BRIEFINGNOTE

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Cross border insolvency – reconsidering the Second Core Requirement and foreign recognition?

Up Energy Development Group Limited [2022] HKCFI 1329 (date of decision: 6 May 2022)

Introduction

The 3 core requirements are factors considered by the Hong Kong Court when deciding whether to exercise its discretion to wind up a foreign incorporated company in Hong Kong.

In the case of *Up Energy*, the approach adopted by Linda Chan J in considering the second core requirement seems to be different from the approach of the Court since the case of *Re China Huiyuan Juice Group Limited* [2020] HKCFI 2940. Her Ladyship also made comments on the legal basis of cross border recognition and assistance granting power to foreign liquidators.

The 3 core requirements

As explained in the case of *Kam Leung Sui Kwan v Kam Kwan Lai* [2015] 18 HKCFAR 501 (i.e. the Yung Kee case), the 3 core requirements are factors considered by the Hong Kong Court when deciding whether to exercise its discretion to wind up a foreign incorporated company in Hong Kong:

1. there had to be a sufficient connection with Hong Kong, but this did not necessarily have to consist in 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.

The key dispute in most of the recent winding up cases on offshore company in Hong Kong is the second core requirement. Prior to the case of *Re China Huiyuan Juice Group Limited*, a debtor foreign company's listed status in Hong Kong would always be able to satisfy the three core requirements. The validity of such proposition seem to have changed in the decision of *China Huiyuan Juice Group* (see our previous article here). In that case, the Hong Kong Court considered the second core requirement in detail and held that it is not a benefit to creditors to obtain a winding up order in Hong Kong against a foreign incorporated company if its assets are in Mainland China which are held by offshore intermediate companies. The decision was followed in the case of *Grand Peace Group Holdings Limited* [2021] HKCFI 2361, in which the Court found that cash in Hong Kong bank accounts under HK$80,000 and the value of the Company's listed status were not capable of satisfying the second core requirement (see our previous article here).

Background

Up Energy Development Group Limited ("**Company**") is incorporated in Bermuda. It is registered as a non-Hong Kong company under the Companies Ordinance and listed on The Stock Exchange of Hong Kong. Winding up petitions against the Company were presented by creditors in both Hong Kong and Bermuda.

By the orders dated 7 and 28 October 2016, the Bermuda Court appointed provisional liquidators ("**PLs**") over the Company to supervise the restructuring of the Company. On 11 March 2021, the Bermuda Court ordered the winding up of the Company because the scheme of arrangement sanctioned by the Bermuda Court lapsed. Meanwhile, the petition in Hong Kong was adjourned multiple times and was substantively argued on 14 February 2022 and 1 April 2022.

The PLs' submissions against a winding up order

As the Court noted in the decision, it is unusual for provisional liquidators to oppose the making of a winding up order. Despite the Company was insolvent, the PLs opposed the making of a winding up order on the following grounds:

1. The Hong Kong Court should give primacy to the Bermuda Court and decline to wind up the Company;

2. Harris J in his decision dated 31 August 2021 found that the second core requirement was not satisfied;

3. If there were matters which needed to be dealt with in Hong Kong, the liquidators to be appointed could seek recognition and assistance or a winding up order in Hong Kong;

4. An ancillary winding-up order would lead to additional time and costs, and add to the burden of the estate rather than benefit it.

The Court's decision

Linda Chan J rejected the PLs' submissions and made a winding up order on the basis that the 3 core requirements were satisfied.

Her Ladyship held that the second core requirement is not a high threshold to discharge, and the petitioner is only required to demonstrate a real possibility of benefit. The fact that there are assets in Hong Kong (in this case, cash of HK$ 0.2 million and receivables from Hong Kong incorporated subsidiaries) which may be recovered for the benefit of the creditors would be sufficient to satisfy the second core requirement. Her Ladyship considered that Harris J had not made a finding to the effect that the second core requirement had not or would not be satisfied in his decision. Had he reached such finding of fact, he would have dismissed the petition. Also, the mere fact that the Company had been wound up in Bermuda was not a ground against winding up the Company in Hong Kong.

Further, Her Ladyship held that in the absence of a winding up order in Hong Kong, the Hong Kong court does not have power under the common law to confer any powers on the Company's liquidator appointed in another jurisdiction, or make any provisions under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("**CWUMPO**") available to the Company. This finding would seem to be in contrast with a body of case laws in Hong Kong developing the jurisprudence on common law cross border recognition and assistance as well as the cross-border mechanism providing for mutual recognition of insolvency processes and office holders in Mainland China and Hong Kong. Under the cross-border mechanism, among other things, a Mainland bankruptcy administrator may apply to the High Court of Hong Kong for recognition of and assistance to Mainland bankruptcy proceedings (see our previous article here).

Lastly, Her Ladyship consider that it would be in the interests of the creditors to wind up the Company as this would avoid the need for the Bermuda liquidators to make successive applications to the court for recognition and powers under the CWUMPO, even assuming the court had power to do so (which Her Ladyship considered otherwise).

Takeaway points

It appears that the Court has taken a different approach in the considerations of (i) the second core requirement and (i) granting recognition and assistance to foreign liquidators. It would be helpful if there are judicial clarifications on these two issues in the near future.

Parties involved in winding up petitions against foreign companies as well as insolvency practitioners applying for recognition and assistance will need to take note of the approach taken by the Court in this case.

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