Article

Provisional Liquidators, the Automatic Stay, and the Hong Kong Court

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This article considers the approach taken by the Cayman Court when faced with an application by a company to appoint 'soft touch' provisional liquidators and obtain the benefit of the statutory moratorium when proceedings are extant in another jurisdiction, and a recent decision of the Hong Kong Court providing an indication of how such an application for recognition of the appointment and stay will be dealt with in Hong Kong.

Section 97(1) of the Companies Act provides:

"When a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings, including criminal proceedings, shall be proceeded with or commenced against the company except with the leave of the Court and subject to such terms as the Court may impose."

The statutory moratorium that arises as a consequence of it means that the appointment of a 'soft touch' provisional liquidator has long since been an attractive option available to Cayman Islands' companies that find themselves in financial distress[1]. The appointment of a 'soft touch' provisional liquidator would result in a debtor company benefiting from the moratorium imposed by the Companies Act and provide it with much needed breathing space to enable it to attempt to restructure its debts by way of scheme of arrangement or otherwise.

An application to appoint 'soft touch' provisional liquidators in the Cayman Islands is often in response to insolvency proceedings commenced against a debtor company in another jurisdiction. This creates two immediate questions for the Cayman Court: firstly, should the Cayman Court appoint provisional liquidators over a Cayman Islands' company even if proceedings are extant in another jurisdiction; and, secondly, would the provisional liquidators and the accompanying moratorium be recognised extra-territorially.

The answer to the first question was answered with a resounding 'yes' by the Chief Justice in *Sun Cheong Creative Development Holdings Limited*[2]. The answer to the second, so it had been thought, was that the provisional liquidator would be recognised (and the stay enforced) following the receipt by that foreign tribunal of a Letter of Request from the Cayman Court. In Hong Kong, this traditional understanding has been challenged in recent case law.

Sun Cheong Creative Development Holdings Limited

In *Sun Cheong*, the Chief Justice was faced with a common scenario. Sun Cheong Creative Development Holdings Limited ("Sun Cheong") was a company incorporated in the Cayman Islands, registered in Hong Kong and listed on the HKSE.

Sun Cheong was said to have been profitable historically but had found itself in financial difficulty due to what the Chief Justice described as *'an unfortunate confluence of events in 2019 and 2020'*. These events resulted in Sun Cheong being indebted to 11 different bank creditors in the sum total of HK$168m.

A number of the creditor banks had taken steps in Hong Kong to recover amounts due and owing including the presentation of two separate winding up petitions. In the application before the Cayman Court Sun Cheong acknowledged that it was unable to satisfy these debts and sought the appointment of provisional liquidators to benefit from the statutory moratorium and to give it breathing space to present a compromise to its creditors.

Section 104(3) of the Companies Act provides that the Cayman Court may appoint joint provisional liquidators following the presentation of a winding up petition if that company is, or is likely to become insolvent and intends to present a compromise or arrangement to its creditors.

[1] Such an application was first discussed in In the Matter of Fruit of the Loom (Unreported, 26 September 2000)
[2] Unreported (20 October 2020)

The Cayman Court has long since shown a willingness to promote a restructuring culture in the jurisdiction and afford a debtor company an opportunity to avail itself of the statutory moratorium in an attempt to restructure its debts as an alternative to entering into official liquidation. Of course when dealing with companies whose affairs largely take place in other jurisdictions (and particularly if enforcement proceedings are extant), the issue of judicial comity comes to the fore.

Faced with this consideration, the Chief Justice found that:

"All other things being equal, this will generally be assumed to be the place of incorporation of the company, being the place that its investors, service providers and trade creditors would typically associate with, among other things, the company's registered office and the law governing the duties of its board of directors and its Articles of Association."

The Chief Justice was emboldened in concluding this due to the fact that the Cayman Islands is an 'advanced and reputable international financial centre', and, importantly noted long established jurisprudence in Hong Kong recognising foreign insolvency officeholders appointed in the country of incorporation[3].

It was however accepted that there were circumstances in which the Cayman Court would recognise foreign insolvency practitioners that had been appointed over a Cayman Islands domiciled company by a foreign court. In particular, recognition may be given to a foreign office holder when his or her appointment was to facilitate a restructuring, whereas the Cayman Court may be less willing to do so if the purpose of the appointment was solely to wind up that entity.

Sun Cheong restates what had generally been accepted as the position in the Cayman Islands: unless there was good reason to the contrary, the jurisdiction of incorporation was the most appropriate venue to conduct its restructuring, with recognition being afforded to the local practitioner overseas to assist that restructuring and implement a stay of proceedings wherever necessary.

FDG Electric Vehicles Limited

A significant proportion of companies that have sought the protective wrapper of provisional liquidation are incorporated in the Cayman Islands and carrying out business in Hong Kong or the PRC. More than 50% of the companies listed in the Hong Kong Stock Exchange ("HKSE") are incorporated in the Cayman Islands. The ability of such a company to utilise the Cayman Islands 'soft touch' provisional liquidation regime is of critical importance given no such equivalent process in Hong Kong.

Historically Cayman Islands provisional liquidators had been welcomed in Hong Kong and throughout 2020 Cayman Islands provisional liquidators were recognised (as, importantly, was the automatic stay) with some regularity.

In *Re Moody Technology Holdings Ltd*[4] Deputy Judge William Wong stated the position as he understood it:

"…it is not in my opinion inconsistent with Hong Kong law for restructuring powers to be granted by way of assistance to a provisional liquidator appointed over a foreign company by the court of its place of incorporation, in which a soft-touch provisional liquidation is permissible, as such powers can be granted, albeit in the more limited circumstances discussed in China Solar, to a Hong Kong provisional liquidation."

As part and parcel of this recognition process, it was thought that the recognition of provisional liquidators in an offshore jurisdiction would result in an automatic stay of proceedings in Hong Kong. Indeed, in Sun Cheong the Chief Justice stated this in terms. A 'standard' recognition order made by the Hong Kong Court would often contained a paragraph in the terms of the following:

"For so long as the Company remains in liquidation in [relevant jurisdiction], no action or proceedings shall be proceeded with or commenced against the Company or its assets or affairs, or their property within the jurisdiction of this Honourable Court, except with leave of this Honourable Court and subject to such terms as this Honourable Court may impose."

This was of course seen as desirable to a debtor company subject to proceedings in Hong Kong.

Whilst there is no question as to whether a foreign officer will be recognised in the future, the decision of Justice Harris in *FDG Electric Vehicles Limited*[5] casts doubt as to whether the statutory moratorium imposed by section 97 of the Companies Act will have automatic effect in the future. Here Justice Harris was faced with an application by a foreign officer holder seeking recognition and considered that rather than ordering a general stay, it would be more appropriate for case management orders to be made on a case-by-case basis staying those particular proceedings if appropriate in all of the circumstances. Having reached that conclusion, he made an order in the following terms (and suggested that recognition orders made in due course would be made in the same terms):

"If the Provisional Liquidators wish to apply for a stay or other directions in respect of proceedings in the High Court of any sort as a consequence of the recognition of their appointment by this order such application shall be listed before the Honourable Mr. Justice Harris or such other judge as he shall direct. The Provisional Liquidators shall write to the clerk to the Honourable Mr. Justice Harris seeking case management directions for the determination of any application that they wish to make pursuant to this order."

[3] Citing the decisions of the Hong Kong Court in China Oil Gangran Energy Group Holdings Limited (in Provisional Liquidation) [2020] HKCFI 825 and Moody Technology Holdings Limited (in Provisional Liquidation) [2020] 4 HKC 78.
[4] [2020] 2 HKLRD 187
[5] [2020] HKCFI 2931

Justice Harris consider the decision of the Privy Council in *Singularis*[6] noting that it envisaged a stay being granted in aid of a collective insolvency process. He concluded that the appointment of 'soft touch' provisional liquidators could not, as a matter of Hong Kong law, amount to a collective process and queried (though did not decide[7]) whether foreign proceedings that were not a collective proceeding could justify the imposition of a stay.

It remains to be seen how the Hong Kong Court will determine future applications seeking recognition particularly as it relates to any stay of proceedings, though for now it seems that the benefits to a Cayman Islands' incorporated debtor company of seeking the protective wrapper of an offshore provisional liquidator will outweigh the administrative burden of making an application for a stay in individual actions in Hong Kong.

The tension between the Courts in Cayman and Hong Kong may be expected to increase further as and when Cayman introduces its reforms to Part V of the Companies Act and introduces the concept of a 'Restructuring Officer'. Whilst a company that has appointed a Restructuring Officer will, as a matter of Cayman law, benefit from a statutory moratorium, in light of the decision in FDG, persuading the Hong Kong Court that this amounts to a collective proceeding may prove a difficult task.

*The authors are both members of Conyers' **Asia Disputes & Restructuring Group (ADRG)** which is tasked to provide sophisticated Bermuda, British Virgin Islands and Cayman Islands litigation advice to clients connected to our multi-lingual (Cantonese, English and Mandarin speaking) team based in Asia. The ADRG integrates the most experienced and highest rated partner-led litigation teams in Asia, Bermuda, the British Virgin Islands and Cayman Islands providing seamless and comprehensive services across jurisdictions round the clock. Our advocates in these jurisdictions are leaders in their fields, recognised by all leading independent directories and our greater depth and range of expertise in the region distinguishes us from our competition and ensures that our clients receive comprehensive, reliable and thorough advice.*

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[6] *Singularis Holdings Ltd v PricewaterhouseCoopers* [2015] AC 1675
[7] He was not required to do so as the applicant was content to adopt the case management approach.