

MUTUAL RECOGNITION OF INSOLVENCY IN HONG KONG AND MAINLAND CHINA - FIRST STEPS

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Legal Briefings

Initial arrangements have been put in place for mutual recognition and assistance to be provided by courts in Mainland China and Hong Kong in respect of corporate insolvency proceedings. This is a significant and long awaited development which could substantially enhance the ability for cross border insolvencies and restructurings to be administered and implemented across the two jurisdictions.

The new arrangement expressly contemplates mutual recognition of debt restructurings and business reorganisations. This potentially means that it is possible for Mainland creditors to be crammed down by a Hong Kong scheme of arrangement (and vice versa). This may in turn encourage more use of this procedure.

However, applications for recognition of Hong Kong schemes of arrangement in Mainland China may only be made by Hong Kong liquidators and provisional liquidators. This requirement may therefore reduce the appetite of companies to utilise this recognition mechanism in restructurings where such liquidation or provisional liquidation proceedings have not yet commenced in Hong Kong and are not otherwise desirable.

BACKGROUND

On 14 May 2021, the Vice-President of the Supreme People's Court of the PRC and the Hong Kong Secretary for Justice signed a brief [Record of Meeting](#), setting out a consensus on the mutual recognition of and assistance to insolvency proceedings between the Mainland China and Hong Kong.

Further details of the implementation of this arrangement are set out in an Opinion of the Supreme People's Court ([SPC Opinion](#)) and a [Practical Guide](#) issued by the Hong Kong SAR Government.

In Mainland China, the new arrangement will apply first to the Intermediate People's Courts in certain pilot areas, namely Shanghai, Xiamen and Shenzhen. There are plans to progressively expand the scope of the pilot areas.

RECOGNITION OF HONG KONG INSOLVENCY PROCEEDINGS IN MAINLAND CHINA

Under the new arrangement, a Hong Kong liquidator or provisional liquidator (**Hong Kong Administrator**) may apply to the relevant Intermediate People's Court in a pilot area for recognition of "collective insolvency proceedings" commenced under the Companies (Winding Up and Miscellaneous Provisions) Ordinance and the Companies Ordinance (**Hong Kong Insolvency Proceedings**). These Hong Kong Insolvency Proceedings include:

- compulsory winding-up;
- creditors' voluntary winding-up;
- schemes of arrangement promoted by a liquidator or provisional liquidator and sanctioned by the Hong Kong Court.

The new arrangement will apply to proceedings in which the debtor company's centre of main interests (**COMI**) is in Hong Kong. Whilst the SPC Opinion states that *COMI generally* means the place of incorporation, it also requires Mainland Courts to take into account other factors including the locations of the principal office, business and assets of the subject company. Notably the SPC Opinion requires that the COMI of the debtor company have been in Hong Kong continuously for at least 6 months at the time application is made for recognition and assistance.

The use of the COMI test also opens the door to recognition of Hong Kong insolvency proceedings relating to companies incorporated offshore. This is highly practical and welcome – most HKEx-listed companies are not incorporated in Hong Kong, but may have their COMIs in Hong Kong. Insolvency proceedings relating to these companies form a significant portion of insolvency proceedings in Hong Kong.

However, the SPC Opinion also specifies a number of circumstances that would require a Mainland court to refuse to provide recognition or assistance. These include unfair treatment of Mainland creditors, violation of basic principles of Mainland law, offence to public order or good morals or any other circumstance where the People's Court considers that recognition or assistance should not be rendered.

ASSISTANCE AVAILABLE TO HONG KONG ADMINISTRATORS IN MAINLAND CHINA

In the interim period between the recognition application and when recognition is granted the Mainland Court may deal with an application by a Hong Kong administration for asset preservation measures under Mainland law.

Once recognition is granted, the SPC Opinion provides for a number of automatic consequences, including:

- invalidation for any further payment of debts by the debtor company to individual creditors;
- suspension of civil actions and arbitrations that has not yet concluded; and
- suspension of procedures for execution against the property of the debtor.

In addition, the Hong Kong Administrator may apply for an order of the Mainland Court allowing the Hong Kong Administrator (or a designated “Mainland administrator”) to take over various duties in respect of the administration of the insolvency of the debtor company that fall within the scope of the provided by the *Enterprise Bankruptcy Law of the People’s Republic of China* (**PRC Enterprise Bankruptcy Law**) and by Hong Kong law. This is subject to the proviso that certain acts having a major impact on the interests of creditors require additional separate approval by the Mainland Court.

The Mainland Court may also make an order (on application) granting assistance concerning (among other things) the realisation of bankruptcy property, distribution of bankruptcy property, debt restructuring arrangement or termination of bankruptcy proceedings.

The SPC Opinion places some constraints on the treatment of the assets of the debtor company, requiring that the bankruptcy property of the debtor in the Mainland must first be used to satisfy preferential claims under Mainland law. Once those claims are satisfied the balance of the property is to be distributed in accordance with the Hong Kong Insolvency Proceedings - provided that creditors in the same class are treated equally.

RECOGNITION OF MAINLAND INSOLVENCY PROCEEDINGS IN HONG KONG

We previously wrote about [Re CEFC Shanghai](#) and [Re Shenzhen Everich](#), where the Hong Kong Court granted recognition and assistance to Mainland administrators on the basis of the common law principles of recognition of foreign insolvency proceedings.

Given this recognition and assistance already exists, the Hong Kong implementation of the mutual recognition is by way of Practical Guidance as to how a Mainland administrator should go about seeking the recognition and assistance of the Hong Kong Court. This process involves first seeking a “letter of request” from the appropriate Mainland court addressed to the Hong Kong Court setting out the order sought from the Hong Kong Court. Upon issuance of that letter, the Mainland administrator may then make an application to the Hong Kong Court on an *ex parte* basis. Sample documents in respect of the letter of request, originating summons, affidavit in support and a standard form order are all provided as part of the Practical Guidance.

Whilst not expressly addressed in the Practical Guidance, the Record of Meeting contemplates that an administrator in Mainland bankruptcy proceedings may apply to the Hong Kong Court for:

- recognition of bankruptcy liquidation, reorganisation and compromise proceedings under the PRC Enterprise Bankruptcy Law;
- recognition of the administrator's office as an administrator; and
- the grant of assistance with discharge of the administrator's duties as an administrator.

FURTHER DEVELOPMENTS ON THE HORIZON

Cooperation between the Mainland and Hong Kong courts continue to strengthen.

Assuming the mutual recognition arrangements provided for under the Record of Minute prove successful, there may well be further adjustments to this regime to provide for the recognition in Mainland China of the Hong Kong [provisional supervision or voluntary arrangement envisaged under the Companies \(Corporate Rescue\) Bill](#) - if that legislation is passed.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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