Freshfields Bruckhaus Deringer

Dealing with China-related NPLs and Investments Client Alert 2 – Multi-jurisdictional recovery

This is the second alert in our series on dealing with non-performing loans and troubled investments relating to the PRC.

In our previous alert (available here), we discussed how to detect early signs of NPLs and troubled investments, and initial steps to take to protect your interests. In this alert, we address the complexities surrounding the multiple jurisdictions in which a party can take action in.

Introduction

The past decade has witnessed a significant increase in cross-border commerce involving Chinese companies. If these ventures fail, a common dilemma for our clients has been which jurisdiction they should focus their efforts on when enforcing their rights. As we explain below, the success of a cross-jurisdictional recovery claim can often depend on the important tactical decision of focusing on the correct jurisdiction(s) at the outset.

Identify all relevant jurisdictions

Before commencing proceedings, it is important to identify all potentially relevant jurisdictions. This will depend on a number of factors, including:

- the governing law of the contract(s);
- the choice of court or seat of arbitration in the various transaction documents;
- the location(s) where the companies – including any counterparties and guarantors are incorporated or their shares are listed;
- the principal place of business of relevant companies; and
- where the company's assets and secured assets are primarily located.

The determination of the relevant jurisdictions can get complicated very quickly, especially when the deal involves multiple contracts with different governing laws and numerous parties, such as borrowers, guarantors, directors, and parent and subsidiary companies located in different jurisdictions.

The structure of a typical listed mainland China business is a good illustration of this complexity. Such a structure may involve:

- the ListCo being incorporated in the Cayman Islands or Bermuda;
- the operating business and its assets predominately being located in mainland China, although often there are also assets (for example, shares or cash) in other jurisdictions;
- the directors being located in mainland China or Hong Kong;
- a listing in Hong Kong;
- its lenders located in China with borrowing secured over both offshore and onshore assets;
- its operating entities having taken on various onshore debts; and
- the ListCo having entered into a range of financing instruments including, for example, New York-law governed offshore debts.

The multiplicity of parties and jurisdictions requires a thoughtful, strategic approach to recovery and enforcement.

Choosing the best forum

As contracts will normally have a dispute resolution clause that designates the forum for any dispute, is there still room for forum shopping? The short answer is yes:

1. **Multiple contracts and multiple jurisdictions**: As seen above, a transaction which involves multiple agreements may have incompatible dispute resolution clauses. Thus, there may often be a choice as to which jurisdiction(s) to bring proceedings in. Furthermore, in some cases, mandatory rules, for instance those involving mortgages and intellectual property rights, may require enforcement in the local courts even if the contract says otherwise.
2. **Asymmetric jurisdiction clauses (*AJC*)**: International financial documentation often contain AJCs. These typically allow a lender the option to litigate (or arbitrate) in a number of different jurisdictions. Common choices include the borrower's principal place of business, where its assets are, or a jurisdiction closely linked to the subject matter of the financing. Similarly, parties often enter into non-exclusive jurisdiction clauses, to preserve their ability to bring proceedings in other non-specified jurisdictions. AJCs may face enforcement difficulties in some circumstances. For example, a recent court case stated that Hong Kong courts will not issue a certificate for judgments obtained by virtue of an AJC as opposed to an exclusive jurisdiction clause, for enforcement of the judgment in mainland China[1]. Thus, the advantages and limitations of AJCs need to be taken into account, in deciding which dispute resolution clause to invoke and where to commence proceedings.
3. **Jurisdiction choices can be challenged**: Many courts take a broad and protective approach to their jurisdictions. Anti-suit injunctions and objections based on *forum non conveniens* are good illustrations of the challenges that arise where parties have failed to comply with their choice of forum, or where their dispute resolution clause is not sufficiently robust to withstand a challenge that proceedings have been brought in the wrong jurisdiction.
4. **Liquidation and other insolvency proceedings**: As companies become increasingly global and adopt a multi-layered shareholding structure, the number of jurisdictions in which insolvency proceedings can be commenced naturally increase. For example, a company incorporated in the Cayman Islands can be wound up in Hong Kong, in certain circumstances. Deciding where to commence winding up proceedings can have a real impact on the time frame and on what is achieved by filing a petition to wind-up a company. This is discussed further below.

Different jurisdictions, different tools, different results

In deciding on the jurisdictions to prioritise, it is important to recognise that each jurisdiction has its own rules and procedural tools which may result in vastly different tools available to applicants. Some examples are illustrated below.

Example 1: Interim measures in aid of foreign proceedings

Even if the focus is on progressing the main proceedings in one jurisdiction, interim measures from foreign jurisdictions may still assist the main proceedings greatly.

For example, it is usual for courts in common law or arbitration-friendly jurisdictions – such as Hong Kong and Singapore – to grant interim measures (e.g. freezing orders) in aid of foreign litigation or arbitration.

A bilateral arrangement between mainland China and Hong Kong which came into force in October 2019 allows courts of each jurisdiction to award interim measures in support of arbitrations seated in the other territory. In particular, parties may make an application to the Chinese courts for property, evidence or conduct preservation orders in support of Hong Kong seated arbitrations – an important device where the subject matter of the arbitration is in mainland China.

A US-style discovery order from the US courts under s.1782 of Title 28 of the United States Code is another very useful weapon which can be used to obtain information from individuals or entities in the US which are not directly involved in the foreign proceedings but hold important evidence in the case. A s.1782 application is particularly valuable to parties in jurisdictions that have limited procedures for disclosure of evidence, such as in many civil law jurisdictions.

Example 2: Receivership

Although receivership is available and commonly used in most common law jurisdictions, it is largely unknown to many Chinese parties as it is not available in China. A secured lender can appoint a receiver if a borrower defaults on its loan. The receiver takes control over the secured assets – the directors will consequently lose control over them – and the receiver will market and sell them, with the proceeds being used to pay off sums owed to the lender.

Receivership is a powerful remedy available to secured creditors. Powers of receivers are negotiated by the parties, set out in the security instrument, and exercised without the involvement of a court. A receiver is commonly appointed to take over the company after the occurrence of an event of default.

The reason why secured creditors like to appoint receivers is because their primary duty is to act for their appointor. Receivership can also produce a faster, more cost-effective and more certain result than liquidation.

Even though receivership is not available in China, appointing a receiver over the foreign parent company (such as a listed company incorporated in an offshore jurisdiction) of a mainland operating subsidiary can still be useful to compel the Mainland subsidiary to cooperate, to settle and ultimately repay its outstanding debts.

Example 3: Provisional liquidators

The concept of appointing provisional liquidators to manage a company exists in many jurisdictions but the effect and the procedures can vary in practice. Provisional liquidators are independent officeholders that a court appoints to manage a company's affairs for an interim period. Typically, they are used in the period between the filing of a winding up petition and the court order to wind up the company, where there are concerns that the assets of the company may be lost or dissipated by management. In some common law jurisdictions, they have been adapted to create a breathing space from creditor claims, while the board of directors proposes and implements a restructuring – a so-called light touch provisional liquidation.

In many cases it may be possible to appoint provisional liquidators in more than one jurisdiction, for example, where a company, although incorporated in the Caribbean, has Hong Kong or mainland China businesses. However, a provisional liquidator appointed in Hong Kong cannot act on a light touch basis or be appointed solely for the purpose of a restructuring. By contrast, in Bermuda or the Cayman Islands this is possible. Thus, in this example, there may be tactical advantages in starting proceedings in those jurisdictions rather than in Hong Kong. The offshore-appointed provisional liquidator can then apply to the Hong Kong court for recognition of their appointment in Hong Kong.

Example 4: US Chapter 15

Where parties are enforcing against a company with assets in the US, a Chapter 15 application to the US Bankruptcy Court may be useful. A Chapter 15 application is ancillary to a primary proceeding brought in another country, typically the debtor's home country. The US Bankruptcy Court has previously granted recognition under Chapter 15 to insolvency proceedings in Hong Kong and, in a landmark case from 2019, mainland China.

Where a Chapter 15 recognition is obtained, all collection actions, lawsuits, and other actions against the debtor and its assets in the US are stayed. This is a highly useful tool for a foreign officeholder to protect a debtor's assets in the US from being picked off by offshore creditors.

Key considerations in identifying the most important jurisdiction(s)

If there is some flexibility in the choice of jurisdiction, the following factors should be taken into account when considering where to start recovery proceedings:

1. Assets, assets, assets. Always go after the assets that are easily identified, valuable, unencumbered, and enforceable.
2. Which procedural tools give you leverage or protect your interests the most, and most quickly?
3. Are court judgments or arbitral awards enforceable in jurisdictions where the assets are located?
4. If you are seeking to wind-up a counterparty, will the insolvency proceeding be recognised in all jurisdictions where there are assets?
5. Are there actions that can be taken to reduce the risk of dissipation, including obtaining urgent interim orders from foreign courts in aid of the main proceedings?
6. Cost and time efficiency – which jurisdictions give you the quickest, most cost-effective relief?

7. Which measures maximise pressure on the counterparty? Concurrent proceedings in more than one jurisdiction not only put pressure on the counterparty, but may also increase your chances of recovery if there are insufficient assets in any single jurisdiction.

Dealing with multi-jurisdictional recovery efforts

Where there are multiple relevant jurisdictions, there will be the risk of parallel proceedings and inconsistent decisions – but also opportunities for strategic leverage. Below are some strategic considerations:

- Obtain **first-mover advantage** in enforcing contractual rights, because once proceedings are started in one jurisdiction, it is often harder to dislodge them in favour of another jurisdiction
- **Choose lead counsel** who have relevant expertise in the key jurisdictions, understand the home jurisdiction, and who can play the lead counsel role in managing concurrent proceedings in diverse jurisdictions. When facing multi-jurisdictional issues, it is crucial to have a core legal team who plan strategically, speak your language, control the narrative, coordinate defences, ensure evidence is properly presented, and act swiftly.
- Create and seize opportunities for a **favourable settlement**. The goal will often be to maximise recovery and this is not always the same as winning the case. Fighting to the end may make you worse off.
- Plan carefully to ensure that actions taken in one jurisdiction are **coordinated with the broader strategy**, and do not negatively impact any current or future steps in another jurisdiction
- **Sequence proceedings strategically**. In principle, the largest and most important proceedings from a business perspective should be addressed first where possible, with less critical, slower and less hopeful disputes stayed, postponed or reserved pending the outcome of the main proceedings. This is not a hard and fast rule: there may be opportunities to prioritise less critical disputes which give you more leverage or can result in earlier wins.
- Start a **multiple-front war judiciously**. In some cases, the apparent chaos of related proceedings in multiple jurisdictions can result in a surprisingly effective global settlement. However, such an approach has obvious drawbacks, including hefty costs and increased complexity. Conversely, anticipating multiple jurisdiction battles are equally important, even if there is no intention to start the battle first.

Coming up…

In our next alert, we turn to the interaction between creditors and the company's board of directors during insolvency, how to gain access to information, how to replace a reluctant board and management, and how to pursue director liability actions as a pressure tool.

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[1] Industrial and Commercial Bank of China (Asia) Ltd v Wisdom Top International Ltd [2020] HKCFI 322

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