

Insolvency Conflict of Laws Needs Hong Kong-China Judicial Recognition Mechanism to be Resolved

Examining the recently adjudicated landmark case in Hong Kong of *Securities and Futures Commission v China Metal Recycling (Holdings) Limited* HCCW 210/2013 the author explains the complexities surrounding cross-border (corporate) insolvencies (“CBI”) between Hong Kong and mainland China (“HK-China CBI”). Going forward, HK-China CBI will have a direct bearing on decisions made by Hong Kong and Chinese courts; since they are already increasingly requested to adjudicate on the same issues during a corporate insolvency, a new mechanism is called for in order to provide a practical and economically viable resolution to the regional conflict of laws issue arising from Hong Kong and mainland China having different insolvency laws in spite of Hong Kong being a part of mainland China, although a special administrative region within it. A new mechanism should focus on the judicial recognition of judgments and court orders concerning insolvencies of companies with establishments in both Hong Kong and mainland China; and if a new mechanism is properly implemented, it can more effectively and holistically facilitate resolution of the regional conflict of laws issue that typically arise during the insolvency procedure of a Hong Kong-listed company with subsidiary companies located in mainland China. Without such a mechanism in place, the provisional liquidators (“PLs”) appointed in Hong Kong will need to devise a more convoluted resolution method in order for them to be approved by the Chinese court before they can take control of the Chinese subsidiary companies.

The landmark case in Hong Kong concerning CBIs involved the securities industry regulator (i.e., Securities and Futures Commission) making its first-ever petition to the Hong Kong Court of First Instance for winding-up of a Hong Kong-listed company (i.e., China Metal Recycling (Holdings) Limited). The case has a cross-border aspect because the PLs appointed by the Hong Kong court had to seek recognition from the Chinese court before they can take control of the subsidiary companies of the Hong Kong-listed company that are located in mainland China.

Since Hong Kong’s reversion to Chinese sovereignty on 1 July 1997, the conflict between Hong Kong and mainland Chinese laws falls into the realm of “regional conflict of laws”, owing to Hong Kong’s status as a Special Administrative Region (“SAR”) of China: a SAR is a subordinated region of its Sovereign (China) and not an independent state. The signing of the Joint Declaration of the Government of the People’s Republic of China and the Government of the United Kingdom of Great Britain and Northern Ireland on the Question of Hong Kong (“Sino-British Joint Declaration”) on 19 December 1984 declared that Hong Kong would be returned to China as the Hong Kong Special Administrative Region (“HKSAR”) on 1 July 1997. The Sino-British Joint Declaration was an agreement between China and the United Kingdom (“UK”), guaranteeing Hong Kong’s freedoms and pluralism under the rule of law for 50 years (starting from 1 July 1997). In fact, Hong Kong and mainland China have different

insolvency laws: in Hong Kong, although it does not have a uniform corporate insolvency law, statutory provisions relating to corporate insolvency are embedded in the Companies Ordinance and its subsidiary legislation such as the Companies (Winding-up) Rules; in mainland China, the Enterprise Bankruptcy Law is China's uniform corporate insolvency law. Besides the difference in its corporate insolvency laws, mainland China is a country with civil law traditions while Hong Kong is a common law jurisdiction through adoption of the English common law; also, Hong Kong's Companies Ordinance (particularly those provisions in relation to corporate insolvencies) is heavily influenced by the UK's Insolvency Act of 1986. Therefore, due to different insolvency laws in mainland China and Hong Kong, which are guided by different legal traditions, CBIs that straddle both these jurisdictions are known as "HK-China CBI cases" and often involve the complex regional conflict of laws issue that have caught the interest and attention of private sector insolvency practitioners, insolvency law academics and government policy makers in mainland China and Hong Kong.

Shortly after the UK's return of Hong Kong's sovereignty to China on 1 July 1997, an economic agreement, the Closer Economic Partnership Arrangement ("CEPA"), was signed on 29 June 2003 to foster and facilitate bilateral trades between the two economic entities. CEPA laid out the basis for economic integration between Hong Kong and mainland China under the political arrangement of the 'one country, two systems' principle so that Hong Kong's capitalist and China's socialist economies can co-exist under the same sovereign nation but operate within separate legal and business frameworks. Yet China and Hong Kong still remained, and continue to remain, two separate judicial jurisdictions; as a result, judicial recognition, which is central to the enforceability of any judicial judgment made in the court of a counterparty jurisdiction, remains a problem between Hong Kong and mainland China.

After Hong Kong became the HKSAR, the first formal judicial recognition mechanism for cross-border instances lies with the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned (the "2006 Arrangement"), which was signed in Hong Kong on 14 July 2006 by the Secretary for Justice of the HKSAR (Mr. Yan-lung Wong) and Vice President of the Supreme People's Court of China (Mr. Justice Songyou Huang). The 2006 Arrangement was adopted at the 1,390th Meeting of the Judicial Committee of the Supreme People's Court on 12 June 2006 and it took effect on 1 August 2008. However, as suggested by its name, the 2006 Arrangement applies only to civil and commercial matters and is not extended to cover HK-China CBI cases. It is important to note that the 2006 Arrangement cannot be adapted to create a new judicial recognition mechanism for HK-China CBI cases unless it is substantially revised. The 2006 Arrangement builds around the parties' choice of jurisdiction (to be in either the HKSAR or mainland China); this is not suitable for cross-border insolvency matters because in many of these cases, the court jurisdiction is established on a non-consensual basis.

The legal lacuna and the unsettled CBI issue is of concern to interested parties located in both jurisdictions; it also leaves unanswered the question of whether a new mutual recognition

mechanism (apart from the 2006 Arrangement) can be constructed that focuses on HK-China CBI cases; and if or when it is in place, it shall greatly increase the chances of enforceability within mainland China of a judicial decision made in Hong Kong. Mutual judicial recognition for judgments and court orders on HK-China CBI cases will have strong economic implications. The problems of HK-China CBI issues have direct relevance to the needs of the HKSAR in maintaining its reputation as a key international financial centre in the world while maintaining strong economic ties with mainland China. The HK-China CBI judicial recognition mechanism should be made available for companies and insolvency practitioners in the HKSAR and mainland China so as to simplify as well as unify the insolvency procedures in both jurisdictions. Otherwise, insolvency practitioners must be innovative and strategically plan for any subsequent insolvency proceedings to take place in mainland China: changing legal representatives and management personnel of Chinese subsidiary companies is one important way to achieve this aim, although this would mean that administrative measures would be deployed to achieve a result that a clearly stated insolvency procedure should bring forth as a matter of course and with legal certainty for all concerned parties.

Judicial recognition lies at the heart of CBI disputes because they concern failing or failed debtor companies whose creditors, assets and/or place of incorporation are located in different jurisdictions. Without judicial recognition, a party seeking to enforce a CBI judgment made by a Hong Kong court against a counterparty in mainland China must initiate separate insolvency proceedings in mainland China. The dangers of duplicated law suits are not merely wasted judicial resources, time and costs; without judicial recognition, similarly-situated creditors may be awarded different judgments by different courts, creating an incentive for forum shopping by creditors.

The judicial recognition mechanism, if or when it is to be created between the Chinese and Hong Kong authorities, is a matter of great public interest because the investing public (whether based in Hong Kong, China or overseas) ought to know about the existing legal protections of their shareholding interests in companies whose creditors, assets and/or place of incorporation are in Hong Kong and/or mainland China in the event of their insolvency and CBI reform proposal. Moreover, judicial recognition facilitates creditor rights protection, which is consistent with the World Bank's Principles for Effective Insolvency & Creditor Rights System. With increasing globalisation of business and commercial activities between Hong Kong and mainland China, a judicial recognition mechanism for HK-China CBI cases can fill the legal lacuna and resolve the unsettled regional CBI issues borne from the inadequacy of current enforcement mechanism under the 2006 Arrangement which does not cover HK-China CBI matters. Creating a judicial recognition mechanism for CBI judgments or orders made by Hong Kong and/or Chinese courts is a timely and significant matter with vast potential positive economic benefits and of public interest.

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