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# Aviation Finance & Leasing 2021

Hong Kong  
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# HONG KONG

## Law and Practice

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## 1. AIRCRAFT AND ENGINE PURCHASE AND SALE

### 1.1 Sales Agreements

#### 1.1.1 Taxes/Duties Payable upon Execution of the Sales Agreement

Generally, no transfer taxes or stamp duties apply in Hong Kong in respect of aircraft or engine transfers under sale agreements. However, stamp duty may apply in respect of transfer of securities, such as the transfer of ownership interests in aircraft-owning entities.

#### 1.1.2 Enforceability against Domestic Parties

There is no requirement for a sale agreement to be translated, certified, notarised or legalised to be enforceable.

### 1.2 Transfer of Ownership

#### 1.2.1 Transferring Title

Under Hong Kong law, title passes when parties intend title to pass. In practice, title is usually transferred under:

- a contract of sale; or
- an instrument of conveyance, such as a bill of sale.

#### 1.2.2 Sales Governed by English or New York Law

Generally, the transfer of title to an aircraft or engine physically delivered in Hong Kong is recognised if the bill of sale is governed by either English or New York law. Hong Kong generally gives effect to the choice of foreign law, provided that the choice of foreign law is not against public policy and, pursuant to conflict of law principles, Hong Kong law would generally recognise English or New York law bills of sale as a valid mode of transferring title to aircraft assets.

Apart from general conflict of law principles, there are no specific substantive requirements that must be satisfied for such bills of sale to be recognised.

#### 1.2.3 Enforceability against Domestic Parties

A bill of sale is not required to be translated, certified, notarised or legalised to be enforceable against a domestic party.

#### 1.2.4 Registration, Filing and/or Consent from Government Entities

There is no requirement for a bill of sale to be registered or filed with any Hong Kong government authority. In practice, for an aircraft registered in Hong Kong, it is common to submit information regarding parties' respective interests in the aircraft to the Hong Kong Civil Aviation Department.

#### 1.2.5 Taxes/Duties Payable upon Execution of a Bill of Sale

Stamp duty may apply in respect of transfer of ownership interests in Hong Kong entities, irrespective of the physical location of the aircraft or engine.

## 2. AIRCRAFT AND ENGINE LEASING

### 2.1 Overview

#### 2.1.1 Non-permissible Leases

Operating, wet or finance leases and leases concerning only engines or parts are permissible as long as the engines or parts remain separate and identifiable (see **2.2.4 Risk of Title Annexation**).

#### 2.1.2 Application of Foreign Laws

The Hong Kong courts will generally give effect to the parties' choice of foreign law to govern the lease agreement if the choice of law is made

in good faith and does not contravene public policy.

### 2.1.3 Restrictions Concerning Payments in US Dollars

Generally, there are no material restrictions imposed on domestic lessees making rent payments to foreign lessors in US dollars, subject to compliance with sanctions and other legal obligations which may restrict payments to certain countries or recipients.

### 2.1.4 Exchange Controls

There are no exchange controls which could prevent rent payments under a lease or any repatriation of realisation proceeds (if that lease is enforced by a foreign lessor).

### 2.1.5 Taxes/Duties Payable for the Physical Execution of a Lease

There are no taxes or duties payable for executing a lease physically in Hong Kong and/or by or to a domestic party, or as a consequence of an original or copy of a lease being brought into Hong Kong, either physically or electronically.

### 2.1.6 Licensing/Qualification of Lessors

Generally, no licences are required. However, lessors should consider the potential application of the Money Lenders Ordinance (Cap 163). As the definition of “loan” under the Money Lenders Ordinance captures financial accommodation, including forbearance on late rental payment and is otherwise broadly defined, a lessor may need to obtain a Money Lenders Licence.

## 2.2 Lease Terms

### 2.2.1 Mandatory Terms for Leases Governed by English or New York Law

No mandatory terms are required to be in a lease (or ancillary documents thereto) governed by either English or New York law that would not typically already be included.

### 2.2.2 Tax and Withholding Gross-Up Provisions

Generally, tax and other withholding gross-up provisions are permissible and enforceable where the provisions are designed to allocate risk and responsibility as to payment obligations.

### 2.2.3 Parts Installed or Replaced After a Lease's Execution

A lease can cover parts that are installed or replaced on an aircraft or engine after its execution, provided that the parts incorporated or replaced become the property of the lessor.

### 2.2.4 Risk of Title Annexation

There is a doctrine providing for the accession of component parts into a wider structure. However, it is highly unlikely to apply in the case of engines. It is important that the lease sets out clearly the common intention of the parties that title does not pass for temporary attachments, but that title does pass for permanent replacements.

Also, it is not uncommon to have parties enter into a recognition of rights agreement between the owners of an airframe and the owner(s) of any engines attached temporarily to that airframe.

### 2.2.5 Recognition of the Concepts of Trust/Trustee

The concept of a trust and the role of an owner trustee under a lease is recognised in Hong Kong.

## 2.3 Lease Registration

### 2.3.1 Notation of Owner's/Lessor's Interests on Aircraft Register

The Hong Kong Civil Aviation Department must, when registering an aircraft in Hong Kong, record the interests of the registered owner(s) on the Aircraft Register and reflect the details of

the registered owner(s) on the aircraft's certificate of registration (see **2.3.2 Registration if the Owner Is Different from the Operator**). In practice, owners, lessors and financiers may submit information regarding their respective interests to the Hong Kong Civil Aviation Department. As far as any information submitted voluntarily is concerned, the information would not be freely accessible by the public. Any such disclosure is voluntary and would have no effect on third parties.

### **2.3.2 Registration if the Owner Is Different from the Operator**

The civil aircraft register is an owner and operator registry. In order for an aircraft to be eligible to be registered in Hong Kong, either the owner, or the operator, must generally be a "qualified person". The qualified person would be recorded as the "registered owner".

"Qualified persons" are: the Government of Hong Kong or the Central People's Government, permanent residents of Hong Kong and bodies incorporated under Hong Kong law or Chinese law and which have their principal place of business in Hong Kong or another part of China.

### **2.3.3 Aircraft/Engine-Specific Registers**

There is no specific register for leases concerning aircraft or engines.

### **2.3.4 Registration of Leases with the Domestic Aircraft Registry**

Except where the owner of the aircraft is a "qualified person", an aircraft under a lease can only become eligible to be registered in Hong Kong by virtue of the lessee under a lease, as the operator, meeting the "qualified person" requirement.

Entry into a lease agreement does not in itself require any government consent or approval.

### **2.3.5 Requirements for a Lease to Be Valid and Registrable**

A lease does not need to be in a specific form or translated, stamped, certified, notarised or legalised to be valid.

### **2.3.6 Taxes/Duties Payable for Registering a Lease**

No taxes or duties are payable, because leases are not registrable.

### **2.3.7 Registration of Aircraft in Alternative Countries**

Aircraft habitually based in Hong Kong are not typically registered in any other countries. An aircraft may not be registered or continue to be registered in Hong Kong if, without limitation, the registration of the aircraft outside Hong Kong does not cease by operation of law at the time when the aircraft is being registered in Hong Kong.

### **2.3.8 Requirements for Documents Concerning Registration**

The aviation authority in Hong Kong does not require any document to be either in its original form, translated, notarised and/or authenticated before accepting and processing the registration of an aircraft.

## **2.4 Lessor's Liabilities**

### **2.4.1 Tax Requirements for a Foreign Lessor**

See **2.4.2 Effects of Leasing on the Residence of a Foreign Lessor**.

### **2.4.2 Effects of Leasing on the Residence of a Foreign Lessor**

A foreign lessor should not be deemed to be resident, domiciled, carrying on a business or subject to taxes by reason only of executing a lease document outside of Hong Kong or enforcing a lease outside of Hong Kong.

### 2.4.3 Engine Maintenance and Operations

Subject to entitlement of contribution from lessees or other parties, the general position under Hong Kong law is for strict liability on aircraft owners for material loss or damage caused to any person or property on land or water by the aircraft. There is, however, an exemption for passive owners, provided that:

- the aircraft is to be operated by the lessee or third-party operator for a period of more than 14 days;
- the lessee or operator is responsible for ensuring the airworthiness of the aircraft; and
- the lease does not provide for the owner to be responsible for the employment of the crew.

### 2.4.4 Damage or Loss Caused by an Asset

A passive foreign aircraft or engine owner or lessor under a lease or financier financing the asset on lease will generally not be liable under the doctrine of strict liability (or any other similar domestic doctrine) as a result of damage or a loss caused by the asset. See **2.4.3 Engine Maintenance and Operations**.

### 2.4.5 Attachment by Creditors

Generally, creditors of a domestic lessee may not attach an aircraft that is leased to it but owned by a different entity.

### 2.4.6 Priority of Third Parties' Rights

Some liens and detention rights could take priority over a lessor's rights. Examples include:

- common-law liens, such as a repairer's lien;
- rights of detention by airport authorities, as a result of a failure to pay airport charges or air-passenger departure tax; and
- a tax authority's rights of detention and power of sale, as a result of a failure to pay profit taxes.

## 2.5 Insurance and Reinsurance

### 2.5.1 Requirement to Engage Domestic Insurance Companies

It is not mandatory for either all or part of the insurances to be placed with domestic insurance companies.

### 2.5.2 Mandatory Insurance Coverage Requirements

Pursuant to Section 6 of the Civil Aviation (Insurance) Order (Cap.448F) (Civil Aviation Insurance Order), the insurance policy for an aircraft must insure the operator against its liability in respect of:

- third-party risks;
- the death of or bodily injury to any passenger in the aircraft;
- any destruction or loss of or damage to baggage carried on board the aircraft; and
- any destruction or loss of or damage to cargo carried on board the aircraft.

The policy of insurance must have a combined single limit coverage of not less than the applicable amount specified in the Civil Aviation Insurance Order.

### 2.5.3 Placement of Insurances outside of Jurisdiction

Reinsurances of up to 100% coverage may be placed outside of Hong Kong.

### 2.5.4 Enforceability of "Cut-Through" Clauses

Cut-through clauses in respect of an insurer located in Hong Kong are generally regarded as being effective.

### 2.5.5 Assignment of Insurance/Reinsurance

Assignments of reinsurance can be effective under Hong Kong law. They will generally be registrable with the Companies Registry if granted by way of security by a Hong Kong company (or

foreign company registered to carry on business in Hong Kong).

## 2.6 Lease Enforcement

### 2.6.1 Restrictions on Lessors' Abilities

In respect of a lessor's ability to terminate an aircraft lease and/or sell the aircraft, termination and re-export is governed by contract law. The aircraft does not need to be located in Hong Kong for its lease to be terminated, and there are no other specific requirements (other than the lessor having to comply with the termination provisions of the lease itself). Under Hong Kong law, no licences or consents are specifically required to export or re-export an aircraft for civil use from Hong Kong.

However, the lessor may face practical difficulties in dealing with the aircraft after terminating the lease, as follows:

- where the aircraft is registered with the Civil Aviation Department in the name of the lessee as the registered owner, the Civil Aviation Department would usually expect the lessee (as registered owner) to be the person who makes the application to deregister the aircraft and the person who will need to provide the maintenance records and compliance statements in respect of the aircraft to the Civil Aviation Department;
- unless the lessor obtains assistance from the lessee, the lessor will need to possess the necessary licences (for example, it would need to have a valid air operator's certificate and the aircraft would need to have a certificate of airworthiness) in order for the lessor to reposition the aircraft from Hong Kong to another jurisdiction;
- the lessor will need consent from airports and/or landlords of the premises where the aircraft is located in order to enter into premises to take possession of aircraft.

In practice, after an aircraft is deregistered from the Aircraft Register, it will likely be necessary for the lessor to obtain a statement of conformity for export from the Civil Aviation Department, so as to be able to fly the aircraft to, and facilitate the registration of the aircraft in, the export destination. The Civil Aviation Department also requires a certificate of airworthiness to be issued by the aviation authority of the export destination before the aircraft can take off from Hong Kong. Only under very limited circumstances will the Civil Aviation Department permit the aircraft to take off from Hong Kong with a permit to fly (which is issued by the aviation authority of the export destination).

### 2.6.2 Lessor Taking Possession of the Aircraft

Hong Kong allows for self-help remedies, permitting lessors to take physical possession without the need for judicial proceedings (subject to the exercise of those remedies not amounting to a breach of the peace).

However, there are number of reasons why a lessor may wish to seek a court order to repossess an aircraft. For example, the lessor may be exposed to potential liability if it is considered to have terminated the lease wrongfully, and therefore, the lessor may wish to obtain a court determination prior to repossessing the aircraft.

### 2.6.3 Specific Courts for Aviation Disputes

There is no specific court for aviation disputes.

### 2.6.4 Summary Judgment or Other Relief

A summary judgment may be granted by the court if the plaintiff can show to the court that the defendant has no arguable defence. If the lessor raises sufficient evidence to prove the lessee's breach, for example, if the breach is as a result of periodic non-payment of rent, and the lessee cannot raise any arguable defence, summary judgment may be granted by the court.



An interlocutory injunction could be sought from court pending final resolution of the court. The plaintiff has to show that there is a serious question to be tried and the balance of convenience lies in favour of granting the injunction.

#### **2.6.5 Domestic Courts' Approach to Foreign Laws and Judgments**

The court will generally give effect to the parties' choice of foreign law to govern an agreement, and their submission to the courts of a foreign jurisdiction if the choice of law and submission to that jurisdiction is not against public policy. However, under Hong Kong law, if the lessee is a sovereign state, the sovereign state enjoys absolute immunity, which cannot be waived in contractual documents entered into prior to the commencement of any dispute. See **2.6.11 Lessees' Entitlement to Claim Immunity**.

#### **2.6.6 Domestic Courts' Recognition of Foreign Judgments/Awards**

The statutory recognition and enforceability of judgments of foreign courts in Hong Kong depends on whether a treaty of reciprocal enforcement of judgments has been entered into between Hong Kong and the jurisdiction of that foreign court.

In the case of the PRC and Hong Kong, there are a number of bilateral agreements relating to mutual recognition of judgments. The most important to note is the current Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters. This arrangement provides that the parties must have entered into a written agreement as to the choice of either the PRC or the Hong Kong courts. Where there is a valid agreement that the PRC has jurisdiction over a matter, a party may seek to enforce a judgment of the PRC court through the Hong Kong courts. It should be noted that Hong Kong and the PRC have signed a new mutual assistance arrangement that will

supersede the current arrangements. Once the new mutual assistance arrangement comes into effect, it will no longer be necessary to have a written agreement as to the choice of courts.

In general, where there is a reciprocal treaty or the judgment has been obtained from another common-law jurisdiction, the conditions for the enforcement of that foreign judgment include the requirement that the judgment is final, for a fixed sum, and is not penal in nature.

#### **2.6.7 Judgments in Foreign Currencies**

A Hong Kong court is likely to grant judgment for a debt or damages in US dollars (or other foreign currency), if it finds that US currency (or another currency) most fairly expresses the plaintiff's loss.

#### **2.6.8 Limitations on Lessors' Actions Following Termination**

Generally, there are no limitations, subject to the application of the doctrine of penalties and the statutory prohibition against extortionate interest rates (see **3.1.1 Restrictions on Lending and Borrowing**).

#### **2.6.9 Lessor's Requirement to Pay Taxes/Fees**

Generally, a lessor under an aircraft lease is not required to pay taxes or fees in a significant (ie, non-nominal) amount in connection with the enforcement of that lease; the costs will be limited to legal costs, storage and remarketing costs and costs of applying for a statement of conformity for export.

#### **2.6.10 Mandatory Notice Periods**

While the law of penalties and relief against forfeiture generally applies to termination of leasing of aircraft leased to Hong Kong lessees, there are no mandatory notice periods for a lease under Hong Kong law.



## 2.6.11 Lessees' Entitlement to Claim Immunity

Foreign states, foreign state entities, the PRC government and PRC state entities enjoy absolute immunity in the Hong Kong courts. The question of whether a particular entity forms part of the PRC government or a foreign state will, under Hong Kong law, depend on the function of that entity and the level of control exercised over it by the PRC government or that state and is therefore largely a question of fact.

Importantly, pre-dispute contractual waivers will not be recognised by a Hong Kong court as an effective waiver of sovereign or Crown immunity. To be effective, the waiver of immunity must be given to the Hong Kong court itself at the time when the court is asked to exercise jurisdiction over the foreign state, the PRC government or PRC state entity.

## 2.6.12 Enforcement of Foreign Arbitral Decisions

Hong Kong is a party to the New York Convention (with a reservation made by China that the New York Convention will only apply to commercial disputes).

## 2.6.13 Other Relevant Issues

Since Hong Kong is not a Cape Town Convention jurisdiction, a lessor must consider their enforcement rights with reference to local law. However, generally speaking, the local law position is largely considered to be lessor- and creditor-friendly.

## 2.7 Lease Assignment/Novation

### 2.7.1 Recognition of the Concepts of Contractual Assignment and Novation

The concepts of contractual assignment and novation are recognised in Hong Kong.

### 2.7.2 Assignment/Novation of Leases under Foreign Laws

Hong Kong courts will give effect to the terms of a lease in accordance with its governing laws. Generally, parties will choose the same governing law for the assignment/novation to avoid conflict of laws issues.

There are no mandatory terms that are required to be included in the documents.

### 2.7.3 Enforceability of Lease Assignments/Novations

There are no requirements in Hong Kong to translate, certify, notarise or legalise an aircraft and/or engine lease assignment and assumption/novation.

### 2.7.4 Filing/Registration of Lease Assignments/Novations

There is no requirement or avenue to register or file an aircraft and/or engine lease assignment and assumption/novation. Entry into these documents does not require government consent.

### 2.7.5 Taxes/Duties Payable on Assignment/Novation

There are no taxes or duties payable in respect of an assignment and assumption/novation agreement, or as a consequence of an original or copy of it being brought into Hong Kong, either physically or electronically.

### 2.7.6 Recognition of Transfer of Ownership Interests

A transfer of the beneficial interest in a trust would be treated similarly to English law where, generally, the beneficiary holds equitable title to an indivisible interest in the trust property, and the trustee holds legal title to the trust property. The transferee would have the same interest in the aircraft, as beneficiary of the trust, as the transferor. The exact treatment and status of the

beneficiary would also depend on the terms of the trust deed.

## **2.8 Aircraft Deregistration and Export**

### **2.8.1 Deregistering Aircraft in this Jurisdiction**

According to Article 4(11) of the Air Navigation (Hong Kong) Order 1995 (Cap 448C), the registered owner is the entity that is entitled to deregister the aircraft.

The registered owner can do so by making an application to the Hong Kong Civil Aviation Department.

### **2.8.2 Lessee's/Operator's Consent**

If the registered owner is the lessor or other owner, the lessor may deregister the aircraft in its own right. However, if the lessee is the registered owner, then the lessee should be the person who makes the application to deregister the aircraft.

In circumstances where the lessee is in default or the lease is terminated, there should be no reason why the holder of a deregistration power of attorney should not be able to make the application to deregister the aircraft.

### **2.8.3 Required Documentation**

Usually, the registered owner would simply be able to file a notification of deregistration to the Hong Kong Civil Aviation Department.

It is expected that the owner/mortgagee/lessor under a deregistration power of attorney would execute a notification of deregistration to the Hong Kong Civil Aviation Department in the same manner.

### **2.8.4 Duration of Deregistration Process**

The Civil Aviation Department will usually process an application for deregistration immediately upon receipt of all required information and documents.

### **2.8.5 Aviation Authority's Assurances**

The aviation authority does not provide advance assurances to an aircraft owner, mortgagee or lessor as to the prompt deregistration of the aircraft.

### **2.8.6 Costs, Fees and Taxes Relating to Deregistration**

No tax or fee is payable on deregistration of the aircraft.

### **2.8.7 Deregistration Power of Attorney**

A power of attorney must be created in accordance with the Powers of Attorney Ordinance (Cap 13), which (among other things) requires that an instrument creating a power of attorney be signed and sealed by, or by direction and in the presence of, the donor of the power.

There is no requirement that the instrument be translated, certified, notarised, legalised or lodged in advance.

### **2.8.8 Documents Required to Enforce Deregistration Power of Attorney**

The use of deregistration powers of attorney is untested in the context of commercial aviation transactions. It may be that the Hong Kong Civil Aviation Department may request additional documentation or information before processing any application for deregistration.

### **2.8.9 Choice of Laws Governing Deregistration Power of Attorney**

Generally, a deregistration power of attorney does not have to be governed by the laws of Hong Kong. However, in circumstances where a power of attorney is governed by a foreign law, the Hong Kong Civil Aviation Department may require further proof as to the validity of such a power of attorney.

## 2.8.10 Revocation of a Deregistration Power of Attorney

Generally, a deregistration power of attorney does not have to be governed by the laws of Hong Kong. However, in circumstances where a power of attorney is governed by a foreign law, the Hong Kong Civil Aviation Department may require further proof as to the validity of such a power of attorney.

## 2.8.11 Owner's/Lessor's Consent

The deregistration of an aircraft can technically only be achieved by the registered owner. If the lessee is the registered owner, the application for deregistration must be made by the lessee. Accordingly, in such circumstances, if the aircraft needs to be deregistered for export, the export of the aircraft can only happen with the assistance of the lessee.

It should be possible for lessors to effect deregistration and export through the exercise of a deregistration power of attorney; however, this remains untested. It would be advisable to require the lessee to confer on the donee of a deregistration power of attorney an express power to do all things necessary in connection with the export of the aircraft.

## 2.8.12 Aircraft Export Permits/Licences

Under Hong Kong law, no licences or consents are specifically required to export or re-export an aircraft for civil use from Hong Kong. In practice, after an aircraft is deregistered from the Aircraft Register, and assuming the aircraft is otherwise airworthy, the Civil Aviation Department will issue a statement of conformity for export for the aircraft.

## 2.8.13 Costs, Fees and Taxes Concerning Export of Aircraft

No tax or fee is payable on export or repossession of the aircraft itself; however, if the aircraft is not in the condition required for the Hong Kong

Civil Aviation Department to issue a statement of conformity for export, there may be costs incurred in rectifying any discrepancies. If the aircraft is withdrawn from service, a pro rata amount in proportion to the renewal fee for its airworthiness certificate must be paid for every month that the aircraft was in service since its last renewal.

## 2.8.14 Practical Issues Related to Deregistration of Aircraft

The Civil Aviation Department is unlikely to be used to dealing with parties other than the Hong Kong airline operators (considering that there have been no cases in which lessors have used deregistration powers of attorney to deregister the aircraft in Hong Kong). Therefore, it is anticipated that, in practice, some effort may be required to explain to the Civil Aviation Department a lessor's use of deregistration powers of attorney when seeking to deregister an aircraft in the lessee's name where that aircraft has been registered with the lessee as the "registered owner" (see **2.6.1 Restrictions on Lessors' Abilities**).

Notwithstanding recent litigation and repossession action with respect to aircraft operated by Hong Kong commercial airline operators, as far as is known following enquiries to the Hong Kong Civil Aviation Department, there is as yet no precedent of deregistration pursuant to an exercise of a lessor's rights under a deregistration power of attorney.

## 2.9 Insolvency Proceedings

### 2.9.1 Overview of Relevant Laws and Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations

The Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) provides that companies in Hong Kong can be wound up

by the court (ie, compulsory winding-up) or by application by the companies' directors (ie, voluntary winding-up).

Hong Kong currently does not have any statutory corporate rescue regime incorporating a statutory moratorium, but plans to introduce a Companies (Corporate Rescue) Bill have been announced. Under the existing regime, a company can enter into a non-statutory workout agreement with its major creditors or implement a scheme of arrangement together with its shareholders and/or creditors following requirements under the Companies Ordinance (Cap 622). These mechanisms do not impose a moratorium on actions against the company while it attempts to execute the rescue plan.

### 2.9.2 Overview of Relevant Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership

Where a company is solvent, the liquidation can proceed as a members' voluntary liquidation, which requires a certificate of solvency to be issued by the majority of the company's directors in accordance with the statutory provisions.

Where a company is insolvent (or where a certificate of solvency is not issued), it can be wound up via the creditors' voluntary liquidation or compulsory winding-up processes.

The compulsory winding-up process can be initiated by presenting a winding-up petition to the court. Actions against the company will be stayed, unless leave is granted by the court, during a compulsory liquidation.

The courts also have extensive powers to approve compromises or arrangements which have been approved by the majority (50% in number and 75% in value) of creditors of the company. Once approved by the court, the

scheme of arrangement is capable of binding all creditors of the company. However, the initiation of the scheme of arrangement process will not, on its own, prevent other creditors from taking enforcement action against the company.

### 2.9.3 Co-ordination, Recognition or Relief in Connection with Overseas Proceedings

The recognition of foreign insolvency proceedings in Hong Kong is governed by common law principles.

Hong Kong is not a signatory to the UNCITRAL Model Law on Cross-Border Insolvency and there are no statutory provisions mandating cross-border co-operation or recognition of foreign insolvency proceedings.

However, the Hong Kong Government and the Supreme People's Court of the PRC entered into a new framework arrangement on 14 May 2021, to facilitate the mutual recognition of bankruptcy proceedings, including bankruptcy liquidation, compromise and reorganisation proceedings in the two jurisdictions. Commercial parties should continue to monitor these developments to assess the practical impact of this arrangement in practice.

There is nothing prohibiting the court from adopting the American Law Institute and International Insolvency Institute Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases 2001. Furthermore, although its guidelines have not been formally adopted by the court by way of Practice Direction, Hong Kong judges have taken part in the Judicial Insolvency Network (JIN) (as observers).

### 2.9.4 Effect of Lessee's Insolvency on a Deregistration Power of Attorney

Provided that the power of attorney is expressed to be irrevocable and is a power coupled with an interest, deregistration powers of attorney

should survive insolvency. However, see **2.8.10 Revocation of a Deregistration Power of Attorney** in respect of the use of a power of attorney for deregistration purposes, as this remains untested.

## 2.9.5 Other Effects of a Lessee's Insolvency

There is a stay on proceedings against a company without leave of the courts where a liquidator is appointed by the court. This does not apply where the liquidator was appointed in a voluntary winding-up (see **2.9.8 Liquidation of Domestic Lessees**). However, a secured creditor may appoint a receiver and a court would be expected to grant leave for the receiver to take possession of secured assets. In addition, leased assets owned by other persons are considered outside of the lessee's insolvency estate and a lessor would be able to take steps to (or apply to a court for an order to) recover the leased asset (provided it was entitled to do so under the terms of the lease).

Following the winding-up of a company, certain transactions may be invalidated if the transaction entered into within a certain time period (the look-back period) before the commencement of a winding up is regarded as giving an "unfair preference". Generally, an unfair preference is when a company has done something which would put a creditor in a better position than the creditor would have been if that transaction had not been entered into. The look-back period is six months for creditors generally and two years if the creditor is an associate of the company that is being wound up.

A liquidator may apply to court for an order to unwind a transaction if a company in liquidation enters into a transaction with a person at "undervalue". The look-back period for undervalue transactions is five years. A transaction is at undervalue if it is entered into on terms that provide that the company receives no consider-

ation or where the consideration received by the company is of a value which is significantly less than the consideration provided by the company (in monetary terms), unless the court is satisfied that the company entered into the transaction in good faith and there were reasonable grounds for believing the transaction would benefit the company.

Unsecured creditors generally share *pari passu* on distribution of assets on the winding-up of a company, subject to certain creditors mandatorily preferred by law. The claims of lessors and secured parties (to the extent the asset is insufficient to discharge any outstanding liabilities) would rank *pari passu* with the claims of other unsecured creditors, other than any creditors mandatorily preferred by law.

## 2.9.6 Risks for a Lender if a Borrower, Guarantor or Security Provider Becomes Insolvent

See **2.9.5 Other Effects of a Lessee's Insolvency**. In addition, it should be noted that floating charges are generally invalid if they are granted over a company's property or undertaking within 12 months of the commencement of a winding up, unless the company was solvent immediately after the floating charge was created.

## 2.9.7 Imposition of Moratoria in Connection with Insolvency Proceedings

While there is a stay on proceedings against a company following the appointment of a liquidator appointed by the court, there is no fixed period, as the stay will typically end when the insolvency proceedings end.

## 2.9.8 Liquidation of Domestic Lessees

There are two types of liquidation in Hong Kong, namely, voluntary liquidation and compulsory liquidation.

A voluntary liquidation may be initiated by a special resolution of the company, irrespective of the company's solvency. If the company is solvent, the directors are required to make a statutory declaration as to solvency. If the company is insolvent, the creditors will be involved in the process of liquidation.

A compulsory liquidation may be initiated by the presentation of a winding-up petition to the court. The following are some of the grounds to have a company wound up:

- the company has by special resolution resolved that it be wound up by the court;
- the company is unable to pay its debts; or
- if the court is of opinion that it is just and equitable that the company should be wound up.

A receiver may be appointed to enforce a charge by the court or under a power contained in a debenture or a trust deed.

#### **2.9.9 Ipso Facto Defaults**

Ipso facto defaults should generally be sufficient; however, please note the stay on commencement of proceedings without leave of a court against a company when it is in compulsory liquidation.

#### **2.9.10 Impact of Domestic Lessees' Winding-Up**

Generally, aircraft on lease would be considered to be owned by the owner or lessor and therefore would be outside the insolvency estate. With respect to the lease rentals, to the extent that such amounts are unpaid at the time of the winding up or are payable damages as a consequence of default under the default provisions of the lease, these amounts would be unsecured amounts owing to the lessor, in respect of which the lessor could file a proof of claim as a creditor of the company.

The position of lease security deposits would depend on how these deposits are structured. Generally, the lessor should in appropriately drafted leases be able to apply these deposits to satisfy the obligations of the lessee, following an insolvency event giving rise to a default.

### **2.10 Cape Town Convention and Others**

#### **2.10.1 Conventions in Force**

Hong Kong is not a party to the Convention and the Protocol.

#### **2.10.2 Declarations Made Concerning Conventions**

Hong Kong is not a party to the Convention and the Protocol.

#### **2.10.3 Application of Article XIII of the Protocol on Matters Specific to Aircraft Equipment**

Hong Kong is not a party to the Convention and the Protocol.

#### **2.10.4 Enforcement of Conventions**

Hong Kong is not a party to the Convention and the Protocol.

#### **2.10.5 Other Conventions**

Hong Kong is not a party to the Geneva Convention or to the Rome Convention.

## **3. AIRCRAFT DEBT FINANCE**

### **3.1 Structuring**

#### **3.1.1 Restrictions on Lending and Borrowing**

The Money Lenders Ordinance requires that a person carrying on business as a money lender in Hong Kong must obtain a money lender's licence. Foreign lenders may need to obtain a licence for the purpose of financing an aircraft



locally. Generally, there is no restriction on borrowers using the loan proceeds.

### 3.1.2 Effect of Exchange Controls or Government Consents

There are no exchange controls or government consents that would be material to any financing or repatriation of realisation proceeds under a loan, guarantee or security document.

### 3.1.3 Granting of Security to Foreign Lenders

Borrowers are not restricted from granting security to foreign lenders.

### 3.1.4 Downstream, Upstream and Cross-Stream Guarantees

Downstream, upstream and cross-stream guarantees may be provided by a Hong Kong company, as long as there is authorisation from the company. For upstream and cross-stream guarantees, it is common practice for them to be approved by unanimous board and shareholder resolutions of the guarantor.

### 3.1.5 Lenders' Share in Security over Domestic SPVs

While not absolutely necessary, security over shares in special-purpose vehicles are commonly taken in order to give secured parties maximum flexibility on enforcement. The form of security taken is usually a share charge (accompanied by a deposit of certificated shares).

### 3.1.6 Negative Pledges

A negative pledge is recognised in Hong Kong.

### 3.1.7 Intercreditor Arrangements

Generally, there are no restrictions on parties to enter into inter-creditor arrangements to regulate priority contractually.

### 3.1.8 Syndicated Loans

The concept of agency and the role of an agent (such as the facility agent) under a syndicated loan is recognised in Hong Kong.

### 3.1.9 Debt Subordination

Three types of subordination are commonly used: contractual subordination, structural subordination, and intercreditor arrangements.

### 3.1.10 Transfer/Assignment of Debts under Foreign Laws

This will depend on the governing law of the underlying loan. Hong Kong courts will generally give effect to the parties' choice of governing law, subject to conflict of law principles.

In the case of a Hong Kong law loan agreement, Hong Kong law would in the application of conflict of law principles recognise the modes of assignment typically contained in English or New York law-governed assignment documents as being valid modes of assignment (provided they were valid under the relevant governing law of the assignment document).

### 3.1.11 Usury/Interest Limitation Laws

In addition to the equitable doctrine of penalties, where applicable, the Money Lenders Ordinance prohibits a person who lends money at an interest rate which exceeds 60% per annum, or an interest rate which exceeds 48% per annum, as such interest rates are considered extortionate.

## 3.2 Security

### 3.2.1 Typical Forms of Security and Recourse

Security over an aircraft can take the form of a mortgage or a charge. A mortgage is the typical form of security over the aircraft. Mortgages can be legal or equitable. A charge is usually effected as a fixed charge.



### 3.2.2 Types of Security Not Available

Generally, there is no restriction on the type of security that can be taken over an aircraft or related collateral such as engines, warranties or insurances. However, care should be taken when property is located in jurisdictions outside of Hong Kong, as other laws may apply.

### 3.2.3 Trust/Trustee Concepts

The concept of a trust and the role of a security trustee is recognised in Hong Kong.

### 3.2.4 Assignment of Rights to an Aircraft by a Borrower to a Security Trustee

A borrower may, pursuant to a security assignment or a mortgage, assign to a security trustee its rights to the aircraft or under an aircraft lease (including in relation to insurances).

### 3.2.5 Assignment of Rights and Benefits without Attendant Obligations

Consistent with the position in other common-law jurisdictions, it is only possible to assign rights, not obligations. It is therefore common practice if rights and obligations are intended to be transferred (for example, to a new lessor), for transfers to be effected by way of novation (which legally gives rise to the termination of the existing contract and the creation of a new contract between the lessee and the incoming lessor).

### 3.2.6 Choice of Foreign Law

There is no requirement for security to be governed by domestic law, and it is common to have such documents governed by English law. However, documents which are governed by other laws are subject to proof of foreign law and, pursuant to conflict of law principles, Hong Kong law would determine the question of whether a security is effectively created in accordance with the law of the place where the property is located.

### 3.2.7 Formalities/Mandatory Terms to Create and Perfect Security Assignments

There are no requirements for the mortgage document to be in a specified form. There is also no requirement that the instrument be translated, certified, notarised or legalised.

### 3.2.8 Domestic Law Security Instruments

There is no strict requirement for security documents to be governed by Hong Kong law. However, care should be taken when property is located in jurisdictions outside of Hong Kong, as other laws may apply.

As the Cape Town Convention does not apply to Hong Kong, the question of whether domestic law instruments should be entered into for filing does not arise.

### 3.2.9 Domestic Registration of Security Assignments Governed by Foreign Laws

An English or New York law-governed security assignment or a domestic law security instrument can be registered domestically, to the extent that those documents create security of the kind that is registrable under Hong Kong law.

### 3.2.10 Transfer of Security Interests over Aircraft/Engines

The transfer of security interests over an aircraft and/or engines is recognised in Hong Kong.

### 3.2.11 Effect of Changes in the Identity of Secured Parties

The change of name of a company would not affect any rights or obligations of that company.

### 3.2.12 “Parallel Debt” Structures

This does not apply. Hong Kong is a common-law jurisdiction that recognises trust structures, so it is not strictly necessary to include parallel debt provisions.

### 3.2.13 Effect of Security Assignments on Residence of Secured Parties

See **2.4.2 Effects of Leasing on the Residence of a Foreign Lessor**.

### 3.2.14 Perfection of Domestic Law Mortgages

There is no specific registry for mortgage or charges on aircraft. However, it is customary to inform the Civil Aviation Department of a mortgage or charge.

If a mortgage or charge over an aircraft is granted by a company incorporated in Hong Kong or a registered non-Hong Kong company under Part 16 of the Companies Ordinance, the aircraft mortgage or charge must be registered with the Companies Registry within one month after the date of its creation.

If registration is not made within this time, the security interest created by the mortgage will be void against any other liquidators or creditors.

### 3.2.15 Differences between Security over Aircraft and Spare Engines

There is no difference between the form of security (or perfection) taken over an aircraft and that taken over spare engines.

### 3.2.16 Form and Perfection of Security over Bank Accounts

Usually, a fixed charge and floating charge would be created over a bank account. The charge has to be registered within one month of creation, as for other mortgages and charges. The floating charge would then be converted into a fixed charge or “crystallised” by events such as liquidation or events agreed by the parties.

## 3.3 Liens

### 3.3.1 Third-Party Liens

A third party could, in certain circumstances, have a lien over an aircraft or engine by opera-

tion of law. However, any lien which arises by operation of law is not registrable.

A repairer would have a lien only for the price of the repairs actually executed.

Consistent with the position in other common-law jurisdictions, the lien-holder has the right to detain the goods but there is no right to sell the detained goods unless agreed.

Hong Kong confers certain powers of detention of aircraft, which is similar to the concept of a fleet lien.

- The Hong Kong Airport Authority may detain any aircraft whose operator is in default for payment of landing charges. If the charges are not paid within 60 days, the authority may apply to a court for leave to sell the aircraft in order to satisfy those charges. However, the authority is required to take steps to notify interested persons and those persons may take part in any leave proceedings concerning the sale of the aircraft.
- The Hong Kong tax authorities may detain an aircraft owned by an operator for unpaid debts. It may also apply for an order to seize and sell the aircraft for unpaid taxes owed by the owner (lessor).

In December 2019, the Hong Kong Airport Authority purported to exercise powers of detention under the Airport Authority Ordinance (Cap 483), by impounding seven aircraft operated by Hong Kong Airlines.

### 3.3.2 Timeframe to Discharge a Lien or Mortgage

There is no specific timeframe in respect of liens, as liens are not required to be registered. The lienor would be required to relinquish possession of the asset in question upon payment of the amounts owing to the lienor.

In relation to mortgages, the mortgagee would be required to discharge the mortgage and any registrations made with the Companies Registry following the discharge of the obligations secured by the mortgage. Usually, the loan or mortgage documentation will include a requirement that the mortgagee must release the mortgaged property promptly or within a certain time period (in which case, the mortgagee would need to comply with that requirement).

The release would be effected by the execution of a release document and any registrations made with the Companies Registry would occur upon the filing of the requisite form with the Companies Registry. The deregistration filings would usually be reflected in the Companies Registry in a matter of days.

### 3.3.3 Register of Mortgages and Charges

See **3.2.14 Perfection of Domestic Law Mortgages**.

### 3.3.4 Statutory Rights of Detention or Non-consensual Preferential Liens

See **3.3.1 Third-Party Liens**.

### 3.3.5 Verification of an Aircraft's Freedom from Encumbrances

A potential purchaser could obtain mortgage or charge documents registered at the Hong Kong Companies Registry through a company search. However, there is no guarantee that the documents registered are complete.

## 3.4 Enforcement

### 3.4.1 Differences between Enforcing Security Assignments, Loans and Guarantees

A security assignment gives rise to a proprietary interest in the underlying rights or cash flow due to the assignor, and the assignee only has rights under the assigned contract to the extent the assignor had any such rights.

In addition, assignments by way of security give rise to an equity of redemption, such that the secured party is required to release and reassign the underlying collateral to the assignor (or pay excess proceeds back to the assignor) once the secured obligations are discharged.

### 3.4.2 Security Trustees' Enforcement of their Rights

The position is similar to that under English law, where an assignment will only take effect in equity until such time as the assignment is perfected by notice to the lessee. Until such time as notice is given, the lessee may give a good discharge of its obligations by paying or performing to the lessor (rather than the security trustee).

Under Hong Kong law, an acknowledgment is not, strictly speaking, necessary. However, it is common practice in leasing transactions for the notice to be acknowledged by the lessee for evidentiary purposes and to bind the lessee to comply with certain provisions (such as the bank account for the payment of money) of the notice.

### 3.4.3 Application of Foreign Laws

The agreement of the parties to use a foreign law to govern the documents or to submit to a foreign jurisdiction would be upheld by the courts as long as the agreement is made in good faith and is not against public policy.

### 3.4.4 Recognition and Enforcement of Foreign Judgments and Arbitral Awards

See **2.6.6 Domestic Courts' Recognition of Foreign Judgments/Awards**.

### 3.4.5 Secured Parties' Right to Take Possession of Aircraft

A secured party can take physical possession of the aircraft to enforce a security agreement or aircraft mortgage, provided the lessor had the right to do so under the lease. In circumstances where the lessee still has quiet enjoyment rights,

a mortgagee would only be able to deal with the aircraft and the lease to the extent it does not breach the quiet enjoyment rights of the lessee.

In relation to enforcement against the lessee, see **2.6.2 Lessor Taking Possession of the Aircraft**.

#### 3.4.6 Domestic Courts Competent to Decide on Enforcement Actions

The High Court of Hong Kong, which consists of the Court of Appeal and the Court of First Instance, is competent to decide enforcement action.

#### 3.4.7 Summary Judgments or Other Relief

See **2.6.4 Summary Judgment or Other Relief**.

#### 3.4.8 Judgments in Foreign Currencies

See **2.6.7 Judgments in Foreign Currencies**.

#### 3.4.9 Taxes/Fees Payable

If no court action is required, there will not be any substantial taxes or fees, other than any which arise as a consequence of its exercise of certain remedies (for example, landing charges, hangarage fees and insurance premiums may be payable in connection with repossession).

#### 3.4.10 Other Relevant Issues

Usually, in a security agreement or aircraft mortgage, there would be express provisions to allow taking possession of the aircraft and subsequently re-marketing the aircraft without the leave of the court, unless contested by the other party.

## 4. OTHER ISSUES OF NOTE

### 4.1 Issues Relevant to Domestic Purchase, Sale, Lease or Debt Finance of Aircraft

As previously noted, there have been no cases of lessors using the deregistration powers of attorney to deregister their aircraft in respect of Hong Kong commercial airline operators, and therefore the actual repossession and de-registration steps remain untested. As far as is known, recent repossession action was achieved without de-registration of the aircraft and presumably with co-operation from the airline.

The Hong Kong Autonomy Act (HKAA) came into force in the United States of America on 14 July 2020, imposing mandatory sanctions against certain individuals, entities and financial institutions which have ties to individuals in China and Hong Kong who could be viewed as making a “material contribution” to actions by the Chinese government which undermine Hong Kong’s autonomy. The HKAA also extends to financial institutions that knowingly conduct a “significant transaction” with such persons. Parties having an active business in Hong Kong should therefore be mindful of the associated risks and restrictions, and closely monitor the implementation of the HKAA by the US government.

### 4.2 Current Legislative Proposals

As mentioned in **2.9.1 Overview of Relevant Laws and Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations**, plans to introduce a Companies (Corporate Rescue) Bill have been announced by the Hong Kong government.

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PwC professionals in other disciplines to deliver integrated solutions to business needs, which cover legal, accounting, tax, risk management and financial considerations. The aviation finance team is fully integrated into PwC's aviation business services, to offer clients a one-stop, all-inclusive solution covering accounting consultation, taxation, legal and other aspects. The firm would like to thank Charissa Chu of Tiang & Partners, who also contributed to this article.

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## Trends and Developments

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*Tiang & Partners see p.26*

### The Future of Keepwell Structures

#### *Keepwell deeds, their origin and how they work*

In the past decade or so, keepwell deeds have been widely used in the bond and loan markets as a form of credit enhancement provided by PRC parent companies in support of their offshore subsidiaries' borrowings. While falling short of a formal guarantee to repay the offshore creditor in the event of a default by the subsidiary borrower, a keepwell deed serves as a quasi-security under which the PRC parent company typically promises to ensure the subsidiary borrower is able to meet its obligations. One objective of structuring the onshore credit comfort in this manner was rooted in the historical difficulties in obtaining approvals or meeting formality requirements which would otherwise apply to cross-border guarantees and securities granted by PRC companies, whilst providing some level of comfort to the offshore creditors.

Under PRC regulations, a cross-border guarantee granted by a PRC company in favour of an offshore guarantor for debts owed by its offshore subsidiary would be classified as a "Nei Bao Wai Dai" transaction and must be registered with the PRC State Administration of Foreign Exchange (SAFE) within 15 working days after the date of execution.

Although it is generally accepted that failure or delay in completing the SAFE registration is unlikely to render a guarantee invalid or unenforceable, the PRC company would not be able to perform its guarantee obligations upon enforcement and remit funds outside of the PRC. The new PRC Civil Code, which came into

force on 1 January 2021, also strengthens this position.

#### *Relevant laws*

Keepwell deeds are usually governed by offshore law (such as English or Hong Kong law) and subject to the exclusive jurisdiction of a foreign court. However, PRC law could also be relevant where the keepwell deed is enforced against the PRC keepwell provider, particularly where the keepwell provider is insolvent or undergoing a corporate restructuring procedure. For example, it is understood that there are circumstances where the PRC bankruptcy court would have exclusive jurisdiction to hear a dispute between a foreign creditor and a keepwell provider (or its bankruptcy administrator) after it has entered into corporate restructuring procedure or insolvency proceedings.

In contrast to a full guarantee, which allows for direct recourse to the guarantor, the creditor does not have a direct debt claim against the keepwell provider under English and Hong Kong law. Rather, the creditor will need to bring a claim under a breach of contract, which requires the claimant to establish breach of undertaking and resulting loss, and must also satisfy the relevant causation and remoteness requirements. In practice, commercial parties may also prefer to bring a liquidation claim outside of the PRC against the subsidiary and then commence action in its name (via the appointed liquidator) against the parent for the ultimate benefit of the keepwell-backed creditors.

#### *Keepwell deeds and aviation*

In the aviation financing and leasing world, although subject to their own conceptual chal-



lenges, it is not uncommon for keepwell arrangements to be used in conjunction with other credit protection measures such as buy-back agreements requiring the PRC parent to purchase the relevant asset at a pre-agreed price upon the occurrence of certain adverse events, or stand-by lease agreements requiring the PRC parent to step into the shoes of the lessee and continue to perform obligations under the lease.

## *Recent developments*

Although the keepwell structure is relatively well understood by the market and underpins a significant portion of outstanding offshore debt issuances from Chinese lessors and liquidity lines provided to them by international banks, the structure has been relatively untested by the PRC and Hong Kong courts.

As with the interpretation and enforcement of letters of comfort under Hong Kong law and English law, the legal effect is largely a matter of construction and would hugely depend on the factual matrix. However, given the limited judicial attention on this matter, it would be useful to consider the following two PRC cases in greater detail.

## *PUFG case*

### *The case*

In the high-profile Peking University Founder Group (PUFG) restructuring, the state-appointed restructuring administrator, in making its final decision on 23 August 2020, refused to recognise USD1.7 billion worth of claims backed by a keepwell deed and deed of equity interest purchase undertaking that was provided by PUFG as credit support for bonds issued by its offshore subsidiaries. PUFG undertook under an English law governed keepwell deed, amongst other things, that it would cause the subsidiary to have sufficient liquidity to ensure timely repayment of amounts due under the bonds.

As a result, the keepwell backed creditors were precluded from taking part in the debt restructuring process of the keepwell provider. In contrast, claims based on direct guarantees granted by PUFG had been accepted by the administrators early on in the restructuring.

Reportedly, the foundation of the administrator's decision was that, in the administrator's view, the keepwell provider had not agreed to directly assume the liability of the debtor.

## *The implications*

The administrator's decision, being the first time a PRC administrator has decided on this issue, has caused concern and anxiety in the foreign lender and investor community regarding the effectiveness of keepwell arrangements.

It should be noted that whilst creditors seeking to rely on a keepwell deed are entitled to file objections against the administrator's final decision to the PRC Court, such proceedings must be initiated within a short timeframe after the final decision is announced and may involve material court filing and other associated fees.

Some of the aggrieved creditors have initiated legal actions in other jurisdictions for a better chance of recovery, including proceedings in the Hong Kong courts against PUFG on the grounds of failure to make good on keepwell securities.

## *CEFC case*

### *The case*

In November 2020, the PRC court recognised, for the first time, a Hong Kong judgment relating to a keepwell deed in the ruling of the Shanghai Financial Court in the CEFC Shanghai International Group Limited (CEFC) case. CEFC (a PRC company) granted a keepwell deed to support the issuance of offshore bonds by its BVI subsidiary.

Under the keepwell deed, which provided for English law as the choice of law and an exclusive jurisdiction clause in favour of the Hong Kong courts, CEFC undertook to ensure that the subsidiary would maintain a consolidated network and sufficient liquidity to meet its payment obligations in order to protect the interests of the bondholder. CEFC stated in the keepwell deed that the undertaking was not a guarantee but it would assume the corresponding liabilities in the event that it failed to perform its obligations.

After the default of the bond issuer, the bondholder successfully obtained a default judgment against CEFC for breach of the keepwell deed. Subsequently, the bondholder applied to the Shanghai Financial Court for recognition and enforcement of the Hong Kong judgement against CEFC.

#### *The decision*

The PRC court gave effect to the Hong Kong judgment pursuant to the Arrangement on Reciprocal Recognition and Enforcement of Civil and Commercial Judgments between Hong Kong and the mainland PRC, and consistent with the Arrangement, limited the scope of its review to procedural matters.

In reaching its decision, the PRC court rejected CEFC's arguments that the keepwell deed was essentially a guarantee which should be regulated by the relevant PRC authorities and that the Hong Kong default judgment went against the "social and public interest". The PRC court held that the public interest exception to recognition and enforcement of Hong Kong judgment must be construed narrowly, and as the keepwell deed in question was not governed by PRC law and was subject to the Hong Kong court's exclusive jurisdiction, there was no public interest concerns preventing it from recognising the Hong Kong judgment, and that the validity of the keepwell deed (which is a question of the

substantive law) was outside of the scope of its review.

#### *The implications*

The CEFC case demonstrates that, at least in circumstances where the keepwell provider is not insolvent at the time of the Hong Kong court judgment, PRC courts would be willing to enforce a Hong Kong judgment that gives effect to a keepwell arrangement and keepwell deeds should be drafted accordingly.

Notably, the Hong Kong default judgment was obtained prior to the CEFC being placed into insolvent liquidation. As there is no formal precedent system under PRC law, there remains some uncertainty as to whether future PRC decisions will follow the reasoning of the CEFC decision.

As a side note, the wider CEFC restructuring also gave rise to a noteworthy decision of the Hong Kong courts (*Re CEFC Shanghai International Group Limited* (HCMP 2295/2019)) in which the courts, for the first time, recognised and granted assistance to PRC bankruptcy administrators. This decision was handed down even before the signature of the Record of Meeting on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between Courts of the Mainland and Hong Kong earlier this year.

The development of case law and regulations in this space will be closely monitored.

#### *Takeaways*

While the exclusive use of and reliance on keepwell structures have declined since the relaxation of SAFE regulations around the conversion of offshore debt into renminbi back in 2016, keepwell arrangements continue to play a prominent role in the PRC fund-raising landscape.

Accordingly, these recent cases serve as a timely reminder to commercial parties that care must

be taken when dealing with keepwell structures through-out the life cycle of the transaction from formulation to enforcement.

Financiers and investors may also wish to consider requesting other viable and robust credit protection measures while balancing the relevant regulatory, timing and cost considerations.

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