Cross-border insolvency in Hong Kong – listed companies and the second core requirement

***China Huiyuan Juice Group Limited* [2020] HKCFI 2940 (date of decision: 19 November 2020)**

The Hong Kong courts have developed over time three core requirements by reference to which the court assesses whether or not a good reason for making a winding-up-order against a foreign incorporated company in Hong Kong has been demonstrated.

Previously, it appears that with the debtor foreign company having a listing status in Hong Kong, it would always be able to satisfy the Hong Kong Court on the three core requirements.

It seems that this assumption could no longer be made in view of the recent decision in *China Huiyuan Juice Group Limited* [2020] HKCFI 2940, in which the Hong Kong Court of First Instance considered the second core requirement.

The three core requirements

The three core requirements 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) are as follows:

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.

Background

It is common for corporate groups with businesses in Mainland China and listed in Hong Kong to adopt a group structure such that (i) the listed holding company incorporated in an offshore jurisdiction holds one or more layers of wholly owned subsidiaries incorporated in offshore jurisdictions and/or Mainland China; and (ii) underneath such subsidiaries is a web of Mainland incorporated subsidiaries which hold the group's assets and conduct its business. When such corporate groups are in financial difficulty, creditors will petition to seek a winding up order or the group will initiate to restructure the debt (commonly through the appointment of soft touch provisional liquidators).

It has been well established that listing status in Hong Kong is sufficient to satisfy the first core requirement, and because commonly there is more than one creditor subject to the jurisdiction of the Hong Kong Court that is sufficient to satisfy the third core requirement. Traditionally, little attention has been given to the second core requirement.

In the *China Huiyuan Juice* case, Harris J held that the Petitioner has not demonstrated a real benefit that it would gain from the appointment of a liquidator in Hong Kong over China Huiyuan Juice Group Limited (the "**Company**") and consequently the second core requirement was not satisfied.

The Company is incorporated in the Cayman Islands and listed on the Main Board of the Hong Kong Stock Exchange. Its business operations are conducted in Mainland China through companies incorporated in Mainland China and held indirectly by the Company through intermediate holding companies incorporated in the British Virgin Islands. These intermediate subsidiaries own subsidiaries in Mainland China, which in turn own the Company's underlying assets and carry on the manufacturing and other operations, which constitute the Company's business and source of revenue.

The Petitioner issued a petition against the Company on the grounds of insolvency by relying on an undisputed debt arising from a default under a convertible bond. There is no dispute that the Company is insolvent. The question before the Court is whether to make an immediate winding-up order or grant an adjournment.

Listing status and the second core requirement

Harris J made the following comments and observations in respect of the second core requirement:

- Based on the Court's latest observations, it is highly unlikely that the listing status of the Company if it is wound-up has any residual value. The court will require evidence to demonstrate that there is a real prospect of a material financial benefit to creditors from realisation of a listing in order to satisfy the second core requirement. It is no longer sufficient to invite the court to assume that the value of a listing can be realised and realised at a value that proves to be more than an insignificant benefit to creditors.

- If in future a petitioner wishes to rely on the value of the listing as the benefit that satisfies the second core requirement, evidence has to be adduced. The evidence will have to establish that there is a real, not hypothetical, prospect of the listing being realised for an amount that produces a meaningful return to creditors; not an amount so small that they are likely to be largely indifferent as to whether they receive it or not.

- A liquidator appointed in Hong Kong to wind-up the Company would be unlikely to be recognised in the Cayman Islands except for the purpose of introducing a scheme of arrangement. Liquidators appointed by a Hong Kong court would be unable to take control of the Company's British Virgin Islands subsidiaries which are the intermediate holding companies of the Mainland China subsidiaries.[1] It must therefore be assumed that any liquidator appointed by the Hong Kong court would not be able to obtain control of the Company's intermediate subsidiaries and obtain control of the Mainland China companies. It follows that if the benefit that is sought by winding-up the Company is to recover assets in the Mainland China, it is not a benefit that can be obtained by winding-up the Company in Hong Kong.

- Further, it is very unlikely that a liquidator appointed over the Company in Hong Kong could carry out a meaningful investigation or commence any legal proceedings which required the subsidiaries involvement as their appointment would not be recognised in the Mainland China.

Takeaway points

It appears to be more difficult now to put a foreign incorporated listed company into liquidation in Hong Kong. In many cases, demonstrating a real benefit may not be easy because of the issues raised by the court in the *China Huiyuan Juice* case.

---

[1] Citing *Kam Leung Sui Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501 and a number of offshore judgments e.g. *Re China Arotech Holdings Ltd* Cayman Islands Grand Court, 19 September 2017 and *Re Dickson Group Holdings* [2008] SC (Bda) 37 Com, 9 May 2008

A petitioner issuing a winding up petition in Hong Kong against a foreign incorporated company listed in Hong Kong will need to recite in the petition and evidence adduced the facts and matters relied on as demonstrating a real benefit. If it is asserted that the realisation of the value of the listing constitutes a real benefit, it will be necessary to adduce evidence demonstrating that on balance this will prove to be the case if a winding-up order is made. It will not be sufficient to file an affirmation in which the deponent simply recites this to be his or her belief.

Hong Kong assets directly held by the debtor company would be the most straightforward way to satisfy the second core requirement, but it is not always easy for a petitioner to have access to information about the debtor company's assets in Hong Kong.

Contact us

Alexander Tang
Partner
T: +852 2533 2881
Email: Alexander

Jeannie Liu
Associate
T: +852 2533 2859
Email: Jeannie