

Client Alert

February 2020

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Novel coronavirus outbreak – New business disruptions to Hong Kong industries

On 30 January 2020, the World Health Organization declared that the coronavirus outbreak constituted a public health emergency of international concern. The PRC and Hong Kong have been at the forefront of the coronavirus outbreak. Whilst the Hong Kong government, judiciary and many in the private sector are gradually returning to 'business as usual' after a month long work from home, and limited public services, understandably many companies and businesses will be keeping a close eye on the risks which the coronavirus outbreak poses to business in Hong Kong, including management of insolvency risks in the coming months.

Notably, during the 2020 to 2021 Financial Budget Speech¹ in the Legislative Council on 26 February 2020, Financial Secretary Paul Chan noted that whilst he believes that the economy would recover after the coronavirus epidemic was over, its impact could "*possibly be greater than that of the SARS outbreak in 2003*", and some sectors e.g. tourism and consumption-related sectors, were already entering into a "harsh winter".

Our client alert focuses on management of the insolvency risks in light of economic uncertainties that may arise following the coronavirus outbreak. For information on the effect of the coronavirus on force majeure clauses, see Baker McKenzie's earlier alert "[Coronavirus: Crisis management through force majeure – a Hong Kong law perspective](#)".

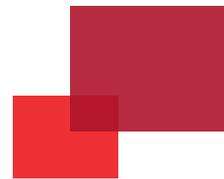
What is an insolvency event?

Many in Hong Kong will be aware that '*inability to pay debts*' is a ground for winding-up a company under s.177(1)(d) Companies Winding-Up and Miscellaneous Provisions Ordinance (Cap.32)(CWUMPO), and that compulsory liquidation by court winding-up order will be an insolvency event. Under s.178 CWUMPO, a company will be deemed unable to pay its debts under statute in certain circumstances e.g. failure to pay debts within 21 days of service of a statutory demand for more than HKD10,000.

Other events which may be an insolvency event by law or deemed to be an insolvency event in contractual clauses include:

- Creditors' Voluntary Liquidation (where the company resolves to wind-up in circumstances where the board of directors form the view that the company is unable to pay its debts); or Members' Voluntary Liquidation (where the company resolves to wind-up, notwithstanding the ability to pay its debts as they come due in the next 12 months).
- The company is insolvent on a cash flow and / or balance sheet test.

¹ <https://www.budget.gov.hk/2020/eng/budget03.html>



- The company is served with a statutory demand or served with a winding-up petition (regardless of the grounds or merits of winding-up).
- Where receivers or managers are appointed over the company or its assets.

How will insolvency affect my business?

Whilst many will be aware that a company in liquidation will be unable to continue business as a going concern as a result of liquidation, companies may find themselves unprepared for the wide scope of events that can be caught by "Insolvency Event" clauses and the contractual defaults that may be triggered as a result. Companies should actively review "Insolvency Event" and "Event of Default" clauses and definitions in existing contracts to consider the events or consequences that may be set in motion if those clauses are triggered.

An insolvency event may trigger wide reaching consequences. For instance:

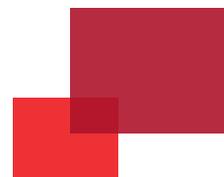
- It will typically be an event of default in contracts, and can trigger breach of contract, although in some circumstances the event of default may be remedied e.g. withdrawal of the statutory demand or petition.
- It can trigger cross-defaults of other contracts e.g. leases, finance agreements, supplier agreements, joint venture agreements, and therefore may require a holistic approach to negotiating waiver of breaches or other means of resolution.
- Due to the public nature of winding-up petitions, which are gazetted and advertised in local newspapers, it may give rise to wide scale negative publicity and the freezing of bank accounts or other credit lines by creditors who become aware that the company is subject to a winding-up petition. These considerations also apply where the company has given notice of meetings to resolve for voluntary liquidation.

Even in the event of liquidation, directors must remain alert as former directors of a company in liquidation may be liable for breaches that took place before liquidation and will also owe duties in liquidation, for example:

- Duties to deliver assets, books, records and papers to the liquidators;
- Duty to prepare a sworn statement of affairs verifying the company's assets and liabilities; and
- Other duties to assist the liquidators e.g. to attend interviews or meetings, and to co-operate during the liquidation.

What should management do when facing insolvency risks in uncertain times?

While the coronavirus continues to impact local and regional businesses, and the overall global economy remains uncertain, we would recommend companies take the following steps to actively monitor and manage potential insolvency risks (whether their own or those of business stakeholders):



- Review contracts to consider Insolvency Event and Event of Default clauses, noting that different contracts will have clauses of different thresholds, e.g. from threatened to actual liquidation, and some will have remedy provisions.
- Monitor news regarding the financial position of business partners, including news of winding-up petitions or court actions for debt recovery, breaches of other contracts, or closing of business operations.
- Review the business' balance sheet / fund flow position with financial and legal advisors for early detection of insolvency and cross-default risks and timely financial restructuring.
- Seek legal advice on directors' duties when there is a risk of insolvency, and ensure that the business complies with good corporate governance notwithstanding economic difficulties.
- Consider the implications of an insolvency event on key stakeholders including creditors and employees, where there may be intervention by the Labour Department in appropriate cases, e.g. default in wages.
- Review new contracts and those coming up for renewal with particular attention to whether Event of Default and Insolvency Event clauses need to be specially tailored in times of greater economic uncertainty.
- For multinational companies or companies with cross-border businesses or assets outside of Hong Kong, where insolvency events may be triggered in jurisdictions outside of Hong Kong, consider cross-border insolvency risks which require Hong Kong and foreign law advice.
- Consider strategies to preserve the value of tangible and intangible assets such as intellectual property rights, especially where different operational assets are held by different entities within a group of companies.

Different considerations will apply depending on the industry in which the company operates – we have subject matter and industry specialists who can assist and offer practical advice.

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