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The Counterproductive Effects of the Low-Threshold Winding-Up Regime on Creditor Protection amid Debt Defaults by Hong Kong SAR Property Developers

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Abstract. This paper examines the counterproductive effects of Hong Kong SAR's low-threshold winding-up regime on creditor protection during debt defaults by real estate developers. Although the regime is designed to offer creditors a fast and accessible remedy, its application to highly leveraged, asset-heavy developers may undermine collective creditor interests. The analysis shows that low petition thresholds can encourage strategic petitions, trigger herd claims and liquidity runs, restrict restructuring opportunities, and destroy going-concern value before courts complete substantive review. These problems arise from a mismatch between formal insolvency procedures and the commercial structure of the real estate industry, where project value depends on long development cycles, market confidence, and coordinated creditor action. The paper therefore proposes a three-tier reform framework based on filtering, buffering, and coordination. Moderate threshold elevation, preliminary substantive review, statutory automatic stays, and creditors' committees can preserve the deterrent function of winding-up while reducing unnecessary liquidation risks. Such reforms would better align individual creditor remedies with collective welfare, improve restructuring efficiency, and support financial stability in the property sector.

Keywords: creditor protection, real estate developers, debt default

1. Introduction

In the wave of global corporate debt difficulties, the Hong Kong Special Administrative Region of the People's Republic of China (HKSAR) and other special administrative regions with common law systems have witnessed a significant surge in bond defaults and liquidity crises of large listed real estate developers. The real estate industry is characterized by high leverage, long development cycle, heavy dependence on assets and extreme sensitivity to market sentiment, and heavy reliance on continuous capital turnover and stable market confidence to maintain operational sustainability. As the cornerstone of the bankruptcy framework of the HKSAR, the low-threshold compulsory winding-up regime was originally intended to simplify creditor remedies, strengthen judicial deterrence against strategic default, reduce access barriers for small and medium-sized creditors, and promote fair and timely asset distribution. However, against the background of the general default of heavy-asset real estate enterprises, this long-standing institutional arrangement is increasingly

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deviating from its legislative purpose. Instead of protecting the collective interests of creditors, it has led to speculative petitions, market operation, collapse of restructuring opportunities and irreversible continuous attention to value destruction, which has a serious counterproductive effect and threatens the recovery rate and industrial financial stability of creditors.

The main goal of this study is to unravel the causal mechanism of linking low-threshold liquidation rules with counterproductive creditor results in the real estate industry of the HKSAR. By clarifying the institutional defects and communication channels of market interruption, this paper aims to propose a legally sound and practical reform package.

2. Features of the low-threshold regime and its design rationale

2.1. Specific embodiments of the low-threshold

The low threshold of the winding-up regime of the HKSAR is reflected in three main aspects. First of all, the threshold of qualifying debt is extremely low. According to Section 178 of Cap. 32, any creditor holding an overdue debt of HK$1,000 or more is eligible to submit a winding-up petition to the court [1]. Compared with the bankruptcy system of most global companies, this threshold is disproportionately broad. For example, Singapore has set a minimum eligible debt of S$15,000 (about HK$87,000) and has additional safeguards to prevent abuse of declaration, because small trade arrears or nominal interest defaults are rarely enough to cause liquidation [2]. In contrast, ordinary outstanding trade notes, service fees or interest payments on small bonds in the HKSAR can be used as a valid reason for initiating liquidation proceedings.

Secondly, only formal procedural conditions are required for petition filing. The applicant only needs to prove three basic facts. First is an outstanding debt of not less than HK$1,000. The effective performance of legal requirements, and the debt has not been settled for 21 consecutive days. The legal presumption that the company cannot pay its continuous liabilities [1]. The petitioner does not need to prove that the actual balance sheet is bankrupt or the continuous cash flow is insufficient. In liquidation cases initiated by creditors, the mere failure to repay the due debt is enough to establish legal bankruptcy.

Thirdly, the court only conducts formal procedural review at the acceptance stage. According to Section 182 of Cap. 32, a judge will not make a substantive evaluation when accepting a petition. They did not examine the company's actual solvency, distinguish between temporary liquidity pressure and fundamental bankruptcy, assess the feasibility of restructuring, or judge whether the petitioner acted in good faith or merely used liquidation as a coercive negotiation tool [3]. As long as the procedural procedures are completed, this formal review allows creditors to easily initiate the liquidation process.

2.2. Design rationale of the regulatory regime

HKSAR's low-threshold winding-up arrangement is not a legislative loophole, but a deliberate policy design with three clear rationales. First, it discourages debtors from defaulting maliciously. Low application costs make the threat of liquidation credible, limiting asset concealment and deliberate negotiation delays, and encouraging debtors to repay debts voluntarily or reach negotiated settlements.

Second, it lowers litigation barriers for small and medium-sized creditors. Excessively high thresholds would prevent suppliers, contractors and retail bondholders from seeking legal redress

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due to unaffordable costs, contradicting the core legal principle of equal protection and fair distribution among all creditors.

Third, it accelerates debt resolution and fair asset distribution. For ordinary small and medium-sized enterprises, timely winding-up preserves remaining assets, prevents predatory individual enforcement, and ensures proportional allocation for all creditors

When a company is genuinely unviable with limited residual assets, the low-threshold mechanism functions effectively to protect creditor interests. Nevertheless, the system relies on an implicit premise: it is designed for ordinary small-scale enterprises with simple asset structures and low market sensitivity. When applied to large listed real estate developers characterized by massive assets, long operational cycles and high market vulnerability, the same regime inevitably generates unexpected adverse consequences.

3. Manifestations of the regime's perverse effects

3.1. Inducement of strategic and speculative winding-up petitions

Excessively low thresholds transform winding-up from a legitimate debt recovery method into a strategic bargaining weapon. Since a mere HK$10,000 overdue debt suffices for petition initiation, small creditors can commence proceedings at almost no cost. In many cases, their real intention is not debt recovery, but coercing preferential private repayment, forcing unequal settlement terms, and gaining dominant negotiating leverage through the threat of liquidation.

It should be clarified that HKSAR courts are not powerless against such misconduct. Under Section 178 of Cap. 32, courts possess discretionary power to dismiss petitions filed in bad faith, abusive in nature or driven by improper motives. In the China Evergrande winding-up case, the court explicitly ruled that certain low-value petitions were not legitimate debt claims, but deliberate procedural pressure amounting to judicial abuse [4].

The fundamental problem lies in the delayed timing of substantive judicial review. Courts cannot easily identify hidden malicious motives during initial formal assessment; dismissal of abusive petitions usually occurs only in later court hearings. Before any corrective ruling is issued, market panic, credit downgrades and partner withdrawal have already caused irreversible operational damage [5]. Although institutional safeguards exist, their slow response constitutes the key weakness of the low-threshold design: it simplifies petition initiation without establishing timely anti-abuse restrictions.

3.2. Triggering herd petitions and liquidity runs

A single winding-up petition often triggers destructive chain reactions. Petition issuance itself serves as a strong negative market signal, publicly exposing corporate financial distress. In Hong Kong's information-intensive and highly concentrated capital market, negative sentiment spreads rapidly and triggers three interrelated vicious cycles:

First, other creditors file follow-up winding-up petitions to minimize losses and secure priority in future asset distribution, creating a herd petition phenomenon.

Second, financial institutions freeze credit lines, rating agencies downgrade corporate creditworthiness, and suppliers tighten trading terms and demand advance payments.

Third, property pre-sales decline sharply, homebuyers shift to competitors, strategic investors suspend due diligence, and cooperative parties terminate project partnerships.

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These factors reinforce one another because credit contraction worsens liquidity pressure, deteriorating cash flow amplifies market pessimism, and pessimism attracts further petition filings. Real estate enterprises are exceptionally vulnerable owing to high-leverage financing reliance and long development cycles that make cash flow highly sentiment-sensitive. Winding-up petitions destroy market confidence rather than relying on judicial judgments alone, rapidly turning temporary liquidity difficulties into full-scale insolvency.

The Evergrande case clearly demonstrates this mechanism because clustered low-value petitions triggered widespread panic, cut off external financing, and ruptured capital liquidity long before any substantive court judgment was delivered [4, 6]. Specifically, commencing in 2022, several small creditors filed separate winding-up petitions against China Evergrande Group. Although these amounts exceeded the statutory threshold, they remained minuscule relative to the Group's multi-billion-dollar liabilities. The HKSAR court issued a winding-up order on 29 January 2024 after a series of adjournments. Crucially, the market reaction did not await the final ruling: upon the first petition filing, Evergrande's share price plunged by over 20% within days, credit rating agencies downgraded the Group to selective default, overseas bondholders accelerated claims, and pre-sale revenues from mainland projects collapsed as homebuyers lost confidence [6]. The court's adjournments, while intended to allow restructuring negotiations, could not reverse the irreversible market damage triggered by the mere existence of the petitions. Market sentiment determined corporate fate ahead of judicial conclusion.

3.3. Restricting corporate restructuring and self-rescue space

The fundamental reason why low-threshold winding-up restricts restructuring is premature judicial intervention, rather than the existence of liquidation itself. While winding-up is an essential component of insolvency law, the current system allows irreversible petition initiation even when corporate restructuring remains feasible.

Once a petition is admitted, corporate operational autonomy is severely constrained. Major asset disposal requires judicial approval; new financing becomes difficult as investors avoid procedural uncertainty and unfavorable repayment priority; comprehensive debt negotiations face dual obstacles: ongoing winding-up timetables limit negotiation windows, while conflicting creditor interests hinder consensus-building.

The Kaisa Group case serves as typical evidence. When the petition was filed, Kaisa had formulated a preliminary restructuring framework and reached consensus with major creditors. Nevertheless, the mere publication of the petition caused investor withdrawal, cross-default contract termination by partners, and protective intervention from offshore bond trustees. Restructuring ultimately collapsed, and compulsory liquidation became inevitable [7]. This reveals the core systemic flaw: HKSAR's regime lacks an effective preliminary screening mechanism to distinguish salvageable enterprises from fundamentally unviable ones.

3.4. Destruction of going-concern value and reduction of creditor recovery rates

All aforementioned adverse effects ultimately lead to declining overall creditor recovery rates. Strategic petitions, market runs and shrinking restructuring space together form a negative chain, pushing potentially recoverable enterprises toward unnecessary liquidation. Liquidation and restructuring differ enormously in value preservation capacity.

Corporate value consists of two components: liquidation value and going-concern value. Liquidation value refers to proceeds from fragmented asset sales; going-concern value represents

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additional value generated by continuous holistic operation, including reputation, client networks, project profitability, human capital and operational synergy. For real estate developers, going-concern value is particularly critical. Unfinished properties and land reserves achieve maximum value only through unified completion and operation; fragmented liquidation causes permanent value loss.

Kaisa's judicial data provides direct evidence that liquidation proceeds accounted for merely 35% of original going-concern value [7]. This significant disparity highlights a systemic paradox: the low-threshold regime originally designed for creditor protection ultimately harms collective creditor interests by forcing premature liquidation. This contradiction, where protective mechanisms produce counterproductive outcomes, defines the core perverse effects analyzed in this paper.

4. Underlying causes: systemic-industry mismatch

4.1. Absence of effective creditor petition screening

Current regulations set minimal entry requirements for debt validity without establishing substantive dual review, neither assessing petitioner motives nor evaluating corporate solvency and restructuring feasibility.

Initiating winding-up only requires three formal prerequisites: modest mature debt, valid statutory demand service with 21-day non-payment, and statutory insolvency presumption [1, 3]. Courts avoid three critical assessments at admission: whether petitioners act legitimately or seek preferential advantages, whether default arises from temporary liquidity pressure or fundamental insolvency, and whether viable restructuring solutions exist.

Singapore's regulatory framework offers valuable comparison. Section 64 of Singapore's Insolvency, Restructuring and Dissolution Act 2018 mandates judicial evaluation of restructuring prospects upon petition filing, empowering courts to stay or dismiss petitions to preserve negotiation opportunities [2]. Singapore's experience is highly relevant to HKSAR for several reasons. Both jurisdictions share a common law heritage, operate as international financial centers with sophisticated capital markets, and host a large number of listed real estate developers. Moreover, both face similar challenges of cross-border debt enforcement and creditor coordination. However, in HKSAR, substantive screening is delayed until formal hearings, by which time petition publicity has already damaged corporate reputation, financing channels and business partnerships. The structural flaw of excessively lenient entry and excessively delayed supervision constitutes the institutional root of all perverse outcomes.

4.2. Fundamental conflict between industrial traits and winding-up logic

The absence of effective screening is compounded by inherent conflict between winding-up logic and real estate operational characteristics. Winding-up prioritizes rapid asset realization and short-term distribution, pursuing immediate returns rather than long-term value optimization. This mechanism suits conventional light assets such as inventory and receivables, yet fundamentally contradicts real estate development.

The real estate industry exhibits three defining features: heavy asset investment, long development cycles, and strong market timing dependence. Firstly, a single property project usually requires more than one year for full completion. Secondly, project value relies heavily on holistic completion; unfinished projects retain far higher value as integral assets than fragmented liquidation

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sales. Thirdly, HKSAR listed developers carry high aggregate leverage, creating heavy refinancing dependence.

This conflict is inevitable because winding-up demands rapid discounted sales while property projects require patient market waiting, emphasizes rigid procedural schedules while restructuring requires flexible buffers, and prioritizes present asset value while ignoring future post-completion appreciation. The regime pursues speedy exit while the industry requires breathing space, making value destruction almost inevitable once liquidation commences.

4.3. Creditor collective action dilemma

The dual mismatch between system and industry is further intensified by the creditor collective action dilemma. Large-scale real estate developers possess highly complicated debt structures with numerous diversified creditors including banks, bondholders, suppliers, property buyers and contractors, each holding conflicting interests. Under such circumstances, individually rational creditor behavior often results in collectively irrational losses.

This can be illustrated through a simple game-theory model [8]. Suppose a company generates total value of 100 under restructuring but only 70 under liquidation. Cooperative consensus enables proportional benefit for all creditors. However, any single creditor can gain preferential advantage by filing an early individual petition, securing higher personal returns while leaving remaining parties to share diminished liquidation value.

Since every creditor fears preemptive action from others, early petition filing becomes the dominant self-interested strategy. Lower petition thresholds reduce unilateral action costs and make collective cooperation increasingly difficult. Small enterprises feature concentrated creditors and easy communication, whereas listed developers have globally dispersed, anonymous creditors with extreme coordination difficulty. Low-threshold winding-up provides convenient speculative unilateral tools, fundamentally undermining cooperative restructuring foundations.

4.4. Disconnection between judicial procedures and commercial restructuring

The three aforementioned causes collectively reveal a deeper structural defect, namely the serious disconnection between judicial procedures and commercial restructuring logic.

HKSAR courts maintain procedural restraint at the petition stage, focusing merely on formal compliance while avoiding commercial judgment. Judges seldom evaluate going-concern value, optimal asset disposal timing, or balanced interest allocation among diverse creditors. This restraint is reasonable for ordinary commercial disputes, as courts should not replace market decision-making. Nevertheless, real estate value is deeply tied to market and project cycles; purely formal review proves costly, enabling irreversible liquidation without essential commercial evaluation.

Comparative legal systems demonstrate clear differences. Singapore's insolvency law allows early judicial involvement in restructuring assessment and establishes statutory automatic moratoriums to protect negotiation cycles [2].

By contrast, HKSAR relies entirely on discretionary judicial adjournments without unified statutory rules or predictable mechanisms. Misalignment between judicial timetable and commercial restructuring needs amplifies all existing negative consequences stemming from insufficient screening and collective action failures.

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5. Pathways to mitigating perverse effects

5.1. Establishing a three-tier filtering-buffering-coordination mechanism

Based on comprehensive analysis, this paper proposes a three-tier institutional reform framework: Filtering-Buffering-Coordination. The core principle is to preserve the legitimate deterrent function of winding-up while breaking the negative transmission chain from individual petitions to systemic value collapse through targeted institutional adjustments.

At the filtering stage, moderate threshold elevation should be combined with preliminary substantive review. It is recommended to raise the minimum qualifying debt from HK$10,000 to HK$100,000. The purpose is not to exclude legitimate small creditors, but to eliminate purely speculative petitions. Comparative jurisdictions employ thresholds close to HK$100,000, and given the high asset values and complex debt structures in HKSAR, a similar threshold of HK$100,000 is reasonable. A counterargument is that raising the threshold to HK$100,000 would harm the interests of small and medium-sized creditors, whose claims may fall below this amount. However, this concern can be addressed in two ways. First, the threshold would apply only to winding-up petitions; small creditors would still be able to serve a statutory demand, which in itself has coercive effect without triggering full winding-up proceedings. Second, if small claims arise from the same debt relationship or can be assigned to a single petitioner, they may be consolidated, allowing for joint enforcement. Therefore, the reform does not favour large developers at the expense of small creditors. Instead, it rebalances the system to prevent abuse while preserving remedies for genuinely aggrieved small claimants. A higher threshold increases coercive petition costs and reduces tactical liquidation threats, while remaining accessible for genuine supplier and contractor claims. Section 182 of Cap. 32 should be amended to require preliminary judicial assessment of petitioner good faith and basic restructuring feasibility, eliminating obvious procedural abuse without excessive commercial intervention [9].

At the buffering stage, a statutory automatic restructuring moratorium should be introduced. A compulsory 6-12 month moratorium should take effect automatically upon petition admission, prohibiting individual debt enforcement, asset seizure and separate litigation. This creates a stable restructuring window for formulating plans, attracting investment and conducting unified debt negotiations. Statutory automatic stay replaces uncertain discretionary adjournments, stabilizing market sentiment at an early stage.

At the coordination stage, a statutory creditors' committee system should be established. Legislation should mandate committee formation during the moratorium, including diversified creditor representatives with authority to review restructuring proposals, supervise asset disposal and appoint professional advisors. This transforms fragmented competitive creditors into cooperative collectives, resolving collective action dilemmas institutionally [10].

The three tiers form an interconnected protective system in which filtering blocks malicious petitions, buffering rescues viable enterprises, and coordination ensures practical restructuring implementation.

5.2. Replacing discretionary adjournments with statutory automatic stay

Winding-up petition market signals often destroy corporate value long before substantive judicial hearings.

Under HKSAR's current system, judges may discretionarily grant adjournments to facilitate restructuring, yet two critical defects persist. Firstly, outcomes remain highly unpredictable;

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adjournment approval and duration depend entirely on individual judicial judgment, preventing predictable restructuring planning for both enterprises and creditors. Secondly, responses are chronically delayed; adjournment rulings are usually issued only in formal hearings, after irreversible market damage has already occurred [11].

Statutory automatic stay resolves both deficiencies simultaneously. It takes immediate effect upon admission, eliminating discretionary uncertainty, and restricts debt enforcement at the earliest procedural stage to contain market panic. This proposal is not blind transplantation of Western models, but moderate localized adaptation that balances legitimate debt deterrence with restructuring flexibility within Hong Kong's existing regulatory framework [12].

5.3. Optimizing creditor coordination to resolve collective action dilemmas

The creditors' committee mechanism resolves collective action dilemmas through institutionalized coordination. The existing system lacks unified information sharing and collective decision-making platforms, allowing self-interested preemptive behavior to generate collective losses. Statutory committees reduce cooperation costs through mandatory information disclosure and collective voting, while raising barriers against unilateral speculative conduct, making cooperative restructuring practically achievable [13].

6. Conclusion

This study systematically evaluates the counterproductive effects of HKSAR's low-threshold winding-up regime in the context of widespread debt defaults by real estate developers, and clarifies the institutional logic, adverse consequences, deep-seated causes and reform pathways of such unintended outcomes.

In response, this study proposes a three-tier Filtering-Buffering-Coordination reform framework. This integrated reform can rebalance the regime so that it upholds legitimate creditor deterrence while rescuing viable enterprises, preserving going-concern value and advancing collective creditor interests.

It contributes to both theoretical understanding and regulatory practice by challenging the traditional view that low access thresholds uniformly strengthen creditor protection. It proves that institutional design must be industry-sensitive and that individual creditor remedies should be aligned with collective welfare and systemic stability.

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