with the Chapter 11 proceedings. On the same day, the Bermuda court appointed provisional liquidators ("**PLs**") to the Companies.

In anticipation of the US Bankruptcy Court's order ("**Confirmation Order**") confirming the Chapter 11 reorganisation plan, the PLs applied for an order from the Bermuda court recognising the Chapter 11 plan and permanently staying all creditors' and shareholders' claims against the Companies.

The minority shareholders of Sevan Drilling Limited ("**Sevan**") opposed the PLs' application for a permanent stay in order to preserve their right to bring derivative proceedings in relation to Sevan in Bermuda.

The court ruled against the minority shareholders, and granted an order conditionally:

(a) recognising the Confirmation Order which the US Bankruptcy Court was expected to make later in the month; and

(b) permanently restraining creditors and shareholders from pursuing claims against the Companies in breach of their obligations under the proposed Chapter 11 plan.

As regards the court's competence to conditionally recognise the Confirmation Order, the court relied on ***Re Energy XXI*** [2016] SC (Bda) 79 Com (18 August 2016) and reasoned as follows.

First, the minority shareholders (along with Sevan itself), having submitted to the jurisdiction of the US Bankruptcy Court, would be bound by the Confirmation Order.

Second, the minority shareholders could not argue that the Confirmation Order was an *in rem* order which had no effect under Bermudian law on their shares which were located in Bermuda. This is because the US Bankruptcy Court had jurisdiction over the minority shareholders' shares in Sevan. This was the consequence of the minority shareholders having submitted personally to the US jurisdiction in connection with the Chapter 11 proceedings, the function of which was to determine (among other things) the extent of the shareholders' rights.

Comments

The Bermuda court's reasoning seems to be somewhat out of line with the common law as applied elsewhere. If the Confirmation Order was a judgment *in rem* in relation to the minority shareholders' shares (being assets situated in Bermuda), it is hard to see why the minority shareholders could not argue that the Confirmation Order could not be recognised in Bermuda in relation to the shares.

It is well established that a foreign judgment *in rem* is enforceable at common law only if the asset in question was situate within the jurisdiction of the foreign court at the time of the foreign proceedings ***(United States of America v. Abacha*** [2014] EWCA Civ 1291; [2015] 1 WLR 1917). The fact that the minority shareholders were subject to the US Bankruptcy Court's *in personam* jurisdiction does not seem relevant to the question of recognition of a US judgment *in rem* (see ***Pattni v. Ali*** [2006] UKPC 51; [2007] 2 AC 85). Nor is it relevant that the judgment *in rem* arose out of a US bankruptcy proceeding (see ***Rubin and Singularis***). Therefore, it seems that Bermuda has developed its foreign judgment recognition regime.

Will the Hong Kong court follow Bermuda's approach going forward? The position in Hong Kong is that "[f]or judgments *in rem*, a foreign court's judgment will only be recognised where the subject matter of the said judgment is situated in that foreign country" ***(Re Performance Investment Products Corp*** [2014] HKEC 465 at [28]). It is thus improbable that the Hong Kong court could recognise a foreign restructuring order in respect of assets situated in Hong Kong.

José-Antonio Maurellet SC

Look-Chan Ho

José-Antonio Maurellet SC and **Look-Chan Ho** co-authored this Case Report.

Flexible Application of Pari Passu in Cross-Border Insolvency: *Re Guangdong International Trust & Investment Corporation Hong Kong (Holdings) Ltd* [2018] HKCFI 2498

In the ground-breaking case of *Re Guangdong International Trust & Investment Corporation Hong Kong (Holdings) Ltd* [2018] HKCFI 2498, the Court held that the principle of pari passu distribution may be applied flexibly to distribute the insolvent estate's assets in Hong Kong and abroad.

The factual context

Guangdong International Trust & Investment Corporation Hong Kong (Holdings) Limited ("**Company**") was in the final stages of its liquidation which started in October 1998.

To close the liquidation, the liquidators had to distribute the Company's remaining assets in the form of cash held in Hong Kong and Mainland bank accounts. The usual way of dealing with assets in different jurisdictions would be for the liquidators to gather and pool all the assets so that they could be distributed pari passu to all creditors in accordance with section 250 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32).

But the Mainland bank account balance could not be converted into Hong Kong Dollars and remitted to Hong Kong because the Mainland balance represented the proceeds of recoveries of a loan made by the Company to a Mainland entity and that loan did not comply with certain Mainland regulatory requirements. Under Mainland regulatory rules, the Mainland balance could be distributed only in RMB and only to creditors holding Mainland bank accounts.

Some creditors did not have a Mainland bank account. If the liquidators were to distribute the Mainland balance to creditors with Mainland bank accounts and the Hong Kong balance to the remaining creditors, it would result in an unequal distribution because the Mainland balance was more than twice the amount of the Hong Kong balance. In other words, one could not achieve a pari passu distribution of the Company's assets on a pooled basis.

Therefore, the liquidators applied for directions authorising them to distribute:

(a) the Mainland balance to creditors who have Mainland bank accounts and were willing to accept RMB dividends, on a pari passu basis; and

(b) the Hong Kong balance to the remaining creditors on a pari passu basis.

Ruling

The Court granted the directions sought, reasoning thus:

(1) The proposed distribution of the Mainland balance was capable of two alternative analyses, neither of which would constitute a breach of the pari passu principle:

(a) Every creditor with a Mainland bank account would be entitled to pari passu distribution from the Mainland balance. The requirement of having a Mainland bank account ought to be regarded as merely a procedural requirement which would not detract from the substance of pro rata division of the Mainland balance among all eligible creditors.

(b) Alternatively, given that the pari passu principle would apply only to assets that were available for pari passu distribution and Hong Kong insolvency law (including section 250 of Cap 32) would not override the Mainland limitations attached to the Mainland balance which was a chose in action governed by Mainland law, the operation of the Hong Kong pari passu principle in respect of the Mainland balance must be qualified accordingly.

(2) In any event, this would be a proper case for the Court to depart from the pari passu principle because permitting the proposed distribution of the Mainland balance would be in the best interests of the creditors as a group and would be consistent with the principle of liquidation being an administrative process which did not expand or diminish the Company’s substantive rights and obligations.

(3) In principle, the Hong Kong balance must be distributed to all creditors on a pari passu basis. But creditors who have received dividends from the Mainland balance would be subject to the hotchpot rule. Given the amount of the Mainland balance and the Hong Kong balance, the effect of the hotchpot rule would be that creditors who have received RMB dividends would not be eligible to receive further dividends from the Hong Kong balance.

As regards the flexible application of the pari passu principle, the Court cited with approval the dicta in *Beluga Chartering v Beluga Projects (Singapore)* [2013] SGHC 60; [2013] 2 SLR 1035 and Look Chan Ho's book, *Cross-Border Insolvency: Principles and Practice* (Sweet & Maxwell, 2016).

Comments

The typical cross-border insolvency case concerns the recognition of foreign insolvency proceedings, but this case concerns something not usually discussed in cross-border cases, namely choice of law.

The Court's application of the pari passu principle is as much pragmatic as it is intellectually sound – pragmatic because it enables the 20-year old liquidation to progress to closure in the best interests of all creditors, and intellectually sound because it gives effect to choice of law principles applicable to the Mainland balance (the lex situs being Mainland law).

Look-Chan Ho acted for the liquidators

Misfeasance Actions Against Directors or Officers of Insolvent Companies: ***The Liquidator of Wing Fai Construction v. Yip Kwong Robert and 2 Others.*** (HCCW 735/2002)

In his recent Judgment handed down on 24 November 2017, the Hon. Mr. Justice Godfrey Lam, provided valuable guidance to practitioners and liquidators alike and clarified the legal principles involving claims against directors of a company in liquidation for misfeasance whilst in office, pursuant to S.276 of the Companies Winding Up (Miscellaneous Proceedings) Ordinance, Cap. 32. The Judgment brought to an end long-drawn-out and protracted litigation, which spanned the course of over 13 years and involved various (well-known) related applications and appeals to the Court of Appeal, and Court of Final Appeal.

On 6 July 2002, a petition was presented to wind up Wing Fai Construction (**the Company)**. On 9 December 2002, **the Company** was wound up and provisional liquidators were appointed. On 28 February 2003, they were appointed as the original liquidators of the Company.

In August 2004 the original liquidators of Wing Fai initiated a claim for misfeasance against the 3 directors, which was later continued by the liquidator acting alone. The liquidator alleged that the 3 directors had fraudulently authorised $33 million worth of payments on fictitious L/Cs for the benefit of 2 companies, that were alleged to be connected to them.

The learned Judge held:

S.276 actions were confined to actions against the limited class of persons to whom the section applies, and the respondents were not officers of the Company merely on the basis of their alleged trusteeship of corporate funds under their control but the 1st and 2nd Respondents were however de facto directors of the Company during the time the alleged misconduct took place [§97]: cf ***Revenue and Customs Commissioners v. Holland*** [2010] 1 WLR 279.

The purpose of S.276 actions was to compensate the company for actual losses incurred by reason of misfeasance and were not to be used as a means to punish directors for misfeasance **[§273]**.

S.276 ends with the words “as the court thinks just”, which enables the Court to exercise its discretion to do what it considers to be just in the circumstances of the case **[§338]**.

S.276 actions did not apply to alleged losses arising merely out of accounting entries, and proof of actual loss was required before S.276 would be applied **[§§156-163]**.

S.276 is a provision directed against individual persons, and duties of directors are owed personally and individually to the company, there is **<u>no</u>** basis to make all or some of the board of directors jointly liable for the misfeasance of other directors. Conceptually, the proceedings comprised 3 applications against the 3 respondents individually **[§190]**.

In this case, the Liquidator had failed to prove his case that the Company had suffered any losses; and/or, in any event, the directors had made good any depletion of the Company's funds such that the Company should have given credit for those returned funds and there was no loss to the Company and no liability on the directors to compensate the Company at all - cf ***<u>Re Derek Randall Enterprises Ltd</u>.*** [1990] BCC 79.

Barrie Barlow SC and **Chan Pat Lun** represented the 2nd Respondent in this case.

Barrie Barlow SC

Pat Lun Chan

Re Le Corporation **HCCW 398/2017 – When might a company itself apply for for its own winding-up?**

In the recent unreported matter of ***Re Le Corporation*** (HCCW 398/2017), the company was wound up pursuant to Section 177 of the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap. 32).

Amongst the grounds relied upon was section 177(1)(a) which provides that a company may be wound up if "the company has by special resolution resolved that the company be wound up by the court". Perhaps unsurprising given the generally unopposed nature of such petitions, there is limited discussion on section 177(1)(a) in the case law. In Hong Kong, the leading decision is that of Madam Justice Le Pichon (as she then was) in ***Re Comtowell Ltd*** [1998] 2 HKLRD 463. According to the learned judge, "*there is very little case law on the operation of paragraph (a) and certainly there is no reported Hong Kong authority*". And the situation has not changed much since 1998.

When might section 177(1)(a) be invoked?

It is self-evident from the provision itself that the starting point must be the existence of a validly-passed shareholders' resolution. In ***Comtowell***, the learned judge, in applying Canadian authority, held that a company was prima facie entitled to the winding-up order unless there are "*special circumstances militating against the making of such an order*".

It would appear, from the learned judge's judgment as well as the Canadian decision of ***Re United Fuel Investments Ltd*** (1961) 31 DLR (2nd) 331, the "special circumstances" require some evidence that the majority shareholders "*were acting fraudulently or in bad faith in adopting the resolution*".

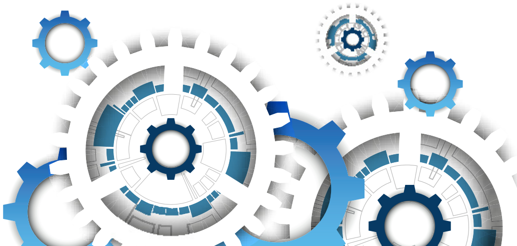
This author submits therefore that section 177(1)(a) should find application where the shareholders come to a genuine and bona fide commercial decision that winding-up is the proper and appropriate course to take. In line with established principles, the court should be slow to interfere with a business or commercial judgment of such character.

As a matter of practice, to make clear that such considerations have been taken into account, a petitioner should identify such underlying commercial factors with particulars, backed with sufficient evidence where applicable.

In addition, it may be advisable to concurrently rely on more than one ground. For instance, in ***Re Comtowell Ltd*** itself, the petitioner also relied upon section 177(1)(d) (that the company is unable to pay its debts) and section 177(1)(f) (that it is just and equitable that the Company be wound up, on the main premise that the company's affairs require investigation). First, this ensures that the Court is not limited to considering whether the pre-requisites under section 177(1)(a) are satisfied. Secondly, the circumstances relied upon under the other grounds may well complement and reinforce the commercial considerations. Thus, it will reinforce the analysis advanced under section 177(1)(a) as well.

Michael Lok acted for the Petitioner Company.

Michael
Lok



A trio of interesting issues arising from a strike-out application in ***Days Impex Ltd (in liquidation) and another v Fung, Yu & Co (a firm) and another***

In ***Days Impex Ltd (in liquidation) and another v Fung, Yu & Co (a firm) and another*** (unrep., HCA 1035/2014, 24th October 2017), the Court considered a strike-out application brought by the defendants, who were auditors of the plaintiff company, in an action for negligence brought by the liquidators of the plaintiff company in the latter's name. The complaint was that the defendant auditors had breached their duty owed to the company by signing off unqualified "clean" opinions on the status of the plaintiffs' accounts and by failing to detect and report fraud carried out by the controlling shareholder and director of the plaintiff.

In rejecting the application to strike out, the Court considered a number of grounds raised by the defendants. Amongst them, three interesting issues on the law were considered.

The first was the scope of the auditors' duty. The Court held that it was at least arguable that an auditor's duty extended to detecting material irregularities in the company's accounting statements and reporting any fraud detected. It was also arguable that these duties were affected by the fact that the company was insolvent, in which case the interests of creditors required protection. The question of whether and how creditors' interests factor in to directors' or auditors' negligence actions when one is concerned with companies in liquidation is a developing area and the principles in relation thereto are highly unsettled. The fact that the Court did not close off this line of argument is indicative of a willingness to entertain creditors' interests going forward.

The second issue, of potentially wider application, is the question of illegality and attribution. The defendant auditors argued that the controlling fraudster's knowledge could be attributed to the company in an audit negligence claim against an auditor such that the company was not entitled to sue the defendants. The Court reviewed a difficult and unsettled line of cases on this issue, including ***Stone & Rolls Ltd v Moore Stephens*** [2009] 1 AC 1391, ***Bilta (UK) Ltd v Nazir (No 2)*** [2016] AC 1, ***Moulin Global Eyecare Trading Ltd (in liquidation) v The Commissioner of Inland Revenue*** (2014) 17 HKCFAR 218 and ***Livent Inc v Deloitte & Touche*** 2014 ONSC 2176, and concluded that the context in which attribution is explored was an important factor. In finding that those authorities did not directly address the situation where a company was seeking to sue not the wrongdoing director, but a third party auditor which the company alleged was in breach of duty owed to it in failing to detect the wrongdoing, and noting that the illegality defence had become much more of a factual enquiry since the decision of the English Supreme Court in ***Patel v Mirza*** [2016] 3 WLR 399, the Court declined to strike out on this ground as it involved difficult points of law. This also contributed to the Court deciding that the question of limitation could only be dealt with at trial. This would seem to be an issue ripe for further discussion in future cases.

The third issue was circuity of action. The defendant auditors argued that if the plaintiffs' claim were successful, this would give rise to a cause of action available to the defendants on the basis that the defendants had relied on fraudulent representations given by the directors of the plaintiffs, which would render the plaintiffs vicariously liable as the representations were made within the authority of the directors. The Court declined to strike out the claim on this ground without proper pleadings and hearing evidence on, *inter alia*, particulars of the misrepresentation and whether the defendants had indeed been deceived.

Due to the nature of the strike out application, a definite view was not expressed by the Court on these and other complex legal issues involved in the case. It is hoped that the opportunity will soon arise for these points to be considered.

DVC Counsel involved:

Rachel Lam for the plaintiff companies (acting by liquidators), led by Victor Joffe QC of Temple Chambers.

Adrian Lai for the defendant auditors.

Jasmine Cheung authored this case report.

Rachel Lam

Adrian Lai

Jasmine Cheung

Reflecting on Loss in ***Re Wah Nam Group Ltd***

In ***Re Wah Nam Group Ltd*** (unrep., HCCW 166/2000 & HCA 960/2015 & HCA 962/2015, 5th September 2017), the Court was faced with former liquidators' summonses to dismiss two related actions against them. One action had been brought by Wah Nam Group Limited, while the other was brought by its subsidiaries on largely similar grounds concerning alleged negligence on the part of the former liquidators. The plaintiffs were acting by new liquidators who had replaced the former liquidators.

The former liquidators were partially successful on the "reflective loss issue" ground, under which they complained that Wah Nam Group Limited was not the proper party to pursue the alleged claims because, to the extent that any loss or damage was suffered, such loss and damage was merely reflective in nature. The Court examined case law on the reflective loss principle and noted that the pleadings of the two actions showed a high degree of overlap. Ultimately, it found in favour of the former liquidators on this point and struck out the action by Wah Nam Group Limited, leaving only one action against the former liquidators.

A number of other grounds to strike out were raised and dealt with, including that the matters pleaded in both actions had already been addressed and sanctioned by Barma J, when the judge sanctioned entry into and implementation of a settlement deed. The Court opined that that sanction dealt with a different subject matter and not the issue of negligence of the former liquidators, and that although it did not seem right that, having gone to the court and obtained the sanction of the court to enter into a compromise, the former liquidators could subsequently be sued again for negligence in entering into the compromise, this was not a matter for striking out.

Also of interest was the Court's consideration, in the striking out context, of the issue of limitation and attribution of knowledge. Both actions had been commenced out of time, so the plaintiffs in each action had to rely on the extended secondary limitation period under section 31 of the Limitation Ordinance, which provides for a special time limit for negligence actions where the facts relevant to the cause of action were not known at the date of accrual. This is commonly known as the "latent defect" extension.

The key question discussed was whether the former liquidators' knowledge of their own or their own employees' acts during the time when they were in office should be attributed to the plaintiff companies. If the answer was yes, then even section 31 could not save the actions. If the answer was no, and it was only on the new liquidators' entry into office that knowledge should be attributed, then the section 31 provision could save the actions.

For the purposes of striking out, the Court opined that it did not accept the former liquidators' contention. In declining to strike out on this ground, it opined that the former liquidators could not have had knowledge that they were liable for the damage which was "attributable in whole or in part to the act or omission which is alleged to constitute negligence", given that their case all along was that no negligent act or omission had been committed by them. The Court also went on to opine that, as a matter of law, the knowledge of the former liquidators should not be attributed to the companies even if fraud or illegality were not involved, as the underlying rationale was to prevent officers or directors from invoking or attributing their own knowledge to a company so as to defeat legitimate claims by the company against them.

The decision to strike out the claim on the basis of reflective loss is being appealed. The ongoing conduct of this case will also bring to the fore interesting issues regarding limitation and attribution of knowledge in the context of liquidation cases.

DVC Counsel involved:

William Wong SC (the Judge).

Rachel Lam for the former liquidators.

José-Antonio Maurellet SC leading **Adrian Lai** for the plaintiff companies (acting by new liquidators).

Jasmine Cheung authored this case report.

William M.F. Wong SC

José-Antonio Maurellet SC

Rachel Lam

Adrian Lai

Jasmine Cheung