

Insolvency law in Hong Kong, China is based on the law of the United Kingdom prior to the implementation of the recommendations of the Cork Report. It is what may be described as a creditor-friendly regime and has this in common with other UK-based jurisdictions, such as Australia and New Zealand.

Corporate insolvency procedures available in Hong Kong, China include contractual restructuring, schemes of arrangement, compulsory liquidations, creditors' voluntary liquidations and receiverships. The legislation dealing with corporate insolvency procedures is contained in the Companies Ordinance, the Bankruptcy Ordinance and the Companies (Winding-up) Rules.

The legislation is now outdated and in need of reform. The most obvious deficiency is the absence of a modern corporate rescue procedure which incorporates a moratorium. Perhaps this is why out-of-court restructuring has been widely used in Hong Kong, China. The general attitude to workouts in Hong Kong, China is reflected by "the Hong Kong Approach to Corporate Difficulties", a joint publication of the Hong Kong Monetary Authority and the Hong Kong Association of Banks. This paper consists of formal, but non-statutory, guidelines covering how institutions should deal with customers in difficulties when the borrower is dealing with multiple banks. The paper supports the survival of businesses which would otherwise fail, and it does so by suggesting throughout that the banks' initial attitude towards borrowers with financial problems should be one of support, with decisions based only on reliable information that is shared fully with all banks.

Statutory reform has made slow progress during the last decade. The future should see the introduction of statutory provisions dealing with insolvent trading and corporate rescue. In January 2000, a bill was gazetted by the Hong Kong, China government with a view to enacting legislation relating to insolvent trading and provisional supervision and voluntary arrangements for companies. However, as a result of extensive criticism of the bill, plans to introduce the legislation have been delayed. Although overdue, it is currently uncertain when this proposed legislation will become effective.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

There are five principal remedies available to judgment creditors:

- ▲ In garnishee proceedings a judgment creditor seeks to recover the sum owed to it by a judgment debtor from a third party (the garnishee) who is indebted to the judgment debtor. This remedy is especially effective to "garnish" monies in the judgment debtor's bank account.
- ▲ A writ of execution issued over the judgment debtor's goods and chattels (moveable property) which orders a court officer to seize and sell as much of the debtor's goods and chattels as may be sufficient to realize the judgment debt and expenses.
- ▲ A charging order can be taken over immovable property which puts the judgment creditor in the position of a secured creditor, subject to any prior mortgages and charges affecting that property. By similar procedures, a judgment creditor can also obtain a charging order on a judgment debtor's beneficial interest in securities, as well as over chattels such as ships or aircraft.
- ▲ Winding-up proceedings are commonly used because of their potentially serious impact on a debtors' business or affairs. Winding-up proceedings are available to both judgment and non-judgment creditors who nevertheless have a debt which is not *bona fide* disputed. Bankruptcy proceedings in Hong Kong, China are analogous to winding up proceedings except that they apply to individuals. Winding-up proceedings are an effective alternative to pursuing judgment remedies or remedies enforcing debts. The effect of a winding up petition is to prohibit all dispositions of a debtor's assets without leave of the court.
- ▲ Examination of judgment debtors to obtain information about property and income may help to supplement existing information known to the judgment creditor.

b) Secured property enforcement remedies.

Security documents usually confer four principal remedies: (i) right to take possession of assets, (ii) power of sale of assets, (iii) power to appoint a receiver over assets charged, and (iv) right of foreclosure.

A mortgagee or chargee can take possession of the secured assets and exercise its power of sale or appoint a receiver without a court order if, as is always the case, the documentation confers this power on a mortgagee or chargee.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

Hong Kong, China has no special legislation regarding banking sector creditors.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

There are two types of voluntary liquidation:

- ▲ Members' voluntary winding-up which occurs when the members, by special resolution (75 percent), resolve to wind-up the company and when the directors make a declaration of solvency in accordance with the Companies Ordinance. The Liquidator is appointed by the company in general meeting.
- ▲ Creditors' voluntary winding-up occurs if the company arranges for a meeting of creditors to be summoned immediately after the general meeting sanctioning the winding-up of the company. Creditors have the right to appoint their own liquidator in preference to the company's nominated liquidator. In the event of a conflict, the creditors' choice prevails.

In addition, or alternatively, the creditors can petition the court for the winding-up of a company on the grounds, among other things, of the corporate debtor's inability to pay its debts. Presentation of a winding-up petition freezes the business of the company without orders from the court.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

The scheme of arrangement is the only formal corporate rescue process available in Hong Kong, China. A scheme of arrangement may be initiated by the company or any of its creditors by filing an application with the High Court together with an explanatory statement, the prescribed notices summoning meetings and forms of proxy for those meetings. The court will provide directions as to the timing and location of the meetings of creditors. Notices, together with the explanatory statement, must be sent to all known creditors or given by advertisement. The explanatory statement must give sufficient information to creditors to enable them to decide whether or not to approve the scheme. It is not necessary for a scheme to deal with all classes of creditors. However, if any creditors' claims are not addressed in the scheme, those creditors retain their full original rights against the company, following implementation of the scheme.

Meetings of creditors or classes of creditors are then held to approve the scheme. A resolution approving the scheme must be passed at each meeting (including meetings of any separate classes) by a majority in number representing at least 75 percent in value of those present and voting (including by proxy). If the scheme is approved, there should also be a general meeting of the shareholders of the company and, if deemed necessary, a board meeting of the company to approve the company entering into the scheme of arrangement.

Once all appropriate meetings have approved the scheme, a petition must be presented to the court for approval. The scheme does not take effect until the filing of the order of the court sanctioning the scheme with the Registrar of Companies.

Formulation and implementation of even a very basic scheme is likely to take at least two months. A more complicated scheme may take in excess of six months to take effect.

The term “creditor” for the purposes of the legislation relating to schemes of arrangement includes parties holding any claim whether liquidated or unliquidated, prospective or contingent.

Once the scheme is approved by the court, it will take effect so as to bind all creditors in each class approving the scheme, not just those creditors who voted or were entitled to vote at the relevant meetings.

The primary advantage of a scheme of arrangement is that it does not require unanimity.

The perceived problems with schemes of arrangement include delay, cost, uncertainty, the lack of a moratorium or stay of proceedings and the lack of implied powers for scheme administrators.

f) Informal corporate rescue processes.

Informal corporate rescue processes in Hong Kong, China are undertaken by contract. The Hong Kong Monetary Authority and the Hong Kong Association of Banks have jointly published non-binding, recommended guidelines for the Hong Kong Approach to corporate difficulties. In summary, the guidelines provide that the attitude of banks should be one of support, with decisions only being made based on information that is reliable and shared fully with all banks. The guidelines encourage collective decisions and equal treatment of banks tempered by certain restrictions on the borrower's activities.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

Hong Kong, China does not currently have any other rescue-related legislation. Legislation to implement a court-based rescue procedure has been postponed.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

After the commencement of a winding-up (which in the case of a winding-up by the court is the date the winding-up petition is presented, or in the case of a voluntary winding-up is the date the resolution is passed), many significant enforcement proceedings against a company are void. Generally, a winding-up order stays all actions against the company. Where a winding-up order has been made, no action or proceeding shall be proceeded with or commenced against the company except by leave of the court, and subject to such terms as the court may impose.

The power of a secured creditor to appoint a receiver is not restrained by liquidation, although upon liquidation of the company the receiver ceases to act as agent of the company. Secured creditors may also realize their security and obtain full satisfaction without proving their claim in the corporate liquidation, although they may prove for what they consider to be the amount of their shortfall (i.e. the difference between the value of the assets over which they hold security and their outstanding claim) in the liquidation.

b) The commencement of a formal corporate rescue process?

There is no legal mechanism to prevent individual creditors from enforcing their debts before a scheme of arrangement is approved, or preventing a creditor from filing a winding-up petition, or preventing a secured creditor from enforcing its security.

c) The initiation of an informal corporate rescue process?

The effect of an informal corporate rescue on debt and security enforcement processes against a company are a matter of contract between the company and its creditors. It is unusual for there to be a formal pre-existing agreement (a formal standstill agree-

ment) to defer enforcement in the event of a restructuring. In the absence of such agreement, creditors are free to pursue their remedies at will although informal standstill arrangements between financial creditors are common.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

The powers of the board of directors effectively cease in a winding-up.

b) The commencement of a formal corporate rescue process?

Application to court to convene meetings to consider a scheme of arrangement does not restrict the power of the management of the company. The scheme, when implemented, is likely to give the powers to a scheme manager who is generally an insolvency practitioner.

c) The initiation of an informal corporate rescue process?

Management retain their powers, although if a standstill agreement is put in place these powers will be curtailed by contract.

d) The initiation of an insolvency, or insolvency-related, process under special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

4 Who is responsible for “case management” control and administration in:

a) A corporate bankruptcy/liquidation?

Administration of a liquidation, whether voluntary or compulsory, is undertaken by the liquidator. The liquidator may seek directions from the court on any matter and, where creditors are involved, appoint a committee of inspection to assist him in his functions.

b) A formal rescue?

The responsibility for managing a formal rescue by way of a scheme of arrangement is on the company. It also often involves the input of a steering committee of financial creditors. A scheme manager generally manages the administration of the scheme of arrangement itself.

c) An informal rescue?

Management remains in control of the company. Its major creditors exercise control over management through a standstill arrangement and by obtaining security (if this is available).

d) A case of corporate insolvency under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

In a scheme of arrangement, the scheme documents incorporating the rescue plan are prepared by the company and its legal and financial advisers.

b) An informal rescue?

Generally, an informal rescue plan is prepared by the company in conjunction with the steering committee of its creditors and relevant legal and financial advisers.

c) A case of corporate insolvency under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

In a winding-up, the following claims (in order of priority) will be paid in priority to all debts (other than secured debts):

- ▲ Costs and expenses of the winding-up (including the liquidator's remuneration and legal fees).
- ▲ Wages and salaries of employees, severance payments to employees, long services payments to employees, workmen's compensation, wages in lieu of notice, accrued holiday remuneration and unpaid pension contributions (including all amounts which the Protection of Wages on Insolvency Fund is entitled to receive).
- ▲ All statutory debts due to the Government within the 12 months before the appointment of a provisional liquidator or the date of the winding-up order in the case of a compulsory liquidation or the date of commencement of a voluntary winding-up.

The debts in the second point above rank equally among themselves and are paid *pro rata* if the company has insufficient assets to meet them all. Some of those debts are subject to statutory limits that vary from time to time.

The creditors owed debts described in the first and third points are termed preferential creditors. Unsecured creditors rank *pari passu* amongst themselves.

b) A formal rescue?

There is no legislation setting out the priorities of different classes of creditors in relation to a scheme of arrangement, however, creditors of different classes must separately approve the scheme. Note that the court in Hong Kong, China has shown an unwillingness to approve a scheme where shareholders will receive in excess of 5 per cent of the funds put into the scheme.

c) An informal rescue?

This is a matter of negotiation between the company and its creditors.

d) A case of corporate insolvency under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

Creditors (or a class of creditors) that disagree with a proposed scheme of arrangement may vote against it at the court-convened meeting. If the scheme obtains the necessary majority from a claim however, dissenting creditors in that claim are bound by it regardless. The scheme also binds creditors even if they did not receive notice of or did not know of the scheme, but such a creditor can challenge a scheme on the grounds that the company took inadequate steps to bring the scheme to its attention.

b) An informal rescue?

Creditors who disagree with an informal plan of rescue are still entitled to actively pursue all rights and remedies against the company until the scheme is implemented.

c) A case of corporate insolvency under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

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- 8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:
- a) A formal rescue?
There is no legal impediment to allowing overdraft and other short-term facilities to revolve within existing limits, although the standstill agreement should provide for equalization. Likewise, there is no legal impediment to lenders taking security for fresh advances.
 - b) An informal rescue?
Please refer to Section 8a above.
 - c) A case of corporate insolvency under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.
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- 9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:
- a) A corporate bankruptcy/liquidation?
Some of the methods by which a transaction may be avoided by a liquidator include:
 - ▲ Vulnerable under the general law, for example by reason of the abuse of powers doctrine, absence of corporate benefit if the recipient of the consideration knew or ought to have known of such absence, or for misrepresentation, undue influence or some other ground.
 - ▲ An unfair preference pursuant to s.266 and s.266B of the Companies Ordinance.
 - ▲ A floating charge given by an insolvent company within 12 months of commencement of the winding-up pursuant to s.267 of the Companies Ordinance.
 - ▲ A registerable but unregistered charge pursuant to s.80 and s.267 of the Companies Ordinance.
 - ▲ A disposition of the company's property made without the leave of the court after the commencement of winding-up pursuant to: s.182 (compulsory liquidation only) and pursuant to s.232 of the Companies Ordinance (relates to the transfer of shares, involuntary liquidation only).
 - ▲ Any attachment, sequestration, distress or execution put in force after commencement of the winding-up pursuant to s.183 of the Companies Ordinance (compulsory liquidation only) and s.269 of the Companies Ordinance.
 - ▲ An extortionate credit transaction pursuant to s.264B of the Companies Ordinance.
- There is no concept of transactions at an undervalue in the context of corporate insolvency in Hong Kong, China. Legislation to this effect has been postponed.
- b) A formal rescue?
No similar provisions apply to companies bound by a scheme of arrangement.
 - c) A case of corporate insolvency under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.
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- 10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:
- a) A corporate bankruptcy/liquidation?
Provisions of general law apply as set out in Section 9a above. There are no specific legal provisions invalidating the realization of a secured property under insolvency law.
 - b) A formal rescue?
The law on unfair preferences does not apply to secured property transactions of companies bound by a scheme of arrangement.
 - c) A case of corporate insolvency under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.
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11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

Legislation in Hong Kong, China does not make specific provision for the extra-territorial effect of Hong Kong, China insolvency orders, although a liquidator will obviously seek to secure and realize assets located outside Hong Kong, China. The effect of insolvency orders in other jurisdictions will depend upon the extent to which the courts in those jurisdictions are prepared to recognize Hong Kong, China orders.

In relation to foreign insolvency orders, Hong Kong, China legislation does not expressly provide for recognition of foreign orders. However, the courts will generally recognize foreign proceedings in accordance with the principle that matters as to a company's status are to be determined in accordance with the law in its place of jurisdiction.

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1 Is the restructuring/insolvency legislation generally:

- a) Understood?
- b) Being followed and/or available opportunities being taken up?
- c) Being enforced by relevant authorities?

As is the case in many countries, the Hong Kong, China insolvency legislation is generally understood by professional persons, and less so by the rest of the community. It would be fair to say that the Hong Kong, China business community has experienced a steep learning curve since late 1997, when the Asian financial crisis first hit the region.

The average person's lack of understanding of Hong Kong, China's insolvency legislation/process is exemplified by the protests that arose when the brokerage firm CA Pacific collapsed. In this case, clients demanded the full return of shares from an insolvent brokerage that did not have sufficient shares to repay its clients.

As a general rule, Hong Kong, China insolvency legislation is being followed, but there is always room for improvement – an example is the issue of the licensing of insolvency practitioners. Licensing is *de rigueur* in most other common law jurisdictions and the Hong Kong Law Reform Commission on Insolvency recommended its implementation just over five years ago. However, at present, licensing is still in the cards and anyone can be appointed liquidator of a Hong Kong, China company. Court-appointed liquidators, however, are chosen from a panel of suitably qualified practitioners.

Insolvency legislation in Hong Kong, China is effectively policed by the court and the Official Receiver. Statutory powers are available in certain industries and are affected by such government or quasi-government authorities as the Securities and Futures Commission ("SFC"), the Office of the Insurance Commissioner and the Hong Kong Monetary Authority. For example, the SFC petitioned to place a number of share brokerages in Hong Kong, China (the largest of which was CA Pacific) in liquidation after they detected discrepancies.

Where funding and manpower constraints permit, the office of the Official Receiver will investigate the issues raised by liquidators' reports lodged in Directors' conduct returns. Where there is sufficient public interest, an inspector may be appointed to examine reasons for a particular collapse. When the Peregrine Group (the largest investment bank in Asia outside of Japan) collapsed and went into liquidation, the court appointed an inspector for this purpose on the application of the Hong Kong Financial Secretary. The costs of the inspector were paid from public funds. Controversy surrounds this particular appointment because the findings of the inspector's report have not been made public.

2 Broadly speaking, in practice, does the restructuring/insolvency legislation tend to lead to:

- a) Early recognition and action on financial difficulties experienced by a corporation?
- b) Restructuring alternatives as opposed to liquidation, and if not, why not?

Insolvency legislation in Hong Kong, China is very much focused on formal procedures, leaving little opportunity for restructuring under the legislation. Other than schemes of arrangement, which are particularly difficult, costly, and time consuming to implement, there are no formal restructuring processes such as administrations. Thus, companies are either successful in working out their financial difficulties in an out-of-court environment or move straight into liquidation or receivership.

In what originally was thought to be good news, a formal, court-driven workout process, called Provisional Supervision, was put before the Legislative Council for consideration last year. This legislation has been many years in coming and is conceptually supported by the business community. However, when the actual draft legislation was proposed, there were many submissions from insolvency practitioners, bankers, academics and professional bodies that suggested that the proposed legislation was unworkable for practical purposes. The Legislative Council is currently considering a further draft bill, but it appears to be substantially unchanged from the first.

In some countries, insolvency legislation works to make directors focus on a company's financial difficulties in the early stages by making them personally liable for debts incurred in certain situations (such as when the company is insolvent). The legislation of Hong Kong, China does not work in this way. Directors of Hong Kong, China companies are only liable under fraudulent trading provisions, wherein it must be proved that they had the intent to defraud creditors. This very high threshold of proof is rarely met in cases against directors, and thus few cases are brought before the court. The recently completed case of *Wheelock Marden*, which ran through various appeals for over 15 years, is an example of how costly and complex fraudulent trading cases can be. The Final Appeal Hearing in *Wheelock* ran before the Court of Final Appeal for 189 days. The costs of both sides are estimated to well exceed the initial claim and at the end the plaintiff, who sued the former directors, was unsuccessful.

The Hong Kong Association of Banks, with the full endorsement of the Hong Kong Monetary Authority, has issued "The Hong Kong Approach to Corporate Difficulties" to workouts in Hong Kong, China. The guide focuses primarily on how lenders should act when faced with problem loans situations, particularly in multi-bank problem loan situations. The guide encourages workouts and a code of conduct, but discourages formal intervention by banks except in cases of fraud or serious mismanagement. The guide also encourages banks to work together as a unified group, rather than as separate competing interests.

3 What are the main practical difficulties being encountered in:

- a) The preparation of restructuring plans?
b) The implementation of restructuring plans?

The main difficulties encountered in the preparation of restructuring plans are the nature of banking relationships in Hong Kong, China, as it is rare for a medium or large company to be financed by only one bank. Bank groups of 10 to 20 are considered normal and on some of the large workouts, bank groups exceeding 100 are not uncommon. Bank groups typically comprise of Hong Kong, China banks, non-Hong Kong, China (foreign banks) and the People's Republic of China banks.

The prevalent use of multi-bank lending leads to workouts involving a liaison or lead bank, steering committees and even working groups within steering committees to ensure a successful restructuring. Nearly every major restructuring in Hong Kong, China involves foreign banks. Foreign banks with Hong Kong, China offices often require head office guidance and/or approval for action on problem loans. The relevant head office may not have sufficient knowledge or understanding of local problems or legal requirements to implement an appropriate strategy. However, local office expertise and head office understanding has improved greatly since the start of the financial crisis in 1997. "The Hong Kong Approach to Corporate Difficulties" advocates that banks set up in-house problem credit management teams in Hong Kong, China.

Differing philosophical, cultural, legal, economic and corporate ideas can complicate a restructuring in Hong Kong, China. A diversified group of banks have diversified and competing interests: different banks have different attitudes towards and requirements from a restructuring; banks from different jurisdictions have different philosophies; different foreign banks may have different cash flow requirements, depending on the state of their home economy; and different banking jurisdictions also have different legal requirements. For example, Japanese and Italian banks have difficulty converting debt to equity if it requires them to hold onto such securities.

Hong Kong, China companies often have assets and/or operations in the People's Republic of China, and to further complicate matters, the laws, and consequently the enforceability of charges, loans, etc., are different between the two jurisdictions.

In most jurisdictions, banks can use the threat of enforcement, receivership or liquidation as a negotiating tool. The People's Republic of China does not generally recognize Hong Kong, China security or liquidators over assets. Creditors in the People's

Republic of China can enforce their debts against assets in priority to foreign creditors. While there is one country, there are two systems for debt recovery purposes and Hong Kong, China creditors are considered foreign creditors in the People's Republic of China. This again makes restructuring difficult in many cases.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

The goal of most companies undergoing a restructuring process in Hong Kong, China is simply to reduce debt to an acceptable level and carry on with business. It is rare that fundamental changes are made to the existing business operations. The reasons for this appear to be that companies have little ability to access to capital (due to their poor balance sheets) and have no rights to a standstill period that allows them to reorganize their business properly.

There are many instances where listed shells of insolvent companies are used as a means of "backdoor listings" onto the Hong Kong Stock Exchange. A current example is the Yaohan situation in which a listed department store went into liquidation. The company has entered into a scheme of arrangement whereby an investor will effectively buy a clean company shell – the listing – for a fraction of the amount the company owes its creditors – effectively becoming a listed company through the "back door".

An example of a more comprehensive restructuring of business operations is that of QPL International Holdings Limited ("QPL"). QPL sold a minority share in its most profitable business to pay creditors and fund working capital. By realizing the value in their organization, they were able to expand and move forward.

Measured in terms of debt, the US\$4.6bn restructuring of Guangdong Enterprises Limited ("GDE") is the largest ever insolvency to date in People's Republic of China. GDE was the largest so-called "window company" (government-owned entity established primarily to make investments in the People's Republic of China using foreign debt financing) of the Guangdong Province of the People's Republic of China, and one of the largest in the country as a whole. In addition to the large debt burden, it boasted approximately 300 operating subsidiaries, including five corporates listed in Hong Kong, China.

GDE was restructured by way of an out-of-court negotiated workout involving some 170 foreign and People's Republic of China banks and a series of bond issues largely held by US investors. GDE engaged Goldman Sachs as its financial advisor in the restructuring, and PricewaterhouseCoopers advised the banks.

The negotiations took place over a period of two years culminating in legal completion of the deal – including obtaining all necessary approvals from the People's Republic of China – in December 2000. The Guangdong Provincial Government ("GPG") participated in the negotiation process on behalf of GDE and it was understood that key aspects of the restructuring proposal passed across the desk of the Premier in Beijing. The restructuring was regarded as a test-case for the People's Republic of China, and the government saw it as key to establishing their *bona-fides* with the international investment community.

As a measure of government commitment, the key plank of the restructuring was the privatization and injection of the GPG owned Dongshen water project (WaterCo) – the provider of approximately 70 percent of the water needs of Hong Kong, China. Financial creditors exchanged their existing debts for a package of assets including a US\$1.8bn 10 year loan note issued by WaterCo, together with equity in WaterCo, debt and equity assets arising from the restructuring of GDE itself, and some cash. The corporate restructuring of the existing GDE involved segregating its assets into three broad categories (saleable property in Hong Kong, China; performing assets; and distressed assets) each of which was injected into newly-formed corporate entities with appropriate strategies to realize value from each category. Each of the three newly-formed corporate entities issued debt and equity instruments which were part of the package offered to the financial creditors. It was agreed that PricewaterhouseCoopers would monitor the progress and performance of the newly-formed corporate entities and of WaterCo on behalf of the financial creditors going forward.

The GDE deal had a number of unique and interesting features which are beyond the scope of this guide. It appears, however, that the restructuring was regarded as a success story by the majority of foreign banks and bondholders involved, and by the reform minded politicians within the People's Republic of China. As other large restructurings in the People's Republic of China come to a close in its wake (including the large Guangzhou ITIC restructuring), it remains to be seen what the precedents are, and to what extent providers of foreign capital into the People's Republic of China are encouraged to resume lending into the jurisdiction.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

The most common forms of funding for Hong Kong, China companies undergoing restructuring are as follows:

- ▲ Through a "white knight" or associates of shareholders – i.e. friendly investors usually interested in a long-term stake.
- ▲ Genuine third party investors (e.g. QPL as discussed above).
- ▲ "Creditor refinancing" – where creditors either write off debt or convert to equity to release cash flow.
- ▲ Through a "black knight" – investors who squeeze shareholders and creditors.

Debtor-in-possession ("DIP") financing, where a lender loans money to a company in restructuring on a super-priority basis, is not particularly common in Hong Kong, China. In PricewaterhouseCoopers' experience, this is due to a lack of early recognition of financial difficulties and acceptable sources of repayment.

There appears to be some scope for bank financing when a company first owns up to its financial difficulties. At that stage banks may choose to fund working capital for a short period while they explore their options.

In large-scale insolvencies there has been an increase in the purchase of debt by venture capitalists and specialist distressed debt sectors of banks. Usually these traders enter the market after winding-up. There does not appear to be much interest at the restructuring phase, although this may change.

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