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A welcome red packet – Hong Kong court recognizes mainland Chinese administrators for first time

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Just in time for the Chinese New Year, a Hong Kong court has taken a major step forward in the developing law on cross-border insolvency by recognizing a mainland Chinese liquidation for the first time. In the Joint and Several Liquidators of CEFC Shanghai International Group Ltd [2020] HKCFI 167, Mr. Justice Harris granted recognition and assistance to mainland administrators in Hong Kong so they could perform their functions and protect assets held in Hong Kong from enforcement.

He also declined to follow English precedent dating back more than a century by granting a stay on creditor proceedings in Hong Kong, reasoning that it was in line with modern thinking and practice in cross-border insolvency that a debtor's assets should be distributed as part of a single proceeding, as per the pari passu principle.

A valuable asset

CEFC Shanghai International Group Ltd. (Company) is a mainland-incorporated holding company and part of a conglomerate whose business interests include capital financing, petroleum refining, and infrastructure. It was placed into insolvent liquidation on 15 November 2019 pursuant to an order by the Shanghai Court under the Enterprise Bankruptcy Law (EBL). Administrators were appointed on 24 November 2019.

The Company's assets in Hong Kong included a claim against a Hong Kong subsidiary in liquidation, Shanghai Huaxin Group (Hong Kong) Ltd. amounting to HK$7.2 billion (Receivable). After their appointment, the administrators discovered that an investment fund, Right Time Global Investment SPC-Right Time Value Investment Fund SP (Right Time) had obtained a default judgement against the Company in Hong Kong for €29 million in August 2018, subsequently obtaining a garnishee order nisi in respect of the Receivable in August 2019.

The initial hearing was scheduled for 11 December 2019 but was blown off course when the administrators made an urgent application to the Court for recognition and assistance, and requested the adjournment of the garnishee proceedings until after their application was determined. The administrators' application was supported by a letter of request issued by the Shanghai Intermediate People's Court. Harris J. granted an order in terms, giving his reasons in a judgment dated 13 January 2020.

Not so new

Harris J. noted that the Court had dealt with a large number of applications for recognition and assistance, principally from common law jurisdictions such as the Cayman Islands, Bermuda, and the British Virgin Islands reflecting the fact that many Hong Kong listed companies are incorporated in those jurisdictions.

The Court had even provided a standard-form recognition order to guide applicants, as set out in Re Joint and Several Liquidators of Pacific Andes Enterprises (BVI) Ltd HCMP 3560/2016, subsequently revised in Re Joint Provisional Liquidators of Hsin Chong Group Holdings [2019] HKCFI 805.

The criteria that had to be satisfied before recognition and assistance would be granted are that the foreign insolvency proceedings are

i. collective insolvency proceedings; and

ii. opened in the company's country of incorporation.

The powers that could be granted were limited, and would not include allowing foreign officeholders to do something which they would be unable to do even under the law by which they were appointed.

So won't you stay?

The powers under the standard-form order do, however, include a stay on proceedings against the debtor in Hong Kong, as if the debtor were in liquidation in Hong Kong. Harris J. found that the reasoning of an early 20th century English House of Lords authority *Galbraith v. Grimshaw* [1910] AC 508 – which had held that an English garnishee order nisi made before a Scottish bankruptcy order should be allowed to stand – was out of kilter with cross-border insolvency law and practice as now understood and applied.

Harris J. reasoned he was not precluded by that decision from giving assistance to the mainland proceedings by declining to make the garnishee order in favor of Right Time, obtained before the commencement of the mainland insolvency proceedings, absolute. Harris J. noted that it would "generally be desirable that all debtor's assets are taken into the control of the foreign liquidator in accordance with the process that the local court has recognized".

Collective and consistent

Harris J. said the mainland liquidation was undoubtedly a collective insolvency proceeding, since it encompassed all of the debtor's assets. The powers sought were consistent with mainland insolvency law and the standard recognition order developed by the Hong Kong courts.

The purpose of recognizing and assisting a foreign liquidation is to make it possible for there to be one bankruptcy and for the debtor's assets to be realized, creditors' claims determined and a distribution of available assets made to creditors on a pari passu basis under the control of insolvency practitioners appointed and supervised in accordance with one insolvency regime.

The Court noted that it was unclear to what extent the mainland courts would respond to an application for recognition, though Article 5 of the EBL envisaged recognition of foreign liquidators "as one would expect to be the case given the transnational business conducted by many mainland businesses."

Precedent past?

The decision represents another decisive step forward in the development of the Court-led insolvency law in Hong Kong, in the absence of a comprehensive statutory regime.

It is also another occasion in which Harris J. has made waves by refusing to follow what might be regarded as classical orthodoxy, following his controversial decision in *Lasmos Ltd. v. Southwest Pacific Bauxite (HK) Ltd.* [2018] HKCFI 426, which has led to some appeal court questioning (see our client alert Back to Basics – Hong Kong Court of Appeal queries approach to winding-up petitions where arbitration is involved).

Despite the legislature's reluctance to establish a new statutory framework, the decision keeps Hong Kong at the forefront of the development of the law in cross-border insolvency assistance. It also serves as a useful warning message that the assistance of the court may only be available in other jurisdictions which take a similar unitary approach to transnational insolvencies as Hong Kong does.

The judgment is available here.

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