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# China's Lehman Brother Moment: Will the Mainland China’s Courts Recognise Hong Kong High Court’s Winding-Up Order Against Evergrande?

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# Introduction

# Over the past decade, China has been slowly yet steadily opening up its market for recognising and assisting foreign insolvency proceedings. The Supreme People's Court of China (SPC), in the 2014 *Thumb case[[1]](#footnote-1),* first recognised the status of foreign insolvency representatives in China. However, this recognition was limited to the capacity of foreign representatives to manage affairs of Chinese subsidiaries on behalf of the foreign parent companies, but did not extend to allowing them to remit insolvency assets into their home proceedings. In 2017, SPC introduced a more adaptable presumption reciprocity to replace the previously rigid *de facto* reciprocity.[[2]](#footnote-2)

On 14 May 2021, SPC and the Hong Kong government signed the Record of Meeting on Mutual Recognition of and Assistance to Insolvency Proceedings Between Mainland China and Hong Kong courts (Meeting Record). To this end, SPC also issued the Opinions on Taking Forward a Pilot Measure concerning the Recognition of and Assistance to Insolvency Proceedings in Hong Kong (Pilot Opinion), using UNCITRL Model Law on Cross-Border Insolvency as a reference. The Pilot Opinion has been tested in two cases to be effective.[[3]](#footnote-3) Scholars optimistically believe that these judicial moves are progressively paving the way for adopting the 1997 Model Law in Mainland China.[[4]](#footnote-4)

However, there have been concerns that the trend towards the adoption of the Model Law in China may be at a crucial turning point. In a recent Insolvency case, Re China Evergrande Group*[[5]](#footnote-5)*, the High Court of Hong Kong ordered to winding-up of Evergrande and appointed liquidators. Judge Linda Chan, who ruled on this case, said she has had 'enough is enough' of Evergrande's repeated failures to present a proper debt restructuring plan, so liquidation may be the better option for protecting the interests of creditors.[[6]](#footnote-6) Nevertheless, this move may be a drawn-out process for foreign creditors, as over 90% of its assets available for liquidation are in Mainland China.[[7]](#footnote-7)

This winding-up order in Hong Kong places China's cross-border insolvency law in the spotlight. An unavoidable question is whether or to what extent this winding-up order in Hong Kong will be respected and enforced by Mainland China's courts. Although a new recognition and assistance mechanism for insolvency proceedings has been established between Mainland China and Hong Kong, it is unclear how the Chinese courts will treat this liquidation order. After all, the catastrophic ripple effects of the ongoing Evergande crisis on China's financial, property markets, as well as on political and social stability.

This winding-up order issued by the Hong Kong High Court places the Chinese government between a rock and a hard place. There are two options available to the Chinese government to respond to Evergrande's liquidation order, although each option has its unique challenges. First, the Chinese courts can assist the Hong Kong liquidators in collecting, administering and distributing Evergrande's assets located in China in accordance with the Pilot Opinion. By doing so, it allows foreign investors to be confident that their investments located in China will be treated fairly and safely, facilitating the maintenance of their enthusiasm and confidence in the Chinese market. Yet, how the Pilot Opinion will protect 1.6mn Evergrande's pre-sold-but-unfinished homebuyers are crucial assessments of whether the Mainland courts will recognise this winding-up order. [[8]](#footnote-8) More precisely, in insolvency proceedings, those owners of unfinished housing would become non-adjusting creditors who need priority protection from Chinese courts; otherwise, they would be a potential source of social discontent.[[9]](#footnote-9)

Another way is that Beijing sticks to its previous domestic protectionism in cross-border insolvency, that is, dismissing Hong Kong's liquidation order and forbidding Evergrande's complete insolvency in Mainland China. Evergrande is a main representative of the Chinese real estate market. The real estate sector contributes a quarter of China's GDP, and over 70% of the personal wealth composition of Chinese households is closely tied to real estate ownership.[[10]](#footnote-10) Evergrand's sudden meltdown could induce a disorderly collapse of house prices in China, resulting in a massive loss of resident's wealth. However, rejecting the liquidation order could mean that the claims of foreign creditors would be little satisfied as Evergrande has fewer overseas assets. Such disparate treatment may discourage foreign investors from investing in the Chinese market, which in turn will make it more difficult for Chinese businesses to access global capital markets in the future.

Against this backdrop, this article examines and estimates the possible regulatory stance of Chinese policymakers towards this winding-up order in Hong Kong. This article is composed of four parts. After this introduction, Part Two elaborates on what the ongoing Evergrande debt crisis is really like by tracing the factors that contributed to its debt crisis. Part Three answers the question of whether Evergrande is 'too big to fail' by analysing its catastrophic economic, political, and social stability implications. Part Four assess the possible regulatory stance of Chinese policymakers toward this winding-up order in Hong Kong.

# A Brief Overview of the Evergrande Debt Crisis

## 2.1 The Background of the Evergrande Debt Crisis

Over the past two decades, the real estate sector has long been a key driver of Chinese economic growth and urban expansion. By 2021, the real estate sector's contribution to China's GDP has been 22%, and with the addition of its related sectors, this proportion has been over 30%.[[11]](#footnote-11) Meanwhile, real estate and its related sectors have provided more than 15% of urban employment.[[12]](#footnote-12) However, in recent years, China's property sector has been undergoing many challenges, of which the unsustainable debt of real estate developers is the most pressing. This has raised concerns regarding the sustainability of China's property market, financial security, broader social stability, and economic slowdown. Among them, the Evergrande debt crisis is the most notorious. Given that Evergrande is symbolise of the ups and downs of China's real estate market, its treatment is also seen as a reference for treating other debt-ridden Chinese real estate developers.

Evergrande Group, founded by Hui Ka Yan in 1996, is China's second-largest real estate developer whose headquarters is located in Shenzhen in the Chinese province of Guangdong.[[13]](#footnote-13) Evergrande's rapid expansion has been largely attributable to the extraordinary boom in the Chinese real estate market over the past 25 years. During this period, the huge demand for Chinese residential housing and the relative ease of borrowing contributed to the rise and growth of many Chinese real estate giants, including Evergrande. It was reported that Evergrande had delivered about 1300 residential projects in over 280 Chinese cities before its debt crisis broke out, generating an annual turnover of approximately US$ 73.5bn.[[14]](#footnote-14) In 2018, Evergrande was ranked the world's most valuable real estate brand. In addition to its main business, Evergrande's ambitions extended to electric vehicle manufacturing, tourism, bottled water, football clubs and health and retirement care.[[15]](#footnote-15)

Nevertheless, the Evergrade debt crisis became public on 3 December, 2021, when it formally announced its inability to fulfil an outstanding guarantee of US$260mn from overseas creditors.[[16]](#footnote-16) Shortly after, Moody, a credit rating agency, downgraded Evergrande's credit rating from B2 to Ca, and it warned investors that Evergrande was likely to default on its debts because it had run out of cash and time.[[17]](#footnote-17) The rating downgrade triggered investors' panic and premature expiration of numerous subsequent liabilities, and it also generated expensive default penalties. The progressive debt, coupled with the constant eruption of negative news about Evergrande, such as dishonesty to lenders, slowing home sales, and the founder's lavish lifestyle, ended up being the nails in Evergrande's coffin.[[18]](#footnote-18)

At present, the Evergrande is the world's most indebted real estate developer. According to Evergrande's 2022 annual report, its total liabilities are already at nearly CNY 2.44trn (US$ 330bn), of which current liabilities are as high as CNY 1.67trn (US$225bn).[[19]](#footnote-19) Such a high amount of current liabilities means that Evergrande will face a large number of maturing debt and puttable bonds over the next 12 to 18 months. Although Evergrande's total assets still stand at a whopping CNY 1.8trn (US$248bn), most of them are property projects under construction and undeveloped land reserves; instead, its total cash is only CNY 14.3bn (US$ 1.93bn).[[20]](#footnote-20)

It has been argued that the nature of the Evergrande debt crisis is a liquidity problem, that is, Evergrande has enough assets to pay its debts, but lacks enough time to convert its assets into cash flow.[[21]](#footnote-21) Recently, Evergrande has embarked on realisation by selling properties and plots of land reserves at major discounts. However, the long realisation cycle of these assets, coupled with declining residential property demand in China, has made Evergrande's realisation process less than expected. It has been suggested that Evergrande should sell its 230mn square metres of land reserves to improve its financial stability.[[22]](#footnote-22) The difficulty, however, is that a significant portion of these prime land reserves has either been mortgaged to banks or seized by powerful domestic creditors. The remaining land reserves, primarily located in China's inland cities, coupled with the tightened property policies, result in difficulty in attracting strategic investors with willingness and ability.[[23]](#footnote-23) Moreover, such a gigantic amount of land reserves being sold off in the traditional fire-sale manner would immediately upset China's land economy balance and drastically reduce local government revenues.[[24]](#footnote-24) As a result, domestic and international investors have raised serious questions about the viability of its restructuring plans.

## 2.2 The Main Causes of the Evergrande Debt Crisis

There are various reasons behind Evergrande's frighteningly large liquidity deficit, including its high-leverage, high-debt, high-turnover model, its blind diversification strategies, the tightened regulatory policies, and the downward trend of the Chinese real estate market.[[25]](#footnote-25) Not only Evergrande but other debt-ridden Chinese real estate enterprises, like Country Garden and Greenland Holding, are also encountering similar challenges.

First and foremost, Evergrande's long-standing high-leverage, high-debt, high-turnover expansion model can no longer adapt to the fundamental changes in China's current property market. China's changing demographics (rapid ageing of China's population), rising urban unsold housing inventory and falling house prices have led to an accelerated decline in urban residential property demand in China.[[26]](#footnote-26) To put it bluntly, real estate development and investment in China have reached a point of sharply diminishing returns.[[27]](#footnote-27) However, the high-debt expansion model amplified the adverse impact of diminishing returns, ultimately leading to a high liquidity deficit for Evergrande.

The real estate sector is typically considered capital-intensive, because real estate companies have a significant demand for capital for land acquisition, project construction, labour recruiting and marketing. Given the long-term nature of real estate projects and the slow return on investment, many Chinese real estate companies have embraced a high-debt model to increase profits. Specifically, Chinese real estate companies utilise bank loans to acquire land, and then pre-sell housing units before construction begins. Right after receiving the advanced receipts from consumers, they reinvest these proceeds and new bank loans into the next project. Moreover, developers often mortgage the land and projects they hold to commercial or shadow banks to leverage more funds for further investment. In short, this debt-fueled model facilitates real estate developers to readily access massive credit to enable the high liquidity needed for their projects.[[28]](#footnote-28)

This debt-fueled expansion model was popular before 2020, which is partly influenced by traditional Chinese culture. The Chinese society has long regarded homeownership as a significant symbol of family success, economic stability and security. Owning a home is also traditionally considered a prerequisite for marriage, particularly for Chinese men. This deep-rooted belief has also been reinforced during China's urbanisation process since the turn of the century. For this reason, many families struggle to buy property in the city for their children to help them start a new family, even if it will leave them with a heavy financial burden.

In addition to the huge demand for housing created by cultural factors, the gradual acceleration of urbanisation in China has also attracted a large number of rural residents to the cities. More precisely, China's urbanisation rate has soared from 30.49% in 1996 to 63.89% in 2020, which means that China has added about 543mn urban residents in the last 25 years.[[29]](#footnote-29) There has also been a considerable need from former urban residents to upgrade their houses. In this situation, this debt-fueled model seemed the only way to ensure that real estate companies kept pace with these significant needs.

Apart from the real estate sector, this debt-fueled model has also benefited banks and homebuyers. For nearly two decades, real estate-related loans have been considered safe, high-quality sources of income for banks, accounting for about 25% of Chinese bank's assets.[[30]](#footnote-30) Banks have also not been overly concerned about the non-performance rate of these loans, because the surge in house prices over the past 20 years has allowed them to easily recover the principal amd interests by liquidating the housing. In addition, the soar in house prices has convinced consumers that real estate is a profitable investment, which in turn stimulates them to buy more homes. In short, this debt-fueled model has worked well regarding the continued rise in house prices.

However, the sustainability of this debt-fueled model has raised widespread concerns. Firstly, this model inevitably leads real estate developers into a borrowing race, whereas their accumulated overleveraged debt could threaten the Chinese economy's long-term prospects.[[31]](#footnote-31) As of 2021, the Chinese real estate sector has borrowed nearly US$5.2 trillion from commercial banks, shadow banks and private sectors.[[32]](#footnote-32) Secondly, this expansion model is graphically described as the use of short-term bank loans to invest in long-term projects with a rather long payback period, which is equivalent to walking a tightrope.[[33]](#footnote-33) Once the returns from certain projects deviated significantly from the expected income, they had no choice but to continue to borrow from banks or issue corporate bonds, resulting in a bigger debt snowball. Thirdly, this model also fosters real estate developers to overestimate their cash flows and project returns, further stimulating them to engage in more aggressive expansion and high-premium M&A.[[34]](#footnote-34) Fourthly, this model has contributed to speculative increases in house prices in China, rendering them unaffordable for many working-class families.

Last but not least, this model also stimulates the emergence and increase of property pre-sale, bringing about potential social instability. The real estate pre-sale system, as the name suggests, is a system that allows real estate developers to pre-sell housing under construction to consumers and receive advanced receipts. In general, Chinese homebuyers are required to pay full prices. Its original purpose was to address the issue of inadequate liquidity for real estate developers in order to accommodate the rapidly growing demand for urban housing. In principle, under the pre-sale system, homebuyers' advance deposits should be placed in designated escrow accounts, and local governments will allow developers to withdraw part deposit money according to the progress of construction.[[35]](#footnote-35) In practice, however, developers can readily withdraw all pre-sale funds from the escrow accounts due to lax regulation, fraud and greed.[[36]](#footnote-36) Once the project has been stopped due to lack of funds, it is difficult to find new strategic investors to start resuming the project, as it is no longer profitable. The vast majority of owners of pre-sale-yet-to-be-constructed houses are the biggest losers. This is because that these homeowners must continue to repay their outstanding loans even if they have only gained unfinished apartments, which inevitably leads to social instability.

The Chinese government has realised that this debt-fueled expansion model of real estate developers cannot go on forever. In order to prevent overheating in the real estate sector in China and curb unsustainable increases in housing prices, the Chinese government has conducted a series of stringent regulatory policies. In late 2016, Chinese President Xi Jinping first proposed the warning ' houses are for living in, not for speculation' to criticise the excessive enthusiasm about buying houses for investment.[[37]](#footnote-37) In August 2020, the People's Bank of China and the Ministry of Housing implemented stricter financing and refinancing thresholds for Chinese real estate developers to reduce their leverage, known as the 'Three Red Lines'.[[38]](#footnote-38) More precisely, Chinese real estate developers are permitted to refinance only if they meet the requirements of keeping their asset-liability ratio (after excluding advance receipts) below 70%, their net debt ratio below 100%, and their cash-to-short-term-debt ratio over 100%.[[39]](#footnote-39) This policy expects these developers to shift away from the past high-debt model to business refinement operations through prudent financial and credit management and good corporate governance.[[40]](#footnote-40)

Apparently, a year after the tightened regulatory policies, Evergrande's debt size still far exceeds the Three Red Lines, especially its asset-liability ratio (after excluding advance receipts) remaining as high as 80.33%, its debt ratio exceeding 117.99%, and its cash-to-short-term-debt ratio about 0.67.[[41]](#footnote-41) Consequently, Evergrande's new outward fundraising channels have been narrowed down, making it unable to sustain its past practice of borrowing new debt to repay old debt. Additionally, many restrictive policies on home sales have further worsened Evergrande's ability to raise sufficient cash flow from its main business to repay its debt. In summary, the previous debt-fueled model led Evergrande into a liquidity crisis of funds due to the downward trend of Chinese house sales and tightened regulatory policies.

Secondly, Evergrande's unreasonable diversified strategic layout and its aggressive pace of diversified expansion continued to worsen its liquidity shortages. Since 2009, Evergrande has embarked on developing new industries to obtain new profits. However, these non-core businesses of Evergrande, such as bottled water, football, electric vehicles (EV) and agriculture, seem to lack a strong industrial connection with its main business, resulting in its inability to create effective synergies and economies of scale.[[42]](#footnote-42) These non-core businesses have consumed a significant amount of Evergrande's cash flow, but have failed to provide Evergrande with a stable, long-run return on investment. For example, Evergrande Bingquan (Bottled Water), which invested CNY 6bn, has lost CNY 4bn as of 2021. Evergrande EV, which invested nearly CNY 280bn, has not yet realised mass production.[[43]](#footnote-43) These non-core businesses had obtained sustained credit support when this debt-fueled model was working well, but they quickly depleted Evergrande's cash flow when this model struggled.

# 3. Is Evergrande 'Too Big to Fail'?

Since 2021, Evergrande has been at the centre of an unprecedented liquidity crisis in China's real estate sector, and it has been slowly moving toward insolvency. Despite its efforts to rescue the situation, successive losses of CNY 800bn two years in a row and the increase of total debt from CNY1.9trn to CNY 2.4trn have proved its inability to reverse its downward spiral. As Scott Kennedy claims, neither Evergrande's investors nor other people should be surprised by Evergrande's meltdown, as it is inherently a combination of aggressive and risky strategies.[[44]](#footnote-44)

However, the Chinese authoritiest appears unwilling to witness Evergrande, once a symbolise of China's booming real estate market, slide into free-fall insolvency. In some ways, Evergrande is 'too big to fail' as it is intricately linked to China's property market, local governments, banks, homebuyers, vendors, domestic and overseas bondholders and retail investors. Its free-fall insolvency inevitably triggers fear of wider contagious effects in the economic, financial, world marketplace and political and social stability.

First and foremost, the most immediate impact of Evergrande's insolvency will be the overwhelming loss to its lenders, investors and vendors, especially banks, bondholders, stock investors, suppliers and construction workers. To put it bluntly, liquidation is not the best way to maximise the interests of creditors, as the surplus cash yielded by liquidating Evergrande is far less than the amount needed to repay creditors. By the end of 2022, Evergrande's total outstanding debt was still as high as CNY 753.7bn, of which approximately CNY 558.4bn was outstanding interest-bearing debt.[[45]](#footnote-45) Evergrande's trade payables related to real estate construction activities stood at CNY 1trn.[[46]](#footnote-46) In contrast, its total cash flow (including restricted cash) was only CNY 14.3bn in 2022. Once Evergrande is liquidated, almost 250 banks and trust and factoring companies have been ddirectly exposed to Evergrande. Moreover, loans from real estate developers and residential mortgages from homebuyers account for over 40% of Chinese banks' total loans as of 2020.[[47]](#footnote-47) The Chinese banks' heavy exposure to the property sector makes them believe Evergrande is 'too big to fail'; otherwise, the domino effect of Evergrande's free-fall insolvency on the real estate sector would further worsen fears of financial instability.

In addition, liquidation is also unprofitable for Evergrande's hundreds of thousands of shareholders worldwide, because shareholders are always paid after ordinary unsecured creditors in insolvency proceedings in most jurisdictions. Although their share has been rendered worthless after a 99% plunge in Evergrande's share prices, its restructuring will retain a glimmer of silver lining for them.[[48]](#footnote-48)

Second, Evergrande's free-falling insolvency will have an immediate and fatal impact on the millions of homeowners who purchased their yet-to-be-built homes through the pre-sale. It was reported that Evergrande has about 1.6mn homebuyers waiting for the properties they have already paid for.[[49]](#footnote-49) Once Evergrande goes into insolvency, these homeowners will have to queue up with other preferential creditors, vendors and retail investors for the drawn-out liquidation process. However, these homebuyers are more likely to resort to protests with banners or chants at strategic locations to compel the local governments to offer solutions.[[50]](#footnote-50) Many homebuyers are even boycotting residential mortgages, which is putting enormous pressure on banks and authorities, further fuelling fear of social discontent and instability.

Thirdly, Evergrande's insolvency has a direct spillover effect on China's property market and, ultimately, on the long-term prospect of China's economy as a whole. Evergrande's frequent negative news, sky-high debts and price-cutting house sales have shaken market confidence in the growth of the Chinese real estate sector, resulting in a plummet in home prices, sales and construction. The most direct impact of plummeting home prices would be the Chinese middle class, whose 70% of household wealth is tied up in homeownership.[[51]](#footnote-51) Rapidly falling house prices are wiping out the family wealth they accumulated in previous years, which could lead to feelings of furious and protest. Given China's traditional investment preference for property and relatively limited availability of other investment options (return on investment of stock, mutual funds and bank's wealth management products remain relatively low), the losses in housing wealth will hardly be offset in the short-term.[[52]](#footnote-52) In addition, Evergrande's insolvency will also drag down the entire real estate supply chain, such as construction, decoration, sale and advertisement, and construction workers.

Fourthly, Evergrande's insolvency may undermine the model of local governments in China relying on land sales and land mortgages to raise funds to develop local public infrastructure and urban projects.[[53]](#footnote-53) In China, there is an intricate link between real estate developers and local government. The government owns rights to all urban land, so any real estate developer intending to develop projects can only buy land-use rights by paying land transfer fees. Local government operations sometimes rely heavily on land transfer fees. Adequate land transfer fees facilitate the completion of their responsibilities for upgrading more urban public infrastructure and boosting economic growth, which in turn facilitates the political prospects of local officials. Land sales are the most crucial source of this important fiscal revenue, with land transfer fees received by local government through land sale already accounting for 42.5% of the local government's total revenues as of 2021.[[54]](#footnote-54) As a result, real estate is seen as 'too big to fail' for local governments; otherwise, it would be disastrous for the development of the local economy, provision of social welfare and the promotion of local officials.

Last but not least, in the contemporary era of globalisation, Evergrande's debt default has also rapidly spilled over into international capital markets. According to Evergrande's 2022 Annual report, its outgoing overseas debt remains as high as CNY 140.7bn.[[55]](#footnote-55) Many foreign investors even compare the ongoing Evergrande debt crisis to the 2008 insolvency of Lehman Brothers, which threw the US and global economies into turmoil. They fear that Evergrande's insolvency would exert catastrophic implications on China and the world, much as the Lehman insolvency had on the US and global economic in 2008. Similar to the Evergrande debt crisis triggered by its aggressive credit, the root of Lehman's troubles was also the combination of soaring housing prices in the US and high leverage by subprime households.[[56]](#footnote-56) When US home prices dropped in 2005, financial participants began a frenzy of fire sale of various mortgage-related portfolios, especially subprime mortgages with minimal equity and less security. Such a panic run forced the collapse of Lehman Brothers. The continued fall in China's house prices could also cause Chinese homebuyers to refuse to repay outstanding residential mortgages, leading to a rise in non-performing loan ratio in banks.

However, the ongoing Evergrande debt crisis cannot be China's Lehman Brothers moment. This is because the Chinese government can strictly control the exit of any financial participants, and the Chinese homebuyers always have high down payment requirements.[[57]](#footnote-57) A substantial down payment share and strict political controls can favourably offset the financial risks brought about by a modest fall in house prices. Notably, the main intention in palleneling the two is to remind the Chinese government to directly bail Evergrande out, because the 2008 global financial crisis was because the US regulators underestimated the impact of Lehman's failures.[[58]](#footnote-58)

While the Evergrande debt crisis intensifies, the Chinese central government seems unlikely to drastically change its bottom line on using the market to address the debt problems of indebted real estate developers. In other words, it does not seem to regard Evergrande as 'too big to fail'. Instead, it sees runaway debt and leverage in the real estate sector as a life-and-death risk for China's overall economic health.[[59]](#footnote-59) It is evident that the Chinese central government has long known that China's over-reliance on the debt-fueled model of real estate developers for economic growth is unsustainable and imbalanced.[[60]](#footnote-60) At present, more than 90% of Chinese households already own their own first homes, and almost a quarter of the total housing units are now empty.[[61]](#footnote-61) These figures indicate that the current boom in China's property market is fueled by speculative demand rather than real demand. Worse still, this gigantic property bubble is still accumulating. Faced with this challenge, the Chinese central government has developed many slogans and policies to tighten the disorderly debt financing of developers to facilitate the property market slowly digesting its inventory. These policies also reflect that the Chinese central government has begun to pursue other rather important policy agendas, such as common prosperity, sustainable development and balancing against capitalists.[[62]](#footnote-62)

Indeed, the central government has been aware of some of the noise in the process of reducing the dependence on real estate for economic growth, and has also moderately changed its radical policies. For example, the Chinese central government has recently relaxed the borrowing cap and grace period for meeting debt targets set by the Three Red Line to facilitate room for developers to refinance.[[63]](#footnote-63) Simultaneously, it has sought to exclude the compliance scrutiny of Three Red Line for debt raised by one real estate enterprise that intends to acquire the distressed assets of another developer.[[64]](#footnote-64) In addition, the central government is also planning to draw up a list of 50 real estate developers, allowing eligible developers to obtain financing support from banks if necessary.[[65]](#footnote-65) Notably, the real intention of these policies is to delay the collapse of these indebted real estate developers and minimise the catastrophic impacts of the property market crash.

It is clear that these macroeconomic and monetary policies reflect that the central government appears to have been reluctant to directly bail out reckless real estate developers like Evergrande. The bailout could send a wrong message to other developers caught in a similar situation that the Chinese government will always bail them out, triggering more moral hazard and potential contagion effects. Meanwhile, the central government also appears to have been reluctant to bail out bondholders and retail investors who bought Evergrande's bonds because they should bear responsibility for their high-risk, high-return decisions. Instead, the central government, which prizes social and political stability, is expected to provide Evergrande with special loans to compel it to start resuming work to continue delivering houses.[[66]](#footnote-66) The central government has severally reaffirmed the policy of 'guaranteed delivery' of real estate and facilitated the resumption of shutdown projects by issuing special loans. In this case, a restructuring plan between offshore creditors and Evergrande would be crucial for the Chinese government, as it would alleviate pressure on the state-owned banks that offered these special loans.[[67]](#footnote-67)

However, the winding-up order in Hong Kong seems to have disrupted its original plan. This situation makes it impossible for the Chinese government to address the Evergrande debt crisis through private instructions; instead, it must respond publicly as to whether or not it will recognise this liquidation order. The next section focuses on analysing the possible regulatory stance of Chinese policymakers on the recognition of this liquidation order in Hong Kong.

# 4.China's Possible Regulatory Stance Toward this Winding-Up Order in Hong Kong

On 14 August 2022, the petitioners, Top Shine Global Ltd, filed a petition in the High Court of Hong Kong for the liquidation of the China Evergrande Group on the ground that Evergrande had failed to pay an offshore debt of HK$ 862.5mn.[[68]](#footnote-68) After six times of hearings, the Hong Kong High Court issued a winding-up order against Everrgande on 31 January 2024 on the grounds that the debtor was unable to reach a reasonable debt restructuring arrangement for its offshore debts.[[69]](#footnote-69) However, the enforceability of this liquidation order has been widely questioned, as over 90% of assets are located in Mainland China, which is a separate jurisdiction from Hong Kong due to the 'One Country, Two Systems' regime. This liquidation order raises Two questions: 1) what is the legal basis for Hong Kong liquidators to seek recognition from Mainland Chinese courts; 2) whether or to what extent the Chinese courts will recognise this winding-up in Hong Kong.

This liquidation order in Hong Kong provides an important litmus test for the efficiency and practicability of a new mechanism for cross-border insolvency cooperation between Mainland China and Hong Kong. Chinese policymakers should answer this question promptly, as this outcome could have a critical influence on the future investment decisions of foreign investors in China. If this uncertain climate persists, foreign investors may gradually and cautiously avoid investing in China. In addition, the outcome of this liquidation order will also affect Hong Kong's position as a global financial centre.[[70]](#footnote-70)

## 4.1 Legal Basis for Hong Kong Liquidators to Seek Recognition of Winding-Up Orders in Mainland China

On 14 May 2021, SPC and the Hong Kong government signed the *Record of Meeting on Mutual Recognition of and Assistance to Insolvency Proceedings Between Courts of the Mainland China and Hong Kong Special Administrative Region* (Meeting Record).[[71]](#footnote-71) Legally, the Meeting Record, as a new judicial arrangement, is the only formal legal basis for cross-border insolvency judicial cooperation between courts in Mainland China and Hong Kong.[[72]](#footnote-72)

When it comes to recognising foreign insolvency proceedings in China, many initially refer to Art. 5 (2) of the 2006 Enterprises Insolvency Law (2006 EBL), which is the only legislative provision in China that concerns the recognition of foreign insolvency judgments.[[73]](#footnote-73) However, the persistent issues in cross-border insolvency practice between Mainland China and Hong Kong is whether the recognition of foreign insolvency orders provided by Art.5 (2) extends to Hong Kong. In simple terms, the answer is no, because the constitutional principle of 'One Country, Two Systems' results in Hong Kong not being regarded as a foreign jurisdiction by China's courts after 1997.[[74]](#footnote-74)

For a long time after the handover of Hong Kong, the Chinese authorities did not make a clear distinction on this issue. Thus, scholars still cited Art. 5 of *Provisions Concerning the Jurisdiction Problems of Foreign-Related Civil and Commercial Cases* issued in 2002 by the SPC to imply that the Mainland judicial authority still treats Hong Kong as a foreign jurisdiction.[[75]](#footnote-75) Recently, however, the Mainland authority has repeatedly reiterated that 'One Country' is a necessary precondition for the existence of 'Two Systems', which implies that the Mainland could not treat Hong Kong's legal conflicts as foreign but inter-regional conflicts.[[76]](#footnote-76)

This observation is also supported in the case of *2011 Northstar Automobile Industrial Holding Limited[[77]](#footnote-77),* that is, the Beijing High Courts sought a reply from the SPC as to whether a winding-up order in Hong Kong could be recognised in Mainland China. The SPC replied:

In accordance with Art. 1 of *Arrangement on Reciprocal Recognition and Enforcement of the Decision of Civil and Commercial Matters by the SPC between Mainland and Hong Kong Pursuant to the Choice of Court Agreements between Parties Concerned* (2006 Arrangement), the winding-up order in dispute does not fall within the ambit of the enforceable final judgment under the arrangement...... Art. 265 of the Civil Procedure Law and Art.5 of 2006 EBL, which provide provisions for recognition and enforcement of foreign judgments, cannot be applied to this case, either.

As an inter-regional conflict, mutual judicial assistance between Mainland and Hong Kong should based on Art. 95 of HKSAR Basic Law. That is, Hong Kong can render mutual judicial assistance with judicial organs of other parts of China through consultation.[[78]](#footnote-78) This article provides a clear legal basis for inter-regional judicial cooperation between courts in Hong Kong and Mainland China but lacks specific details.[[79]](#footnote-79) In practice, consultation is interpreted as *ad hoc* judicial arrangements between the Mainland and Hong Kong in relation to mutual judicial recognition and assistance.

Indeed, prior to the Meeting Record, there have already been seven arrangements of judicial assistance, including arbitral awards, matrimonial and family matters, civil judgments, service of judicial documents civil and commercial judgments, etc. In particular, the scope of the *Arrangement for the Reciprocal Recognition and Enforcement of Judgments in Civil Commercial Matters* issued in 2019 (2019 Arrangement) covers nearly the vast majority of money judgments, but still explicitly excludes corporate liquidation and reorganisation.[[80]](#footnote-80) To put it bluntly, like the purpose of other judicial arrangements, the Meeting Records is the only current legal basis for mutual judicial assistance involving insolvency proceedings between Mainland China and Hong Kong. The first motive appearing in the Preamble to the Meeting Record is implied in this point, that is, the Meeting Record is to 'thoroughly implement Article 95 of the HKSAR Basic Law' so as to 'further improve the mechanism for judicial assistance'.[[81]](#footnote-81)

However, Emily Lee explicitly opposed considering the Meeting Record as a formal judicial arrangement between the Mainland and Hong Kong. She criticised that although the Meeting Record was also drawn up in consultation between the SPC and the Department of Justice of Hong Kong, its cooperation mechanism is significantly less formal than the 2006 and 2009 judicial arrangements.[[82]](#footnote-82) More precisely, in order to further refine the 2006 Arrangement, Hong Kong policymakers have enacted and implemented the Mainland Judgment (Reciprocal Enforcement) Ordinance (Cap. 597), providing a clear statutory basis for judicial assistance of civil and commercial matters. In a similar vein, Hong Kong lawmakers have also made the Mainland Judgment in Civil and Commercial Matter (Reciprocal Enforcement) Ordinance (Cap. 645) to guide the implementation of the 2019 Arrangement.[[83]](#footnote-83) In contrast, SPC and the Department of Justice of Hong Kong only promulgated the *Opinion on Taking Forward a Pilot Measure in Relation to the Recognition of and Assistance to Insolvency Proceedings in HKSAR* (Pilot Opinion) and t*he Mainland Administrator's Application to the HKSAR Court for Recognition and Assistance Practical Guid*e (Practical Guide) to guide the Meeting Record. Emily Lee argued that both the Pilot Opinion and Practical Guide are overly simple in terms of legal certainty and formality.[[84]](#footnote-84)

Emily's concerns are not without merit. The existence of the constitutional system of 'One Country, Two Systems' has always prevented China from bypassing the special nature of Hong Kong judicial cases, that is, it is neither a foreign case nor a domestic case. It has led to the situation where it appears that the only way to avoid such political conflicts is to develop a cross-border insolvency judicial arrangement between the Mainland and Hong Kong. However, the cross-border insolvency cooperation mechanism between Mainland China and Hong Kong has developed rather slowly, failing to meet the rapidly developing business needs of both sides. As a result, Chinese policymakers should introduce the 1997 UNCITRAL Model Law on Cross-Border Insolvency as a judicial arrangement between Mainland China and Hong Kong. Its introduction will not only provide a more efficient cooperation mechanism for cross-border insolvency practices between both sides, but will also circumvent the aforementioned political conflicts. This is because the term 'State' occurs in the Model Law has been interpreted to mean the entity or jurisdiction enacting the Model Law, not a sovereign state in the political sense.[[85]](#footnote-85)

## 4.2 Do Mainland Courts Recognise Winding-Up Order Against Evergrande?

Having identified the legal basis for Hong Kong liquidators to seek recognition of its winding-up order in Mainland China, this section turns to the recognition regime of the Pilot Opinion. Recognition is a fundamental procedural step in cross-border insolvency regime, for it serves as an essential procedural basis for any form of following cooperation.[[86]](#footnote-86) This section analyse whether the Mainland courts will recognise this winding-up against Evergrande in the light of the eligibility requirements for recognition contained in the Pilot Opinion, the COMI test, public policy exception and practical considerations of Chinese authorities.

### 4.2.1 Pilot Areas and Eligible Hong Kong Insolvency Proceedings

According to Art. 1 of the Pilot Opinion, Hong Kong insolvency practitioners are entitled to seek recognition of Hong Kong insolvency proceedings from three Mainland designated courts, namely Shanghai, Xiamen and Shenzhen.[[87]](#footnote-87) Notably, Hong Kong liquidators must ensure that the debtor has principal assets, a place of business or a representative office in the 3 Mainland pilot areas before seeking recognition and assistance.[[88]](#footnote-88)

It is important to note that the legal effects consequent on recognition are not also only limited in the pilot areas.[[89]](#footnote-89) Instead, the legal effect of the relief granted by the pilot court is valid in respect of all debtor’s assets located in the Mainland. The primary role of the pilot courts is simply to confer competence on certain Mainland courts to hear Hong Kong insolvency petitions. After all, Shanghai, Shenzhen and Xiamen are the three cities with a high concentration of Hong Kong-fund enterprises in Mainland China. Meanwhile, three pilot courts have relatively good experience in handling cross-border insolvency cases and a wealth of legal talents.

Although Evergrande was established in the Guangzhou in Guangdong Province, it had already moved its headquarters to Shenzhen in 2017. Although it moved its headquarters from Shenzhen again after its debt crisis broke out, its registered office is still in Shenzhen.[[90]](#footnote-90) As a result, the Hong Kong liquidators could seek recognition of this winding-up order against Evergrande issued by High Court of Hong Kong in the Shenzhen court.

According to Art.2 of the Pilot Opinion, the Pilot Opinion can recognise collective insolvency proceedings under the HKSAR Companies (Winding-Up and Miscellaneous Provisions Ordinance and the Companies Ordinance.[[91]](#footnote-91) These eligible collective insolvency proceedings include only three types: 1) compulsory winding up, 2) creditor's voluntary winding up, and 3) schemes of arrangement proceedings initiated by the liquidator or provisional liquidator and approved by the HKSAR High Court under Art. 673 of the Companies Ordinance. It is clear that this High Court of Hong Kong’s winding-up order against China Evergrande Group is eligible insolvency proceedings under the Pilot Opinion.

The reason for restricting the scope to these three types of Hong Kong proceedings is that Mainland courts only recognise foreign proceedings which have the comparable local procedure under EBL 2006.[[92]](#footnote-92) The first two are similar to liquidation proceedings in Mainland China, and the third court-supervised debt restructuring is similar to reorganisation proceedings in the mainland.

### 4.2.2 COMI Test

The most notable feature of the Pilot Opinion is that SPC abandons the previous strict and rigid recognition standards (treaties and reciprocity) and adopts the elastic COMI criteria.[[93]](#footnote-93) For example, Art. 4 of the Pilot Opinion explicitly stipulates that the designated Mainland courts shall recognise insolvency proceedings where the debtor's Centre of Main Interest (COMI) is in Hong Kong.[[94]](#footnote-94) The Pilot Opinion straightforwardly interprets COMI as the place of incorporation of a debtor because the registered office is an objective public record easily observable by creditors and third parties. However, the debtor's true administration centre sometimes has no coincidence with its place of incorporation in the context of globalisation. The flexible COMI also leaves room to rebut the presumption that the debtor's domicile is its COMI when there is evidence that is objective and ascertainable by a third party. In the meantime, the Pilot Opinion requires the Mainland courts to assess the weight and quality of the place of the principal office, the place of principal business, and the place of principal assets in the process of rebutting the presumption.[[95]](#footnote-95)

In addition, Art. 4 also stipulates COMI’s time requirement, that is, a Hong Kong liquidator seeking recognition must ensure that the debtor's COMI has been located in Hong Kong for at least six months.[[96]](#footnote-96) It is worth noting that this reference date refers to when the filing for the recognition application in the Mainland is made, instead of when the Hong Kong insolvency proceeding is opened. This move is effective and justifiable to prevent forum shopping by debtors who maliciously move their COMI to Hong Kong on the eve of a recognition application to access greater insolvency benefits in China.[[97]](#footnote-97)

The SPC has provided two justifications accounting why the Pilot Opinion adopted the COMI test standard. Firstly, as opposed to a single standard, the COMI with a rebuttable presumption is an internationally recognised synthetic and fair recognition standard.[[98]](#footnote-98) In general, the debtor's assets and debts do not always end neatly within its place of incorporation, so that other states always grab the debtor’s assets based on various connections. In order to achieve the goals of maximising the value of the debtor's assets and treating creditors and stakeholders fairly, it is essential to identify the debtor's true administration centre. COMI is defined as a place where the debtor conducts the administration of its interests and can be ascertainable by the third party. Thus, COMI is in line with current business practices and technological trends in cross-border insolvency.

Secondly, the introduction of COMI test standard is particularly significant given the specificities of the mainland-Hong Kong company models.[[99]](#footnote-99) Hong Kong has been regarded as a preferred gateway to attract Chinese companies interested in expanding their international presence. For Chinese companies, they often choose to incorporate in offshore islands, such as the Cayman Islands, listed on the Stock Exchange of Hong Kong and carry out their business and operations on the mainland. This is done because they expect to circumvent the restrictive regulations in Mainland China or to benefit from the favourable tax policies of offshore jurisdictions. However, these companies’ assets, business, and operations is generally not linked to offshore jurisdictions other than registration, also known as letterbox jurisdictions.

The most Hong Kong liquidation order involving Chinese companies would not be recognised in the Mainland courts if the rebuttable COMI standard was not adopted and only the straightforward place of incorporation. According to the Report issued by Hong Kong Stock Exchange in 2020, approximately 76% of the entities listed in Hong Kong were registered in offshore jurisdictions.[[100]](#footnote-100) It is rather unfair because insolvency proceedings opening in this offshore are unlikely to facilitate efficient and fair treatment of the debtor's global assets. Thus, the elastic COMI allows Chinese courts to examine *ex officio* the location of the debtor's head office or *de facto* administration to rebut the presumption that the offshore island is its COMI.

As Justice Harris stressed in *Re China All Access[[101]](#footnote-101),* the introduction of COMI can make those winding-up petitions accepted by the Hong Kong courts, regardless of whether their registered offices are in Hong Kong, to be recognsied by the Mainland courts. His statement is a bit of an exaggeration, as whether it is recognised by the Mainland courts is still subject to the test of public policy. But it certainty reflects, to some extent, seeming willingness of the Mainland courts to abandon the rigid treaty and reciprocity standards in favour of more expeditious and fair COMI standards.

For China Evergrande Group, it is a typical special purpose vehicle registered in the Cayman Islands, listed in Hong Kong and operated in Mainland China. It was listed on the Hong Kong Stock Exchange in 2009 as an unregistered Company in Hong Kong. Before its debt crisis, its had hundreds of thousands of shareholders worldwide. Given Evergrande’s extremely weak link to the Cayman Islands and strong ties to Hong Kong, the presumption that its COMI is located in its registered office should be indisputably rebutted. Mindful of the main intention of the Meeting Record to facilitate Hong Kong's global financial status, the mainland courts should give more priority to the place of the principal office. In addition, the High Court of Hong Kong has also issued a winding-up order against Evevgrande, which also proves that Evergrande’s COMI is regarded in Hong Kong.

### 4.2.3 Public Policy Exception

Art. 18 of the Pilot Opinion provides a broader range of grounds for refusal of recognition. As follows:[[102]](#footnote-102)

1) If the debtor's COMI is not located in HKSAR, or if its COMI has been continuously present in HKSAR for less than six months;

2) Insolvency proceedings opened in Hong Kong will not comply with Article 2 of the 2006 Enterprise Bankruptcy Law of PRC;

3) Unfair Treatment of Mainland creditors;

4) Fraud;

5) Any other circumstances that the pilot court may justify the refusal to grant recognition or assistance;

6) If the pilot court deems that recognising or assisting Hong Kong insolvency proceedings would violate the fundamental principles of Mainland Law or violate public order or good faith

The Pilot Opinion has more barriers for Hong Kong insolvency practitioners seeking recognition in Mainland China than the 1997 UNCITRAL Model Law. However, in the Understanding and application of the Pilot Opinion, the SPC provided clear interpretation on each of the grounds. The first two reasons are related to the eligible Hong Kong insolvency proceedings for recognition pursuant to the Pilot Opinion. It is understandable that these two grounds are mentioned at this stage, as the Pilot Opinion was originally intended to implement the consensus on cross- border insolvency cooperation with Hong Kong. The latter three reasons are clearly related to the public policy exception.

More importantly, the third reason appears to be one of the major breakthroughs in China's recognition system. The Chinese courts used to adopt the standard that substantial economic interests of Chinese creditors should not be infringed by recognition. Encouragingly, in the Pilot Opinion, unfair treatment of the Mainland creditors refers more to unfairness in procedural rights. That is, Chinese creditors did not equally participate in Hong Kong insolvency proceedings, including not receiving notification of their claims and not being able to express their opinions fully.[[103]](#footnote-103) If mainland creditors receive a lower proportion of payment, or if their claims are lawfully and reasonably, this does not fall under this category.

Whether or not the Mainland courts would refuse to recognise the winding-up order against Evergrande would depend largely on how they interpreted subparagraphs 6. That is, whether the Hong Kong insolvency proceedings will be contrary to the fundamental principles of the Mainland laws, or contrary to public order and good faith. If the Pilot Opinion follows the interpretation of the public policy exception contained in the Model Law, that is, recognition manifestly violates the Mainland constitutional guarantees, it may recognise winding-up order in Hong Kong. If not, foreign creditors may not be able to obtain any protection.

### 4.2.4 Practical Considerations of the Chinese Authorities

The vast majority of observers have negative expectations regarding the recognition of this liquidation order in China due to the catastrophic impacts of Evergrande and China's poor track record on cross-border insolvency cooperation.[[104]](#footnote-104) They believe that Hong Kong liquidators and foreign creditors may be 'hung out to dry' by the Chinese courts, as Chinese courts have done in the past, neither rejecting nor recognising their claims.[[105]](#footnote-105)

However, the writer believes that Mainland courts would recognise such a winding-up order in Hong Kong because the Pilot Opinion can protects the local creditors prioritised by the Chinese authorities and refusing this order would incur high costs. For the Chinese government, the highest priority is to protect the interests of the large number of pre-sold-yet-uncompleted homeowners in Mainland China. In the past, these homeowners became unsecured creditors in Chinese insolvency proceedings, leading to social discontent and instability. However, SPC recently issued a new judicial interpretation stating that if the pre-sale-yet-incompleted homeowners cannot obtain their houses and have no any chance of doing so, their claims have priority over construction proceeds and mortgage.[[106]](#footnote-106) This means these homeowners have the highest priority followed by secured creditors, priority of constriction proceeds, employee, taxes and unsecured creditors in Chinese insolvency proceedings of a property developer.

This judicial interpretation has significantly improved the unfavourable position of pre-sale-yet-incompleted homeowners in the insolvency proceedings. According to Art. 20 of Pilot Opinion, Evergrande’s surplus assets can be remitted into Hong Kong insolvency proceedings for distribution under the Hong Kong laws, provided that the preferential claims under 2006 EBL should be satisfied.[[107]](#footnote-107) In other words, the owners of unfinished house, Chinese banks with mortgages and Evergrande’s building suppliers and construction workers receive priority satisfaction. All in all, recognition of this winding-up will not only minimise harm to Chinese preferred creditors, but also enhance the investment confidence of foreign investors and further consolidate Hong Kong’s international financial position.

There are concerns that recognition of this winding-up order in Hong Kong could upset the currently weak property market and slow down China’s economic recovery. In the meantime, they emphasised that the Chines authorities do not need to be overly concerned that the rejection of this winding-up would significantly undermine foreign investor’s confidence in the Chinese market. China can still maintain or even surpass its past attractiveness to foreign investors simply by the lure of participating in the future growth of the Chinese market without modern cross-border insolvency cooperation frameworks.[[108]](#footnote-108)

However, the author believes that such an opinion is outdated. Prior to 2010, Chinese legislators appear to be caught in a paradox, that is, the lack of efficient rules did not appear to be a legal obstacle to attracting foreign investment. More precisely, Art.5 of 2006 was inefficient but did not become a deterrent to China attracting more foreign investment. This idea was understandable. Lubman offered a plausible explanation: this paradox was attributable to the fact that since the main contributors to China's early Foreign Direct Investment were overseas Chinese investors from Hong Kong, Taiwan and South East Asia.[[109]](#footnote-109) In this way, the quest for profit, the hospitality of China's leaders, personal connections, and patriotism were decisive factors in investing in China; instead, the rule of law was not a decisive factor.[[110]](#footnote-110) Although the proportion of overseas Chinese in FDI in China declined in the 2000s, it was still as high as 70%-80% before the enactment of the 2006 EBL.[[111]](#footnote-111)

As Friedman claims, people's perceptions and preferences for law are shaped to some extent by the moral norms ingrained in their traditional culture.[[112]](#footnote-112) Both domestic and overseas Chinese investors are influenced to a greater or lesser extent by notions of hierarchy, harmony, and non-adversarial dispute resolution, which are deeply rooted in Confucianism.[[113]](#footnote-113) Under Confucianism, they may also prefer to rely on informal social norms, such as reputational penalties and relational networks (Guanxi), to deal with disputes rather than a more formal written law. Meanwhile, they prefer mediation, a way of achieving dispute resolution by mutual compromise, rather than an adversarial court system.[[114]](#footnote-114)

Besides, the lack of law of rule in China may give overseas Chinese more chances than other Western foreigners to obtain potential competitive advantages. The reason for this is the personal relationship (Guanxi) that often appears in many Western business analyses and is boasted as being the key to success in business operations in China. Guanxi, as the name suggests, is a particular connection network between individuals based on a sense of belonging or some shared experience, such as kinship, work, ethnicity, or same educational background.[[115]](#footnote-115) In business life, Guanxi can also be established through monetary payments. It aims to serve the mutual benefits between individuals, especially the expectation that one party would be able to provide the necessary help to the other at a given moment.[[116]](#footnote-116)

As an informal social norm, Guanxi is a matter in Chinese business life. As one Western observer asserted, as long as foreign investors establish good Guanxi with powerful officials in China, they will get almost any project, even if layers of political restrictions are put in place.[[117]](#footnote-117) Even if certain conditions conflict with Chinese policies or laws, Chinese officials can help find some variation for foreign investors.

Significantly, in principle, Guanxi should not be directly conflated with corruption which involves the use of money in exchange for power. The establishment of Guanxi is based on mutual trust and intended to provide a variant within a legitimate scope for the other party. In the early period of Chinese economic reform, Chinese leaders encouraged overseas Chinese investors who were patriotic and homesick to invest in China. In turn, overseas Chinese investors could also rely on national identity and investment to help local government in better local economic development in exchange for closer guanxi with more powerful local officials. In insolvency, where the Chinese government interferes most heavily in judicial decision-making, Guanxi would help foreign investors take care of risks or find workarounds. Even if Chinese laws cannot recognise foreign insolvency proceedings, Guanxi often permits them to realise these assets located in China quickly in the form of a transfer of equity.

Secondly, Chinese policymakers believed that the supranational privileges they offered foreign investors and allowing them access to untapped markets would trump concerns about the lack of effective cross-border insolvency law. For example, in line with the Income Tax for Foreign-Invested Enterprises and Foreign Enterprises (1991), the corporate income tax rate for FIEs (15% to 24%) was much lower than that of domestic enterprises (33%).[[118]](#footnote-118) Besides, foreign-invested enterprises are not required to pay tax for the first two years of profitability and only half of the tax for the third to fifth years of profitability. Apart from the tax incentives, if an FIE invests a lump sum of US$4 million or more, it can acquire land at 55% of the Chinese government-directed price.[[119]](#footnote-119)

With a range of supranational treatments, coupled with low labour prices, it seems that whether a cross-border insolvency regime is effective has become relatively less influential in the decision of foreign investors. However, when the independent variable of granting supranational treatment to FIEs is cancelled, the consideration of cross-border insolvency regimes reverts to the decision of foreign investors. Virtually, such a shift (the abolition of partial supranational treatments for foreign-invested enterprises) gradually occurred after 2008. This also seems to partly explain Chinese legislators' growing interest in viable cross-border insolvency regimes in the last decade. However, at the turn of the century, Chinese lawmakers did not need to worry that ineffective Art. 5 of 2006 EBL discouraged the enthusiasm of foreign investors.

Thirdly, a number of international cooperation on cross-border insolvency cases might expose Chinese local governments and officials to the heavy risks involved. For local officials, the potential benefits of a good reputation from a fully cooperative approach are illusory, but the economic losses and unemployment caused by the withdrawal of foreign investment are also immediate. It remains to be seen whether these indirect benefits happen to occur during the short tenure of local officials in China, but the deterioration of the local economy certainly exposed them to censure from their superiors.

Fourthly, the level of legal education and specialisation of judges and insolvency practitioners are also important factors in the effectiveness of the application of cross-border insolvency. Before reform and opening up, the decades-long legal vacuum resulted in a relatively low level of professional standards of Chinese judges and insolvency practitioners, such as lawyers and accountants.[[120]](#footnote-120) For example, prior to 1995, possession of a college degree was not one of the key criteria for selection as a judge, and many retired army officers and policemen were recruited as judges.[[121]](#footnote-121) Although Chinese judges' legal education level has steadily increased over time, less than 10% had graduated from formal law schools with an LLB degree by 1998.[[122]](#footnote-122) It was not until 2002 that the selection of judges was required to give more weight to the certificate of the national bar examination, marking the selection of judges in China in the right way.

Likewise, the level of specialisation of Chinese lawyers has gradually increased since the reform and opening up, but still remains low. Although the number of lawyers in China was purported to be 100000 in 2000, only approximately 25% of them had received a formal and systematic law school education.[[123]](#footnote-123) Thus, the relatively low level of professional standards of judges and lawyers could be an important reason for the low use of complicated cross-border insolvency. In short, Art. 5 was designed to be consistent with the extremely limited internationalisation of Chinese companies and the ideology about insolvency at the beginning of the 21st century.

However, as China's pro-market reforms escalated, the continued reliance on strong state control and nepotism is increasingly untenable for fostering the entrepreneurial elements that will drive future growth and is neither enough nor legitimate. After all, unlike overseas Chinese investors, well-functioning pro-market laws are granted greater weight in the decision-making of Western investors. Thus, Chinese legislators should also have more expressly recognised the importance of stabilising a market-oriented cross-border insolvency law, which will become increasingly essential for embarking on building a business-friendly environment for foreign investors. Over time, China’s cross-border insolvency law has exhibited a more market-friendly nature; instead, the influence of traditional legal culture on these laws appears to be diminishing.

Therefore, I believe that recognition will happen because it is not worth saving the already oversized property market at the cost of foreign investor’s loss of confidence in the Chinese market.

# Conclusion

In conclusion, whether or to what extent this winding-up order will be enforced will be a test of how far the Chinese policymakers are willing to go to tackle the cross-border debt default of Chinese enterprises. The first two parts analyses the nature of the ongoing Evergrande debt crisis, finding The Chinese central government does not seem to regard Evergrande as 'too big to fail'. Instead, it sees runaway debt and leverage in the real estate sector as a life-and-death risk for China's overall economic health. Meanwhile, the Chinese central government sees the ongoing Evergrande debt crisis as 'a controlled implosion', provided that Evergrande goes through a slow insolvency or orderly restructuring under strict government control. It appears willing to reduce over-reliance on the previous growth engine at the cost of the economic pain caused by some real estate giants.

The fourth part explores the cross-border insolvency solution to the Evergrande debt crisis by answering two questions. The first question is to discuss the legal basis for Hong Kong liquidators seeking recognition of insolvency proceedings in the Mainland China. The second question is to discuss whether or to what extent the Pilot Opinion can recognise and assist Hong Kong's liquidation order. It finds that the Mainland Chinese courts should recognise this Hong Kong’s winding-up order against Evergrande.

It is widely acknowledged that this crisis exerts severe and far-reaching implications in many aspects, so it cannot be dealt with from a cross-border insolvency perspective in silos. Instead, this crisis needs to be resolved in a way that addresses cross-border insolvency, financial security, protection of owners of pre-sold-but-unfinished homes and rational realisation of Evergrande's land reserves in concert. For example, even though the liquidators could realise or transfer Evergrande's 230mn square metres of land reserves, it is not an appropriate time to sell these lands. After all, the property market in China is weak right now that large-scale, rushed land sales could lead to further depressed prices by buyers, harming the interest of all creditors.

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