

Insolvency & Restructuring
November 2010
Insolvency

PROVISIONAL LIQUIDATION IN A BOND HOLDER SCENARIO

It is commonly known that a bond is a debt security in which the authorized issuer owes the holders a debt and depending on the terms of the bond, is obliged to pay interest and/or to repay the principal at a later date upon the maturity of the bond. Many listed companies issue bonds, in particular convertible bonds, as a way to raise funds for the companies. Under the laws of many countries, bondholders are in line to receive the proceeds from the sale of the assets of a liquidated company ahead of some other creditors. However, in lack of such specific provisions, a bondholder might rank *pari passu* with other unsecured creditors to share the distribution of the assets and dividend of a company when it goes into liquidation.

In order to achieve the optimum result for bondholders receiving payment upon a company becoming insolvent, putting a company into provisional liquidation is a sensible and viable approach. The most important ticket to persuade the court in Hong Kong to put a company into provisional liquidation is that the applicant must be a creditor of the company. Most bond instruments contain the following provisions:

- The payment obligations of the company under the Bonds shall, save for such exceptions as may be provided by applicable legislation, at all times rank at least equally with all its other present and future unsecured and unsubordinated obligations.
- No Disposal of the Bonds or any part thereof shall be effected or agreed within [] months from the Issue Date ...
- "Maturity Date" means the [] anniversary of the Issue Date of the Bond
- Any bondholder may give notice to the company that the bonds are immediately due and repayable of an event of default.
- An event of default includes the company is insolvent or unable to repay its debt

Based on the above provisions, a bondholder can only have the right to demand for repayment when the bond reaches the maturity date.

CAN A BOND HOLDER DEMAND FOR REPAYMENT BEFORE MATURITY OF THE BOND?

Very often, a bondholder overlooks the events of default provisions as provided for in the bond instrument. In accordance with the general provisions that appear in a regular bond instrument, once an event of default occurs, the bond will become due and payable and the bondholder will automatically have the right to demand for repayment. However, sometimes an event of default might not have occurred or even it has occurred, the bondholder might not have realized that it has occurred to facilitate invoking the failure to pay provisions under the bond.

We came across a situation in which the terms and conditions of a convertible bond issued by a listed company contained the general clauses. On the face of these clauses, some practitioners took the view that the particular bondholder did not have the right to demand the company to repay the principal prior to the maturity date. In this matter, as there was a minority creditor who had already petitioned for the winding up of the company, we came to a conclusion that the company

was unable to pay its debt. As such, it gave this particular bondholder enough ammunition to trigger off the events of default provisions under the bond. Based on this basis, we proceeded to apply for and successfully asked the court to put the company into provisional liquidation. By undergoing a restructuring process, the provisional liquidators and the potential investors brought the company back to life. The bondholder was then in a secure position for having dividend to be distributed.

BONDHOLDER SHOULD NOTE THAT...

There are no specific boilerplate provisions that must appear in a bond instrument. As such, the rights to demand for repayment under a bond instrument vary from case to case depending upon the wording of the events of default provisions. Sometimes, a lesser burden is imposed if the clause provides for proving the company is unable to pay its debt whereas a higher burden is required if the clause requires the company to be insolvent. In that regard, the drafting process of the bond is very crucial to a bondholder's exercise of its rights to demand for repayment and hence apply for provisional liquidation of a company. Our firm is pleased to advise on the drafting of the bonds and conduct a review of the terms of your bonds.

© Vivien Chan & Co., November 2010

Please note that the information and opinions contained in this newsletter are intended to provide a general overview only, and should not be treated as a substitute for proper legal advice concerning an individual situation. We disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the contents of this newsletter. Readers should make their own enquiries and seek appropriate legal advice on the particular facts and circumstances at issue.

Should you have other enquiries, please feel free to contact us.

Hong Kong Office

38/F, Cosco Tower,
183 Queen's Road Central,
Hong Kong
T: (852) 2522 9183
F: (852) 2845 9205
E: vivchan@vcclawservices.com

Beijing Office

Suite 508,
Changan Tower,
10 East Changan Street,
Beijing 100006, China
T: (8610) 6522 7069, 6522 7072
F: (8610) 6522 6967
E: beijing@vcclawservices.com

Shanghai Office

Suite 1002, 10/F,
The Headquarters Building,
168 Central Tibet Road,
Shanghai 200001, China
T: (8610) 6387 9222
F: (8610) 6387 9111
E: shanghai@vcclawservices.com

www.vcclawservices.com