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Insolvencies in Hong Kong in a post-COVID World

The Situation in Hong Kong

COVID-19 has created unforeseen challenges to businesses all over the world, resulting in many companies being unable to survive the pandemic. Hong Kong has been no exception. In Hong Kong, according to data published by the Hong Kong Government's Official Receiver's Office, in the first seven months of the year, 5,219 compulsory bankruptcy petitions and 247 compulsory winding-up petitions were presented, representing 13.7% and 5.1% year-on-year increase respectively. The effect of COVID-19 may yet be fully reflected by these figures.

Governments worldwide have realised the need for relief measures in light of the severe implications stemming from the COVID-19 pandemic. Some common law jurisdictions have implemented temporary insolvency law measures to help businesses.

The Current Regime

At present, Hong Kong does not have any statutory corporate rescue regime. Compared to the administration process of England and Wales, the United States' Chapter 11 regime & Singapore's judicial management process and superiority for rescue financing, financially distressed companies in Hong Kong can only access corporate rescue through the appointment of liquidators or a scheme of arrangements.

The main drawbacks of the current insolvency regime in Hong Kong are therefore:

- Lack of corporate rescue regime
- Lack of statutory moratorium of legal actions
- No express recognition of cross-border insolvency

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How have other jurisdictions incorporated interim measures into their insolvency law regimes?

The United States, United Kingdom and Singapore provide contemporary examples of making temporary changes to insolvency law in the face of COVID-19 and its legal repercussions.

In the United States, for example, The Coronavirus Aid, Relief, and Economic Security (CARES) Act, which was signed into law on the 27th of March 2020, raised the debt limit of USD\$2,725,625 set in subchapter 5 of Chapter 11 of the United States Bankruptcy Code to USD\$7,500,000. The change applies to bankruptcies filed after the enactment of the CARES Act. The amount of USD\$2,725,625 is planned to be reinstated as the debt threshold on 27th March 2021.

In the United Kingdom, on the 20th May 2020, the Government published both the Corporate Insolvency and Governance Bill to implement temporary changes to the UK's insolvency law. This was largely to provide financial relief for businesses that were financially viable yet struggled with the economic implications of COVID-19. This included:

- Temporarily suspending wrongful trading rules
- New restructuring processes
- Prohibiting the operation of termination clauses in contracts for the supply of goods and services where the counterparty enters a relevant insolvency process

In Singapore, the COVID-19 (Temporary Measures) Act ("COVID-19 Act") has been implemented to tackle the issue of financial difficulty faced by both businesses and individuals during COVID-19. The monetary thresholds in the Insolvency, Restructuring and Dissolution Act from 2018 (IRDA) have been temporarily increased:

For individuals:

- The monetary debt threshold for commencing bankruptcy proceedings has been changed from SGD15,000 to SGD60,000.
- Suitability for a 'debt repayment scheme' is changed from the previous SGD100,000 to SGD250,000 for individuals.

For businesses:

- The monetary debt threshold for commencing winding up proceedings has been changed from SGD10,000 to SGD100,000.

There has been an additional change to the amount of time for a debtor to respond to a creditor's demands, for both businesses and individuals, from 21 days to 6 months before insolvency proceedings can be commenced.

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What measures have been taken by the Hong Kong Government to combat the financial distress caused by COVID-19?

Currently, Hong Kong has responded to COVID-19 with a variety of measures. This can be seen in the Employment Support Scheme (ESS) wages subsidies of up to HK\$9,000 per month per employee for all employers making Mandatory Provident Fund contributions in return for an undertaking not to implement redundancy, and a one-off cash pay-out of HK\$10,000 to each Hong Kong Permanent Identity Card Holder aged 18 or above. The Government has also implemented changes in the form of various tax measures and specific sector relief but there is no temporary change to the insolvency law.

What does Hong Kong offer in regard to corporate rescue of financially distressed companies and can we expect to see a change in insolvency law in Hong Kong?

In Hong Kong, there are only two possible options in terms of corporate rescue for distressed companies – scheme of arrangement and provisional liquidation. A scheme of arrangement is a process used to seek a compromise, usually with creditors accepting a lesser amount than they are owed in a final settlement of claims against the relevant company. Provisional liquidation involves the appointment of provisional liquidators in attempting to keep the status quo rather than distributing the company's assets to creditors, which is the role of a liquidator. However, provisional liquidation is in fact not a corporate rescue regime.

Although the scheme of arrangement mechanism is a statutory tool for corporate rescue in Hong Kong, it is not seen as an ideal procedure. It is expensive, and the lack of a statutory moratorium means that there is no period of protection for the company to negotiate with its creditors.

In addition, Hong Kong currently does not have any cross-border insolvency legislation (like the UNCITRAL Model Law on Cross-Border Insolvency) in place and this may give rise to issues for companies with their place of incorporation outside Hong Kong but with a presence in Hong Kong. Nonetheless, seeking recognition and assistance in a cross-border insolvency context is not uncommon in Hong Kong. The Hong Kong Courts are prepared to recognise the appointment and powers of foreign office-holders (on a full power or light-touch basis) by way of common law assistance if and when the grounds are met.

As a result of the growing and urgent need for insolvency law reform in Hong Kong, a proposal for corporate rescue legislative reform in Hong Kong has re-emerged and is a welcome development. In March 2020, the Government announced its plan to finalise a corporate rescue bill in the first half of the 2020/2021 legislative session, however, the implication of this potential change may take a while to be passed in the Legislative Council and only time will tell if it is effective in cushioning the impact of COVID-19 to businesses and individuals.

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