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Incentivising Early-Stage Debt Restructuring for Large Firms: A Study of Hong Kong and some United Kingdom Comparisons

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Abstract

Financially distressed companies are more likely to be rescued as going concerns if they enter into debt restructuring early whilst still high up on the 'demise curve'. In Hong Kong, early-stage non-consensual debt restructuring is effected via the scheme of arrangement. Yet, despite the similarities in the legislative framework, Hong Kong is less successful than the United Kingdom (UK) in using the scheme for early going-concern restructuring as the directors often invoke the scheme only when their company is far down the demise curve. We address the reasons for the difference based on the comparative outcomes of the schemes and interviews with insolvency professionals. Our results show that the reasons are attributed less to the differences in directors' duties in the zone of insolvency but the perception on how these duties are enforced. Urgent law reform is thus required to incentivise directors to address the problems early.

Keywords: Insolvency and restructuring law; corporate demise curve; schemes of arrangement; directors' duties; the United Kingdom; Hong Kong

1. Introduction

It is well established that companies benefit from early renegotiations with their creditors when financial distress begins to emerge but has not yet spread to the operations which would otherwise result in economic distress.[1] Accountants and turnaround specialists have used the term corporate 'demise curve'[2] or 'downward spiral'[3]. It refers to a range of situations from the early stage of financial distress where restructuring is possible (particularly if the distress is only financial in nature) up to the late stage where financial distress progresses at an extreme speed to negatively impact the operations, thus inevitably leading to insolvent liquidation. If financial distress is addressed early, financially distressed but economically viable firms may then emerge from the restructuring and continue to contribute productively to the economy. Meanwhile, companies which are unviable can exit the market where their assets can be put to better use.

In the United Kingdom (UK), since the late 1990s, for several reasons documented elsewhere including the fragmentation of the debt market and the rise of distressed debt trading, the scheme of arrangement has emerged as a debtor-in-possession (DIP) tool to effect early-stage

[1] See generally, J Payne, *Schemes of Arrangement: Theory, Structure and Operation* (2nd edn, CUP, 2021) 229.
[2] For a discussion on the corporate demise curve, see Figure 1 below. Sutton, Adam, and Richard Setchim, 'Valuing Sponsor Support' (2014) 19(2) *British Actuarial Journal* 404. See also e.g. Deloitte, 'A rise in financial restructuring scenarios is predicted' <https://www2.deloitte.com/content/dam/Deloitte/za/Documents/za-Deloitte-NED-programme-event-summary.pdf>.
[3] See e.g. Donald Hambrick and Richard D'Aveni, 'Large Corporate Failures as Downward Spirals' (1988) 33 *Administrative Science Quarterly* 1; William McKinley, Scott Latham and Michael Braun, 'Organizational Decline and Innovation: Turnarounds and Downward Spirals' (2014) 39 *Academy of Management Review* 88; Jenny Rudolph and Nelson Repenning, 'Disaster Dynamics: Understanding the Role of Quantity in Organizational Collapse' (2002) 47 *Administrative Science Quarterly* 1; William Weitzel and Ellen Jonsson, 'Decline in Organizations: A Literature Integration and Extension' (1989) 34 *Administrative Science Quarterly* 91.

financial restructuring for large companies.[4] Prior to 2020, a moratorium was not regarded as necessary since~~as~~ the debts that were restructured were financial debts. Financial creditors ~~were regarded as~~ are more sophisticated than 'operational' creditors and would agree either explicitly or implicitly not to enforce their financial agreements in situations where they believe that the debtor remains economically viable.[5] In 2020, significant legal reforms made in the UK via the Corporate Insolvency and Governance Act 2020 (CIGA) included the addition of other tools that are inspired by regulatory competition and influenced by the DIP framework in Chapter 11 of the US Bankruptcy Code 1978 (Chapter 11), such as the moratorium which enables the directors to stay in control of the business while providing breathing space to work out the debt renegotiations, including those to be effected via schemes of arrangement.[6] The restructuring plan was also added as part of the 2020 reforms.[7]

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Hong Kong's legislation and case law track the development of the scheme of arrangement in the UK, except for the 2020 UK reforms. As an international financial hub, the developments in the Hong Kong financial market mirror its UK counterpart. In fact, in 2022, the London and Hong Kong markets are ranked second and third respectively, in the global financial centres' index, after New York.[8] Yet, recent scholarship on Hong Kong schemes of arrangement (sanctioned between 2015 to 2020) suggest that schemes have been used for the restructuring of both financial and operational debts,[9] indicating that by that time, the debtors have ~~clearly~~ slid far down the 'demise curve', and are at the crisis stage such that operations are impacted. Alternatively, the scheme of arrangement is used to facilitate a back-door listing, where the aim is not to preserve the business as a going concern (as the business no longer exists) but for the new investor to inject its (the investor's) assets into the company and enabling the creditors and contributors to realise value of the listing status of the company.[10] These studies are consistent with the earlier studies on Hong Kong schemes of arrangement sanctioned in the 1990s and 2000s.[11]

The existing studies suggest two possible reasons why non-consensual debt restructuring occurs late in the day. First, the regulatory standards imposed on directors to consider creditors' interests in the zone of insolvency could be lax or these duties are not effectively enforced.[12]

[4] See e.g. S Paterson, *Corporate Reorganization Law and Forces of Change* (OUP 2020), chs 2-4.
[5] See e.g. Payne (n 1); S Paterson, 'Reflections on English Schemes of Arrangement in Distress and Suggestions for Reform' (2018) 15(3) European Company and Financial Law Reform 472.
[6] Corporate Insolvency and Governance Act 2020 (CIGA), discussed Section 5.1 below.
[7] See discussion below in n 18 and accompanying text.
[8] 'Leading financial centers globally as of March 2022' (Statista 2022) <https://www.statista.com/statistics/270228/top-financial-centers-on-the-global-financial-centres-index/> accessed 7 August 2022.
[9] WY Wan, *Court-Supervised Restructuring of Large Distressed Companies in Asia* (Hart Publishing 2022), pp 130-131 (referencing the schemes of arrangement in Hong Kong where trade creditors get their debts compromised); WY Wan and C Watters, 'Mandatory Disclosure in Corporate Debt Restructuring via Schemes of Arrangement: A Comparative Approach' (2021) 30 *International Insolvency Review* S111.
[10] Wan (ibid), pp 46-47; 84-85. The listing status of a company on the Hong Kong Stock Exchange is a valuable asset, and is recognised judicially in *Re China Solar Energy* [2017] HKCFI 700; [2017] 2 HKLRD 1074; HCCW 108/2015 at [24]. While the listing status is a valuable asset, it does not belong to the company but to its creditors and contributors; see *Longrun Tea Group Co Ltd v The Stock Exchange of Hong Kong* [2021] HKCFI 1883; HCAL 3809/2019, at [112]. We use the terms "reverse takeovers" and "back-door listing" interchangeably.
[11] See e.g. Qu, 'Towards An Effective Scheme-Based Corporate Rescue System for Hong Kong' (2012) 12 JCLS 85, fn 62 citing the successful schemes of arrangement in Hong Kong and discussed in Section 2.2 below.
[12] See e.g. A Gurrea-Martinez, "Towards an Optimal Model of Directors' Duties in the Zone of Insolvency: An Economic and Comparative Approach" (2021) 21 (2) Journal of Corporate Law Studies 365; see e.g. Wan (n 9), pp 271-273, pointing out the relative weak enforcement of directors' duties "on the books" in Hong Kong.

In either or both situations, opportunistic or ignorant directors will continue trading (and increasing risks of non-payment for the creditors) and/or strategically delay a rescue in the hope that the financial distress is only temporary. Given that the content of directors' duties is similar in both Hong Kong and the UK, and that private enforcement of directors' duties face similar limitations in the two jurisdictions, as explained in Section 4.2 below, further investigation is required as to why directors in Hong Kong are not so similarly incentivised as to their UK counterparts.

Second, a jurisdiction's reorganisation regime may not favour directors retaining full control over the business of the company once proceedings commence. For instance, jurisdictions may require the debtor's management to be completely displaced or even if the management remains to steer the rescue, independent oversight by insolvency practitioners is required.[13] In particular, in Hong Kong, without a formal rescue procedure, and in the absence of unanimous creditor consent, the debtor will have to go into provisional liquidation or winding-up by the time the scheme is proposed to obtain a *de facto* stay of proceedings against unsecured creditors.[14] The result is that directors have few incentives to initiate early restructuring discussions and will do so when creditors commence enforcement proceedings, in which case the directors will be compelled to cede full or partial control.[15] However, given that Hong Kong law is very similar to UK law (at least pre-2020), both which are creditor-friendly jurisdictions, further investigation is required why there are so many more instances of late stage restructuring of large debtors in Hong Kong.

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This paper aims to fill the gap by addressing why large corporate debtors in Hong Kong approach non-consensual debt restructuring via schemes of arrangement late in the 'demise curve', as compared to their UK counterparts and the appropriate legal reforms for a more effective rescue regime in Hong Kong. We make the following contributions. First, the paper combines a theoretical and comparative perspective in examining the extent of, and the circumstances giving rise to, the problems. It draws principally on comparisons with the UK and unlike the earlier studies on Hong Kong restructuring, the paper includes an empirical perspective that draws heavily on interviews conducted with practitioners in Hong Kong as to the law in practice. Second, the paper builds on earlier studies which examines directors' duties in the zone of insolvency 'in the books' in Hong Kong;[16] in this paper, we investigate not only the law in the books but also *how* these duties are actually enforced. Third, the existing studies on Hong Kong restructurings do not comprehensively investigate the behaviour of the directors *vis v vis* creditors when attempting schemes of arrangement but which are ultimately not sanctioned by the court. This is likely due to the limitations on the observability of the data. We partially seek to overcome the limitations by investigating the number of winding up petitions brought against listed companies on the ground of inability to pay (in comparison with the UK) together with the Hong Kong case law where directors are seeking adjournment or stay of winding-up petitions and/or provisional liquidation applications on the express ground of restructuring. The case law is relevant in observing the behaviour of the directors (and the creditor responses) since the debt restructuring is proposed

[13] UNCITRAL, *Legislative Guide on Insolvency Law* (2004, New York), pp 20, 162-165.
[14] E.g. Qu (n 11); see also *Re Legend International Resorts* [2006] 2 HKLRD 192; *Re China Solar Energy Holdings Ltd* [2017] 2 HKLRD 1074; *Re China Solar Energy Holdings Ltd* [2018] HKCU 938 . See CZ Qu, "The court's power to appoint provisional liquidators to carry out rescue roles: Rethinking Legend" (2019) 28 *International Insolvency Review* 86.
[15] E.g. Qu (n 11).
[16] E.g. Wan (n 9), pp 271-273.

using schemes of arrangement even if the applications lead to winding-up. Thus, based on the outcomes of the schemes of arrangement, applications relating to adjournment or stay of winding-up petitions and/or provisional liquidation applications discussed above, interviews and enforcement data, we have a more complete picture in order to propose reforms in Hong Kong which are required irrespective of the wider debate as to whether a corporate rescue framework is necessary for Hong Kong. [17]

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We focus on the scheme of arrangement, as it is the only method to effect a non-consensual restructuring of debts in Hong Kong. While we note that the UK has other gateways to effect non-consensual going-concern restructurings including the company voluntary arrangements (CVAs) and the new restructuring plan introduced in 2020, these gateways are utilised when the company is insolvent or close to insolvency,[18] which is clearly far down the 'demise curve'. In contrast, the scheme of arrangement may be invoked even if the company is not in financial distress.

The paper is organised as follows. Section 2 sets out the literature review on the importance of early stage restructurings in going-concern reorganisations and compares the regulatory framework in Hong Kong and the UK on both 'carrots and sticks' to incentivise early stage restructurings. Section 3 investigates the extent of the problem, that is, *when* companies invoke schemes of arrangement in Hong Kong and the reasons why debtors invoke schemes of arrangement much later, principally through the outcomes and interviews with the insolvency professionals. The interviews reveal the market perception that directors' duties to consider creditors' interests in the zone of insolvency are seldom enforced in Hong Kong.

In Section 4, we seek to support ~~corroborate~~ the evidence with other sources of data, particularly in relation to the question on whether Hong Kong directors of distressed firms are held to account for their actions (or lack of actions) when their companies face financial difficulties. We first rule out significant differences between the debt instruments that are used in financial markets in the UK and Hong Kong which may have accounted for differences in how restructuring takes place. We compare the manner in which directors' duties are enforced in the two jurisdictions, especially during insolvency, and find that there are gaps in the enforcement of directors' duties for failing to consider creditors' interests in the zone of insolvency. We next observe that for listed firms (which we proxy for large firms), winding-up petitions in Hong Kong are more prevalent than the UK, and the criticism in the case law as to the Hong Kong directors' conduct in ignoring the creditors' interests while attempting late-stage restructurings.

Section 5 explains the implications on the shortfalls of the 'carrot and stick' approach towards encouraging directors to come forward early in debt restructuring in Hong Kong.

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[17] Hong Kong has proposed a formal rescue framework since 1996: see Financial Services and Treasury Bureau, *legislative Proposals on the Companies (Corporate Rescue) Bill*, LC Paper No. CB(1)48/20-21(03) (22 October 2020). See also P Smart & CD Booth "Reforming Corporate Rescue Procedures in Hong Kong, Journal of Corporate Law Studies" (2001) 1 JCLS 485.

[18] For company voluntary arrangements (CVAs), there is no requirement that the company must be insolvent but in practice, CVAs are only used when the company is insolvent because it is hard to survive a challenge to the CVA when the company is still solvent; see K Stephenson and Z Stembridge, "Market Development" in *Company Voluntary Arrangements: Law and Practice* (E Nolan and T Smith eds), OUP, 2022, ch 1, para 1.09. For new restructuring plan under Part 26A of the Companies Act 2006 introduced by the 2020 reforms, the new restructuring plan can only be used when the company has or is encountering financial difficulties that affect the company's ability to carry on business as a going concern; in other words, the company is far down the demise curve. See also *Re Gategroup Guarantee Limited* [2021] EWHC 775 (Ch).

Firstly, law reform is required to incentivise directors to come forward early when the company remains high up in the demise curve. Secondly, a more effective mechanism is needed to enforce directors' duties in considering the creditors' interests in the zone of insolvency. Section 6 concludes.

2. Literature Review and Institutional Framework in Hong Kong and the UK

2.1 Shifts in control and the corporate demise curve

It is well established in ~~the law and also~~ legal and finance literature that when a company is solvent, the interests of directors are consistent with the creditors' interests, and debt is the intermediating feature that controls risk-taking on the part of ~~managers~~directors.[19] The directors ~~Control and management of~~ control and manage the company ~~lies with the managers for the company~~ in order to pursue value-maximising activities for the benefit of the company and its shareholders.[20] However, once the company is in financial distress, the interests of the directors and the creditors start to diverge. Directors may start engaging in value-destructive activities that benefit themselves at the expense of creditors. These activities include gambling for resurrection or undertake risky activities in the hope that the company will revive. In addition, directors may withhold information from creditors, which make it difficult for creditors to preserve the company's assets. If the ~~managers~~ directors are appointed by the controlling shareholders, the ~~managers'~~ directors' interests may be aligned with the shareholders, exacerbating the conflicts. In theory, the company and its creditors could have privately contracted as to their course of actions post-insolvency ~~at the time of contracting the debt~~. However, doing so is often inefficient due to the myriad of circumstances that can arise after the debt is incurred. Thus, ~~the jurisdiction's~~ insolvency law steps in to supplant the 'incomplete contract'[21] and requires that control be passed from the debtor to the creditors who can enforce against the assets of the ~~company~~debtor.

Transferring control to the creditors in insolvency, in itself, will not~~, in itself,~~ provide a net benefit for the general body of creditors. Jackson has described the problem as one that creditors, in their own self-interest, will prefer racing to grab the assets of the company in financial distress, even if they are better off bargaining over how the assets should be best used.[22] There are also the wasteful duplicative efforts of enforcement. Hence, insolvency law resolves the coordination problem in several ways. One is to appoint an independent party who decides how to deal with the assets,[23] which is the approach in the UK (in the absence of the moratorium) and in Hong Kong. Another approach is that instead of having an independent party to take control of the assets (and who may decide to sell the assets piece-meal as it does not have the expertise to decide on the company's future),[24] the company's assets may be better kept together for value to be maximised through a going-concern sale or

[19] M C Jensen and W H Meckling, 'Theory of the firm: Managerial behaviour, agency costs and ownership structure' (1976) 3 *Journal of Financial Economics* 305.

[20] P Aghion and P Bolton, 'An Incomplete Contracts Approach to Financial Contracting' (1992) 59 *Review of Economic Studies* 473; P Aghion and P Bolton, 'Incomplete contracts and the theory of the firm: what have we learned over the past 25 years' (2011) 25(2) *Journal of Economic Perspectives* 181.

[21] Aghion and Bolton, 'Incomplete contracts and the theory of the firm: what have we learnt over the past 25 years', ibid.

[22] Eg TH Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, Cambridge 1986); see also TH Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 *Yale Law Journal* 857.

[23] P Aghion, O Hart and J Moore, 'The Economics of Bankruptcy Reform' (1992) 8 *Journal of Law, Economics and Organization* 523.

[24] Ibid.

a corporate rescue.[25] In a going-concern sale, the company's business is sold and will operate under new ownership.[26] In a corporate rescue or reorganisation, the assets are not largely sold, but the balance sheet of the company is restructured into having a more sustainable debt.

Financial distress is a continuum that encompasses a wide range of situations that apply to the companies, the corporate 'demise curve', as a term used by accountants and turnaround specialists. Figure 1 below shows a pictorial representation of demise curve, [27] together with the stages when the directors lose control of the business. Five phases broadly comprise the demise curve: (1) comfort (when the directors view the absence of impending threat to the business); (2) concern (when the business is under pressure); (3) crisis (when distress spreads to the operations and the debtor is, or is likely to be, unable to meet its debts as they fall due); (4) 'control watershed'[28] (or when the directors lose control of the business) and (5) insolvent liquidation. [29] After the stage of the control watershed, the directors are ordinarily displaced unless insolvency law allows the debtor to stay in possession while attempting a restructuring. While not the focus of this article, it is noted that in *BTI v Sequana*,[30] the UK Supreme Court recently held that if the company is insolvent or bordering on insolvency but does not face actual or inevitable insolvent liquidation or administration, the issue of concern was to what extent shareholder interest or creditors interests are taken into account in assessing what is in the interests of the company.~~directors are obliged to balance the interests of the creditors and the shareholders where they conflict, with greater prominence to be placed to the interests of creditors.~~[31]

<Figure 1 here>

In this paper, we are concerned with putting in place a regime that has the appropriate incentives for the directors to invoke such process in advance of actual insolvency and in situations when rescue is still possible that maximises benefit for the general body of creditors. Non-consensual ~~C~~corporate rescue should not be triggered too early; if the company is able to pay its debts and is not insolvent, no reason justifies engaging in the expensive process that interferes with the debtor's management rights or where creditors take an unnecessary haircut for their debts to be compromised. Furthermore, not encouraging the debtor to engage in strategic invocation of corporate rescue to obtain favourable outcomes against the interests of creditors has good reasons.[32]

[25] For example, see Douglas G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 *Journal of Legal Studies* 127, 134. US Chapter 11 is regarded the most progressive pro-reorganisation regime; in the past two decades, several jurisdictions have reformed their insolvency and restructuring laws along the lines of Chapter 11, including the United Kingdom (via the enactment of CIGA).
[26] R Squire, *Corporate Bankruptcy and Financial Reorganizations* (New York, Wolters Kluwer 2016), chs 22-23.
[27] The figure is adapted from the references in note 3.
[28] The term 'control watershed' is used by PWC in describing the shift in control from the debtor management to the creditors and other stakeholders. See Gilbertson, 'What is driving the change in UK retail market' (2007) 32 *Real Estate Issues* 41.
[29] For instance, Chapter 11 of the US Bankruptcy Code 1978 allows for the debtor to petition for bankruptcy, and the directors remain in possession whilst driving the restructuring. See generally, Squire (n 26).
[30] [2022] UKSC 25.
[31] *Sequana*, [2022] UKSC 25 para [81]. The case has generated an extensive literature with many issues for discussion and reflection.
[32] See KJ Delaney, *Strategic Bankruptcy~~-~~: How Corporations and Creditors Use Chapter 11 to Their Advantage*, Berkeley: University of California Press, 1992.

~~If~~ Thus, if the company remains high on the demise curve, that is, at the concern phase in Figure 1, ~~and~~ the company is still economically viable~~,~~ and it does not make sense for control to shift to creditors~~;~~. In this concern phase, the managers will have the most information on the company than the creditors or insolvency practitioners appointed by the creditors or the court. Moreover, the managers are more likely to come up with a workable plan. At this stage, if the number of financial creditors is small with the operations being unaffected or if a single secured creditor exists, it is efficient for the debtor to reach a consensual out-of-court restructuring with the financial creditors, as ~~and~~ the creditors (often bank creditors) can~~are~~ appraise~~d of~~ the financial situation of the company through the covenants of the ~~company to report the financial position, reaching a consensual out-of-court restructuring with the debtor is efficient for the financial creditors.~~ company.

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Once the company reaches the crisis phase (see Figure 1), where it is unable to service its debt payments, the options that are available to the debtor decrease as the debtor enters into formal negotiations with all of the creditors, including the trade creditors.[33] At this stage, a fully consensual restructuring mechanism is difficult and a non-consensual option, such as a scheme of arrangement, will be required. It is often not obvious as to where the company is at the demise curve,[34] and any incentives designed by the lawmakers are unlikely to take the form of bright-line rule-based duties imposed on directors to consider debt restructuring or take steps to avoid losses for the creditors; [35] rather they are likely to be in the form of standards imposed on directors.

2.2 Emergence of the scheme of arrangement for early-stage restructuring in Hong Kong and comparison with the UK

Prior to 2000, both Hong Kong and the UK share many similarities where corporate restructuring has largely been creditor-led and out-of-court affairs. In particular, in Hong Kong, which was a British colony until its reunification with China in 1997, the Hong Kong Monetary Authority (HKMA) instituted a consensus-based approach towards debt restructuring in the 1990s which apply to bank creditors.[36] In the UK, the 'London approach" was dominant for debt restructurings of large troubled companies where bank creditors are largely dominant and influential among creditors in their attempt to determine whether the company can be saved.[37]

The shift away from the consensus-based approach began in the early 2000s with the rise of bond issues and an active distressed debt market in both jurisdictions, utilising the consensual work-out became more challenging. As several scholars pointed out, the finance debt markets became fragmented as the bond investors and distressed debt traders are not regulated by

[33] Deloitte, n 2.
[34] Even in the state of insolvency, if what is relied on is cash-flow insolvency, it is often not possible to determine precisely when the debtor reaches an insolvent state: see e.g. Davies, n 52 below.
[35] See also *BTI v Sequana*, note 31.
[36] HKMA, 'Hong Kong Approach to Corporate Difficulties' (2008) <https://www.hkma.gov.hk/eng/regulatory-resources/regulatory-guides/circulars/2008/11/circu_20081119-1/> accessed 7 August 2022. For a discussion on corporate restructuring in Hong Kong until the early 2000s, also A Tang, *Insolvency in China and Hong Kong: A Practitioner's Perspective* (Sweet & Maxwell Asia 2005).
[37] British Bankers' Association, 'Description of London Approach' (*Quality Bulletin* 1993); J Armour and S Deakin, 'Norms in private insolvency procedures: the 'London Approach' to the resolution of financial distress' (2001) 1 JCLS 21.

banking regulators and hence not bound by these norms.[38] The scheme of arrangement[39] emerges as a remarkable tool to restructure debts for large companies.[40] Whereas the English or English-origin scheme of arrangement was initially described as a somewhat cumbersome process,[41] the judiciary and market practitioners value it as a highly flexible debt restructuring tool which enables the implementation of the restructuring plan despite the lack of unanimous agreement among all creditors.[42]

In ~~particular, in~~ the UK, ~~in earlier years,~~ the scheme was traditionally utilised to compromise the debts of sophisticated financial creditors only[43] and has remained popular, particularly after the 2008 financial crisis, even as the UK has introduced a menu of other options for corporate rescue such as company voluntary arrangements,[44] administration and more recently, the restructuring plan referred to above.[45]

The provisions on the scheme of arrangement are found in the company legislation in the Hong Kong[46] (and the UK[47]) and the law has also been developed substantially by judicial interpretation. Essentially, the scheme procedure involves an arrangement between a company and its creditors with some element of 'give and take' on both sides. The sanctioning of a scheme is a three-stage procedure with initially an application to the court to convene relevant meetings of creditors or members of a company. Secondly, the relevant class meetings are held, and the scheme requires approval by 75 per cent in value and a majority in number of creditors within each class. The third stage involves the scheme coming before the court for approval. The court must be satisfied that the scheme proposed is a reasonable one such that a reasonable member of the class concerned and acting with respect to its own interests could have voted for it.[48] Although the court is not a rubber stamp, the scheme proposed need not be satisfied as the only fair one.[49] Thus, the court must be satisfied that not only the statutory provisions have been observed, the relevant class must have been fairly represented by those who attended the meeting and that the statutory majority were acting *bona fide* and not coercing the minority to promote interests adverse to those of the class they purport to represent. The court addresses whether an intelligent and honest person, a member of the class concerned acting with respect to its own interest, might

[38] Payne (n 1) and Armour and Deakin, ibid (for UK); WY Wan (n 9), pp 109-110 and C Qu, 'Towards An Effective Scheme-Based Corporate Rescue System for Hong Kong' (2012) 12 JCLS 85 (Hong Kong).
[39] Companies Act 2006, pt 26 ss 895–9 (UK); Companies Ordinance, Cap 622, ss 668-674 (Hong Kong).
[40] See generally C Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet & Maxwell 2017); G O'Dea, J Long and A Smyth, *Schemes of Arrangement Law and Practice* (Oxford University Press 2012); Payne (n 1)*;* See also LC Ho, 'Making and enforcing international schemes of arrangement' (2011) 26 JIBLR 434; J Payne, 'Cross-Border Schemes of Arrangement and Forum Shopping' (2013) 14 EBOR 563.
[41] Sir Kenneth Cork, *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558, H.M.S.O 1982) para 419 and see also, 'Report of the Joint DTI/Treasury Review of Company Rescue and Business Reconstructions Mechanisms' (The Insolvency Service 2000) para 43.
[42] *Re Van Gansewinkel Groep BV* [2015] EWHC 2151, [5].
[43] Payne (n 1). However, the position may be somewhat changed due to COVID-19 where more restructurings involving operational creditors happen, such as Re *MAB Leasing* [2021] EWHC 379 (Ch).
[44] Insolvency Act 1986, pt I.
[45]Companies Act 2006 (UK), pt 26A (UK).
[46] Hong Kong Companies Ordinance, pt 13.
[47] Companies Act 2006 (UK), pt 26.
[48] See *UDL Argos Engineering and Heavy Industries Co Ltd v Li Oi Lin* [2001] 3 HKLRD 634; *Anglo-Continental Supply Co Ltd* [1922] 2 Ch 723.
[49] The test has been pointed out not whether the opposing creditors have reasonable objections to the scheme as a creditor might be acting equally reasonably in voting either for or against the scheme. In these circumstances, the English courts consider that creditor democracy should prevail: see *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621, [75].

reasonably approve the scheme. Once the court sanctions the scheme, it is binding on all of the creditors of the class, including those who have voted against the scheme.

A number of points should be noted. Firstly, creditors always have the ability to petition for winding-up when their debts are due but not paid. When the petition is filed or granted, the provisional liquidator (or liquidator) that is appointed immediately displaces the directors and takes day-to-day control of the company. In the UK, if the company has a secured creditor, the holder of the security may also file for administration without going to court. [50] No equivalent of administration exists in Hong Kong.

Secondly, unlike jurisdictions such as Germany,[51] no direct obligation exists to require the directors in the UK or Hong Kong to file for insolvency. In the UK, the arguments against imposing such a duty to initiate insolvency proceedings are well documented, not least because it obliges the debtor to enter an insolvency process, thereby incurring costs, even where it would be possible for the parties to do a consensual work-out.[52] Instead, the UK and Hong Kong have mechanisms to prevent harm to third parties by constraining directors from continuing to trade while the company is insolvent or close to insolvency. Hong Kong lacks a wrongful trading regime, but the criminal offence of fraudulent trading exists.[53] In the UK, directors can be civilly liable for fraudulent trading under section 213 or wrongful trading under Section 214 or 246ZB of the Insolvency Act 1986.[54] Wrongful trading liability is imposed on directors who cause the companies to trade when the directors know or ought to have concluded the lack of a reasonable prospect to avoid insolvent liquidation. Civil liability can be avoided by demonstrating that he or she has taken all steps necessary to minimise potential loss to the company's creditors. Liability for wrongful trading has no monetary limit. Wrongful trading provisions of the Insolvency Act 1986 entail a much lower burden of proof than fraudulent trading.[55]

In addition, in both Hong Kong and the UK, directors must also comply with their common law duties to act in the interests of the company; when the company is insolvent or is likely to become insolvent, the directors must have regard to the creditors' interests.[56] Whereas the common law duty has been traditionally viewed as constraining the directors from undertaking risky transactions at the expense of the creditors, van Zwieten has argued more recent cases demonstrating that the English courts have instead used the provision for the

[50] Insolvency Act 1986, Part II.
[51] For a discussion on the obligation to file in continental European jurisdictions, see A Martinez, n 12 above.
[52] P Davies, 'Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency' (2006) 7 EBOR 301, 313-314 (comparing the positions in the UK and in Germany and arguing that such a mandatory filing will be inconsistent with a rescue culture).
[53] Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO), s 275.
[54] Insolvency Act, section 214 applies to a company in liquidation and section 246ZB applies to a company administration.
[55] Insolvency Act 1986, s 213; s 246ZA. In the UK there is potential criminal liability for fraudulent trading (s 993 Companies Act 2006) but not for wrongful trading.
[56] *West Mercia Safetywear v Dodd* [1988] BCLC 250; [1988] 4 BCC 30; *BTI v Sequana SA*. [2022] UKSC 25. *West Mercia* applies in Hong Kong: see *Moulin Global Eyecare Holdings Ltd v Olivia Lee Sin Mei* [2014] 17 HKCFAR 466; *Re China Bozza Development Holdings Ltd* [2021] HKCFI 1235; [2021] 4 HKC 560; HCMP 172/2021 (11 May 2021). For general analysis see R T Langford and I Ramsay, 'The creditors' interests duty: when does it arise and what does it require' (2019) 135 LQR 385; K van Zwieten, 'Disciplining the directors of insolvent companies: essay in honour of Gabriel Moss QC' (2020) 33(1) Insolvency Intelligence 2; P Watts, 'Why as a matter of English-law principle directors do not owe a duty of loyalty to creditors upon insolvency' (2021) JBL 103.

company to avoid preferences made to certain creditors and/or rendering the directors liable for such preferences.[57]

Directors of insolvent companies also face possible disqualification where their conduct makes it unfit to be concerned with management of a company in Hong Kong.[58] Similarly, in the UK, the Company Directors Disqualification Act 1986 renders the directors directly liable for disqualification and consequent compensation orders to creditors if their conduct leading to the disqualification caused losses to the creditors.[59]

Thirdly, while there are some differences between Hong Kong and English law on ancillary legislative tools that support schemes of arrangement, these differences are only more pronounced after the 2020 reforms in the UK. Hong Kong does not have a formal corporate rescue framework and outside of an insolvency procedure (such as a winding-up or appointment of provisional liquidator), a debtor which is proposing debt restructuring does not have the ability to seek a stay of proceedings.[60] Similarly, in the UK, prior to 2020, there is no stay of proceedings against enforcement actions pending a corporate rescue unless the debtor goes into administration (which is itself an insolvency procedure). [61] It is only pursuant to the 2020 reforms that a debtor may now seek a stand-alone moratorium for various purposes, including that of negotiating a scheme of arrangement.[62] There are now also restrictions on invoking 'ipso facto' or termination clauses when the company is undergoing an insolvency process.[63]

Fourthly, under Hong Kong (and English law) and unlike other jurisdictions such as the United States,[64] no specific provision exists to allow a post-petition creditor to obtain any form of super-priority in granting new money credit to the company which may otherwise serve as an *incentive* for the company to engage in early-stage restructuring.[65] In the UK, the lack of super-priority is attributable to a combination of the lack of necessity for such financing and the general opposition by the bank creditors.[66] In any event, pursuant to the new restructuring plan introduced in the 2020 reforms, market participants have found creative ways to put up new money to gain a larger share of the restructuring surplus than what they would have received under the relevant alternative to the plan such as administration.[67]

[57] K van Zwieten, 'Director Liability in Insolvency and Its Vicinity' (2018) 38 OJLS 382.
[58] Companies Winding-up and Miscellaneous Provisions Ordinance, s 168H.
[59] Company Directors Disqualification Act 1986, s 15A (amended in 2015). The first case brought under the provision was *The Secretary of State for Business, Energy and Industrial Strategy v. Kevin William Eagling* [2019] EWHC (ch) 2806.
[60] See n 14 and accompanying text above.
[61] Insolvency Act 1986, pt II.
[62] Insolvency Act 1986, Part A1.
[63] Insolvency Act 1986 (UK), ss 233A and 233B.
[64] US Chapter 11, s 364.
[65] It could be argued however that in a UK administration different ~~form~~ forms of post-commencement finance could have super-priority under para 99 Schedule B1 Insolvency Act 1986. Moreover, under the new Part A1 moratorium, 'moratorium debts' have priority in subsequent insolvency proceedings.
[66] Department for Business, Energy & Industrial Strategy, *Insolvency and Corporate Governance: Government Response* (26 August 2018).
[67] For instance, in *Re Virgin Atlantic* [2021] EWHC 1246 (Ch), a case under Part 26A, the restructuring plan involves the provision of new money by existing shareholders and secured creditors, together with haircut for unsecured creditors, for the company that offers gymnasium services to be revived. However, certain classes of the unsecured creditors were not offered the opportunity to participate in the new money and failed to take advantage of the restructuring surplus which would have gone to the shareholders that rank behind these unsecured creditors. See also *Re Houst Limited* [2022] EWHC 1941 (Ch).

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In summary, Hong Kong law (and English law) provide some *incentives* for directors of a company to engage in early-stage restructurings as the directors can remain in control of the company. (After 2020, in the UK, the CIGA has a number of additional restructuring tools which the company can utilise, such as the standalone moratorium, the restrictions on ipso facto clauses and the new restructuring plan.)[68] However, in each case, the *disincentives* do not operate heavy-handedly, and the directors' obligation to have regard for the creditors' interests only operates when the company is far down the demise curve, as the requirement operates only when the company is insolvent or is likely to become insolvent.[69]

Given that the legal tools available for early-stage insolvency and restructuring track their UK antecedents and provenance, one would expect that Hong Kong follows a similar trajectory in the successful outcomes reached as the UK with respect to the schemes of arrangement. These antecedents and provenance remain even though UK law has undergone significant changes to include the restructuring plan that builds on the existing UK scheme of arrangement procedure that is similar to the Hong Kong scheme.

However, despite the similarities between Hong Kong and UK law, the ~~important~~ study by Qu shows that approximately two-thirds of the companies with successful schemes of arrangement during the 1989-2009 period are under the control of insolvency practitioners and not the pre-petition management. [70] This evidence suggests that schemes are invoked when the companies have fallen far down the demise curve (that is, the companies are past the crisis stage), as the directors are no longer in charge of the assets of the debtor. See Figure 1; after the stage of 'control watershed', creditors seize control of the assets, in the absence of any moratorium. We then investigated further whether the remaining one-third of the cases with pre-petition management are early-stage restructuring cases. Our closer examination of the facts of the cases showed that winding-up petitions were already brought by creditors in the majority (seven) of these cases when the scheme of arrangement was proposed, suggesting that they are *not* early-stage restructuring where the debtor seeks to address the problems even before the creditors bring the winding-up petitions.

The study by Qu ~~was an important one which~~ demonstrated the predominance of the practitioner-in-possession model for schemes of arrangement in Hong Kong. The study ~~is~~ was for an earlier period of 1989-2009 and it analysed~~s~~ the case law involving the use of schemes of arrangement during that period. It ~~does~~ did not investigate the kinds of restructuring, such as whether it ~~is~~ was a going-concern restructuring or a backdoor listing. The puzzle remains as to *why* schemes of arrangement are used later by the debtors in Hong Kong, as compared with their UK counterparts. A more wide-ranging and in-depth empirical study is required to study the use of schemes of arrangement and how the market professionals view the schemes of arrangement as corporate restructuring tools.

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[68] See nn 179~~176~~-185~~182~~ and accompanying text.

[69] *West Mercia Safetywear v Dodd* (n 56); *BTI v Sequana SA*. [2022] UKSC 25.

[70] Qu (n 11). Qu identifies that only approximately a third (10 out of 28) of successful schemes of arrangement are controlled by pre-petition (debtor in possession) management during the 1989-2009 period. Out of the 10 cases identified, the seven cases are *Re Kosonic Industries Ltd* [1999] HKEC 1183; *UDL Argos Engineering and Heavy Industries Co Ltd v Li Oi Lin* [2001] 3 HKLRD 634; *Re Yetyue Ltd* [2001] HKEC 1156; *Re CIL Holdings Ltd* [2003] HKEC519; *Re APP (Hong Kong) Ltd* [2005] HKEC 1583; *Re Stereo Ltd* [2005] HKEC 1085; *Re Sun Motor Industrial Co Ltd* [2008] HKEC 2006.

3. Empirical Study of Schemes of Arrangement in Hong Kong in C~~c~~omparative C~~c~~ontext

In this section, we first investigate when debt restructuring (using schemes of arrangement) occurs in Hong Kong with some appropriate UK comparisons. Obtaining direct evidence as to the stages in the corporate 'demise curve' where restructuring occurs is difficult given the range of situations involving financial distress. Instead, we use proxies by (1) observing the outcomes of the restructuring pursuant to the schemes of arrangement as well as (2) interview data.

In comparison with earlier studies conducted by Qu and Wan, [71] we extend beyond schemes of arrangement sanctioned by the Hong Kong courts[72] to include schemes of arrangement of foreign-incorporated (but Hong Kong-listed) debtors that are sanctioned by these foreign courts. The reason is that over 75% of the Hong Kong-listed companies are incorporated[73] in Cayman Islands and Bermuda, [74] both of which have similar schemes framework as Hong Kong and the UK.[75] Given the small number of the schemes of arrangement of listed companies sanctioned by the Hong Kong courts averaging less than three a year,[76] the addition of these cases would provide further illustrations how Hong Kong directors have in fact invoked debt restructuring outside Hong Kong.

3.1 Outcomes of schemes of arrangement

Appendices 1 and 2 provide the list of companies that have undergone schemes of arrangement for the period 2015–2021 for Hong Kong (23) and the UK (40), respectively. The data are obtained from subscription websites (Debtwire, Perfect Information and Practical Law for Companies), the explanatory statements of the companies found on publicly available websites and information agents and court decisions found on Westlaw, Hong Kong Legal Information Institute and British Legal Information Institute.

The data are subject to several limitations. Firstly, given the absence of a comprehensive dataset of schemes of arrangement, the data represent those schemes of arrangement which we hand-collected from court judgments, subscription websites and announcements made by publicly listed companies. Hence, caution should be made in extrapolating findings to represent the entirety of all of the schemes of arrangement in the two jurisdictions. However, we are confident that the sample in Appendices 1 and 2 have most of the large corporate restructurings in the two jurisdictions given that they are tracked on the major subscription

[71] E.g. Qu (n 11); Wan (n 9).

[72] E.g. Wan (n 9), finding 8 sanctioned Hong Kong schemes of arrangement over 6-year period (or 1.33 schemes a year); Qu (n 11), 53 Hong Kong schemes of arrangement proposed over a 20-year period (or 2.65 schemes a year).

[73] As at 31 December 2020, 58% and 20% of the listed companies are incorporated in Cayman Islands and Bermuda respectively, as compared with 8% of the companies incorporated in Hong Kong. See Stock Exchange of Hong Kong, *Listing Regime for Overseas Issuers* (March 2021), available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/March-2021-Listing-Regime/Consultation-Paper/cp202103.pdf.

[74] See e.g. Payne (n 1), pp 13-14.

[75] Recent Hong Kong court decisions also remind practitioners parallel schemes (in both the place of incorporation and Hong Kong) should only be pursued if they are necessary. See e.g. *Da Yu Financial Holdings Limited* [2019] HKCFI 2531; *Re China Oil Gangran Energy Group Holdings Ltd* [2021] HKCFI 1592; *Re Grand Peace Group Holdings Ltd* [2021] HKCFI 1563.

[76] Supra, n 72~~71~~.

websites. In the case of restructurings in Hong Kong, as outlined above, we included schemes of arrangement of listed companies that are sanctioned not only in Hong Kong but also in Cayman Islands and Bermuda, being the top two overseas jurisdictions for the Hong Kong listed companies.[77] For the schemes of arrangement of these companies that are sanctioned in the Caribbean jurisdictions, we are limited only to Hong Kong-listed companies (which exclude non-listed companies) due to the availability of data.

In our analysis, we coded the outcomes of the schemes of arrangement using five variables: (1) whether a white knight investor or plan sponsor exists; (2) whether the scheme involves a debt-equity swap; (3) whether the scheme is an 'amend and extend' scheme; (4) whether the scheme is a reverse takeover and (5) others which do not fall within the aforementioned categories. For variables (1), (2) and (3), the judgment or the explanatory statement would disclose whether there is a white knight or plan sponsor. For the variable (4), it may not be explicitly stated in the judgments sanctioning of schemes of arrangement or the explanatory statements that what is proposed is a reverse takeover. Thus, we classify the transaction as a reverse takeover if it is specified in the explanatory statement as a reverse takeover or the existing shareholders are diluted by more than 80%.[78] The categories are not mutually exclusive. For instance, the scheme could involve amending and extending the maturity of the loan, and also a debt-equity swap. Figures 2 and 3 below set out the analysis of the nature of the outcomes of the restructurings in Hong Kong and the UK. Owing to the overlaps, the corresponding breakdown is found in Tables 1 and 2, respectively.

We have chosen the above categories for coding on the basis of identifying which are the schemes of arrangement that are more likely to be a reorganisation of the business as a going concern and those which are more likely to be monetising of listing status (which are not true reorganisation cases).
~~We~~ For instance, we argue that the presence of (3) (an 'amend and extend') would indicate that the scheme of arrangement is one where what is proposed is to rescue the existing business as a going concern, by reducing the cash-flow pressure on the company in pushing out the maturity date. ~~Such a scheme of arrangement may or may not involve a debt-equity swap.~~ A reverse takeover is one where what is being sought is normally not to rescue the

[77] See Stock Exchange of Hong Kong (n 73~~72~~).
[78] The Hong Kong Stock Exchange classifies as a reverse takeover if, among others, it is a very substantial acquisition were the equity share capital issued is increased by 100% or more (r 14.06B) and that there is a change in control. Assuming that the equity share capital is increased by 100% or more, the dilution of existing shareholder will be at least 50%. A higher dilution figure of 80% is used in Wan (n 9) 85 as it would be a clearer case involving a massive injection of assets.

existing business as a going concern but instead to allow the listing status to be realised.[79] The presence of a white knight injecting cash or assets will normally, but not inevitably, accompany a debt-equity swap.

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We have a number of observations. Firstly, a considerable number (13 out of 23) of Hong Kong's schemes of arrangement are reverse takeovers involving sale or transfer of the listing status of the listed firms. Out of these 13 cases, 12 involve the presence of the white knight or plan sponsor. None exists for the UK, which can be explained by the fact that executing reverse takeovers for premium listings of the UK companies is difficult as the listing rules were amended in 2012 to prevent back-door listing and the schemes of arrangement under study relate to the period after 2012.[80] In Hong Kong, similar rules were enacted in 2019,[81] which makes it far more difficult to effect reverse takeovers (though not impossible) as indicated from the interviews in Section 3.2.

The significance of reverse takeovers in Hong Kong is that in these cases, the economic aspect of the outcome is not that of a going-concern reorganisation of a company's business. When the publicly listed company no longer has economically viable businesses, what is left is only the listing status, which is an asset not in the balance sheet but is recognised by the court as having value.[82] The listed company is seeking to find a new investor or white knight to inject assets into the company and for the company to resolve the debts through a deep haircut (so that the new investor is not saddled with holding shares in a company with high levels of debt). As the Stock Exchange of Hong Kong (SEHK) would have suspended the company from trading and will provide a time-line for trading to resume, failing which it would be delisted,[83] the investor will have to demonstrate sufficient high-quality assets and operations in the new company to meet the listing requirements.[84]

Secondly, only four out of the 23 cases in Hong Kong involve amending and extending the schemes of arrangement~~, which comprise conversion of debt into a more sustainable debt structure~~.[85] All of these four cases relate to the financial restructuring of the listed companies' bonds and notes issued to offshore investors and the restructuring showed that these enterprises intended to resolve the offshore debt.[86] Otherwise, it is likely that they would face difficulties in going into the international capital market for future fund-raising. Out of the four cases, only one involves a debt equity swap and the other three are only 'amend and

[79] See note 10 and accompanying text.
[80] Financial Conduct Authority, Listing Rules, r 5.6.
[81] See the Hong Kong Stock Exchange, 'Consultation Conclusions: Backdoor Listing, Continuous Listing Criteria and other Rule Amendments' (July 2019). See also Securities and Futures Commission, 'Statement on the SFC's approach to backdoor listings and shell activities' (26 July 2019).
[82] *Re China Solar Energy* [2018] HKCFI 555 [39].
[83] Currently, the SEHK will cancel the listing after a trading suspension of 18 months. See SEHK listing rules, ch 6.
[84] SEHK, Practice Note 17.
[85] Kaisa Group, Yestar Healthcare Holdings, Hilong Holdings and GCL-Poly New Energy Holdings. A perusal of the explanatory statements showed that the companies have significant Mainland operations: Explanatory statements, copies on file with the authors.
[86] Explanatory statements of the four companies, copies on file with the authors.

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extend', raising the question of whether an 'amend and extend' restructuring is in general sufficient without addressing the underlying capital structure. In comparison, with the 40 UK schemes of arrangement listed in Appendix 2 for the same period, out of the 19 ~~19 relate to only~~ 'amend and extend' schemes of arrangement, ~~where~~ a significant number (10) involve not only extending the maturity date of the debt but are also ~~the maturity date of the bonds or loans is extended without involving~~ simultaneously ~~haircut or~~ debt-equity swaps or where there is a white knight injecting new cash or assets. However, it is acknowledged that the sample sizes in both Hong Kong and the UK are quite small to be able to draw firm conclusions.

3.2 Interview results

To understand the reasons why schemes of arrangement are not often used to effect early-stage restructurings in Hong Kong (especially in comparison with the UK), we conducted a survey of the insolvency professionals. This section summarises the results of our semi-structured interviews with 18 insolvency professionals in Hong Kong. They comprise 4 insolvency lawyers, 11 insolvency practitioners and 3 accountants. Their clienteles include creditors (e.g. banks, distressed funds and institutional bond investors) and companies (including large listed companies, mid-cap companies and small- and medium-sized enterprises) in the Hong Kong market. The insolvency practitioners surveyed serve as liquidators and/or financial advisers to insolvent companies while the accountants mainly advised companies on debt restructurings. The interviews took place over a seven-month period between April to October 2021, all of which were held face to face in Hong Kong except with two interviewees held over Zoom calls.

Out of these 18 interviewees, 13 of them are in law or accounting firms with global practices and out of which six have direct (prior) experience on the UK debt restructuring practice, having worked in the UK market. All of the interviewees are partners of their firms and have at least 10 years of practice on debt restructuring and in nearly all of the instances, they have more than 20 years of practice experience. The interviewees are recruited from the principal investigators' contacts through earlier research projects as well as contacts referred to the research team. The list of the questions is set out in Appendix 3 of this article. Each interview lasted approximately 45 minutes to 1 hour. Each interview was led by at least one of the co-authors of the paper based in Hong Kong.

We began each interview with a series of questions exploring the ways as to when the advisers are appointed and how companies react when they face financial distress. We then explore how the restructuring takes place in Hong Kong and for the interviewees with prior UK experience, in the UK. We particularly focus on the debt that the companies have in their balance sheets, the shareholding structures and the behaviour of creditors and management of the companies when they (the companies) run into financial distress. In asking their views on Hong Kong's restructuring framework, we also seek responses on the desirability of the current creditor-friendly framework and the relevance of the DIP model.

A number of interviewees pointed out the substantial changes in the Hong Kong debt markets in the past two decades, principally the diversification of the debt market.[87] Interviewees L1 and L2 also mentioned that the same changes have occurred in the UK market. In Hong

[87] Interview with L1 (HK, 6 May 2021); L2 (HK, 10 August 2021); P5 (HK, 10 August 2021); P8 (HK, 31 August 2021); P10 (HK, 2 September 2021); P14 (HK, 18 October 2021).

Kong, substantially more bond issuances now exist among listed companies. In many of the large debt restructurings (involving listed companies), no bank creditor exists or bank creditors constitute only a minority of the outstanding debt.[88] The Hong Kong approach promulgated by HKMA towards debt restructuring, will simply not be effective as the approach only binds regulated banks and not the other creditors. [89] For instance, Interviewee L1 pointed out that in the 1990s through to 2000s, the two major banks in Hong Kong[90] invariably took the lead in any large-scale restructurings as the largest creditors. However, in the last few years, these banks were either absent or if they were present, their lending only constituted a minority of the outstanding debt.[91]

Bondholders add complexity to the negotiations. Bondholders are themselves diverse: they can be asset management companies, distressed funds and high net-worth individuals.[92] Their identities are often not known as the bonds are held in the name of the trustee,[93] unless the bondholder is looking to bring a lawsuit against the company.[94] In particular, for the last category, individual Mainland investors invested in non-listed bonds issued by Hong Kong firms to satisfy immigration requirements in Hong Kong and whom the courts have not regarded them as being sophisticated investors.[95] This immigration scheme has since been discontinued, but the litigation over the bonds that have been issued (and not repaid) has not ended. Individual bondholders are more concerned about recovery rather than restructuring to preserve any longer-term relationship.[96]

A recurring theme by a majority of the interviewees is that directors of companies which are in financial distress seek legal or financial advice and/or commence negotiations very late in the day, including listed firms,[97] medium sized companies and small and medium enterprises (SMEs).[98] As such, creditors are often not inclined to go to the negotiation table as they do not believe that companies are negotiating in good faith to resolve the outstanding debt. The main reasons why directors fail to seek advice earlier are as follows: (1) unaware of their legal obligations when the company enters into the zone of insolvency;[99] (2) stigmatism surrounding bankruptcy;[100] and (3) unable to produce financial information of the company, including cash flow statements and forecast information necessary for the insolvency practitioners or financial advisers to put together the rescue plan for discussions with the creditors. [101] One interviewee has a more optimistic view, mentioning that position has improved in the last few years in that directors are seeking help earlier likely due to increased

[88] Interview with L1, ibid; P13 (HK, 5 October 2021); P5, ibid.
[89] Ibid.
[90] They were identified as Hong Kong and Shanghai Banking Corporation and Standard Chartered Bank.
[91] Interview with P8 (n 87~~84~~); P5 (n 87~~84~~); P4 (HK, 23 July 2021).
[92] Interview with L2 (n 87~~84~~).
[93] Interview with P4 (n 91~~88~~); L1 (n 87~~84~~).
[94] Interview with L2 (n 87~~84~~); P2 (HK, 13 May 2021).
[95] Interview with P12 (HK, 14 September 2021); P10 (n 87~~84~~) (mentioning 50 to 100 possible bondholders in one single restructuring). References are also found in the case law in *Li Yiqing v Lamtex Holdings Ltd* [2021] HKCFI 622; [2021] 2 HKLRD 177; HCCW 263/2020 (11 March 2021).
[96] Interview with P10 (n 87~~84~~).
[97] Interview with P10 (n 87~~84~~); P12 (n 95~~92~~); P13 (n 88~~85~~) (who said that even for listed companies which have professional managers, the management often only seek external advice when they are close to default on their loans or after the winding-up petitions are served).
[98] Interview with P13 (n 88~~85~~); P11 (HK, 14 September 2021); P1 (HK, 30 April 2021).
[99] Interview with P10 (n 87~~84~~); P8 (n 87~~84~~); P14 (n 87~~84~~).
[100] Interview with P12 (n 95~~92~~), P9 (HK, 31 August 2021); L2 (n 87~~84~~); P5 (n 87~~84~~); P14 (n 87~~84~~).
[101] Interview with P12 (n 95~~92~~), P13 (n 88~~85~~): L1 (n 87~~84~~); P14 (n 87~~84~~).

awareness of the personal risks (and liabilities) involved in insolvencies.[102] However, another interviewee observes that in more recent cases, controlling shareholders of offshore parent companies (listed in Hong Kong) which have issued offshore debt are more prepared to let the parent companies fail, especially if there are no assets in Hong Kong and the operating subsidiaries are in Mainland China.[103] In such a case, they would only be interested in restructuring the onshore debts of the Chinese operating subsidiaries where the assets are located, and not the offshore debts.[104]

In general, interviewees agree that the earlier the management approaches the insolvency practitioners, the more likely the latter would come up with restructuring plans that would be acceptable to creditors.[105]

Whilst the focus of the interviews is on large restructurings, the insolvency practitioners observed that for SMEs and medium-sized companies, the loans are often secured with assets of the company or with the personal guarantees of the directors or shareholders. [106] Less incentive exists for the creditor banks to negotiate with the SMEs or medium-sized companies if the outstanding loan is covered by the value of security.[107] Much of the debt restructuring in these cases is done consensually and out of court for reasons of costs.[108] However, for larger firms, interviewees mentioned that banks are still keen to restructure the secured loans to preserve the business and enable continuation of the relationship. [109]

When asked about the drawbacks for Hong Kong moving to a DIP regime with early-stage restructuring, the most common answer is that the approach is *currently* unsuitable for Hong Kong due to two factors that they have observed; firstly, directors lack general knowledge as to what they ought to do when the company is in the zone of insolvency; secondly, the directors in controlled firms often do not prioritise considering the creditors' interests even when the company is in the zone of insolvency.[110]

For the latter, a number of interviewees pointed out the recent trend of offshore listed companies appointing soft-touch provisional liquidators in their place of incorporation (particularly Bermuda and Cayman Islands), with a view of effecting a restructuring via a scheme of arrangement. While provisional liquidators are appointed, it is on a soft-touch basis; in other words, there is only light oversight and management continues to be in control

[102] Interview with P4 (n 91~~88~~).
[103] Interview with P2 (n 94~~91~~).
[104] The background has to do with how Chinese operating companies (Opcos) raise financing from offshore investors (that is, outside Mainland China). These Opcos have parent companies incorporated offshore and listed in Hong Kong and which issue bonds to offshore investors. The Opcos are prohibited from giving guarantees or collateral directly to the offshore investors under Chinese law and would also have borrowed money from onshore (Chinese) lenders. Hence, the offshore investors take security only over assets located outside China and the shares of the opcos. If the only security is the shares of the Opcos that go into default, the offshore investors are structurally subordinated to the onshore creditors. In theory, separate restructurings will be required for the onshore and offshore creditors. For an account, see M Fucci and N Moore, "Is it the structure? Chinese onshore bankruptcies and offshore bond default" *Global Restructuring Review* (15 November 2016).
[105] Interview with P10 (n 87~~84~~).
[106] Interview with P13 (n 88~~85~~).
[107] Interview with P13 (n 88~~85~~); P11 (n 98~~95~~); P3 (HK, 20 July 2021).
[108] Interview with P3 (n 107~~104~~); P1 (n 98~~95~~).
[109] Interview with P8 (n 87~~84~~); P2 (n 94~~91~~) (mentioning that at times, creditor banks believe that the management has been fraudulent).
[110] Interview with P5 (n 87~~84~~).

of the business and work with the provisional liquidator to formulate a rescue plan.[111] The applications in the overseas courts are made *ex parte*[112] and often very speedily.[113] However, the potential for abuse is high if the company uses the process of soft-touch provisional liquidation to delay the winding-up petition filed by the creditor in Hong Kong.[114]

Thus, some of the interviewees are in favour of the retention of the current regime, where the insolvency practitioner unambiguously takes over the control of the company's assets upon filing for winding-up petition to ensure that directors do not act improperly to put the assets out of reach of creditors.[115]

Nearly all of the interviewees opined that directors of financially distressed companies are seldom held to account for breaches of their duties to consider creditors' interest for the following reasons. Firstly, unless litigation funding is available for large claims, no monies are generally available for liquidators to pursue such claims.[116] Secondly, the interviewees are all unaware of any prosecution under fraudulent trading provisions in the Companies (Winding-up and Miscellaneous Provisions) Ordinance[117] in recent times. Only Interviewee P14 gave an account of his/her experience where a Hong Kong public regulator, with the cooperation of a (unnamed) foreign regulator, took enforcement action against the errant directors of the insolvent firm but acknowledged that this situation was uncommon. Thirdly, as for disqualification, the threat only bites if the directors plan on becoming directors of other firms in Hong Kong.[118] If the directors are not Hong Kong residents or plan to be directors of other firms in Hong Kong, the disqualification has little impact. [119] Fourthly, several interviewees raised the problem involving listed companies where their substantial operations are outside Hong Kong, and where the directors are not residents in Hong Kong. In such a case, holding the directors to account is challenging.[120] Disqualification orders made in Hong Kong are not enforceable in Mainland China.[121]

All six interviewees with prior experience in the UK market mentioned that directors, at least of publicly listed companies in UK, are often much more concerned about their liabilities for wrongful trading or breaches of directors' duties when the companies enter into insolvency. Many would request for advice from the financial or legal advisers.[122] They will not wait for

[111] Interview with P8 (n 87~~84~~); P9 (n 100~~97~~).
[112] Interview P5 (n 87~~84~~).
[113] Interview with P12 (n 95~~92~~) (giving the example of obtaining a hearing date 3 months after the petition is filed in the offshore jurisdiction versus 6 months in Hong Kong).
[114] Interview with P5 (n 87~~84~~); P4 (n 91~~88~~).
[115] Interview with P9 (n 100~~97~~); P13 (n 88~~85~~).
[116] Interview with P5 (n 87~~84~~) (mentioning that litigation funders take a 50% cut in the recovery); L3 (HK, 12 August 2021).
[117] Cap 32 (HK).
[118] Interview with P5 (n 87~~84~~).
[119] Interview with P5 (n 87~~84~~); P14 (n 91~~88~~).
[120] Interview with P5 (n 87~~84~~); L2 (n 87~~84~~).
[121] Hong Kong SAR is under a "one country, two system" principle. While Hong Kong has entered into a series of mutual legal assistance with Mainland China, none of them relate to disqualification orders. In particular, Article 3 of the 2019 Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters between Hong Kong SAR and Mainland China explicitly excludes insolvency matters. The only agreement relating to mutual assistance on insolvency matters is the Record of Meeting of the Supreme People's Court and the Government of the Hong Kong SAR on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong SAR but the assistance and recognition relate to the collective insolvency proceedings, not to directorial disqualification.
[122] Interview with P8 (n 87~~84~~); L2 (n 87~~84~~); L4 (HK, 24 September 2021).

a winding-up petition to be filed as they are aware that creditors often would have exhausted all means of negotiation or patience with the companies.

We asked the interviewees on reverse takeovers undertaken by companies, which were previously described by the courts as realising the listing status.[123] Many of the interviewees expressed that this method of realising the listing value is becoming increasingly difficult; additionally, these transactions have been significantly reduced since 2019, pointing out the amendments to the listing rules of the SEHK which tighten the requirements for reverse takeovers to prevent the back-door listing of low-quality assets.[124] However, such transactions do continue to exist.[125]

Finally, we asked what would be the missing tool-kit in the insolvency framework in Hong Kong to promote the early-stage scheme of arrangement. A general consensus suggests that the main missing tool is the moratorium. Without the moratorium, they and their clients spend a substantial amount of professional time fire-fighting on ancillary issues, such as negotiating with creditors which have brought or who are threatening to bring winding-up petitions.[126] Such valuable time can be better spent on formulating the restructuring plan and discussing with the other creditors to get their buy-in for the scheme of arrangement.[127] Others point out that valuable time is spent on negotiating standstill with a diverse group of creditors.[128] These negotiations are costly, and the issues pertaining to the legality of preferences granted in connection with the standstill (such as covering the costs of the negotiations and continued payment of the interest) are debated; oftentimes, additional covenants are demanded by the creditors.[129] However, despite the general agreement for a need to put some limits on the moratorium that can be granted, no consensus exists among the interviewees on the outer limit of the moratorium.[130] Many have stated that the moratorium must be accompanied by either a wrongful trading regime for directors (referring to Section 214 of the UK Insolvency Act 1986) as well as mechanisms to enforce directors' duties.[131] However, support for restricting the use of ipso facto clauses was more muted, with many emphasizing that, in general, trade creditors in Hong Kong are often pragmatic and it is better left to the market forces.[132]

Whether DIP financing is essential to incentivise the use of the scheme of arrangement receives more mixed reviews, with the majority against the DIP financing. A minority of interviewees mentioned that the availability of DIP financing is essential as it is a tool to entice investors which is impossible to achieve without legislation or consensus;[133] one described such financing would be 'transformational' to restructuring practice in Hong Kong

[123] E.g. *Re China Solar Energy Holdings Ltd* (No 2) [2018] 2 HKLRD 338, para 39.
[124] Interview with P10 (n 87~~84~~); P12 (n 95~~92~~); P4 (n 91~~88~~).
[125] Interview with P13 (n 88~~85~~).
[126] Interview with P9 (n 100~~97~~); P10 (n 87~~84~~); P12 (n 95~~92~~); P6 (HK, 13 August 2021); L3 (n 116~~113~~); L4 (n 122~~119~~); P14 (n 91~~88~~).
[127] Ibid; Interview with P6, ibid, pointed out that a standstill could take three to nine months to negotiate.
[128] Interview with P7 (HK, 31 August 2021). Interviewee P6 also pointed out that in many cases, the creditors make a number of demands before agreeing to a standstill (e.g. continuation of payment of interest, provision of additional security from the company or its shareholders and payment of costs).
[129] Interview with P6 (n 126~~123~~) (where security is provided by the debtor in exchange of the standstill); L4 (n 122~~119~~).
[130] Interview with P10 (n 87~~84~~) (arguing for 6 months); P12 (n 95~~92~~) (arguing for 12 months); L3 (n 116~~113~~) (arguing for 4 to 5 months).
[131] Interview with P5 (n 87~~84~~); P14 (n 87~~84~~); L2 (n 87~~84~~); L4 (n 122~~119~~).
[132] Interview with P6 (n 126~~123~~).
[133] See Interview with L1 (n 87~~84~~); P10 (n 87~~84~~), P7 (n 128~~125~~).

in incentivising a new type of lending.[134] To avoid abuse or mere transfers of value from a lender to another, it was suggested that either the controlling shareholders also contribute DIP financing or that the existing creditor banks have the first right of refusal to grant DIP financing, failing which a transparent process occurs for outside financiers to grant such financing.[135] However, a number of interviewees mentioned that DIP financing should be left to the market solutions—if economic value actually exists, existing creditors would be prepared to lend to the company and would also obtain the consent of the other creditors to gain priority in terms of additional loans.[136] Others pointed out the lack of a developed market for DIP financing in Hong Kong, and a statutory framework does not create demand when none exists.[137] For completeness, there was no explicit support for a cross-class cramdown of the kind found in the UK restructuring plan, though it should be noted that most of the interviews were conducted only shortly after the major decisions on cross-class cram-down in UK were handed down.[138]

4. ~~Corroborating~~ Supporting the E~~e~~vidence with O~~o~~ther S~~s~~ources of D~~d~~ata

4.1 Comparing the two financial markets

One of the shortcomings of the survey is that the collective account by the interviewees may not be an accurate reflection of the state of practice in Hong Kong (or the UK) due to certain biases on the part of the participants. In this Section 4, we seek to ~~corroborate~~ support our empirical analysis and survey results in Section 3 with other sources of data as to the directorial behaviour, particularly in relation to the question on whether directors of distressed firms are held to account for their actions (or lack of actions) when their companies face financial difficulties.

Even though the UK and Hong Kong are two international financial centres, we first rule out any significant differences in the lending markets used by the large firms. In the UK, it has been argued that the following three developments in the finance markets since the 2000s[139] have been instrumental in shaping corporate insolvency law and resulting in debtors and creditors coming to the negotiation table late in the day: (1) the diversification of debt markets away from bank lending; (2) the use of high yield debt which has no ‘maintenance’ financial covenants (explained below) and (3) covenant-lite loans (not limited to high yield debt) which have no ‘maintenance’ financial covenants.[140]

The first relates to the phenomenon of diversification of the debt markets, which may exacerbate the coordination problem among creditors. In the two markets, the trend in Figure 4 suggests that the importance of bank credit relative to total credit granted to the non-financial sector has steadily (though gradually) diminished over the last 25 years in both jurisdictions, although a small rebound occurs in Hong Kong in 2020. A distinct development

[134] See Interview with L1 (n 87~~84~~); P6 (n 126~~123~~).
[135] Interview with L1 (n 87~~84~~).
[136] See Interview with P4 (n 91~~88~~), P12 (n 95~~92~~), P9 (n 100~~97~~) (who gave an example where the debtor provides a charge over unencumbered assets in favour of the creditor extending new loans), with the consent of the other creditors; L3 (n 116~~113~~).
[137] Interview with P4 (n 91~~88~~); L2 (n 87~~84~~); P5 (n 87~~84~~); L3 (n 116~~113~~); L4 (n 122~~119~~); P14 (n 87~~84~~) (pointing out that where bondholders are concerned, they are not as keen to provide further financing).
[138] The first decision that allows for a cross-class cramdown was *Re Deep Ocean I UK Ltd* [2021] EWHC 138 (Ch), whose judgment was delivered in January 2021.
[139] S Paterson, *Corporate Reorganization Law and Forces of Change* (OUP 2020).
[140] S Paterson, ‘Reflections on English Schemes of Arrangement in Distress and Suggestions for Reform’ (n 5).

in Hong Kong is the influx of Mainland enterprises which have conducted offshore capital fund-raising on the SEHK.[141]

<Figure 4 here>

Secondly, we then investigated whether a similar pattern of high yield corporate debt issuance exists in both the UK and Hong Kong. Financial covenants in lending market are instrumental to bringing debtors and creditors to the negotiation~~ng~~ table; consequently, the trend of issuance of high yield corporate debt which have limited financial covenants has led to the debtors and creditors negotiating later (and thus having to use the tools in corporate restructuring law for non-consensual restructuring).[142] High yield bond debt typically do not have maintenance covenants[143] and the only covenants that are present are the 'incurrence' financial covenants, namely debtors are required to maintain the ratios when they undertake certain actions, such as incurring further indebtedness. Hence, creditors may not know that the debtor is in financial difficulty until an actual default occurs, if the debtor does not incur further debt during the life of the debt and the creditors lack access to periodic financial statements. If a higher proportion of high yield bonds exist in Hong Kong as compared to the UK, it may explain why debtors and creditors come to the negotiation table later in Hong Kong.

We find no evidence that differences exist in the finance markets as to the pattern of issuing high yield corporate bond. We obtained corporate bond information from the SDC Platinum Global New Issues Database and restricted to fixed rate bonds and notes issued by firms which are located in the UK and Hong Kong. We excluded bonds issued by financial firms and utility firms, and we restricted to high-yield debts that do not contain any financial covenants. The sample comprises 153 and 522 high yield bonds in Hong Kong and the UK, respectively, over the 2000–2019 period. Figure 5 shows the time period in relation to the issuance of high yield bonds. The issuance pattern of high-yield debt in Hong Kong is similar to that of the United Kingdom post-financial crisis of 2008, although further variation exists during the 2016–2019 period.

<Figure 5 here>

Finally, we also investigated whether financial covenants for unsecured loans for private borrowers (i.e. private firms) are also decreasing since the 2008 global financial crisis in the two markets. Traditionally, loans differ from bonds in that loans have more restrictive

[141] The total outstanding amount of bonds listed in Hong Kong has grown from HK$392 billion in 2009 to HK$5,205 billion in 2019. This figure was partly attributable to the issuance of offshore RMB bonds in Hong Kong by issuers in the Mainland, Hong Kong and overseas. See SEHK, 'The Rising On-Exchange Bond Market in Mainland China and Hong Kong' (Research Report, 2020) <https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2020/CCEO_ExBond_202009_e.pdf?la=en> accessed 7August 2022.
[142] Paterson, n 140~~137~~.
[143] Maintenance financial covenants typically require the debtor to maintain specified levels of debt or cash flows at periodic intervals during the life of the loan and the failure to comply with these covenants will alert the lenders as to the financial conditions of the debtors. See S Nebitt, 'Covenants and the Loan Agreement' in *Private Debt: Opportunities in Corporate Direct Lending*, John Wiley & Sons, Inc, pp 79–82. John Wiley & Sons, Inc.

covenants.[144] If the financial covenants in loans are decreased, it signals looser monitoring by lenders and hence the debtors and creditors come to the negotiation table late in the day.

Following Bradley and Roberts, we used the DealScan database, a subscription database by the Loan Pricing Corporation, which reports the covenant information of loan contracts in six categories: dividend restriction, asset sweep, debt sweep, equity sweep, whether a loan contains more than two financial covenants (which are accounting ratios) and whether a loan is secured.[145] The first covenant, dividend restriction, refers to the restriction of the debtor to pay cash to its shareholders where certain events occur. The second to fourth covenants relates to covenants or 'sweeps', where they refer to the fraction of the loans that must be repaid upon occurrence. For example, an asset sweep refers to the situation where a debtor sells 50% of the assets, it must repay 50% of the loan, and applies to the debt and equity. The fifth relates to financial covenants, which are accounting ratios (e.g. leverage and net worth) that must be met throughout the tenor of the loan when the amount is outstanding.[146] The last category refers to whether the loans are secured. For this study, we only focus on the covenants in the first five categories known as 'relevant covenants'. We have excluded secured loans, the covenants in the last category in our study as the database captures only whether the loan is secured or unsecured but does not indicate if the security is wholly or partly underwater, which creates difficulty in interpreting whether the creditors will be incentivised (or disincentivised) to engage in early-stage restructurings. The sample comprises 2,170 (Hong Kong) and 1,509 (UK) loans over the 2007–2019 period.

Figure 6 shows that from 2013 onwards, the average number of financial covenants in the two markets is broadly comparable, with Hong Kong and the UK peaking in 2014 and 2016, respectively.

<Figure 6 here>

Accordingly, based on a comparison between the lending markets in the two jurisdictions, we do not find significant differences between the UK and Hong Kong.

4.2 Threat of liability of directors in the zone of insolvency

A large number of the interviewees have focused on the fact that directors of financially distressed companies are seldom held to account for breaches of their duties to consider the creditors' interests.[147] In this section, we examine the extent to which directors actually face the credible threat of personal liability for failing to comply with their statutory and common law duties and we find that the evidence on enforcement is not very clear. Historically, in UK, directors face the potential of liabilities under Section 212 of the Insolvency Act 1986 (for misfeasance) or fraudulent or wrongful trading under Sections 213 and 214. They also face liabilities for breach of duties under the Companies Act 2006.[148] In earlier studies,

[144] See Darmouni, Olivier and Siani, Kerry, Bond Market Stimulus: Firm-Level Evidence from 2020-21 (January 31, 2022). Available at SSRN: https://ssrn.com/abstract=3693282.
[145] See also M Bradley and MR Roberts, 'The Structure and Pricing of Corporate Debt Covenants' (2015) *Quarterly Journal of Finance* 5.
[146] Following Bradley and Roberts, ibid, we count those loans with more than two accounting ratios as having among the relevant covenants.
[147] See notes 116~~113~~-122~~119~~ and accompanying text.
[148] The UK also has criminal liability for fraudulent trading under Companies Act 2006, s 993.

scholars have documented that private enforcement by liquidators in the UK is relatively rare, and other substitutes such as disqualification of directors are more prominent.[149] As for wrongful trading, not many cases were also reported where liquidators have brought actions for enforcement against directors.[150] Others have argued that the low number of cases may not be indicative of low levels of enforcement.[151]

However, a widespread belief has existed, evidenced by consultation papers, that the potential threat of liability is (or at least can be made) a credible threat for the directors.[152] To the extent of directorial disqualification, which is a public enforcement action brought by the Secretary of State for Business, Energy and Industrial Strategy, the UK Insolvency Office reports the 14,681 directors who are disqualified or provided undertakings under Sections 6 and 7 of the Company Directors Disqualification Act 1986 (CDDA) for 2009 to 2021; out of these cases, 1,255 involve allegations of entering into transactions that prejudice creditors' interests. [153] In 2015, the CDDA was amended to introduce the power of the court to make a compensation order against a disqualified director who has caused loss to one or more creditors of the insolvent company.[154] The CDDA was also recently amended to allow for investigations to be conducted against directors of companies which have been dissolved.[155]

In Hong Kong, in earlier studies,[156] Hong Kong is found to enforce directors' duties through a combination of private enforcement and public enforcement, but public enforcement is the major contributor. When the company is insolvent, private enforcement is brought by liquidators and public enforcement by the Securities and Futures Commission (SFC) pursuant to Sections 213 and/or 214 of the Securities and Futures Ordinance (SFO).[157] The SFC can bring enforcement actions, regardless whether the company is solvent or not.

Liquidators may bring enforcement action against directors for misfeasance.[158] As is the case in the UK, directors of Hong Kong companies are obliged to have regard to the creditors' interests when the company is in the zone of insolvency.[159] A search in the Hong Kong

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[149] Armour, J and others, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2008) 6 JELS 687.
[150] Richard Williams, 'What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?' (2015) 78 MLR 55; R Mokal, *Corporate Insolvency Law* (OUP, 2005); see A Keay, J Loughrey, T McNulty, F Okanigbuan, and A Stewart, 'Business judgment and director accountability: A study of case-law over time' (2020) 20 JCLS 359 (finding 10 cases for wrongful trading for the 2011–2018 period); van Zwieten, 'Director Liability in Insolvency and Its Vicinity' (2018) 38 OJLS 382.
[151] P Davies, 'Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency'(note 52) above.
[152] Williams (n 150~~147~~). Department for Business, Innovation and Skills, 'Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Businesses' (Discussion Paper, July 2013) [11.1–11.12]; Department for Business, Innovation and Skills, 'Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Businesses' (Government Response, April 2014) p 66.
[153] 'Insolvency Service Enforcement Outcomes: 2020/21' (Statistics on new outcomes resulting from the enforcement activities of the Insolvency Service, 22 April 2022) <https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-202021> accessed 7 August 2022.
[154] Company Director Disqualification Act 1986, ss 15A-B. See *Noble Vintners* [2019] EWHC 2806 (Ch).
[155] Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act 2021.
[156] WY Wan, C Chen and SH Goo, "Public and Private Enforcement of Corporate and Securities Laws: An Empirical Comparison of Hong Kong and Singapore" (2019) EBOR 319.
[157] Cap 571 (HK).
[158] Cap 32 (HK), s 276.
[159] See above, n 56 and accompanying text.

judgements revealed only two cases involving private enforcement actions brought against the directors which relate explicitly to failing to consider the creditors' interests when the company is insolvent or close to insolvency.[160]

For public enforcement, in particular, Section 214(2) allows the SFC to apply to the court for an order where the 'business or affairs of a corporation has been calculated in a manner… (a) oppressive to its members or any part of its members; (b) involving defalcation, fraud misfeasance or other misconduct towards it or its members or any part of its members…'.[161] The order that the court may make is wide-ranging, including an order for the company to bring an action against the defendants and any order that the court considered appropriate.[162] Prior literature has discussed the cases in which such orders were sought by the SFC.[163] Disqualification orders of up to 15 years may also be sought by the SFC.[164]

However, public enforcement is often limited by resources and when it occurs, extensive delays may occur. We compiled the 19 instances which the SFC has exercised its powers under Section 213 and/or 214 in Appendix 4 reported in the case law during the 2010–2021 period. Out of the 19 instances, only five were involved in insolvent companies. In the most recent insolvency case, the court allowed a Section 214 action where directors failed to consider the interests of the insolvent company. In *Re EganaGoldfheil (Holdings),*[165] in 2007, the directors of the publicly listed company breached their duties by procuring the company to borrow large sums of money HK$622 million to effect a buyback of a controlling stake in the company and were found to breach their duties to act in the best interest of the company. The company became insolvent when it was unable to repay the loan. The liquidators did not pursue actions against the directors owing to a lack of funds.[166] However, it was more than 10 years *after* the company was ordered to be wound up that the SFC sought an order for compensation under Section 214 of the SFO and disqualification of the directors (who had since resigned). If the compensation order was successful, the money would have gone to the company, which will be distributed to the creditors of the company in accordance with the liquidation waterfall. At first instance, the order was denied. However, on appeal, the Court of Appeal held that this case was appropriate for a Section 214 order to be made as the cause of action was clear, the amount of losses was ascertainable (being the entire sum that was used improperly) and no prospect for the company's liquidators bringing the action.

Finally, the criminal offence of fraudulent trading exists in Hong Kong.[167] However, no prosecution happens under such provision based on the search in the case law.[168]

4.3 Adjournment or stay of winding-up petitions on the ground of restructuring

[160] *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* [2020] HKCFI 398; *Wing Hong Construction Ltd v Hui Chi Yung* [2020] HKCFI 2985.
[161] SFO, Section 214(1)(a).
[162] SFO, Section 214(2)(b)-(e).
[163] See Wan et al., note 156~~153~~; see also *Re Styland Holdings (No 2)* [2012] 2 HKLRD 325; *Securities and Futures Commission v Yeung Chung Lung & Ors* [2013] HCMP 205.
[164] See *Re Minth Group* [2019] HKCFI 2735.
[165] [2021] HKCA 897.
[166] *Ibid*, para 32.
[167] Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO), s 275.
[168] A search on the judgments with Hong Kong Legal Information Institute and LexisNexis did not reveal any prosecution under the provision.

Finally, we seek to supplement the observations raised by interviewees that directors of companies in financial distress seek advice late in the day. [169] We examine the behaviour of directors of Hong Kong publicly listed companies who are seeking a stay or adjournment of winding-up proceedings allegedly on the ground of debt restructuring. We find that: (1) winding-up petitions for listed companies in Hong Kong far exceeds that of the UK; (2) even in the late stage when winding-up petitions[170] are filed by creditors and the directors are seeking a stay of such proceedings on the ground of debt restructuring, there is often no serious attempt by directors to expedite such restructuring.

The publicly available statistics on these petitions aggregate the data and do not provide the breakdown as to the size of the companies subject to winding-up. However, when listed companies have winding-up petitions brought against them or their material subsidiaries, they are required to disclose to the respective stock exchanges. Based on the searches for material announcements on the stock exchanges over the 2018–2021 period (due to availability of data), we only find two such filings in the UK[171] but filings against 44 Mainboard-listed companies in Hong Kong where the basis is on the inability to pay the debts. The list of the Mainboard-listed companies is found in Appendix 6. Even accounting for the number of the listed companies in the two jurisdictions, the number of such petitions is much higher in Hong Kong.[172]

In addition, we also examine the recent case law in Hong Kong where after the winding-up petitions are filed, the directors have argued for a stay or adjournments of the petitions on the explicit ground they are attempting debt restructuring. We find that in many of these cases, the debtor has not made serious attempts to provide credible financial information to the creditors[173] nor engage in meaningful negotiations.[174] The Hong Kong courts have criticised the directors of the company as not acting in the interests of creditors[175] and have rejected the application for adjournment or stay and granted the winding-up petition.[176]

The fact that many of these winding-up petitions have been outstanding for some time without meaningful restructuring attempts underscores that the companies are fairly late in seeking assistance. In the five Hong Kong cases involving companies listed on the SEHK, where the provisional liquidators attempted to seek adjournments or stay of the winding-up petitions on the purported ground of debt restructuring, more than 6 months have elapsed after the date the petition is filed or the statutory demand is served.[177] In three of these

[169] See notes 96~~93~~-105~~102~~ and accompanying text.
[170] Companies (Winding-up and Miscellaneous Provisions) Ordinance, Cap 32.
[171] They are Carillion plc and Thomas Cook plc. See Online Appendix.
[172] The London and Hong Kong Stock Exchanges have 1,976 and 2,568 listed companies, respectively, as of June 2021. Source: World Federation of Exchanges. Number of listed companies in the UK is going down
[173] *Re Victory City International Holdings Ltd* [2021] HKCFI 1370; *Re Lerthai* [2021] HKCFI 207.
[174] *Re Lamtex Holdings Ltd* [2021] HKCFI 622; *Re Trinity Management Services* [2021] HKCFI 2207.
[175] Eg *Re China Bozza* [2021] HKCFI 1235 (no consultation was made with the creditors).
[176] *Re Trinity Management Services*; *Re Lerthai Group Limited* [2021] HKCFI 207. See also *Re GTI Holdings Limited* [2022] HKCFI 2598; HCMP 1556/2020 (19 August 2022).
[177] The cases are *China Bozza*[2021] HKCFI 1235; *Re Lerthai* [2021] HKCFI 207; *Re Trinity Management Services* [2021] HKCFI 2207; *Re Victory City International Holdings Ltd* [2021] HKCFI 1370; *RE GTI Holdings* [2021] HKCFI 3647; HCCW 51/2020. The data on filing of petition or service of statutory demand are found on the case law and the stock exchange data.

companies where a winding-up order was sought by bank creditors in Hong Kong, they were wound up by the court.[178]

5. Implications of our F~~f~~indings and R~~r~~ecent D~~d~~evelopments

5.1 Incentivising early debt restructurings in Hong Kong

The evidence shows that to optimise the success of corporate restructurings, the directors have to be appropriately incentivised to file for restructuring early, whilst the company remains high on the demise curve, above the crisis stage. In examining the tool kit of restructuring tools as incentives for the directors to file, two mechanisms, namely automatic moratorium and provision of DIP financing, have been used by several jurisdictions in considering reforming their restructuring laws.

As discussed in Section 2, in 2020, the UK introduced the stand-alone moratorium in CIGA, which may be used to stay enforcement actions by secured and unsecured creditors who are within the scope of the legislation and provide breathing space for companies whilst they formulate a restructuring plan for the purposes of the scheme of arrangement. Creditors can apply to lift the moratorium in cases where no prospect of success exists, and the company is merely delaying matters. The moratorium is overseen by an insolvency practitioner or a monitor under the supervision of the court, so that the entire process is not completely conducted on a DIP basis.[179] Entitlement to the moratorium is largely delegated to the judgment of the monitor with a considerable amount of leeway given to the monitor's opinion on the viability of a rescue.[180] The documents that must be filed with the court before the moratorium coming into force include a statement that in the proposed monitor's view, a moratorium is likely to result in the rescue of the company as a going concern.[181] The monitor brings the moratorium to an end if it can no longer achieve its purpose.[182] This situation includes non-cooperation by the directors of the company who fail to provide any information required by the monitor for the purpose of carrying out the monitor's functions. Notably, however, the company itself chooses who should act as monitor.

We argue that there is a case for the moratorium to support schemes of arrangement for Hong Kong but not the form that is set out in the CIGA. The UK experience is that the moratorium is not as well used as may be hoped possibly due to the limitations in the payment holiday, exclusion of many creditors including those that have issued bonds[183] and the fact that directors need to be able to confirm that the company is, or likely to become, unable to pay its

[178] They are *Re Lerthai*; *Re Trinity Management*; *Re GTI Holdings*, *ibid*. In the other two cases, the bank creditors opposed the recognition of the provisional liquidation made by the Caribbean courts (but did not petition specifically for winding-up order) in Hong Kong.
[179] Insolvency Act 1986, ss A34 to A41.
[180] *Re Minor Hotel Group* [2022] EWHC 340 (Ch).
[181] Insolvency Act 1986, s A6.
[182] *Ibid*, s A38.
[183] For instance, a debtor which is a party to a capital market instrument (e.g. having issued bonds), will not be able to invoke the moratorium: see Insolvency Act 1986, sch ZA1. See also P Walton and L Jacobs, *Corporate Insolvency and Governance Act 2020 – Final Evaluation Report November 2020* (December 2020), available at UK Insolvency Service, https://www.gov.uk/government/publications/corporate-insolvency-and-governance-act-2020-evaluation-reports/corporate-insolvency-and-governance-act-2020-final-evaluation-report-november-2022 (the survey indicated that the moratorium was not used as often as would be expected).

debts.[184] In other words, the requirement that the company is or likely to become unable to pay its debts indicates that when the company is between the concern and the crisis phases in Figure 1, the directors will not be able to invoke the moratorium ~~earlier than the crisis phase found in Figure 1~~until the company is either very close to crisis or thereafter. The motivations of Hong Kong may not be the same as the UK (post-Brexit), which is intended to be relevant as an international restructuring hub and where restructuring tools perform the signalling function of installing a progressive bankruptcy regime.[185] By contrast, Hong Kong has not signalled such intention.

Nonetheless, having a mechanism has certain benefits to allow the company some breathing space whilst attempting a restructuring in view of the diversity of the creditors involved or where both financial and operational creditors are implicated, when the company remains relatively higher up the demise curve. ~~In other worords, w~~We argue that the moratorium should be available to support a scheme of arrangement proposed by the debtor, similar to the regime in Singapore, which does not have a requirement for the debtor to be unable or likely to be unable to pay its debts. [186] Critics may argue that the debtor may end up using the moratorium for effecting a scheme of arrangement to cram down dissenting creditors in a strategic manner where the debtor is able to meet its debts,[187] but this can be managed with a requirement with evidence that there is creditor support (or at least a lack of opposition) for the scheme of arrangement and managed with oversight by the court and monitor. Provisions for the priority of moratorium debts in subsequent insolvency proceedings should also be considered.

Otherwise, obtaining the protection of the stay of enforcement proceedings when the company is insolvent or close to insolvency requires managers to wait for the company to descend on the demise curve. If Hong Kong were to adopt the moratorium, based on the interviews with the insolvency professionals and their ~~due to~~ concerns over the behaviour of directors, safeguards clearly have to be put in place, including the length of the period and the requirement of an independent third party to monitor. In other words, the process cannot be strictly DIP but requires a degree of oversight by the court and the independent insolvency practitioner to avoid the situation that it is used to prop up an economically unviable company. ~~We note that there is~~ As argued above, the possibility that the moratorium may be misused to interfere with creditors' rights in non-financial distress situations ~~but we argue that it would be for~~ would either be for the court to dismiss the application for moratorium or for the monitor to oppose the continuation of the moratorium if there is the absence of good faith.

[184] Insolvency Act 1986, s A6.
[185] For the UK, see G McCormack, 'Schemes, Plans and International Recognition', *Gore-Browne on Companies Special Release 2022*, p SR81. See also UK Insolvency Service, *Implementation of Two UNCITRAL Model Laws on Insolvency* (7 July 2022), stating that "[g]lobal cooperation allows international businesses to choose to restructure in the UK, knowing that this will lead to the best result for their creditors, shareholders and management, with confidence that the outcome will be accepted both in their local courts and across the world". Changes in EU procedures as well as reforms in other countries have led to increased competition for restructurings and the changes contained in the 2020 Act were probably needed even if Brexit had not occurred.
[186] Insolvency, Restructuring and Dissolution Act 2018, s 64 (the company can apply for a moratorium if it proposes or intends to propose a compromise or an arrangement with the creditors).
[187] Cf J Payne, "An Assessment of the UK Restructuring Moratorium", (2021) Lloyds Maritime and Commercial Law Quarterly 455.

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The need for DIP financing is less clear given the lack of such financing in the Hong Kong market. The ability to grant such priority provides an additional carrot for the directors to engage in early-stage restructuring, particularly if no other unencumbered asset exists.[188] The UK market lacks such DIP financing.[189] Nonetheless, with the new restructuring plan under Part 26A, other incentives exist in the UK, such as allowing existing secured creditors and shareholders to capture the restructuring surplus (but which have the effect of excluding junior creditors).[190] Our interviews in Hong Kong also reveal that deciding whether existing creditors would consent to the new monies to gain priority may be best left to their commercial judgment.

We acknowledge that in the case of Hong Kong companies with predominantly Mainland operations, and what is required is to restructure not only the offshore debt but also the onshore debt, there would be additional complexities, due to the diversity of creditors in Mainland China and the offshore restructuring may depend on the outcome of the onshore restructuring. Nevertheless, we argue that incentives should still be in place for directors in Hong Kong to engage in negotiations and address the problems early.

5.2 Enforcing directors' duties

At present, the drawback in Hong Kong on a DIP regime of debt restructuring is the fact that, at least based on perception, directors are seldom held to compensate the company or creditors if they fail to consider the creditors' interests in their decision making at the time the company is at the zone of insolvency or is insolvent. Cases involving actions by liquidators against the errant directors are rare (due to the lack of assets of the company or absence of funding of the litigation). While the liquidator may seek external litigation funding to pursue actions against third parties in Hong Kong,[191] the interviews review that only large cases will attract litigation funding. The interviews also reveal that disqualification orders do not deter errant directors.

The added complication is the considerable number of directors of companies whose operations are not in Hong Kong (and particularly located in Mainland China) and are not residents in Hong Kong. The latter is not a new problem; the existing scholarship has documented the challenges in enforcing ~~corporate governance~~ directors' duties ~~for these companies~~ in Hong Kong.[192] Compounding the problem is how directors' duties are perceived in Mainland China and Hong Kong; Chan et al. have argued that business executives in both Mainland China and Hong Kong subscribing to conservative Chinese values have been more lenient in overlooking the chairman's breaches of directors' duties

[188] See e.g., K Ayotte, and D Skeel, 'Bankruptcy Law as a Liquidity Provider' (2013) 80 University of Chicago Law Review 1557.
[189] Department for Business, Energy & Industrial Strategy, *Insolvency and Corporate Governance: Government Response* (26 August 2018).
[190] See the discussion in, inter alia, *Re Houst Ltd*, 2022] EWHC 1941 (Ch) and the discussion of the implications of the case in https://www.pwc.co.uk/services/business-restructuring/insights/restructuring-plans-what-difference-year-makes.html and https://www.kirkland.com/-/media/publications/alert/2022/07/houst---english-court-approves-sme-restructuring-plan_final.pdf

[191] *Re Cyberworks Audio Video Technology Ltd* [2010] HKCFI 404; [2010] 2 HKLRD 1137; HCCW 1113/2002 (4 May 2010).
[192] C Chen, WY Wan and W Zhang, 'Board Independence as a Panacea to Tunneling? An Empirical Study of Related-Party Transactions in Hong Kong and Singapore' (2018) 15 *Journal of Empirical Legal Studies* 987.

and are also less likely to report such breaches.[193] Confucian culture also has a negative likelihood of probability of directors dissenting in boardrooms, which would mean that executive directors may not face the kinds of oversight and probing as would be otherwise be expected in other Western cultures.[194]

The argument for the public regulator to step up these cases to bring the actions (e.g. in *EganaGoldfheil*) is not compelling. The regulator would only bring the action if the public interest is high. The public regulator may not regard these actions as of high priority. ~~Unlike shareholders who face several obstacles in enforcing directors' duties, including having to seek leave to bring shareholder derivative action, creditors do not face such difficulties because they can directly enforce on their debt by obtaining judgments and putting the companies into winding up.~~ Bondholder creditors are generally either sophisticated or are high net-worth individuals although the same cannot be said of trade creditors. ~~By contrast, shareholders are also often diversified and face collective action problems.~~ Hence, critics may argue that the resources of the public regulator should not be expended to take enforcement proceedings that will indirectly benefit bondholders, even if the liquidator lacks the funds to pursue such actions.

We argue that the solution would have to lie in public enforcement but perhaps not through compensation orders. Whereas Section 214 of the SFO is a powerful provision as the securities regulator has the powers including that of taking out freezing orders, the regime is less geared towards the securities regulator enforcing directors' duties for failure to act in the creditors' interests. We argue that expressly allowing compensation to be ordered for the creditors (e.g. found in Sections 15A-B of the UK CDDA) may not be necessary. [195] Instead, a civil penalty provision will incentivise the wrongdoing directors to negotiate with the securities regulator to pay compensation to the insolvent company (from which the creditors can benefit).[196]

6. Conclusion

Our empirical evidence demonstrates that directors of firms in Hong Kong approach debt restructuring at a later stage than its UK counterparts, and often when the company has slid far down the corporate demise curve when operational restructuring is impacted. Thus, the English-origin scheme of arrangement, which has been successfully used in the early-stage restructuring in the UK, has not worked effectively in going-concern restructurings in Hong Kong. The reasons are complex but they appear less to deal with the differences in the substantive duties of directors of companies in the zone of insolvency but likely to the perception of enforcement of these duties. Thus, we propose that in addressing law reform, the tools have to be fashioned to incentivise the directors to address the problems early. This takes the form of the statutory moratorium to support the scheme of arrangement but it must

[193] Chan, R. S. Y., Ho, D., & Young, A. 'Rethinking the Relevance or Irrelevance of Directors' Duties in China: The Intersection between Culture and Laws' (2014) 1 *Asian Journal of Law and Society* 183–203.
[194] Chen, S., Ye, Y., Jia, F., & Wang, C. 'Accounting for the R~~r~~ole of C~~c~~ulture in B~~b~~oard D~~d~~irectors' D~~d~~issent' (2022) 61 *Research in International Business and Finance*, 101652. See also Pang, J. C., & Lo, S. M. (2017). Effect of Place of Incorporation, Chinese Culture, and Business Practices on Corporate Fraud: Evidence from Hong Kong Listed Companies. *Asia-Pacific Journal of Financial Studies*, 46(2), 221–245.
[195] See n 154~~151~~ and accompanying text. The provision allows for compensation to be made not only to the company but also to *creditors*. For critique of the complexity of Sections 15A-B, see K van Zwieten, 'Disciplining the Directors of Insolvent Companies: An Essay in Honour of Gabriel Moss QC' (2020) 33 *Insolvency Intelligence* 2.
[196] For examples of how civil penalty provisions can provide the incentives, see Wan et al (n 156~~153~~).

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be supported by safeguards discussed in this paper and more robust enforcement of directors' duties.

Finally, what are the implications on the longer-term direction of insolvency reforms in Hong Kong? While there may be a lack of urgency in the past and the fact that many of the larger companies listed on the SEHK are registered in offshore Caribbean jurisdictions, Hong Kong remains an outlier in not having a formal corporate rescue framework. Since 1996, Hong Kong has considered introducing the provisional supervision and corporate rescue bill and after several rounds of consultation, it was announced that the bill will be tabled before Legislative Council in 2021.[197] However, as at end of 2022, the bill remains pending before Legislative Council. Even if the proposed provisional supervision and corporate rescue bill is enacted, we argue that that our proposals for the moratorium for the scheme of arrangement is still required. The proposed provisional supervision and corporate rescue bill only applies when the company is insolvent or is likely to become insolvent,[198] that is, where the company is either at or near the bottom of the demise curve.

In the longer term, the legal infrastructure in this area in Hong Kong would need to be modernised in line with international developments including those in the UK to promote a corporate rescue regime that is closer to the DIP for the rescue of economically viable but financially distressed firms. While out of court consensual restructurings are most efficient at the concern stage, companies which are approaching the crisis stage will require the DIP process.

[197] See n 17 and accompanying text.

[198] The bill has not yet been published and the reference to insolvency is drawn from Financial Services and Treasury Bureau, *legislative Proposals on the Companies (Corporate Rescue) Bill*, LC Paper No. CB(1)48/20-21(03) (22 October 2020).

Appendix 1

Hong Kong schemes of arrangement, 2015–2021

Name of company	**Year of sanction of scheme**
Kaisa Group Holdings Ltd	2016
Winsway Enterprises Holdings Ltd	2016
First Mobile Group Ltd	2016
Grande Holdings Limited	2016
Mongolian Mining Corporation	2017
Z-Obee Holdings	2017
Shanell Ltd	2017
Asia Television Holdings	2017
Hong Kong Building and Loan Agency	2019
Union Asia Enterprise Holdings Ltd	2019
Da Yu Financial Holdings Ltd	2019
China Singyes Solar Technology Holdings	2019
Up Energy Development Group Ltd	2019
National Arts Entertainment and Cultural Group Ltd	2020
China Lumena New Materials	2020
Hsin Chong Aster Building Services	2020
Asia Today Ltd	2020
China Oil Gangran Energy Group Holdings Ltd	2021
Freeman Fintech Corp Ltd	2021
Sampson Paper Holdings	2021
Yestar Healthcare Holdings Limited	2021
Hilong Holdings Limited	2021
GCL-Poly New Energy Holdings Ltd	2021

Sources: Hong Kong case law, explanatory statements, filings from SEHK; Perfect Information; information agents for bond restructurings

Appendix 2

UK schemes of arrangement, 2015–2021

Case Name / Company Name	**Year of commencement**
Codere Finance (UK) Limited	2015
Stemcor	2015
Van Gansewinkel Group	2015
TORM plc	2015
Towergate	2015
Gulf Keystone Petroleum Limited	2016
The Co-operative Bank plc	2017
Bibby Offshore Services plc	2017
Frigoglass Finance BV	2017
Algeco Scotsman PIK S.A.	2017
Noble Group Limited	2018
Avanti Communications Group Plc	2018
House of Fraser	2018
Lecta Paper UK Ltd	2019
Syncreon Group BV & Syncreon Automotive (UK) Ltd	2019
New Look Limited	2019
Agrokor d.d. (SoA)	2019
Petra Diamonds US Treasury plc	2020
Petroleum Geo-Services	2020
Swissport Fuelling Ltd	2020
Steinhoff International Holdings	2020
KCA Deutag Drilling Limited	2020
Sunbird Business Services Limited	2020
Selecta Group	2020
New Look	2020
Codere	2020
ED&F Man	2020
HEMA B.V.	2020
Flint Group SA	2020
Matalan Limited	2020
African Minerals Limited	2020
Swissport Fuelling Ltd	2020
Doncasters Group Limited	2020
Premier Oil Plc	2020
West African Gas Pipeline Company	2021
Jain International Trading BV	2021
Provident Financial	2021
DTEK Finance PLC	2021
Obrascon Huarte Lain, S.A. (OHL)	2021
MAB Leasing Limited (Malaysia Airlines)	2021

Sources: UK case law, explanatory statements, Debtwire

Appendix 3 (List of questions for the insolvency practitioners and lawyers)

1. **Introduction**:
    a. Briefly describe the clients that you work most often: (a) debtor / creditor (b) size of client (listed/unlisted, medium, large) (c) region (international, national, cross-border); (d) type of client activity (services, etc.)
    b. In which capacity do you normally act e.g. legal counsel or insolvency practitioner?
    c. How long have you been advising in debt restructuring?
2. **Process of advice:**
    a. At what stage of financial distress do debtors come to you for advice? Does it depend on sector or type of shareholding/ management? Have creditors started to foreclose or initiate legal proceedings? Have they started negotiations or discussions on restructuring attempts? Who within the debtors' organisations are responsible for the restructuring?
    b. Are other advisers involved e.g. consultancy firms, private equity firms etc.?
    c. Describe the most common initial approach by debtors (are they fully aware of the distress or only much later in the process? Do debtors have an idea on what type of strategy to use for restructuring?
    d. What are the debtors' typical urgent concerns? What measures do you advise (e.g. civil and criminal litigation, dealing with liquidity)
    e. Do the debtors have the financial information that creditors ask for? Or do they have to construct the financial statements for the restructuring process?
    f. In what circumstances do you normally suggest rescuing the business? When do you suggest liquidating the business?
3. **Types of restructuring:**
    a. If the business is worth rescuing in your opinion, is your preferred strategy out of court or in-court? Are financial creditors in Hong Kong reluctant to use out of court or in court procedures? Do they often participate in creditor committees?
    b. What is your estimate as to the percentage of success of restructuring, whether in court or out of court?
    c. What are the most common aspects of out of court restructuring agreement that you have seen?
4. **SMEs:**
    a. For SMEs, if the business is organised as a company and the director/shareholder has given a guarantee or has used the personal assets as security, how would the guarantee/security be affected as part of the restructuring? Do you see the business owner/ entrepreneur closing down the business and restarting?
5. **Stakeholders:**
    a. How often do you engage in negotiations with other stakeholders, such as landlords, employees, key suppliers and shareholders?
    b. How often are banks willing to provide additional financing? How about key suppliers?
6. **Catch all**: Do you think that the law should be reformed for rescue financing to receive some kind of super-priority status over existing loans? What are the main limitations that you see in relation to the existing restructuring options in Hong Kong? What aspect do you think should be changed?

Appendix 4

List of enforcement actions brought by the Securities and Futures Commission under Sections 213 and 214 of the Securities and Futures Ordinance (2010–2021)

Years	Name of company	Citation
2010	Rontex International Holdings Ltd	[2010] HKEC 413
2011	Styland Holdings Ltd	[2011] 1 HKLRD 96
2012	Styland Holdings Ltd	[2012] 2 HKLRD 325
2012	China Asean Resources (known as Medical China)	[2012] HKCFI 1604
2014	Tack Fat Group International Ltd	[2014] HKEC 2011
2015	First China Financial Networks Holdings Ltd	[2015] HKEC 86
2015	China Best Group Holding Limited	[2015] HKEC 2284
2017	Hanergy Thin Film Power Group Ltd	[2017] 2 HKLRD 785
2017	First Natural Foods Holdings Limited	[2017] HKEC 313
2018	Freeman FinTech Corp Ltd	[2018] 1 HKLRD 320
2019	Tack Fat Group International Ltd	[2019] HKCFI 2322
2019	Inno Tech Holdings Ltd	[2019] HKCFI 2463
2019	Minth Group Limited	[2019] HKCFI 2735
2020	Karce International Holdings Company Limited (Sinogreen Energy)	[2020] HKCFI 435
2020	Long Success (Holdings) Ltd	[2020] HKCFI 606
2021	Long Success (Holdings) Ltd	[2021] HKCFI 624
2021	Shandong Molong Petroleum Machinery Co Ltd	[2021] HKCFI 497
2021	EganaGoldpfeil (Holdings) Ltd	[2021] HKCA 897
2021	Anxin-China Holdings Ltd	[2021] HKCFI 1975

Source: Judgments from Hong Kong Legal Information Institute and LexisNexis, Website of the Securities and Futures Commission

Appendix 5

Table 4. Interviewees coded (conducted April–December 2021)

Date	Position	Code
30 April 2021	Accountant	P1
6 May 2021	Insolvency lawyer	L1
13 May 2021	Insolvency practitioner	P2
20 July 2021	Accountant	P3
23 July 2021	Insolvency practitioner	P4
10 August 2021	Insolvency lawyer	L2
10 August 2021	Insolvency practitioner	P5
12 August 2021	Insolvency lawyer	L3
13 August 2021	Insolvency practitioner	P6
31 August 2021	Insolvency practitioner	P7
31 August 2021	Insolvency practitioner	P8
31 August 2021	Insolvency practitioner	P9
2 September 2021	Insolvency practitioner	P10
14 September 2021	Insolvency practitioner	P11
14 September 2021	Insolvency practitioner	P12
24 September 2021	Insolvency lawyer	L4
5 October 2021	Accountant	P13
18 October 2021	Insolvency practitioner	P14

Appendix 6

Listed Companies with Winding-up Petitions (2018-2021)

UK

Company Name	Year of Winding-up Petition
Carillion PLC	2018
Thomas Cook PLC	2019

Hong Kong

Stock Code and Name of Company	Year of Winding-Up Petition
1400 - Wang Tai Holdings	2018
1227 - National Investment Fund Holdings	2018
381 - Kiu Hung International Holdings	2018
1096 - Sino Energy International Holdings Group	2019
279 - Freeman Fintech Corporation	2019
433 - North Mining Shares Company	2019
153 - China Saite Group Company	2019
651 - China Oceanwide Holdings	2019
750 - Singyes Solar	2019
39 - China Beidahuang Industry Group Holdings	2019
313 - Richly Field China Development	2019
3344 - GTI Holdings	2019
1400 - Moody Technology Holdings	2019
1192 - Titan Petrochemicals Group	2019
907 - Elegance Optical International Holdings	2019
2882 - HKR International	2019
33 - Cloud Copper Company	2020
996 - Carnival Group International Holdings	2020
1004 - C Smarter Energy Group Holdings	2020
1069 - Bozza Development Holdings	2020
1520 - CEFC Financial Investment Holding Co., Ltd.	2020
1699 - Putian Food Holdings	2020
1305 - Wai Chi Holdings Company	2020
2014 - Ozner Water International Holding	2020
112 - Lerthai Group	2020
1386 - V Estate Group Holdings	2020
3708 - China Supply Chain Holdings	2020
1269 - First Capital Securities	2020
618 - PKU Resources	2020
653 - Bonjour Holdings	2020
1150 - Milan Station Holdings	2020

627 - Fullsun International Holdings Group Co., Ltd.	2020
1185 - China EnergiNE International (Holdings)	2020
731 - Samson Paper Holdings	2020
601 - REMT	2021
574 - Pashun International	2021
2112 - CAA Resources	2021
1191 - China Gem Holdings	2021
727 - Crownicorp	2021
1194 - Bay Area Gold Prosperity	2021
886 - Silver Base Group Holdings	2021
901 - Goldstone Investment Co., Ltd.	2021
526 - China Automotive Interior Decoration Holdings	2021
147 - International Business Settlement Holdings	2021

Source: Announcements on the relevant stock exchanges. We only include companies where winding-up petitions have been brought against them by creditors on the ground of inability to pay the debt. We exclude winding-up petitions brought by companies which are seeking provisional liquidation.

Figures

Figure 1. Corporate Demise Curve

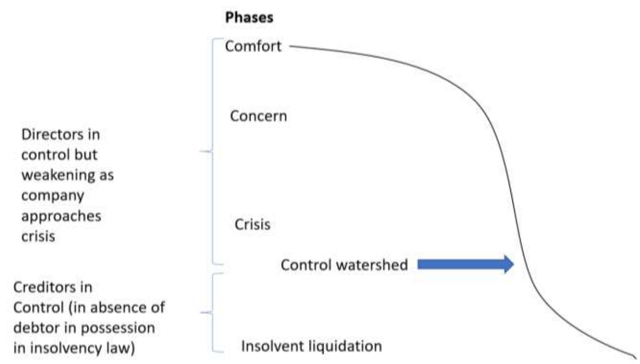
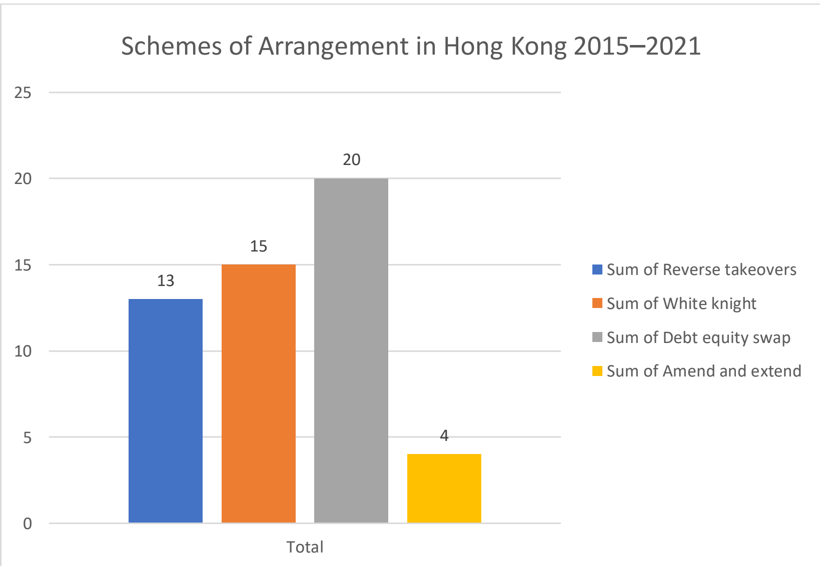
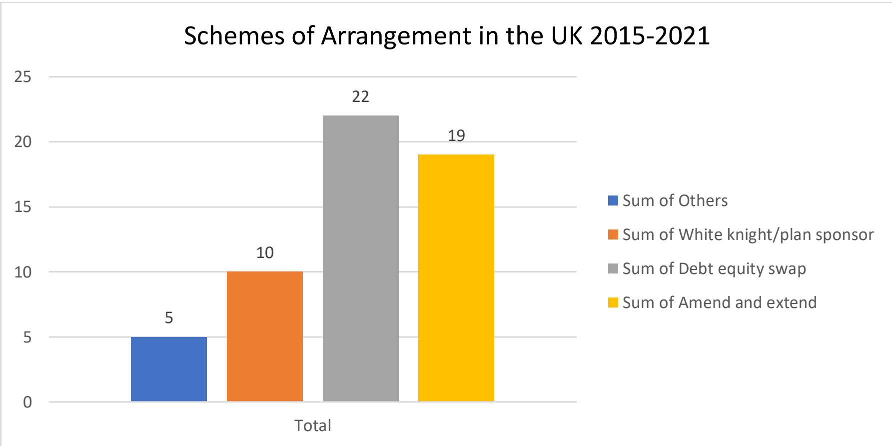


Figure 2 Schemes of Arrangement in Hong Kong 2015–2021



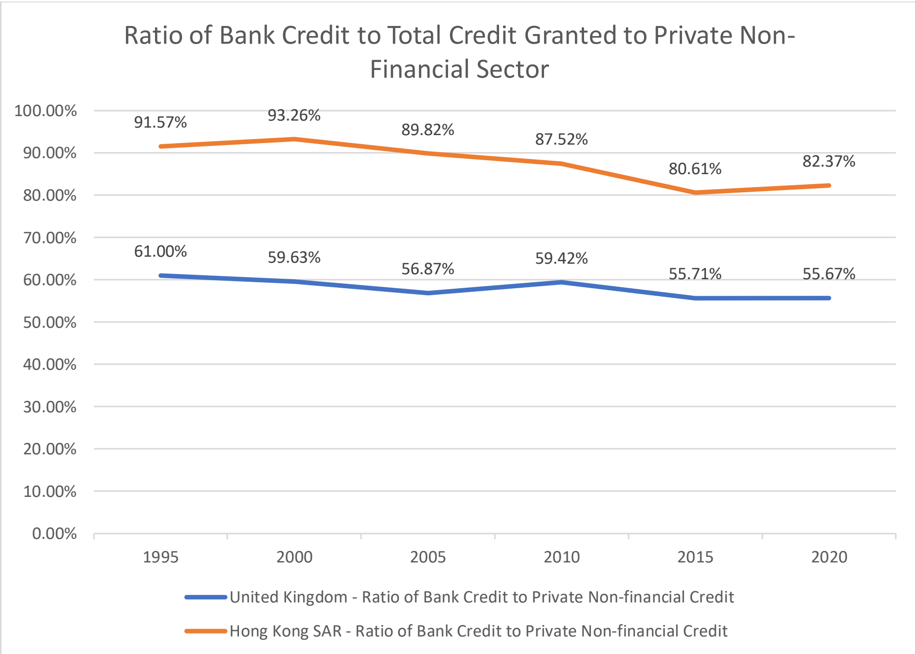
Note: Overlaps may exist between debt equity swap and white knight/plan sponsor.

Figure 3. Schemes of Arrangement in the UK 2015–2021



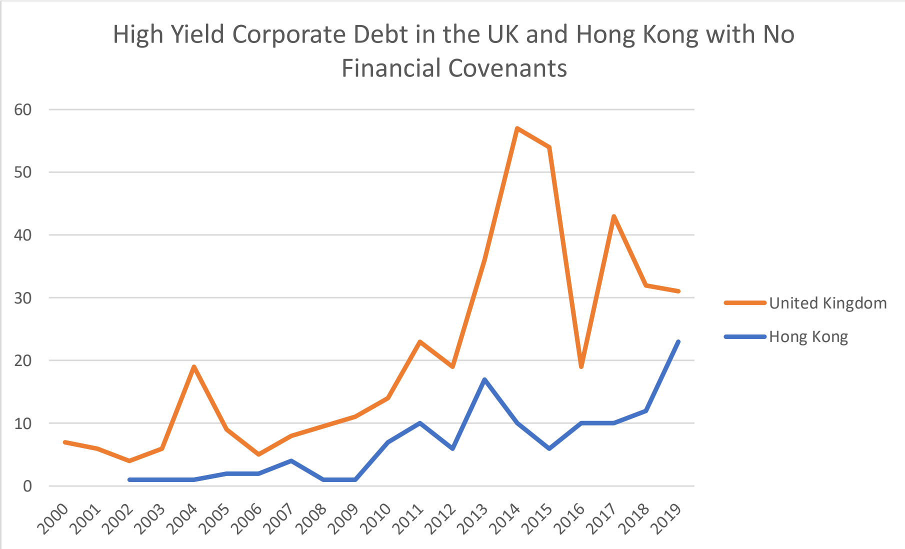
Note: Overlaps may exist between debt equity swap and white knight/plan sponsor.

Figure 4. Ratio of bank credit to total credit granted to private non-financial sector



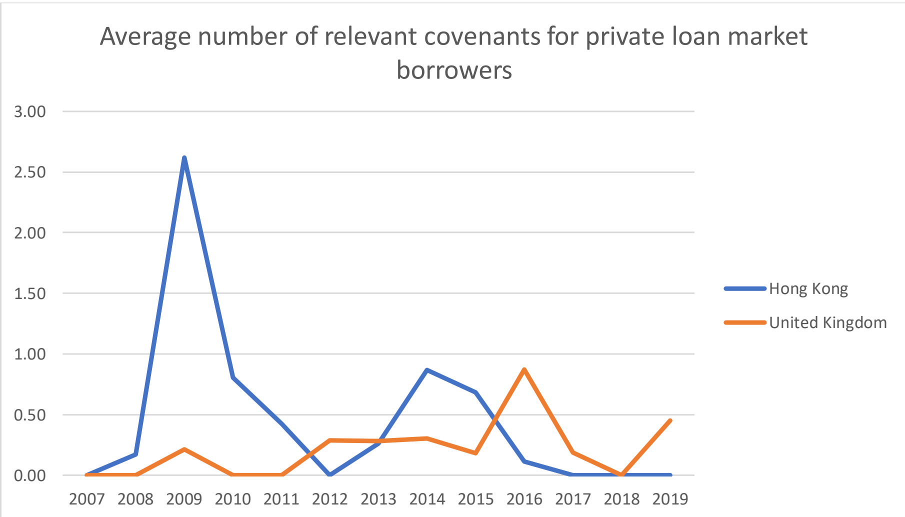
Source: Data collected from Bank for International Settlements

Figure 5. High yield corporate debt in the UK and Hong Kong



Source: Data collected from SDC Platinum Global New Issuance

Figure 6. Average number of relevant covenants for private loan market borrowers



Source: Data collected from LPC Dealscan

Table 1 Breakdown of the outcomes of Hong Kong schemes of arrangement

Classification	Number
Debt equity swap only	3
Amend and extend only	3
Debt equity swap and amend and extend only	1
Debt equity swap and reverse takeover only	1
Debt equity swap and white knight only	3
Debt equity swap, white knight and reverse takeovers	12
Total	23

Table 2 Breakdown of the outcomes of UK schemes of arrangement

Classification	Number
Debt equity swap only	10
Amend and extend only	9
White knight only	1
Debt equity swap and amend and extend only	6
Debt equity swap and white knight only	4
Debt equity swamp, amend and extend and white knight	2
Amend and extend and white knight only	2
Others	6
Total	40