Global Restructuring Review

Scheming in Hong Kong: court hands down Winsway and Kaisa decisions

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Partner **Sue Moore**, senior associate **James Watson** and associate **Eloise Fardon** of Stephenson Harwood consider two notable decisions of the Hong Kong court handed down during the last week; the first in the matter of Winsway Enterprises Holdings (now known as E-Commodities Holdings) and the second in the matter of Kaisa Group Holdings.

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The decisions include interesting points relating to consent fees, use of schemes to compromise exclusively foreign law debt and recognition of schemes in the United States.

Earlier this year, Winsway completed a successful restructuring of its offshore bond debt. Teams from Stephenson Harwood's London and Hong Kong offices acted for Winsway in relation to the restructuring.

Winsway, the parent of one of China's biggest coking coal groups, is incorporated in the BVI and its shares are listed on the Hong Kong Stock Exchange (HKEX). In 2011, the company issued US$500 million of New York law governed notes maturing in April 2016. On maturity, approximately US$350 million of debt (principal and accrued but unpaid interest) remained outstanding. A restructuring was required as a result of challenging conditions both in the region and the sector.

The outstanding bond debt was exchanged for a combination of cash (funded by a parallel rights issue), shares and contingent value rights. The restructuring was implemented through parallel schemes of arrangement in Hong Kong and the BVI, coupled with Chapter 15 recognition of the Hong Kong scheme in the US.

Harris J has recently handed down his reasons for decision supporting his order sanctioning the Hong Kong scheme in *Re Winsway Enterprises Holdings Limited*.

The Winsway scheme (and decision) is of note for a number of reasons:

- This is the first decision in Hong Kong where the court has considered whether the provision of a consent fee to creditors who agree in advance to vote in favour of a scheme (pursuant to a restructuring support, or lock-up, agreement) could "fracture" scheme classes for voting purposes.
- The Hong Kong court was satisfied that it could sanction a scheme of arrangement which compromised debt governed exclusively by foreign law.
- This is the first Hong Kong scheme of arrangement to be recognised in the United States under Chapter 15 of the US Bankruptcy Code.

Harris J also handed down his reasons for decision in the matter of *Kaisa Group Holdings Ltd* shortly afterwards. This referred to, and followed, the *Winsway* decision in a number of respects. Kaisa is incorporated in the Cayman Islands, listed on the HKEX and its main business is property development in mainland China. The company implemented a restructuring of its offshore debts (including New York-governed notes) by parallel schemes of arrangement in Hong Kong and Cayman Islands, coupled with Chapter 15 recognition in the US.

Consent fees

A scheme of arrangement must be approved by the requisite majorities (75% in value and more than 50% in number of those present and voting) of each class of scheme creditors.

Whether scheme creditors should vote in the same class, or different classes, is a question of the similarity or dissimilarity of their legal rights against the scheme company, not their interests (the leading Hong Kong case in respect of the identification of classes is *Re UDL Argos Engineering & Heavy Industries Co*, which Harris J cites in *Winsway*). As recognised in the English cases (to which the Hong Kong Court has regard), in deciding on the correct number of classes, there is a careful balancing act to be struck between creating too few and allowing a minority to be oppressed by a majority who have substantially different rights, and creating too many and giving the minority an effective veto right. Generally, the judicial trend has been to err on the side of fewer classes, increasing the chances that a scheme will be approved.

The English courts have considered in a number of cases (Harris J cited *Re DX Holdings Ltd, PrimaCom Holdings GmbH v Credit Agricole and Re Seat Pagine Gialle SPA*) whether the existence of a restructuring support (or lock-up) agreement or the agreement to pay a fee to creditors who agree in advance to vote in favour of a proposed scheme could create separate voting classes (ie, one class for those who have signed the agreement or become entitled to receive the fee, and one class for those who have not). However, this issue had not been considered by the Hong Kong Court before the *Winsway* decision.

Before the launch of the scheme, Winsway and certain of its subsidiaries had entered into a restructuring support agreement (RSA) with the holders of approximately 83% by principal value of the notes. Pursuant to the RSA, the relevant noteholders agreed to vote in favour of the scheme on customary terms. In exchange, Winsway agreed to pay on completion of the restructuring an aggregate consent fee equivalent to 2% of the outstanding principal and accrued interest as at the date of the RSA. The consent fee was to be shared pro rata between all holders that had acceded to the RSA by a certain date (ie, it was an "early-bird fee").

Harris J considered whether the entitlement of some scheme creditors to a share of the consent fee meant they should be placed in a different class to those who were not so entitled. He noted that the key question was whether the right to be paid an additional sum was likely to influence materially a scheme creditor in deciding how to vote. In his view, this would depend on whether or not the sum was substantial and whether it had been offered to all scheme creditors in an objectively fair manner.

Harris J noted that although the consent fee was larger than had been offered in the three English scheme cases to which he referred, it was still relatively small. Further, it was made available to all scheme creditors and was a bona fide attempt to introduce certainty in the progress of the restructuring. In the court's view, it was therefore unlikely to have influenced materially how a scheme creditor voted and did not require the creditors to be divided into two classes for voting purposes.

Harris J took the same approach in the *Kaisa* scheme. In that case, scheme creditors that had acceded to the relevant restructuring support agreement by a certain date were entitled to receive a fee equal to 1% of the principal amount of their debt (dropping to 0.5% for those who acceded during the two weeks thereafter). In *Kaisa*, Harris J referred to his reasons in *Winsway* and held that there was no material difference between the two schemes as they related to the fee issue, save that in *Kaisa* the consent fee was lower. As such, following the reasons in *Winsway*, the Court held that the provision of a consent fee did not fracture the class.

In *Kaisa*, there were also several different types of offshore debt subject to the scheme. Harris J separately considered whether the relevant creditors should vote as a single class and concluded that, notwithstanding certain differences in their collateral, they should.

Foreign law debt

In *Winsway*, the debt subject to the Hong Kong scheme of arrangement was governed exclusively by New York law.

This can be contrasted with the notable restructuring of LDK Solar Co Ltd, where, in addition to New York law bonds, certain of the debts dealt with by the Hong Kong schemes were governed by Hong Kong law. In that case, Godfrey Lam J seemed to regard this as important in concluding that the Hong Kong schemes were appropriate.

In Winsway, Harris J asked to be addressed fully at the sanction stage on the significance of the relevant debt being governed exclusively by New York law. The Court appeared to be concerned that sanctioning a scheme compromising purely foreign law debt would be inconsistent with the common law rule in *Gibbs* that a foreign composition does not discharge a debt unless it is discharged under the law governing the debt.

The English court has on a number of occasions sanctioned schemes of arrangement for companies, both those incorporated in England and

abroad, where some or all of the debt compromised by the scheme was governed by a foreign law (for example, *Re Magyar Telecom BV*). In all such cases, the English court has concluded that it is appropriate to sanction such a scheme provided there is both a sufficient connection to the jurisdiction in which the scheme is proposed and sufficient evidence that the scheme would be effective abroad. An opinion from an English QC as to the current practice of the English courts was provided by Winsway to Harris J, who was then content to adopt the same approach.

Firstly, following the approach taken by Godfrey Lam J in *LDK Solar*, Harris J was satisfied that there was a sufficient connection between Winsway and Hong Kong. In this regard, he commented that the listing of the company's shares in Hong Kong "clearly constitutes a material connection with Hong Kong". He also noted that the company had a registered office at leased premises in Hong Kong at which it had staff and kept its books and records. Its auditors were based in Hong Kong. Further, over half of its shareholders were resident in Hong Kong, and the company held its general meetings in the jurisdiction. These factors were enough in Harris J's view to constitute sufficient connection to give the Hong Kong Court jurisdiction to sanction the scheme, though he also identified other factors.

Next, Harris J recognised that, regardless of the governing law of the debt, the Hong Kong scheme would prevent action being taken within the jurisdiction of the Hong Kong courts. He noted that this was one of the principal reasons for proposing a scheme in Hong Kong in that it would prevent a dissident creditor taking action in the jurisdiction which could interfere with the company's listed status.

Finally, Harris J was satisfied that the purpose of the scheme was likely to be achieved. Winsway had made an application under Chapter 15 of the US Bankruptcy Code for recognition of the Hong Kong scheme in New York as a foreign non-main proceeding, and for ancillary relief including an order giving full force and effect to the compromise of debt and releases under the scheme. The recognition order was granted prior to the Hong Kong sanction hearing, but the US Bankruptcy Court deferred consideration of the application for ancillary relief until after the scheme sanction hearings. The ancillary relief was subsequently granted by Judge Glenn in New York in an order made on 16 June 2016. Winsway had submitted evidence in the form of an expert report from independent US counsel to the effect that it was likely that such relief would be granted.

Therefore, *Winsway* is a notable precedent for the proposition that, like an English scheme of arrangement, a Hong Kong scheme of arrangement can be used to compromise debt governed exclusively by foreign law subject to the criteria noted above.

Chapter 15 recognition

Following from the above, *Winsway* was the first Hong Kong scheme of arrangement to be recognised under Chapter 15 of the US Bankruptcy Code.

Like *Winsway*, the *LDK Solar* restructuring involved parallel schemes of arrangement in Hong Kong and the Caribbean (in that case, the Cayman Islands rather than BVI). However, in *LDK Solar*, Chapter 15 recognition was sought (and obtained) in respect of the Cayman scheme and not the Hong Kong scheme. This was because the centre of main interests (COMI) of the relevant scheme company in that case was considered to be in the Cayman Islands following the appointment of provisional liquidators in that jurisdiction.

Also notable is the fact that the Winsway scheme was recognised under Chapter 15 as a foreign non-main proceeding rather than a foreign main proceeding, and the requested ancillary relief was granted on this basis.

This is relatively unusual. In most cases where Chapter 15 recognition of a scheme is sought, it will be on the basis that the scheme comprises a foreign main proceeding. However, this requires the scheme company to have its COMI in the jurisdiction of the scheme proceedings. In the case of Winsway, it was not certain that the company's COMI was in Hong Kong. However, it was clear that the company had an "establishment" in Hong Kong, which was enough to seek recognition of the scheme as a foreign non-main proceeding instead.

The theoretical significance of this distinction is that, whereas recognition of a process as a foreign main proceeding carries with it an automatic entitlement to certain relief in the United States including a stay, relief is only discretionary with respect to a foreign non-main proceeding. However, following sanction of the scheme in Hong Kong, Judge Glenn was content to grant all of the orders sought by Winsway in the Chapter 15 proceedings – including, most importantly, an order giving full force and effect to the Hong Kong scheme in accordance with its terms. As such, perhaps the importance of this distinction should not be overstated in a scheme context.

Hot on the heels of the first Hong Kong scheme to be recognised under Chapter 15 came the second: the Hong Kong scheme of arrangement in Kaisa was recognised as a foreign main proceeding a month later. As was the case in *Winsway*, a recognition order had been obtained from the US Bankruptcy Court (on 3 June 2016) prior to the scheme being sanctioned and further orders were granted (on 14 July 2016) post-sanction recognising, granting comity and giving full force and effect to the Hong Kong scheme in accordance with its terms.

Conclusion

Harris J's decisions in both *Winsway* and *Kaisa* provide comfort to debtor companies and creditor committees who wish to include a consent fee in a lock-up or restructuring support agreement to incentivise other creditors to support a prospective scheme and thereby promote certainty and avoid wasted costs.

However, in line with the English cases, such a consent fee must be freely available to all creditors and should not be so large that it could be said to materially influence how a scheme creditor might vote. In this regard, in certain cases it might be appropriate to consider this latter question by reference to debt prices in the secondary market rather than par value. It will be interesting to see if the Hong Kong court follows suit, and, if so, where and how the courts draw the line in practice.

The willingness of the Hong Kong court to follow the approach of the English court in *Magyar Telecom*, and the US Bankruptcy Court to recognise and make orders giving full force and effect to Hong Kong schemes of arrangement under Chapter 15, are also noteworthy. Together, these pave the way for further Hong Kong schemes to be used to restructure foreign law debts; most notably offshore bond debt governed by New York law and raised by issuers listed in Hong Kong, but incorporated in a Caribbean jurisdiction.