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LAW AND PRACTICE IN THE GREATER BAY AREA II

King & Wood Mallesons　KWM Institute

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KWM INTERNATIONAL CENTER

In response to the national Greater Bay Area (GBA) development strategy, KWM established the KWM International Center in the GBA on 28 April 2018 to better serve the clients and continuously promote its international development strategy. Backed by KWM Shenzhen, Guangzhou and Hong Kong offices, KWM International Center will closely follow the market demand in the GBA, connect and release the KWM global network resources and focus on the business areas with strong market demand including the "Belt and Road"/"Going Global", high-end financial services, private equity/venture capital, capital market, unicorn, intellectual property protection, and cross-border dispute resolution.

KWM Hong Kong office currently has nearly 240 lawyers and other legal professionals. Many partners and lawyers are licensed to practice law in multiple jurisdictions and well versed in cross-border transactions. In addition to provision of services under the laws of Hong Kong SAR, Australia, the UK, the US and other jurisdictions, KWM Hong Kong team deeply understands the needs of Chinese enterprises in respect of culture and operation/management and is able to leverage the extensive international experience to provide all-round services in all aspects of banking and financing, corporate, private equity, M&A and commercial affairs, competition, trade and regulation, international fund, securities and capital market, dispute resolution and litigation/arbitration, construction disputes, projects, energy and resources, real estate, etc.

KWM has two offices in South China – Shenzhen office and Guangzhou office. The Shenzhen office was established in 1998 and has over 200 lawyers and other legal professionals; the Guangzhou office was founded in 2002 and gathers more than 160 lawyers and other legal professionals. These two offices provide a full range of legal services covering foreign investment, overseas investment, M&A and restructuring, banking and project financing, listing, wealth management and trust, international and domestic dispute resolution, bankruptcy & liquidation, IP and regulatory compliance, etc., and have received recognition from the market and the industry for their high quality and professional legal services. KWM Shenzhen and Guangzhou offices have advised on numerous representative and high-profile projects and cases in the GBA area and across China, and are committed to providing one-stop and comprehensive legal services for clients during the implementation of the GBA Outline Plan.

As an international law firm with over 2,400 lawyers in 27 locations around the world, KWM is able to provide legal services covering laws in PRC, the UK, the US, Hong Kong SAR, Australia, Germany, Italy, etc. and our presence and resources in the world's most dynamic economies are profound. Leveraging exceptional legal expertise, KWM is ready to assist clients to unleash all their growth potentials in Asia and the world beyond by advising both Chinese and foreign clients on a full spectrum of domestic and cross-border transactions.

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A new blueprint for growth -- analysis of the *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area*

Wu Ye, Tan Lanwei

Wu Ye

Since the signing of the *Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Greater Bay Area* on 1 July 2017, the long-awaited *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* (the "Outline") was finally released on 18 February 2019. Issued by the Central Committee of the Communist Party of China (CPC) and the State Council, this significant Outline provides guidance for the current and future cooperation and development of the Guangdong-Hong Kong-Macao Greater Bay Area (the "GBA"). It has not only made clear the role and position of each city within the GBA, but also sets the objectives of the plan covering the period from now to 2022 in the immediate term, and extending to 2035 in the long term. Released in the context of emerging trade protectionism, intense trade frictions, and a potential slowdown in the development of the global economy, the Outline gives direction for the development of the GBA and, importantly, provides a new model for China's growth and economic development.

This article sets out a brief summary of the Outline and its vision for the core GBA cities.

I. Overview of the Outline

The GBA consists of the Hong Kong SAR, the Macao SAR, as well as the municipalities of Guangzhou, Shenzhen, Zhuhai, Foshan,

Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqing in the Guangdong Province, covering a total area of 56,000 square kilometres with a combined population of approximately 70 million at the end of 2017. As one of the most open and economically vibrant regions in China, the GBA plays a significant strategic role in the overall development of the country. It is foreseeable that a world-class cluster of cities will gradually take shape, matching or even surpassing the world's three major bay areas, namely New York, San Francisco and Tokyo.

The Outline was jointly prepared by the relevant departments of the central government together with the governments of the Guangdong Province, Hong Kong SAR and Macao SAR, and consists of 11 chapters and 41 sections. The Outline sets out the vision of developing an international innovation and technology hub, expediting infrastructural connectivity, building a globally competitive modern industrial system, promoting ecological conservation, developing a quality living area for work and travel, strengthening cooperation and jointly participating in the Belt and Road Initiative, and jointly developing Guangdong-Hong Kong-Macao cooperation platforms. The Outline sets forth an overall plan for the strategic positioning, basic principles, development objectives and spatial layout, marking the new phase of GBA construction and development. Going forward, it is anticipated that Guangdong, Hong Kong SAR and Macao SAR will continue to develop and release supporting policy documents.

II. Highlights of the Outline

1. Positioning and key areas of core cities

Core City	Positioning	Area	Major Supporting Measures
Hong Kong SAR	International financial centre, shipping and trade centre, as well as an international aviation hub A global offshore RMB business hub An international asset management centre and a risk management centre An international legal and dispute resolution hub in the Asia-Pacific region	Finance	1. offshore RMB business; 2. international asset management and risk management businesses; 3. support the engagement of Hong Kong's private equity funds in the financing of innovation and technology enterprises in the GBA; 4. allow eligible innovation and technology enterprises to secure listing in Hong Kong SAR for capital financing; 5. support Hong Kong's institutional investors in raising RMB funds in accordance with the relevant regulations in the GBA for investment in the capital markets of Hong Kong SAR; 6. support Hong Kong's institutional investors in participating in the investment of domestic private equity funds and venture capital funds; 7. support Mainland and Hong Kong insurance institutions in developing cross-border RMB reinsurance business; 8. support Hong Kong SAR to set up an internationally recognised green bond certification institution.
		Trade, commercial	1. support Dongguan's cooperating with Hong Kong SAR in the development of the Dongguan Binhaiwan New District; 2. support Hong Kong SAR and Foshan in offshore trade cooperation.
		Shipping and logistics	1. support Hong Kong's development of high-end shipping services such as ship management and leasing, ship finance, marine insurance as well as maritime law and dispute resolution services; 2. support Hong Kong's development of high value-added freight, aircraft leasing and aviation financing services, etc.
		Professional service	1. leverage Hong Kong's status as an international financial centre, and provide financing and advisory services for Mainland enterprises "going global"; 2. support Mainland enterprises in establishing capital operation and corporate treasury centres in Hong Kong SAR for carrying out business operations such as financing and financial management, as well as enhancing risk management.
		Innovation and technology	1. promote the integration of Hong Kong SAR into the national innovation system and pursue the development of the "Guangzhou-Shenzhen-Hong Kong-Macao" innovation and technology corridor; 2. support the development of major carriers for innovation such as science and technology industrial parks; take forward the development of Partner State Key Laboratories in Hong Kong SAR; 3. support the development of the five Hong Kong R&D Centres for integrated technology and the application in logistics and supply chain management, textiles and apparel, information and communications technology, automotive parts, nano technology and advanced materials, along with the development of the Hong Kong Science Park and the Hong Kong Cyberport.

Core City	Positioning	Area	Major Growth Points
Guangzhou	National core city and an integrated gateway city International commerce and industry centre Integrated transport hub Technological, educational and cultural centres	International commerce and industry centre	1. support Guangzhou to develop a regional private equity trading market and establish a regional centre for equity and commodity trading; 2. support Guangzhou to research and establish an innovative futures exchange that takes carbon emission as its first trading commodity.
		Integrated transport hub	1. carry out reconstruction and expansion work at the airports in Guangzhou; conduct preliminary research for the construction of a new airport in Guangzhou; and research and develop a batch of regional airports and general airports; 2. speed up the development of an integrated Guangzhou-Shenzhen international transportation hub.
		Technological, educational and cultural centres	proactively plan and carry out next generation information technology, artificial intelligence, healthcare, marine technology and new materials; nurture and develop new operational models and platforms for sharing economy and experience economy.

Core City	Positioning	Area	Major Growth Points
Shenzhen	A special economic zone, a national core economic city and a national innovation hub To expedite its transformation into a modern and international city A city of innovation and creativity with global influence	Finance	1. support Shenzhen in developing its capital markets with the Shenzhen Stock Exchange as its core in accordance with relevant regulations; and expedite the process of financial liberalisation and innovation; 2. support Shenzhen in developing a pilot zone for development in insurance innovation; further enhance the connectivity between Hong Kong SAR and Shenzhen markets and promote cooperation between Macao SAR and Shenzhen with respect to special financial products; and launch TechFin pilot projects.
		Innovation, creativity and living	1. support Shenzhen in bringing in international high-end creative and design resources; and vigorously developing its modern cultural industries; 2. develop an international cultural and creative base, and explore a new mode of cooperation in cultural and creative industries between Hong Kong SAR and Shenzhen; 3. support the introduction of domestic and international high-end education and medical resources.
		Technology	1. support the establishment of the Belt and Road Life Science and Technology Advancement Alliance by relying on the China National GeneBank in Shenzhen; 2. support the development of a globally influential and competitive cluster of world-class high-end digital-focused manufacturing industries on the east bank of the Pearl River with Shenzhen and Dongguan.

2. Key areas for three free trade zones

Free Trade Zones	Positioning	Key Areas
Qianhai of Shenzhen	Strengthen the role of Qianhai as an engine of cooperation and development	1. expand the functions of offshore accounts (OSA); 2. support international financial institutions to set up branches in Qianhai of Shenzhen; 3. support the Qianhai Mercantile Exchange of the Hong Kong Exchanges and Clearing Limited in establishing a spot commodities trading platform for serving domestic and foreign clients; 4. develop a new type of international trade centre, develop offshore trading, and create a settlement platform for trade in goods; 5. build a platform for offshore innovation and entrepreneurship, and allow technology enterprises that register in the zone to operate worldwide; 6. support the commencement of R&D businesses in suitable bonded Special Customs Supervision Areas; 7. collaborate with Hong Kong SAR to develop an international legal services centre and an international commercial dispute resolution centre.
Nansha of Guangzhou	Collaborate with Hong Kong SAR and Macao SAR to develop a high-standard gateway for opening up	1. devote efforts in developing niche financial services such as shipping finance, fintech, as well as aircraft and ship leasing; 2. develop offshore financial business, and explore the development of a trading platform for innovative insurance elements such as international shipping insurance; 3. explore the establishment of a GBA international commercial bank in the China (Guangdong) Pilot Free Trade Zone; 4. support the establishment of a global quality and traceability centre for import and export commodities in Nansha of Guangzhou; 5. plan and develop an industry cooperation zone for in-depth collaboration between Hong Kong SAR and Guangdong in Nansha of Guangzhou.
Hengqin of Zhuhai	Develop a demonstration zone for in-depth cooperation among Guangdong, Hong Kong SAR and Macao SAR	1. support the coordinated development of Hengqin, Zhuhai Free Trade Zone and Hongwan area, and develop a Guangdong-Hong Kong-Macao logistics park; 2. expedite the development of major cooperation projects including the Macao-Hengqin Youth Entrepreneurship Valley (Inno Valley Hengqin) and the Guangdong-Macao Cooperation Industrial Park, and study the development of a Guangdong-Macao information hub; 3. support the development of the Traditional Chinese Medicine Science and Technology Industrial Park of Cooperation between Guangdong and Macao SAR; 4. explore allowing eligible Hong Kong SAR, Macao SAR and foreign medical personnel to practice directly in Hengqin; 5. study delegating authority to Hengqin for issuing residence permits to foreigners; 6. jointly develop an integrative livelihood project covering elderly care, living, education and healthcare; 7. research the possibility of establishing a healthcare fund to offer healthcare protection for Macao residents receiving medical treatment in Hengqin; 8. consider the possibility of establishing schools in Hengqin for children from Macao SAR.

In addition to the above policies that are applicable to each of the Free Trade Zones, the Outline also supports eligible banks and insurance institutions from Hong Kong SAR and Macao SAR to establish physical presence in the Free Trade Zones to facilitate the establishment of a Hong Kong-Macao entrepreneurship and employment pilot zone.

3. Key takeaways for intra-zone cooperation

The Outline defines the positioning and functionality of each core city and Free Trade Zone, setting out a solid foundation for effective coordination of the overall development of the GBA. With respect to intra-zone cooperation, the Outline further specifies the following key cooperation projects and areas:

Major Cooperation Areas	Key Cooperation Projects or Areas
Technology and Innovation	1. pursue the development of the "Guangzhou-Shenzhen-Hong Kong-Macao" innovation and technology corridor; 2. support the development of major carriers for innovation such as the Hong Kong-Shenzhen Innovation and Technology Park; 3. support the development of Hong Kong SAR as a regional intellectual property (IP) trading centre; 4. launch an IP securitisation pilot.
Infrastructure	1. devise a development plan for inter-city railway in the GBA, and improve the railway networks of the GBA; 2. focus on connecting the Mainland China with Hong Kong SAR and Macao SAR, as well as connecting the east and west coasts of the Pearl River Estuary, and build a rapid inter-city transport network mainly focused on high-speed rails, inter-city railway and highways; 3. pursue the operations of public inter-city passenger transport service in the GBA, and promote the use of a "single ticket" for all connecting trips and a "single card" for all modes of transport.
Quality of Life	1. explore opening up a Hong Kong-Shenzhen-Huizhou-Shanwei sea travel route; 2. support Hong Kong and Macao investors in setting up pension and other social services facilities through sole proprietorship, joint-venture, cooperation, etc. in the nine Pearl River Delta (PRD) municipalities in accordance with regulations.
Major Cooperation Platforms	1. support the development of the Hong Kong-Shenzhen Innovation and Technology Park in the Lok Ma Chau Loop and the adjacent Shenzhen Innovation and Technology Zone, to develop an innovation and technology cooperation zone; 2. take forward with the development of youth entrepreneurship and employment bases for Hong Kong SAR and Macao SAR, such as the Shenzhen-Hong Kong Youth Innovation Entrepreneurship Base, and the Qianhai Shenzhen-Hong Kong Youth Innovation and Entrepreneur Hub.

III. KWM in GBA

The sheer scale and ambition of the GBA as set out in the Outline will bring boundless opportunities to local and international business. However, combining two social systems, three customs territories, and three legal systems in one bay area, the GBA will also bring a unique set of challenges. Having been in the bay area for over a decade, we are well-placed to help our clients navigate the intricacies and complexities of the area, while helping them realise their objectives.

In April 2018, King & Wood Mallesons announced the creation of the KWM International Centre in the GBA to combine the expertise of our Shenzhen, Guangzhou, Hong Kong and Sanya offices, as well as the resources of our global network.These four offices and the KWM International Centre boast over 450 legal professionals, who are well-positioned to provide one-stop comprehensive legal services for our clients in China and abroad.

Science and technology innovation enterprises in the Greater Bay Area: a bright future built on the capital

Zhou Rui

Zhou Rui

Introduction

On 18 February 2019, the Central Committee of the Communist Party of China (CPC) and the State Council promulgated the *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* (the "Plan"). Since its promulgation, the Plan has garnered extensive attention and has been widely perused by people from all walks of life. Particularly, we note that the Plan states: "*[t]o make great efforts in broadening channels of direct financing, rely on the regional equity trading market, and develop a supporting platform for technology, innovation and financial services. To support the engagement of Hong Kong's private equity funds in the financing of innovation and technology enterprises in the Greater Bay Area, allow eligible innovation and technology enterprises to secure listing in Hong Kong for capital financing, and develop Hong Kong into a financing centre for high-tech industries in the Greater Bay Area.*" From what stated in the Plan, we can reasonably expect that sci-tech innovation enterprises in the Greater Bay Area (the "GBA") will have more choices in their future capital operation,

especially in the private equity financing, and domestic and overseas listings where we've already seen new opportunities.

As a giant regional economy, the GBA has seen rapid development of science and technology, highly open economy and full-fledged industrial system since the reform and opening-up and has been playing a leading role in a new era marked by the ongoing reform of the national economic system. According to the *White Paper on Unicorns in the Guangdong-Hong Kong-Macao Greater Bay Area (2018)*, the 35 unicorn enterprises (including super unicorns and unicorns) in the GBA are valued at approximately US$106.3 billion in total. If scientific and technological progress is the driving force behind the rapid development of the GBA in recent years, then sci-tech innovation enterprises will serve as the core driving force for the development of the GBA. As the most comprehensive and detailed planning document for the GBA from the central government, the Plan proposes the overall planning and policy support for the development of sci-tech innovation enterprises in the GBA, especially in the field of capital market. In the meantime, domestic and overseas stock exchanges have also issued relevant policies to attract and encourage the sci-tech innovation enterprises to go public. Thus, the GBA plays a crucial role in promoting the further development of science, technology and innovation in China.

I. Bringing in: equity investment benefits from the win-win scenario

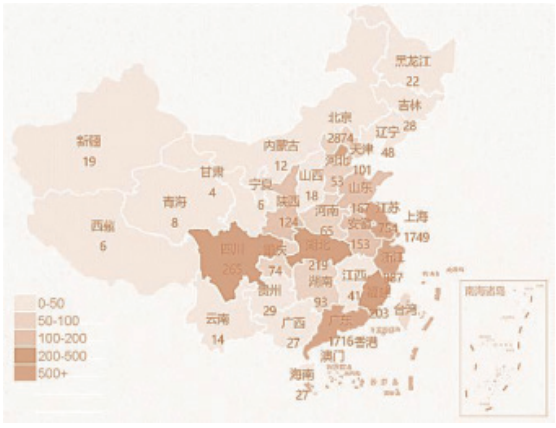
The GBA, as a pioneer engaging in venture capital investment and other investment in China, has a relatively active venture capital market and is in a leading position in the number of institutions and management capabilities. In addition to the Introduction, the Plan also explicitly proposes to support Hong Kong's institutional investors in raising RMB funds in accordance with the relevant regulations in the Greater Bay Area for investment in the capital markets of Hong Kong SAR, and in participating in the investment of domestic private equity funds and venture capital funds.

1. Hong Kong private equity funds eye on sci-tech innovation enterprises

According to a media report, Hong Kong Financial Secretary Chan Mo-po indicated at the 2019 Asian Private Equity BBS that, Hong Kong SAR has become the second largest private equity market in Asia. According to the report released by the Hong Kong Venture Capital and Private Equity Association, the private equity investment in Hong Kong SAR stands at approximately US$3.678 billion, involving about 17 transactions in 2018, compared with that of US$13.877 billion, involving 19 transactions in 2017.

In 2018, Guangdong Province topped the list in the number and amount of equity investment projects conducted nationwide (see the data below). Under the guidance of the Plan, we believe that Hong Kong investment institutions will bring more possibilities and choices for the financing of sci-tech innovation enterprises in the GBA, and may trigger the "aggregation effect" to spur private equity institutions to invest in the sci-tech innovation enterprises.

Guangdong Province topped the list in the number of equity investment projects conducted nationwide in 2018



Data source: ZERO2IPO Research, Research Institute of Pingan Securities

Guangdong Province topped the list in the amount of equity investment made nationwide in 2018

Data source: ZERO2IPO Research, Research Institute of Pingan Securities

According to prevailing laws and regulations and our past experience, Hong Kong investors can make equity investment in Mainland China through foreign direct investment and establishment of investment platforms in Mainland China (such as foreign-invested enterprises, foreign-invested equity investment pilot enterprises (i.e. QFLP Fund) etc.) for reinvestment.

On 22 September 2017, Shenzhen Municipal Financial Service Office, Shenzhen Economic and Trade Information Commission, Shenzhen Market and Quality Supervision Commission and the Qianhai Administration Bureau jointly issued the *Measures for the Pilot Program of Foreign-invested Equity Investment Enterprises* (Shen Jin Gui [2017] No.1, the "Measures"). The Measures, on the basis of the previous model of "foreign-invested equity investment management company managing foreign-invested fund" (that is, the "foreign-invested equity investment management company" manages the "foreign-invested equity investment fund"), unveiled the new QFLP model which allows "foreign-invested fund management company managing domestic fund" and "domestic fund management company managing foreign-invested fund." This new model has once brought the Shenzhen QFLP system into the spotlight.

In addition, the pilot program of RMB Qualified Foreign Limited Partner ("R-QFLP") based on the QFLP pilot program is also a means for foreign investors to set up domestic funds. Up to now, some enterprises have obtained the qualifications to launch R-QFLP pilot program in cities, including Shenzhen, Shanghai, Chongqing and Qingdao.

In addition, we also see that the QFLP Pilot program has eased the restrictions on QFLP managers and investors for access to Chinese market. Against the backdrop of the integration of the GBA supported by relevant policies, this will attract more overseas capital management institutions and investors to the GBA and their overseas funds will play an indispensable role in promoting the development and construction of sci-tech innovation enterprises in the GBA.

2. Regional equity transactions may highlight the incubation role

On 5 December 2018, Premier Li Keqiang presided over the executive meeting of the State Council, at which a number of reform initiatives were proposed to promote innovation and stimulate creativity, including the establishment of a special sci-tech innovation board in the regional stock market.

Following the promulgation of the Plan, the General Office of the State Council released the *Circular to Roll Out Nationwide the Second Group of Innovative Government*

Measures (Guo Ban Fa [2018] No. 126, the "Circular") on 8 January 2019, aiming to promote 23 reform measures in five areas nationwide, including the area of innovations in scientific and technological finance. The Circular laid out five measures about innovations in scientific and technological finance, including that regional stock markets are allowed to set up a sci-tech innovation board, which will be administered by China Securities Regulatory Commission (CSRC). The Circular mainly focuses on *launching "sci-tech innovation board" in the regional stock market, providing services such as publicity upon listing, custody transactions, investment and financing services, and training and counseling, exploring financing channels and alleviating the financing challenges facing small- and medium-sized sci-tech enterprises according to the realities of small- and medium-sized sci-tech enterprises*. In addition, the establishment of the special sci-tech innovation board is limited to 8 reform pilot areas including Beijing-Tianjin-Hebei Region, Shanghai, Guangdong (the Pearl River Delta), Anhui, Sichuan, Wuhan, Xi'an and Shenyang.

Meanwhile, the Shenzhen Municipal People's Government issued the *Notice on Circulating Certain Measures for Promoting the Development of the Venture Capital Industry* to (i) support the regional equity trading centers, financial

institutions and venture capital institutions in building platforms for the transfer of venture capital transactions in accordance with laws and regulations, (ii) support Shenzhen Qianhai Equity Exchange Center in setting up a sci-tech innovation board, encourage enterprises to be listed on the board and accept incubation services in the capital market such as training and consulting, custody registration, bond financing and off-market investment banking, and (iii) grant a subsidy of RMB 100,000 to enterprises that meet the relevant requirements of the *Implementation Rules of Special Subsidy Plan for Encouraging Small- and Medium-Sized Enterprises to List in the Regional Equity Trading Market (Trial)*.

From above, we can see that the GBA will gradually introduce and implement relevant policies and rules to support the establishment of a financial support platform for sci-tech innovation in the regional equity trading market, and the sci-tech innovation enterprises to be listed on the regional stock market will enjoy a clear landscape for their future development.

II. Looking back: reform in the A-share market accelerates

1. The debut and future development of SSE STAR Market

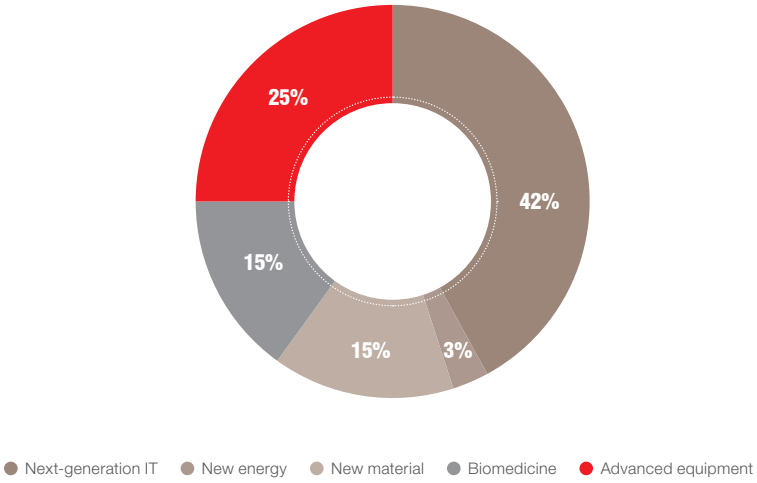
On 30 January 2019, China Securities Regulatory Commission issued the *Implementation Opinions on Setting up the Science and Technology Innovation Board and Launching the Pilot Program of the Registration System on the Shanghai Stock Exchange* at its official website, proposing to establish the sci-tech innovation board ("STAR Market") and pilot a registration-based IPO system on the Shanghai Stock Exchange ("SSE"). The release of the Implementation Opinions has sparked widespread concern and in-depth discussion in the capital market. Afterwards, the Shanghai Stock Exchange has successively unveiled supporting regimes and guidelines to improve the system of the STAR Market. Financial experts hold that the debut of the STAR Market and the pilot registration-based system is the country's much-anticipated capital market reform.

As a newly established independent section of the Shanghai Stock Exchange, the STAR Market has several breakthroughs compared with the current A-share market: first, it allows unprofitable enterprises to go public; second, it allows enterprises with different structure of voting rights to go public; third, it allows red chip and VIE structured enterprises to go public. In particular, the STAR Market has a higher degree of tolerance for sci-tech innovation enterprises, and will give priority to supporting enterprises that are in line with national strategies and have key technologies, outstanding technological innovation capabilities and a great space for development.

As of 6 May 2019, the Shanghai Stock Exchange has handled applications for IPOs on the STAR Market from 100 enterprises, of which 79 have entered the stage of inquiry. After examining the industry distribution of these enterprises, we found that they are mainly from emerging industries, including next-generation IT, advanced equipment, biomedicine and new materials.

Industry distribution of enterprises applying for IPOs on the STAR Market

Data source: the website of Shanghai Stock Exchange, China Securities Cooperation



We believe that the STAR Market not only opens a new chapter for China's capital market, but also brings new opportunities for sci-tech innovation enterprises in their fundraising. In addition, it is expected to promote the in-depth integration of capital market and sci-tech innovation, and drive the rapid development of sci-tech innovation enterprises.

2. Highly anticipated reform for the ChiNext Market

Following the launch of the STAR Market, the Guangdong Provincial Local Financial Supervision Bureau said in a response to the questions from netizens on 27 February 2019 that Guangdong Province will actively promote the reform and development of the ChiNext Market of Shenzhen Stock Exchange, coordinate with the CSRC to facilitate the reform of the ChiNext Market and develop a pilot registration-based system, as well as relax the thresholds for listing in order to ensure that the ChiNext Market and STAR Market will have consistent basic regimes for listing.

On 28 February 2019, the State Council Information Office of the People's Republic of China held a press conference on the Plan. Lin Shaochun, Executive Vice Governor of Guangdong Province, said at the conference that Guangdong is currently creating favorable conditions for the reform of the ChiNext Market and the rollout of the pilot registration-based system in accordance with the requirements of the State.

On 2 March 2019, Wang Jianjun, a NPC member and the general manager of Shenzhen Stock Exchange said in an interview with *Securities Times* at a NPC deputy-based location that, this year is a year marked by the significant reform of China's capital market, and the launch of the STAR Market and registration-based system is a reconstruction of the capital market systems. It will take time to promote the brand new board and registration-based system from Shanghai to other cities. The ChiNext has fully prepared for reform, and the reform is approaching.

Therefore, we can expect that a full-fledged STAR Market will trigger the "radiation effect" to cause the ChiNext Market and the SME Board to seek timely reform, which is also in line with the vision as set out in the Plan: "*to support Shenzhen in developing a capital market with the Shenzhen Stock Exchange as its core in accordance with relevant regulations, and expedite the process of financial liberalisation and innovation*."

III. Going out: overseas markets release multiple favorable messages

1. Hong Kong Stock Exchange -- China anchored and technology empowered strategic vision

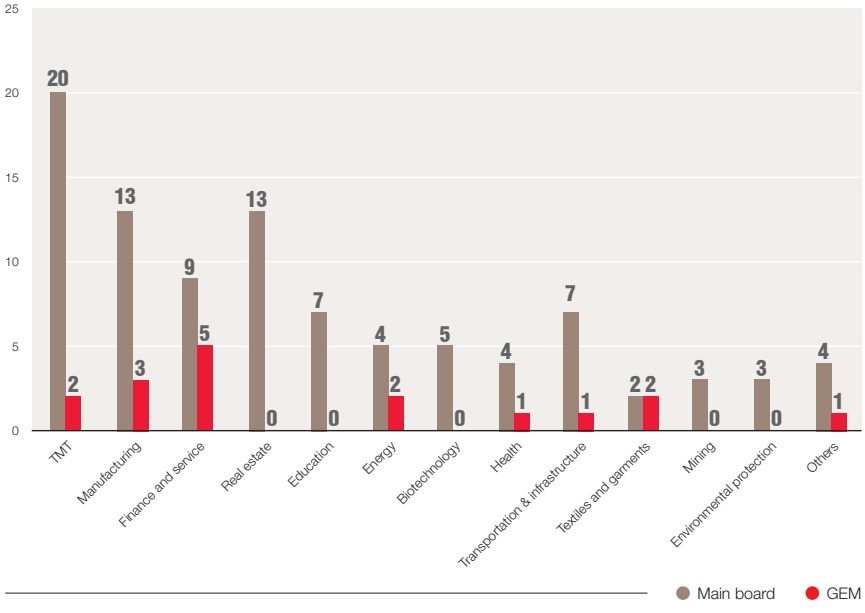
Looking back, only 31 enterprises were listed in Hong Kong SAR in 2008, which is quite different from where we are now. To attract new economy issuers, further promote the development of the real economy, and improve the international competitiveness, Hong Kong Stock Exchange ("HKSE") undertook the most significant reforms to its listing regime in the past 25 years in April 2018. The reform to the listing regime regarding the "emerging and innovative industry companies" was launched to allow companies with weighted voting rights (WVR) structures to be listed in Hong Kong SAR.

The year of 2018 is doomed to be a significant year for the HKSE. As of December 2018, the Hong Kong Stock Exchange has seen 218 newly listed enterprises, ranking first in the number of IPOs in the world. The specific data are as follows:

The number of enterprises listed in Hong Kong SAR	Mainland enterprises	All listed enterprises	Mainland enterprises
	in 2018	in 2018	proportion
Main board	94	143	65.73%
Growth enterprise market	17	75	22.67%
Sum	111	218	50.92%

Amount raised in HKSE	Mainland enterprises	All listed enterprises	Mainland enterprises
	in 2018 (100 million)	in 2018 (100 million)	proportion
Main board	2,726.11	2,814.36	96.9%
Growth enterprise market	11.53	50.61	22.8%
Sum	2,737.63	2,864.97	95.6%

Statistics on the industry distribution of Chinese Mainland enterprises listed in Hong Kong SAR in 2018



It can be seen that a large number of enterprises listed in Hong Kong SAR are from industries dominated by science and technology, such as TMT, manufacturing, finance and service. That said, Hong Kong SAR is expected to double its efforts to promote the development of sci-tech innovation enterprises by unveiling more favorable policies and increasing relevant investments.

On 28 February 2019, the Hong Kong Stock Exchange released the *Strategic Plan 2019-2021*, setting out three strategic visions: "China anchored, technology empowered and globally connected". In addition, the Plan explicitly proposes to develop Hong Kong SAR into the high-tech industry financing center of the GBA. Therefore, we expect that, under the context of the Plan, HKSE will give full play to its advantages to provide more policy support for the development of the GBA, and thus sci-tech innovation enterprises will be able to share the new opportunities brought by the rapid development of the GBA through listing in Hong Kong SAR.

2. The Singapore Exchange attracts high-tech enterprises by providing allowance

To address the capital crisis in 2018, many overseas governments and stock exchanges had made great efforts. For example, the Singapore government amended relevant laws in 2018 to promote financial development. In 2019, the Singapore government provided financial supports to enterprises and allowed the listing of companies with WVR structures in a bid to attract sci-tech innovation enterprises to be listed in Singapore and promote the recovery of capital market in Singapore.

On 14 January 2019, the Monetary Authority of Singapore announced that it would launch a new three-year plan in February 2019, providing an allowance of SG$75 million to enterprises entering the Singapore capital market. Both local and foreign enterprises are eligible for the allowance, among which enterprises with a market value of at least SG$300 million from the emerging technology industry (including emerging financial technology, consumer digital technology, services on demand and game service companies etc.) are entitled to 70% of the listing fee subsidy in their proposed listing on the Singapore Stock Exchange, with the maximum limit of SG$1 million. This is undoubtedly a great news for sci-tech innovation enterprises.

In summary, the more convenient investment and financing environment and the more inclusive domestic and overseas IPO market in the future are expected to benefit more sci-tech innovation enterprises in the GBA. Therefore, we believe that the sci-tech innovation enterprises in the GBA will be well-positioned to use capital to accelerate their future growth. Meanwhile, driven by both the technology and the capital, the GBA will soon embark on a path towards integration and strong growth.

Opportunities and challenges facing domestic real estate companies in overseas bond offerings

Wang Lixin, Sun Haotian, Chen Qiansi, Chen Shaozhu

Wang Lixin

Sun Haotian

Preface: Financing of domestic real estate enterprises -- the trend of overseas offering of bonds

Real estate, as a capital-intensive industry, has a huge demand for capital. Along with the implementation of the macro-control policies of real estate industry, domestic financing has been and will continue to be tightened for real estate market players in a long run, and thus, overseas bond offering has become an important supplementary source of financing for real estate enterprises. According to statistics, in the first quarter of this year, the total value of overseas bond offerings by domestic real estate enterprises increased by 40%, much higher than the data in the same period of last year[1]. On the basis of overseas bond offerings by domestic real estate enterprises in recent years, this article will analyze in detail relevant regulatory requirements, the structure of overseas bond offering and typical legal issues, to allow domestic real estate enterprises to have a full understanding of the issues related to overseas bond offering and also get prepared to accurately grasp opportunities as regional policy of the "Guangdong-Hong Kong-Macao Greater Bay Area" (the "GBA") brings about dividends.

I. An overview of overseas bond offerings by domestic real estate enterprises

In recent years, the number and size of overseas bond offerings by domestic real estate enterprises has been on the rise. In 2017, the market of USD-denominated bonds issued by domestic real estate enterprises was brisk, with a total size of US$50.728 billion over the year, marking a record high of the market. This climax of bond offerings emerged against the backdrop of rigorous implementation of domestic financial deleveraging that year and the intensive release of real estate regulatory policies. Bond offerings at a total value of US$49.770 billion were completed in 2018, representing a slight decrease, compared to that in 2017[2]. This was the first time since 2015 that the market saw decline of USD-denominated bond offerings by domestic real estate enterprises, which is closely related to China's regulatory environment of cross-border bond offerings in 2018 dominated by the central government's caution in terms of macro-economic policy. In the first quarter of 2019, the size of offshore debt offerings by domestic real estate issuers has reached US$23.840 billion, representing an increase by 22% compared to the previous quarter and by 30% on year-on-year basis[3].

[1]Data sources: http://finance.sina.com.cn/roll/2019-03-12/doc-ihsxncvh2012509.shtml

[2]Data sources of issuance scale in 2017 and 2018: https://new.qq.com/omn/20190218/20190218A0ZGWL.html?pgv_ref=aio2015&ptlang=2052; Data sources of issuance scale in 2019: http://finance.sina.com.cn/roll/2019-03-12/doc-ihsxncvh2012509.shtml

[3]Data sources: China Lianhe Credit Rating Co., Ltd. *Research Report on Chinese USD-denominated Bonds in the First Quarter of 2019*.

According to the WIND's data, since 2017, the overseas debt offerings by domestic real estate enterprises are characterized as follows: (1) the top 10 of the total 64 domestic real estate enterprises as bond issuers in the overseas market, in terms of the size of offering, have issued debts of US$53.294 billion in total, representing 49.37% of the total value of overseas bond offerings by all real estate enterprises in China; (2) in terms of place of offering, the size of bond offerings on the Singapore Stock Exchange is larger than those on the Hong Kong Stock Exchange; (3) in terms of the currency of bonds, USD-denominated bonds are more popular than HKD-denominated bonds, RMB-denominated bonds and SGD-denominated bonds; (4) in terms of bond maturity, medium- and long-term bonds represent the majority, while short-term and long-term bonds account for a small proportion; (5) in terms of the interest rate, the interest rate may vary significantly in its range, mainly depending on the rating of the issuer, market recognition and market environment.

II. Regulatory requirements for overseas bond offerings by domestic real estate enterprises

1. Classification into direct overseas offering, indirect overseas offering and red chip structured offering

Overseas bond offerings can be classified by offering mode into direct overseas offering, indirect overseas offering and red chip structured offering. To be specific: (1) direct overseas offering means an overseas offering by a domestic enterprise, directly, as an issuer; (2) indirect offering by a domestic enterprise means an overseas offering by a domestic enterprise's wholly-owned or controlled offshore subsidiary (typically a Hong Kong, BVI or Cayman vehicle), as an issuer; (3) red-chip structured overseas offering means an overseas offering by a company registered overseas and controlled by a domestic individual or legal person, as an issuer.

These three types of offering structure differ in terms of the subject's legal status, credit enhancement and tax implication. To be specific: (1) in the case of direct overseas offering, generally, no credit enhancement or overseas platform is required, and the offering structure is relatively simple. However, this approach is highly demanding for the issuer. Because the issuer is a domestic resident enterprise, the domestic issuer should withhold and pay 10% withholding tax when he pays interest on a bond to an overseas bondholder as it is the income obtained from China. This will increase the considerable cost of the issuer. (2) in the case of indirect overseas offering, whether an overseas issuer needs to withhold and pay 10% withholding tax for the payment of interest depends on whether the overseas issuer is recognized as a Chinese resident enterprise by Chinese tax authorities. If it is not recognized as a Chinese resident enterprise, it will not be required to pay the above-mentioned withholding tax. In addition, in an indirect overseas offering, a domestic enterprise will provide guarantee, keep-well arrangement or other credit enhancement. (3) in the case of the red chip structured offering, in addition to the withholding tax considerations like an indirect overseas offering, keep-well arrangement or other credit enhancement is typically required from its domestic subsidiaries, as the assets of issuer are substantially onshore.

In the case of a direct overseas offering, the domestic issuer shall, within 15 working days of the signing of the debenture, register or file with the local foreign exchange bureau such information as the signing, withdrawal and repayment of foreign debt and the settlement and sale of foreign currency, and go through the foreign debt signing registration procedure. However, in terms of a real estate enterprise, for the purpose of registration of foreign debt with the State Administration of Foreign Exchange (SAFE), only foreign invested real estate enterprises established prior to 1 June 2007 may incur foreign debt to the extent of the difference between its invested capital and registered capital for now. Such quota of foreign debt, if any, is extremely rare and precious for such real estate enterprises. Direct overseas offering may take away the amount of debt from such quota directly. Therefore, in the entire market, real estate enterprises usually adopt indirect offering or red chip structure in their overseas debt offerings.

2. Regulatory requirements for direct overseas offering, indirect overseas offering and red chip structured offering

In general, either direct offering, indirect offering or red chip structured offering, involves domestic regulators consisting of National Development and Reform Commission (NDRC) and SAFE. The details are as follows:

(1) File before offering and report after issuance with NDRC

According to the *Notice of the National Development and Reform Commission on Promoting the Administrative Reform of the Recordation and Registration System for Enterprises' Offering of*

Foreign Debts (Fa Gai Wai Zi [2015] No. 2044) ("Notice No. 2044") issued by the NDRC in September 2015[4], a domestic issuer of foreign debt, whether adopting direct overseas offering or indirect overseas offering, shall apply to the NDRC for filing and registration prior to the offering as long as it issues debt instruments denominated in either RMB or any foreign currency with a maturity of one year or more. It shall also file the offering information with the NDRC within 10 working days of each tranche of offering. In addition to the above pre-filing and post-offering reporting requirements as specified in Notice No. 2044, we further discuss whether pre-filing and post-offering reporting are required for typical practice in a number of ways that we've seen, although there are no explicit provisions of laws, administrative rules or regulations and normative documents governing the same.

a. Are "small red chip" bonds subject to filing requirements?

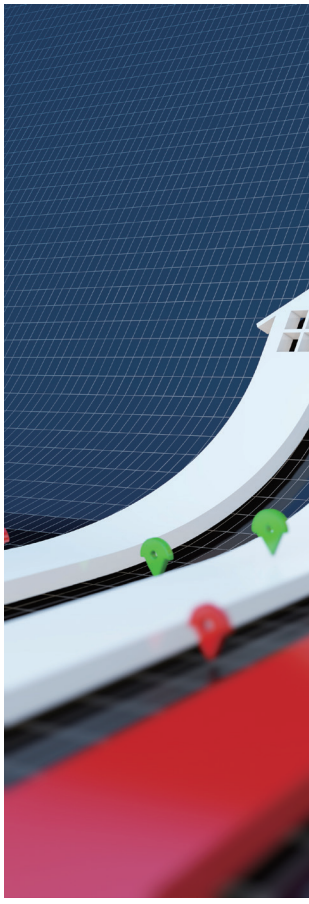
Although an issuer of red chip structure is not a domestic enterprise or its controlled overseas enterprise or branch, whether the bonds due in one year or more issued overseas by a "small red-chip" enterprise controlled by a natural person is subject to filing requirements, has been controversial since the release of Notice No. 2044. However, in recent years, according to the list of enterprises notified in the risk alert for overseas bond offering and the published list of enterprises that have completed the filing of foreign debt posted on the website of NDRC, both of which involve "small red chip" enterprises and based on the information from the communications with NDRC, although the issuer under the small red chip model is the parent/subsidiary established offshore, the actual controller or substantial business of the offshore entity is mainly in China. Accordingly, its offering of bonds denominated in RMB or any foreign currency due in one year or more shall be subject to the requirements in Notice No. 2044 in respect of pre-offering application for filing and registration and filing of the offering information with the NDRC within 10 working days of each tranche of offering.

b. Are bonds due in 364 days subject to filing requirements?

Since Notice No. 2044 applies to foreign debt due in one year or more only, foreign debts due in 364 days or less which are common in the market are not subject to filing with the NDRC under Notice No. 2044. In response to rumors that the NDRC will ban overseas offering of 364-day USD-denominated bonds by domestic issuers, relevant officials of the Foreign Investment Division of NDRC responded on 29 June 2018 to a reporter's question about "the NDRC is considering banning 364-day of USD-denominated bond offerings", that relevant departments of the State Council, including the NDRC, have never considered banning domestic enterprises from issuing bonds overseas, and the rumors of a ban on overseas offering of 364-day USD-denominated bonds are unfounded.

(2) Registration with SAFE

As previously mentioned, in the case of a direct overseas offering, a domestic issuer shall, within 15 working days of the signing of the debenture, register or file with the local foreign exchange bureau such information as the signing, withdrawal and repayment of foreign debt and the settlement and sale of foreign currency, and go through the foreign debt signing registration procedure. After the foreign debt signing registration, the SAFE shall issue to the debtor a *Statement of Foreign Debt Signing by Domestic Institutions* affixed with the capital account business seal. The loan contract and guarantee contract shall become effective upon registration of signing with the local branch of SAFE. A domestic institution may apply to a domestic bank for opening a foreign debt account only upon registration of signing of the debenture of foreign debt[5].



[4]A domestic enterprise or any of its controlled offshore enterprises or branches that incurs debt offshore and issues debt instruments due in one year or more denominated in RMB or any foreign currency, including overseas offering of bonds and medium- and long- term international commercial loans etc., shall apply to the NDRC for filing and registration prior to the offering, and file the offering information with the NDRC within 10 working days of each tranche of offering.

[5]Pursuant to Article 22 of the *Interim Administrative Measures for Foreign Debt*, Article 3 and Article 25 of Notice No. 29 and provisions on the signing and registration of foreign debt contracts by non-bank debtors in the *Operating Guidelines for the Administration of Foreign Debt Registration*, a domestic issuer shall, within 15 days of the signing of the debenture, register or file with the local foreign exchange bureau such information as the signing, withdrawal and repayment of foreign debt and the settlement and sale of foreign currency, and go through the foreign debt signing registration procedure. After the foreign debt signing registration, the SAFE shall issue to the debtor a *Statement of Foreign Debt Signing by Domestic Institutions* affixed with the capital account business seal. The loan contract and guarantee contract shall become effective upon registration of signing with the local branch of SAFE. A domestic institution may apply to a domestic bank for opening a foreign debt account upon registration of signing of the debenture of foreign debt.

In case of an indirect offering or red chip structure, if a domestic institution provides the guarantee, it shall register the same with the local branch of SAFE within 15 working days of signing of the contract of the PRC-guaranteed foreign loan, and such contract will take effect upon such registration. Where the performance of guarantee occurs, the guarantor may go through the process on its own. After the performance of the guarantee, the guarantor shall complete the overseas credit registration[6]. It should be noted that overseas bond offering is categorized as "special transaction" specified in the *Operating Guidelines for the Foreign Exchange Administration of Cross-border Guarantees*, pursuant which, an overseas debt offering guaranteed by way of PRC-guaranteed foreign loan shall be subject to the satisfaction of the following conditions: (1) the offshore debtor shall be held directly or indirectly by a domestic institution; (2) the proceeds from overseas bond offering shall be used for offshore investment that the domestic institution has an equity interest in; and (3) the relevant offshore institutions or projects have been approved by, registered or filed with, or confirmed by the domestic competent authorities for outbound investment in accordance with relevant regulations.

III. Selection of the structure of overseas bond offering by domestic real estate enterprises

According to WIND's data, so far from 2017, there have been 64 domestic real estate enterprises that completed bond offerings overseas, among which 4 issuers adopted direct overseas offering model, 23 adopted indirect overseas offering model and 32 adopted red-chip structure. China Evergrande Group, Country Garden, Greenland Group, Seazen Holdings Group and Shui On Group have taken both indirect overseas offering and red chip structured offering models (hereinafter referred to as "Dual Structure").

The four issuers of direct overseas offering are all state-owned real estate companies, and no private companies are involved. This is mainly because, on the one hand, an SOE controlling shareholder makes the issuer and its debt highly rated and well-recognized by investors, and hence, its debt would generally has an interest rate in favour, which suffice to offset the additional cost of the 10% withholding tax; on the other hand, an SOE controlling shareholder is conducive to coordinating the issuer's registration of foreign debt with the local branch of SAFE, and helpful to the inflow of funds raised. In addition, an issuer controlled by an SOE shareholder may have a good credit standing, and may generally get favorable ratings of itself and its bonds without relying on external credit enhancement. Therefore, these four real estate enterprises had no keep-well arrangement or guarantee credit enhancement in place when completing their direct bond offerings.

Among the 28 enterprises that adopted the indirect offering model, one completed the debt offering without guarantee or keep-well arrangement or other credit enhancement, one completed its debt offering with credit enhancement from its domestic parent or group, and the remaining 26 were guaranteed by their domestic parents/groups or offshore affiliates. As the issuer of an indirect overseas offering is generally an offshore subsidiary or branch of the

[6]Pursuant to the *Provisions on the Foreign Exchange Administration of Cross-border Guarantees* (Hui Fa [2014] No. 29) ("Notice No. 29") and its Operating Guidelines, it shall register the same with the local branch of SAFE within 15 working days of signing of the contract of the PRC-guaranteed foreign loan. If the performance of the guarantee occurs, the domestic guarantor or domestic counter-guarantor becoming a creditor shall register the foreign creditor's rights.

domestic parent/group, typically a BVI company, which has no operations, it has to rely on internal or external credit enhancement due to its low rating in general or low rating of its particular debt. The cost of external credit enhancement by a bank is relatively high, so the issuer would typically choose internal credit enhancement, that is, offshore guarantee, cross-border guarantee or keep-well arrangement. Compared to guarantee, pros of keep-well arrangement is that it is in essence a kind of liquidity support, which, unlike guarantee, is usually not required to go through the relevant registration procedure as a PRC-guaranteed foreign loan; and the cons is that keep-well arrangement will relatively raise the cost of offering, because keep-well arrangement is weaker than guarantee in terms of credit enhancement effect. Even if the structure of keep-well agreement plus equity repurchase commitment (in the event of the issuer of insolvency, the parent shall repurchase one of the issuer's domestic subsidiaries at the "agreed price" and pay the consideration to the issuer with which the issuer may repay the debt) is adopted to further enhance its credit, it cannot match up with guarantee in terms of credit enhancement effect as its effect is indirect. The only one enterprise mentioned above that completed indirect overseas debt offering without guarantee or keep-well arrangement or other credit enhancement is Vanke Property, and Vanke Real Estate (Hong Kong) Co., Ltd. completed its offering of USD-denominated bonds in Hong Kong SAR, as the issuer. This was substantially due to Vanke Property's status as an A- and H-share listed company and its low asset-liability ratio among real estate enterprises, as well as its outstanding brand strength, which is recognized by investors in the Hong Kong market.

Among the 37 enterprises that adopted red chip structured offering (including the red chip structure of Dual Structure), 10 enterprises completed their debt offerings without guarantee or keep-well arrangement, and 27 completed debt offerings with credit enhancement from their affiliates. The main reason is that an offshore issuer under the red chip structure is generally a shell company incorporated in Cayman Islands to build the red chip structure, and has no substantial business activities. As an issuer, even if it is a listed company, its ratings may be affected by the fact that its business operations are substantially in China. Therefore, domestic affiliates would generally provide guarantee or keep-well arrangement.

China Evergrande Group, Country Garden, Greenland Group, Seazen Holdings Group and Shui On Group have adopted both indirect overseas offering model and red chip structured offering model, which are directly related to their business segments and shareholding structure. Take China Evergrande Group as an example, in addition to real estate development, the business of China Evergrande Group's listed entity also includes tourism, health, finance, etc., therefore, there are not only indirect offerings by the real estate business as the issuer, but also red-chip structured offerings by China Evergrande Group as the issuer guaranteed by offshore affiliates.

IV. Analysis of typical legal issues of overseas bond offering by domestic real estate enterprises

1. Analysis of typical legal issues of overseas bond offering

As domestic enterprises need to complete overseas bond offerings "efficiently within a short period of time", the definition of due diligence scope is crucial to meeting the schedule. At the beginning of the project, all parties shall determine the scope of due diligence, taking into account consolidated subsidiaries for the purpose of financial statements. The scope of due diligence often depends on the focus of investors, concerning the issuer's ability to raise debt and solvency. As the scope is determined, the due diligence on a subsidiary generally involves such subsidiary's subject status, shareholding structure, equity pledge status, licenses and qualifications, major properties and land assets and encumbrances, major intangible assets, external investments, material business contracts, major financing and guarantee contracts, environmental protection, financial subsidies, tax preference, major litigations and arbitrations, major administrative penalties, labor disputes, employees' social security, etc., which may be adjusted, as applicable, based on the company's industry and the parties' comments. In the due diligence, it is also required to pay attention to the industry-related laws and regulations as well as regulatory rules of overseas regulatory authorities.

2. Analysis of special legal issues of real estate enterprises

In terms of determining the scope of subsidiaries covered by the due diligence, a real estate enterprise generally has a large number of consolidated subsidiaries. The parties concerned will generally give comprehensive consideration to the assets, and revenue and profit contribution of each subsidiary, for the purpose of the consolidated statement of the issuer, as well as the division of business segments

of the group, and select important subsidiaries to be covered by the due diligence in the principles of overwhelming majority and importance, at a coverage ratio of 50-70% of relevant indicators.

In terms of the due diligence on major financing and guarantee contracts, as an overseas debt offering will further increase an issuer's corporate indebtedness, which may hence covertly harm its prior creditors or trigger the default on the prior contract, it is necessary to review all financing contracts and guarantee contracts that are being performed within the issuer's system in the "cover-all" principle, and note whether any such contract has any conflict with the proposed offering or whether they may affect the subsequent profit distribution and thus affect the timely repayment of bond interest to bondholders. In addition, due to the diversity of the financing structure and complexity of contracts of real estate enterprises, it is necessary to clarify various legal relations based on different transaction arrangements. The clarification of all the effective financing contracts and guarantee contracts in the issuer's system has become the focus of due diligence.

In addition, taking into account the characteristics of real estate enterprises, the due diligence focuses on the following: (1) as the main business of a real estate enterprise is real estate development, whether it has good and valid real estate development qualification directly determines whether the issuer has actual operating capabilities; (2) as a real estate enterprise's assets are substantially the properties that it owns or is developing, in light of the concern over the issuer's solvency going forward, it is necessary to check the status and license of existing properties that the issuer owns or is developing, including whether the land-transferring fees are paid in full, whether the developing procedure is good and complete, whether there are defects in title, and whether there is any idle land and any punishment arising therefrom.

V. Challenges and opportunities for domestic real estate enterprises in overseas bond offerings in 2019

As early as 19 April 2018, officials from the SAFE said that financing platforms of local government and real estate enterprises may not incur foreign debts, except as otherwise provided in special provisions[7]. On 28 June 2018, when responding to questions from reporters on the *Notice of the NDRC and the Ministry of Finance on Improving the Market Restraint Mechanism and Strictly Preventing Foreign Debt Risks and Local Debt Risks*, the relevant officials of the NDRC pointed out that NDRC would formulate the *Administrative Measures for the Registration of Foreign Debt Offerings of Enterprises* as soon as possible, and guide and regulate use of proceeds from overseas bond offerings of real estate enterprises; and real estate enterprises shall mainly use the proceeds from overseas bond offerings to repay debts due and prevent default on debt; and that the NDRC would restrict real estate enterprises from investing the proceeds from overseas debt offerings in domestic or overseas real estate projects or using the same to replenish working capital, and require enterprises to submit commitments of the use of proceeds. The above response to questions reflects that the policy and supervision on real estate enterprises' overseas bond offering will gradually turn from the status quo of relative macroscopic supervision into rules-based and standard supervision going forward, which will undoubtedly pose new challenges for real estate enterprises in their overseas bond offerings.

The deepening construction and development of the GBA indicate an upcoming wave of policy dividends therefrom. On 16 November, 2018, a spokesman of the NDRC said that, in order to give full play to the comprehensive strengths of Guangdong-Hong Kong-Macao area and build a first-class bay area full of vitality and international competitiveness, the state will actively promote relevant work in six respects, among which the spokesman detailed the study and introduction of policies and measures to help private enterprises raise funds in the bond markets, as well as the active support of high-quality private enterprises in debt offering[8]. As the *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* was released in February 2019, the deepening development of the GBA will definitely promote the integrated development of the bond markets. In the past few years, the GBA issuers have played a major role in offerings of USD-denominated bonds by Chinese issuers, and real estate enterprises are among the mainstream of these issuers. It is believed that the integrated development of the GBA bond markets will further benefit the financing of real estate enterprises in the area.

Let's wait and see the opportunities and challenges facing the real estate companies in overseas bond offerings in 2019.

[7]Source: http: //www.gov.cn/xinwen/2018-04/19/content_5284088.htm

[8]Source: http: //www.gov.cn/zhengce/2018-11/16/content_5340987.htm

Overview of the offshore bond obligation management

Hao Zhou, Lu Ming

There was an explosive boost in the amount of Chinese-issued U.S. dollar bonds ("Chinese-issued dollar bonds") in 2016 and 2017, represented by the rapid growth in the scale of the issuance of dollar bonds by Chinese corporate issuers in the areas of city investment and real estate. Since last year, due to the tightened domestic regulations, the changes in macro-economic environments at home and abroad, and the rise of interest rates 4 times by the Federal Reserve System, the amount of the Chinese-issued dollar bonds in 2018 has reduced to some extent compared with its historical peak in 2017. In addition, against the backdrop of the continuing implementation of domestic macro-policies, the default risks derived from the onshore bond market, the dollar appreciation and the trade friction, both the amount and scale of default Chinese-issued dollar bonds since 2018 have reached a peak for the last decade. Meanwhile, with the expansion of the market capacity, a great number of Chinese-issued dollar bonds will be matured in three years (from 2019 to 2021). Issuers will have great demands for refinancing.

As is known to all, for both the investment grade dollar bonds and the high-yield dollar bonds, the issuers are subject to various restrictive commitments and obligations under bond terms, including but not limited to relevant requirements for financial index, restrictions on financing and guarantee and other restrictions that may affect the cash flow, assets and revenues of the issuers or relevant groups. If the Chinese corporate issuers fail to comply with the restrictive commitments of dollar bonds or other relevant requirements, they will face default risks and may suffer a lot in terms of their images and reputations on the foreign and domestic capital markets.

In the face of the liquidity pressure of debt servicing, refinancing costs and the restrictions of relevant bond terms, the Chinese issuers of dollar bonds have shown great concerns in recent years on how

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to manage the obligations of repayment and comply with other restrictive commitments of outstanding bonds (hereinafter referred to as “bond obligation management”) from the perspective of compliance, risk control and optimization of capital structure. This article will employ the method of case analysis to briefly introduce the common pattern, major process and documents required for bond obligation management in terms of law application and practice. Hopefully this can help those offshore Chinese corporate issuers, underwriters and peers in the industry who are interested in this subject.

I. Common patterns of bond obligation management

The common patterns of bond obligation management in the current market include cash repurchase (e.g. tender offer and open market repurchase), exchange offer and consent solicitation. These methods may be used in combination or twisted, depending on the realities of the issuers and the purposes of the transactions.

1. Cash repurchase

Tender offer

Tender offer derives from the practice of corporate acquisition in the US, which is one kind of corporate acquisition by publicly purchasing the shares of a listed company. In the context of bond obligation management, it means that issuers (or third parties) offer to repurchase part or all of the outstanding bonds in an open market in cash according to specified prices and terms.

Open market repurchase

Open market repurchase refers to a situation where the issuers repurchase part of the outstanding bonds in a low profile by accepting offers from secondary market participants. This only applies to issuers who intend to repurchase part rather than all of the bonds so as to avoid the requirement of public disclosure. Otherwise it will be deemed as tender offer.

The major differences between the tender offer and the open market repurchase are:

- Timing: the open market repurchase can be implemented at any time while the tender offer takes more time and may be subject to certain requirement of opening period;
- Scale: the issuers may repurchase all the outstanding bonds through tender offer;
- Flexibility: the tender offer may be prohibited by preferred debt or restrictive terms of financing agreement with the bank.

2. Exchange offer

The exchange offer usually takes place where the issuers offer to exchange new securities for certain amount of outstanding bonds with the holders. In other words, the exchange offer is similar to the cash offer except that under the mechanism of exchange offer, the issuers or third parties issue new bonds to the holders of outstanding bonds instead of using cash as the consideration for the outstanding bonds. This method of bond obligation management is a feasible way of refinancing to some extent, and the issuers may extend the maturity date of the outstanding bonds to relieve the burden

of payment of interest, and issue new bonds different from those prescribed by the existing bond terms. Unlike the cash offer, the issuers may spend less cash through exchange offer to realize their purposes of bond obligation management. Therefore, exchange offer is attractive to those issuers reluctant to spend much cash on the repurchase of the outstanding bonds.

3. Consent solicitation

In the context of bond obligation management, consent solicitation usually refers to the situation where the issuers, in compliance with the bond terms, solicit for the bond holders' consent of modification of relevant terms or request waiver for default. Issuers may modify the restrictive commitments under the bond terms through consent solicitation to achieve flexibility in business operation or financing. They may also relieve the pressure of repayment of financing and liquidity by extending the maturity dates of the outstanding bonds.

Given that some bond holders may decline the tender offer and continue to hold the outstanding bonds, the issuers usually combine the mechanisms of tender offer and consent solicitation to conduct a more efficient bond obligation management. Under such combined mechanism of bond obligation management, the bond holders may be "motivated" to accept the tender offer, because if the issuers modify the bond terms by consent solicitation (whether by removing the parts favorable to the bond holders in the original bond terms or adding new terms favorable to relevant issuers), those bond holders dissenting to such modifications may have to face the consequences of not only losing the "consent fees" (usually the issuers only pay such fees to the consenting parties) but also accepting an unfavorable terms (because the modification of a large part of restrictive terms does not require unanimous consent from the bond holders). Therefore, the combination of these two mechanisms usually makes it easier to realize the issuers' purposes. However, since such arrangement may be regarded as an invasion of the interest of minority bond holders, the issuers and the intermediaries involved should take into account relevant cases and laws to design the overall mechanism.

II. Laws applicable to bond obligation management

When considering the common patterns of bond obligation management from the perspective of law application, special attention should be paid to the US federal securities acts, the applicable laws (such as the British laws and the New York laws) for documents of relevant transactions and the listing rules of stock exchanges (such as the HKEX and the SGX) in the Chinese-issued dollar bond market.

1. Considerations of the US federal securities acts

Tender offer

The relevant US federal laws include Article 14 of the *US Securities Exchange Act of 1934* ("Securities Exchange Act of 1934") and relevant rules governing tender offer. Technically speaking, the above statutes do not define "tender offer" — the concept mainly comes from the US case laws. To determine the existence of a "tender offer", there are two precedents widely accepted by the US courts: *Wellman v. Dickinson* decided by the US District Court for the Southern District of New York in 1979 which established eight factors to determine the existence of a tender offer, and *Hanson Trust PLC v. SCM Corporation* in which the US Court of Appeals for the Second Circuit in 1985 established another applicable standard for the comprehensive consideration of the existence of a tender offer. It is noticeable that, to this date these two cases concerning tender offers on stock markets have not been applied to any tender offer on bond markets. Therefore, the standards established in these two cases are only theoretically applicable to bond trading.

If the issuers decide to make tender offers to a certain proportion of the US investors (bond holders), they may need to comply with relevant US securities rules, including but not limited to (subject to certain special waivers): (1) the shortest opening period for tender offer (the offer must remain open for at least 20 business days since its first announcement or delivery to the investors); (2) the extension for the opening period (the offer must remain open for another 10 business days when there is any modification to the proportion of the bond or the offer price); (3) instant payment (upon termination or withdrawal of the tender offer); (4) "highest price" (the consideration paid to the bond holders must be no less than that paid to the rest bond holders in the tender offer); and (5) anti-fraud terms (any fraud or manipulation concerning the tender offer is illegal).

For most Chinese issuers of dollar bond, if the bonds held by the US investors represent only a small proportion of their outstanding bonds, then the risks of violating the abovementioned US federal securities rules for tender offer can be significantly mitigated. Of course, if the initial issuance of bonds includes the resale prescribed by Rule 144A of the *US Securities Act of 1933* ("Securities Act of 1933"), it is generally recommended that the issuers should consider managing the bond obligation in accordance with the abovementioned US federal securities rules for tender offer from a prudent perspective. In addition, even if the initial bond issuance is in accordance with Regulation S ("Reg S") of the Securities Act of 1933, the bonds may "flow" into the secondary market in the US and be held by the US

investors. Therefore, it cannot be concluded that the US securities rules are not applicable simply because the bonds are issued under Reg S.

Exchange offer

As the exchange offer usually involves the acquisition of outstanding bonds and the issuance of new bonds, and the listing and trading of new bonds on relevant stock exchanges, regulations on the issuance of new bonds are stricter than those on the outstanding offers. The issuers who adopt the mechanism of exchange offer must consider if they should comply with both the rules governing tender offer in the Securities Exchange Act of 1934 and the rules governing bond sale and issuance in the Securities Act of 1933 (e.g. the registration and disclosure requirements under Chapter 5, and the liability terms under Chapter 11 and Chapter 12). To avoid the burdensome procedural requirements and the compliance costs mentioned above, Chinese issuers who employ the mechanism of exchange offers usually consider relying on the waivers prescribed by relevant US securities rules such as Rule 144A, Reg S or other private placement rules.

Consent solicitation

Generally speaking, the consent solicitation alone usually will not trigger the application of the US Securities Exchange Act, but when it is combined with tender offer or exchange offer, or if the modification to bond terms results in significant changes to the nature or risks of the investment, the US Securities Exchange Act may be applicable. For instance, when the modification made through consent solicitation or bond holders meeting concerns fundamental terms of economic substance (e.g. the interest rates, principals, maturity dates or currencies), a series of precedents decided by the US courts concludes that such modification touches the essence of the bonds and thus constitutes the issuance of new bonds. This means that the issuers must register with SEC or resort to the aforementioned waivers.

2. Considerations of contract laws

In addition to the US federal securities laws, the issuers need to pay special attention to the applicable laws for and relevant terms of the transaction documents concerning bond issuance when they consider managing bond obligations. Taking the Chinese-issued dollar bonds for an example, the most common laws applicable to the relevant documents are the British laws (usually apply to the issuance of investment grade bond to investors outside the US under Reg S) and the New York laws (usually apply to the issuance under Rule 144A or the issuance of high-yield bonds). Under the mechanism of consent solicitation, the issuers need to consider the features and differences of relevant applicable laws, including but not limited to: (1) the voting mechanism of ordinary resolution and special resolution; (2) the timing for advance notification of consent solicitation; (3) the proportion of voting rights required for ordinary resolution or special resolution; and (4) how the resolutions on the modification or waiver of bond terms take effect. For instance, the trust deed governed by the British laws provides that voting for consent solicitation usually requires the convening of bond holders meetings where certain requirements for voting rights must be met (although theoretically there exist special voting which do not require such meetings), and the detailed meeting procedures are usually set out in relevant terms. In contrast, for the bond issuance under Rule 144A governed by the New York laws or the trust deed of high-yield bonds, the voting for consent solicitation may be conducted in writing or electronic form. Once it meets the requirements of the quorum or voting rights, the outcome of the voting for consent solicitation will be binding for all the bond holders.

3. Considerations of listing rules

The Chinese corporate issuers should also consider relevant listing rules of the stock exchange for their bond listing. For instance, when they employ the mechanism of consent solicitation to modify the trust deed (or trust agreement), or repurchase the bonds through tender offer, they must perform their continuing compliance obligations regarding the listed bonds at both the HKEX and the SGX, especially the obligation of announcement for redemption or cancellation of certain proportion of bonds.

III. Practical applications of bond obligation management

The following passages will briefly introduce the practical applications of bond obligation management by Chinese issuers of dollar bonds in terms of the parties involved in transactions, the major documents and the implementation procedures by method of case analysis.

1. Tender offer

- Major parties: the major parties in a tender offer include the transaction manager, the tender agency, the information and tabulation agency, the trustee and the legal counsel.
- Major documents:
  - tender offer memorandum;
  - transaction manager agreement;
  - tender agency agreement;
  - tabulation agency agreement;
  - notice.

• Practical application procedures:

Project preparation period:
- the issuer engages third-party intermediaries and prepares relevant documents;
- draft the tender offer memorandum and other transaction documents;
- the issuer and the transaction manager discuss and determine the final acquisition price of the bonds;
- the issuer and the transaction manager discuss on whether to set a cap on the acquisition price (the decision can be made after the announcement of the transaction but prior to the deadline of the tender offer);
- the information and tabulation agency establishes the website for tender offer.

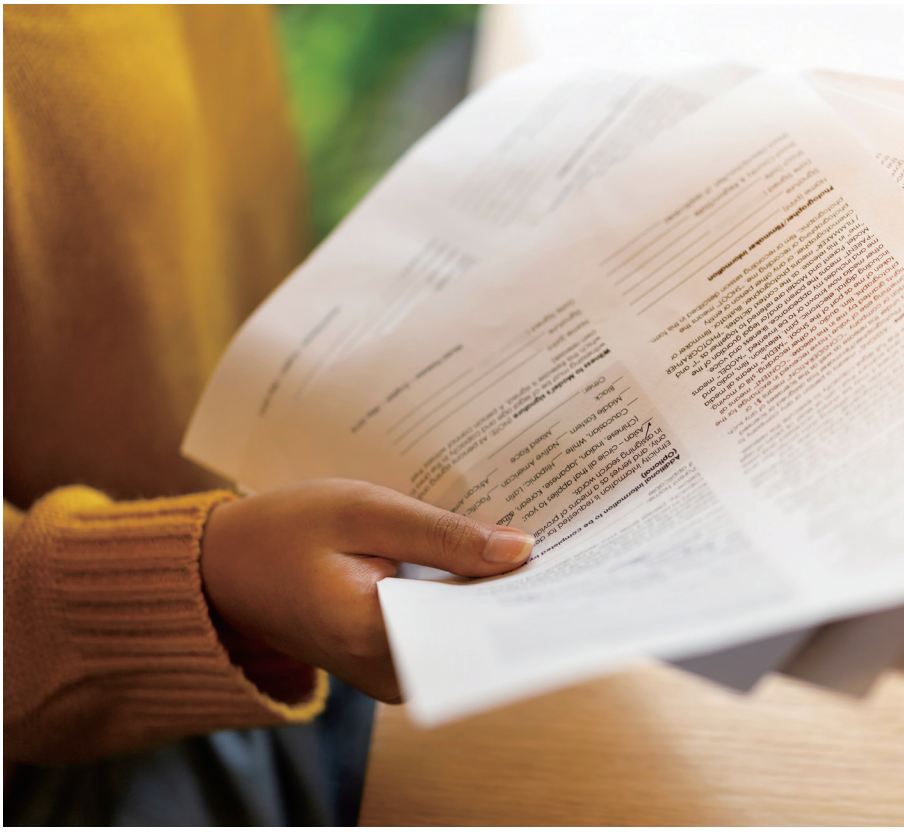
Announcement of the transaction:
- distribute the tender offer memorandum and the notice to bond holders through the electronic system of the clearing bank;
- publish the tender offer memorandum and the notice on the tender offer website and websites of relevant stock exchanges (if the bonds will be listed on such stock exchanges);
- the issuer signs the transaction manager agreement, the tender agency agreement and the information and tabulation agency agreement;
- if the issuer sets a cap on the acquisition price, notice should be issued before the deadline of the tender offer.

Deadline of the tender offer:
- leave enough time to the bond holders for their consideration based on their needs, and certain time to the clearing bank for its receipt of the bond holders' instructions through its electronic system; the offer usually remains open for at least 5 business days;
- the issuer announces the result of the tender offer.

Closing date:
- the issuer pays the acquisition price to the bond holders accepting the tender offer;
- the issuer announces the closing of the transaction.

• Case Analysis

In this case, the issuer intended to reduce the unpaid principal of the bonds and mitigate its ongoing obligation of debt servicing. Thus, the issuer decided to make a tender offer to acquire certain series of unpaid bonds in cash. Although there was no minimum requirement of the principal amount of the bonds to be repurchased, if the tender offer provisions in the US federal securities acts apply to this transaction, the issuer and its agents must take into account relevant rules governing the shortest opening period for tender offer (at least 20 business days), the instant payment (usually the third business day since the issuance of the tender offer), etc. in designing transaction structure and timetable. Finally, the tender offer will be open for 30 calendar days. Because of the instant payment rule, the issuer decided to remit money from its subsidiaries in china to an offshore issuer so as to pay the acquisition price of the bonds. The Chinese legal counsel of the issuer prepared a detailed memorandum concerning the capital flow to illustrate issues of relevant laws and regulations and impact involved concerning the operation designed for outbound remitting, including the timing of obtaining necessary approval from relevant government authorities in China. The Chinese legal counsel also conducted due



diligence on the financing agreement of the issuer's subsidiaries in China in order to ensure that no term in such agreement would restrict the remitting of capital to the offshore issuer for this transaction.

In addition, to provide incentive for the active participation of the bond holders, the issuer paid "early tender premium" to those bond holders who accepted the tender offer at an early stage. Another purpose for such arrangement is that the issuer can get to know the chance of success of its tender offer as soon as possible. Meanwhile, this offers the issuer an opportunity to reset the price of its tender offer. If the bond holders do not respond to the initial tender offer, the issuer may consider raising the acquisition price so as to obtain more bonds to be repurchased. Although the right to withdraw is not a must for a tender offer, according to market practice, the issuer will usually grant the bond holders such right when material changes to the terms of the tender offer occur (in the first 10 business days of the opening period). It is notable that the aforementioned concerns may be irrelevant to the transaction if the tender offer provisions in the US federal securities act are not applicable.

2. Exchange offer

- Major parties: the major parties in an exchange offer include the transaction manager, the exchange and tabulation agency, the trustee, the legal counsel and the auditor.
- Major documents of the transaction:
  - exchange offer memorandum (the disclosure of the issuer's relevant business and financial status is required in the issuance of new bonds);
  - exchange and tabulation agency agreement;
  - (for new bonds) trust agreement/trust deed and agency agreement;
  - (for new bonds) global certificates (of securities depositaries);
  - (for new bonds) creditors agreement (if applicable);
  - (for old bonds) supplementary trust agreement/ trust deed (if the bond holders decline such exchange and the issuer intends to modify relevant terms of the old bonds);
  - arrangement letter and comfort letter from auditors;
  - notice.
- Practical application procedures:

Project preparation period:
- the issuer engages third-party intermediaries, conducts due diligence and prepares relevant documents;
- draft the exchange offer memorandum and other transaction documents;
- submit listing application (if new bonds will be listed on stock exchanges);
- the issuer and the transaction manager discuss and determine the exchange price and the terms and conditions of the new bonds;
- the issuer and the transaction manager discuss and determine the indicative timetable (i.e. the commencing date, the deadline and the closing date of the offer);
- the issuer and the transaction manager discuss and determine the necessity of modifying the terms and conditions of the old bonds held by those bond holders reluctant to accept the exchange offer;
- the issuer and the transaction manager discuss on whether to set a cap on the exchange price (the decision can be made after the announcement of the transaction but prior to 2 business days before the deadline of the offer);
- the issuer and the transaction manager discuss and determine the minimum interest rates and term of the new bonds (the decision can be made after the announcement of the transaction but prior to 2 business days before the deadline of the offer);
- the exchange and tabulation agency establishes the website for exchange offer.

Announcement of the transaction:
- distribute the exchange offer memorandum and the notice to bond holders through the electronic system of the clearing bank;
- publish the exchange offer memorandum and the notice on the exchange offer website and websites of relevant stock exchanges (if the bonds will be listed on such stock exchanges);
- the issuer signs the exchange agency agreement and the exchange and tabulation agency agreement;
- the issuer announces the interest rates and term of the new bonds before the deadline of the exchange offer;

- if the issuer sets a cap on the exchange price, it should be announced before the deadline of the offer.

Deadline of the exchange offer:
- leave enough time to the bond holders for their consideration based on their needs, and certain time to the clearing bank for its receipt of the bond holders' instructions through its electronic system; the offer usually remains open for at least 5 business days;
- the issuer announces the result of the exchange offer.

Closing date:
- the issuer pays the exchange price to the bond holders accepting the offer, including the issuance of new bonds;
- the issuer signs (for new bonds) the trust agreement/trust deed and the agency agreement, the global certificates (of securities depositaries) and the creditors agreement (if applicable);
- the issuer signs (for old bonds) the supplementary trust agreement/trust deed (if applicable);
- the issuer announces the closing of the transaction.

• Case analysis

In this case, the issuer intended to extend the maturity date of its debt and adopt new bond terms in conformity with those of its recently issued bonds. Therefore, the issuer decided to make an exchange offer to acquire a certain series of unpaid bonds (the "old bonds"). Meanwhile, the issuer took into account of the possibility that some bond holders might decline such exchange offer and thus adopted a scheme of consent solicitation separately at the same time in order to modify the terms of the old bonds. Given the constituents of the holders of the old bonds, the opening period of the exchange offer was finally set as 5 business days (it is 5 to 10 business days according to common market practice). Those bond holders qualified to instruct exchange offer will be fewer if the bond holders are more concentrated, and the clearing system will receive such instructions within a shorter amount of time, thus reducing the time required for exchange offer. Based on this practice, the issuer set 5 business days (comparatively short) as the opening period of exchange offer. Unlike other issuers who set the interest rates for new bonds at the time of announcing the deal, the issuer in this case stated in its transaction announcement documents that the interest rates for new bonds shall only be announced 2 business days prior to the deadline of the offer. In addition, in consideration of various commercial factors, the issuer set a cap on the principal of exchanged old bonds.

3. Consent solicitation

• Major parties: the major parties in a consent solicitation include the soliciting agency, the information and tabulation agency, the trustee and the legal counsel.

• Major transaction documents:
- consent solicitation memorandum;
- soliciting agency agreement;
- information and tabulation agency agreement;
- supplementary trust agreement/trust deed;
- other supplementary documents such as the supplementary keepwell agreement (based on modification plan);
- bond holders' meeting documents, including meeting notice and special resolution (if trust deed governed by the British laws applies to the bonds);
- notice.

• Practical application procedures:

Project preparation period:
- the issuer engages third-party intermediaries and prepare relevant documents;
- draft the consent solicitation memorandum and other transaction documents;
- the issuer and the transaction manager discuss and determine the details of modification and consent fees;
- (if trust deed governed by the British laws applies to the bonds) special resolution concerning consent solicitation must be approved by bond holders meeting, thus the issuer needs to determine the date, time and place of such meeting.

Announcement of the transaction:
- distribute the consent solicitation memorandum and the notice to bond holders through the electronic system of the clearing bank;
- publish the consent solicitation memorandum and the notice on the exchange offer website

and websites of relevant stock exchanges (if the bonds will be listed on such stock exchanges);

- the issuer signs the soliciting agency agreement and the tabulation agency agreement.

Deadline of the consent solicitation:

- (if trust deed governed by the British laws applies to the bonds) bond holders are usually given 21 days' notice of the meeting, which means that such meeting can be held as early as 21 days after the announcement of the transaction;

- (if trust deed governed by the British laws applies to the bonds) hold the bond holders meeting on a specified date after the deadline to approve the special resolution;

- (if bond indenture governed by the New York laws applies to the bonds) leave enough time to the bond holders for their consideration based on their needs, and certain time to the clearing bank for its receipt of the bond holders' instructions through its electronic system; the consent solicitation usually remains open for at least 5 business days without the convening of the bond holders meeting;

- the issuer announces the result of the bond holders meeting/consent solicitation.

Closing date:

- the issuer pays the consent fees to the bond holders accepting the solicitation;

- the issuer signs the supplementary trust agreement/trust deed and other relevant documents.

• Case analysis

In this case, the default terms of the old bonds held by an issuer restricted the shareholding restructuring arranged by the issuer and its guarantor. Therefore, the issuer decided to make a consent solicitation to acquire a certain series of unpaid bonds (the "old bonds"), that is, to solicit the bond holders' consents to modify the terms of the old bonds by means of signing supplementary trust deed.

The trust deed adopted in the old bonds is governed by the British laws, which provides that (1) the bond holders meeting is required for the passing of the special resolution ("special resolution") on the modification of bond terms; (2) minimum number of consenting votes is required for the approval of such special resolution; and (3) bond holders shall be notified of the bond holders meeting no less than 21 calendar days prior to such meeting. The supplementary trust deed signed by relevant parties will not come into effect until the approval of the special resolution.

In consideration of the requirement of prior notice (21 days prior to the bond holders meeting) in item (3) of the above paragraph, the issuer must specifically consider and examine the timetable for the execution of its restructuring plan to ensure timely modification of the terms of the old bonds in order to avoid default. As the purpose of this consent solicitation is to avoid potential default, it is crucial for the issuer to secure the number of consenting votes required for the approval of the special resolution. In view of this, the issuer chose to pay consent fees to bond holders who had voted for the special resolution. Generally, the amount of consent fees paid by the issuer may vary depending on the constituents of the bond holders. For instance, if the bond holders are comparatively concentrated, the issuer may pay less consent fees, because the issuer may have more confidence in obtaining the number of consenting votes required for the approval of the special resolution through preliminary communication with part of the bond holders.

In this case, the representative of the transaction manager presided over the bond holders meeting and the information and tabulation agents cast their votes at the meeting as the bond holders' agency. The issuer, the transaction manager, the trustee and their respective legal counsels also joined the meeting (the terms of the trust deed governing bond holders meeting determine whether such presence is voluntary or compulsory). At the bond holders meeting, the presider announced that the issuer had secured the number of consenting votes required for the passing of the special resolution and the special resolution was thus approved.

Counsel Cynthia Tan, senior associate Du Jun and associate Wennie Li from Hong Kong office are great contributors to this article.

Cross-border AR financing and e-trade connect -- financial innovation in integration of blockchain and supply chain in the Greater Bay Area

Li Wenmin, Zhang Le

Zhang Le

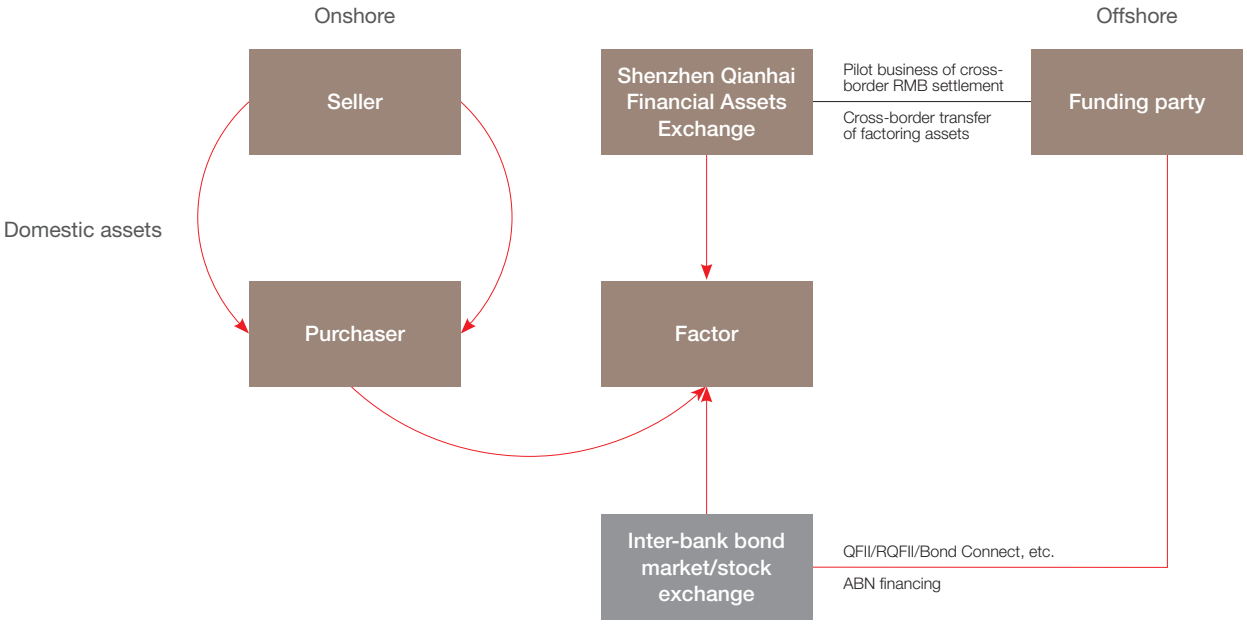
On 18 February, the Central Committee of the Communist Party of China and the State Council issued the *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area*. With the issuance of this Plan, the landscape of an international first-class bay area and a world-class city cluster is gradually emerging. In the future, an open, collaborative and innovative community and a globally competitive modern international financial hub and industrial system will be established in Guangdong, Hong Kong SAR and Macao SAR. The Greater Bay Area (the "GBA") will become a new gateway for the comprehensive reform and opening-up in China.

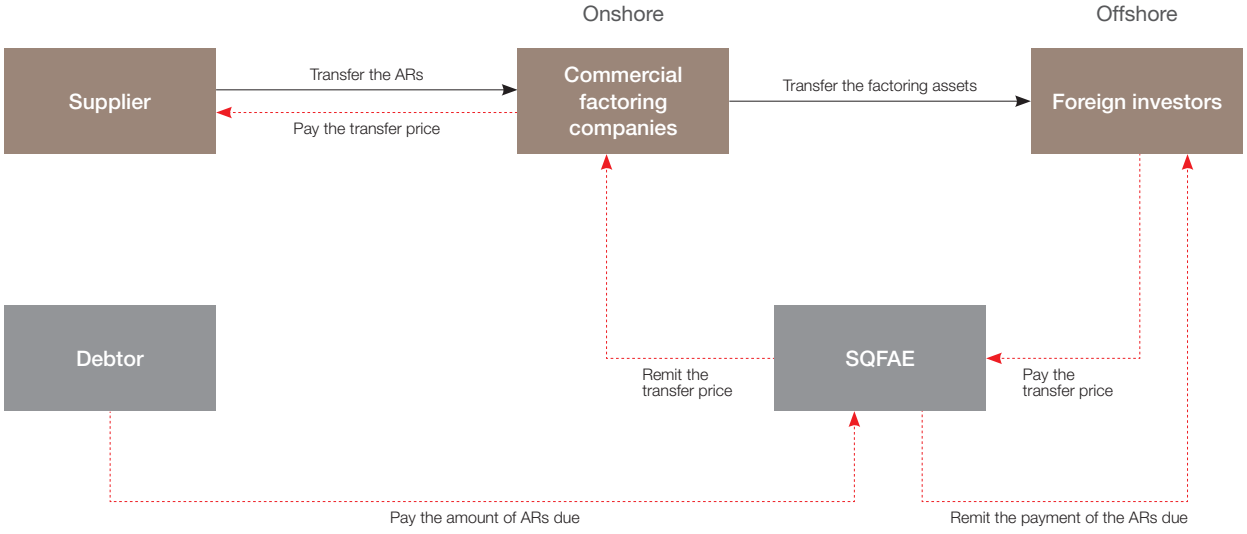
It is important for the coordinated development of the GBA members to promote the pilot financial policies and facilitate the development of cross-border financial products. As the development plan for the GBA has become clearer, cross-border financing of domestic enterprises' accounts receivable ("AR") through the platform of financial asset transaction has become the increasingly popular pilot products of cross-border financing in Shenzhen Qianhai Free Trade Zone.

This article focuses on the practice of cross-border AR financing in the GBA, and briefly introduces the up-to-date pilots for the involvement of overseas fund in domestic AR financing and e-trade connect, a blockchain technologies-enabled finance platform jointly researched and developed by Hong Kong SAR and Shenzhen.

I. Involvement of overseas fund in domestic AR financing

Pursuant to the current laws and regulations of China, overseas fund may be invested in the domestic bond market in order to be involved in AR financing for domestic trade, but the AR must be packaged in accordance with the requirements of asset-backed securitization ("ABS") in China. Although the current ABS or asset-backed notes ("ABN") are named as private equity products, the compliance thresholds and disclosure requirements for them are no less strict than those for the public offerings, and there is a high standard for the underlying assets. Because there is a huge discrepancy in the negotiation positions of the supply chain parties and the trade chain parties, and the transaction is not highly streamlined or standardized, AR qualified for ABS is usually not a large part of the total assets of potential fund raisers.





In addition to the above methods, overseas fund may be involved in AR financing for domestic trade through the pilot business of cross-border RMB settlement operated by Shenzhen Qianhai Financial Assets Exchange Ltd. ("SQFAE"), which enables the cross-border transfer of domestic debts. On 8 March 2018, a Shenzhen-based commercial factor transferred its factoring assets to foreign institutional investors through SQFAE, including 4 tranches of ARs in the amount of RMB 3,720,000 with a maturity of 166 days[1]. The transaction structure is as above:

In the SQFAE cross-border AR transaction illustrated above:

[1]Available at the webpage of the Commercial Factoring Expertise Committee of CATIS: http://www.cfec.org.cn/view.php?aid=1474

- The factor pays the transfer price to the supplier in order to obtain the ARs;
- Foreign investor remits the transfer price (offshore RMB) to SQFAE from its overseas account, and SQFAE remits such price to the factor;
- When the ARs are due, the domestic debtor pays the amount of the ARs to SQFAE domestic account. SQFAE then remits such amount (RMB) to the overseas account of the foreign investor.

When it comes to the traditional transaction pattern, the cross-border transfer of ARs renders the creditor an overseas subject, and the inbound flow of overseas fund will result in foreign debt of the domestic debtor, which must be examined, approved and registered. Otherwise, the domestic debtor will find it difficult to make outbound payment when the debt is due. In contrast, pursuant to the SQFAE pilot plan of RMB settlement for cross-border transfer of ARs, SQFAE, as the agent for the factor and the overseas funding party, implements unified administration in accordance with the cross-border RMB foreign debt quota set by the People's Bank of China ("PBC") Shenzhen Branch, and facilitates the cross-border capital flow for both parties.

II. Self-liquidating and the pain point of cross-border trade finance

Self-liquidating is the essential attribute of trade finance. The authenticity of trade backgrounds is the premise for the realization of self-liquidating.

Since 2015, our team has handled a number of direct financing projects in which ARs are underlying cash flows assets. For each project, either domestic or foreign, the most disturbing obstacle and pain point lies in how to examine the trade backgrounds of ARs in the shortest time. Financial products, either Bond Connect or the aforementioned SQFAE pilot plan, merely provide connections and possibilities for cross-border trade finance from the perspective of capital flow and cannot resolve the problem of authenticity examination of the trade backgrounds in cross-border trade finance.

Since the paper-based documents are numerous and the course of dealings is not unified, no transactions can be completely reproduced by post examination. In practice, various problems exist such as whether a deal can be substantiated solely by relevant contracts and invoices, whether the certificates of contract performance provided by clients can correspond strictly to the underlying transaction of a trade finance, and whether there is repetitive financing in a certain transaction. Because of the difficulties in trade backgrounds examination, the competition pressure and profit motive, a substantial number of financial institutions have been relaxing their requirements for self-liquidating. Some even substitute the verification of core debtor (or "buyer confirmation") or independent guarantee of credit subject for substantive trade backgrounds examination of each financing deal. The absence of substantive authenticity examination of trade backgrounds and the intentional indifference towards self-liquidating transform trade finance into "financed trade". Various inconceivable frauds concerning trade finance emerge in a seemingly endless stream.

Only open and transparent transaction information can help to improve the efficiency of financing and thus satisfy the commercial needs of trade finance. It will be crucial for the sustainable development of cross-border trade finance in the GBA - how to ensure the authenticity of trade backgrounds and control the product flow, document flow and capital flow spanning different customs territories and jurisdictions so as to make the authenticity of trade backgrounds verifiable and even to ensure the "self-liquidating" of trade finance and render the ARs of domestic enterprises readily recognizable for overseas investors.

III. Advanced integration of the blockchain and the supply chain

Can fintech, as one of the focuses of the collaboration across the GBA, facilitate the efficient and convenient flow of people, goods, capital, information and other factors of production and accelerate the cross-border trade finance against the background of financial innovation? The current market mainly depends on the further development and application of blockchain technologies to cater the above requirements. Indeed, the features of blockchain technologies, such as decentralization, distributed ledger and non-tampering, are conducive to the authenticity examination of trade backgrounds. Therefore, the general consensus in the financial industry is that trade finance and supply chain finance will become two of the most important scenarios in which blockchain technologies are applied.

Attempts have been made at home and abroad to apply blockchain technologies to improve the efficiency of trade finance:

- In September 2016, Barclays Bank completed the world's first export trade settlement transaction using the blockchain technologies. Although this L/C business has no difference from traditional operations in terms of letter issuance, document examination and goods delivery, Barclays Bank is the first to adopt blockchain technologies to realise electronic presentation in the L/C business.
- Since 2016, SWIFT (Society for Worldwide Interbank Financial Telecommunication, used by banks in most

countries and adopted by most L/C business for electronic messaging) has begun to experiment the implementation of blockchain DLT (distributed ledger technology) and released its lab report in March 2018.

- In May 2017, the Hong Kong Monetary Authority (HKMA) officially launched a blockchain-based trade finance platform developed by a consortium of major banks to provide loan, L/C, factoring, export credit, insurance and other services. The platform helps to unify data and relevant procedures, improve the efficiency, transparency and security of the procedures and effectively lower the risks of fraud.
- In October 2017, through collaboration with banks in several countries, IBM developed a blockchain-based trade finance platform, helping the banks and their clients to automatize the then-current manual paper-based procedure of trade finance.
- In May 2018, HSBC officially announced that it had completed the world's first trade finance transaction leveraging blockchain technologies and successfully issued a L/C. This application of blockchain technologies not only leads to paperless transaction, but also helps to shorten transaction hours.
- Since 2017, domestic banks and BAT giants - Baidu, Alibaba and Tencent - have introduced blockchain technologies to their supply chain finance platforms.

As mentioned above, to this date, at home and abroad, the starting point of "verifiability" enabled by blockchain technologies-based trade finance platforms is still behind the time-point when ARs are generated. Most blockchain technologies are used at the financing stage only in trade finance without removing the underlying pain point of authenticity examination of trade backgrounds.

According to our observations and understandings, the supply chain transaction data relates to the procurement and fund management of an enterprise, which are its core business information. It is not fully reasonable to require parties (especially the party who is reluctant to cooperate with the other's financing) to disclose their supply chain transaction data solely for increased efficiency of trade finance backgrounds investigation. The trust issue concerning data security is always the handicap for the enablement of supply chain finance by blockchain technologies. Therefore, we note that some major enterprises have established a trustable virtual community with their upstream suppliers and clients in order to clarify the financing needs throughout the supply chain. In the community, members simplify or waive the authenticity examination of trade backgrounds for transactions between them, establishing a closed platform of supply chain finance with similar effects brought by blockchain. Since the system and infrastructure of the upstream chain operation concerning the flow of goods, documents and capital have not been established, we believe that it is pressing for the government to make policies to facilitate the integration of the blockchain and supply chain. It is an issue difficult to be resolved - how to establish and implement the uniform system and infrastructure concerning the application of blockchain technologies in the GBA spanning three customs territories and jurisdictions. The solution requires the wisdom and efforts of the Central government, the Guangdong, Hong Kong and Macao governments and local enterprises and people.

IV. Practice in the GBA

We note that HKMA and the PBC Shenzhen Branch have led the establishment of a trade finance platform based on blockchain technologies in 2017 and 2018 respectively. The leading role of the government is expected to boost the confidence of transaction parties in data security management of the platform and make available the data of their respective supply chain management and trade flow so as to improve the efficiency and accuracy of the transaction, lower the financing risks and human errors, increase the financing transparency and avoid repetitive financing and financing fraud.

	Hong Kong SAR	Shenzhen
Platform	eTradeConnect	GBA Trade Finance Blockchain Platform
Leading parties	This project is led by HKMA, managed and owned by the Hong Kong Trade Finance Platform Company Limited, and ultimately controlled by the shareholder Hong Kong Interbank Clearing Limited.	This project is promoted and coordinated by the PBC Digital Currency Research Institute and Shenzhen Branch.
Other parties		Bank of China, China Construction Bank, China Merchants Bank, Ping An Bank, Standard Chartered Bank and BYD Company Limited.
Functions	By digitalizing trade documents, the platform helps transaction parties to verify and transmit trade documents effectively. It employs the encryption techniques to ensure that only transaction parties can share trade materials and use such materials to apply for financing from the bank. It automatizes the transaction procedures such as sending the shipping receipts and purchase orders, and receipts reconciliation.	The platform is designed for trade finance such as AR financing and also serves as a system which monitors various financing activities on a real-time basis. According to relevant reports, the transaction information of core enterprises and medium/small enterprises in the supply chain is recorded at the blockchain platform.
Future	eTradeConnect and we.trade, a European blockchain trade platform, signed a memorandum of understanding to conduct a proof of concept on connecting the two platforms. Such connection provides preliminary conditions for the digitalization of cross-border trade corridors between Asia and Europe and sets standards for the connection between major blockchain platforms.	Phase 2 of the platform will entail the connection of cross-border trade, taxes and customs in the future.

Conclusion and prospect

As a professional legal services provider deeply involved in trade finance, we understand that it is important to develop financial instruments and products for financial innovation in the area of trade finance. When it comes to the sustainable development of trade finance segment, however, it is much less important compared with overcoming its natural pain point and difficulty - the authenticity examination of trade backgrounds. In cross-border trade finance, the overseas investors may be affiliates of the domestic holders of AR assets. Regardless of this scenario, the transparency and visibility of basic transactions is one of the greatest concerns for overseas investors when they make investment decisions because of the discrepancies in the legal, geographical, cultural and other objective factors. In the future, it is expected to introduce blockchain and other financial technologies to facilitate the sourcing and verification of the supply chain information. The establishment and expansion of the trustable closed communities among enterprises and the establishment of a trustable public community backed by governmental resources help transaction parties to trustingly input their commercial information into the blockchain platforms and eliminate obstacles for the development of supply chain finance caused by information asymmetry. We look forward to such a day.

Fostering growth as reinsurance and risk management centres in the GBA -- Hong Kong SAR sets to introduce insurance linked securities legislation

Minny Siu, Angus Sip

On 18 February 2019, the State Council announced the *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* (the "Outline Development Plan"). The insurance sector is set to be one of the pillar industries under the Greater Bay Area blueprint, which seeks to promote cross-border Renminbi reinsurance business and explore the development of a trading platform for innovative insurance elements, among other things. The Outline Development Plan also supports Hong Kong SAR in strengthening its status as a risk management centre.

Against this background, we expect the Hong Kong government will proactively implement these strategies in accordance with the guiding directions set forth in the Outline Development Plan. In the 2018 Hong Kong Chief Executive's Policy Address and the 2019 Hong Kong Budget Speech, the Hong Kong government has already identified the importance of insurance-linked securities ("ILS") as a key driver of the future growth of Hong Kong reinsurance industry, and recommended allowing the formation of special purpose vehicles for issuing ILS in Hong Kong SAR by amending the *Insurance Ordinance* (Cap. 41) with a view to enriching the risk management tools available in the Hong Kong market[1].

This article provides a brief overview of the ILS structure, and explores the potential opportunities arising from this important initiative for Hong Kong SAR in its role in the Greater Bay Area.

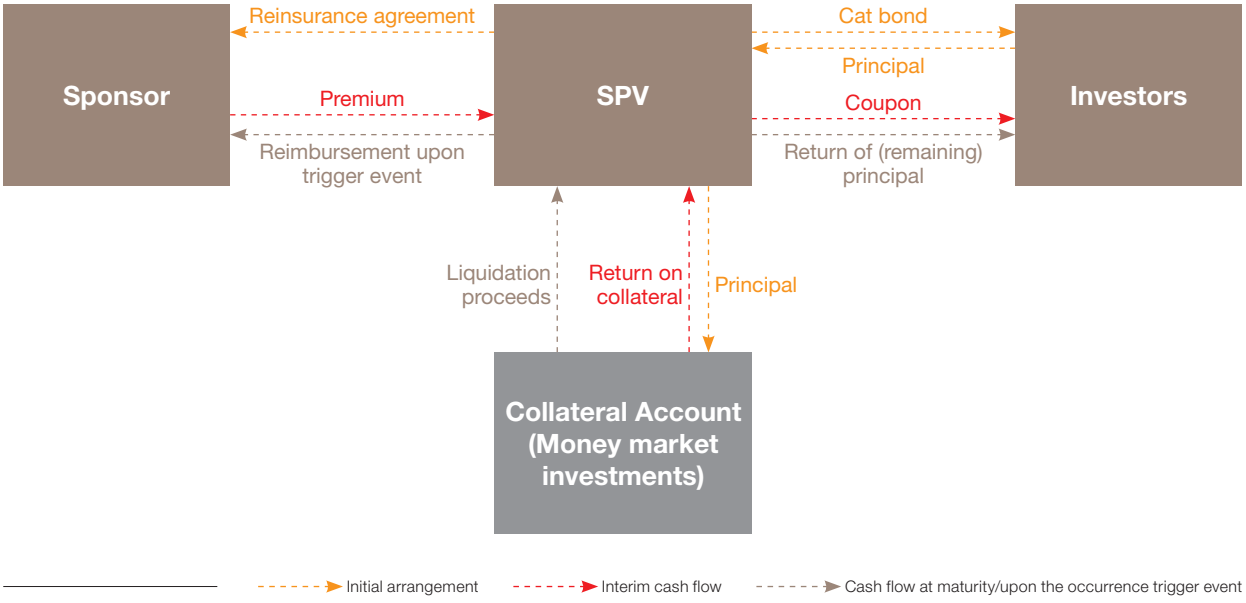
I. What are ILS?

ILS are a form of alternative risk transfer (also known as "ART") which gives protection buyers (who are usually insurers or reinsurers seeking to get protection and are commonly known as "sponsors") new options to transfer risk to the capital markets investors. The most common form of ILS is catastrophe bonds (also known as "cat bonds"). These are generally privately placed risk-linked securities of which all, or a portion of, the repayment of the principal is linked to a specific set of risks (generally natural disaster and catastrophe risks in a specified geographic region) – for example, the occurrence of one or more wildfire in California or earthquakes in Japan resulting in losses to the sponsor exceeding certain specified thresholds.

ILS allow sponsors to obtain reinsurance protection from a new pool of capital separate from traditional reinsurers. ILS become increasingly attractive to a large pool of institutional investors, ILS funds, money managers and pension funds due to their relatively stable market return during the financial crisis and their liquidity profile.

II. How do ILS work?

The diagram below illustrates how a typical catastrophe bond work:



[1]See paragraph 118 of the Chief Executive's 2018 Policy Address and paragraph 57 of the 2019-20 Budget Speech. This echoed the Hong Kong Financial Services Development Council (FSDC)'s observations on the importance of ILS as a driver of the future growth of Hong Kong reinsurance industry back in 2017. See section 1.3.2 of the FSDC Paper No.27 entitled "Turning Crisis into Opportunities: Hong Kong as an Insurance Hub with Development Focuses on Reinsurance, Marine and Captive" (the "FSDC Paper").

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Angus Sip

Initially:
A special purpose vehicle (SPV) specifically designed for the cat bond issuance is established and enters into a reinsurance agreement with the sponsor. Pursuant to the reinsurance agreement, the SPV will receive premiums and provide coverage to the sponsor upon the occurrence of a "trigger" event.

The most commonly used trigger type in the cat bond market is an indemnity trigger, which is the actual loss incurred by the sponsor following the occurrence of a specified catastrophe event, in a specified geographic region, for a specified line of business – for example, a trigger event may occur if the sponsor's commercial property insured losses from a single earthquake in Japan exceeds US$50 million, in the time period from 1 November 2018 to 31 October 2021.

The SPV issues the cat bond to investors in the capital markets. The cat bond contains default provisions that mirror the terms of the reinsurance agreement.

The proceeds from the sale of the cat bond are deposited into a segregated collateral account and invested in highly rated money market instruments to provide a stable return.

In the interim:
The SPV makes periodic coupon payments to investors of the cat bond. The coupon payments are derived from the investment return on the collateral and premiums the sponsor pays.

At maturity/upon the occurrence of a trigger event:
If no "trigger" event occurs during the term of the cat bond (typically three years) then the collateral is liquidated at the end of the cat bond and cat bond will be redeemed at 100% of face value.

If a trigger event has occurred, the SPV will liquidate all or part of the collateral required to reimburse the sponsor, and the redemption price of the cat bond is reduced accordingly.

III. Why choose ILS?

ILS offer a viable alternative to traditional reinsurance for risks that are hard to model.

For reinsurers, ILS provide multi-year capacity and pricing certainty. They are more secure due to their fully collateralised nature and ability to be rated, and are capital-efficient.

For investors, ILS' low correlation with other asset classes makes them an effective asset diversification instrument. Further, in comparison to equities and bond markets, ILS have relatively low volatility and stable returns to offer investors a liquid investment option in secondary markets.

IV. ILS market overview

Bermuda in the lead
Bermuda is the leading domicile for the issuance of ILS in recent years, underlined by the fact that 74.5%, or US$24.8 billion of total outstanding ILS capacity was issued in Bermuda, as at the end of the first-quarter of 2018, according to the Bermuda Monetary Authority.

The growth of the ILS in Bermuda was sparked by its introduction of the legislative framework to support the creation of "special purpose insurers" (SPI) in 2009 for ILS issuance. SPI enjoy an overall lighter and more efficient regulatory regime, with a minimum capital requirement, ability to waive the requirement for an audit and low licensing fees, to name a few.

In addition to this legislative and infrastructure advantage, Bermuda is also renowned for its speed to market, investor familiarity and tax friendliness.

Asia ILS market
There is currently no established market in Asia for ILS given their relatively novel nature to the Asian based reinsurers and investors. ILS are generally recent instruments employed by reinsurers operating in Asia in the capital market. For example, the first-ever cat-bond covering China earthquake risk was only issued in 2015[2].

Singapore has been hoping to encourage ILS and catastrophe bond business to its shores for some years now, having developed special purpose reinsurance vehicle (SPRV) legislation,

[2]The Panda Re Series 2015-1 cat bond was issued by a Bermuda domiciled SPI and sponsored by China Property and Casualty Reinsurance Company. The cat bond uses an indemnity trigger and has a three-year term.

taken step of offering an ILS grant which funds 100% of the upfront costs incurred in issuing catastrophe bonds in the country and provided tax neutrality for ILS vehicles.

Hong Kong ILS market

We are yet to observe the further development and growth of ILS market in Hong Kong SAR. Hong Kong insurers tend to use ILS to help manage the risks of their business by arranging deals with offshore vehicles, such as Bermuda[3].

Hong Kong SAR is well-positioned to tap opportunities in promising growth of the Mainland China's reinsurance market, with the broader policy drive for the "Belt & Road" and "Greater Bay Area" initiatives in becoming the largest Asian ILS hub. Reports show that Mainland China's reinsurance market was valued at HKD 273 billion in 2013 and is expected to reach up to HKD 1,544 billion by 2020, fuelled by explosive growth in the primary general and life insurance markets[4]. Swiss Re has estimated that Belt & Road Initiative related commercial insurance premiums of USD 28 billion could be generated by 2030[5].

However, in the lack of a robust regulatory and tax framework specifically designed for ILS, Hong Kong's current ILS regulatory regime could be viewed as restrictive in comparison with the established ILS market leader Bermuda and other new jurisdictions looking to develop their ILS capabilities, such as Singapore and the United Kingdom[6].

V. What's next for Hong Kong SAR?

We welcome and are excited to see the proposed legislative amendments to promote ILS transactions within a new specially designed framework in Hong Kong SAR. This will provide fresh impetus to Hong Kong's development as a reinsurance and captive centre in the Greater Bay Area[7]. Leveraging off Hong Kong's very well established and stable financial infrastructure with global recognition, Hong Kong SAR is in a unique position to tap into the ILS markets in this region as part of the Greater Bay Area initiatives, so as to attract more insurance and reinsurance companies to efficiently replenish and diversify their own capital base through issuing ILS from Hong Kong SAR. A specially designed ILS regime in Hong Kong SAR will provide a significant opportunity to strengthen Hong Kong's influence in the Asia reinsurance market and secure a strong position in this rapidly evolving and expanding sector.

We look forward to the upcoming legislative process to establish the ILS legal framework in Hong Kong SAR this year.

King & Wood Mallesons has a dedicated team across our network focusing on derivatives and structured finance over a wide range asset classes including insurance-linked instruments. We look forward to working with our clients on these exciting initiatives. We will keep a close eye on the developments on this front and provide a further update once the details of the proposed legislative changes are published. Please speak to us if you have any questions.

[3]Over 75% ILS transactions still being completed in Bermuda. See paragraph 1.3.2 of the FSDC Paper.

[4]See paragraph 1.3 of the FSDC Paper.

[5]See the March 2017 Report entitled "China's Belt & Road Initiative: the impact on commercial insurance in participating regions" published by Swiss Re Institute.

[6]The United Kingdom government has recently enacted ILS regulatory and tax framework with a view to attracting China to gain access to greater disaster insurance or reinsurance protection.

[7]Hong Kong SAR is already well placed to attract mainland enterprises in establishing reinsurance and captive business. From the year of assessment 2018/19 onwards, a tax concession for reinsurers or captive insurers to enjoy a 50 per cent reduction in the profits tax (from 16.5 per cent to 8.25 per cent) on their insurance business has been extended to cover on-shore risks in addition to the offshore risks. In July 2018, the China Banking and Insurance Regulatory Commission announced a preferential arrangement to Hong Kong reinsurers that when a mainland insurer cedes business to a Hong Kong qualified reinsurer, the capital requirement of the mainland insurer will be reduced.

Privatisation of listed companies in Hong Kong SAR

Sheldon Tse, Sheryl Cheung, Katherine Yang

I. Introduction

The stock market in Hong Kong SAR has exhibited significant volatility in recent years amid global political and economic events and local macro-economic factors. In a volatile stock market, the share price of some listed companies may represent a significant discount to their net asset value, and there may be limited liquidity of the shares in the stock market. As such, the privatisation of a listed company provides an attractive opportunity for shareholders of the listed companies to dispose their shares for cash at a price above the prevailing market price without having to suffer from any illiquidity discount and settlement risk.

The following table shows the privatisation of non-H share listed companies in Hong Kong SAR by major shareholder in 2016, 2017 and 2018:

Privatisation of non-H share listed companies in Hong Kong SAR by major shareholder

	Stock Code	Company	Delisting date
2018	0382	Welling Holding Ltd.	20 February 2018
	0589	Portico International Holdings Ltd.	24 August 2018
	0044	Hong Kong Aircraft Engineering Co. Ltd.	29 November 2018
2017	3668	Chinalco Mining Corporation International	16 March 2017
	1833	Intime Retail (Group) Co., Ltd.	22 May 2017
	1880	Belle International Holdings Ltd.	28 July 2017
	0283	Goldin Properties Holdings Ltd.	18 August 2017
	0319	China Metal International Holdings Inc.	9 October 2017
	0963	Bloomage Bio Technology Corporation Ltd.	2 November 2017
	0170	China Assets (Holdings) Ltd.	7 November 2017
	1136	TCC International Holdings Ltd.	20 November 2017
2016	3386	Dongpeng Holdings Co. Ltd.	23 June 2016
	0477	AUPU Group Holding Co. Ltd.	30 September 2016
	2618	TCL Communication Technology Holdings Ltd.	3 October 2016
	1438	Nirvana Asia Ltd.	7 October 2016
	1768	Bracell Ltd.	25 October 2016
	1968	Peak Sport Products Co., Ltd.	3 November 2016

Source: *HKEX Fact Book 2016, HKEX Fact Book 2017* and *HKEX Fact Book 2018*

The following table shows the privatisation of H share listed companies in Hong Kong SAR from 2013 to January 2019:

Stock Code	Company	Delisting date
3355	Advanced Semiconductor Manufacturing Corporation Limited	25 January 2019
1893	China National Materials Co. Ltd.	24 April 2018
0549	Jilin Qifeng Chemical Fiber Co., Ltd	16 June 2017
8058	Shandong Luoxin Pharmaceutical Group Stock Co., Ltd.	16 June 2017
0839	Anhui Tianda Oil Pipe Co. Ltd.	12 December 2016
3699	Dalian Wanda Commercial Properties Co., Ltd.	21 September 2016
1025	Wumart Stores, Inc.	7 January 2016
0350	Jingwei Textile Machinery Co. Ltd.	29 December 2015
2626	Hunan Nonferrous Metals Corporation Ltd.	31 March 2015
6199	China CNR Corporation Ltd.	21 May 2015
0074	Great Wall Technology Co. Ltd.	11 July 2014
0739	Zhejiang Glass Co. Ltd.	31 May 2013

Source: *HKEX Fact Book 2013, HKEX Fact Book 2014, HKEX Fact Book 2015, HKEX Fact Book 2016, HKEX Fact Book 2017, HKEX Fact Book 2018* and http://www.hkexnews.hk/index.htm

Sheldon Tse

Sheryl Cheung

In this article, we will provide a brief introduction on the privatisation of listed companies in Hong Kong SAR and share our experience from a recently completed privatisation transaction.

II. Privatisation of non-H share listed companies in Hong Kong SAR

To undertake the privatisation of a non-H share Hong Kong listed company, it generally requires the compliance with the applicable company laws of the jurisdiction in which the offeree company is incorporated, the *Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited* (the "Listing Rules"), the *Codes on Takeovers and Mergers and Share Buy-backs* (the "Takeovers Code") administered by the Securities and Futures Commission (the "SFC") and the *Securities and Futures Ordinance* (Chapter 571 of the *Laws of Hong Kong*) (the "SFO") which regulates, among others, the disclosure of inside information by listed companies and insider dealing and other market misconduct offences that may be relevant to a privatisation transaction.

1. Methods adopted

The main methods of delisting a non-H share Hong Kong listed company from The Stock Exchange of Hong Kong Limited (the "Stock Exchange") are:

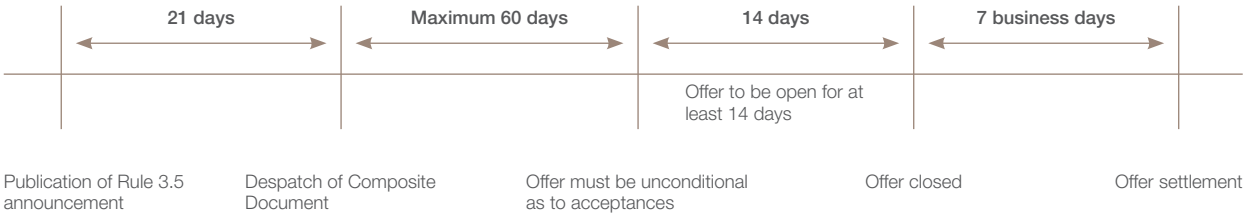
- General offer – the making of a voluntary general offer to acquire all voting rights (not already held by the offeror) in the offeree company and using squeeze out when condition is met. For a Hong Kong-incorporated offeree company, "squeeze-out" rights (that is, the rights of compulsory acquisition of the outstanding minority shares after an offer) arise only if the offeror acquires, during the four-month period after posting the initial offer document, a total of not less than 90% of the disinterested shares of the offeree company.
- Scheme of arrangement – a scheme of arrangement is an alternative to a general offer to privatise a listed company, which requires sanction by the court. A scheme of arrangement shall be conducted in accordance with the company law of the jurisdiction in which the offeree company is incorporated, and the scheme must be voted upon by the shareholders of the offeree company. Under the Takeovers Code, except

with the consent of the SFC, privatisation by way of scheme of arrangement requires, in addition to satisfying any voting requirements imposed by law, approval by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of the holders of the disinterested shares, and the number of votes cast against the resolution to approve the scheme at such meeting is not more than 10% of the votes attaching to all disinterested shares. "Disinterested shares" means shares in the offeree company other than those which are owned by the offeror or persons acting in concert with the offeror. Once approved, the scheme is binding on all shareholders of the offeree company.

2. Indicative timeline

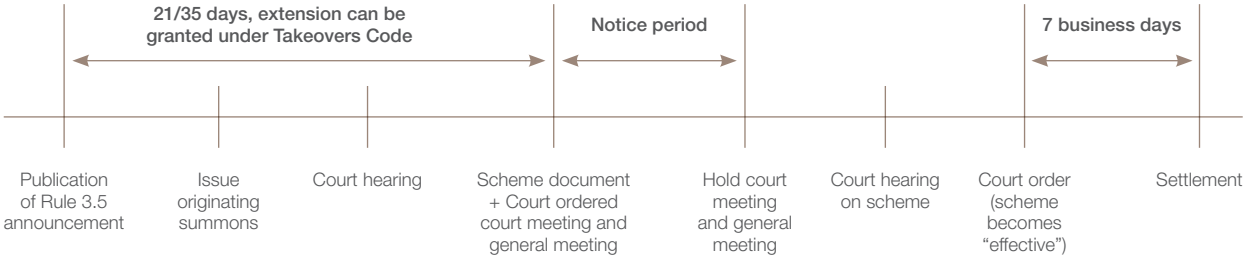
The following illustrates the timelines for privatisation by general offer and scheme of arrangement, respectively:

General offer



Note: The timetable is subject to notice periods for holding general meetings and the Takeovers Code.

Scheme of arrangement



Note: The timetable is subject to court process, notice periods for holding general meetings and court meetings and the Takeovers Code.

III. Privatisation of H share listed companies in Hong Kong SAR

1. Methods adopted

An H share listed company is a company incorporated in the People's Republic of China (the "PRC") with its H Shares listed on the Stock Exchange. The three main methods of privatising an H share listed company in Hong Kong SAR are:

- general offer;
- merger by absorption;
- a combination of general offer and merger by absorption.

Merger by absorption is a similar approach to a scheme of arrangement but with its own unique features. Merger by absorption involves an absorption of one company by another under Article 172 of the *PRC Company Law*. As a result, the absorbed company is deregistered and its assets and liabilities (together with the rights and obligations attached to such assets), the business and employees are merged into and resumed by the surviving entity. Court sanction is not required for privatisation by way of merger by absorption.

The choice of method to privatise an H share listed company in Hong Kong SAR will depend on the deal structure taking into account relevant regulatory and commercial factors.

Privatisation of an H share listed company will be subject to the *PRC Company Law* and other applicable laws, the *Takeovers Code*, the *Listing Rules* and the SFO. The H share listed company is also required to comply with the requirements under its articles of association.

IV. Applicable *Takeovers Code* and *Listing Rules*

1. *Takeovers Code*

General offer

Rule 2.2 of the *Takeovers Code* is applicable to privatisation by way of a general offer, of which the resolution to approve the delisting must be subject to (a) approval by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of the holders of the disinterested shares; (b) the number of votes cast against the resolution being not more than 10% of the votes attaching to all disinterested shares; and (c) the offeror being entitled to exercise, and exercising, its rights of compulsory acquisition.

As an H share company is incorporated in the PRC under the *PRC Company Law*, which does not afford compulsory acquisition rights to the offeror, the H share company is required to apply for a waiver from the SFC in compliance with the requirement of "*the offeror being entitled to exercise, and exercising, its rights of compulsory acquisition*" under Rule 2.2(c) of the *Takeovers Code*. In granting such a waiver, the SFC will normally require, among other things, the offeror to put in place arrangements such that: (i) where the offer becomes or is declared unconditional in all respects, the offer will remain open for acceptance for a longer period than 14 days which is normally required under Rule 15.3 of the *Takeovers Code* (which, in practice, the offer is required to remain open for acceptance for at least 28 days after the offer becomes or is declared unconditional in all respects); (ii) shareholders who have not yet accepted the offer will be notified in writing of the extended closing date and the implications if they choose not to accept the offer; and (iii) the resolution to approve the delisting is subject to the offeror having received valid acceptances amounting to 90% of the disinterested shares.

Merger by absorption

Similar to privatisation by way of scheme of arrangement, privatisation by way of merger by absorption is subject to the requirements under Rule 2.10 of the *Takeovers Code*. In addition to satisfying any voting requirements imposed by the *PRC Company Law*, the resolution to approve the delisting by way of merger by absorption must be subject to (i) approval by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of the holders of the disinterested shares; and (ii) the number of votes cast against the resolution to approve the delisting at such meeting is not more than 10% of the votes attaching to all disinterested shares.

Rule 2.2 of the *Takeovers Code*, which is applicable to privatisation by way of a general offer, is not applicable to privatisation by way of merger by absorption. As such, it is not necessary for the H share company to apply for a waiver in compliance with the requirement of "*the offeror being entitled to exercise, and exercising, its rights of compulsory acquisition*" under Rule 2.2(c) of the *Takeovers Code*. In addition, it is not compulsory for the resolution to approve the delisting by way of merger by absorption to be subject to the offeror having received valid acceptances amounting to 90% of the disinterested shares.

A combination of the general offer and merger by absorption

If the merger by absorption is conditional upon the delisting of the H share company, Rule 2.2 of the *Takeovers Code* is applicable to privatisation by way of a combination of general offer and merger by absorption.

The offeror is required to apply for a waiver from Rule 2.2(c) of the *Takeovers Code* and the resolution to approve the delisting is subject to the offeror having received valid acceptances amounting to 90% of the disinterested shares in the general offer.

2. *Listing Rules*

General offer

Upon the general offer becoming unconditional, the offeree company may make an application for the delisting of its shares on the Stock Exchange in accordance with Rule 6.12 of the *Listing Rules*, which, among others, the delisting is approved by at least 75% of the votes attaching to any class of the offeree's securities held by holders voting either in person or by proxy at the meeting

and the number of votes cast against the resolution is not more than 10% of the votes attaching to any class of the offeree's securities held by holders permitted to vote in person or by proxy at the meeting.

Merger by absorption

Similar to privatisation by way of scheme of arrangement, the offeree company may voluntarily withdraw its listing from the Stock Exchange according to Rule 6.15 of the *Listing Rules* if, among others, all the relevant requirements, including the shareholders' approval requirements, under the *Takeovers Code* have been complied with.

A combination of the general offer and merger by absorption

Upon the general offer becoming unconditional, the offeree company may make an application for the delisting of its shares on the Stock Exchange in accordance with Rule 6.12 of the *Listing Rules*.

3. Comparison of the different methods of privatising an H share listed company

	General offer	Merger by absorption	A combination of general offer and merger by absorption
Continuing operation	The offeree company will continue to operate as a private company upon the delisting of its H shares from the Stock Exchange. The offeree company may or may not continue to be subject to the *Takeovers Code* (depending on whether the offeree company remains as a public company).	The offeree company will cease to exist as a separate legal entity and will be merged and absorbed into the offeror company. The assets and liabilities, business, employees, contracts of the offeree company will be assumed by the offeror company as the surviving entity.	Upon completion of the general offer and the merger by absorption, the offeree company will cease to exist as a separate legal entity and will be merged and absorbed into the offeror company. The assets and liabilities, business, employees, contracts of the offeree company will be assumed by the offeror company as the surviving entity.
License continuity	The licences of the offeree company will not be affected, and the offeree company may continue to use its licences.	According to the relevant PRC laws, once an entity ceases to exist as a legal entity, all licences of such company will be revoked. The licences of the offeree company will not be assumed by the offeror company as the surviving entity. If the offeror company wishes to hold such licences as the surviving corporation, the offeror company shall re-apply for the licences.	According to the relevant PRC laws, once an entity ceases to exist as a legal entity, all licences of such company will be revoked. The licences of the offeree company will not be assumed by the offeror company as the surviving entity. If the offeror company wishes to hold such licences as the surviving corporation, the offeror company shall re-apply for the licences.
Use existing company name	The offeree company will continue to use its business name.	The offeree company will no longer use its business name since it will cease to exist as a separate legal entity.	The offeree company will no longer use its business name since it will cease to exist as a separate legal entity.
Shareholders holding unlisted shares	As the *PRC Company Law* does not afford compulsory acquisition rights to the offeror, upon the general offer becomes unconditional in all respects, shareholders not accepting the H share offer will hold unlisted shares of the offeree company upon the privatisation of the offeree company.	Upon the implementation of the merger by absorption and the payment of the merger price, all the shares of the offeree company will be deemed as cancelled. There will not be any shareholders holding unlisted shares of the offeree company.	Upon the implementation of the merger by absorption and the payment of the merger price, all the shares of the offeree company will be deemed as cancelled. There will not be any shareholders holding unlisted shares of the offeree company.
Notice to creditors	N/A	The offeree company and the offeror company are required to notify their respective creditors of the merger by absorption transaction by way of notifications and announcements.	The offeree company and the offeror company are required to notify their respective creditors of the merger by absorption transaction by way of notifications and announcements.
Dissenting shareholders	N/A	Any shareholder who has cast effective dissenting votes in respect of each of the resolutions at the general meeting and H share class meeting (if applicable) is entitled to exercise its right to demand the offeree company or the shareholders of the offeree company who have approved the merger by absorption to acquire its shares at a "fair price".	Any shareholder who has cast effective dissenting votes in respect of each of the resolutions at the general meeting and H share class meeting (if applicable) is entitled to exercise its right to demand the offeree company or the shareholders of the offeree company who have approved the merger by absorption to acquire its shares at a "fair price".

V. The ASMC transaction

On 25 January 2019, the H-shares of Advanced Semiconductor Manufacturing Corporation Limited ("ASMC", SEHK Stock Code: 3355), a PRC-incorporated company principally engaged in the manufacture and sale of semiconductor wafers, were delisted from the Stock Exchange. ASMC was privatised by GTA Semiconductor Co., Ltd. ("GTA"), an indirect wholly-owned subsidiary of China Electronics Corporation ("CEC"), by way of merger by absorption under the *PRC Company Law*.

KWM advised GTA on the privatisation of ASMC as to Hong Kong and PRC laws.

1. Key features of the privatisation of ASMC

Privatisation by way of merger by absorption

The privatisation of ASMC was undertaken by way of merger by absorption in accordance with Article 172 of the *PRC Company Law* (the "Merger"). ASMC and GTA entered into a merger agreement (the "Merger Agreement") pursuant to which, subject to the fulfilment (or waiver, if applicable) of the conditions set out in the Merger Agreement, (i) GTA shall pay the cancellation price to all its shareholders; and (ii) ASMC shall be merged and absorbed by GTA in accordance with the *PRC Company Law*, the applicable PRC laws and the articles of association of ASMC. Upon the payment of the cancellation price, the relevant rights attaching to all issued shares of ASMC were deemed cancelled. ASMC shall be deregistered and its assets and liabilities (together with the rights and obligations attached to such assets), the business and employees shall be merged into and resumed by GTA.

Right of dissenting shareholders

A special feature of Merger is the right of the dissenting shareholders to request for an acquisition of its shares at a "fair price". Pursuant to the articles of association of ASMC and the Merger Agreement, a dissenting shareholder who, among others, (i) validly voted against the resolutions at each of the extraordinary general meeting and the independent H shareholder class meeting of ASMC (if applicable) convened for approving the Merger; and (ii) having been validly registered as a shareholder on the registers of members of ASMC since the date of the

extraordinary general meeting and the independent H shareholder class meeting of ASMC (if applicable) until the date of the exercise of the right of dissenting shareholders shall have a right to demand ASMC or the shareholders of ASMC who have approved the Merger to acquire its shares in ASMC at a "fair price".

Such rights of the dissenting shareholders are contained only in the *Articles of Association of Companies Seeking a Listing Outside the PRC Prerequisite Clauses* and are not otherwise stipulated in any PRC Laws or regulations. The disputes arise from the right of dissenting shareholders may be resolved through the China International Economic and Trade Arbitration Commission or the Hong Kong International Arbitration Centre as stipulated in the articles of association of ASMC.

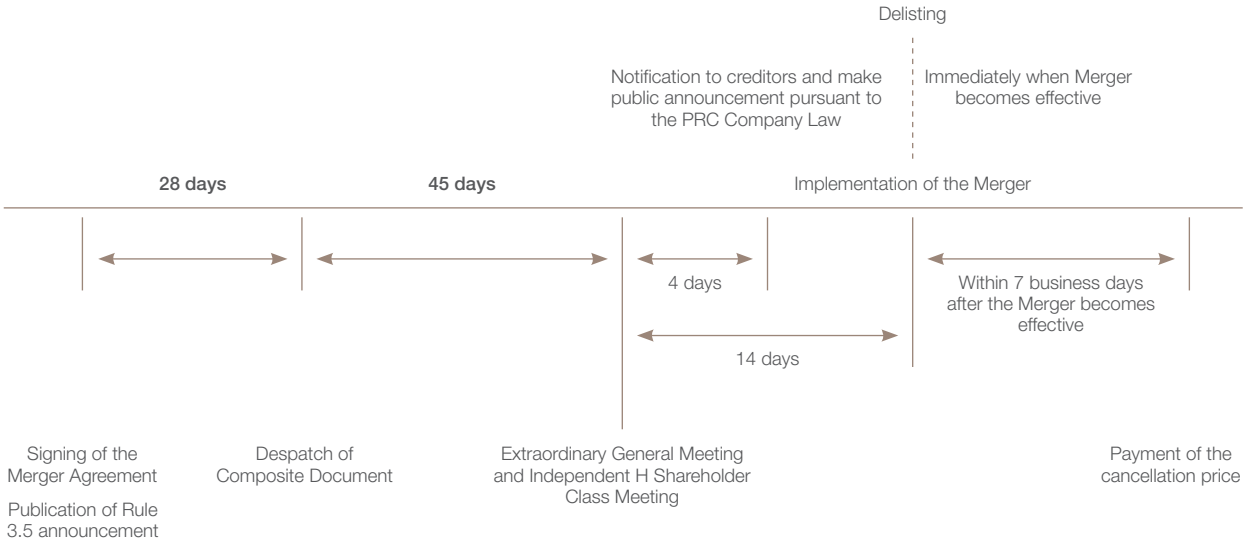
Delisting of the H-shares of ASMC from the Stock Exchange

After the Merger Agreement became effective, ASMC made a conditional application to the Stock Exchange for voluntary withdrawal of the listing of H-shares of ASMC from the Stock Exchange pursuant to Rule 6.15 of the *Listing Rules*. ASMC was delisted from the Stock Exchange upon the implementation of the Merger on 25 January 2019.

Indicative timeline of a merger by absorption transaction

The following is the indicative timeline of ASMC transaction, which illustrates some key events for a privatisation transaction by way of merger of absorption:

2. The ASMC transaction timeline



3. Key challenges of the ASMC transaction

GTA has committed a very tight timetable for the privatisation of ASMC. It only took approximately three months from the publication of the Rule 3.5 announcement to the delisting, which is a swift transaction of its kind in the market.

The ASMC transaction is the first completed privatisation of an H shares listed company in Hong Kong SAR after the amendments on the *Takeovers Code* in July 2018 which concerns the privatisation of companies which does not afford compulsory acquisition rights to the offeror under the company law of the place of jurisdiction of the offeree company. It involves complex regulatory requirements and certain unique issues throughout the process.

KWM is proud to act for CEC again. The involvement of KWM in this complex transaction represents our client's recognition of our experience with state-owned enterprises and our in-depth knowledge on *Takeovers Code* matters to guide them in meeting the complex regulatory requirements throughout the transaction. The ASMC transaction also requires the seamless efforts of our Hong Kong SAR and Mainland PRC team to offer on the ground support to deal with certain unique issues throughout the process, as well as corporate, securities, tax and antitrust matters related to Hong Kong and PRC laws.

Warranty and indemnity insurance in an M&A transaction -- how to make use of warranty and indemnity insurance to hedge risks and make successful bidding

Zhang Tiandi, Chen Chuqi

Warranty and indemnity insurance ("W&I insurance"), as a typical risk control tool in M&A transactions, has prevailed for years in M&A markets of the United Kingdom, Australia and the United States. So far, it has been increasingly used in global M&A market year by year. Specifically, more and more Chinese enterprises, including those based in the GBA, has implemented their "going-global" strategy and engaged in overseas investments and cross-border mergers and acquisitions. Such Chinese enterprises may certainly use W&I insurance either actively or passively to satisfy the requirements for an overseas bid. Based on our experience in advising our GBA clients on outbound investments and advising insurers in providing W&I insurance, this article briefly introduces this risk-hedging tool and analyzes noteworthy matters in using W&I insurance for Chinese investors.

Zhang Tiandi

I. Overview

1. W&I insurance

A set of M&A transaction documents in line with international market standard, typically contains a series of representations and warranties by the seller with respect to the target's assets, business, financial condition, compliance with laws and regulations. In support of the same, the transaction documents would usually provide the seller's liability for indemnity in case of its breach of such reps and warranties as well as the mechanism by which the buyer files claims for indemnity against the seller. As such, W&I insurance is the tool by which risks are transferred to a third party, as such third party (an insurer) insures against the risks of potential financial loss that may be incurred by the buyer or the seller in case of the seller's breach of such reps and warranties.

2. Reasons and advantages of using W&I insurance

The common scenarios that the parties to an M&A transaction use W&I insurance consist of the following:

- The seller wishes to minimize its warranties or liabilities for indemnity so as to get released from the same as soon as possible. In particular, in case of any seller as a private equity investor or any investor ready to retire or exit from certain investment, such seller is generally reluctant to assume any contingent liabilities beyond certain time limits or amount and would ask the buyer or have a third party to assume such risks, subject to the life cycle and of PE funds and investment recovered as well as the demand for distribution of investment income;
- As a result of the seller's market or the good quality of the target's assets, many buyers (such as a Chinese buyer in an outbound M&A transaction), have to procure insurance as required by the sellers, or elect to procure insurance to make its proposal competitive;
- Where the seller rejects the buyer's recourse for any loss incurred as a result of the seller's breach of reps and warranties or agrees to only limited liability therefor in a transaction, the buyer may elect to customize an insurance policy from an insurer or from a number of insurers based in different regions which jointly underwrite the policy, so as to enhance or supplement the remedy available to the buyer;
- The buyer has concern for the creditability, warranty capabilities and solvency of the seller for the warranty period of relevant M&A transaction;
- The buyer has concern for potential legal proceeding against the seller by reason of maintaining the buyer's or its parent's reputation, the cooperation relationship between the buyer and the seller or important business relationship.

In the context of China, "incorporating insurance into corporate risk management mechanism" has become the requirements of State-owned Assets Supervision and Administration Commission (SASAC) upon central state-owned enterprises[1]. The Department of Commerce of Guangdong Province has included the cost of indemnity insurance at the buyer's side, break-up fee liability insurance and other M&A-related insurance in an outbound M&A transaction in the 2019 fiscal subsidy policy[2]. We anticipate that as the W&I insurance is promoted, domestic enterprises based in the GBA would increasingly adopt such risk-hedging tools in outbound investment transactions going forward.

3. Seller's and buyer's insurance policies under W&I insurance

W&I insurance is typically categorized by the insured as the seller's insurance policy and the buyer's insurance policy. In practice, either of them may be used to hedge the risks in relation to breach of reps and warranties and facilitate the transaction. It depends on the parties' positions in negotiation who will bear the cost of insurance, one party or both sides jointly. The table below sets forth the difference between the seller's and the buyer's policies in short:

[1]Please refer to Article 27 of the *Measures for the Supervision and Administration of Overseas Investments by Central Enterprises* (Order of the State-owned Assets Supervision and Administration Commission of the State Council No. 35) for detail.

[2]Please refer to the *Notice of the Department of Commerce of Guangdong Province on Major Tasks of Special Fund for Economic Growth Promotion (both outbound and inbound investments) for 2019* (Yue Shang Wu Zi Han No. [2018]242) and Exhibit 2 - "Guide of Application for Outbound Investment Promotion Matter in relation to Special Fund for Economic Growth Promotion for 2019" for detail.

	Seller's W&I insurance	Buyer's W&I insurance
Insurance policy	The insurance contract between the seller and the insurer	The insurance contract between the buyer and the insurer
The insured	The seller	The buyer
Claims	If the seller is in breach of reps and warranties, the buyer may claim damages against the seller in accordance with the merger agreement, and the seller may claim the losses against the insurer to the extent of the coverage of the policy.	If the seller is in breach of reps and warranties, the buyer may claim damages directly against the insurer to the extent of the coverage of the policy, without notifying and claiming damages against the seller.
Limitation of the seller's liabilities by the merger agreement	It is the same in general with a typical merger agreement, and the buyer may not even know the existence of such insurance policy.	Although the seller has also made customary reps and warranties, it is probably set forth in the merger agreement that the buyer must first claim the damages arising in relation to the breach against the insurer, and even that the seller may be exempted from all or part of the liabilities for such damages arising from its breach of reps and warranties (except as a result of the seller's fraud).

Accordingly, a buyer's insurance policy, on the one hand, saves the steps that would be otherwise taken to claim damages against the seller by way of legal proceeding, and, on the other hand, allows the seller to be flexible in requiring limitation of its liabilities for damages in the merger agreement. This is also the reason why a buyer's insurance policy is more extensively used than a seller's insurance policy is in M&A transactions.

We will briefly go through a few common issues in a transaction in the following sections, for the purpose of advising the buyer in procuring a buyer's insurance policy.

II. Common issues and risk warning

1. Collaboration between W&I insurance policy and transaction agreements

As W&I insurance policy appears strange to Chinese enterprises and both W&I insurance and merger agreement are highly specialized and complex, buyers tend to focus on the premiums and sum insured in making the business decision when considering procuring W&I insurance policy. However, in addition to the target's industry, jurisdiction and transaction price, premiums are subject to factors like term of policy, coverage, retention/deductibles, and excluded liabilities. Each merger agreement may vary significantly in terms of coverage of the seller's warranty obligations and liabilities. Therefore, the buyer should also analyze and compare the provisions on the seller's warranty obligations, liabilities and recourse as particularly and accurately as possible, based on the merger agreement and the insurance policy, considering the difference and collaboration between both, in order to minimize the buyer's risk exposure. This is particularly important in a nil recourse transaction or in a transaction in which only quite limited indemnity is available.

A typical W&I insurance policy includes provisions like the term of the policy, the sum insured, the amount of retention, the basket, etc. An outbound merger agreement often limits the liability of the seller for breach of any rep and warranty to a certain period or amount, and in such case, the buyer may not receive sufficient indemnification or even any material compensation after closing (except as a result of the seller's intentional fraud). However, unlike a merger agreement, the term of the policy, insured sum, retention amount, basket and other factors of the policy can be flexibly customized to cater for the needs of the buyer.

Therefore, in order to make effective use of the risk-hedging tool of W&I insurance, the buyer should first pay attention to the risk exposure in the merger

agreement (for example, a short period of warranty unacceptable to the buyer, limited indemnity far below the transaction price or other losses excluded from the scope of indemnity). In doing so, the buyer can effectively and accurately choose or flexibly assort the policies provided by various insurers in different regions. For example, as applicable to the buyer's needs and acceptability of the premiums, the buyer should:

- Check whether the term of the policy covers the warranty period of the merger agreement and, if necessary, consider extending the term appropriately;
- Define the basket, retention limit, amount insured and other limits of the policy by reference to the limitation of indemnity clauses of the merger agreement (including basket, deductible, maximum indemnity and other restrictions). The buyer may require the insurer to insure the loss in excess of the deductible set out in the merger agreement only, or may require the insurer to provide additional coverage for the loss that has not yet met the deductible therein, as applicable. If the buyer considers that the limited indemnity of the merger agreement is insufficient, the buyer may also elevate the limitation appropriately, and even set the coverage of the insurance policy or the joint insurance policy at 100% of the transaction amount (in a rare case);
- Check whether the coverage of the policy covers the claims by the parties to the transaction and third-party claims, as well as incidental costs of defense, etc.

In addition, when drafting the insurance policies and the merger agreement, the buyer should also pay attention to whether there is any inconsistency between them in terms of important definitions and descriptions related to the merger transaction (e.g. descriptions of the closing, "to seller's knowledge" and test of materiality, etc.) or whether any of them is not acceptable to the buyer. Otherwise, it may also expose the buyer to risks, resulting in the buyer's failure to claim compensation from the insurer.

2. Inadequate due diligence and disclosure by the seller

According to AIG's M&A Claims Intelligence 2018 (*M&A Insurance - The new normal?*) ("AIG Report"), claims have occurred to approximately 19.4 per cent of AIG's W&I insurance policies (equivalent to one in five policies receiving a claim from the insured for breach of contract by the seller).[3] Thus, even if the buyer and its intermediaries actively lead the due diligence and the seller's information disclosure, the risk of seller's breach of contract is still substantial. Therefore, for the purpose of merger and acquisition, the buyer should conduct comprehensive, thorough and professional due diligence to ensure that the seller fully discloses the risks. For the purpose of procuring W&I insurance, comprehensive, thorough and professional due diligence, covering all aspects of the seller's reps and warranties, is the basis for the buyer to obtain adequate insurance coverage from the insurer at a reasonable premium rate.

W&I insurance generally does not cover known risks (e.g., those disclosed by the seller, those identified by the buyer's due diligence). Accordingly, before insurance underwriting, an insurer and its legal adviser usually verify and assess the insurer's compensation risks by reviewing the transaction documents, reviewing the due diligence reports of the buyer and the seller, accessing the seller's database, raising underwriting issues with the buyer and its legal advisers, financial advisers, tax advisers, etc., and conducting insurance underwriting meetings.

As such due diligence can only reflect the circumstances within the scope of due diligence for a specific period of time, an insurer will generally require supplemental due diligence from the buyer or exclusion of such warranty liability from the coverage as to the seller's reps and warranties not covered

[3]Source: AIG's *M&A Claims Intelligence 2018 (M&A Insurance - The new normal?)*. Please visit the page for details: https://www.aig.com/content/dam/aig/america-canada/us/documents/insights/aig-manda-claimsintelligence-2018-w-and-i.pdf

by the due diligence. The buyer may have to accept such exclusions as supplemental due diligence may affect the process of signing the transaction documents or incur additional costs. Therefore, it will not only reduce the buyer's risk exposure but also facilitate the buyer's procurement of W&I insurance at relatively reasonable costs, to ensure that due diligence is comprehensive in scope and adequate in quality to cover all aspects of the seller's reps and warranties.

3. Excluded liabilities of the insurance policy

Excluded liabilities are often provided in the "excluded liabilities" clause of the policy and in the "coverage form" attached thereto. Therefore, when the buyer procures the insurance, it is necessary for the buyer to analyze not only the reps and warranties included in the coverage under the "coverage form" one by one in combination with other clauses of the insurance policy, but also the "excluded liabilities" clause in detail, so as to clarify the coverage of the insurance policy.

In addition to the exclusions mentioned above, W&I insurance may only partially insure or even completely exclude the following risks:

- certain highly risky areas (e.g., environmental warranties, tax liabilities, anti-corruption and anti-bribery issues);
- future risks (e.g., forward-looking warranties, financial forecast, earn-out);
- inadequate pension contribution;
- criminal penalty or punishment; and
- adjustment to the transaction consideration, etc.

In addition, the buyer should pay attention to the specific high risk areas of the target based on the due diligence and consider whether to accept the relevant exclusion of liabilities accordingly. According to the AIG report, based on the statistics of W&I insurance policies issued by AIG, the common breaches of warranties by the seller involve: financial statements (18%), tax (16%), legal compliance (15%), material contracts (14%), and employee-related matters (9%). However, according to AIG, the breaches may vary by industry, e.g., such breaches may involve tax (25%), intellectual property (19%), financial statements (12%), material contracts (11%), and legal compliance (9%) in an M&A transaction in the technology sector.

Whether for the purpose of remedying the risk exposure or focusing on prevention of specific type of risks, the buyer should take advantage of the diversity of insurance policies of various insurers and jurisdictions, and attach importance to negotiation with insurers on the exclusion of liability and coverage of W&I insurance. In addition, the buyer can also consider procuring insurance to cover certain risks separately, such as environmental liability insurance, tax liability insurance, litigation insurance, contingent liability insurance, based on its business needs.

Conclusion

This article summarizes the advantages of W&I insurance and a few key points of effective application of W&I insurance in overseas investment. Scrupulous planning and careful drafting of insurance policy based on comprehensive and solid M&A due diligence can provide greater protection for the parties concerned. We also anticipate that W&I insurance as a risk-hedging product and competitive bidding tool, may play certain role in domestic M&A transactions going forward, in which it has realistic necessity and broad market prospects.

An overview of the dispute resolution within the Greater Bay Area

Teng Haidi, Yu Qing

Teng Haidi

Introduction

On February 18th, 2019, *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* (hereinafter referred to as the "Outline") was officially promulgated, in which the Greater Bay Area is strategically positioned as an important support factor in the construction of the "Belt & Road". In particular, the Outline emphasizes on improving the international commercial dispute resolution mechanisms, establishing the international arbitration centre, enhancing the communication and cooperation among arbitration and mediation institutions in Guangdong, Hong Kong SAR and Macao SAR, to provide arbitration and mediation services for the Greater Bay Area economy and trade. In Mainland China, with the further implementation of the Outline, courts at all levels in Guangdong Province will also face more cases involving Hong Kong SAR and Macao SAR.

The purpose of this article is to introduce the commonly used dispute resolution institutions (courts and arbitration commissions) in the Greater Bay Area and their jurisdiction for your reference. At the same time, this article will also focus on the mutual recognition and enforcement of effective judgments and arbitral awards among various judicial institutions in the Greater Bay Area with the growing judicial integration. In recent years, a good many judicial arrangements under the "One Country, Two Systems" policy have been reached, such as the recent promulgation of *Arrangements for Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Cases between Courts of the Mainland and Hong Kong Special Administrative Region* and *Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region*. While they have not yet taken effect, they show the way forward and the legal practice should learn about and prepare for them in advance, equipping ourselves for a more integrated regional judicial environment.

I. People's Courts in Guangdong Province and their jurisdictions for first instance civil and commercial cases

According to *Civil Procedure Law of the People's Republic of China* (hereinafter referred to as "Civil Procedure Law"), except for special courts such as Maritime Courts and Railway Courts, ordinary People's Courts are divided into District Courts, Intermediate Courts, Provincial High Courts and the Supreme People's Court. The jurisdiction of each court to accept civil and commercial cases of first instance is generally determined by geographical region and level, unless the parties have agreed on a particular jurisdiction.

In Guangdong Province, except for Guangdong High People's Court, the first circuit of the Supreme People's Court is listed and set up in Shenzhen on January 28th, 2015. At present, there are four levels

of judicial adjudicatory organ in Guangdong Province, ranging from basic court to supreme people's court (hereinafter referred to as "Supreme Court").

The Outline highlights the role of Hong Kong SAR and Macao SAR as open platforms and role models, supporting the nine Pearl River Delta municipalities in expediting the establishment of mechanisms that are in line with international standard investment and trade regulations and rules. The perfection of these legal mechanisms is the most important support in forming a stable, fair, transparent and predicable first-class business environment. The China International Commercial Court, established per the *Provisions of the Supreme People's Court on Several Issues Concerning the Establishment of International Commercial Courts* implemented on July 1, 2018, was set up in response to the "Belt & Road" initiative in order to create a globally competitive business environment.

The jurisdiction of the first instance civil and commercial cases in Guangdong Province from the basic court to the Supreme Court is briefly introduced as follows:

Supreme People's Court			
The First Circuit Court	First-instance civil and commercial cases with significant impact nationwide		
International Commercial Court	1. First-instance international commercial cases where parties agreed to choose[1] the Supreme People's Court to exercise jurisdiction and cases where the subject matter of action has a value of not less than 300 million yuan 2. First-instance international commercial cases with significant impact nationwide		
Guangdong Province			
	Domestic cases in which all parties are domiciled in Guangdong province	**Domestic cases in which one of the parties is not domiciled in Guangdong province**	**Foreign-related civil and commercial cases[2]**
Provincial Higher People's Court	Subject matter of action at a value of not less than 5 billion yuan		
Municipal Intermediate People's Court	Subject matter of action at a value of not less than 100 million yuan	Subject matter of action at a value of not less than 50 million yuan	Subject matter of action at a value of less than 200 million yuan
Basic People's Court	Subject matter of action at a value of less than 100 million yuan	Subject matter of action at a value of less than 50 million yuan	Provincial capital cities and special economic zone[3]: subject matter of action at a value of less than 20 million yuan Other cities: subject matter of action at a value of less than 10 million yuan
※ People's Court of the Shenzhen Qianhai Cooperation Zone	Commercial cases involving a foreign country, Hong Kong Special Administrative Region ("Hong Kong SAR"), Macao Special Administrative Region ("Macao SAR") or Taiwan region and subject matter of action at a value of less than 50 million yuan in Shenzhen[4].		

The enforcement of domestic judgment is quite standard. In terms of the current status and future development of the recognition and enforcement of judgments issued by courts in Hong Kong SAR, Macao SAR, Taiwan region and foreign countries, please see below summary.

[1]Parties' choice shall comply with the Civil Procedure Law, Article 34.
[2]This rule shall apply to civil and commercial cases in Hong Kong SAR, Macao SAR, and Taiwan region.
[3]Provincial capital cities and special economic zone in Guangdong Province includes Guangzhou, Shenzhen, Shantou and Zhuhai.
[4]This rule does not apply to foreign-related civil cases, which shall be heard by basic people's courts respectively.

II. Enforcing judgments issued by Hong Kong SAR, Macao SAR, Taiwan region and foreign courts

1. Hong Kong SAR

Recognition and enforcement of Hong Kong judgments	
Name	1. *Arrangements for Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Cases under Agreed Jurisdiction between Courts of Mainland and Hong Kong Special Administrative Region*; 2. *Arrangements for Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Cases between Courts of the Mainland and Hong Kong Special Administrative Region* (NOT YET EFFECTIVE)[5].
Type of cases to be recognized and enforced	1. An enforceable final judgment requiring payment of money issued by any court of the Hong Kong SAR in a civil and commercial case pursuant to a choice of court agreement in writing; 2. Effective judgments in civil and commercial cases issued by courts of the Hong Kong SAR; effective judgments on civil compensation in criminal cases[6].
Jurisdiction	1. The Intermediate People's Court at the domicile or the place of permanent residence of the respondent, or place where the property is located; 2. The Intermediate People's Court at the domicile of the applicant or the respondent, or place where the property is located.
Asset preservation	Yes
Legal remedies	The party can apply for reconsideration to the upper People's Court re the decision to recognize and enforce or not.

Regarding the recognition and enforcement of judgments issued by Hong Kong and Mainland courts, the Mainland and Hong Kong SAR entered into the *Arrangements for Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Cases between Courts of the Mainland and Hong Kong Special Administrative Region*.

Compared with the previous arrangement, this new arrangement (not effective yet) considerably expands the scope of recognizable/enforceable civil and commercial judgments, including non-monetary judgment items and some intellectual property cases, which will minimize duplicate litigation, enhance judicial mutual trust between the Mainland and Hong Kong SAR, enshrine the "One Country, Two Systems" policy and better serve the innovation-driven industry development of the Guangdong-Hong Kong-Macao Greater Bay Area.

[5]The date of the new Arrangements coming into force will be announced by both parties after the Supreme People's Court issues the judicial interpretation and the Hong Kong SAR completes the relevant procedures. The judgments made as from the date of the new Arrangements coming into force by the courts of the Mainland and of the Hong Kong SAR shall be subject to the new Arrangements. On the date of the new Arrangements coming into force, the *Arrangements for Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Cases under Agreed Jurisdiction between Courts of Mainland and Hong Kong Special Administrative Region* shall be repealed in the meantime. If, the new Arrangements enter into force, the parties have already signed the "Written Agreement on Jurisdiction" under the *Arrangements for Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Cases under Agreed Jurisdiction between Courts of Mainland and Hong Kong Special Administrative Region*, those arrangements shall still apply.

[6](1) excluding judicial review cases heard by the Hong Kong SAR Courts and other cases directly arising from the exercise of administrative power; (2) not currently applicable to judgments on inheritance, maritime, liquidation cases, etc. Details see Article 3 of the Arrangement.

2. Macao SAR

Recognition and enforcement of Macao judgments	
Name	*Arrangements between the Mainland and the Macao Special Administrative Region on the Mutual Recognition and Enforcement of Civil and Commercial Judgments*
Type of cases to be recognized and enforced	Judgments of civil and commercial cases (including the civil labor cases in the Macao SAR); the judgments and verdicts of civil damages involved in criminal cases; not applicable to administrative cases.
Jurisdiction	The Intermediate People's Court at the domicile or the place of permanent residence of the respondent, or place where the property is located
Asset preservation	Yes
Legal remedies	The party can apply for reconsideration to the upper People's Court re the decision to recognize or not; the party can apply for relevant remedies to the upper People's Court as per the PRC laws re the decision made in the enforcement proceedings.

3. Taiwan region

Recognition and enforcement of Taiwan region judgments	
Name	*Provisions of the Supreme People's Court on Recognition and Enforcement of the Civil Judgments of Courts of the Taiwan Region*
Type of cases to be recognized and enforced	"Civil judgments of courts of the Taiwan region" includes among others, the effective civil judgments, rulings, settlement transcripts, mediation transcripts and payment orders issued by courts of the Taiwan region. These Provisions shall apply to applications for recognition of the effective judgments, rulings and settlement transcripts on civil damages in criminal cases issued by courts of the Taiwan region. These Provisions shall apply, mutatis mutandis, to applications for recognition of the mediation papers that are issued by the mediation committees of townships, towns or cities in the Taiwan region, among others, approved by courts of the Taiwan region, and of legal effect equal to the effective civil judgments of courts of the Taiwan region.
Jurisdiction	The Intermediate People's Court or a Special People's Court at the place where the applicant is domiciled or habitually resides, the respondent is domiciled or habitually resides, or the relevant property is located
Asset preservation	Yes
Challenge of jurisdiction	Yes
Legal remedies	The applicant may file an appeal against the ruling not to accept the case; A ruling issued by the people's court shall take effect immediately upon service thereof. Against the above ruling, a party may apply for reconsideration to the people's court at a higher level within ten days of service of the ruling.

4. Foreign countries

Recognition and enforcement of foreign judgments	
Name	1. Treaties Such as: *Treaty between the People's Republic of China and the Kingdom of Spain on Judicial Assistance in Civil and Commercial Matters;* *Treaty between the People's Republic of China and the Federative Republic of Brazil on Judicial Assistance in Civil and Commercial Matters;* *Agreement between the People's Republic of China and the United Arab Emirates on Judicial Assistance in Civil and Commercial Matters.* From 1987, China has entered into treaties on judicial assistance in civil and commercial matters with more than 30 countries, please see below for details: http://treaty.mfa.gov.cn/Treaty/web/index.jsp 2. The principle of reciprocity A People's Court can also recognize and enforce a foreign judgment based on the principle of reciprocity if no treaty exists between the two countries. Many countries, including the United States, Britain, Germany and Israel have recognized and enforced Chinese court judgments.
Type of cases to be recognized and enforced	Civil and commercial judgments
Jurisdiction	The intermediate People's Court of the People's Republic of China having jurisdiction for recognition and enforcement (at the place of the domicile of the party whom the enforcement is sought or at the place where the property under enforcement is located.)
Asset preservation	During judicial review period: No[7] In enforcement process following the recognition of the judgment : Yes
Legal remedies	No appeal or reconsideration.

After introducing the court system of the Greater Bay Area and the enforcement of extraterritorial judgments in Mainland China, we now introduce the recognition and enforcement of extraterritorial arbitration procedures and the arbitral awards in the Greater Bay Area.

III. Asset preservation re arbitration outside of China

Except for the people's court, there also are many arbitral institutions in the Greater Bay Area. Generally speaking, choosing an arbitral institution is the commercial arrangement of the two parties to a transaction. In practice, parties to foreign-related transaction usually prefer choosing arbitral institutions as the venue to solve the disputes to avoid long court proceedings and enjoy the confidentiality and flexibility of arbitration.

For a long time, a party who brings an arbitration case abroad is often frustrated by the difficulty to simultaneously conduct asset preservation in the Mainland and the counterparty taking the opportunity to dissipate valuables. As of today, a party to an arbitration outside of China still cannot apply for preservation of evidence of assets with a Chinese courts.

[7]In practice, generally, courts only allow asset preservation after recognition of foreign judgments, but some courts also allow asset preservation during judicial review period. For detailed information please see the court order issued by Shanghai No. 2 Intermediate People's Court in *EUNICELYNNSCHOENMAN v. GEORGEQUINN.CHEN* (Case No.: (2013) Hu Er Zhong Min Ren (Wai) Zi No. 11).

To solve those problems and further promote the integration process of the legal systems within the Greater Bay Area, on April 2, 2019, the PRC Supreme People's Court and Hong Kong Department of Justice signed the *Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region*, which is the first document signed by the Mainland with other jurisdictions that deals with providing assistance of arbitration preservation. This arrangement treats the Hong Kong arbitration procedure in a similar way to the arbitration procedure in the Mainland in the aspect of preservation, allowing parties in Hong Kong arbitration procedure to apply to the People's Courts within the Mainland for asset preservation. At the same time, parties in the arbitration proceedings in the Mainland can also apply to the Hong Kong courts for an injunction and other provisional measures.

While this arrangement has not yet come into force, it is foreseeable that after this arrangement is effective, Mainland courts will escort the smooth enforcement of Hong Kong arbitral awards, protect the legitimate rights and interests of the parties more effectively, and Hong Kong's status as an international commercial dispute resolution centre will be further enhanced.

IV. Enforcing arbitral awards issued by Hong Kong SAR, Macao SAR, Taiwan region and foreign arbitration institutions

As mentioned above, in commercial transactions, especially those involving foreign affairs, or involving Hong Kong SAR, Macao SAR and Taiwan region, many parties tend to choose arbitration as the way to settle disputes. As for how to recognize and enforce overseas arbitration awards in Mainland China, we hereby make a brief introduction as follows:

1. Hong Kong SAR

Enforcement of Hong Kong arbitration awards	
Name	*Arrangements of the Supreme People's Court on the Reciprocal Enforcement of Arbitration Awards by Mainland China and the Hong Kong Special Administrative Region*
Type of cases to be enforced	Arbitration awards made in the Hong Kong SAR in accordance with the *Arbitration Ordinance* of the Hong Kong SAR
Jurisdiction	The Intermediate People's Court at the domicile of the respondent, or place where the property is located
Asset preservation	Yes[8]
Challenge of jurisdiction	Yes
Legal remedies	The party can appeal to the upper People's Court re the decision on in-admission, dismissal of application or objections to jurisdiction; other than that above-mentioned decisions, ruling issued by the People's Court shall take effect immediately upon service thereof.

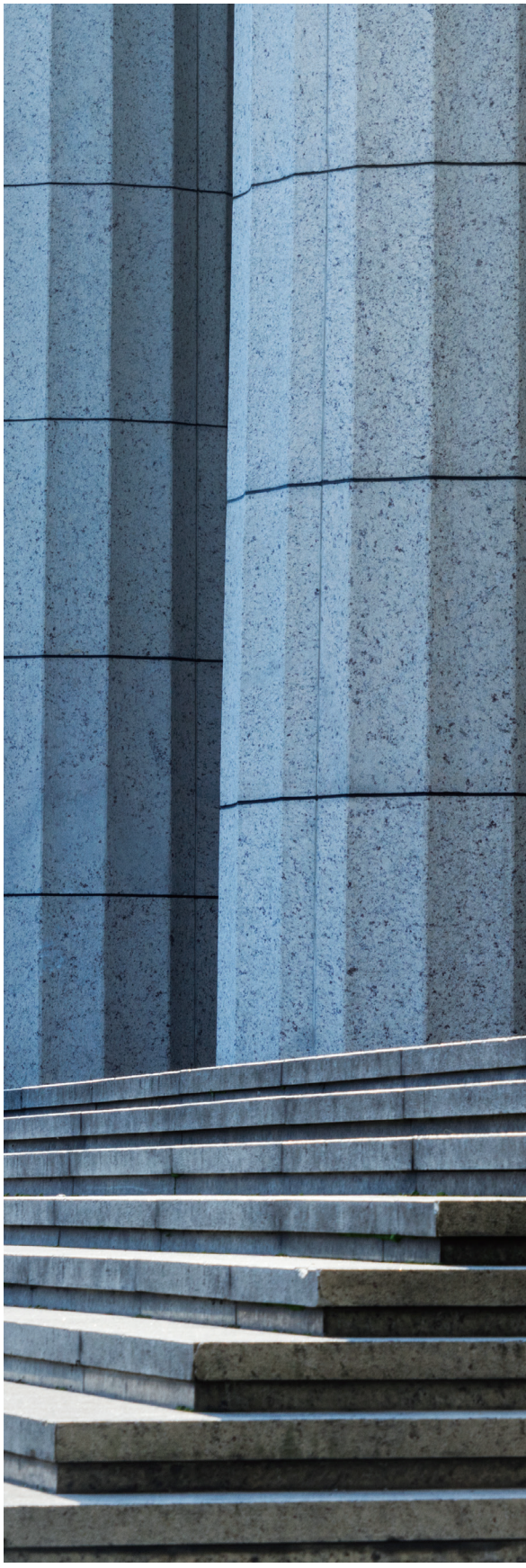
[8] *Arrangements of the Supreme People's Court on the Reciprocal Enforcement of Arbitration Awards by Mainland China and the Hong Kong Special Administrative Region* does not make a clear regulation, but as opinions of the Supreme Court in *Reply to the High People's Court of Hubei Province on the Application of AUTOMOTIVE GATE FZCO for Asset Preservation in the Case of Applying for Recognition and Enforcement of the Arbitration Award of the Hong Kong Special Administrative Region* [(2017) zui gao fa min ta No.129]:"Currently, there is no clear regulation for the applicant applying to the People's Court for asset preservation following applying for recognition and enforcement of the arbitration award of the Hong Kong SAR, but the application for property preservation may be approved if the applicant provides full security according to the principles specified in article 100 of the *Civil Procedure Law of the PRC*." We found similar operations in other cases.

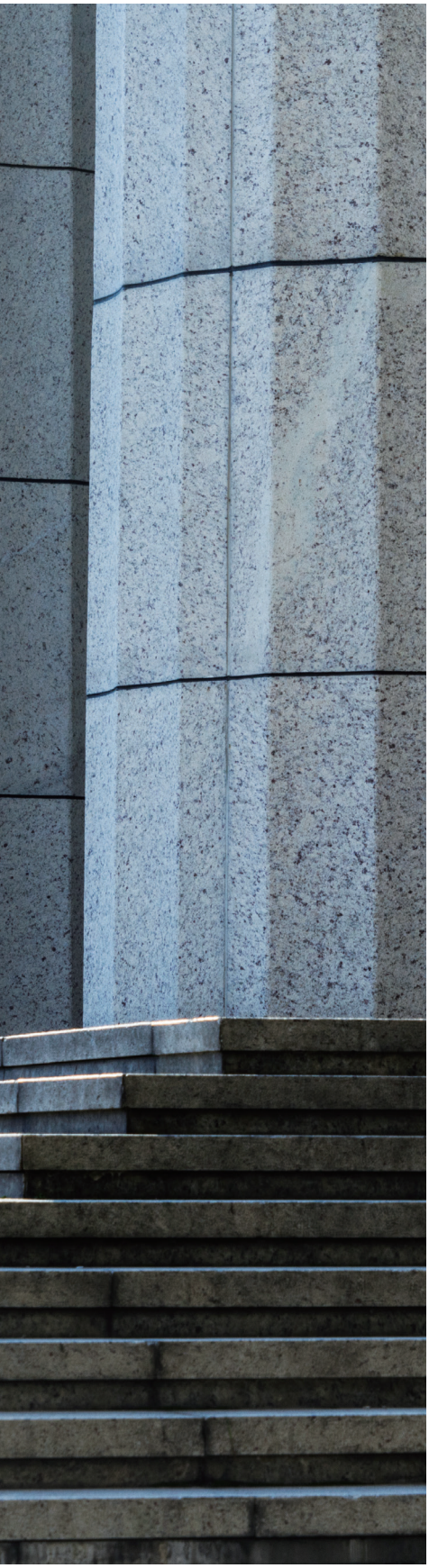
2. Macao SAR

Recognition and enforcement of Macao arbitration awards	
Name	*Arrangements of the Supreme People's Court on Mutual Recognition and Enforcement of Arbitration Awards Between the Mainland and Macao Special Administrative Region*
Type of cases to be recognized and enforced	Arbitration awards that are made in Macao SAR by arbitration bodies and arbitrators in Macao SAR pursuant to the arbitration regulations of Macao SAR
Jurisdiction	The Intermediate People's Court at the domicile or the place of permanent residence of the respondent, or place where the property is located
Asset preservation	Yes
Challenge of jurisdiction	Yes
Legal remedies	The party can appeal to the upper People's Court re the decision on in-admission, dismissal of application or objections to jurisdiction; other than that above-mentioned decisions, ruling issued by the People's Court shall take effect immediately upon service thereof.

3. Taiwan region

Recognition and enforcement of Taiwan region arbitration awards	
Name	*Provisions of the Supreme People's Court on Recognition and Enforcement of the Arbitral Awards of the Taiwan Region*
Type of cases to be recognized and enforced	The arbitral awards on civil or commercial disputes issued by the relevant permanent arbitration institutions or temporary arbitral tribunals in the Taiwan region in accordance with the provisions of the Taiwan region on arbitration, including arbitration judgments, arbitration settlements and arbitration mediations
Jurisdiction	The Intermediate People's Court or a Special People's Court at the place where the applicant is domiciled or habitually resides, the respondent is domiciled or habitually resides, or the relevant property is located
Asset preservation	Yes
Challenge of jurisdiction	Yes
Legal remedies	The party can appeal to the upper People's Court re the decision on in-admission, dismissal of application or objections to jurisdiction; other than that above-mentioned decisions, ruling issued by the People's Court shall take effect immediately upon service thereof.





4. Foreign countries

Recognition and enforcement of foreign arbitral awards	
Name	The *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 158 contracting states in all, please see below for details: http://www.newyorkconvention.org/list+of+contracting+states
Type of cases to be recognized and enforced	1. The recognition and enforcement by the PRC of arbitral awards rendered in the territory of another contracting state on the basis of reciprocity only; 2. The PRC applies the convention only to disputes arising from commercial legal relations which are determined to be contractual and non-contractual under the laws of the PRC.
Jurisdiction	1. If the party against whom the award is invoked is a natural person, the place of his or her household registration or the place of his or her residence; 2. If the party against whom the award is invoked is a legal entity, the place of its principal business office; 3. If the party against whom the award is invoked does not have any household registration, residence or principal business office in China but has any property in the territory of China, the place where the property is located; 4. Where a foreign arbitral award is related to a case decided by a people's court, neither the place of the domicile of the respondent nor the place where the property of the respondent is located in Chinese Mainland, and the applicant applies for recognition of the foreign arbitral award, the people's court accepting the related case shall have jurisdiction. If the people's court accepting the related case is a basic-level people's court, the people's court at the next higher level of the basic-level people's court shall have jurisdiction in the case of the application for recognition of the foreign arbitral award. If the people's court accepting the related case is a higher people's court or the Supreme People's Court, the court shall decide whether to conduct the review itself or appoint a higher people's court for the review; 5. Where a foreign arbitral award is related to a case decided by a Chinese Mainland-based arbitral institution, neither the place of the domicile of the respondent nor the place where the property of the respondent is located in Chinese Mainland, and the applicant applies for recognition of the foreign arbitral award, the intermediate people's court in the place where the arbitral institution accepting the related case is located shall have jurisdiction.
Asset preservation	During judicial review period: No In enforcement process: Yes
Challenge of jurisdiction	Yes
Legal remedies	The party can appeal to the upper People's Court re the decision on in-admission, dismissal of application or objections to jurisdiction; other than that above-mentioned decisions, ruling issued by the People's Court shall take effect immediately upon service thereof.

The above is a brief introduction of the People's Courts and relevant arbitration institutions in the Greater Bay Area, and a preliminary summary and explanation of the issues related to the dispute settlement mechanism concerning Hong Kong, Macao, Taiwan and foreign affairs. With the construction and development of Guangdong-Hong Kong-Macao Greater Bay Area, the cooperation among Mainland China, Hong Kong SAR and Macao SAR will be further deepened, and the construction of regional and integrated judicial environment and supporting judicial system will be further improved to better escort the construction of the Greater Bay Area.

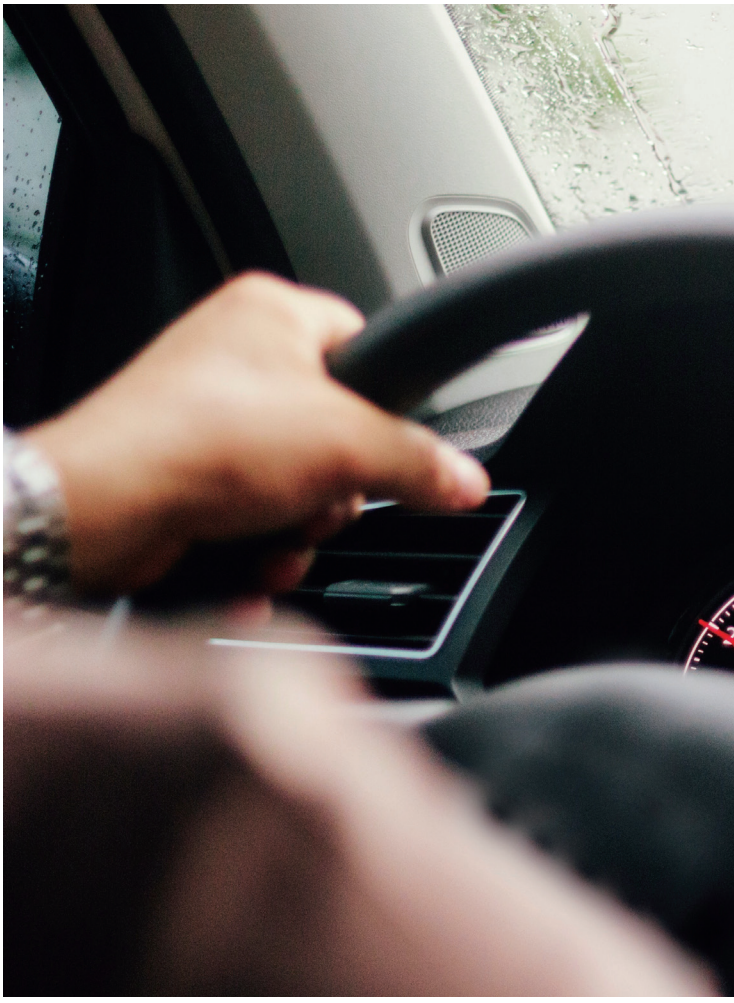
Financial lease in the GBA: risk control as the opportunity arises

Cheng Ke

Recently, the *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* (the "Outline") was officially released, which provides a comprehensive plan for the strategic positioning, development objectives and spatial layout of the Greater Bay Area as a constitutional document for cooperation and development for now and going forward. Among others, it points out that "[i]nfrastructural support and protection, such as transport, energy, information and water resources, should be further strengthened," and "[t]o build regional economic development axes relying on a rapid transport network involving mainly high-speed rails, intercity railways and high-grade motorways, as well as port and airport clusters". It is foreseeable that the infrastructure connectivity will further deepen in the GBA. As an asset-based financial instrument that may serve as means of both financing and leasing, financial lease has been increasingly applied to power facility and equipment, transportation equipment, infrastructure and real estate, general machinery and equipment, industrial equipment and medical and pharmaceutical equipment[1], and therefore, it perfectly satisfies the call for combination of industry and finance in reality and is expected to play a more important role in GBA construction.

Based on the positioning of each city in the planning of the GBA, Hong Kong SAR, as an international financial centre, will definitely serve as an essential power to give financial support for the GBA construction. However, Hong Kong's positioning also indicates the complexity and diversity of the source of fund for the GBA construction. Therefore, the various investment may be safeguarded only upon the basis of a better understanding of the financial lease business under the PRC law and relevant laws.

The legal relation of financial lease is defined in Article 237 of the *Contract Law of the People's Republic of China* ("Contract Law") as "a contract whereby the lessor, upon purchase of the lessee-selected lease item from a lessee-selected seller, provides the lease item to the lessee for its use, and the lessee pays the rent." Such definition represents the fundamental transaction structure of financial lease, i.e., a transaction of purchase and subsequent lease among the lessor, the



[1] MOFCOM: *China Financial Leasing Industry Development Report (2016-2017)*

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lessee and the seller in which the lessee plays an essential role in connecting the subjects. The lessor, as the core subject of the legal relation, assumes the risks of breach of contract by both the lessee and the seller, the lessee's operating risks as well as the risks of transfer of ownership of the object. Therefore, the lessor ought to prudently manage the risks and improve its risk prevention and handling capability in conducting financial lease business. In this article, we will analyze several kinds of common issues based on our experience in handling a great number of disputes over financial lease, in hope that this article may be helpful for the lessor's risk prevention and dispute resolution.

I. Property right is essential to a financial lease transaction

In the legal relation of financial lease, the ownership of the object is not only the result of the earlier purchase and sale, but also the basis of the subsequent lease, which is worthy of attention in particular. However, due to a lessor's intrinsic sense that it attaches more importance to financing than to leasing, and certain foreign financial leasing companies' unfamiliarity with the PRC laws, the lessors quite often focus on withdrawal of funds and repayment, but may well neglect the change of property right and other issues in a financial lease transaction which may therefore give rise to substantial legal risks. In practice, a seller and a lessor in a financial lease transaction are generally sensitive to lending and other financing part of the deal only, and their demands are only limited to acquisition of fund from financial institutions. So, they actually take financial lease as a financial instrument like mortgage loan from banks or consumer loan. In addition, many financial leasing companies' ignorance of the

ownership of the object may easily result in loss of both the money and the object.

The essence of financial lease is financing subject to the lessor's retention of ownership of the object. If any dispute arises from the lessor's ownership of the object, the risk exposure under the transaction would turn out of control from its source. In practice, a financial leasing company, acting as a financial institution, generally may not retrieve the object purchased from the seller and hand over to the lessee by itself due to a number of factors involving business model, personnel cost, the costs of transportation and preservation and other considerations. Instead, it might probably acquire the ownership of the object by way of instructed delivery, as a matter of law, or other non-actual delivery. Based on our research of substantial cases, as the seller and the lessee consider financial lease as "financing" only, quite often, there have been cases that the object had been sold by the seller to the lessee and the transfer of ownership had occurred prior to the lessee's application to the financial leasing company for financial lease service. Even worse, the lessor may be exposed to the risks of fictitious transaction and fraud by the seller and the lessee.

Therefore, in a financial lease transaction, the lessor's oversight of the purchase and delivery of the leased item appears to be extremely important in order to make sure the ownership of the purchased item is transferred to the lessor. This is determined by the financial lease's characteristics distinctive from other financial services.

II. Financial leasing companies should reinforce their sense as a lessor

In terms of financial lease service, a financial leasing company is different from a general financial institution, as the transaction structure reflects its status of both investor and lessor. However, in practice, many financial leasing companies are not aware of the importance of their capacity as a lessor, which may eventually expose them to serious legal risks.

In practice, it is quite common for the lessor to engage the seller or its distributor as the lessor's agent to enter into a financial lease contract with the lessee in the interest of convenience. Moreover, some lessors delegate full authority to the seller or the seller's distributor, ranging from identifying the lessee, executing the contract, purchasing the object, delivering the object, to recovering the rent, while the lessors are responsible for funding only. In the absence of the lessor's exercise of its capacity, the lessor cannot monitor the performance of the financial lease contract, and its negligence in performing the lessor's duty also provides a chance of illegal conduct for the seller and its distributors.

In many of the cases we handled, as the lessor has engaged the seller to manage the leased item and assist with call for rent, the seller or its distributor is hence rendered the opportunity to set up a "pool of funds" by collecting or paying rent on behalf of the lessor or the lessee, to misappropriate the funds. Such circumstances exacerbate the uncertainty of the performance of financial lease contracts and increase risks of performance of contract by the lessor and the lessee. Quite often, the seller finds the truth when the seller's "pool of funds" runs out of money, in which case the seller has lost its capability to fulfill the guarantee obligations, endangering the lessor's funds.

Therefore, in addition to funding, a lessor needs to establish a sound management mechanism for the pre-and post-leasing process to safeguard its fund.

III. The specialty of financial lease shall be taken into account for the credit structure

Financial leasing service generally requires the lessee or the seller to provide certain credit enhancement for the transaction, and the seller's repurchase is a common way of credit enhancement, under which the lessor and the seller generally agree that the seller will pay for the repurchase unconditionally upon receipt of the lessor's notice and receive the ownership of the leased item and the debt of rent, in case of any default by the lessee or other breach. Such arrangement reflects the essence of business: in the case of the seller, offering the lessor credit enhancement is helpful in promoting the sale of its products, and by performing the repurchase obligation, the seller may obtain the leased item and the debt derived from the lease which the seller may claim against the lessee, subsequently; in case of the lessor, repurchase may reduce both the capital risk and the cost of disposal of the leased item as a credit enhancement acceptable to the lessor. However, repurchase does not constitute guarantee defined in the *Guarantee Law of the People's Republic of China*. It is still controversial in academic circles whether the legal essence of repurchase is guarantee, as repurchase is indeed different from general guarantees. Importantly, repurchase is a bilateral legal relation, i.e., both parties need to fulfill certain contractual obligations. Specifically, as the seller repurchase the leased item, the lessor

shall deliver the same to the seller. Therefore, it is necessary to consider the objective practicality of delivery, obviously.

First of all, it is the lessor's ownership of the leased item and the debt of rent that is assigned to the seller in repo, which is a remedy for the lessor upon termination of the financial lease contract in the event of the lessee's default. However, in accordance with Article 21 of the *Interpretation of the Supreme People's Court on Application of Law in Hearing Disputes over Financial Lease Contracts* (hereinafter referred to as the "Judicial Interpretation of Financial Lease") and Article 248 of the *Contract Law*, the lessor's claim of the debt of rent is similar to the accelerated expiration of the contract while claim of return of the leased item constitutes termination of the contract. The two legal status of "performance" and "termination" are incompatible for the same contract, and only one of them may be adopted. Therefore, upon termination of the financial lease contract, it lacks objectivity and practicability to a certain extent to define the object of the repurchase agreement as the ownership of the leased item and the debt of rent.

Secondly, as a matter of law, financial lease is unique that the ownership is separated from the right of use for a long term. However, subject to the parties' rights and obligations under the repurchase agreement, the fact that the lessor "owns" but does not "hold" the leased item, may become an obstacle for the lessor to claim repurchase. Under the legal relation of financial lease, the lessor does not actually control the equipment, and the delivery approach by which the property right is transferred is usually instructed delivery. In the repurchase agreement, the provision that "no actual delivery will occur as to the object to be repurchased" appears in conformity to Article 26 of the *Property Law of the People's Republic of China* in its form and a valid and practical transfer of property right. However, if it becomes clear that the lessor cannot objectively notify the lessee of the transfer of the claim of returning property right to the repurchaser as the lessee is missing, or in case of loss of the leased item or any seizure or preservation of the leased item by any court of law due to any third party's application which may become a material obstacle to the repurchase, the repurchaser may quite probably decline to fulfill the repurchase obligation in reliance of the defense of uncertainty (Einrede der Unsicherkeit).

Thirdly, sometimes the lessor may obtain credit enhancement provided by a third party other than the seller. Like the repo, a problem may arise to obstruct the repo as the object to be repurchased cannot be divided, in case that none of several repurchasers may solely and independently fulfill the repurchase obligations.

The essential issue of the above-mentioned potential risks that may arise from repurchase is that the party concerned was not fully aware of the importance of property right in the legal relation of financial lease and the unique risks brought thereby. When choosing the credit structure of a financial lease transaction, the parties concerned may need to fully and comprehensively consider the legitimacy and practicability of the credit structure in accordance with the relevant provisions of the *Property Law of the People's Republic of China*, if it involves the property right of the object or other rights attached thereto.

Taking advantage of the easterly wind of the GBA construction, the financial lease business, which plays the role of both financing and leasing and integrates industry and finance, sees the new development opportunity. As we give full play to financial lease to help regional economic development and industrial upgrading, we should also pay attention to the risk management in the business development and promote the steady and orderly progress and development of the industry.

Drafting effective dispute resolution clauses for M&A transactions in the Greater Bay Area

Paul Starr, Ariel Ye, Fan Yang[1]

Key highlights

- The *Outline Development Plan for the GBA*, in particular, encourages the enterprises of Guangdong, Hong Kong SAR and Macao SAR to join hands in multinational mergers and acquisitions. It is foreseeable that M&A transactions will remain active in the GBA and M&A related disputes will continue to increase not only in number, but also in disputes value.
- China Mainland, Hong Kong SAR and Macao SAR each has its own sophisticated court system to hear M&A disputes. Please see the comparison table below.
- Given that M&A disputes in the GBA are potentially subject to the tangle and overlapping of the three different and separate court systems, it is important for practitioners in the GBA to think through M&A disputes issues with the potential choice of arbitration as the preferred dispute resolution mechanism.
- Mediation should always be carefully considered as part of an effective and efficient dispute resolution process of M&A disputes in the GBA, mainly due to the perceived particular importance of preservation of often close business relationships among the parties involved in the M&A transactions in the GBA.
- It is common in the context of M&A transactions for parties to provide for, alongside their arbitration agreement, expert determination of actual or technical issues (as opposed to legal issues), such as post-closing price adjustment. However, expert's determination does not have res judicata effect and is not enforceable in the GBA.
- Some basic drafting rules for dispute resolution clauses in general include careful considerations on the following topics: validity, scope, seat of arbitration, institutional or *ad hoc* arbitration, appointment of arbitrators, appointment/ constitution of the arbitral tribunal, and confidentiality.
- We would advise parties to incorporate institutional rules, such as the *2018 HKIAC Administered Arbitration Rules* that provide for sophisticated arbitration procedures for joinder, consolidation, single arbitration for multiple contracts, and concurrent arbitral proceedings, which could potentially assist parties in M&A disputes to resolve multi-party and multi-contract issues effectively and efficiently.
- Some special procedures, such as expedited procedures and emergency arbitrator procedures available under the *2018 HKIAC Administered Arbitration Rules* are potentially very useful for resolving M&A disputes in a time and cost efficient manner.

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Introduction

Research published in August 2018 shows that the value of China M&A fell by 18% in the first six months of 2018 to US$348 billion, despite a slight increase in the volume of transactions.[2] Against the backdrop of a slowdown of China's outbound investment, private equity activity remains robust, especially in the Greater Bay Area (the "GBA").

The *Outline Development Plan for the Guangdong-Hong Kong-Macao GBA* (the "Plan") was published on 18 February 2019, Chapter 9 of which, in particular, encourages the enterprises of Guangdong, Hong Kong SAR and Macao SAR to join hands in green field investments, multinational mergers and acquisitions, and development of industrial parks, support enterprises in Hong Kong SAR and Macao SAR in connecting with external economic and trade cooperation zones, jointly expand global markets, and lead the GBA's products, equipment, technologies, standards, testing and certification, and management services etc. to "go global".[3]

It is foreseeable that M&A transactions will remain active in the GBA and M&A related disputes will continue to increase not only in number, but also in disputes value. M&A disputes often relate to failure to complete the transaction, price adjustment, earn-out, misrepresentations and breach of warranties, or the pre-contractual failure to disclose relevant information (usually involving allegations of fraud, wilful misconduct or gross negligence with a view to avoiding the application of clauses limiting liability).

What are the factors that should be considered in drafting dispute resolution clauses to address effectively the specificities of M&A disputes, and minimise the impact of disputes on ongoing business relationships, often at the heart of a successful M&A transaction?

In this article, we will first examine the choice of various dispute resolution mechanisms, i.e. domestic courts, including the First China International Commercial Court in Shenzhen, arbitration, mediation and expert determination in resolving M&A disputes in the GBA; then analyse basic drafting rules and key aspects related to M&A pre-closing as well as post-closing disputes, before making concluding remarks.

I. Various dispute resolution mechanisms available in the GBA

In this section, we will examine the various choices of dispute resolution mechanisms available to resolve M&A disputes in the GBA.

[2]See e.g. https://www.pwccn.com/en/services/deals-m-and-a/publications/ma-2018-mid-year-review-and-outlook.html, accessed on 11 February 2019.

[3]For a bi-lingual version of the Plan, see e.g. http://language.chinadaily.com.cn/a/201902/19/WS5c6b6b4da3106c65c34ea19d_1.html

1. Domestic courts

Traditionally, major M&A disputes are heard in domestic courts. We have highlighted the hierarchy and the key characteristics of the courts in China Mainland, Hong Kong SAR and Macao SAR.

	Mainland China	Hong Kong SAR	Macao SAR
Highest	First Circuit Court of the Supreme People's Court	Court of Final Appeal	Court of Final Appeal (also known as Court of Last Instance)
Intermediate	High People's Court of Guangdong Province Intermediate People's Courts of Shenzhen, Guangzhou, Zhuhai, Foshan, Dongguan, Zhongshan, Jiangmen, Huizhou and Zhaoqing	High Court, which includes Court of First Instance and Court of Appeal	Court of Second Instance
Lowest	Various basic people's courts, e.g. people's courts of districts and counties	District Court (including the Family Court) and seven Magistrates' Courts (including the Juvenile Court)	Courts of First Instance, which includes the Lower Court and the Administrative Court. The Lower Court is further divided into: Civil Courts; Criminal Preliminary Enquiries Courts; Small Claims Courts; Criminal Courts; Labour Courts; and Family and Juvenile Courts
Special courts	First China International Commercial Court; Guangzhou Maritime Court; Guangzhou Intellectual Property Court; Guangzhou Railway Transportation Intermediate Court	Coroner's Court and a number of tribunals dealing with specific areas defined by the law, e.g. the Land Tribunal and the Small Claims Tribunal etc.	

(1) China Mainland courts in the GBA

The highest court within the GBA is the First Circuit Court of the Supreme People's Court, established in Shenzhen in 2015. As a standing judicial arm of the Supreme People's Court ("SPC"), it handles civil and commercial cases, administrative lawsuits and criminal appeals of first and second instance and retrials in Guangdong, Guangxi and Hainan. It also handles civil and commercial and judicial relief cases related to Hong Kong SAR, Macao SAR and Taiwan region, which are under the jurisdiction of the SPC. Its judgments, rulings and decisions are the same as those rendered by the SPC.[4]

The First China International Commercial Court ("CICC") was established in Shenzhen in 2018. It has jurisdiction to hear five categories of disputes:

- "First instance international commercial cases in which the parties have chosen the jurisdiction of the SPC according to Article 34 of the *Civil Procedure Law*, with an amount in dispute of at least 300,000,000 Chinese yuan;
- First instance international commercial cases which are subject to the jurisdiction of the higher people's courts who nonetheless consider that the cases should be tried by the SPC for which permission has been obtained;
- First instance international commercial cases that have a nationwide significant impact;
- Cases involving applications for preservation measures in arbitration, for setting aside or enforcement of international commercial arbitration awards according to Article 14 of these Provisions;

[4]See the SPC's website, available at http://english.court.gov.cn/2015-11/03/content_22357872.htm

- Other international commercial cases that the SPC considers appropriate to be tried by the International Commercial Court."[5]

The High People's Court of Guangdong Province is located in Guangzhou, the capital city of Guangdong Province, and it is the only high people's court in the GBA. In Guangdong Province, there are 21 intermediate people's courts, 3 special courts, (Guangzhou Maritime Court, Guangzhou Intellectual Property Court and Guangzhou Railway Transportation Intermediate Court) and 134 basic people's courts. Among the 21 intermediate people's courts, 9 are located in the GBA: each of the 9 cities in the GBA has its own intermediate people's court.[6]

The High People's Court of Guangdong Province has original jurisdiction over civil cases involving disputed amounts greater than RMB 500 million, while disputed amounts for the intermediate people's courts' jurisdiction is from RMB 100 million to 500 million in Guangdong Province.[7] As a court of appeal and review court, the High People's Court of Guangdong Province has appellate jurisdiction over all decisions from intermediate courts within Guangdong Province.

In the absence of parties' agreement to arbitration, cross-border M&A disputes in the GBA are potentially subject to the jurisdiction of either any one of the nine intermediate people's courts in the GBA or the high people's court of Guangdong Province. Once they are accepted by the people's courts, they are subject to the normal two-level appeal system within the China Mainland court system.

(2) Hong Kong SAR courts

The court system in Hong Kong SAR is a hierarchical arrangement with the Court of Final Appeal ("CFA") at the top, and then the High Court, which constitutes both the Court of Appeal ("CA") and the Court of First Instance ("CFI"). Under these are the District Court (including the Family Court) and seven Magistrates' Courts (including the Juvenile Court). Other institutions in the system are the Coroner's Court and a number of tribunals dealing with specific areas defined by the law, e.g. the Land Tribunal and the Small Claims Tribunal etc.

The CFI has unlimited original jurisdiction in both civil and criminal matters. It also has unlimited sentencing power. The jurisdiction of the CA is appellate jurisdiction (s.13(3) of the High Court Ordinance).

The CFA, as Hong Kong's highest court, hears appeals on civil and criminal matters from the High Court (i.e. the CA and the CFI). Leave must be sought for appeal to the CFA. The CA hears appeals on all civil and criminal matters from the CFI and the District Court. The CA also hears appeals from various tribunals and statutory bodies.[8]

Hong Kong SAR has signed an *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned*.[9] The Arrangement covers money judgments given by a designated court of either the Mainland or the Hong Kong SAR exercising its jurisdiction pursuant to a valid exclusive choice of court clause contained in a business-to-business agreement.[10] A list of Recognized Primary People's Courts in China Mainland was updated and incorporated into the Arrangement (published in the Gazette on 14 December 2018), which includes 36 people's courts located in the GBA.[11]

Hong Kong SAR also signed an *Arrangement on Reciprocal Recognition and Enforcement of Civil Judgments in Matrimonial and Family Cases by the Courts of the Mainland and of the Hong Kong Special Administrative Region* on 20 June 2017, but it has not yet entered into force. Another *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the*

[5] *Provisions of the Supreme People's Court on Several Issues Regarding the Establishment of the International Commercial Court*, available at http://cicc.court.gov.cn/html/1/219/199/201/817.html

[6] They are, (1) Intermediate People's Court of Guangzhou City; (2) Intermediate People's Court of Shenzhen City; (3) Intermediate People's Court of Zhuhai City; (4) Intermediate People's Court of Foshan City; (5) Intermediate People's Court of Dongguan City; (6) Intermediate People's Court of Zhongshan City; (7) Intermediate People's Court of Jiangmen City; (8) Intermediate People's Court of Zhaoqing City; and (9) Intermediate People's Court of Huizhou City.

[7] The website of the High People's Court of Guangdong Province, available at http://www.gdcourts.gov.cn/web/list/1996-?action=fygk

[8] See https://www.judiciary.hk/en/about_us/guide.html

[9] https://www.doj.gov.hk/eng/mainland/pdf/mainlandrej20060719e.pdf

[10] For key elements, see https://www.doj.gov.hk/eng/topical/pdf/mainlandrej20060717e.pdf; for SPC interpretation, see https://www.doj.gov.hk/eng/topical/pdf/rejjudicialinterpretationspce.pdf.

[11] See https://www.gld.gov.hk/egazette/pdf/20182250/egn201822509195.pdf.

Courts of the Mainland and of the Hong Kong Special Administrative Region was signed on 18 January 2019, but it has not yet entered into force.

Most recently, Hong Kong SAR signed an *Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region* ("Arrangement"). The signing ceremony took place at the Justice Place in Hong Kong SAR on 2 April 2019. The Arrangement will come into force on a date to be announced by the Hong Kong government and the Supreme People's Court.[12]

(3) Macao SAR courts

Macao SAR has a three-level court system: the Courts of First Instance, which includes the Lower Court and the Administrative Court; the Court of Second Instance; and the Court of Final Appeal, also known as Court of Last Instance.[13] The Lower Court is further divided into: Civil Courts; Criminal Preliminary Enquiries Courts; Small Claims Courts; Criminal Courts; Labour Courts; and Family and Juvenile Courts.[14] M&A disputes are under the jurisdiction of the Civil Courts.[15]

In terms of appeal, in civil and commercial cases, the rules are: if the amount of the claim is less than or equal to MOP 50,000, no appeal is accepted; if the amount of the claim is greater than MOP 50,000 but less than or equal to MOP 1,000,0000, the parties can appeal up to the Court of Second Instance; if the amount of the claim is greater than MOP 1,000,0000, the parties can appeal up to the Court of Final Appeal.[16]

Macao SAR has signed an *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Macao Special Administrative Region*.[17] It was signed on 28 February 2006 in Macao SAR and entered into force on 1 April 2006.

2. Arbitration

Given that M&A disputes in the GBA are potentially subject to the tangle and overlapping of the three different and separate court systems in China Mainland, Hong Kong SAR and Macao SAR, it is important for practitioners in the GBA to think through M&A disputes issues with the potential choice of arbitration as the preferred dispute resolution mechanism.

The reasons for choosing arbitration in a cross-border context may include at least the following. First, an arbitral tribunal may be more neutral than a domestic court. Second, unlike court proceedings, arbitration proceedings are confidential. Third, parties have greater control over arbitral proceedings than court proceedings, including appointment of arbitrators and discovery. Fourth, arbitral awards generally enjoy greater ease of enforcement across jurisdictions than court judgments.

(1) China Mainland arbitration

The current *Arbitration Law of the People's Republic of China* (1994) differs from the *UNCITRAL Model Law on International Commercial Arbitration* (1985) with amendments as adopted in 2006 ("UNICTRAL Model Law")[18] in some significant aspects.[19]

Firstly, compared with the UNCITRAL Model Law, the current China Mainland Arbitration Law prescribes different requirements for the validity of an arbitration agreement.[20] Secondly, China Mainland Arbitration Law provides more mandatory than default procedural requirements and arbitration commissions instead of parties enjoying greater control over arbitral proceedings. Thirdly, the current China Mainland Arbitration Law is more restricted in

[12]See https://www.doj.gov.hk/pdf/2019/arbitration_interim_e.pdf

[13]Article 10, § 1 and 2, and Article 27, § 1, Law n. 9/1999.

[14]Article 27, § 2, Law n. 9/1999.

[15]When the amount of the claim is less than or equal to MOP 50,000, the Small Claims Courts will have jurisdiction.

[16]Apart from the amount of the claim, the admissibility of appeal also depends on some procedural requirements stated on Articles 581 et seq. of MSAR Civil Procedure Code; and see Article 17 and Article 18, Law n. 9/1999.

[17]Available in Chinese and Portuguese at: https://bo.io.gov.mo/bo/ii/2006/12/aviso12_cn.asp

[18]Available at: http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration.html

[19]For a detailed analysis of the current PRC arbitration law, see e.g. Fan Yang, F*oreign-related Arbitration in China: Commentary and Cases* (Cambridge University Press 2016) (2 Volume Hardback Set, ISBN: 978-110-70821-9-9).

[20]See e.g. Fan Yang, *Applicable Laws to Arbitration Agreements under current Arbitration Law and Practice in Mainland China*, *International & Comparative Law Quarterly*, volume 63, issue 03, pp741-754

matters concerning interim measures. For example, arbitral tribunals do not have the statutory power to grant interim relieves and parties' application for interim measures shall be submitted to the arbitration commission, which in turn shall transfer the application to the competent people's court. Fourthly, the practice of arbitration combined with mediation (Arb-Med) within the arbitration proceedings is prevalent in China Mainland. Last but not least, China Mainland arbitration proceedings tend to be much shorter and more time and cost efficient.

There are, however, nine different arbitration commissions within the GBA in China Mainland. The capital city, Guangzhou itself has two arbitration commissions, the Guangzhou Arbitration Commission (which has a branch called China Nansha International Arbitration Court); and the South China Sub-commission of China Maritime Arbitration Commission ("CMAC"). Shenzhen also has two arbitration commissions, the Shenzhen Court of International Arbitration ("SCIA") (which has recently acquired the former Shenzhen Arbitration Commission); and the South China Sub-commission of China International Economic and Trade Arbitration Commission ("CIETAC"). Five other cities within the GBA in China Mainland, i.e. Zhuhai, Foshan, Zhaoqing, Jiangmen and Huizhou each has one arbitration commission, i.e. Zhuhai Arbitration Commission (which has a Hengqin Office) (also known as Zhuhai Court of International Arbitration); Foshan Arbitration Commission; Zhaoqing Arbitration Commission (also known as "Zhaoqing Economic and Trade Arbitration Centre" and "Zhaoqing Finance Arbitration Centre"); Jiangmen Arbitration Commission; and Huizhou Arbitration Commission.

There is no locally established arbitration institution in Zhongshan, except the Zhongshan Sub-commission of Guangzhou Arbitration Commission. Similarly, there is no locally established arbitration institution in Dongguan, except the Dongguan Sub-commission of Guangzhou Arbitration Commission.

All of the nine arbitration institutions listed in paragraph 25 above are also listed as the "recognized Mainland arbitral authorities" under section 97(1) of the *Arbitration Ordinance* (Cap. 609) and thus arbitral awards rendered in these nine arbitration institutions in the GBA in China Mainland can be enforceable in Hong Kong SAR pursuant to the *Arrangement Concerning Mutual Recognition and Enforcement of Arbitral Awards Between the Mainland and Hong Kong SAR*.[21]

Similarly, the arbitral awards rendered in these nine arbitration institutions in the GBA in China Mainland are also enforceable in Macao SAR pursuant to the sister *Arrangement Concerning Mutual Recognition and Enforcement of Arbitral Awards between the Mainland and Macao SAR*.[22] Though the arrangement with Macao SAR does not contain a list of the "recognized Mainland arbitral authorities" as the one identified in the arrangement with the Hong Kong SAR.

The quality of arbitration services provided by these nine arbitration institutions varies. In the absence of any statistics, our general perception based on anecdotal evidence is that the four arbitration commissions in Guangzhou and Shenzhen are often used and considered by parties to M&A transactions in the GBA, especially when parties are agreeable to the use of a China Mainland arbitration commission

[21]Available in English at https://www.doj.gov.hk/eng/topical/pdf/mainlandmutual2e.pdf; and Chinese at https://www.doj.gov.hk/chi/topical/pdf/mainlandmutual2c.pdf

[22]Available in Portuguese and Chinese at https://www.io.gov.mo/pt/legis/int/rec/737

to resolve their disputes.

(2) Hong Kong SAR arbitration

Hong Kong SAR has been identified as the third most preferred seat of international commercial arbitration in the world, behind only Paris and London. Its current arbitration law, codified in the *Arbitration Ordinance* (Cap 609), closely follows the UNCITRAL Model Law.

Hong Kong SAR is generally perceived to have sophisticated but expensive dispute resolution systems with many well-trained personnel and well-resourced and lawyered-up disputants. The challenges for Hong Kong SAR to become the preferred seat of arbitration for M&A disputes in the GBA is two-fold.

First, unlike the civilian legal systems in China Mainland and Macao SAR, Hong Kong SAR has a sophisticated rules- and precedent-based common law system. Although having a sophisticated common law legal system may be perceived as an advantage for Hong Kong SAR to be the preferred seat of arbitration, parties from civilian legal systems in China Mainland and Macao SAR may be uncomfortable to accept Hong Kong SAR, a common law legal system, as the seat of arbitration. Second, as a sophisticated common law jurisdiction, it is generally perceived that arbitration seated in Hong Kong SAR tends to have lengthy procedures resulting in delays and increased costs.

In response to the first challenge, although Hong Kong SAR is a common law jurisdiction, it is important to point out that arbitration seated in Hong Kong SAR does not have to be conducted under the Hong Kong SAR law or in a common law style. In fact, under the Hong Kong *Arbitration Ordinance* (Cap 609), which closely follows the UNCITRAL Model Law, arbitration seated in Hong Kong SAR may be conducted in any style, common law or civil law or the fusion of the two, pursuant to the parties' agreement and/or the direction of the arbitral tribunal.

In addition to a variety of arbitration rules available at the HKIAC, arbitration seated in Hong Kong SAR may also be conducted under the International Chamber of Commerce ("ICC") Rules or CIETAC Rules, or other rules selected by the parties. Perhaps, the ICC and CIETAC Rules may be perceived as more civilian legal system oriented, thus could be more readily accepted by those parties from China Mainland and Macao SAR. More importantly, it is generally perceived that Hong Kong SAR has an enviable pool of professional arbitration practitioners to act as arbitrators and counsels, with experience in both common law and civilian law and other legal systems.

As to the second challenge of high costs and delays to arbitration seated in Hong Kong SAR, like in many other jurisdictions, in Hong Kong SAR, one or both parties to an arbitration must pay for the arbitrator's fees, administration fees charged by the arbitration institution, the use of the hearing rooms and services provided by expert witnesses. Generally, arbitrators' fees in Hong Kong SAR are subject to the regulation by free market forces. Similarly, for expert witnesses, there is great diversity in the fees charged, depending on their expertise, the degree of their involvement and the complexity of the case.

Concerning the recovery of legal costs in arbitration proceedings, it is worth noting here that unlike in China Mainland and Macao SAR where the general default position is that parties bear their own legal costs; in Hong Kong SAR, the starting point is that "winner takes all", the so-called "costs follow events" principle, which means in practice winning parties can typically recover around 70% of their legal costs incurred in the arbitration proceedings conducted in Hong Kong SAR.

For those parties who have chosen CIETAC Rules, under the Fee Schedule III Article II 2 of the CIETAC Rules, the CIETAC administrative fee includes the remuneration of the case manager and the costs of using oral hearing rooms of CIETAC and/or its sub-commissions/arbitration centres. Thus, parties can enjoy the use of the hearing room facilities of CIETAC Hong Kong Centre without additional costs.

As to the time required for arbitration, the HKIAC's experience seems to be that a large number of arbitrations can be completed within one year or so. For those cases that are conducted on document-only basis (e.g., some maritime arbitrations), they may be completed within two to three months if the parties are cooperative. For those cases involving complex legal or technical issues (i.e., some international commercial or construction arbitrations), in-person hearings would be needed and this could last longer. Many of these arbitrations can be completed within one to two years.[23]

More importantly, the current Hong Kong SAR *Arbitration Ordinance* (Cap 609) has adopted the latest version of the UNCITRAL Model Law as the basis for a unitary arbitration regime in Hong Kong

[23]See e.g., http://legco.gov.hk/yr08-09/english/bc/bc59/papers/bc591005cb2-2546-3-e.pdf

SAR. It is presented in a very user-friendly manner. It has given the arbitral tribunal the power and flexibility to enhance the user-friendliness, efficiency and effectiveness of arbitrations seated in Hong Kong SAR. This would also make arbitration be less costly and speedier in Hong Kong SAR.

Furthermore, it is important to note that the current Hong Kong *Arbitration Ordinance* provides for much flexibility and broader scope for interim measures in arbitration. As we will further explain in Part III of this article, the availability of interim measures in arbitration concerning M&A disputes is often a key factor in resolving especially pre-closing disputes effectively and efficiently.

Last but not least, Hong Kong SAR has signed two arrangements on the recognition and enforcement of arbitral awards that cover all the GBA: (i) the *Arrangement Concerning Reciprocal Recognition and Enforcement of Arbitral Awards Between the Mainland of China and the Hong Kong Special Administrative Region*;[24] and (ii) the *Arrangement Concerning Reciprocal Recognition and Enforcement of Arbitral Awards Between the Macao Special Administrative Region and the Hong Kong Special Administrative Region*.[25]

(3) Macao SAR arbitration

Macao SAR has two separate regimes for arbitration: (i) one for domestic arbitration, stated in Decree-Law no. 29/96/M, which is based on the former *Portuguese Arbitration Act*; (ii) the other one for international commercial arbitration, stated in Decree-Law no. 55/98/M, which is based on *UNCITRAL Model Law on International Commercial Arbitration* (1985).

Macao SAR is currently in the process of revising its arbitration regime. First, the two separate arbitration law regimes will be revoked and replaced by a single regime to govern both domestic and international arbitration seated in Macao SAR. Second, the new *Arbitration Act* will adopt the *UNCITRAL Model Law on International Commercial Arbitration* (1985) with amendments as adopted in 2006.

It is generally perceived that challenges for Macao SAR to become the preferred seat of arbitration for M&A disputes in the GBA are mainly related to the inexperience of Macao SAR as seat for international commercial arbitration in addition to the low level of usage of arbitration even in resolving domestic disputes.[26]

Nevertheless, Macao SAR is considered a Model Law jurisdiction, a Civil Law jurisdiction and a party to the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards* ("New York Convention"). These three pillars provide a sound legal framework for Macao SAR potentially to handle cross-border M&A disputes in the GBA.[27]

It is also important to note that Macao SAR has signed two arrangements on the recognition and enforcement of arbitral awards that cover all the GBA: (i) the *Arrangement Concerning Reciprocal Recognition and Enforcement of Arbitral Awards Between the Mainland of China and the Macao Special Administrative Region*, signed in Beijing, on 30 October 2007;[28] and (ii) the *Arrangement Concerning Reciprocal Recognition and Enforcement of Arbitral Awards Between the Macao Special Administrative Region and the Hong Kong Special Administrative Region*, signed in Macao SAR, on 7 January 2013.[29]

3. Mediation

Some commentators have argued that private mediation focusing on interest-based settlement is particularly suited for resolving M&A disputes, for example, as in an earn-out scenario involving non-quantitative issues; boilerplate M&A dispute resolution clauses should be revised to include mediation; and mediation should be considered even where there is

[24]Available in English at https://www.doj.gov.hk/eng/topical/pdf/mainlandmutual2e.pdf; and Chinese at https://www.doj.gov.hk/chi/topical/pdf/mainlandmutual2c.pdf.

[25]Available in English at https://www.doj.gov.hk/eng/mainland/pdf/macao/macaoe.pdf; and Chinese at https://www.doj.gov.hk/chi/mainland/pdf/macao/macaoc.pdf.

[26]José Miguel Figueiredo, O possível papel da RAEM na resolução de litígios no contexto da iniciativa «Uma Faixa, Uma Rota» – Potencial e Desafios, In "Revista Administração", n. 117, vol. XXX, 2017-3, Macau, 2018, pp. 180-182, available at https://www.safp.gov.mo/safppt/download/WCM_066173 (also available in Chinese language, under the tittle "一带一路" 倡议下澳门特别行政区在解决争议方面可能担当的角色—潜力与挑战, at https://www.safp.gov.mo/safptc/download/WCM_066164).

[27]José Miguel Figueiredo, op. cit., pp. 169-179.

[28]Available in Portuguese and Chinese at https://www.io.gov.mo/pt/legis/int/rec/737

[29]Available in Portuguese and Chinese at https://www.io.gov.mo/pt/legis/int/rec/1230.

no mediation clause.[30]

We agree to the above observation and are of the view that mediation should always be carefully considered as part of an effective and efficient dispute resolution process of M&A disputes in the GBA. This is mainly due to the perceived particular importance of preservation of often close business relationships among the parties involved in the M&A transactions in the GBA. Other advantages of using mediation to resolve M&A disputes in the GBA include that, first, as an informal and flexible process, interest-based mediation works in the space between the parties resolving a dispute on their own and the parties escalating the dispute to a lawsuit either in court or in arbitration. Second, as a process based on consensual negotiations that are facilitated by the neutral third party, the mediator, mediation can take place anytime and even when the contract does not provide explicitly a mediation clause and parties can still agree to participate in the mediation after the dispute arises. Thirdly, where arbitration or litigation proceedings could take months or years to reach conclusion, mediation could resolve a dispute in a matter of days or less.

(1) China Mainland mediation

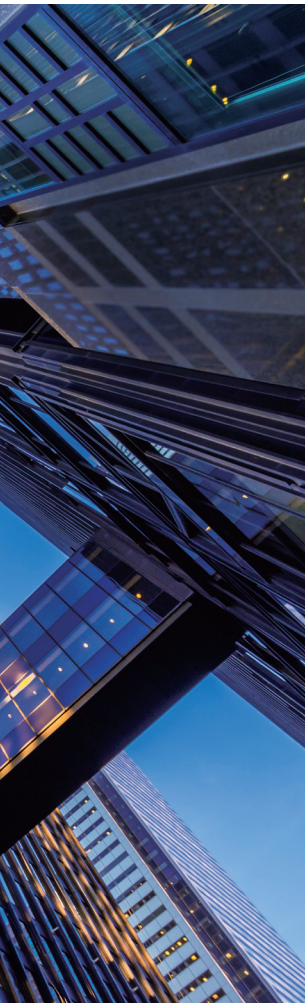
Mediation has long been used for resolving disputes in China Mainland.[31] In recent years, the Chinese Mainland government has continued to implement and improve a range of different forms of mediation including people's court mediation, people's mediation, administrative mediation, commercial mediation and arbitration mediation.[32]

The practice of people's court mediation, which is also known as judicial mediation or court-conducted mediation, can be traced back to the 1930s. The people's courts may conduct mediation not only in civil proceedings, but also in administrative and certain criminal proceedings. Mediation, which is sometimes referred to as conciliation, is essentially evaluative and advisory in nature when conducted by the people's courts in China Mainland. Firstly, the judge-turned-mediator is required to conduct the mediation according to the principles of voluntariness and legality. This means (1) the court-mediated settlement agreement must be agreed to by the parties on a voluntary basis and the parties must not be forced or coerced into settling during the court-conducted mediation process; and (2) the court-mediated settlement agreement must not contravene any law. Secondly, the judge-turned-mediator should conduct the mediation on the basis of ascertaining the facts and distinguishing between right and wrong.

[30]See e.g. Gary L. Benton, *Efficiently Resolving M&A Disputes*, available at: https://svamc.org/efficiently-resolving-ma-disputes/, accessed on 14 Feb. 19.

[31]See e.g. Fan Yang, *Attitudes of Mainland Chinese Judges towards Mediation, The Vindobona Journal of International Commercial Law and Arbitration*, Issue 17(1), pp117-132, July 2013.

[32]For people's mediation, see e.g. *People's Mediation Law of the People's Republic of China* (2010); *Several Provisions of the Supreme People's Court on the Judicial Confirmation Procedure for the People's Mediation Agreements* (2011); for people's court mediation, see e.g. *Civil Procedure Law of the People's Republic of China* (2012 Amendments); for administrative mediation, see e.g. *Patent Law of the People's Republic of China* (2008 Amendments); *Administrative Reconsideration Law of the People's Republic of China* (1999); for arbitration mediation, see e.g. *Arbitration Law of the People's Republic of China*; for special mediation laws, see e.g. *Law of the People's Republic of China on Labor Dispute Mediation and Arbitration* (2008); and *Law of the People's Republic of China on the Mediation and Arbitration of Rural Land Contract Disputes* (2010).



Thus, in practice the judge-turned-mediator often evaluates the merits of the case and gives parties proposals for settlement, which may or may not be accepted by the parties. Thirdly, the judge-turned-mediator has the power to invite relevant units or companies and individuals to assist in the mediation. This clearly raises concerns about a potential lack of confidentiality in the court-conducted mediation process, although the parties can request the People's Court to conduct the mediation in private. Fourthly, the court-mediated-settlement agreement is not only binding on the parties but also, more importantly, directly enforceable as if it were a court judgement. Lastly, the judge-turned-mediator can conduct mediation at any stage during the civil proceedings.

Although people's mediation conducted by the people's mediation commissions in China Mainland is free of charge, it is not suitable for resolving M&A disputes, where the values and amount at stake are high and issues involved are complex.

Administrative mediation is conducted by government's administrative organs concerning, for example, electricity disputes; forests, trees, and woodlands disputes; labor and HR disputes; rural land contract disputes; road traffic accidents disputes; medical disputes; securities disputes; patent disputes and IP disputes.

Arbitration mediation, or the so-called Arb-Med process is widely used in China Mainland. Anecdotally, arbitrators in China Mainland are much more comfortable to see parties settle in mediation/conciliation due to the non-existence of discovery process and often with very limited evidence available. Generally, arbitration hearings in China Mainland are very short and often close within a day. Thus, instead of reaching a conclusive and enforceable decision and rendering an arbitral award, tribunals in China Mainland would be much more comfortable to see parties settle their disputes through mediation/conciliation instead.

Among the 9 arbitration institutions in the GBA in China Mainland, 3 of them have mediation centres (the CMAC Sub-commission in Guangzhou; SCIA; and CIETAC South China Sub-commission in Shenzhen); 5 of them do not have mediation centres but seem to provide mediation services (Guangzhou Arbitration Commission; Zhuhai Arbitration Commission; Foshan Arbitration Commission; Zhaoqing Arbitration Commission; and Huizhou Arbitration Commission).

We do not have any statistics on the quality of the mediation services provided by these China Mainland mediation centres and/or the affiliated arbitration centres. But, based on anecdotal evidence, we believe the mediation services in these centres are not often considered or used by parties to M&A transactions in the GBA.

(2) Hong Kong mediation

Mediation was introduced into Hong Kong's civil and commercial litigation landscape when the Civil Justice Reform ("CJR") in Hong Kong SAR has come into effect on 2 April 2009. One of the underlying objectives of the CJR is to facilitate settlement of disputes before or after commencement of court action to save time and costs. *Practice Direction 31* ("PD 31") states that the court has the duty as part of active case management to further the objective by encouraging the parties to use an alternative dispute resolution procedure ("ADR") if the court considers that appropriate and facilitating its use ("the duty in question"). The court also has the duty of helping the parties to settle their case. The parties and their legal representatives have the duty of assisting the court to discharge the duty in question.

PD 31 sets out how the court discharge the duty in question. It applies to all civil proceedings in the Court of First Instance and the District Court which have been begun by writ with some exceptions.

PD 31 defines ADR as a process whereby the parties agree to appoint a third party to assist them to settle or resolve their dispute. It points out that settlement negotiations between the parties do not amount to ADR and that a common mode of ADR is mediation. PD 31 applies to mediation. Where the parties are engaged in arbitration proceedings, the court proceedings would be stayed and PD 31 would not apply to such proceedings.

Although the Hong Kong courts have the duty to direct parties to mediation, parties conduct the mediation outside of the court. Section 4 of Hong Kong *Mediation Ordinance* (Cap.620) defines mediation as a structured process comprising one or more sessions in which one or more impartial individuals, without adjudicating a dispute or any aspect of it, assist the parties to the dispute to (a) identify the issues in dispute; (b) explore and generate options; (c) communicate with one another; (d) reach an agreement regarding the resolution of the whole, or part, of the dispute.

Mediation conducted in Hong Kong SAR is mainly interest-based and predominantly facilitative as opposed to evaluative in nature.

The Hong Kong *Mediation Ordinance* provides a

modern and sophisticated regulatory framework in respect of certain aspects of the conduct of mediation, including third party funding of mediation, confidentiality of mediation communications, and admissibility of mediation communications in evidence.

Another interesting and mediation related legislation in Hong Kong SAR is the *Apology Ordinance* (Cap.631), which was enacted in July 2017 and came into effect on 1 December 2017. The objective of the *Apology Ordinance* is to promote and encourage the making of apologies with a view to preventing the escalation of disputes and facilitating their amicable resolution.

In addition to its modern and sophisticated regulatory framework, Hong Kong SAR has developed research-based and practical experience-oriented accreditation and training regimes for mediators. For example, the Hong Kong Mediation Accreditation Association Limited ("HKMAAL") has been established to accredit mediators. Professional standards of mediators are maintained and kept under review. Training courses are also accredited by the Council to ensure participants are taught the essential skills of mediation and that those who teach the courses are properly qualified. HKMAAL promotes a culture of best practice and professionalism in mediation in Hong Kong SAR.

According to research published in 2015, mediation remains under-utilized in practice in Hong Kong SAR, despite being widely supported and recognized as having the potential to resolve disputes in a quick, cheap and confidential way.[33]

(3) Macao mediation

Macao SAR does not have a statutory regime for mediation, although several institutions in Macao SAR provide mediation services. Parties can mediate their disputes in Macao SAR, since there is no legal obstacle or prohibition of the parties from doing so. The settlement agreement reached by the parties in a mediation is considered to be a "transaction agreement" between the parties, and will not differ from agreements signed between the parties without the intervention of a mediator. There is no restriction on which styles of mediation (e.g. evaluative or facilitative) can be practiced in Macao SAR.

It is important, however, to distinguish two situations. First, when there is a pending court proceeding, if parties settle outside the court, with or without a mediator, then they can submit their settlement agreement to the judge who, following some formal requirements, can issue a court decision declaring that the matter is closed on the terms as agreed by the parties; this court decision can be enforced directly (i.e. without any recognition process) as a court judgement. Second, when there is no pending court proceeding, if parties settle, with or without a mediator, then that settlement agreement is considered as a private agreement which can be enforced directly (i.e. without any recognition process) in the normal way of enforcing a contract.

Macao Civil Procedure Code provides for conciliation, in which a judge assists the parties in settling disputes. The judge-turned conciliator will return to judge the case if the conciliation fails. It is a mandatory requirement that after the parties submit all their pleadings and just before the trial session starts the judge must attempt to conciliate the parties, if the dispute is under the dispositional powers of the parties; if the parties are not able to conciliate then the trial will proceed. In the event that the parties settle their dispute in conciliation, the settlement will be considered as a "transaction agreement" and the judges will homologate this agreement (under some formal requirements) with the shape and with the same value of a judgement, which can be then enforced directly (i.e. without any recognition process) as a court judgement.

The Macao government is currently revising the mediation regime, aiming to offer a more detailed legal framework, including the styles of mediation admissible, the status and value of the mediation settlement agreement, and the requirements to act as mediator.

4. Expert determination

It is common in the context of M&A transactions for parties to provide for, alongside their arbitration agreement, expert determination of actual or technical issues (as opposed to legal issues), such as post-closing price adjustment. We will further explain the intricacy between expert determination and arbitration clause in Part III below.

We are not aware of any regulatory regime governing expert determination specifically in either China Mainland, Hong Kong SAR or Macao SAR, other than

[33] Julian Copeman, May Tai and Gareth Thomas, *Mediation in Hong Kong Five Years On*, published in *Hong Kong Lawyer* on April 2015.

the regime for ADR in general in these jurisdictions.

As a contractually binding ADR process, the scope and effects of an expert determination process would very much depend on the common intention and agreement of the parties, subject to the governing law of the clause, which may or may not be the same as the governing law of the arbitration clause or the governing law of the M&A transaction agreements.

Generally, expert's determination does not have *res judicata* effect and is not enforceable in the GBA. Parties will need to resort to the relevant court or arbitration to enforce such determination.

II. M&A pre-closing as well as post-closing disputes

Having examined various dispute resolution mechanisms, i.e. domestic courts, including the First CICC in Shenzhen, arbitration, mediation and expert determination available for the resolution of M&A disputes in the GBA, we will now explain some basic drafting rules and analyse key aspects related to M&A pre-closing as well as post-closing disputes.

1. Basic drafting rules

Some basic drafting rules for dispute resolution clauses in general include careful considerations on the following topics: validity, scope, seat of arbitration, institutional or *ad hoc* arbitration, appointment of arbitrators, appointment/constitution of the arbitral tribunal, and confidentiality.

On the topic of validity of the dispute resolution clause, in addition to the usual attention to written form validity requirement under the *New York Convention*, for parties who designate one of the nine Chinese Mainland cities in the GBA as the seat of the arbitration, special attention should be given to the peculiar requirement of a designated arbitration commission under the PRC Arbitration Law, as discussed in paragraph 25 above.

As to the scope of the dispute resolution clause, we recommend broad language to ensure that any dispute arising from the M&A transaction will be subject to the same arbitration clause, unless the parties intend to submit certain specified disputes to expert determination. For instance, if price adjustment disputes are to be submitted to expert determination, then precise description of the scope and mechanism should be set out. Moreover, how the expert determination process interacts with the rest of the dispute resolution clause, for example, mediation and arbitration, should also be carefully considered and specified. Do the parties intend to have a binding or non-binding expert determination process? How many experts should there be and how should they be appointed? Should a time limit be set for the appointment and/or the duration of the expert determination process? In what circumstances should the expert's determination be subject to review by the arbitral tribunal or court?

The seat of arbitration (usually a city) determines the law that will govern certain procedural aspects of the arbitration, such as the power of the arbitrators, judicial supervision of the arbitral process, and challenge to the arbitral award. Most importantly, the law of the seat of arbitration determines the extent to which local courts may intervene in the arbitration proceedings, be it to hinder (by unwanted interventions) or to support them. To the extent it is possible, it is therefore advisable to choose a seat where the legislation and the courts are supportive of arbitration.

As to the choice between institutional or *ad hoc* arbitration, generally speaking *ad hoc* arbitration is not available in China Mainland with limited exceptions in free trade zones pursuant to the Supreme People's Court's Circular.[34] In M&A practice, it seems parties tend to prefer institutional arbitration, in which the arbitration process is administered by an arbitral institution in accordance with a set of pre-determined procedural rules, than *ad hoc* arbitration, where the proceedings are managed by the parties and the arbitral tribunal. Our advice is to select a reputable arbitral institution that will assist parties and the arbitral tribunal in running the arbitration proceedings smoothly. Although designating an arbitral institution means extra charges and fees for the services provided by the arbitral institution, we consider these fees are well spent when a reputable arbitral institution can effectively assists in monitoring the process, handling communications with arbitrators and supporting the process of appointing arbitrators as well as subsequent process of challenging the arbitrators, if any. In addition, the ICC International Court of Arbitration, for example, scrutinizes drafting arbitral awards and verifies that all issues at dispute have been addressed in the awards, without making any review on the substantive decision of the awards.

[34]See Article 9, SPC Circular (2016) No.34, *Opinions of the Supreme People's Court on Providing Judicial Guarantee for the Development of Free Trade Zones*.

Parties often value the opportunity to appoint arbitrators who possess not only experience as arbitrators, but also knowledge of the complexities and mechanics of M&A transactions. Given that the default appointment process varies under different arbitral institutions rules and under different legal regimes in the GBA, we recommend that parties should specify the number and method of appointment of the arbitrator(s) in the arbitration clause, so as to manage in advance the divert expectations of the parties on their involvement in the appointment process.

Confidentiality is generally considered important for both sellers and buyers in M&A disputes. For example, sellers do not want to disclose any price-sensitive information or confidential information regarding the business and operation of the target company; similarly, after spending a considerable amount of time and money in evaluating M&A transactions, buyers tend to want to preserve confidential information concerning its investment from other potential acquirers[35].

We should point out that the approach to confidentiality varies between arbitration institutions and especially differs in the three different legal regimes in the GBA. For example, the current Arbitration Law in China Mainland only provides for privacy in arbitration hearings in its Article 40. By contrast, Sections 16-18 of the Hong Kong *Arbitration Ordinance* provide for a broader and better protection of both privacy and confidentiality in arbitration seated in Hong Kong SAR. We would advise that parties should consider an explicit agreement on confidentiality to cover, for example, one or more of the following matters: the material or information that is to be kept confidential (e.g., pieces of evidence, written and oral arguments, the fact that the arbitration is taking place, identity of the arbitrators, content of the award); measures for maintaining confidentiality of such information and hearings; whether any special procedures should be employed for maintaining confidentiality of information transmitted by electronic means; circumstances in which confidential information may be disclosed in part or in whole (e.g., in the context of disclosures of information in the public domain, or if required by law or a regulatory body). As we know, for example, listed companies are subject to certain and often quite onerous disclosure obligations.

[35]See e.g. Joe Liu, *Arbitration of Cross-Border M&A Dispute*, Kluwer Arbitration Blog, 21 April 2015.

III. Key aspects related to M&A disputes

1. Pre-arbitral dispute resolution processes

M&A disputes are often complex and involve high stakes. Thus, it is important for the parties involved in M&A disputes to carefully consider pre-arbitral dispute resolution processes, such as mediation and expert determination as discussed above in Part II of this article. When drafting pre-arbitral dispute resolution clauses, it is important to specify whether the pre-arbitral steps are mandatory or merely optional and provide time limits for each step to occur, bearing in mind that consequences on non-compliance with any pre-arbitral processes may be subject to the applicable law of the seat of the arbitration.

As a general rule, permitting commencement of arbitration in parallel to any pre-arbitral processes is considered more efficient and effective than spending

several months going through the pre-arbitral processes sequentially, especially when the parties' disagreement makes a pre-arbitral settlement unlikely or even undesirable. On the other hand, commencing arbitration in parallel to any pre-arbitral processes should not prevent the parties who genuinely consider a settlement is possible or desirable to reach one.

2. Expert determination process

When expert determination is adopted not as a pre-arbitral step but as a standalone process designated for certain issues, it is important to specify the scope of the tasks or issues that are subject to expert determination, and it is advisable that parties should explicitly provide that any other issues, including the issue of the scope of the tasks that are subject to expert determination, are well within the jurisdiction of the arbitral tribunal. Given that expert determination does not have *res judicata* effect and is not enforceable as an arbitral awards, the parties will need to resort to the courts or arbitration to enforce such findings should a party disregard it. Careful drafting is required to deal with the situation in which one or both parties disagree on the expert's determination, and the process to challenge it.

3. Expedited arbitration

Arbitration on an expedited basis was first introduced to the HKIAC Rules in 2008, according to which arbitrations should be concluded within 6 months from the constitution of the tribunal. Under the current *2018 HKIAC Administered Arbitration Rules*, Article 42.1 provides that prior to the constitution of the arbitral tribunal, a party may apply to HKIAC for the arbitration to be conducted in accordance with the expedited procedure in Article 42.2, where: (a) the amount in dispute representing the aggregate of any claim and counterclaim (or any set-off defence or cross-claim) does not exceed the amount set by HKIAC, as stated on HKIAC's website on the date the Notice of Arbitration is submitted; or (b) the parties so agree; or (c) in cases of exceptional urgency.

The current threshold on the amount in dispute set by the HKIAC for expedited procedure is HK$25,000,000. However, nothing prevents parties from referring their dispute to fast-track arbitration in other cases not foreseen by the institutional rules. As regards M&A arbitration, parties may for instance consider that, where the role of the arbitrators is limited to assessing whether the decision of an expert is arbitrary, it would be most cost and time efficient to adopt expedited arbitration procedures as opposed to the standard arbitration procedures. However, where the M&A disputes centre on facts and document production plays a central role, (for example when it is alleged that a party knowingly provided inaccurate or misleading representations and warranties), fast-track arbitration may become highly inadequate. The same is also true when the factual or legal issues at stake are complex and it would be difficult for instance, to require that the arbitration proceedings be completed within six months when it takes at least four months for a party-appointed expert to prepare a report.

4. Consolidation or joinder

M&A deals are often concluded through a suite of transaction instruments involving multiple parties, each of which can have their own dispute resolution clause. This could potentially lead to several disputes arising out of various contracts between several

parties, all of which could be the subject of multiple parallel proceedings although they all relate to a single transaction. Permitting consolidation of two or more separate arbitrations into a single arbitration, or the joinder of additional parties into a single arbitration, can be very useful and often crucial in resolving M&A disputes in a time and cost efficient manner. Consolidation or joinder can also ensure consistency and give the tribunal a complete picture of the transaction at issue.

Under the *2018 HKIAC Administered Arbitration Rules*, Article 27 (Joinder of Additional Parties) provides that the arbitral tribunal or, where the arbitral tribunal is not yet constituted, HKIAC shall have the power to allow an additional party to be joined to the arbitration provided that:

(a) prima facie, the additional party is bound by an arbitration agreement under these Rules giving rise to the arbitration, including any arbitration under Article 28 or 29; or

(b) all parties, including the additional party, expressly agree.

Under the *2018 HKIAC Administered Arbitration Rules*, Article 28 (Consolidation of Arbitrations) provides that HKIAC shall have the power, at the request of a party and after consulting with the parties and any confirmed or appointed arbitrators, to consolidate two or more arbitrations pending under these Rules where:

(a) the parties agree to consolidate; or

(b) all of the claims in the arbitrations are made under the same arbitration agreement; or

(c) the claims are made under more than one arbitration agreement, a common question of law or fact arises in all of the arbitrations, the rights to relief claimed are in respect of, or arise out of, the same transaction or a series of related transactions and the arbitration agreements are compatible.

Moreover, Article 29 of the *2018 HKIAC Administered Arbitration Rules* provides for situations where a single arbitration can deal with disputes arising out of multiple contracts. Claims arising out of or in connection with more than one contract may be made in a single arbitration, provided that:

(a) a common question of law or fact arises under each arbitration agreement giving rise to the arbitration; and

(b) the rights to relief claimed are in respect of, or arise out of, the same transaction or a series of related transactions; and

(c) the arbitration agreements under which those claims are made are compatible.

Furthermore, Article 30 of the *2018 HKIAC Administered Arbitration Rules* provides for concurrent proceedings. The arbitral tribunal may, after consulting with the parties, conduct two or more arbitrations under the Rules at the same time, or one immediately after another, or suspend any of those arbitrations until after the determination of any other of them, where:

(a) the same arbitral tribunal is constituted in each arbitration; and

(b) a common question of law or fact arises in all the arbitrations.

By incorporating such rules into the arbitration agreement, the parties are deemed to have consented in advance to, firstly, a possible consolidation of the various arbitration proceedings even when the parties to the various agreements are not the same; secondly, claims arising out of or in connection with more than one contract may also be made in a single arbitration; and thirdly, even when joinder or consolidation or single arbitration for multiple contracts are not available, two or more arbitrations under the Rules may be conducted concurrently. Hence, the *2018 HKIAC Administered Arbitration Rules* provide a powerful regime that can potentially address multi-party and multi-contract issues often present in M&A disputes effectively and efficiently.

5. Emergency arbitration

M&A arbitration may require the issuance of interim measures and emergency relieves, for instance in the closing phase (between signing and closing) to prevent a seller from aggravating the financial situation of the target company before closing, to enjoin a party from disposing of the shares of the target, or to order a party to refrain from calling up a bank guarantee issued to secure the parties' obligations.[36]

[36]Andrea Carlevaris, *The Arbitration of Disputes Relating to Mergers and Acquisitions: A Study of ICC Cases*, 2013, *ICC International Court of Arbitration Bulletin* Vol. 24 No. 1.

Under the *2018 HKIAC Administered Arbitration Rules*, Article 23 provides for Interim Measures of Protection and Emergency Relief. A party may apply for an urgent interim or conservatory relief ("Emergency Relief") prior to the constitution of the arbitral tribunal. At the request of either party, the arbitral tribunal may order any interim measures it deems necessary or appropriate. An interim measure, whether in the form of an order or award or in another form, is any temporary measure ordered by the arbitral tribunal at any time before it issues the award by which the dispute is finally decided, that a party, for example and without limitation:

(a) maintain or restore the status quo pending determination of the dispute; or

(b) take action that would prevent, or refrain from taking action that is likely to cause, current or imminent harm or prejudice to the arbitral process itself; or

(c) provide a means of preserving assets out of which a subsequent award may be satisfied; or

(d) preserve evidence that may be relevant and material to the resolution of the dispute.

Schedule 4 of the *2018 HKIAC Administered Arbitration Rules* provides for the Emergency Arbitrator procedures. A party requiring Emergency Relief may submit an application (the "Application") for the appointment of an emergency arbitrator to HKIAC (a) before, (b) concurrent with, or (c) following the filing of a Notice of Arbitration, but prior to the constitution of the arbitral tribunal. If HKIAC determines that it should accept the Application, HKIAC shall seek to appoint an emergency arbitrator within 24 hours after receipt of both the Application and the Application Deposit. Any decision, order or award of the emergency arbitrator on the Application (the "Emergency Decision") shall be made within 14 days from the date on which HKIAC transmitted the case file to the emergency arbitrator. This time limit may be extended by agreement of the parties or, in appropriate circumstances, by HKIAC.

Any Emergency Decision made under the above mentioned *2018 HKIAC Administered Arbitration Rules* shall have the same effect as an interim measure granted pursuant to Article 23 of the Rules and shall be binding on the parties when rendered. If the Emergency Relief is rendered in the form of an arbitral award, then arguably, it should be enforceable in the GBA pursuant to the relevant mutual recognition and enforcement regimes of arbitral awards.

Conclusion

Having examined the choice of various dispute resolution mechanisms, i.e. domestic courts, including the First CICC in Shenzhen, arbitration, mediation and expert determination in resolving M&A disputes in the GBA, we found that the most effective cross-border dispute resolution mechanism within the GBA for resolving M&A disputes is arbitration.

Given the complexity and high stakes involved in M&A disputes, we would advise parties to carefully consider pre-arbitration processes, including meditation and expert determination. Sophisticated drafting skills are required to prevent these pre-arbitration steps from becoming blockages or a false economy as they may merely delay resolution and increase costs.

Having analysed both the basic drafting rules and key aspects related to M&A pre-closing as well as post-closing disputes, we would advise parties to incorporate institutional rules, such as the *2018 HKIAC Administered Arbitration Rules* that provides for sophisticated arbitration procedures for joinder, consolidation, single arbitration for multiple contracts, and concurrent arbitral proceedings, which in our views could potentially assist parties in M&A disputes to resolve multi-party and multi-contract issues effectively and efficiently.

We are also of the view that some special procedures, such as expedited procedures and emergency arbitrator procedures available under the *2018 HKIAC Administered Arbitration Rules* are potentially very useful for resolving M&A disputes in a time and cost efficient manner.

Last but not least, given the divergent or not yet harmonised arbitration regimes present in the GBA, it remains crucial for the parties involved in M&A transactions to carefully consider various options available for the law governing the arbitration agreement, the law governing the substantive issues, the choice of the seat of the arbitration and the language of the arbitration.

After all, well thought through and well-designed dispute resolution clauses can easily save millions for parties involved in M&A transactions. Parties are well advised to seek tailor-made professional advice at the negotiation and drafting stage of M&A transactions, and to avoid cut and paste standard arbitration clauses without understanding the potential risks involved not only in the M&A transaction itself but also in the subsequent dispute resolution processes.

Re-interpretation of the interim measure enforcement arrangement

Huang Tao, James Guan, Barbara Chiu

I. Issuance of the Arrangement

On 2 April 2019, the Supreme People's Court (the "SPC") and the Department of Justice of Hong Kong SAR officially signed the *Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region* (the "Arrangement"). Since then, the Arrangement is being heavily discussed in the legal profession in the Mainland China and Hong Kong SAR. A party in an arbitral proceeding being conducted in Hong Kong SAR has no legal basis to apply for interim measures in the Mainland China. This has long troubled investors in the Mainland China and Hong Kong SAR. The Arrangement not only makes the breakthrough to resolve such issue but also comprehensively specifies the scope of interim measures, procedures to apply, how to deal with such an application and costs of interim measures. Upon effectiveness, the Arrangement will provide parties in arbitral proceedings with a full set of operable rules.

This article will make a comparison between the interim measure systems and practices in the Mainland China and Hong Kong SAR and re-examine the impacts that the Arrangement may have when investors seek remedies after a dispute arises. After the comparison and re-examination, it is intended to provide some constructive trains of thought for investors in the GBA to choose how to resolve their dispute.

II. Positive exploration of the Arrangement

The Arrangement makes an innovative and positive exploration and attempt in many aspects:

1. Thoughts to formulate the Arrangement -- never sidestepping difficulties and seeking common grounds while reserving differences

Judicial assistance between different jurisdictions, especially between different legal systems, in "One Country" is quite challenging and different from international judicial assistance and from judicial assistance between different regions in a single jurisdiction. Generally, the Arrangement aims at providing similar treatment for arbitral proceedings in Hong Kong SAR and the Mainland China in terms of interim measures. It follows the principle of "in which jurisdiction the interim measure is applied for, the rules of that jurisdiction shall apply" to minimize the strangeness and discomfort of the parties when they apply for cross-jurisdictional interim measures.

For example, with respect to the scope of interim measures, Article 2 of the Arrangement defines "interim measure" in two cases - the Mainland China and Hong Kong SAR. Specifically, in the case of the Mainland China, "interim measure" includes property preservation, evidence preservation and conduct preservation, which is consistent with the relevant provisions of the *Arbitration Law of the People's Republic of China* (the "Arbitration Law") and the *Civil Procedure Law of the People's Republic of China* (the "Civil Procedure Law"). In the case of Hong Kong SAR, "interim measure" includes injunction and other interlocutory measures.

Under Article 45 of the current *Arbitration Ordinance* (Cap. 609) and *The Rules of the High Court* (Cap. 4A), the court may grant an interim measure in aid of a litigation or an arbitral proceeding that is instituted outside Hong Kong SAR. Such interim measures include: (1) property preservation: Mareva injunction; (2) evidence preservation: Anton Piller order; and (3) conduct preservation: mandatory/prohibitory injunction. In general, Mareva injunction is granted in conjunction with an Ancillary Disclosure Order against the respondent. If necessary, the court will also issue a Norwich Pharmacal disclosure order to a third party such as a bank. Although the Arrangement does not specify any asset disclosure measures, the systems established under the prevailing laws of Hong Kong SAR are applicable.

For another example, Articles 4 and 5 of the Arrangement specify the materials to be submitted by a party applying to a people's court of the Mainland China for interim measure and the content to be contained in the application. Such provisions largely accord with the requirements for domestic interim measures under the *Provisions of the Supreme People's Court on Several Issues Relating to Handling of Property Preservation Cases by People's Courts* (the "SPC Property Preservation Provisions"). Correspondingly, Articles 6 and 7 of the Arrangement provide for the application to be submitted by a party in an arbitral proceeding seated in the Mainland China for interim measures in Hong Kong SAR. The *Arbitration Ordinance* and t*he Rules of the High Court* also contain similar provisions.

The Civil Procedure Law provides "[w]here the applicant fails to institute an action or apply for arbitration in accordance with law within 30 days after the people's court takes an interim measure, the people's court shall remove such measure." Article 3 of the Arrangement further specifies, "[t]he people's court of the Mainland shall discharge the interim measure if it has not received a letter from the relevant institution or permanent office certifying its acceptance of the arbitration case." Pursuant to the laws of Hong Kong SAR, the court may require the applicant applying for interim measures in Hong Kong SAR to make undertakings such as to institute the arbitral proceeding within 14 days.

2. Positive signals of the Arrangement in support of arbitration

On 18 January 2019, the SPC and the

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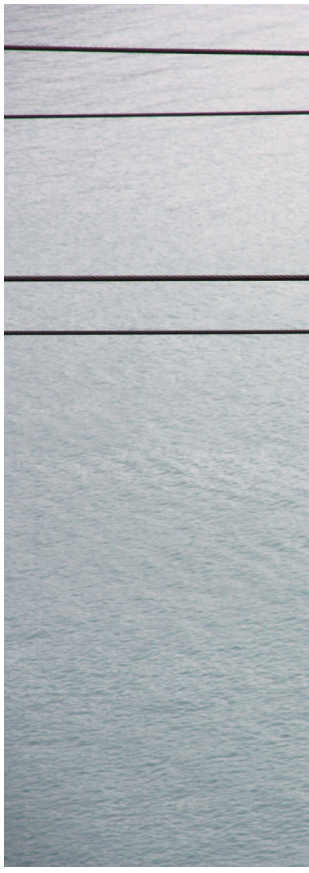
Department of Justice of Hong Kong SAR signed the *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region* (the "Reciprocal Arrangement"). Under the Reciprocal Arrangement, the scope of reciprocal recognition and enforcement is expanded to cover civil and commercial cases in which there is no written agreement on exclusive jurisdiction. In terms of the types of cases, basically all civil and commercial disputes are included. However, the Reciprocal Arrangement clarifies that the "judgments" are limited to those on the merits and exclusive of rulings concerning preservation measures rendered by the courts of the Mainland China and anti-suit injunctions and orders for interim relief rendered by the courts of Hong Kong SAR. In a word, for investors in the Mainland China and Hong Kong SAR, they are still not entitled to any assistance of the courts of the Mainland China in respect of interim measures if they choose to resolve their dispute in a court of Hong Kong SAR.

In contrast, for arbitration in Hong Kong SAR, the two key factors - enforcement and interim measures - to choose how to resolve a dispute in the Mainland China or Hong Kong SAR are resolved in light of the *Arrangement Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and the Hong Kong Special Administrative Region* signed in 1999 and the Arrangement. Before the Arrangement comes into effect, except for maritime cases, the Mainland China cannot provide assistance in interim measures for extra-jurisdictional arbitration, including that in Hong Kong SAR, in accordance with the Civil Procedure Law and the Arbitration Law.[1] On the basis of the Reciprocal Arrangement, the issuance of the Arrangement opens up a way for parties to arbitration in Hong Kong SAR to apply to the courts of the Mainland China for interim measures. It provides closer assistance to Hong Kong SAR within the "One Country" framework than to other jurisdictions and releases positive signals in support of arbitration. Accordingly, it is even more beneficial to choose arbitration than litigation in Hong Kong SAR.

In addition, the interactions in arbitral proceedings between the Mainland China and Hong Kong SAR provide more choices for investors to design their ways to seek remedies. First, in terms of costs, a party to an arbitral proceeding in Hong Kong SAR may institute an interim measure process in the Mainland China at lower costs. Take Hong Kong International Arbitration Centre ("HKIAC") as an example. A party may institute an arbitral proceeding after paying only HK$8,000 and apply to a court of the Mainland China for interim measures based on such proceeding. In contrast, in a litigation proceeding in the Mainland China, a party must prepay a great amount of court fees to institute the interim measure process if the amount in dispute is relatively high and it is hard to seek a pre-trial interim measure. This may pose a relatively great capital pressure on the party. Second, in terms of difficulty, it is easier to obtain an interim measure in the Mainland China since the requirements for a court of the Mainland China to grant an application for interim measure are looser than those for a court of Hong Kong SAR to grant an interlocutory injunction. Assuming that the respondent has assets in both the Mainland China and Hong Kong SAR, a party to arbitration in Hong Kong SAR may choose the assets located in either the Mainland China or Hong Kong SAR in consideration of the varied review requirements to increase the possibility of success. Third, in terms of procedures of interim measures, because the notice of arbitration is to be served by the claimant on the respondent in an arbitral proceeding in Hong Kong SAR (while by the arbitration institution in the Mainland China, always with a specified time limit), the claimant may time the service flexibly to match the time required for the court of the Mainland China to complete the formalities for interim measure.



According to Article 3 of the Arrangement, the procedures to apply to a court of the Mainland China for interim measure in an arbitral proceeding in Hong Kong SAR is similar to those for a court of the Mainland China to forward such an application. Taking into account the increasingly closer judicial assistance between the Mainland China and Hong Kong SAR, we incline to opine that it is less possible for the courts of the Mainland China to set any additional procedural prerequisites or review requirements for the requests from Hong Kong arbitration institutions to forward applications for interim measures. Of course, it is still pending since the detailed supporting rules of the Arrangement are not yet released.

[1]Under the *Arbitration Ordinance*, Hong Kong SAR may provide assistance in interim measures for extra-jurisdictional arbitration, including that in the Mainland. In another word, even if the Arrangement was not signed, an arbitration institution and a party in the Mainland may apply to a court in Hong Kong SAR for assistance in interim measure while an arbitration institution and a party in Hong Kong SAR may not do so to a court in the Mainland.

3. Dual standards for determining the nationality of arbitral proceedings -- “seat + approved arbitration institution”

Article 2 of the Arrangement defines the “arbitral proceedings in Hong Kong” as those administered by arbitration institutions on the list to be provided by the government of Hong Kong SAR and seated in Hong Kong SAR. For the nationality of the arbitration, the Arrangement adopts the internationally mainstream “seat” standard. However, it is not supportive for all Hong Kong arbitral proceedings. As a matter of fact, the Arrangement explicitly excludes *ad hoc* arbitral proceedings seated in Hong Kong SAR and arbitral proceedings seated in Hong Kong SAR but administered by non-listed institutions. Besides, the Arrangement is aimed at providing assistance for commercial arbitration between parties with equal status, thus excluding investment arbitration.

The list of the approved arbitration institutions or permanent offices under the Arrangement have not been released at present. It may be predicted that they include at least the HKIAC, the International Chamber of Commerce - Hong Kong (ICC-HK) and CIETAC Hong Kong Arbitration Centre.

4. Reciprocity of information channels and rights available to parties in the Mainland China and Hong Kong SAR

Article 6 of the Arrangement provides that a party to an arbitral proceeding in the Mainland China may, pursuant to the *Arbitration Ordinance* and *The Rules of the High Court*, apply to the High Court of Hong Kong SAR for interim measure. Before the Arrangement was signed, Article 45 of the *Arbitration Ordinance* has expressly specified that the court may grant an interim measure in relation to any arbitral proceedings regardless of whether they are conducted in Hong Kong SAR, even before the commencement of the arbitral proceedings. In practice, however, many parties to arbitral proceedings in the Mainland China have no idea that they may apply to a Hong Kong court for interim measures. Article 6 of the Arrangement will allow more parties in the Mainland China to understand and resort to the prevailing rules to protect their legitimate rights and interests. Article 7 of the Arrangement sets forth the materials to be submitted to apply for interim measures under the laws of Hong Kong SAR, including an application, an affidavit supporting the application, exhibits thereto, a skeleton argument and a draft court order. It provides a more convenient reference basis for parties in the Mainland China who are unfamiliar with the laws of Hong Kong SAR.

The interim measures in the Mainland China in relation to arbitral proceedings in Hong Kong SAR under the Arrangement are something new. Starting earlier, the arbitration in Hong Kong SAR is highly internationalized and has well-established rules and thus is preferred by investors in the Mainland China and Hong Kong SAR. The Arrangement will provide great benefits for parties who choose Hong Kong arbitration institutions to resolve their disputes. On one hand, a party may, before or during an arbitral proceeding, apply for evidence preservation or property preservation against any of the other party’s property in the Mainland China to prevent the other party from maliciously destroying evidence or transferring property. On the other hand, the applicant may also apply to the court of the Mainland China for conduct preservation in relation to certain misconducts of the other party to mitigate losses and eliminate adverse impacts.

III. Issues to be clarified

Although the Arrangement is commendable in many aspects, it is still to be explored how to effectively protect parties in arbitral proceedings in Hong Kong SAR and to allow them to truly benefit from the Arrangement. There are at least the following issues to be clarified:

1. No provisions in the Arrangement concerning an application for an interim measure between the rendering and recognition of a Hong Kong arbitral award

Before the issuance of the Arrangement, there were two major issues facing parties in arbitral proceedings in the Mainland China and Hong Kong SAR when they apply for property preservation: (i) whether it can be supported if a party applies to a court of the Mainland China for an interim measure when an arbitral proceeding has been instituted and is being conducted in Hong Kong SAR; and (ii) whether a party's application for an interim measure can be supported in the recognition and enforcement process if the party applies to a court of the Mainland China for recognition and enforcement of an arbitral award that has been rendered in Hong Kong SAR.

Articles 3 and 6 of the Arrangement expressly grant the right to a party in an arbitral proceeding in the Mainland China or Hong Kong SAR to apply to the court of the other jurisdiction for an interim measure before the arbitral award is rendered. Therefore, the first issue above will be resolved upon the effectiveness of the Arrangement. For the second issue, however, the Arrangement remains silent although there are no relevant existing laws in the Mainland China. From the perspective of litigation strategy, it seems unnecessary to wait and apply for an interim measure until the recognition and enforcement process is started. However, it will be a long time from the institution of an arbitral proceeding in Hong Kong SAR to the arbitral award's recognition by a court of the Mainland China. During such period, the interim measure issued before the arbitral award is rendered may have expired in the process of application for recognition. Alternatively, a party did not discover any clue that the other party has property in the Mainland China until such party applies for recognition. If there are no rules that protect the right of the party to apply for an interim measure or continued seizure at the stage of application for recognition, it would be impossible for the previous interim measure issued before the arbitral award is rendered to achieve the expected effect. This is undoubtedly contrary to the original intention of the Arrangement.

Although the legislation contains no explicit guidelines, there are notable precedents in practice in the Mainland China providing experience for reference. For example, in a process of recognition and enforcement of an arbitral award rendered by a HKIAC tribunal, the Intermediate People's Court of Guangzhou City issued an interim measure to preserve the property of the respondent.[2] The SPC also pointed out in a reply letter that there are currently no express provisions of law governing that a party submits an application for property preservation to a people's court after it has applied for recognition and enforcement of an arbitral award rendered in Hong Kong SAR. With reference to the principle established in Article 100 of the Civil Procedure Law, the people's court may grant the application for property preservation if the applicant provides sufficient guarantee.[3] By now, the issuance of the Arrangement marks closer judicial assistance between the Mainland China and Hong Kong SAR and gives positive signals. Accordingly, we are optimistic about whether an interim measure may be sought in the process for a Hong Kong arbitral award to be recognized and enforced in the Mainland China. Of course, we also expect that the legislation may provide further clarification and regulation regarding this issue.

2. No specified time limits in the Arrangement for examining applications for interim measures

Article 8 of the Arrangement provides that a requested court *shall expeditiously* examine a party's application for interim measure but does not specify a time limit for the court to do so. In this aspect, the Mainland China and Hong Kong SAR have established a proven set of mature and effective practices under their respective legal framework. We suppose that it is the reason why it is unnecessary to provide additionally for a specified time limit for interim measures under the Arrangement.

Pursuant to the relevant provisions of the Civil Procedure Law and the SPC Property Preservation Provisions, where a party submits an application for property preservation before litigation or arbitration, upon the acceptance of the application, the court shall make a ruling within 48 hours; where a party submit an application for property preservation in the litigation or arbitral proceeding, upon acceptance of the application, the court shall make a ruling within 5 days of the applicant's provision of guarantee, or within 48 hours under urgent

[2]Civil Ruling (2014) Sui Zhong Fa Min Si Chui Zi No. 42 ((2014) 穗中法民四初字第42号民事裁定书).

[3]Reply Letter (2017) Zui Gao Fa Min Ta No. 129 ((2017) 最高法民他129号复函).

circumstances. We understand that the courts of the Mainland China will also comply with such time limits when examining an application for interim measure after the Arrangement officially takes effect.

In Hong Kong SAR, the courts have established a set of proven effective procedures for a party to seek an interim measure. For urgent applications for ex parte injunctions such as Mareva injunctions and Anton Piller orders, the courts may generally issue a decision on the same day of application or within one or two days. Furthermore, the courts have a summons day every week on which they will handle the applications for injunctions and other interlocutory measures.

3. Potential issues of falsely adopted interim measures under the Arrangement

In the Mainland China, with the increasing demands for bona fide action in the judicial practice, courts are imposing heavier liabilities for false adoption of interim measures. We have noted in practice an increased number of cases in which the respondent sued the applicant, claiming losses resulting from false adoption of an interim measure for which the applicant had applied. Against this background, it is worth considering the following: if the substantive claims of the applicant seeking an interim measure in an arbitral proceeding in Hong Kong SAR are eventually denied by the tribunal, the other party against who the interim measure is adopted in the Mainland China may claim losses against the applicant on the ground of the false adoption of interim measure. If such other party is awarded a favorable judgment, it may need to apply to a Hong Kong court for recognition and enforcement of the same. In this scenario, it would be practically difficult for such successful other party to hold the malicious applicant liable if the *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region* had not become effective by then. Thus, the enforceability of its remedies would heavily depend on the guarantee that the malicious applicant may have provided when applying for the interim measure. In order to prevent malicious application for an interim measure and provide the highest level of protection for the rights and interests of the parties, when considering an application for interim measure under the Arrangement, the courts in the Mainland China may place higher requirements on the guarantee to be provided, such as a bank guarantee to be provided by the applicant, a higher ratio of cash guarantee or equivalent collaterals to be provided.

In Hong Kong SAR, the grounds on which a Mareva injunction may be sought are somewhat different from those on which the property preservation may be applied for in the Mainland China. In addition to an arguable cause of action, the applicant shall also demonstrate that there is a risk that the respondent may transfer its assets. On such basis, the court will balance whether it is just and convenient to grant such an injunction. The courts examine an application for an injunction or any other interim measure very strictly. When applying for an interim measure, an applicant shall comply with the obligation of full and frank disclosure. The courts will also require the applicant to provide guarantee and give the respondent the right to apply for dissolution of the injunction. We hope that in the course of the implementation of the Arrangement, the differences between the laws and procedures of the Mainland China and Hong Kong SAR will be mitigated gradually to further facilitate the judicial cooperation between the two jurisdictions.

Conclusion

The issuance of the Arrangement makes it even more beneficial to choose arbitration in Hong Kong SAR. When choosing how to resolve a dispute, the parties should draft the “midnight clauses” proactively and diligently in consideration of their respective positions in the negotiations and actual needs[4]. Once a dispute arises, they should not take it lightly. It is advisable to seek professional advice from local counsels in both the Mainland China and Hong Kong SAR and resolve the dispute effectively and efficiently in light of the commercial considerations and realities.

(We would like to acknowledge the contribution of counsels and associates Zhao Guannan, Chen Ziwei, Li Hanwen, Crystal Luk, Yuk Tak Cheuk and Wan Suet Yuen as well as intern Tu Zhenni.)

[4]The dispute resolution clause is otherwise known as the “midnight clause”. This may reflect a common phenomenon: the parties generally focus more on the interests that the transaction itself may bring to them and disregard proper drafting of the dispute resolution clause. At the last moment of the negotiations, they draft the dispute resolution clause hastily or simply copy the boilerplates. Once a dispute arises, they will have to bear the consequences resulting from their previous negligence.

Greater Bay Area insight: service of court documents in Hong Kong SAR, China Mainland and Macao SAR

Paul Starr, Haidi Teng, Jose Lupi , Suraj Sajnani, Yu Qing, Lai Junyi, Dong Long, Andrew Watson

With an increase of commerce in the Greater Bay Area, and along the Belt and Road, the likelihood of cross-border disputes is going to become even greater. With such disputes comes the need to serve documents from various fora across several cities. As such, this note outlines the general requirements for service of court documents in Hong Kong SAR, China Mainland and Macao SAR.

I. Service of Hong Kong court documents in Hong Kong SAR

The starting position for service of Hong Kong court documents within Hong Kong SAR is that a writ or originating process must be served personally on each defendant,[1] or, in the case of a company, left at or sent by post to the company's registered office.[2]

However, personal service is not required in certain limited circumstances, including:

(a) Where the documents are served by registered post to or inserted through the letter box at a defendant's usual or last known address;[3]

(b) Where the defendant's solicitor accepts court documents on behalf of the defendant;[4]

(c) Where the defendant acknowledges service;[5]

(d) Where an order for substituted service is made;[6]

(e) Where the action is in respect of a contract which specifies the manner or place of service;[7]

(f) Certain situations for land possession[8] and Admiralty claims,[9] and service against the government.[10]

Parties may also agree to a manner of service which is outside the rules, this being "consensual service".[11] Personal service is usually a pre-requisite to hold a person liable for contempt in the event of non-compliance with a Hong Kong court order.

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[1] *Rules of the High Court* ("RHC"), Order 10, rule 1(1).
[2] *Companies Ordinance* (Cap 622), section 827.
[3] RHC, Order 10, rule 1(2).
[4] RHC, Order 10, rule 1(4).
[5] RHC, Order 10, rule 1(5).
[6] RHC, Order 65, rule 4.
[7] RHC, Order 10, rule 3.
[8] RHC, Order 10, rule 4; RHC Order 113, rule 4.
[9] RHC, Order 75, rules 8 and 11.
[10] RHC, Order 77, rule 4.
[11] *Kenneth Allison Ltd v AE Limehouse & Co* [1992] 2 AC 105.

II. Service of Hong Kong court documents in China Mainland

Hong Kong court documents can only be served on parties outside of Hong Kong SAR with permission of the court. In order to obtain the court's permission, the plaintiff must establish:

(a) a connection between the foreign defendant and Hong Kong SAR;[12]

(b) a good arguable case that the plaintiff's claims fall within one of the categories listed in the Hong Kong court rules;[13]

(c) the plaintiff's evidence discloses a serious issue to be tried;[14] and

(d) the case is a proper one for the exercise of the court's discretion to grant leave.

In exercising its discretion, the court will consider whether it or another court is most appropriate forum in which to resolve the dispute.

Upon being granted leave, the plaintiff must lodge a request with the Hong Kong High Court Registry for service of the court documents through PRC judicial authorities,[15] together with 2 copies of the court documents required to be served and 2 additional copies for each defendant,[16] and certified Chinese translations.[17]

It is not uncommon for this process to take several months (often between three and nine months).

Using an agent or PRC lawyer to serve documents is not permitted unless leave for substituted service is granted by Hong Kong courts.[18] Such leave will be granted where it is impracticable for the court documents to be served through the PRC judicial authorities. In determining whether it is impracticable to serve documents through PRC judicial authorities, the court must be satisfied that:

(a) it is practically impossible to effect actual service; and

(b) the method of substituted service proposed by the plaintiff is one which will in all probability be effective to bring the court documents to the attention of defendant.

Substituted service can occur by post, by service on other person(s) whom the defendant has been or is likely to be in communication with, such as their lawyers, or in other ways.[19]

[12]RHC, Order 11, rule 1.

[13]RHC, Order 11, rule 1(1); *GDH Ltd v Creditor Co Ltd* [2008] 5 HKLRD 895.

[14]See *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Irani* [1993] 3 WLR 756.

[15]RHC, Order 11, rule 5A(2).

[16]RHC, Order 11, rule 5A(2).

[17]RHC, Order 11, rule 5A(4) and (5).

[18]*Deutsche Bank AG, Hong Kong Branch v Zhang Hong Li* [2016] 3 HKLRD 303.

[19]*Deutsche Bank AG, Hong Kong Branch v Zhang Hong Li* [2016] 3 HKLRD 303.

III. Service of Hong Kong Court documents in Macao SAR

On 5 December 2017, Hong Kong SAR and Macao SAR entered into an arrangement for mutual service of court documents. However, that agreement has not yet entered into force, and it is not yet known when exactly the arrangement will come into force. When it does come into force, requests for service of Hong Kong court documents in Macao SAR will be made through the High Court in Hong Kong SAR.

Until then, the general rule for service out of the jurisdiction of Hong Kong court documents applies to service in Macao SAR; that is that such documents can only be served on parties outside of Hong Kong SAR with permission of the Court.

Once the court has granted permission, service in Macao SAR can be effected in one of the following ways:

(a) Personal service;[20]

(b) Indorsement on the court documents by the defendant's solicitor that service is accepted on behalf of the defendant;[21]

(c) If service is acknowledged by the defendant;[22]

(d) Substituted service;[23]

(b) Service in accordance with the terms of a contract between the parties;[24]

(f) Service in accordance with the laws of Macao SAR; and[25]

(g) Service in accordance with the *Hague Convention on the Service Abroad of Judicial and Extrajudicial Document in Civil or Commercial Matters* ("the Convention").[26]

Under the Convention, requests can be sent to Registrar of the High Court,[27] who will forward the requests to the Procuratorate of the Macao Special Administrative Region. The Procuratorate will then arrange for local authorities to effect service.[28]

The Hong Kong court documents have to be in Chinese or Portuguese, otherwise a translation into either of the 2 languages is required.[29]

Frequently, service is carried out by registered post with notice of receipt or personal service by a judicial officer. In some cases, solicitors can also request that they be allowed to serve the document themselves or through another agent.

No fee is charged for the execution of requests under the Convention. Generally, it takes about three to four months to carry out the request.

IV. Service of China Mainland court documents in Hong Kong SAR

Pursuant to the Arrangement between the Mainland and Hong Kong SAR entered into in 1999,[30] requests

[20] RHC, Order 11, rule 5(1).

[21] RHC, Order 11, rule 5(1).

[22] RHC, Order 11, rule 5(1).

[23] RHC, Order 11, rule 5(1).

[24] RHC, Order 10, rule 3(1)(b).

[25] RHC, Order 11, rule 5(3)(a).

[26] RHC, Order 11, rule 5(8).

[27] Convention, article 9.

[28] <https://www.hcch.net/en/states/authorities/details3/?aid=253>.

[29] Convention, article 5(3).

[30] *Arrangement for Mutual Service of Judicial Documents in Civil and Commercial Proceedings between the Mainland and Hong Kong Courts* ("the Mainland-HK Arrangement").

for service of Mainland judicial documents on parties domiciled in Hong Kong SAR can be made to the higher people's courts in the Mainland to the Hong Kong High Court.[31] The Supreme People's Court may also make direct requests to the Hong Kong High Court.[32]

The same Chinese language and duplicate copy requirements noted above for Hong Kong documents served in the Mainland courts apply, and service of the documents is effected according to Hong Kong law.[33] The Hong Kong court is required to attend to service of the documents within two months of receiving the request, but does not have legal responsibility over the contents of or consequences arising from the document.[34] Service of documents is free of charge.[35]

The Mainland-HK Arrangement has been codified in the form of a Supreme People's Court judicial interpretation that came into effect on 30 March 1999.

We point out that mutual service of documents under the Mainland-HK Arrangement is not the only way that Mainland judicial documents can be served in Hong Kong SAR. In response to the increasing number of court litigations relating to Hong Kong SAR or Macao SAR commenced in the Mainland, the Supreme People's Court issued a judicial interpretation in 2009 confirming the following methods to serve on parties domiciled in Hong Kong SAR:[36]

(a) Service on Hong Kong representative located in the China Mainland: if the Hong Kong party has a legal representative, authorised representative, representative office or branch that is authorised to receive documents in the Mainland, the people's court may serve judicial documents directly on that person or entity;[37]

(b) Service made pursuant to the Mainland-HK Arrangement: further to the above, if no proof of service is received by the requesting people's court within three months after the request is made, service will be deemed to have failed;[38]

(c) Service by post: if no proof of service is received by the requesting people's court within three months after the documents are posted, service will be deemed to have failed;[39]

(d) Service by facsimile, email, or other appropriate methods whereby the receipt can be verified;[40]

(e) Service by public announcement: only in the event that all of the aforesaid methods are unsuccessful, the people's court may effect service by way of a public announcement. The announcement should be published in newspapers circulated in the Mainland and in the domiciles of the parties. The service will be deemed to be effected after a period of three months from the date of the public announcement has elapsed.[41]

The people's court is not confined to choosing one of the many available methods to effect service, and may deploy a combination of the methods simultaneously. The date of the earliest successful service will be deemed the date of service.[42]

Further, even if no proof of service is received by the People's Court, but actions from the relevant parties indicate that they have received the documents (e.g. by mention of the judicial documents being served, or by performing in accordance with the judicial documents), service will be deemed to have been successful.[43]

In practice, service made pursuant to other methods set out in the SPC Rules is considered more efficient and preferable to service made purely under the Mainland-HK Arrangement.[44]

[31]The Mainland-HK Arrangement, article 2.

[32]The Mainland-HK Arrangement, article 2.

[33]The Mainland-HK Arrangement, article 6.

[34]The Mainland-HK Arrangement, articles 4 & 7.

[35]The Mainland-HK Arrangement, article 8.

[36]*Several Provisions of the Supreme People's Court on the Issues concerning the Service of Judicial Documents of Hong Kong- and Macao-related Civil and Commercial Cases* ("the SPC Rules").

[37]The SPC Rules, articles 3-5.

[38]The SPC Rules, article 6.

[39]The SPC Rules, article 7.

[40]The SPC Rules, article 8.

[41]The SPC Rules, article 9.

[42]The SPC Rules, article 10.

[43]The SPC Rules, article 12.

[44]Lei Caixia and Hu Jiang, *A Brief Discussion on the "Reasonable Route" of Service of Judicial Documents in Civil and Commercial Cases related to Hong Kong and Macao* at Guangdong Court Website < http://www.gdcourts.gov.cn/index.php?v=show&cid=171&id=52333 >

V. Service of China Mainland court documents in Macao SAR

An arrangement similar to that of the Mainland-HK Arrangement was entered into between the Mainland and Macao SAR in 2001.[45] While the Mainland-Macao Arrangement is largely identical to the Mainland-HK Arrangement, there are a few notable differences:

(a) Requests for service of Mainland judicial documents in Macao SAR are to be made from higher people's courts in the Mainland to the Court of Final Appeal of Macao SAR (*Tribunal de Ultima Instancia*);[46]

(b) Service of documents is effected according to Macao law, but special requests made by the people's court may be fulfilled if such special requests are not in breach of Macao law;[47] and

(c) The competent Macao court may refuse a request when complying with a request would be beyond the Court's jurisdiction, or where that request offends a fundamental principle of law or public policy of Macao SAR.[48]

The SPC Rules described under Section IV as applicable to Hong Kong SAR are also applicable to service of judicial documents from Mainland Courts in Macao SAR, *mutatis mutandis*.

VI. Service of Macao court documents in Hong Kong SAR

As stated above, on 5 December 2017, Hong Kong SAR and Macao SAR entered into an arrangement for mutual service of court documents. However, that agreement has not yet entered into force, and it is not yet known when exactly the arrangement will come into force. When it does come into force, requests for service of court documents in Hong Kong SAR will be made through the Court of Final Appeal in Macao SAR and the High Court of Hong Kong SAR.[49]

Until then, service can be effected by having the Procuratorate of the Macao Special Administrative Region[50] send a copy of the court documents to the Chief Secretary for Administration in Hong Kong SAR.[51] Alternatively, the plaintiff can send their request to the Hong Kong court as its practice is to forward such requests to the Chief Secretary for Administration in Hong Kong SAR.[52]

The court documents have to be in English or Chinese, otherwise a translation into either of the 2 languages is required.[53]

Service is then carried out by the Chief Bailiff of the Court.[54] No fee is charged for the execution of requests under the Convention. It takes about 3-4 months to execute the request.

Alternatively, direct service can be effected through an agent, usually solicitors.

VII. Service of Macao court documents in the China Mainland

By virtue of the Mainland-Macao Arrangement,[55] judicial documents from the courts of Macao SAR can be served on parties in the China Mainland through the Court of Final Appeal in Macao SAR and the higher people's courts or the Supreme People's Court in the China Mainland.[56]

Upon receipt of the request from the Court of Final Appeal of Macao SAR (the "Requesting Court"), along with the relevant Macao court documents to be served, the receiving higher people's court of the China Mainland (the "Receiving Court") shall immediately forward it to the court with jurisdiction (determined in accordance with PRC law, the "Entrusted Court") to complete service.[57]

The request should be drafted in or translated into Chinese.[58] If the Entrusted Court deems the request does not comply with the terms of the Mainland-Macao Arrangement, it should immediately notify the Requesting Court, explain its opposition to the request, and ask for additional information or documents, if necessary.[59]

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[45] *Arrangement for Mutual Entrustment with Service of Judicial "Documents and Taking of Evidence in Civil and Commercial Cases by Courts in the Mainland and the Macao Special Administrative Region* ("the Mainland-Macao Arrangement").

[46] The Mainland-Macao Arrangement, article 2.

[47] The Mainland-Macao Arrangement, article 6.

[48] The Mainland-Macao Arrangement, article 8.

[49] *Arrangement for Mutual Service of Judicial Documents in Civil and Commercial Cases between HKSAR and Macao SAR*, article 3.

[50] Convention, article 9.

[51] <https://www.hcch.net/en/states/authorities/details3/?aid=393>.

[52] Convention, article 10(b).

[53] Convention, article 5(3).

[54] Convention, article 5.

[55] The Mainland-Macao Arrangement has been codified in Macao law as the *Arrangement of the Supreme People's Court for Mutual Entrustment in Civil and Commercial Matters for the Service of Judicial Documents and Investigation and Evidence Obtainment between the Mainland and Macao Special Administrative Region* ("Notice 39/2001").

[56] Notice 39/2001, article 2.

[57] Notice 39/2001, article 3.

[58] Notice 39/2001, article 4.

[59] Notice 39/2001, article 3.

Service of documents must be completed within two months from the date of receipt of the request.[60] Service is effected according to PRC law, or in accordance with particular requests from the Requesting Court, so long as such particular requests are not deemed to violate PRC laws.[61]

The request cannot be refused on the following grounds:[62]

(a) PRC laws and regulations grant the Receiving Court or Entrusted Court exclusive jurisdiction over the underlying civil and commercial proceeding; or

(b) PRC laws and regulations do not provide the legal basis to make such claim.

However, the request may be refused on the following grounds:[63]

(a) The matter is outside the jurisdiction of the Receiving Court or Entrusted Court; or

(b) The request is in violation of the fundamental principles of PRC law or public interest of the China Mainland.

Such reasoning shall be immediately communicated in writing to the Requesting Court.

The request must generally be served in duplicate,[64] with two copies for each receiving party, duly chopped, and indicating:[65]

(a) name of the requesting entity;

(b) name or designation and full address of the addressees of the service; and

(c) nature of the process.

Where there are particular requests from the Requesting Court, or where there are matters requiring special consideration, it shall also be indicated in the request.

Once the judicial documents have been served, the Entrusted Court shall issue a document attesting to the service, which shall include:[66]

(a) form of service;

(b) date of service;

(c) identification of the person to whom it is delivered; and

(d) stamp of the competent court.

In the event that it is not possible to serve the documents, the Entrusted Court shall indicate in the supporting documentation or certificate of service the reasons why it was impossible to serve the documents and the date of refusal, and immediately return the request and all attached documents.[67]

The Entrusted Court:[68]

(a) must serve the documents even if the date or time fixed for the appearance in court is overdue; and

(b) is not legally responsible for the contents of and consequences arising out of the request for service of judicial documents and its attachments.

The judicial documents that can be served under the Mainland-Macao Arrangement include copies of:[69]

(a) claim;

(b) appeal;

(c) counterclaim and defense;

(d) power of attorney;

(e) summons;

(f) judgment;

(g) conciliation;

(h) judicial decisions;

(i) payment orders and other decisions;

(j) notifications;

(k) certificates; and

(l) supporting documents for service, and other attachments.

Finally, at the request of the Requesting court, the Entrusted Court may investigate and provide legislations of its jurisdiction.[70]

[60]Notice 39/2001, article 5.

[61]Notice 39/2001, article 6.

[62]Notice 39/2001, article 8.

[63]Notice 39/2001, article 8.

[64]Notice 39/2001, article 10.

[65]Notice 39/2001, article 9.

[66]Notice 39/2001, article 11.

[67]Notice 39/2001, article 11.

[68]Notice 39/2001, articles 12 & 13.

[69]Notice 39/2001, article 14.

[70]Notice 39/2001, article 23.

Enforcement of foreign/Mainland judgments in Hong Kong SAR – a practical guide

Barbara Chiu, Crystal Luk, Desmond Cheuk

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The long-awaited *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* (the "Outline") was released on 18 February 2019. The Outline follows the signing of the *Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Bay Area* on 1 July 2017. Released by the Central Committee of the Communist Party of China and the State Council, the Outline provides guidance for the current and future cooperation and development of the Greater Bay Area.

In the Outline, Hong Kong SAR is positioned as an international legal and dispute resolution hub in the Asia-Pacific Region. Thus moving forward, Hong Kong courts are expected to handle an increasingly significant amount of disputes as well as enforcement of foreign/Mainland judgments in Hong Kong SAR against the counterparties who possess assets in Hong Kong SAR. Focusing on the aspect of enforcement, this practical guide serves as user-friendly reference to those who have obtained Mainland/foreign judgments in their favour and are considering to enforce the judgments in Hong Kong SAR.

A foreign/Mainland judgment can be enforced in Hong Kong SAR either under the statutory regimes provided for by the *Foreign Judgments (Reciprocal Enforcement) Ordinance* (Cap. 319) and the *Mainland Judgments (Reciprocal Enforcement) Ordinance* (Cap.597) or at common law. If a judgment falls within any of the statutory regimes, then it should be enforced under the statutory regimes instead of at common law.

I. *Foreign Judgments (Reciprocal Enforcement) Ordinance* (Cap. 319) ("FJREO")

The FJREO covers judgments from the following jurisdictions: Australia, Austria, Belgium, Bermuda, Brunei, France, Germany, India, Israel, Italy, Malaysia, Netherlands, New

Zealand, Singapore and Sri Lanka.

In order for a judgment to be recognized and enforceable under the FJREO, the judgment in question has to satisfy the following conditions:

(a) It has to be final and conclusive between the parties;

(b) It has to be for a payable sum of money (not being a sum payable in respect of taxes or other charges of a similar nature or in respect of a fine or other penalty);

(c) It has to be given after the coming into operation of the order directing that the provisions of the FJREO shall extend to that foreign country;

(d) It has not been wholly satisfied; and

(e) It could be enforced by execution in the country of the original court.

The procedure to get a foreign judgment recognized under the FJREO is as follows:

(a) The judgment creditor should make an ex parte application (i.e. without notifying the other party) to the court of first instance. The judgment creditor will be under a duty of full and frank disclosure;

(b) The application should be supported by affirmation/affidavit explaining that requirements have been met;

(c) If the court finds the application to be in order, the foreign judgment will be registered;

(d) The judgment creditor should then serve the notice of registration on the judgment debtor;

(e) If the registration is not set aside within the specified time (usually 14 days), the judgment creditor is free to enforce the judgment.

For the registration of a judgment under the FJREO, the judgment creditor should apply for registration of the foreign judgment within six years from the date of the foreign judgment.

II. *Mainland Judgments (Reciprocal Enforcement) Ordinance* (Cap. 597) ("MJREO")

The MJREO specifically deals with Mainland judgments. Under the MJREO, a "Mainland Judgment" means a judgment, ruling, conciliatory statement or order of payment in civil or commercial matters that is given by a designated court in the PRC as specified under the ordinance.

Similarly to the FJREO, there are requirements on the Mainland judgment in order for it to be recognized under the MJREO:

(a) It should be given on or after 1 August 2008;

(b) It should be given by designated courts in the Mainland;

(c) It should be final and conclusive as between the parties to the judgment;

(d) It should be enforceable in the Mainland;

(e) It should be an order for the payment of a sum of money (not being a sum payable in respect of taxes or other charges of a nature or in respect of a fine or other penalty).

The procedure for application under the MJREO is also very similar to that of the FJREO:

(a) The judgment creditor should make an ex parte application (i.e. without notifying the other party) to the court of first instance. The judgment creditor will be under a duty of full and frank disclosure;

(b) The application should be supported by affirmation/affidavit explaining that the requirements have been met. It also should exhibit a copy of the Mainland judgment, the underlying agreement and a certificate issued by the Mainland court certifying that the judgment is final and conclusive;

(c) If the court finds the application to be in order, the Mainland judgment will be registered;

(d) The judgment creditor should then serve the notice of registration on the judgment debtor;

(e) If the registration is not set aside within the specified time (usually 14 days), the judgment creditor is free to enforce the judgment.

The time limit for making an application for registering a Mainland judgment is two years from (i) the last day of the period for performance as specified in the Mainland judgment; or (ii) if there is no specified period for performance, the date of the Mainland judgment.

III. At common law

At common law, a foreign judgment is "recognized" in the sense that a foreign judgment can constitute a cause of action in court. The foreign judgment in this case should be:

(a) For a fixed sum of money;

(b) Final and conclusive; and

(c) From the foreign court with the requisite jurisdiction to adjudicate the matter.

Once a Hong Kong judgment is obtained based on

the foreign judgment, the same can be enforced as explained further below.

IV. Common means of enforcement in Hong Kong SAR

Having gotten a foreign judgment recognized in Hong Kong SAR, that is to give force and effect to it as if it is a Hong Kong judgment. The judgment creditor can then take steps to enforce the judgment to realise the remedy awarded in the judgment.

There are various means to enforce a judgment in Hong Kong SAR. What will be the most appropriate will depend on the facts and circumstances of each case and the type of assets that the judgment debtor has in Hong Kong SAR. It is pertinent to investigate the assets of the judgment debtor and obtain legal advice at early stages so that an effective strategy on enforcement can be formulated.

The following are some common means of enforcement in Hong Kong SAR:

Garnishee proceedings

Garnishee proceedings are the ideal enforcement means against money sitting in the debtor's bank account. A garnishee order is an order to be attached to debts due or accruing to a judgment debtor owed by a third party (the "garnishee"). Upon granting of the order, the garnishee would, instead of paying to the judgment debtor, be obliged to pay such debts directly to the applying judgment creditor.

Charging order and order for sale of assets

Charging orders are usually used for (i) land and securities; (ii) interests under a trust; and (iii) certain property held by a person as trustee, and beneficially owned by the judgment debtor. By obtaining a charging order over a debtor's assets, the debtor will be prohibited from disposing of the assets. If the judgment remains unsatisfied, the judgment creditor may enforce the charging order by obtaining an order for the sale of the property subject to the charging order and the sale proceeds can be applied to satisfy the judgment debt.

Writ of Fieri Facias

Enforcement by writ of fieri facias is ideal where the judgment debtor has moveable property that is worth seizing, such as goods, bank notes, bills of exchange or promissory notes. The writ of fieri facias gives the bailiff (a public officer appointed by the court) the legal right to seize such goods, chattels and other properties of the judgment debtor as are reasonably sufficient to satisfy the judgment debt together with interest and costs of the execution.

Appointment of receivers

Receivers can be appointed to handle income-producing assets, such as property that is tenanted, or where the asset in question falls outside the scope of other enforcement means. The court will appoint a receiver to receive the income from the debtor's property, of which the income will be applied to satisfy the judgment debt.

Liquidation -- application for winding up or bankruptcy

This is often considered as a last resort, where there is no real prospect of the judgment debt being recovered by execution, or where the debtor has absconded, or closed down shops, leaving no available assets. Bankruptcy or winding up of an insolvent debtor is a process of collective enforcement of the debtor's debt for the benefit of the general body of creditors. Once a bankruptcy or winding up order is made, the trustees in bankruptcy or the liquidators would take over the assets of the bankrupt/wound up company and distribute the assets upon realization to the creditors in accordance with the established principles.

Examination orders

If little is known about the judgment debtor's assets, it is possible to proceed first by way or oral examination of the judgment debtor. This method can be used to enforce a judgment or order for payment of money. Under an order for oral examination, the judgment debtor is obliged to attend before the court and be examined as to his income and assets, and to produce any relevant documentation. non-compliance of examination order and/or supplying false or misleading information at examination may lead to possible contempt proceedings which is serious in nature, and may lead to imprisonment.

Sharing of recent case of successful registration and enforcement of Mainland judgment in Hong Kong SAR

Barbara CHIU, CHENG Ke, Crystal LUK

As Mainland China continues to promote outbound investment, more and more Mainland residents and legal entities in Mainland China have invested in or relocating their assets to Hong Kong SAR. Further, there are increasing instances of registration and enforcement of the Mainland judgments in Hong Kong SAR by judgment creditors. This article provides a brief introduction of the conditions for the registration and enforcement of Mainland judgments in Hong Kong SAR, the grounds of objection and the types of assets that are enforceable, including the enforcement of bank accounts, shares in listed companies and real properties held by the debtors in Hong Kong SAR etc.

I. Registration of Mainland judgments

Prior to the enforcement of the Mainland judgments in Hong Kong SAR, creditors shall apply to the Hong Kong courts for the registration of the *Mainland judgments in accordance with the Mainland Judgments (Reciprocal Enforcement) Ordinance* (Cap. 597 of the Laws of Hong Kong) (the "Ordinance"). The registration of the Mainland judgment shall satisfy the following conditions:

- the judgment involves disputes over civil or commercial contracts (except contracts for non-commercial purposes, including employment, personal consumption or family affairs etc. Mainland China and Hong Kong SAR have separately entered into the *Arrangement on Reciprocal Recognition and Enforcement of Civil Judgments in Matrimonial and Family Cases by the Courts of the Mainland and of the Hong Kong Special Administrative Region*, which has yet to enter into force);
- the judgment orders the payment of a sum of money (not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty);
- the relevant contract must be entered into on or after 1 August 2008;
- the relevant contract must provide that Mainland courts have the sole or exclusive jurisdiction over any disputes arising therefrom;
- the judgment is given by a designated court specified in Schedule 1 to the Ordinance; and

- the judgment is final and conclusive, and enforceable in Mainland China.

Subject to the satisfaction of the above conditions, the time limit for making an application for the registration of a Mainland judgment shall be 2 years from the date of which the judgment takes effect (or from the last day of the period where a period for performance of the Mainland judgment has been specified in the Mainland judgment).

Based on our experience, the approval of the application is substantially an administrative or mechanical procedure. If the statutory conditions to the registration of the Mainland judgments are satisfied, Hong Kong courts will generally order the registration of the same. In addition, Hong Kong courts will provide a time limit for the debtors to apply to set aside the registration of the Mainland judgments, which is generally 28 days from the service of the notice of the registration of the Mainland judgments.

Section 18 of the Ordinance sets out grounds on which the registration of the Mainland judgment shall be set aside, which include:

- the judgment is not a Mainland judgment which satisfies the requirements specified in the Ordinance;
- the judgment has been registered in contravention of the Ordinance;
- the relevant choice of Mainland court agreement is invalid under the law of the Mainland;
- the judgment has been wholly satisfied;
- the courts in Hong Kong SAR have exclusive jurisdiction over the case according to the law of Hong Kong SAR;
- the judgment debtor who did not appear in the original court to defend the proceedings -
  - (i) was not summoned to appear according to the law of the Mainland; or
  - (ii) was so summoned but was not given sufficient time to defend the proceedings according to the law of the Mainland;
- the judgment was obtained by fraud;
- a judgment on the same cause of action between the parties to the judgment has been given by a court in Hong Kong SAR or an arbitral award on the same cause of action between the parties has been made by an arbitration body in Hong Kong SAR;
- a judgment on the same cause of action between the parties to the judgment has been given by a court in a place outside Hong Kong SAR or an arbitral award on the same cause of action between the parties has been made by an arbitration body in a place outside Hong Kong SAR, and the judgment or award has already been recognized in or enforced by the courts in Hong Kong SAR;
- the enforcement of the judgment is contrary to public policy; or
- the judgment has been reversed or otherwise set aside pursuant to an appeal or a retrial under the law of the Mainland.

The above grounds largely concern challenges to the procedures as Hong Kong courts generally do not intervene in the grounds of the ruling in the Mainland judgments.

A registered Mainland judgment shall, for the purpose of enforcement, have the same force and effect as if it had been a judgment originally given by the Hong Kong court.

II. Common types of enforceable assets

Before enforcing the judgments, judgment creditors should first understand the conditions relating to the debtors' assets in Hong Kong SAR and may adopt different enforcement procedures for different types of assets. Creditors may have certain knowledge about the debtors' assets in the course of their business cooperation.

Creditors may also conduct an asset search by conducting a public search or by engaging a private investigation company to investigate the debtors' assets. In addition, creditors may apply to the court for mandatory disclosure orders and require third parties (such as banks and accountants etc.) to disclose the debtors' assets so as to assist the enforcement proceedings if the relevant legal requirements are satisfied.

We will briefly discuss the types of assets that are generally available for enforcement by illustration of a successful case of registration and enforcement in Hong Kong SAR below:

(1) Balance of bank/securities account

Based on a successfully registered Mainland judgment in Hong Kong SAR, creditors can file a garnishee order application with Hong Kong courts, requiring the banks and securities firms to pay directly to the creditors out of the balance in the bank and securities accounts held by the debtors in Hong Kong SAR in order to discharge the debts due under the Mainland judgment. According to our experience, the garnishee order application is straightforward and effective, and the banks and securities firms generally will not oppose the application.

(2) Shares of listed companies

It is common for domestic residents or legal entities in Mainland China to invest in the shares of listed companies in Hong Kong SAR, particularly, if they are directors or senior management of the listed companies in Hong Kong SAR. Shareholders holding 5% or more of the shares of a Hong Kong listed company have to disclose their interests to the public. In addition, it is also possible for creditors to investigate the debtors' shareholding through public announcements issued or share registers kept by the listed companies. Creditors may apply to Hong Kong courts for charging orders and orders for sale against the shares held by the debtors, or to compel the securities

firms to dispose of the debtors' shares in order to discharge the debtors' obligations to repay under the Mainland judgment.

(3) Landed properties

The registration information of landed properties in Hong Kong SAR is public and creditors can search through the Land Registry. If a domestic resident or a legal entity in Mainland China holds a landed property in Hong Kong SAR, creditors can also apply for a charging order and an order for sale against the relevant property. Generally, creditors can compel sale of the property through an auction so as to have their debts repaid.

(4) Shares of overseas companies

It is common that debtors' assets may involve shares of overseas companies, such as a BVI company or a Cayman Islands company, through which the debtors indirectly hold their assets in Hong Kong SAR (such as shares of a Hong Kong listed company). The shareholding information of these overseas companies are not available to the public in general. However, if the debtors hold more than 5% of shares of a Hong Kong listed company indirectly through an overseas company, as mentioned above, the Hong Kong listed company is required to publicly disclose the relevant information of the shareholding and particulars of the shareholders of the overseas company.

Creditors may commence legal proceedings in the place of incorporation of the relevant overseas company and apply for enforcement against shares of the overseas company held by the debtors. After the creditors take control of the overseas company, they can then enforce the assets held by the overseas company in Hong Kong SAR.

Conclusion

The procedure of applying for the registration of the Mainland judgment under the Ordinance is relatively straightforward and convenient. Upon successful registration of the Mainland judgments, creditors may apply for enforcement of the debtors' assets in Hong Kong SAR. As soon as a contractual dispute arises in Mainland China or a Mainland judgment is obtained, it is advisable to investigate the conditions of the debtors' assets as soon as possible and then evaluate the prospect and strategies of registering and enforcing the Mainland judgment in Hong Kong SAR.

On 18 January 2019, the Supreme People's Court of China and the Department of Justice of the Government of the Hong Kong Special Administrative Region entered into the *Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region* (the "New Arrangement"). Under the New Arrangement, the scope for recognition and enforcement of judgments will become wider (for example, the New Arrangement will cover both monetary and non-monetary remedies). The Arrangement will take effect on a date to be announced after the legislation procedures are completed. In 2006, both places had entered into the arrangement for the recognition and enforcement of judgments in civil and commercial matters pursuant to choice of court agreements made between the parties concerned (the "Choice of Court Arrangement"). With reference to the experience relating to the Choice of Court Arrangement, it is expected that the New Arrangement may take two years to implement. The discussion of the aforementioned statutes and cases relate to the laws and regulations currently in effect only. We anticipate that both places will complete the implementation procedure for the New Arrangement shortly. Please stay tuned with us on the update of the development.

As regards the highlights of the New Arrangement, please refer to another publication of our firm entitled "Eight Points of Highlights of the New Enforcement Arrangement between the Mainland and Hong Kong Strengthening the role of Hong Kong as a Dispute Resolution Centre on One Belt, One Road Initiative". (available in Chinese text only)

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Further, as regards the proposal on how to preserve and recover assets through Hong Kong courts, please refer to another publication of our firm entitled "Belt and Road Practical Guide: How to get your money back? Asset preservation in Hong Kong". https://www.kwm.com/en/hk/knowledge/downloads/asset-preservation-in-hong-kong-20171130.

Market misconduct tribunal case update

Barbara Chiu, Crystal Luk, Nichole Hou

The *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* was released on 18 February 2019 (the "Outline"). One of the objectives of the Outline is to consolidate and enhance Hong Kong's status as an international financial centre and its role as an international asset management centre and risk management centre through promoting and developing high-end and high value-added financial services.

There have been an array of Mainland policies and measures to target financial development in the Greater Bay Area leading up to the release of the Outline, and the Mainland regulatory regime is becoming more and more in line with the international standard. It is anticipated that the securities market in Hong Kong SAR will continue to experience robust growth and development. Listed companies and participants in the securities market should also take heed of the regulatory developments in Hong Kong SAR.

In this case update, we will take a closer look at how the Market Misconduct Tribunal (the "MMT") and the Hong Kong court view and interpret certain regulatory misconducts under the *Securities and Futures Ordinance* (the "SFO"). In particular, we will examine the MTT's and the court's: (1) approach to the elements of the market misconduct of "disclosure of false or misleading information inducing transactions"; (2) adoption of an objective approach to one of the statutory defences to insider dealing; and (3) clarification on the inquisitorial nature of the MMT proceedings in Hong Kong SAR.

I. Disclosure of false or misleading information inducing transactions

One of the most commonly investigated and enforced forms of market misconduct by the regulator, Securities and Futures Commission (the "SFC"), is the market misconduct under section 277(1) of the SFO, namely, "*disclosure of false or misleading information inducing transactions*". Some examples of the recent and notable cases include:

- In early 2019, the Court of Appeal upheld the MMT's conviction against the head of research of a market research institution of disclosing false or misleading information inducing transactions in the publication of a research report on a PRC real estate group company in mid-2012;

- In early 2018, the Court of First Instance found that a PRC paper manufacturing company and its former chairman and vice-chairman had disclosed false or misleading information inducing transactions in that company's IPO prospectus in 2007 as well as its results announcements by materially overstating its turnover and understating its bank borrowings.

As regards the nature of this market misconduct, it takes place when a person discloses, circulates or disseminates information that is likely to induce a person to subscribe, sell or purchase securities or impact the price of the securities, if the information is false or misleading as to a material fact or omission and the person knows, is reckless or negligent as to the fact.

There are four essential elements of this market misconduct under section 277(1) of the SFO, namely, (1) publication, (2) market effect, (3) false or misleading information, and (4) *mens rea*.

What do these elements mean? First, the publication element concerns the dissemination of information, whether in Hong Kong SAR or elsewhere, by a person (such as the company or its directors). Second, the market effect element is limited to the effect of published information but not the effect of what omitted information would have had. There has to be a causal link between the disclosed information and its effect on the market, supported by evidence. Third, the false or misleading information element concerns whether the disseminated information is false or misleading as to a material fact or omission of fact. Lastly, the *mens rea* element is established if the person in question knows, or is reckless or negligent as to whether, the information is false or misleading.

Case illustration: a PRC conglomerate (the "Conglomerate")

For the purpose of illustration, the application of principles was demonstrated to a large extent in this case.

To hedge its foreign exchange risks, the Conglomerate had entered into a number of foreign exchange derivative contracts and instruments, namely Target Redemption Forward Contracts ("TRFs"), in particular with the Australian dollar in relation to its iron ore project in Australia. After entering into a number of these TRFs in mid-2008, the global financial crisis hit and the Australian dollar began to plummet as against the US dollar. As a result, the Conglomerate found itself in a position of being forced to continue to purchase Australia dollar at the previously agreed prices, which then stood significantly higher than market value.

At the relevant time, the Conglomerate was facing billions of dollars' worth of unrealised losses, or mark-to-market losses ("MTM Losses"). Consequently, in October 2008 the Conglomerate published a profit warning. In that statement, the Conglomerate stated that they had been aware of the exposure arising from the TRFs since September 2008. That date was important, as within one week after that the Conglomerate published an unrelated circular about a "disclosable and connected transaction" which stated that the directors were "not aware of any material adverse change" in the financial or trading

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position of the Conglomerate ("Circular"). The SFC argued that, by issuing the "no adverse material change" statement in the Circular, the Conglomerate committed market misconduct contrary to section 277(1) of the SFO.

For the market effect element, the SFC argued that the Circular omitted to inform the public of the unrealised MTM Losses. In the context of the global financial crisis, the "no adverse material change" statement was likely to reassure the market and "maintain" the price of the Conglomerate's shares. However, the MMT disagreed and found that, due to the lack of evidence as to any actual influence caused by the "no adverse material change" statement to the market, the Circular could not be said to have influence on the market, that is, to reassure the market and "maintain" the price of the Conglomerate's shares.

For the false or misleading element, first, the MMT was not satisfied that there was in existence, at the relevant time, an *actual* material adverse change in the Conglomerate's financial position. For example, the MMT found that, while the unrealised losses were of a significant magnitude, there was no question of an *actual* imminent crystallisation of capital loss on the relevant date. There was possibly a threat of material adverse change in the Conglomerate's financial position, but not a change which had already occurred at the relevant time.

As the above two elements, namely, the market effect and the false or misleading elements, were not satisfied, the MMT ruled that the relevant persons, namely the Conglomerate and the directors, had not engaged in market misconduct under section 277(1) of the SFO.

II. Insider dealing

Another common type of regulatory misconduct is insider dealing under section 270 of the SFO. In general, insider dealing takes place when a person with inside information about a corporation deals in the listed securities of the corporation.

One of the statutory defences to insider dealing is provided under section 271(3) of the SFO, namely, a person shall not be regarded as having engaged in insider dealing if the person's dealing in the listed securities was not for the purpose of securing or increasing a profit or avoiding or reducing a loss by using inside information. There has been an important case on how the court would view and apply this statutory defence to insider dealing which is illustrated in the following case:

Case illustration: a Hong Kong-listed PRC finance company (the "Finance Company")

The Finance Company owed a lady a sum of 58 million odd Hong Kong dollars, who subsequently assigned this debt to a third company. The third company then sought to recover the debt from the Finance Company by issuing a statutory demand and serving a winding-up petition on the Finance Company. As a result, the Finance Company's shares were suspended from trading in mid-2007. When the trading of the Finance Company's

shares resumed in October 2007, the share price dropped by approximately 60%.

The Finance Company's executive director and company secretary (collectively, the "Senior Officers") held certain share options in the Finance Company. In early 2007, the Finance Company received the notice of assignment about the debt and in April 2007, the statutory demand for the debt. The public, however, was never informed of these events. Around the same time, there had been a surge in the share price of the Finance Company due to market speculation. The Officers exercised their share options in the Finance Company after the Finance Company had received the notice of assignment. The Officers sold the shares over a period of time (and before the winding-up petition), and each of them made a profit of around HK$5 million.

The Senior Officers were suspected of insider dealing under section 270 of the SFO, in view of the sales of shares and their knowledge about the threatened winding-up proceedings at the material time.

The MMT ruled in late 2015 and acquitted the Officers on the basis of their defence under section 271(3) of the SFO. The MMT found that: (i) the sole motivation of the Officers in selling the Finance Company shares was simply to take advantage of the surge in price; and (ii) the Officers did not use the inside information since they believed that whatever threatened the share price of the Finance Company could be dealt with "behind closed doors", and would not influence the market price of the shares.

The SFC appealed and the Court of Appeal upheld the MMT's decision. The SFC further appealed to the Court of Final Appeal.

The Court of Final Appeal, by a majority decision, held that the MMT had erred in ruling that the Officers succeeded in establishing the section 271(3) defence. The defence requires a person to prove on a balance of probabilities that dealings which constitute insider dealing were done not for the purpose of securing or increasing a profit (or avoiding or reducing a loss). To rely on the defence, one would expect the insider to positively establish an innocent purpose, for example, dealing in securities pursuant to a prior contractual obligation and having to sell whether realising a profit or a loss, or selling shares in compliance with a court order such as in matrimonial financial relief proceedings etc.

The Court further remarked that the MMT should not have accepted the "behind closed doors" justification. The Officers could not rely on the section 271(3) defence by asserting their subjective belief at the material time that (i) the negative news of the Finance Company would remain "behind closed doors" and (ii) the negative impact would disappear in the future because "whatever problems face the company will be successfully resolved".

III. The nature of MMT proceedings

The inquisitorial nature of MMT proceedings is very different from the adversarial nature of court proceedings (civil or criminal). The Court of Appeal has in a recent case clarified and reiterated the nature of MMT proceedings:

The nature of the inquiry on market misconduct is civil and inquisitorial. Its function is not to adjudicate between rival claims or positions but to inquire into the question of insider dealing. As the nature of the inquiry is civil, the standard of proof is on a balance of probabilities.

In the inquisitorial jurisdiction including the MMT proceedings, no party bears the burden of proof. The concept of burden of proof is only a tool in the adversarial jurisdiction as a last resort for the court to dispose of a case when no findings of fact are possible or when all explanations are improbable.

Case illustration: a Hong Kong-listed PRC natural gas company (the "Natural Gas Company")

In early 2011, a Hong Kong-listed PRC natural gas distribution company (the "Natural Gas Distribution Company") approached a Hong Kong-listed PRC petroleum company (the "Petroleum Company") to fund a takeover of the Natural Gas Company (the "Project").

The director of the Natural Gas Distribution Company had knowledge about the Project in or around early November 2011. After the kick-off meeting of the Project in November 2011, there were discussions between the director of the Natural Gas Distribution Company, the Petroleum Company and their financial adviser about the Project.

In December 2011, the Natural Gas Distribution Company and the Petroleum Company issued a joint Pre-Conditional Voluntary General Offer announcement ("Announcement") regarding their offer to acquire all of the outstanding shares of the Natural Gas Company at HK$3.50, representing a premium of 25% to the previous closing price of the Natural Gas Company.

The SFC's allegation is that, whilst in possession of the relevant information about the Project since early November 2011, the director of the Natural Gas Distribution Company used the securities account of another person to purchase the Natural Gas Company's shares. The director of the Natural Gas Distribution Company also provided the funds for the purchase of the shares and received the proceeds from the subsequent sale of the shares before the Announcement was issued.

The MMT found that the director of the Natural Gas Distribution Company had not "dealt" with the shares of the Natural Gas Company as SFC failed to prove the market misconduct on the part of the director of the Natural Gas Distribution Company.

The SFC appealed against the MMT's decision. In September 2010, the Court of Appeal held that it was wrong for the MMT to put the burden of proof on SFC, as if it were an adversarial system. It was also wrong to require the SFC to adduce evidence to rule out all other possibilities in the factual circumstances -- by doing so would go beyond what is required by the civil standard of a balance of probabilities. Accordingly, the Court of Appeal ruled that the MMT was plainly wrong in acquitting the director of the Natural Gas Distribution Company of insider dealing, and ordered a retrial by the MMT (on the sole question of whether the director of the Natural Gas Distribution Company had dealt with the shares of the Natural Gas Company).

Summary

In view of the above decisions of the MMT and the Hong Kong court, there are some key points to note:

First, as regards the market misconduct of disclosure of false or misleading information inducing transactions under section 277(1), only published statements can be said to influence the market and the effect of what a statement might have if it were published is irrelevant. There must also be a causal link between the misleading or false information and its market effect.

In considering what constitutes false or misleading information, the threshold is high. Price sensitivity is a distinct and different concept and will not alone amount to material adverse change whereas unrealised losses or exposure to losses could be regarded as existing material adverse change depending on the circumstances.

As regards the defence to insider dealing under section 271(3), the Hong Kong court appears to adopt a more cautious approach to the interpretation of the defence, expecting there to be an innocent purpose. If the trading in question involves the use of price-sensitive information, it will be difficult for a defendant to rely on this defence to insider dealing under section 271(3).

Lastly, on the nature of MMT proceedings, the Hong Kong court reiterated that MMT proceedings are civil and inquisitorial in nature and, therefore, no party should bear the burden of proof. The Hong Kong court's clarification is of significant importance to a defendant when it comes to preparation of defence and adducing evidence in MMT proceedings.

For more information on the SFC's enforcement trend relating to the legal action brought by SFC on behalf of investors under section 213, please refer to our other article "SFC's recent enforcement trend with s213 - what does this mean for listed companies?" at https://www.kwm.com/en/hk/knowledge/insights/sfc-recent-enforcement-trend-with-s213-20180425; and for more information on the market misconduct of disclosure of false or misleading information, please refer to our other article "The Securities and Futures Commission in Hong Kong imposes serious consequences on market misconduct" at https://www.kwm.com/en/hk/knowledge/insights/the-securities-and-futures-commission-in-hong-kong-imposes-serious-consequences-on-market-misconduct-20150126.

Reviving distressed enterprises through bankruptcy reorganization to protect the healthy development of the economy in the GBA -- the way for SX to revive through bankruptcy reorganization

Wang Fuxiang, Li Kai, Shang Denghui

In order to innovate economic development models and expand opening-up, China established the Guangdong-Hong Kong-Macao Greater Bay Area (the "GBA") and is endeavoring to build it as a vibrant world-class city cluster and a showcase for in-depth cooperation between the Mainland China and Hong Kong SAR and Macao SAR. From such strategic positioning of the GBA, it is undoubtedly an important mission of the GBA to develop a fully market-oriented economy based on the rule of law and to provide a new engine and model for the economic development in all the other regions across the country. To achieve this sacred mission, the bankruptcy reorganization system is indispensable. It may revive financially or operationally distressed entities to protect the healthy development of the economy in the GBA. The revival of SX-Corporation ("SX") through bankruptcy reorganization is such a typical example.

I. Introduction: opportunities and challenges of bankruptcy reorganization

1. Profile of SX

Founded in 1981, SX became listed at Shenzhen Stock Exchange in 1994, with a total of approximately 350 million shares - 180 million float shares and 170 million restricted shares.

SX had control over or participation in four industrial entities: SX-Technology, SX-Industry, SX-Feedstuff and SX-Xibu (together, the "Subsidiaries").

2.The Court's acceptance of the application for reorganization of SX

Upon the application of the creditor SX-Feedstuff, Shenzhen Intermediate People's Court (the "Court") ruled on 10 November 2009 that SX enter a reorganization process due to its insolvency and designated King & Wood Mallesons (Shenzhen) ("KWM") as the administrator (the "Administrator").

SX conducted no operations by itself and had all its operational assets in its subsidiaries. Therefore, it was taken over by the Administrator who was responsible for managing its assets, developing its reorganization plan and disclosing its information. SX was delisted on 11 December 2009. The weighted average price of its shares was RMB 8.64 per share for the 20 trade days before delisting.

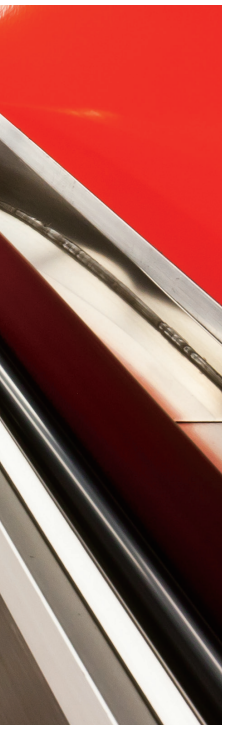
3. The Court's acceptance of the application for reorganization of the four subsidiaries

Upon the application of the creditor, the Court ruled on 15 January 2010 that the Subsidiaries entered a reorganization process due to their insolvency and designated KWM as the Administrator.

All the Subsidiaries had production and operational activities and were found insolvent after asset assessment and debt verification. Upon their application, the Court approved that the Subsidiaries may manage their assets and business affairs under the supervision of the Administrator.

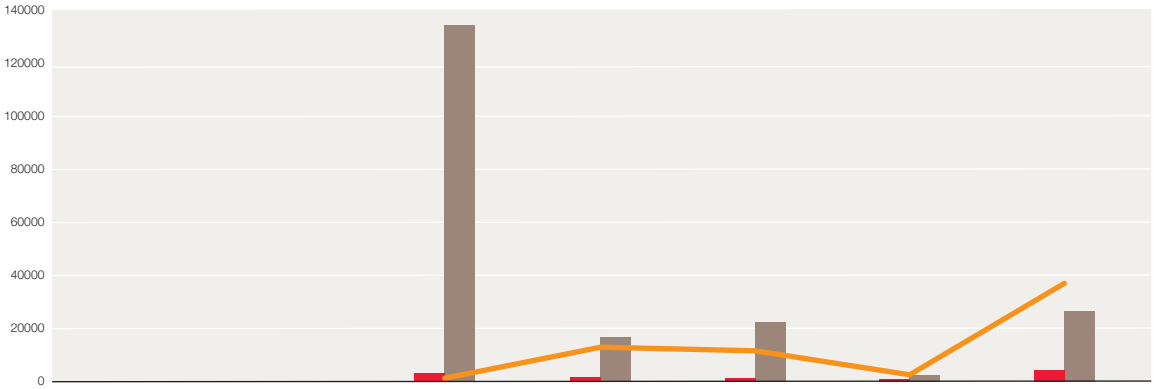
II. Crisis: serious unbalanced ratios of assets and liabilities

In the reorganization process, the Administrator thoroughly verified the debts and assets of SX and its Subsidiaries. At the same time, their financial crisis continuously intensified before reorganization and it was hard for them to realise their stock assets in a timely manner. Affected by these factors, SX and its Subsidiaries became seriously insolvent and suffered from negative assets. The details were as follows:



Assets and liabilities of SX and its Subsidities

RMB Million



	SX	SX-Technology	SX-Feedstuff	SX-Industry	SX-Xibu
Assessed total assets	31	23	23	3.8	39
Total ordinary debts	1,300	170	280	33	230
Discharge ratio of ordinary debts	0.50%	4.80%	4.30%	1.30%	14.00%

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As shown in the above figure, the ratios of the assets and liabilities of SX and its Subsidiaries were all seriously unbalanced. For their discharge ratios of ordinary debts, the highest was below 15% and the lowest even below 0.5%. If they went into a bankruptcy liquidation process, such ratios would further drop down. Moreover, SX and its Subsidiaries had a tremendous amount of liabilities and their ordinary debts added up to over RMB 2,100 million. In this context, how to design the reorganization plans of the five entities became the biggest problem facing the Administrator.

III. Breakthrough: four key factors to design the reorganization plans

Given the complexity of the assets and liabilities of SX and its Subsidiaries, the Administrator must take the basic information of all the five entities into account collectively when designing the reorganization plans. Throughout the design, the Administrator focused on the key thorny and sensitive issues as below:

1. How to ensure the going-concern ability of SX after reorganization

Maintaining the going-concern ability and value of SX and its Subsidiaries was one of the important starting points to implement the reorganization. After examining the status quo of SX comprehensively, the Administrator found that it was obviously impossible for SX to continue as a going concern solely by relying on its own assets. After justification, the Administrator believed that SX must retain the operational assets of the Subsidiaries in order to ensure its ability to continue as a going concern after reorganization.

2. How for SX to retain the operational assets of the Subsidiaries

Retaining the operational assets of the Subsidiaries was a crucial means to maintain the profitability of SX and its Subsidiaries. For this end, two issues were involved. Firstly, since the Subsidiaries were insolvent, their assets must be used to discharge their respective debts. The debts of each of the Subsidiaries must be repaid first in order for SX to retain their assets. Secondly, major assets restructuring would be inevitable and subject to the approval of the competent SASAC if SX, as a listed company, purchased the operational assets of the Subsidiaries directly.

3. How to coordinate the reorganization plans of the five independent corporations

Because SX and each of its Subsidiaries were legally independent, they were required to have their respective reorganization process and plan. For the purposes of reorganization, however, it was necessary to coordinate among the five corporations to draft their reorganization plans. Therefore, when drafting the reorganization plans, the Administrator must consider how to respect the structure of assets and liabilities of each entity and retain all the operational assets of the Subsidiaries with SX. This entailed a holistic approach and integration of the reorganization plans of the five entities.

4. How to ensure the reasonableness and legitimateness of the repayment schemes of the five entities

Repayment was the ultimate means to address the debt crisis of SX and its Subsidiaries. There were two schemes for choice - cash repayment

and debt-for-equity swap - to repay debts. The latter scheme for SX was permitted by law. But the Subsidiaries were not listed and the fluidity of their equity interests was low. Thus, it was difficult for their creditors to exit after the swap and it would be impossible for them to accept the debt-for-equity swap. If the debts of the Subsidiaries were exchanged for equity in SX directly, it would be legally groundless. Therefore, it was necessary to design a legitimate route to do so.

IV. A holistic approach: "1+4" reorganization model

After rounds of deduction, calculation and justification in respect of the above core and thorny issues, the Administrator developed a holistic "1+4" reorganization model and the corresponding reorganization plans.

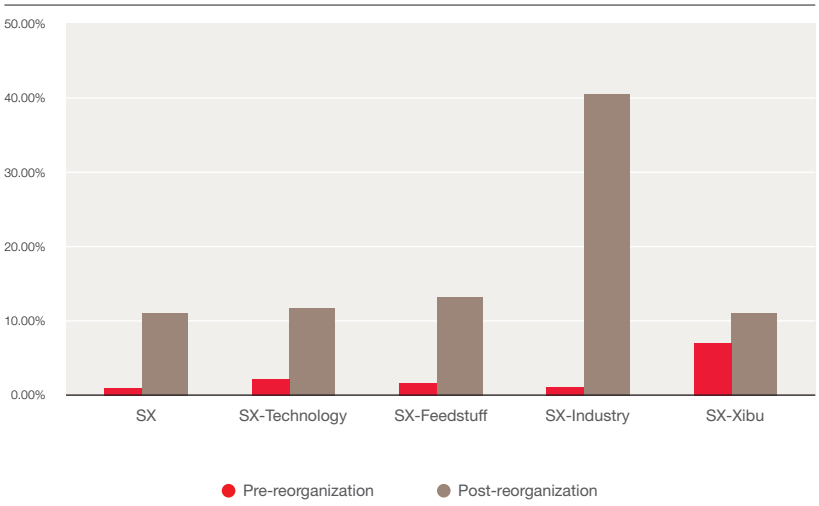
Under the "1+4" reorganization model, each of the entities were expected to discharge their own debts with their own assets. Because each entity had different amounts of assets and liabilities, their discharge ratios also varied. Based on the actual situations of the five entities, the Administrator developed a plan under which SX would provide all the resources for debt discharge and distribute such resources to its Subsidiaries in light of the actual assessment of their respective assets. Specifically:

1. Debt repayment schemes

The debts of the entities were repaid by exchange for shares of stock, all in the listed entity SX. The Administrator predetermined the total number of shares for exchange based on the assets of each entity and the number of shares of SX per RMB 100 debt based on the total ordinary debts of each entity. In order to ensure the compliance for the shares of SX to be used for repayment of the debts of its Subsidiaries, the reorganization plans set forth that SX was required to pay the consideration of the assessed assets of each of its Subsidiaries to preserve the operational assets of its Subsidiaries. Such consideration would then be distributed by its Subsidiaries to their respective creditors as assets for repayment.

The discharge ratios of ordinary debts of SX and its four Subsidiaries under the above scheme increased significantly than in a bankruptcy liquidation process:

Comparison of discharge ratios of ordinary debts before and after reorganization



As shown in the above figure, SX's discharge ratio of ordinary debts was approximately 20% after reorganization, representing an increase of approximately 19% than that in the bankruptcy liquidation process; SX-Technology's discharge ratio of ordinary debts was approximately 20%, representing an increase of approximately 15%; SX-Feedstuff's discharge ratio of ordinary debts was approximately 25%, representing an increase of approximately 20%; SX-Industry's discharge ratio of ordinary debts was approximately 48%, representing an increase of approximately 47%; and SX-Xibu's discharge ratio of ordinary debts was approximately 18%, representing an increase of approximately 4%.

2. Adjustment of equity interest of capital contributors

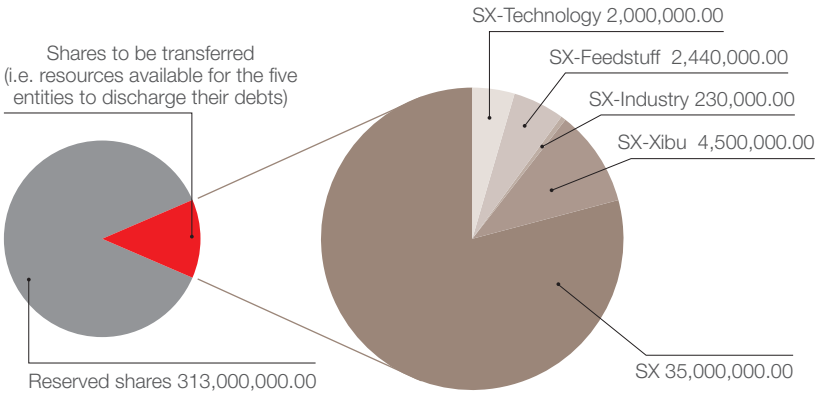
The total number of shares of SX to be used for repayment of debts under the "1+4" reorganization model was predetermined according to the calculation of the Administrator. In some specific circumstances, the discharge ratios of the entities were higher than as indicated in the solvency analysis report issued by the assessment institution, indicating that reorganization was superior to bankruptcy liquidation.

Accordingly, the reorganization plan of SX made an adjustment of the equity interest of the capital contributors. All the restricted shareholders would transfer about 15% of their shares without consideration, i.e. approximately 25 million shares in total. All the free-float shareholders would transfer about 10% of their shares without consideration, i.e. approximately 18.8 million shares in total. Thus, the shares of SX to be transferred would be totaled approximately 44 million, accounting for about 12% of its total shares.

The shares to be transferred by the capital contributors of SX were the source of shares to be used for the debt-for-equity swap under the "1+4" reorganization plans. The approximately 35 million shares to be transferred by all the shareholders were to be used for the reorganization of SX and for payment of the bankruptcy costs, debts of common interests and ordinary debts. Such transfer of original shareholders would be made at RMB 8.64 per share, the weighted average price for the 20 trade days before delisting on 11 December 2009. According to the calculation under the above repayment scheme, the ordinary debts of RMB 100 would be exchanged for 2.35 shares of stock. The float and restricted shares would be distributed on a pro rata basis.

In addition to those shares to be used for reorganization of SX, the remaining shares to be transferred by all the shareholders would be used for reorganization of the four Subsidiaries, i.e. to be paid to the creditors of the Subsidiaries to preserve their respective operational assets. In light of the differences in the assessed values of the assets of the Subsidiaries, SX provided a varied number of shares for each of the Subsidiaries to repay their respective debts. The specific distribution plan was as follows:

Distribution of shares for repayment of debts



Under the "1+4" reorganization model, after the above adjustment of the equity interest of the capital contributors of SX under its reorganization plan, the reorganization plans of the Subsidiaries also made an adjustment of the equity interest of their respective capital contributors. The original capital contributors transferred all their shares to SX without consideration, making the Subsidiaries become wholly-owned Subsidiaries of SX.

V. Completion: institutional effects of the judicial reorganization

After the meetings of the creditors of the five entities and the voting of the capital contributors by group, the above "1+4" reorganization plans were voted and adopted.

On 30 April 2010, the Court made a ruling, approving the reorganization plans of the five entities. By that date, the reorganization process of SX and its Subsidiaries had been concluded and they moved forward to implement their reorganization plans.

In August 2010, SX completed the intended transfer of shares by its shareholders and of equity interest by the capital contributors of its Subsidiaries under their respective reorganization plans.

On 30 August 2010, the Court rendered five civil rulings, affirming the completion of implementation of the reorganization plans of SX and its Subsidiaries.

It took nearly 300 days from the commencement of SX's reorganization process to its completion of the implementation of the reorganization plans. The judicial reorganization achieved the following obvious effects:

1. Confining the debt burden

Under the PRC Bankruptcy Law, no more interest shall be accrued on any debt once a debtor enters a bankruptcy reorganization process. In accordance with such provision, SX and its four Subsidiaries saved a huge amount of financial expenses each year.

2. Lifting the interim measures against the assets

Under the PRC Bankruptcy Law, all the interim measures against the property of a debtor shall be lifted unconditionally once the debtor enters a bankruptcy reorganization process. In accordance with such provision, the property, especially operational property, of the debtors SX and its Subsidiaries were protected in integrity.

3. Self-management by the debtors

Under the PRC Bankruptcy Law, a debtor may apply to the court for self-management of its property and business affairs once the debtor enters a bankruptcy reorganization process. Such self-management system is of great significance for the debtor. This means (i) that the control of the debtor remains unchanged; (ii) that the debtor may conduct its production and operations as it intends to as scheduled; (iii) that the reorganization plan will be prepared by the debtor proactively; and (iv) that the debtor may choose the restructuring partner with certain discretion. In this case, although the reorganization plans were mainly prepared by the Administrator in consideration of their specialty, the relevant entities played a vital role in such preparation.

4. Resolving the debt crisis

All the debts of the debtors were discharged under the "1+4" reorganization model. All the debts were repaid in part by debt/equity swap. The parts that remained outstanding were exempted in their entirety in accordance with the relevant provisions of the PRC Bankruptcy Law. All the debts of the five entities were discharged upon the completion of implementation of their reorganization plans. After the conclusion of the reorganization process, SX became a listed company without any liabilities and holding net assets of over RMB 120 million.

5. Improving the operations

After getting rid of the financial distress and completing the disposal of debts, the debtors maintained their effective operational assets, restored their profitability and stabilized their production and operations, moving back on the right track.

6. Providing the highest level of protection for the equity interest of capital contributors

According to the disclosed annual reports of the listed entity, SX and its Subsidiaries had become seriously insolvent before the commencement of the bankruptcy reorganization. Strictly speaking, the equity interest of the capital contributors should have become zero. In the course of reorganization, the shareholders seemed to suffer losses to some degree because the restricted shareholders transferred 15% of their shares and the free-float shareholders transferred 10% of their shares, both without consideration. After the conclusion of the reorganization process, however, especially after the completion of implementation of the reorganization plans, the production and operations of SX and its wholly-owned Subsidiaries became normal and the net assets per share of SX were approximately RMB 0.36. With the normalization of its production and operations and the increase of its net profits, the stock value of SX rose steadily. The remaining 85% and 90% of the equity interest held by the restricted and free-float shareholders respectively were protected effectively.

VI. Innovation: highlights of the reorganization of SX and its Subsidiaries

After the reorganization plans were drafted and implemented, the debt crisis of SX and its Subsidiaries was addressed, the rights of their creditors to repayment were protected, the operations of the five entities and their going-concern ability were maintained, and the equity interest of the capital contributors were properly protected. In a word, the market value and social value were organically integrated in this case. Throughout the process of this case, the highlights of the reorganization were as below:

1. Saving the real-economy enterprises

In this case, the real-economy enterprises in question were saved through reorganization, reflecting the originally intended purpose of the reorganization system. Prior to this case, listed companies needed injection of additional operational assets to maintain

their going-concern ability after reorganization. In China, it is unprecedented for a listed company to have been reorganized and maintained its operational assets and going-concern ability. As the Administrator, KWM innovatively designed the organization plans, which retained the active operational assets of the listed company in question to maintain its going-concern ability and ultimately save it. Advising on the reorganization in this case, KWM sets an example of "return to the originally intended purpose of the reorganization system" and will provide experience in successfully reorganizing and reviving distressed businesses in the GBA.

2. Reorganization without suspension of production

Once SX and its Subsidiaries as real-economy enterprises had suspended their production and business operation, their going-concern value would have been significantly impaired, the reorganization would have been worthless and the enterprises concerned would have had to be liquidated and go bankrupt. In this case, through the debtors' self-management of their property and business affairs, the production and operations of the reorganized entities were not suspended as a result of the reorganization. It is vital to preserve and increase the value of the operational assets of the reorganized entities and will be of positive and important significance for the healthy, sustainable and stable development of the economy in the GBA.

3. Effectively unlocking the reorganization resources of the listed company

The shares exchanged for equity under the "1+4" reorganization model in this case were all transferred by all the capital contributors of the listed company SX without consideration. The sophisticated design of the "1+4" reorganization model allowed the integrated reorganization of the five entities and the effective use of the reorganization resources of the listed company for the reorganization of the Subsidiaries. This was crucial for the success of the reorganization of the five entities. We believe that with the continued development and opening up of the economy in the GBA, there will be more diverse operating entities and market resources that will provide more valuable and utilizable reorganization resources.

VII. Summary of experience: insights from the reorganization of SX

Reviewing the entire development of this case and the innovative measures proposed in the draft reorganization plans, we may learn from the reorganization of SX and its Subsidiaries as follows:

1. Bankruptcy reorganization is an effective relief for distressed enterprises

It is advisable for financially or operationally distressed enterprises to redeem themselves through bankruptcy reorganization. Market economy is competitive economy, where competition will result in dischargeability of certain debts and financial or operational distresses. Bankruptcy reorganization is a remedial system specially established for financially or operationally distressed enterprises. In a sense, bankruptcy reorganization is a fundamental way for distressed enterprises to get out of trouble.

2. It is crucial to choose the time to enter the reorganization process

All distressed enterprises have the best window of time for redemption. If they go into the reorganization process during such period, a multi-win result may be achieved for creditors, debtors, capital contributors and investors. The reorganization effects will be greatly reduced once the window of time is missed. When the best window of time is depends on the quality of assets, the structure and amount of liabilities, the operations and other basic information of the distressed enterprise as well as the experience and expertise of reorganization professionals.

3. Reorganization plan is key to the success of reorganization

The reorganization plan (or scheme) is the core of reorganization, covering the discharge of debts, adjustment of equity interest of capital contributors and other important matters. It should be developed by taking the actual situations of the debtors, creditors and capital contributors, make innovations based on the data of assets and liabilities of the debtors, and make full use of the resources available to discharge debts, achieving the organically integrated legal, financial and social effects.

4. An administrator is the pivot in a reorganization case

The *SPC Minutes of the National Court Work Meeting on Bankruptcy Trials* mentions that an administrator is the main driver of bankruptcy proceedings and the person who actually carries out bankruptcy affairs. In the process of reorganization, the administrator plays an important role in various aspects such as problem diagnosis and resources integration. The expertise and capabilities of the administrator will have a profound influence on the progress of the reorganization process, the effects of reorganization and the future development of the reorganized enterprise.

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