Cross border insolvency – further consideration of listed companies and the second core requirement by the Hong Kong Court

Grand Peace Group Holdings Limited [2021] HKCFI 2361 (Date of Decision: 24 August 2021)

Up Energy Development Group Limited [2021] HKCFI 2595 (Date of Decision: 31 August 2021)

Introduction

The vast majority of listed companies in Hong Kong are incorporated offshore, with a corporate structure that the operating and asset owning subsidiaries in Mainland China are held through intermediate subsidiaries incorporated in offshore jurisdictions such as BVI and Cayman Islands etc.

In the landmark decision of *Re China Huiyuan Juice Group Limited* [2020] HKCFI 2940 (see our previous article here), the Hong Kong Court considered the second core requirement and since that decision it has become more difficult to put an offshore incorporated listed company into liquidation in Hong Kong.

In the recent case of *Grand Peace Group Holdings Limited*, the Hong Kong Court considered the second core requirement again and declined to wind up an offshore incorporated listed company despite arguments by the substituting petitioner based on the Court of Final Appeal's judgment in Yung Kee. In the case of *Up Energy Development Group Limited*, the Hong Kong Court summarised succinctly the relevant principles in this area.

The three core requirements

The three core requirements that have to be satisfied before the Hong Kong Court will exercise its discretion to wind up a foreign incorporated company are:

1. There has to be a sufficient connection with Hong Kong, but this does not necessarily have to consist of the presence of assets within the jurisdiction;

2. There must be a reasonable possibility that the winding up order would benefit those applying for it; and

3. The court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets[1].

[1] As summarised by the Hong Kong Court of Final Appeal in *Kam Leung Sui Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501 (i.e. the Yung Kee case).

Grand Peace Group Holdings Limited

Grand Peace Group Holdings Limited (the "**Company**") is a company incorporated in Bermuda and listed on the Main Board of the Hong Kong Stock Exchange. The petition against the Company has been adjourned a number of times to allow the Company to restructure its debt. The Listing Committee has determined the Company's shares should be delisted. The Company has appealed the decision but the appeal was dismissed.

One of the Company's creditors was dissatisfied with the adjournments of the petition and applied to be substituted as the petitioner and sought to persuade the Court to make an immediate winding up order. The only issue that the Court has to determine is jurisdiction.

There is no dispute that the first and the third core requirements are met. The Company argues that the second core requirement is not.

Little attention has been given to the second core requirement until the Court of Appeal decision in *Shandong Chenming Paper Holdings Ltd v Arjowiggins HKK 2 Limited* [2020] HKEC 2290 (see our previous article here) and the decision in *Re China Huiyuan Juice Group Limited*.

Taking control of the offshore incorporated subsidiaries and the second core requirement

Following his decision in *Re China Huiyuan Juice Group Limited*, Harris J considered that based on private international law principles the authorities in offshore jurisdictions establish that the courts in the BVI would not recognise liquidators appointed in Hong Kong over a company incorporated in, for example, Bermuda as having the authority to take control of a subsidiary of a company incorporated in the BVI. This means that it is futile to appoint liquidators over a company incorporated in Bermuda in order to take control of its subsidiaries incorporated in the BVI with the ultimate aim of taking control of subsidiaries in Mainland China owned by the BVI companies. Harris J was of the view that the correct course is to wind up the holding company in its place of incorporation.

Relying on the Court of Final Appeal's decision in *Yung Kee*, Counsel for the supporting creditor argued that this problem could be circumvented. It was argued that because the majority of directors are in Hong Kong, the liquidators could apply to the Court for an order that the directors execute the documents necessary for the liquidators to take control of the BVI subsidiaries.

Although Harris J accepted that the Court of Final Appeal's decision in *Yung Kee* does suggest that this method could be taken with a view to obtaining control of the BVI subsidiaries, on a detailed consideration of the private international law principles he doubted that the above problem could be circumvented by such orders against the directors of the holding company.

The Court's decision

Harris J explained that:

(i) According to BVI private international law, only a liquidator appointed by the court of the place of incorporation will be recognised and assisted. As a matter of Bermuda law and BVI law, liquidators appointed by the Hong Kong court would not be the lawful agents of the Company with the power to exercise its voting rights as a shareholder of a BVI Company.

(ii) Even if the Hong Kong court took the view that the above principle is not an impediment to making an order in respect of assets within its jurisdiction, e.g. the shares of a Hong Kong company[2], it is highly questionable whether it should do so in respect of an asset in another jurisdiction particularly if that jurisdiction's own substantive law would not recognise the Hong Kong winding up.

(iii) Under English and Hong Kong laws, once a company has been ordered to be wound up and a liquidator appointed, the powers of the directors cease. Assuming that the legal position in Bermuda and the BVI is the same as in Hong Kong, the directors of the Company would not have the power to change the shareholders of a BVI subsidiary. Also, it would be artificial and disingenuous for the Hong Kong court to make an order compelling directors (who remain to be the authorised agents of the Company under Bermuda and BVI law even after a winding up order is made in Hong Kong) to execute documents at the request of liquidators (who as a matter of the law of Bermuda are not lawful agents of the Company).

(iv) It would therefore be wrong to proceed on the basis that upon a winding up order being made in Hong Kong the liquidators will be able to obtain control of the BVI subsidiaries by seeking orders against the Company's directors unless there is some other overriding principle which justifies treating the Hong Kong liquidators as the agents of the Company. It would be an exception to the general principle if the centre of main interests of the BVI subsidiaries were in Hong Kong and what was sought was the appointment of liquidators in Hong Kong with a view to an application being made to the Intermediate People's Courts of the three pilot cities in Mainland China pursuant to the "*Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region*" signed by the Supreme People's Court and the Secretary for Justice of Hong Kong on 14 May 2021 (see our previous article here). However, there is no such exception in the present case.

(v) The brief evidence adduced in respect of the Company's assets in Hong Kong (e.g. cash in bank accounts under HK$80,000) and the value of the Company's listed status (which has been lost by virtue of the shares being delisted) are not capable of satisfying the second core requirement.

As a result, the substitution application made by the supporting creditor was dismissed. At the call over hearing on 30 August 2021, the winding up petition was further adjourned as per the request of the parties until later this year in order that the Company can put forward a proposal for scheme of arrangement.

Up Energy Development Group Limited

The decision is in relation to the petitioner's further amendments in the winding up petition against the debtor company, which is incorporated in Bermuda and listed in Hong Kong. The amendment application itself is not contentious, but Harris J also summarised the principles on winding up listed companies in Hong Kong, as follows:

"*A creditor of a holding company incorporated in an offshore jurisdiction, which owns a subsidiary incorporated in another offshore jurisdiction, which in turn owns operating and asset owning companies in the Mainland should normally petition to wind up the holding company in its place of incorporation unless the creditor can*

[2] This view was taken by both the first instance judge (HCMP No. 222 of 2021) and the Court of Appeal *[2021] HKCA 1248* (with Hon G Lam JA giving the reasons for the CA judgment dated 25 August 2021) in the case of *Silver Starlight Limited* where the second core requirement was satisfied because the shares in a Hong Kong incorporated subsidiary are among the assets held by the offshore incorporated listed company.

demonstrate that a liquidator appointed in Hong Kong will probably be able to obtain control of the Mainland subsidiaries. The creditor is unlikely to be able to do this unless:

(1) The intermediate offshore subsidiary's centre of main interest is in Hong Kong and thus recognition in the Mainland is possible under the cooperation arrangement signed on 14 May 2021 by the Secretary for Justice and the Supreme People's Court; and

(2) A liquidator appointed over the holding company can petition to wind up an offshore subsidiary in Hong Kong as a creditor.

Unless this can be demonstrated fairly easily a creditor should be advised that a petition should be issued in the place of incorporation because this is more straightforward and effective."

Takeaway points

These cases show that it is now more difficult to wind up in Hong Kong a foreign incorporated listed company which holds operating and asset owning subsidiaries in Mainland China through intermediate subsidiaries incorporated in offshore jurisdictions.

To satisfy the second core requirement, the petitioning creditor will have to persuade the Court that the benefit to wind up the foreign company is tangible and justifies putting the debtor company into liquidation in Hong Kong rather than in its place of incorporation. In most situations, this will involve creditors showing that liquidators appointed in Hong Kong will be able to obtain control over the Mainland subsidiaries, and there are only very limited ways that this can be shown.

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