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Reconsidering the Need for Parallel Schemes of Arrangement

The cautious and prudent approach for distressed companies pursuing a Hong Kong scheme of arrangement is to simultaneously pursue a parallel scheme in their home jurisdiction, even if most if not all of its debts are governed by Hong Kong laws. The rationale is to prevent hostile creditors from disrupting the implementation of the scheme in another jurisdiction, thereby better insulating the distressed company.

Whilst this might at one point be seen as a prudent practice, the fact is that pursuing a scheme of arrangement itself is a costly exercise and it is obvious that interests of creditors of a distressed company may not be best served when the company continues to incur significant expenses in multiple jurisdictions. The Hong Kong Companies Courts express such concern and have given helpful and indicative decisions in very recent authorities on the way forward for distressed companies and insolvency practitioners.

Da Yu Financial Holdings Limited

In ***Da Yu Financial Holdings Limited [2019]*** HKCFI 2531, the Cayman-incorporated and Hong Kong-listed Company pursued schemes of arrangement in both the Cayman Islands and Hong Kong. In that case, Deputy High Court Judge William Wong SC very fairly commented on how the restructuring costs of the liquidators presented a very serious concern to the Court as this has a direct impact on the scheme creditors' recoveries. The courts and practitioners were urged to reconsider the necessity and appropriateness of the practice of parallel schemes.

Re China Oil Gangran Energy Group Holdings Ltd

The Company in ***Re China Oil Gangran Energy Group Holdings Ltd*** [2021] HKCFI 1592 also pursued parallel schemes in the Cayman Islands and Hong Kong. The Company operated mainly in the mainland, and its creditors were almost exclusively in Hong Kong. The Company was listed in Hong Kong. Its COMI was in Hong Kong. Its only connection to the Cayman Islands is the fact that it was incorporated there.

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Against the above background, the Honourable Mr. Justice Harris sanctioned the Hong Kong scheme, but was critical of the Cayman scheme. Harris J remarked that applicants pursuing parallel schemes in the future will be expected to justify the necessity of doing so to the Hong Kong Court.

Re Grand Peace Group Holdings Ltd

In ***Re Grand Peace Group Holdings Ltd*** [2021] HKCFI 1563, Harris J again commented in obiter on the often superfluous nature of parallel schemes, and how the current practice of going for parallel schemes by default is contrary to the interests of creditors. The risks parallel schemes generally seek to mitigate would ordinarily be sufficiently controlled by virtue of the ***Gibbs*** rule.

Harris J ended his judgment re-emphasising how it is not in the most cases justifiable for there to be a parallel scheme and noting that the Court will in the future have to be satisfied by parties proposing the introduction of parallel schemes as to their justifications and how they are in the best interests of unsecured creditors. Practitioners should take note that if parallel schemes are pursued without justifications, the Hong Kong Court may very well refuse to sanction the Hong Kong scheme.

The Court's indications are very apt and helpful in moving the Hong Kong restructuring regime towards a more satisfactory direction. The entire purpose of a scheme of arrangement is to restructure the company's obligations and preserve the interests of unsecured creditors, and the default practice of parallel schemes often advocates unnecessary and unjustifiable over-caution at the expense of distressed companies and their creditors.

Whilst parallel schemes in certain circumstances are certainly required, insolvency practitioners are reminded to consider their need and that they will be expected to justify such need to the Hong Kong Companies Courts.

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