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ARTICLE

# The Distinction between 'Legal Rights' and 'Interests' when Determining Creditor Classes in a Scheme of Arrangement: An Examination of the Restructuring of *China Aoyuan Group*

**Chai Ridgers**, Partner, **Strachan Gray**, Partner, **Sanjev Guna**, Senior Associate, and **Celine Kee**, Associate, Harney Westwood & Riegels, Hong Kong

## Synopsis

When a scheme of arrangement involving a compromise or arrangement is proposed between a company and its creditors or any class of them,[1] the court is required to consider whether it would be appropriate to convene one or more meetings of creditors for the purposes of considering and voting on the scheme of arrangement.[2] The question of how creditors are to be classed is a crucial element to any scheme of arrangement as it often affects the bargaining power (and potential veto capabilities) of creditors which ultimately determines whether the relevant scheme will be approved by the requisite majorities at the scheme meeting.

It is well-established that, in determining whether scheme creditors are properly classed, the court looks at whether the creditors voting in the same class have sufficiently similar legal rights such that they can consult together with a view to their common interest. In determining whether a class of creditors can consult together, the court must consider both their existing legal rights and rights in the relevant alternative if the scheme is not implemented.[3]

It is also well-accepted that it is the rights of creditors, not their separate commercial or other interests, which determine whether they form a single class or separate classes.

Whilst these principles relating to class composition are relatively uncontroversial, its application is often far less straightforward in practice. Complexities arise when the difference in the scheme creditors' relative positions involve different commercial interests and private rights, making it difficult to distinguish between 'legal rights' and 'interests'. This is particularly evident in the context of group restructurings where scheme creditors often consist of some creditors who hold different claims against distinct entities within the same corporate group, and who may, as a result, have additional rights derived from the wider restructuring of the group which the scheme forms part of.

In this article, we explore the case of *China Aoyuan Group*, where the Hong Kong Court of First Instance and the Grand Court of the Cayman Islands grappled with the issue of whether certain creditors who purportedly had a special interest by reason of their ability to vote and receive scheme consideration in both of the inter-conditional schemes proposed by the China Aoyuan Group should be classed separately from other creditors who only had the right to receive consideration in one of the schemes.

In coming to its decision, the courts had to consider whether it should be limiting itself to solely considering a scheme creditor's rights under the specific scheme in question when deciding class composition, or whether it should also consider how the scheme creditor's rights would be affected by the broader restructuring (i.e., both inter-conditional schemes) as a whole.

## Background

China Aoyuan Group Limited ('Aoyuan') is a company incorporated in the Cayman Islands with shares listed

*Notes*

1 The scheme of arrangement provisions in a number of common law jurisdictions (including the Cayman Islands, the British Virgin Islands, Hong Kong, England & Wales and Singapore) are substantially similar. Accordingly, the principles discussed in this article (including the test for class composition) should apply equally in these jurisdictions.

2 This would typically be at the convening hearing stage (being the first hearing before the courts at which permission to convene the scheme meeting(s) is granted).

3 In determining whether creditors are properly classified, the starting point is to identify the appropriate comparator (i.e., the alternative outcome if the scheme does not proceed). Having done so, the court will analyse: (i) the rights that the creditors would have if the scheme was not implemented ('*rights in*'); and (ii) the new rights which the creditors will be entitled to if the scheme was implemented ('*rights out*'). If, having carried out that exercise, there is a material difference between the 'rights in' and 'rights out' of those creditors such that the creditors are so dissimilar as to make it impossible for them to consult together with a view to their common interest, separate meetings must be summoned.

on The Stock Exchange of Hong Kong Limited. Aoyuan is the ultimate holding company of the China Aoyuan Group (the 'Group'), which is in the business of the development and sale of residential and commercial properties in the People's Republic of China. The Group, like many others, had been severely affected by the impact of the COVID-19 pandemic and the general downturn in the real estate sector and capital markets since mid-2021.

In an attempt to alleviate its financial distress and avoid an insolvent liquidation of the Group, Aoyuan, together with its principal subsidiary, Add Hero Holdings Limited ('Add Hero'), promulgated four parallel and inter-conditional schemes of arrangement to restructure the Group's offshore debts of approximately US$6.25 billion. The schemes comprised two parallel and inter-conditional schemes of arrangement proposed by Aoyuan in Hong Kong and the Cayman Islands in respect of Aoyuan's indebtedness as issuer, borrower and guarantor under the relevant debt instruments (the 'Aoyuan Schemes') and another two parallel and inter-conditional schemes proposed by Add Hero in Hong Kong and the British Virgin Islands which seeks to compromise Add Hero's guarantor obligations under those debt instruments (the 'Add Hero Schemes').

## The use of dual schemes of arrangement

Under the Aoyuan Schemes, Aoyuan had two groups of scheme creditors – (1) the '*Overlapping Scheme Creditors*' who, in addition to their primary claims against Aoyuan, had the benefit of guarantees granted by Add Hero, and therefore had structurally senior claims against the Group, and (2) the '*Non-Overlapping Scheme Creditors*' who had structurally subordinated claims as they only had primary claims against Aoyuan.

In order to reflect the Overlapping Scheme Creditors' structural priority and provide the Overlapping Scheme Creditors with an uplift on their recoveries from the restructuring, the Group chose to propose dual schemes of arrangement (namely, the Aoyuan Schemes and the Add Hero Schemes) which allowed the Overlapping Scheme Creditors to participate and vote in respect of the full value of their claims and receive scheme consideration in both schemes. On the other hand, the Non-Overlapping Scheme Creditors with no guarantee claims against Add Hero would only be able to participate in and receive scheme consideration under the Aoyuan Schemes.

Whilst Aoyuan could have restructured its primary obligations owing to both groups of creditors as well as the guarantee claims of the Overlapping Scheme Creditors in a single scheme of arrangement, this would have meant that the Overlapping Scheme Creditors and the Non-Overlapping Scheme Creditors would likely have had to vote in separate classes due to the difference in the structural priority of their rights against Aoyuan, and the Non-Overlapping Scheme Creditors, being the minority group, would potentially have been afforded a veto right in respect of the Aoyuan Schemes.

By adopting a dual scheme approach, Aoyuan sought to enhance the recoveries to its structurally senior creditors, namely, the Overlapping Scheme Creditors, in the restructuring, whilst at the same time allowing all of its scheme creditors to vote in a single class to avoid a situation where a minority group of dissenting creditors would have the ability to veto the Aoyuan Schemes.

## Ping An's objections to the Aoyuan Schemes

At the hearings before the Hong Kong courts, one of the Non-Overlapping Scheme Creditors, China Ping An Insurance Overseas (Holdings) Limited ('Ping An') contended that the Overlapping Scheme Creditors should not have been classed together with the other Non-Overlapping Scheme Creditors as they stood to gain additional benefits under the Add Hero Schemes, which would not otherwise be available to the Non-Overlapping Scheme Creditors. The additional scheme consideration entitlements conferred by the Add Hero Schemes amounted to a difference in rights between the Overlapping Scheme Creditors and the Non-Overlapping Scheme Creditors which rendered the Overlapping Scheme Creditors unable to consult with the Non-Overlapping Scheme Creditors with a view to their common interest.

Ping An argued that the court should adopt a broad approach when determining whether scheme creditors have been properly classed. In this regard, where dual and inter-conditional schemes have been proposed, consideration should be given to the scheme creditors' rights in the context of the restructuring as a whole, instead of simply looking at the scheme in isolation.

In making these arguments, Ping An relied on three English case authorities, namely, *Re Baltic Exchange,*[4] *Re Sunbird Business*[5] and *Codere Finance*[6] where the English courts took a conjunctive approach by considering the scheme creditors' rights not just in the scheme document itself, but in various other restructuring documents that confer other rights or benefits which are provided for under the terms of the scheme, or which are conditional upon it. The English courts found that, as a matter of commercial reality, such scheme

**Notes**

4 *Re Baltic Exchange Ltd* [2016] EWHC 3391.
5 *Re Sunbird Business Services Ltd* [2020] EWHC 2860 (Ch).
6 *Re Codere Finance 2 (UK) Ltd* [2020] EWHC 2441.

creditors would have taken the decision to support the scheme by reference to the 'whole package of rights to which they were entitled'.[7] Therefore, the courts should not adopt a narrow approach in assessing how creditor classes should be constituted in such circumstances.

## Hong Kong decision

In considering Ping An's arguments, the Hong Kong Court placed heavy reliance on the decision of *Re UDL Argos*[8] and found that the English authorities that Ping An had sought to rely on were inconsistent with the principles outlined by the Hong Kong Court of Final Appeal in that case.

Following the reasoning discussed in *Re UDL Argos*, the Hong Kong Court held that 'it is only the rights compromised by the scheme or granted by it that are relevant to the question of class composition'.[9] The Court should only look at the rights of the scheme creditors going in and out of the subject scheme in determining whether the scheme creditors have been properly classed. Any rights, interests or benefits arising from separate, or inter-conditional schemes or other linked arrangements, would only go towards a creditor's interests, which would not fracture the relevant class.[10]

Nonetheless, the Hong Kong Court cautioned that this should not be taken to completely preclude the possibility of such rights or interests affecting the scheme. In fact, the Hong Kong Court observed that these rights or interests acquired outside of the subject scheme (for instance, in a restructuring of an associated company) may nevertheless be relevant at the sanction stage when the court is asked to consider the fairness of the scheme. At that stage, the court may discount or disregard the votes of these creditors who had such other interests or rights that their support for the scheme cannot be regarded as being fairly representative of the class.[11]

## Cayman decision

Whilst the issue of classification was not expressly challenged in the Cayman proceedings, Justice Doyle of the Grand Court of the Cayman Islands did not see any issues with the Overlapping Scheme Creditors voting in a single class alongside the Non-Overlapping Scheme Creditors.

In coming to this view, Justice Doyle had regard to the seminal decision of *Re Ocean Rig,*[12] where the Cayman courts previously found that inter-conditional schemes of arrangement can properly give effect to the structural priority of different creditors to whom debts are separately and additionally owed by a subsidiary guarantor of the primary obligor. In *Re Ocean Rig*, a dissenting creditor sought to argue that a group of creditors with claims against various companies within the group pursuant to certain guarantees should have been placed in a separate class. However, the court upheld the general rule that only rights against the scheme company, and not as against third parties and other commercial interests, will be taken into account.[13]

Interestingly, the same conclusion was adopted by Justice Kawaley in a recent decision regarding the restructuring of *Kaisa Group Holdings Ltd*, which also involved dual schemes of arrangement proposed by the parent company of the group with second inter-conditional schemes proposed by a subsidiary seeking to compromise its guarantee obligations. In that decision, Justice Kawaley interpreted the decisions in *China Aoyuan Group* (i.e., both the Hong Kong and Cayman Islands decisions) as having 'expressly decided that the existence of some scheme creditors with overlapping claims in the scheme of another company does not require a separate class to be constituted.'[14]

Accordingly, the position of the Cayman courts following the decisions in *Re Ocean Rig*, *Re Aoyuan* and *Kaisa Group* appear to be broadly in concert with the Hong Kong Court's position.

## English position

How then can the broader approach taken by the English courts in the cases of *Re Baltic Exchange, Re Sunbird Business* and *Codere Finance*, which suggests that regard should be had to rights outside of the scheme in a broader restructuring, be reconciled and is the English position truly inconsistent with the decisions in Hong Kong and the Cayman Islands?

It would appear that the better view is to draw a distinction between, on the one hand, cases like *Re Baltic Exchange*, *Re Sunbird Business* and *Codere Finance* where a single scheme of arrangement is being proposed and scheme creditors acquire additional rights as against the scheme company as part of the wider restructuring, and on the other hand, situations where parallel

*Notes*

7 *Re Codere Finance 2 (UK) Ltd* [2020] EWHC 2441 at [49].
8 *Re UDL Argos Engineering v Li* (2001) 4 HKCFAR 358 at [27].
9 *Re Add Hero Holdings Ltd* [2025] HKCFI 310 at [73].
10 *Ibid.*
11 *Ibid.*
12 *Re Ocean Rig UDW* [2017] (2) CILR 495.
13 *Re Ocean Rig UDW* [2017] (2) CILR 495 at [67].
14 *In the Matter of Kaisa Group Holdings Ltd* [2025] CIGC (FSD) 9 (7 February 2025) at [13].

and inter-conditional schemes of arrangement are being proposed pursuant to which creditors receive additional scheme consideration entitlement as a result of distinct pre-existing rights that they already hold as against both entities that are the subject of their respective schemes.

In *Re Baltic Exchange*, *Re Sunbird Business* and *Codere Finance*, the benefits conferred or to be conferred in other agreements that formed part of the scheme, or were conditional on the scheme being effective, gave rise to a difference in rights amongst the scheme creditors as these benefits were held to confer new preferential rights arising from the restructuring which the scheme forms part of, and which, such creditors would in effect receive in exchange for the compromise of their rights against the scheme company.[15]

In contrast, the facts of *China Aoyuan* seem to be distinguishable from the aforementioned English authorities on the basis that the Aoyuan Schemes did not purport to artificially grant the Overlapping Scheme Creditors new rights against Aoyuan to be released in exchange for additional scheme consideration. Instead, any additional scheme consideration received by an Overlapping Scheme Creditor under the Add Hero Schemes was derived from a direct and independent right against Add Hero which was pre-existing prior to the restructuring. Therefore, any benefits or entitlements under the Add Hero Schemes were in exchange for the compromise of the Overlapping Scheme Creditors' rights as against Add Hero, and not in exchange for the compromise of their rights against Aoyuan.

Moreover, the benefits or additional rights conferred under the Add Hero Schemes allowed the Group to reflect the structural priority and higher recovery that the Overlapping Scheme Creditors would have been entitled to in a Group-wide liquidation scenario, as compared to the Non-Overlapping Scheme Creditors who would not have been entitled to the same.

Arguably, the English authorities blur the distinction between rights and interests given that consideration is afforded to other interests arising outside of the scheme itself. However, it bears noting that none of the English cases involved parallel and inter-conditional schemes of arrangement. Therefore, it remains to be seen whether the English courts will recognise the distinction as suggested above and adopt the same position as the Hong Kong and Cayman courts should a future debtor opt to replicate the dual scheme approach used by the China Aoyuan Group in restructuring its debts.

Perhaps an argument in favour of the English courts taking the same approach as Hong Kong and the Cayman Islands is the already well-established position under English law that 'cross-holdings'[16] of scheme creditors only give rise to potentially different interests rather than rights and accordingly, do not require separate class meetings to be convened (with such matters being considered at the sanction stage instead).[17] In drawing this analogy, it would only be consistent for the English courts to similarly find that the claims of Overlapping Scheme Creditors which are to be compromised under separate inter-conditional schemes do not fracture class.

## Key takeaways

The Hong Kong and Cayman Island decisions relating to the *China Aoyuan Group* helpfully provide clarification on the legal concepts relating to classification of creditors in corporate restructuring proceedings. It reaffirms the important principle that, when considering class composition, focus should be placed on the similarity or dissimilarity of legal rights released or varied by the specific scheme that the relevant court is asked to sanction, as opposed to the difference in interests of scheme creditors (including any other rights that such scheme creditors may derive from a separate scheme, notwithstanding such scheme may be related and inter-conditional to the first scheme in question).

Critically, the decisions also set a helpful precedent for other debtor companies to utilise, at least in Hong Kong and the Cayman Islands, parallel or dual schemes of arrangement as a strategic tool to drastically diminish the bargaining positions of minority creditors in the context of a group restructuring by eliminating any potential veto abilities they may have, particularly where the scheme creditors have structurally differing claims to be compromised under the scheme.

The decisions of the Hong Kong and Cayman courts in *China Aoyuan Group* make it clear that in the absence of any evidence showing that the special interests which an Overlapping Scheme Creditor would receive was a material factor in its decision to approve the scheme such that it renders the votes unrepresentative of a class (which will go towards the fairness of the scheme), there is nothing sinister about Overlapping Scheme Creditors voting in the same class as Non-Overlapping Scheme Creditors. In fact, it appears from these decisions that allowing the Overlapping Scheme

*Notes*

15 Although the English courts accepted that the additional rights and benefits conferred outside the scheme gave rise to a difference in rights between the scheme creditors, in each of these cases, the English courts found that these additional rights did not make it impossible for the scheme creditors to consult together with a view to their common interest such as to require the relevant scheme creditors (who stood to gain from such additional rights) to be placed in a separate class for the purposes of voting on the scheme.

16 A scheme creditor has 'cross-holdings' where it holds claims across different classes within the same scheme.

17 *Re ColourOz Investment 2 LLC* [2020] EWHC 1864 (Ch) at [88].

Creditors to participate in a second scheme of arrangement allows the distinction between rights and interests to be strictly adhered to whilst enabling a debtor company to minimise the possibility of its dissenting creditors blocking the scheme.

Following the decisions in *China Aoyuan Group*, it should also be noted that the approach of proposing dual schemes of arrangement can no longer be described as unorthodox with other companies such as *Kaisa Group Holdings Ltd* successfully utilising an identical structure to implement its restructuring.[18] Needless to say, this goes to show that the dual schemes approach adopted by the *China Aoyuan Group* is becoming an increasingly desirable option in the restructuring arsenal of debtor companies seeking to restructure their debts.

**Notes**

18 As at the date of this article, Kaisa Group Holdings Ltd's parallel and inter-conditional schemes in Hong Kong and Cayman Islands, which similarly classed its 'Overlapping Scheme Creditors' in the same class as its 'Non-Overlapping Scheme Creditors', were sanctioned on 24 March 2025 and 26 March 2025 respectively.

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