

# Hong Kong government announces long-awaited corporate rescue regime

24 November 2020

The Hong Kong government is proposing much-anticipated legislation for the introduction of a corporate rescue procedure and insolvent trading regime. Hong Kong has, for years, struggled to introduce a statutory corporate rescue procedure (CRP), having previously made unsuccessful attempts in 2000-2001, 2008-2009, and 2014.

Now – with COVID-19 severely impacting the economy – the government has finally tabled the Companies (Corporate Rescue) Bill.

A [Legislative Council Paper](#) published by the Financial Services and Treasury Bureau, sets out the reasons why a statutory CRP is needed. The existing options (a non-statutory workout agreement between a company and its creditors for the purpose of restructuring debt – or a scheme of arrangement under the Companies Ordinance, which enables a compromise between a company and its shareholders and creditors), do not provide for a moratorium (stay of proceedings), which prevents creditors from applying for a winding up of the company, hence hindering the effectiveness of any rescue plan.

The paper says that a new CRP regime, with a statutory moratorium, will be an additional tool to allow the necessary breathing space for financially distressed companies to preserve assets and formulate a rescue plan. It notes as well that the new CRP "may also be a timely and useful option for companies experiencing short-term difficulties" brought about by recent economic setbacks related to the response to COVID-19.

The paper says that all parties involved will benefit if a company is rescued under the CRP rather than undergoing liquidation – shareholders should find their interests better served if the company is rescued, secured creditors will find the value of their security enhanced if the company continues in business, and unsecured creditors may even get a better return whilst employees may be able to keep their jobs when the company continues to operate.

## **Provisional supervision**

The CRP also embraces the concept of provisional supervision, the commencement of which requires the major secured creditors not to object to. The provisional supervisor (PS), who must be a certified public accountant or solicitor, displaces the directors and management of the

company and will act as its agent in the moratorium period during which the company will continue to act as a going concern.

The period of provisional supervision is set at 45 days to allow the provisional supervisors enough time to draw up a rescue plan. The period may be extended up to six months with consent given at a creditors' meeting, or more than six months upon successful court application. The PS will investigate the company's business, property, affairs, and financial circumstances so as to prepare a rescue proposal, known as a voluntary arrangement (VA).

The VA will be considered at a creditors' meeting at the end of the provisional supervision. The creditors will then decide whether to approve the VA. If they do, the VA is implemented under the supervision of a supervisor who must also be a certified public accountant or solicitor.

### **Role of major secured creditor**

Previous proposals had suggested that the major secured creditor (MSC) would have an absolute veto over the appointment of a PS. The option now contemplated suggests that the MSC will instead be provided with a right to object, with the provisional supervision being initiated if the MSC does not issue a notice of objection within five business days after it has been informed of a company's intention to initiate a CRP. There is no indication that the company will have the benefit of a temporary moratorium from the point in time in which any secured creditor is approached for their consent to appoint a PS. This would have been a helpful feature.

### **Wide application**

It is proposed that the regime will apply to both local companies and registered non-Hong Kong companies (RNHKCs) which includes unregistered companies. This will be welcomed by liquidators of non-Hong Kong companies who often find themselves coming to court to apply for recognition for the purposes of "soft touch" company restructuring (see our previous publications: *A soft touch – Hong Kong court recognises foreign appointed provisional liquidators for company restructuring* and *Hot on the heels – Hong Kong court continues to favour corporate restructuring of overseas entities*).

### **Insolvent trading provisions**

The Bill includes insolvent trading provisions to ensure that directors are held responsible if they have not acted promptly where a company is slipping into insolvency. At the same time, the proposals stipulate statutory defenses to provide recourse to directors who may be caught inadvertently by the provision.

### **Employee safeguards**

The Bill includes various measures to protect employees including a provision mandating that the outstanding entitlements of employees owed by a company as at the commencement of provisional supervision should be paid in accordance with a phased payment scheme. The entitlements of employees arising after the commencement of provisional supervision are to be paid in compliance with relevant statutory provisions and the terms and conditions of their employment contracts. Employees also benefit from certain exemptions to the statutory moratorium.

### **Court safeguards**

The brief says that the court will have a role in preventing abuse of the CRP process, maintaining its overall integrity and facilitating its proper comportment. The court will also be given powers

to provide for proper checks and balances on the powers of PS and the supervisor to prevent abuse.

### **Ipsa facto omission**

Singapore and more recently the UK have followed countries such as the United States and Australia in introducing legislation, which prohibits a party from terminating a contract solely on account of an insolvency event affecting the other party. Such legislation is intended to assist distressed companies to continue as a going concern and to preserve value in the business for the benefit of all stakeholders. It appears the opportunity to align Hong Kong's restructuring legislation with other more debtor-friendly rescue regimes has not been taken in this respect.

### **Timing**

The briefing note says the Bill will be introduced into LegCo in early 2021. The government says that it is also preparing the subsidiary legislation necessary to be tabled a few months after the enactment of the Bill.

The introduction of the Bill represents a major step forward for Hong Kong, which has long been seen as falling behind its peers in its lack of a statutory CRP.

We will monitor the Bill's passage closely and provide further updates as and when they become available.

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