

# Securities & Futures Commission v China Metal Recycling (Holdings) Limited: Regional Conflict of Laws, Judicial Recognition and Hong Kong-China Cross-Border Insolvencies

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## I. INTRODUCTION

Using the recently adjudicated landmark case in Hong Kong of *Securities and Futures Commission v China Metal Recycling (Holdings) Limited*<sup>1</sup> as a launching board this article discusses and analyzes the complexities surrounding cross-border (corporate) insolvencies (“CBIs”) between Hong Kong and mainland China (HK-China CBI). Going forward, HK-China CBI will have a direct bearing on decisions made by Hong Kong and Chinese courts; since they are already increasingly requested to adjudicate on the same issues during a corporate insolvency, a new mechanism is called for in order to provide a practical and economically viable resolution to the regional conflict of laws issue arising from Hong Kong and mainland China having different insolvency laws in spite of Hong Kong being a part of mainland China, although a special administrative region within it. A new mechanism should focus on the judicial recognition of judgments and court orders concerning insolvencies of companies with establishments in both Hong Kong and mainland China; and if a new mechanism is properly implemented, it can more effectively and holistically facilitate resolution of the regional conflict of laws issue that typically arise during the insolvency procedure of a Hong Kong-listed company with subsidiary companies located in mainland China. Without such a mechanism in place, the provisional liquidators appointed in Hong Kong will need to devise a more convoluted resolution method in order for them to be approved by the Chinese court before they can take control of the Chinese subsidiary companies. Moreover, without a new mechanism, there will be duplication of insolvency procedures and costs and there may be incentives for forum shopping.

The landmark case is significant because it is the first-ever instance of the securities industry regulator (i.e., Securities and Futures Commission (SFC)) making a petition to the Hong Kong Court of First Instance for winding-up of a Hong Kong-listed company (i.e., China Metal Recycling (Holdings) Limited). The case has a cross-border aspect because the provisional liquidators<sup>2</sup> appointed by the Hong Kong court had to seek recognition from the Chinese court

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<sup>1</sup> *Securities and Futures Commission v China Metal Recycling (Holdings) Limited* HCCW 210/2013.

<sup>2</sup> In Hong Kong, provisional liquidators could be (1) the Official Receiver who automatically becomes the provisional liquidator when a court winding-up order is made against a company; (2) a private sector insolvency practitioner appointed by the Official Receiver pursuant to s.194(1A) of the (Hong Kong) Companies Ordinance (Cap 32); (3) a private sector insolvency practitioner appointed by the Hong Kong High Court under s.193 of the Companies Ordinance (Cap 32); or (4) the person appointed by the directors of a company which is undergoing voluntary liquidation under s.228A of the Companies Ordinance (Cap 32), to safeguard and protect the assets of the company. However, the circumstances in which s.228A can now be employed are very limited. Arguably, the traditional (and most important) kind of appointment of provisional liquidator is that which is made pursuant to

before they can take control of the subsidiary companies of the Hong Kong-listed company that are located in mainland China.

Part one of this article starts with an introduction and part two explains why judicial recognition and assistance, which is required for enforcing judgments or orders on HK-China CBI cases, is a matter of regional conflict of laws. Part three provides the background of the landmark case in Hong Kong whose importance and legal implications are discussed in part four. Part five examines an associated case to illustrate the landmark case's distinguishing CBI elements. Further comments and observations about the landmark case are afforded in part six. Part seven features the fundamental challenges confronting HK-China CBI dispute resolutions. Some concluding remarks are made in part eight.

## II. REGIONAL CONFLICT OF LAWS

The landmark case creates tension to a long-standing issue: how a judgment or order made by a Hong Kong court can be directly enforceable in mainland China, and vice versa, without a formal judicial recognition mechanism available to courts on both sides. Since Hong Kong's reversion to Chinese sovereignty on 1 July 1997, the conflict between Hong Kong and mainland Chinese laws falls into the realm of "regional conflict of laws",<sup>3</sup> owing to Hong Kong's status as a Special Administrative Region (SAR) of China: a SAR is a subordinated region of its Sovereign (China) and not an independent state. The signing of the Joint Declaration of the Government of the People's Republic of China and the Government of the United Kingdom of Great Britain and Northern Ireland on the Question of Hong Kong (Sino-British Joint Declaration)<sup>4</sup> on 19 December 1984 declared that Hong Kong would be returned to China as the Hong Kong Special Administrative Region (HKSAR) on 1 July 1997. The Sino-British Joint Declaration was an agreement between China and the United Kingdom (UK), guaranteeing Hong Kong's freedoms and pluralism under the rule of law for 50 years starting from 1 July 1997. In fact, Hong Kong and mainland China have different insolvency laws: in Hong Kong, although it does not have a uniform corporate insolvency law, statutory provisions relating to corporate insolvency are embedded in the Companies Ordinance<sup>5</sup> and its subsidiary legislation such as the Companies (Winding-up) Rules; in mainland China, the Enterprise

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s.193 of the Companies Ordinance (Cap 32) (i.e., type (3) as noted above). In fact, the two provisional liquidators appointed by the Hong Kong court in the main cases discussed herein concerning China Metal Recycling (Holdings) Limited are the traditional kind of appointment.

<sup>3</sup> Xianchu Zhang and Philip Smart, "Development of Regional Conflict of Laws: On the Arrangement of Mutual Recognition and Enforcement of Judgments in Civil and Commercial Matters between Mainland China and Hong Kong SAR" (2006) 36 *Hong Kong Law Journal* 553.

<sup>4</sup> Joint Declaration, Questions of Hong Kong, [http://www.legislation.gov.hk/blis\\_ind.nsf/CurAllEngDoc/034B10AF5D3058DB482575EE000EDB9F?OpenDocument](http://www.legislation.gov.hk/blis_ind.nsf/CurAllEngDoc/034B10AF5D3058DB482575EE000EDB9F?OpenDocument) (last visited 8 July 2014).

<sup>5</sup> The Laws of Hong Kong, Companies Ordinance (Cap 32). Available at [http://www.legislation.gov.hk/blis\\_pdf.nsf/4f0db701c6c25d4a4825755c00352e35/BFBC0BDE18CA0665482575EE0030D882/\\$FILE/CAP\\_32\\_e\\_b5.pdf](http://www.legislation.gov.hk/blis_pdf.nsf/4f0db701c6c25d4a4825755c00352e35/BFBC0BDE18CA0665482575EE0030D882/$FILE/CAP_32_e_b5.pdf) (last visited 15 July 2014).

Bankruptcy Law (EBL)<sup>6</sup> is China's uniform corporate insolvency law. Besides the difference in its corporate insolvency laws, mainland China is a country with civil law traditions while Hong Kong is a common law jurisdiction through adoption of the English common law; also, Hong Kong's Companies Ordinance (particularly those provisions in relation to corporate insolvencies) is heavily influenced by the UK's Insolvency Act of 1986. Therefore, due to different insolvency laws in mainland China and Hong Kong, which are guided by different legal traditions, CBIs that straddle both these jurisdictions are known as "HK-China CBI cases" and often involve the complex regional conflict of laws issue that have caught the interest and attention of private sector insolvency practitioners, insolvency law academics and government policy makers in mainland China and Hong Kong.

### 1. The Sino-British Joint Declaration

Before Hong Kong was returned to Chinese sovereignty, Hong Kong was regarded as a foreign jurisdiction by mainland China. Ironically, even after the return of Hong Kong to China in 1997, Hong Kong is still regarded as a foreign jurisdiction by China; this may be evidenced by a judicial interpretation issued in 2002 by the Supreme People's Court in China titled 'Provisions Concerning the Jurisdiction Problems of *Foreign-related* [emphasis added] Civil and Commercial Cases', whose Article 5 prescribes that "the jurisdiction of civil and commercial cases involving HKSAR, Macao SAR and Taiwan litigants shall be solved by referring to the Provision".<sup>7</sup> Under the rubric of 'one country, two systems', two judicial systems (in Hong Kong and mainland China, respectively) began to operate in parallel within one country.<sup>8</sup> Guobin Zhu suggested that conflict of laws between China and HKSAR "is seen in a 'vertical' sense, so it cannot be regulated by an analogy of general conflict of laws rules".<sup>9</sup> On the other hand, if the conflict of laws is between the HKSAR and a province or another autonomous region in China, then such a conflict would be treated at a horizontal level.<sup>10</sup> This horizontal level classification has inspired academics to invent the theory of regional conflict of laws (also referred to by some commentators such as Goubin Zhu as 'inter' regional conflict of laws) in order to cope with conflict of laws cases involving the courts in Hong Kong and the courts in mainland China.

### 2. Judicial Recognition for Cross-Border Instances *Before* the Handover of Sovereignty

Against this political backdrop, prior to 1 July 1997, when Hong Kong was a British colony, judicial recognition between Hong Kong and mainland China must be sought through

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<sup>6</sup> The EBL was promulgated on 27 August 2006 and came into effect on 1 June 2007.

<sup>7</sup> Xinyi Gong, "When Hong Kong Becomes SAR, Is the Mainland Ready? Problems of Judgments Recognition in Cross-border Insolvency Matters" (2011) 20 *International Insolvency Review* 57 at 58.

<sup>8</sup> *Id.*, at 57.

<sup>9</sup> Goubin Zhu, "Inter-regional Conflict of Laws under 'One Country, Two Systems': Revisiting Chinese Legal Theories and Chinese and Hong Kong Law, with Special Reference to Judicial Assistance" (2002) 32 *Hong Kong Law Journal* 615 at 626.

<sup>10</sup> *Id.* at 627.

international conventions. First, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (better known as the “New York Convention”) sets out the common legislative standards for the recognition of arbitration agreements, stating that foreign and non-domestic arbitral awards cannot be discriminated against and thus are entitled to court recognition and enforcement in the same way as domestic awards.<sup>11</sup> The UK extended the New York Convention to Hong Kong in 1975. Although Hong Kong was returned to China in 1997, judicial assistance in the field of arbitration between Hong Kong and China began in 1986 when the Standing Committee of the National People’s Congress of the People’s Republic of China ratified the New York Convention in December 1986.<sup>12</sup> Second, the Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters of 1965 (better known as the “Hague Convention”), improved the organization of mutual judicial assistance in cases of civil or commercial matters for a judicial or extra-judicial document to be served abroad. The UK also extended the Hague Convention to Hong Kong on 19 April 1970.<sup>13</sup> China ratified the Hague Convention on 6 May 1991 and subsequently “notified the secretary-general of the United Nations that, with certain reservations and declarations, the international conventions would continue to be applied in the HKSAR [and the Macao SAR]”.<sup>14</sup> This issue was dealt with under Article 153 of the Basic Law of Hong Kong, adopted on 4 April 1990 by the Standing Committee of the National People’s Congress of the People’s Republic of China, which makes clear that international agreements to which China is not a party but which were implemented in Hong Kong (before the handover) may continue to be implemented in the HKSAR (after the handover). However, after the handover, international conventions could no longer be applied between Hong Kong and China because under international law “an international convention may only be applied among states as independent subjects of the international community, but not directly to any part of a country without transplantation”.<sup>15</sup> This view was bolstered by Article 12 of the Basic Law of Hong Kong, which states that the HKSAR is a *local* administrative region of China; in practice, the HKSAR enjoys a high degree of autonomy (except in foreign and defence affairs which are the responsibilities of mainland China).<sup>16</sup>

### 3. Judicial Recognition for Cross-Border Instances *After* the Handover of Sovereignty

Professor Xianchu Zhang and the late Professor Philip Smart, both of The University of Hong Kong, pointed out that after Hong Kong became the HKSAR, the judicial recognition for

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<sup>11</sup> United Nations Commission on International Trade Law, “Convention on the Recognition and Enforcement of Foreign Arbitral Awards—the ‘New York Convention’”. Full text is available at [http://www.uncitral.org/uncitral/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/uncitral_texts/arbitration/NYConvention.html) (last visited 2 July 2013).

<sup>12</sup> Goubin Zhu, “Inter-regional Conflict of Laws under ‘One Country, Two Systems’: Revisiting Chinese Legal Theories and Chinese and Hong Kong Law, with Special Reference to Judicial Assistance”, *supra* note 9 at 644.

<sup>13</sup> Hague Convention, [http://www.hcch.net/index\\_en.php?act=conventions.status&cid=17](http://www.hcch.net/index_en.php?act=conventions.status&cid=17).

<sup>14</sup> Weidong Zhu, “The Relationships between China and Its Special Administrative Regions and Their Regulation” (2009) 4(2) *Journal of Cambridge Studies* 111-118.

<sup>15</sup> *Ibid.*

<sup>16</sup> The Basic Law of Hong Kong, Art 13 and Art 14.

cross-border instances lies with the 2006 Arrangement.<sup>17</sup> However, as suggested by its name, the arrangement applies only to civil and commercial matters and does not cover HK-China CBI cases. The legal lacuna and the unsettled CBI issue that it therefore leaves unanswered is the question of whether a new CBI judicial recognition mechanism which focuses on HK-China CBI cases can be made between the courts in Hong Kong and mainland China by modelling after, rather than extending, the 2006 Arrangement. It is important to note that although the 2006 Arrangement is not actually an agreement akin to a treaty, but rather it is an arrangement made by the Supreme People's Court in consultation with the HKSAR, it cannot be adapted to create a new judicial recognition mechanism for HK-China CBI cases unless it is substantially revised. The 2006 Arrangement applies only to civil and commercial cases under the consensual jurisdiction by the parties. In other words, the 2006 Arrangement builds around the *parties'* choice of jurisdiction to be in either Hong Kong or mainland China; this is not suitable for CBI matters because in many CBI cases, the court jurisdiction is established on a non-consensual basis.

Regardless of this technicality issue, judicial recognition for CBI cases is strongly desired for simplifying and expediting the insolvency procedure, without which creditors in Hong Kong, in order to enforce a favourable judgment ruled by the Hong Kong courts, and vice versa, would be forced to pursue another insolvency procedure in mainland China. This would duplicate the insolvency procedures, judicial resources, time and costs.

#### 4. The Danger of No Formal Judicial Recognition Mechanism for CBI Judgments and Orders

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

The judicial recognition mechanism, if or when it is to be created between the Chinese and Hong Kong authorities, is a matter of great public interest because the investing public ought to know about the existing legal protections of their shareholding interests in companies whose creditors, assets and/or place of incorporation are in Hong Kong and/or mainland China in the event of their insolvency and CBI reform proposal.

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<sup>17</sup> Xianchu Zhang and Philip Smart, "Development of Regional Conflict of Laws: On the Arrangement of Mutual Recognition and Enforcement of Judgments in Civil and Commercial Matters between Mainland China and Hong Kong SAR", *supra* note 3.

The pending judicial recognition mechanism for HK-China CBI cases, once in place, will have a long-term impact on Hong Kong and mainland China. Firstly, Hong Kong is the most preferred investment destination of Chinese investors, being mainland China's fourth largest trade partner and third largest export market, with cross-border trade volume worth US\$103.49 billion from January to April 2014, according to statistics published by China's Ministry of Commerce on 10 June 2014.<sup>18</sup> Also, in April 2014, the SFC in Hong Kong indicated that the aggregate quotas for the cross-border trade of Hong Kong-listed stocks is 250 billion yuan (equivalent to about US\$40 billion) and of Shanghai-listed stocks is 300 billion yuan (equivalent to about US\$48 billion).<sup>19</sup> Secondly, judicial recognition facilitates creditor rights protection, which is consistent with the World Bank's Principles for Effective Insolvency & Creditor Rights System.<sup>20</sup> With increasing globalization of business and commercial activities between Hong Kong and mainland China, a judicial recognition mechanism for HK-China CBI cases can fill the legal lacuna and resolve the unsettled regional CBI issues borne from the inadequacy of current enforcement mechanism under the 2006 Arrangement which does not cover HK-China CBI matters. Creating a judicial recognition mechanism for CBI judgments or orders made by Hong Kong and/or Chinese courts is a timely and significant matter with vast potential positive economic benefits and of public interest.

### **III. BACKGROUNDS OF THE LANDMARK CASE AND OTHER SIGNIFICANT CASES**

Mutual judicial recognition for judgments and court orders on HK-China CBI cases will have strong economic implications. It has direct relevance to the needs of Hong Kong as a key international financial centre in the world that has significant commercial engagement with mainland China. Shortly after the UK's return of Hong Kong's sovereignty to China on 1 July 1997, an economic cooperation agreement, the Closer Economic Partnership Arrangement (CEPA), was signed on 29 June 2003 to foster and facilitate bilateral trades between the two economic entities. CEPA laid out the basis for economic integration between Hong Kong and mainland China under the political arrangement of the 'one country, two systems' principle so that Hong Kong's capitalist and China's socialist economies can co-exist under the same sovereign nation but operate within separate legal and business frameworks. Yet China and Hong Kong still remained, and continue to remain, two separate judicial jurisdictions; as a result,

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<sup>18</sup> Ministry of Commerce People's Republic of China, "Mainland-Hong Kong Economic and Trade Cooperation in January-April 2014", 10 June 2014. Available at <http://english.mofcom.gov.cn/article/statistic/lanmubb/hkmacaotaiwan/201406/20140600642371.shtml> (last visited 6 July 2014).

<sup>19</sup> Shidong Zhang and Kana Nishizawa, "Hong Kong, China Stocks Jump on Cross-Border Trade Deal", Bloomberg News, 10 April 2014. Available at <http://www.bloomberg.com/news/2014-04-10/china-s-stocks-are-little-changed-before-release-of-trade-data.html> (last visited 6 July 2014).

<sup>20</sup> World Bank's Principles for Effective Insolvency & Creditor Rights System. Available at [http://www.eisil.org/index.php?sid=4ails&id=1120&t=link\\_details&cat=642](http://www.eisil.org/index.php?sid=4ails&id=1120&t=link_details&cat=642) and [http://www.worldbank.org/ifa/ipg\\_eng.pdf](http://www.worldbank.org/ifa/ipg_eng.pdf) (last visited 15 July 2014).

judicial recognition, which is central to the enforceability of any judicial judgment made in the court of a counterparty jurisdiction, remains a problem between Hong Kong and mainland China.

After Hong Kong became the HKSAR, the first formal judicial recognition mechanism for cross-border instances lies with the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned (the “2006 Arrangement”), which was signed in Hong Kong on 14 July 2006 by the Secretary for Justice of the HKSAR (Mr. Yan-lung Wong) and Vice President of the Supreme People’s Court of China (Mr. Justice Songyou Huang).<sup>21</sup> The 2006 Arrangement was adopted at the 1,390<sup>th</sup> Meeting of the Judicial Committee of the Supreme People’s Court on 12 June 2006 and it took effect on 1 August 2008. However, as suggested by its name, the 2006 Arrangement applies only to civil and commercial matters and is not extended to cover HK-China CBI cases. The legal lacuna and the unsettled CBI issue is of concern to interested parties<sup>22</sup> located in both jurisdictions; it also leaves unanswered the question of whether a new mutual recognition mechanism (apart from the 2006 Arrangement) can be constructed that focuses on HK-China CBI cases; and if or when it is in place, it shall greatly increase the chances of enforceability within mainland China of a judicial decision made in Hong Kong.

The problems of HK-China CBI issues may be highlighted in two cases concerning HK-listed company China Metal Recycling (Holdings) Limited (the “Company”) which will be expounded in part four and part five of this article. These two cases add to the list of 16 other noteworthy HK-China CBI cases which have been examined by me.<sup>23</sup> These insolvency cases typically involved companies with assets and/or investors located in both jurisdictions; with investors located in Hong Kong; and with the joint venture (JV) investment located in mainland China. Understandably, the Chinese courts will have jurisdiction because China is the JV’s place of incorporation and is also the location of the JV’s assets. Yet the Hong Kong courts can also claim jurisdiction, if and when the JV’s investors who reside in Hong Kong commence insolvency proceedings in the Hong Kong courts against the JV in mainland China. The insolvency proceedings can become even more circuitous if the HK investors incorporated a company in a tax haven jurisdiction, with the objective to invest in the JV. In another article<sup>24</sup>, two significant, yet separate, HK-China CBI cases involved Moulin Global Eyecare Trading Limited<sup>25</sup> and Ocean Grand Holdings Ltd.<sup>26</sup> In the *Moulin Global* case, the place of company

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<sup>21</sup> Xianchu Zhang and Philip Smart, “Development of Regional Conflict of Laws: On the Arrangement of Mutual Recognition and Enforcement of Judgments in Civil and Commercial Matters between Mainland China and Hong Kong SAR”, *supra* note 3.

<sup>22</sup> The interested parties include the creditors, the debtor company, shareholders of the debtor company, stakeholders such as the investing public, government policy makers on cross-border trade and insolvency practitioners in Hong Kong and mainland China.

<sup>23</sup> Emily Lee, “Problems of Judicial Recognition and Enforcement in Cross-Border Insolvency Matters between Hong Kong and Mainland China” (2015) 63(2) *American Journal of Comparative Law* (forthcoming).

<sup>24</sup> Emily Lee, “Comparing Hong Kong and Chinese Insolvency Laws and Their Cross-Border Complexities” (2014) 9(2) *Journal of Comparative Law* (forthcoming).

<sup>25</sup> *Re Moulin Global Eyecare Holdings Ltd* [2007] 4 HKLRD 315, [2007] HKEC 409.

<sup>26</sup> *Re Ocean Grand Holdings Ltd* [2008] HKEC 664.

registration was Bermuda but since the company's shares were listed on the Hong Kong Stock Exchange, liquidators were appointed in Hong Kong. Similarly, in the *Ocean Grand* case, the place of company registration was Bermuda and the company's shares were listed on the Hong Kong Stock Exchange; however, its provisional liquidators were appointed in both Hong Kong and Bermuda. In terms of connection with mainland China, in the *Moulin Global* case, the company's manufacturing base was located in mainland China while in the *Ocean Grand* case some of the company's production sites were located in mainland China. Despite that the relevant body of case law is currently developing, unfortunately, judicial recognition stemming from the regional conflict of laws issue has not been dealt with formally between the courts in Hong Kong and mainland China. For instance, neither Justice Kwan of the Hong Kong High Court (as she then was) in the restructuring of *Ocean Grand* nor Justice Barma (also of the Hong Kong High Court) in the restructuring of *Moulin Global* considered any Chinese law. As a side point, it should be noted that the restructuring for *Ocean Grand* was successful whereas the restructuring for *Moulin Global* had failed.

#### IV THE LANDMARK CASE

*Securities and Futures Commission v China Metal Recycling (Holdings) Ltd* HCCW 210/2013

The landmark case is significant because it was the first-ever instance when the securities industry regulator in Hong Kong, the SFC, petitioned the Hong Kong High Court to wind-up a company under section 212 of the (Hong Kong) Securities and Futures Ordinance<sup>27</sup> (SFO) in order to protect the interests of company's shareholders, creditors and the investing public.<sup>28</sup> The Company, which described itself "China's biggest scrap-metal dealer",<sup>29</sup> is the holding company of a group of companies called China Metal Group; it was incorporated in the Cayman Islands with limited liability and was listed in the Main Board of the Hong Kong Stock Exchange before it was suspended for trading on 28 January 2013; and the suspension remains in effect today.

On 22 December 2009, the SFC commenced an investigation into the affairs of the Company. In July 2013, the SFC asked the court in Hong Kong to wind-up the Company as part of its clampdown on fraudulent accounting practices by companies selling shares to the public. The SFC alleged that the Company "overstated its financial position in the prospectus used for its initial public offering in 2009 and in its annual report for 2009 and that the suspected

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<sup>27</sup> The Laws of Hong Kong, Securities and Futures Ordinance (Cap 571). Available at [http://www.legislation.gov.hk/blis\\_pdf.nsf/6799165D2FEE3FA94825755E0033E532/5167961DDC96C3B7482575EF001C7C2D/\\$FILE/CAP\\_571\\_e\\_b5.pdf](http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/5167961DDC96C3B7482575EF001C7C2D/$FILE/CAP_571_e_b5.pdf) (last visited 15 July 2014).

<sup>28</sup> Securities and Futures Commission (in Hong Kong), "Court Continues Appointment of Provisional Liquidators for China Metal Recycling (Holdings) Limited", News and Announcements, 2 August 2013. Available at <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=13PR74> (last visited 12 June 2014).

<sup>29</sup> China Mining Association, "China Metal Recycling Chairman Says He's Never Broken the Law", 22 October 2013. Available at <http://www.chinamining.org/News/2013-10-22/1382406804d64485.html> (last visited 10 June 2014).



exaggeration of its financial situation remains a current issue”.<sup>30</sup> In the SFC’s winding-up petition, the regulator stated that the Company inflated the size of its business to gain a listing on the Hong Kong Stock Exchange in 2009 by falsifying purchase orders from its three major suppliers from 2007 to 2009.<sup>31</sup> On 26 July 2013, the SFC won a court order whereby the Hong Kong Court of First Instance ordered the appointment of Mr. Cosimo Borelli (Mr. Borelli) and Ms. Jocelyn Chi Lai Man (Ms. Jocelyn) as joint and several provisional liquidators of the Company.<sup>32</sup> Within four days, the two provisional liquidators’ work enabled the plaintiffs to obtain *ex parte* injunctive orders against the 12 defendants (i.e., the first to 12<sup>th</sup> defendants). Among them, the 3<sup>rd</sup> to 10<sup>th</sup> defendants are all corporate entities. The 13<sup>th</sup> defendant, Wellrun Ltd, also a corporate vehicle and through which the first defendant (the Company’s founding chairman and controlling shareholder Mr. Chun Chi Wai) holds his shareholding in the Company; the 13<sup>th</sup> defendant was added later as a defendant and *ex parte* injunctive orders were also obtained against it. Mr. Recorder Pow (of the Hong Kong Court of First Instance) in an associated case of *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others*<sup>33</sup>, expounded further below:

1. Grounds for appointing Provisional Liquidators for China Metal Recycling (Holdings) Ltd

On 22 December 2009, the SFC commenced an investigation against the affairs of the Company pursuant to section 182 of the SFO which prescribes for the SFC to investigate a company’s activities if the regulator has reasonable cause to believe that the company is engaging in any activities not in the interest of the investing public or not in the public interest. The SFC’s investigation’s focus targeted on affairs of the group companies (held by the Company) conducted during or around the period from 10 June 2009 to 17 November 2009.<sup>34</sup> Following the investigation, the SFC sought to invoke the broad power conferred by section 212 of the SFO by presenting a petition to the Hong Kong Court of First Instance in July 2013 to wind-up the Company, then a company listed on the Hong Kong Stock Exchange. The SFC petitioned the court for winding-up the Company in order to protect the interest of public investors on the basis that falsified accounting information was allegedly provided by the Company. The SFC accused the Company of having overstated its financial position in its prospectus during its initial public offering in 2009 and this overstatement persisted through the Company’s financial results for the year ended 2012.<sup>35</sup> Subsequently, the SFC announced that the *ex parte* order to appoint the provisional liquidators was granted on 26 July 2013.

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<sup>30</sup> Securities and Futures Commission (in Hong Kong), “Court Continues Appointment of Provisional Liquidators for China Metal Recycling (Holdings) Limited”, *supra* note 28.

<sup>31</sup> *Ibid.*

<sup>32</sup> *Ibid.*

<sup>33</sup> *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* HCA 1412/2013.

<sup>34</sup> *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* [2013] HKEC 1291, para. 5.

<sup>35</sup> Jonathan Cotton (ed), *The Dispute Resolution Review* (6<sup>th</sup> ed), Law Business Research Ltd, at 311. Available at <http://www.slaughterandmay.com/media/2090817/the-dispute-resolution-review-hong-kong-chapter.pdf> (last visited 17 June 2014).

Furthermore, according to Bloomberg News, the provisional liquidators of the Company said that the company had made payments totalling over HK\$1 billion (US\$129 million) to third parties; and the provisional liquidators initiated legal proceedings against these third parties to recover those payments in the two weeks before their appointment.<sup>36</sup> This may potentially constitute the offence of ‘fraudulent preference’ of the Company’s creditors, as prescribed under section 266 of the Companies Ordinance (Cap 32)<sup>37</sup> which if proven to be true would render the payment void.

## 2. Current Progress of This Case

At the time of writing (July 2014), the case is lodged at the Hong Kong High Court. The first hearing of this case took place on 2 August 2013 and subsequently on 21 October 2013. The Company’s founding chairman and controlling shareholder (Mr. Chun Chi Wai) obtained permission from the Hong Kong High Court to join the proceedings (pertaining to the winding-up of the Company as a defendant) and during that proceeding he objected to the SFC’s petition for winding-up the company. The trial of this case is scheduled to start in February 2015.

## V. AN ASSOCIATED CASE

*China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* HCA 1412/2013

A case which is associated with the landmark case of *Securities and Futures Commission v China Metal Recycling (Holdings) Limited* is *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others*; in this case, the plaintiffs (acting through their provisional liquidators) claimed that the Company’s founding chairman, his wife (Ms. Lai Wun Yin) and 10 companies “orchestrated false trading schemes, disclosed false or misleading information to China Metal [Recycling] and paid dividends on inflated profits”.<sup>38</sup> The plaintiffs herein are the Company (the first plaintiff) and a company incorporated in Macao (the second plaintiff) that is supposedly the sourcing arm of the Company.<sup>39</sup> The defendants in this case include Mr. Chun Chi Wai (the first defendant) who is the Chairman and CEO of the first plaintiff and Mr. Chun’s wife (the second defendant) who is a non-executive director of the first plaintiff. According to Macao company registry records, the second plaintiff was established in Macao on 31 March 2005, with the first defendant being one of the two “Administrators”, along with Mr. Tsui Cham To being the other administrator. Mr. Tsui ceased to be an administrator on 17 July 2007 and his role was taken by the second defendant until she resigned on 14 April 2010. Since then, the first

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<sup>36</sup> Michelle Yun, “China Metal Paid Out Funds Before Liquidators Appointed”, 9 August 2013. Available at <http://www.bloomberg.com/news/2013-08-09/china-metal-paid-out-funds-before-liquidators-appointed.html> (last visited 10 June 2014).

<sup>37</sup> Section 266 of Companies Ordinance (Cap 32) provides that “(1) Any [...] payment [...] relating to property made or done by or against a company within 6 months before the commencement of its winding up [...] shall in the event of the company being wound up be deemed a fraudulent preference of its creditors and be invalid accordingly.”

<sup>38</sup> Michelle Yun, “China Metal Paid Out Funds Before Liquidators Appointed”, *supra* note 36.

<sup>39</sup> *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* [2013] HKEC 1291, para. 3.

defendant was the sole administrator for the second plaintiff until 31 December 2012 when he was replaced by Mr. Wang Yuzhang as the sole administrator for the second plaintiff.<sup>40</sup>

The provisional liquidators for the Company obtained an *ex parte* Mareva injunction on 30 July 2013, freezing more than HK\$1.6 billion belonging to the first defendant (Mr. Chun Chi Wai) and the 13<sup>th</sup> defendant (Wellrun Ltd, a British Virgin Islands (BVI) company which was wholly owned and controlled by the first defendant).

It is worth noting that in the judgment<sup>41</sup> made by Deputy Judge Winnie Tam (of the Hong Kong High Court) on 7 April 2014, it was declared that the Mareva injunction against the fifth defendant (a company) has world-wide effect.<sup>42</sup> This clearly indicates that the case has a strong cross-border insolvency (CBI) implication. In practice, this implication would normally reflect on the essential design of the CBI regulation in which it establishes a hierarchical scheme of main (primary) and secondary (subsidiary or ancillary) jurisdictional competence in relation to a debtor company;<sup>43</sup> specifically, the main proceeding should be commenced in the country or jurisdiction where the centre of the debtor company's main business interests (i.e., COMI) is located. It can be envisaged that in a typical CBI case, the debtor company would possess an establishment in other countries or jurisdictions; and in such instances, the courts of another country would have a jurisdiction to commence insolvency proceedings that are subordinated to the main insolvency proceeding. To this end, unfortunately no CBI regulation, equivalent to section 426 of the UK's Insolvency Act or Chapter 15 of the US Bankruptcy Code, currently exists in any of the Hong Kong law (other than case law<sup>44</sup>) or Chinese law (except in Article 5 of the EBL whose effectiveness is arguably hindered by numerous built-in restrictions)<sup>45</sup>. Besides, although Article 5 of the EBL made provisions for recognition and enforcement of foreign corporate insolvency judgments, it provides no mechanism to facilitate CBI matters, either between two independent states or between the HKSAR and mainland China. It is important to note that Article 5 of the EBL refers expressly to "the courts of foreign countries"; this practically excludes the courts in HKSAR from relying on this specific provision to seek judicial recognition or assistance from the Chinese courts.

Hong Kong courts have been known to take a fairly pragmatic approach towards CBI issues. In *Re Pioneer Iron and Steel Group Co Ltd*,<sup>46</sup> Mr. Justice Harris (of the Hong Kong Court of First Instance) referred to the UK's leading CBI case, *Re HIH Casualty and General*

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<sup>40</sup> *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* [2013] HKEC 1291, paras. 3 and 4.

<sup>41</sup> *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* [2014] HKEC 645 (in regard to HCA 1412/2013).

<sup>42</sup> *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* [2014] HKEC 645, para. 1.

<sup>43</sup> Bob Wessels, *European Union Regulation on Insolvency Proceedings: An Introductory Analysis*, 3<sup>rd</sup> ed (American Bankruptcy Institute, 2009).

<sup>44</sup> See Mr. Justice Harris' decision in *Re Pioneer Iron and Steel Group Co Ltd* [2013] HKCFI 324.

<sup>45</sup> For details, see Emily Lee & Karen Ho, "China's Enterprise Bankruptcy Law—A Great Leap Forward, but Just How Far?" (2010) 19 *International Insolvency Review*, 145-177.

<sup>46</sup> *Re Pioneer Iron and Steel Group Co Ltd* [2013] HKCFI 324.

*Insurance Ltd*,<sup>47</sup> and concluded that while there is no equivalent of section 426(4) of the UK's Insolvency Act of 1986 in Hong Kong on matters of CBI, the liquidator appointed in Hong Kong pursuant to the Companies Ordinance to wind-up an insolvent unregistered Hong Kong company can collect the company's assets located in Hong Kong and overseas and settle a list of creditors *worldwide* [emphasis added] who submit proofs of debt in accordance with Hong Kong law.<sup>48</sup>

## VI. COMMENTS AND OBSERVATIONS

### 1. Tactics Employed by the Provisional Liquidators to Take Control of Chinese Subsidiary Companies

Due to the cross-border nature of HK-China CBI matters, the same facts in the two above-mentioned cases (i.e., *Securities and Futures Commission v China Metal Recycling (Holdings) Ltd* and *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others*) were also considered by the Shanghai Pudong People's Court in a parallel case cited as (2013) Pu Civil-Commercial Case No. S3262.<sup>49</sup> The Chinese court presiding over this case indicated the following: Firstly, starting in July 2013, the provisional liquidators (Mr. Borelli and Ms. Jocelyn) issued letters to the Company's subsidiary companies in mainland China, ordering that no company assets or affairs are to be dealt with by these Chinese subsidiary companies, unless and until they have been authorized in writing to do so by the provisional liquidators. Secondly, the provisional liquidators requested the subsidiary companies in mainland China to stop operating their businesses and stop making payments to any parties. Thirdly, through the powers vested in them by the Hong Kong court orders in *China Metal Recycling (Holdings) Limited*,<sup>50</sup> the provisional liquidators ordered that the directors of subsidiary companies in mainland China must provide them with any important legal documents concerning the operation and management of these companies so as to allow them to acquire the necessary power associated with their job appointments as provisional liquidators for taking control of these subsidiary companies in mainland China.

The provisional liquidators suggested that their appointments should warrant some new changes, referring to the replacement of the old directors (for the mainland Chinese subsidiary companies) with the provisional liquidators themselves as the new directors. This undertaking by the provisional liquidators for director replacements reflects the fundamental challenges faced by many provisional liquidators appointed through a Hong Kong court order. That is, without replacing the old directors, the provisional liquidators simply cannot enforce the court order, which is made in Hong Kong, within the territory of mainland China.

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<sup>47</sup> *Re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852.

<sup>48</sup> *Re Pioneer Iron and Steel Group Co Ltd* [2013] HKCFI 324, para. 30.

<sup>49</sup> 上海市浦东新区人民法院 (2013) 浦民二 (商) 初字第 S3262 号.

<sup>50</sup> *Securities and Futures Commission v China Metal Recycling (Holdings) Limited* HCCW 210/2013; *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* HCA 1412/2013.

## 2. Challenges Facing the Provisional Liquidators and Their Adopted Strategies to Circumvent Enforcement Difficulties without a Formal Mechanism for Judicial Recognition for CBI Matters

Without a formal enforcement mechanism that affords mutual recognition of judicial judgments concerning HK-China CBI matters by the Hong Kong and Chinese courts, liquidators or provisional liquidators appointed by Hong Kong court orders face difficulties in getting recognized by both the Chinese court and the subsidiary companies in mainland China as the persons lawfully authorized for taking over the insolvent company's Chinese subsidiary companies. As such, without judicial recognition, insolvency practitioners in Hong Kong often advise, first and foremost, to change the legal representatives of the Chinese subsidiary companies. For the provisional liquidators appointed by Hong Kong courts, this is generally seen as the normal practice and procedure for them to enforce Hong Kong court orders in mainland China. Indeed, in the case of the Company, the provisional liquidators (Mr. Borelli and Ms. Jocelyn) replaced the directors of the subsidiary companies in mainland China with themselves so that they can become the new directors for the subsidiary companies in mainland China in order to be able to formally take the necessary steps in the insolvency procedure (e.g., gather assets, make payments, etc.). Technically, in order to change the company legal representatives, the provisional liquidators would need to avail themselves with the company chop (also known as the 'company official seal') and the company's business licence. Without the company chop and business licence, change of legal representatives cannot be done since a request for change would be denied by the mainland China's Administration for Industry and Commerce, the Chinese government authority in charge of company registrations. Technicality aside, the need to replace the old directors (of the Chinese subsidiary companies) would become crucial, if and when they are uncooperative with or unresponsive to the provisional liquidators. These uncooperative directors can potentially bring to a halt any ongoing insolvency proceedings, mainly because there is no formal judicial reorganization mechanism available now that focuses on HK-China CBI matters.

## **VII. CHALLENGES CONFRONTING HK-CHINA CBI DISPUTE RESOLUTIONS**

There are some fundamental causes that challenge and drive insolvency practitioners working in Hong Kong and mainland China to come up with creative HK-China CBI dispute resolutions methods; these causes include (1) the lack of a statutorily-based CBI legislation in Hong Kong, (2) the insufficiency of Article 5 of EBL in China (the only provision in China's insolvency law with cross-border implication), together with (3) the absence of an effective judicial recognition mechanism for HK-China CBI cases. The provisional liquidators in the *China Metal Recycling (Holdings) Limited* cases appear to have been successful (to the extent

that it is acceptable by the Hong Kong courts) in applying Hong Kong's company law<sup>51</sup> (as opposed to insolvency law) to replace the uncooperative management personnel of subsidiary companies in mainland China. Given that the purpose of agency appointment is to allow for the management control of subsidiary companies, such decisions can be made by the board of the parent company. Naturally, the appointment of and the extent of power associated with the agent acting as management personnel of the subsidiary companies can be traced back to, or conversely removed by, the board decision of the parent company. Following this logic and line of thought, the provisional liquidators managed to circumvent and eventually overcome the long and outstanding problem of having no formal CBI enforcement mechanisms available either in Hong Kong or China for realizing the claims of the Company. The tactics adopted by the provisional liquidator are rather strategic: they advised the board of the parent company (1<sup>st</sup>-tier company) to replace the management personnel of the subsidiary companies (lower-tier companies) in mainland China in order to gain control of the latter's businesses and assets. Notwithstanding the lack of a formal CBI judicial recognition arrangement, the provisional liquidators performed the tasks associated with their appointments by innovating tactics that supplied them with the legal basis for replacing uncooperative management personnel in Chinese subsidiary companies. The provisional liquidators chose this course of action as a result of the subsidiary's management personnel's refusal to recognize the provisional liquidators' appointment and undertaking and which they are now contesting in Shanghai Pudong People's Court.

## **VIII. CONCLUSION: HOW TO ADDRESS THE CHALLENGES**

HK-China CBI issues have direct relevance to the needs of Hong Kong in maintaining its reputation as a key international financial centre in the world while maintaining strong economic ties with mainland China. The HK-China CBI judicial recognition mechanism should be made available for companies and insolvency practitioners in Hong Kong and mainland China so as to simplify as well as unify the insolvency procedures in both jurisdictions. *China Metal Recycling (Holdings) Ltd and Another v Chun Chi Wai and Others* demonstrated that insolvency practitioners (such as the case's two provisional liquidators) must be innovative and strategically plan for any subsequent insolvency proceedings to take place in mainland China; their aim is to gain recognition by Chinese courts for their appointments as the provisional liquidators and to obtain cooperation from the Chinese subsidiary companies' management personnel for the provisional liquidators to take control of the subsidiary companies' businesses and assets. Changing legal representatives in Chinese subsidiary companies is one important way to achieve this aim, although this would mean that administrative measures would be employed to achieve a result that a clearly stated insolvency procedure should bring forth as a matter of course and with legal certainty for all concerned parties. Otherwise, the provisional liquidators would be left at

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<sup>51</sup> See Hong Kong's Companies Ordinance (Cap 32), 15<sup>th</sup> Schedule, in which it lists out matters for determining the unfitness of directors. The 15<sup>th</sup> Schedule contains two parts: Part 1 is applicable in all cases while Part 2 is for any company that has become insolvent.

the vagary of the mainland China's Administration for Industry and Commerce who may or may not permit them to become new legal representatives.

The Chinese court will often be asked to decide on whether the appointment of provisional liquidators could be recognized. In this regard, some questions jump to mind, including (1) which court within the Chinese court system has jurisdiction over this matter; (2) which law is to be applied, Chinese company law or the EBL as both legislations have insolvency implications; (3) whether the Chinese courts should base their decisions on Hong Kong court judgments or orders (as was done in *Securities and Futures Commission v China Metal Recycling (Holdings) Ltd*); and (4) whether the legal effect of insolvency proceedings in one jurisdiction (e.g., Hong Kong) should be recognized in the other (e.g., mainland China). If a formal mechanism can be established for mutual recognition and enforcement of judgments or orders made by either the Hong Kong or Chinese courts on HK-China CBI matters, not only will the courts and insolvency practitioners in Hong Kong and mainland China benefit, but the international scholarly community and policy makers will also benefit from the dissemination of insights and experiences gained from the study and practice of law in this specialized area. The 2006 Arrangement, made by the Supreme People's Court of China in consultation with the HKSAR, was the first mechanism put in place that directly addressed the judicial recognition of judgments and orders made by the Hong Kong or Chinese courts on civil and commercial cases. Consequently, the recognition of judicial proceedings and enforcement of judicial rulings in HK-China CBI cases remain an unresolved issue whose resolution depends on the signing of a separate 'arrangement' (apart from the 2006 Arrangement), perhaps also by the Supreme People's Court in China in consultation with the HKSAR, similar to the signing process for the 2006 Arrangement. HK-China CBIs have strong economic implication for both Hong Kong and mainland China and, as such, the issue warrants a close study of all legal options that will help cement the commercial engagements between Hong Kong and mainland China.