Coronavirus: Stay Tuned – Hong Kong to resurrect Chapter 11–style corporate rescue bill

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Against the backdrop of months-long social unrest and continuing COVID-19 outbreak, Hong Kong has announced the plan to revive a corporate rescue bill that would include US Chapter 11-style provisions. Public consultation will begin in earnest with a view to introducing the bill in October 2020.

This article revisits some of the crucial provisions included in the government's last public consultation concluded in 2014 and highlights what we may expect in the new proposal.

Limits of existing corporate rescue options

At present, a company in financial difficulties may pursue an "arrangement or compromise" with its creditor on a voluntary basis or under the Companies Ordinance. The major drawback is the lack of a statutory moratorium of legal claims against the company, and any creditor not contractually bound could petition to wind up the company and derail the restructuring efforts.

A scheme of arrangement is a statutory arrangement between the company and creditors. The procedure is available to companies incorporated in or outside Hong Kong so long as the company has a 'sufficient connection' with Hong Kong. Connecting factors may include a listing on the Hong Kong Stock Exchange, creditors located in Hong Kong and all or part of the management of the company being based in Hong Kong. However, seeking court endorsement can be a lengthy process – it starts with an application for court approval to convene a meeting of creditors, in which a majority in number representing at least 75% in value of the creditors must endorse/approve the proposed restructuring plan. That plan, when passed still requires final approval from the court.

Background and key features of the 2014 corporate rescue proposal

Hong Kong's corporate rescue reform has a long history – it was initially touted in the Law Reform Commission's report in 1996 and then formally introduced as the Companies (Corporate Rescue) Bill 2001. However, it received substantial criticism and was eventually lapsed. The proposal was subsequently re-examined in 2003 and 2009 after the SARS outbreak and the global financial crisis respectively, but was not even submitted to the legislative council for first reading. Nonetheless, the government launched another round of consultations in 2014 with a view to reviving the corporate rescue bill.

The key features of the corporate rescue bill as presented in the 2014 consultation conclusions are as follows:

1. Provisional Supervision
Provisional supervision may be initiated by a company, its director, provisional liquidator or liquidator but not the creditor. It allows a third party to be appointed as the provisional supervisor to manage and control the company.

Unlike the existing corporate rescue regime, the company only needs to file relevant documents with the Companies Registry without the need to obtain an order from the court. It will also have to publish the provisional supervisor's appointment in the local newspapers and confirm it has a valid insurance policy to cover its outstanding and future employees' compensation liabilities.

This proposal received support from majority of the stakeholders in the 2014 consultations and we anticipate similar provisions will be included in the upcoming new bill.

2. Moratorium
A cornerstone in any legislation facilitating corporate rescue procedures is invariably a moratorium under which civil proceedings (subject to exceptions) against the company would be stayed. Under the 2014 proposal, the no-claim period will commence from the date that the provisional supervisor is appointed for 45 working days. This will allow the provisional supervisor to formulate a voluntary arrangement proposal to creditors and to restructure the company's finance. The creditors may vote to extend the moratorium for up to 6 months.

Exemptions from the restrictions against new claim or winding up petition will likely include those for employees' outstanding entitlements (such as wages and MPF contributions), and unfairly prejudicial claims by minority shareholders.

While creditors will be allowed to exercise their set-off rights from the commencement of provisional supervision, there were concerns that agreements relating to financial collateral cannot be adequately addressed by set-off. The new bill may address this issue by having an exemption list or by way of subsidiary legislation to facilitate further updates in the future.

3. Treatment of employee's outstanding entitlement
The 2014 proposal suggests a phased payment schedule for outstanding employees' entitlements to ensure that employees would be no worse off than in the situation when the company goes into immediate insolvent winding-up.

The views on this issue were diverse. There were concerns that provisions that overly favors the employees would diminish the chances of rescuing the company's business, or that the rescue process would delay repayment to employees as compared to payments under the Protection of Wages on Insolvency Fund in the event of winding up.

This is an area in which the government still needs to find a common ground among the relevant stakeholders.

4. Secured Creditor
The 2014 proposal divided secured creditors into two categories: "Major secured creditor" as a creditor holding one or more charges over the "whole of substantially the whole of the company's property", and all "other secured creditors". Consent from a major secured creditor will be required to commence the corporate rescue process.

This is another area which requires further consideration, in particular the definition of "major secured creditors" by reference to "whole or substantially the whole of the company's assets" instead of a specific percentage of the company' assets. The new bill will also have to address whether consent from all secured creditors will be required before commencement of the corporate rescue procedure if the company does not have a "major secured creditor".

5. Cross-border issues
One fundamental drawback of the proposed corporate rescue procedure is the moratorium will neither prevent creditors from instituting legal proceedings against the company outside Hong Kong, nor protect the company's assets which are located outside of Hong Kong, as it is very common for Hong Kong companies to have assets and operations in Mainland China as well as other jurisdictions.

The effect of the moratorium will essentially be comprised without legal cooperation agreements between Hong Kong and other jurisdictions. Distressed companies may consider to initiate statutory corporate rescue in parallel in other jurisdictions to ensure they are fully protected against hostile creditor while they reorganize their finances in several countries.

Comments

In view of the challenging economic outlook, it is a logical move for the Hong Kong government to re-introduce the corporate rescue regime. At present, companies in Hong Kong are immediately exposed to winding-up or liquidation threats from any single creditor. The lack of corporate rescue procedures also imposes a huge burden on a liquidator's efforts to restructure the company.

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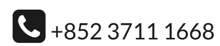
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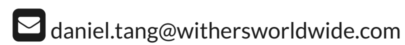
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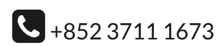
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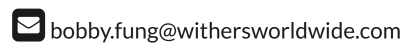
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