

ACUMINOUS

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THE RISE AND FALL OF LIGHT TOUCH PROVISIONAL LIQUIDATION

In the recent Hong Kong judgement of *Li Yiqing vs Lamtex Holdings Limited* [2021] HKCFI 622 (“*Re Lamtex*”), a landmark decision was made by Harris J clarifying the interplay between offshore “light touch” provisional liquidation and Hong Kong winding-up proceedings and setting out certain general approach in determining how a dispute on insolvency process (in primary jurisdiction) is to be resolved.

Executive Summary

In a recent decision made in *Re Lamtex*, the Court considered the view that an application to appoint “light touch” provisional liquidators in Bermuda in that particular case was part of an effort to avoid a winding up in Hong Kong. It effectively engineers a *de facto* moratorium, which is not available under Hong Kong law, to provide extra time for devising a solution to the Company’s financial problems. Harris J, in his judgement, sets out certain important considerations in determining how a dispute on insolvency process is to be resolved, in particular that appropriate weight should be given to the location of the company’s Centre of Main Interest (“COMI”) considering the circumstances of the case.

Going forward, it is anticipated that unless an agreement has been made between the Company and its creditors, the court will unlikely deal with recognition and assistance applications made by “light touch” provisional liquidators after a winding up petition has been presented in Hong Kong.

Light touch provisional liquidation

Hong Kong does not currently have a statutory regime to facilitate a restructuring of a company’s debt. Whilst scheme of arrangement is available under the Companies Ordinance for the purpose of implementing a restructuring, no statutory moratorium is currently available to restrict creditors from frustrating the restructuring effort by placing the company into liquidation.

In light of the above, “light touch” provisional liquidation has become more common for distressed foreign-incorporated companies in the recent years and in turn, a recognition order will be filed in Hong Kong for their appointment. As a result, a moratorium or stay may be granted in the recognition order for the provisional liquidators to facilitate a restructuring.

One of the main advantages of “light touch” provisional liquidation is that it allows “light touch” provisional liquidators to assist the company in implementing a

restructuring while the directors of such company maintain certain control and management of the business operation of the company. Another key advantage is that “light touch” provisional liquidation invokes the statutory moratorium which serves to protect the company from winding up proceedings by creditors. This kind of flexibility allows additional time for the company to implement its restructuring plan, which usually achieve a more preferable outcome for stakeholders of the company as a whole as compared to a liquidation scenario at the other extreme.

The *Re Lamtex* Decision

In *Re Lamtex*, the petitioner presented a winding-up petition in Hong Kong against Lamtex Holdings Limited (“*Lamtex*”), a Hong Kong listed company incorporated in Bermuda, based on an undisputed debt.

Subsequently, Lamtex presented a winding-up petition in Bermuda and sought the appointment of “light touch” joint provisional liquidators for restructuring. Followed by their appointment, the joint provisional liquidators obtained a recognition order in Hong Kong and sought an adjournment of the Hong Kong winding-up petition for the purpose of a restructuring.

The key question for the Hong Kong Court is to determine whether to put Lamtex into immediate liquidation in Hong Kong, or to give primacy to the provisional liquidation in Bermuda (i.e. Lamtex’s place of incorporation), to adjourn the petition in Hong Kong in order to allow Lamtex and the joint provisional liquidators an opportunity to restructure the debt.

Harris J explained that a winding-up order in a company’s place of incorporation would be given extra-territorial effect in Hong Kong under Hong Kong rules of private international law. He added that it had become a prevalent behaviour for companies appointing “light touch” provisional liquidators for the purpose of immunity from creditors’ actions and so to strive for additional time to facilitate the corporate rescue. The Court took the view that there was a need for Hong Kong courts to limit recognition

to liquidators appointed in the place of incorporation.

What the Court criticised was that the owners of the insolvent companies and their operated businesses had no connection with the offshore jurisdiction, that the companies' COMI was likely to be in Hong Kong or in the Mainland. Harris J suggested extending the common law of Hong Kong to permit recognition of insolvencies in places other than a company's place of incorporation, and in particular in its COMI. In conclusion, the Court considered that Lamtex had failed to demonstrate sufficient reason to adjourn the petition; hence, he decided to proceed with the normal winding up order as petitioned.

Despite a "light touch" provisional liquidation being able to provide a higher degree of flexibility to facilitate cross-border restructuring, the Court suggested that the following should be considered when dealing with cross-border insolvency:

- Generally, the place of incorporation should be the jurisdiction in which a company should be liquidated; in practice this means it will be the system for distributions to creditors.
- However, the COMI may be elsewhere with reference to the following factors:
 - Is the company a holding company and, if so, does the group structure require the place of incorporation to be the primary jurisdiction in order to effectively liquidate or restructure the group.
 - The extent to which giving primacy to the place of incorporation is artificial having regard to the strength of the COMI's connection with its location.
- The views of the creditors and whether a viable plan to restructure the company's debt is available in avoidance of scepticality from petitioner and creditors on the companies' prospects.

Taking these suggestions into consideration, which insolvency process should be given primacy will depend on the circumstances of the case and the location of the company's COMI.

Introduction of the Companies (Corporate Rescue) Bill

In early 2021, the Hong Kong Government finally announced its plan to introduce the Companies (Corporate Rescue) Bill ("Bill") in view of addressing the deficiencies in corporate rescue regime in Hong Kong. The Bill is intended to introduce a statutory corporate rescue procedure

("Corporate Rescue Procedure") and insolvent trading provisions in Hong Kong and act as an additional tool to allow necessary breathing space for a financially distressed company to preserve its assets and to formulate a rescue plan.

A company (or the liquidator/provisional liquidator of the company if it has already entered into winding-up or is subject to a winding-up application), which is insolvent or will likely become insolvent, may initiate a Corporate Rescue Procedure (with support from its major secured creditors) and appoint a provisional supervisor ("Provisional Supervisor"). A Provisional Supervisor must be a certified public accountant or solicitor and, once appointed, will displace the directors and management of the company and act as its agent during the period of "provisional supervision". The standard period of provisional supervision will be 45 business days allowing the Provisional Supervisor to devise a rescue plan (which may be further extended).

Under the Bill, insolvent trading provisions are also proposed to ensure that when a company is slipping into insolvency, the director would be held responsible if they have not acted promptly to address the situation.

Conclusion

Even though the Hong Kong Court may be more reluctant to provide foreign provisional liquidators with assistance and recognition after *Re Lamtex*, a detailed and viable restructuring plan in place along with support from creditors would likely have a significant impact on the Hong Kong Court's decision. With the proposed new Bill, it opens new opportunities to methods of restructuring.

One of the key factors to a successful restructuring remains to be effective planning. To increase the chance of success, agreement between the Company and its creditors should be obtained in advance regarding a viable restructuring plan prior to recognition and assistance applications made by "light touch" provisional liquidators to the Hong Kong Courts. Professional advice should be sought for at an earlier stage to effectively plan for a successful restructuring.

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