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Module 8C

Guidance Text

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1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN HONG KONG

Welcome to **Module 8C**, dealing with the insolvency system of **Hong Kong**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Hong Kong's insolvency laws;
- a relatively detailed overview of Hong Kong's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of Hong Kong.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST on 31 July 2021**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2021 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in Hong Kong:

- the background and historical development of Hong Kong insolvency law;
- the various pieces of primary and secondary legislation governing Hong Kong insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;
- the rules of international insolvency law as they apply in Hong Kong;
- the rules relating to the recognition of foreign judgments in Hong Kong.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Hong Kong insolvency law; and
- be able to answer questions based on a set of facts relating to Hong Kong insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through the text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO HONG KONG

Hong Kong is a Special Administrative Region of the People's Republic of China and has had that status since 1 July 1997. However, it is important to understand a little about Hong Kong's history prior to that date to understand the legal system that operates in Hong Kong.

Hong Kong had been under British control or influence since 1842, when Hong Kong Island was ceded to Great Britain pursuant to the Treaty of Nanking, which was concluded to end the so-called "First Opium War".¹ It then became a Crown Colony in 1843.² Hong Kong Island forms only (a small) part of Hong Kong and the other major areas of Hong Kong, namely Kowloon and the New Territories, later came under British control. Kowloon was ceded to Britain by the Convention of Peking in 1860; and the area now known as the New Territories was leased to Britain by the Second Convention of Peking in 1898. The (rent free) lease of the New Territories was granted for 99 years, terminating on 30 June 1997.

Although under the above treaties, only the New Territories was required to be handed back to the People's Republic of China (PRC) in 1997 (upon expiry of the lease), it had become clear long before that date that it was extremely unlikely that Hong Kong could be "split up" with Britain retaining Hong Kong Island and Kowloon, and the New Territories being handed back to the PRC. For one thing, the New Territories is by far the largest part of Hong Kong, representing over 85% of the land area and the areas were inextricably linked economically. This led to the so-called Sino-British Joint Declaration signed in 1984 (and ratified in 1985)³ whereby, amongst other things, it was agreed between the British and the Chinese Governments that the PRC would resume sovereignty over the whole of Hong Kong as from 1 July 1997.

The Joint Declaration provided that upon the PRC resuming sovereignty of Hong Kong, Hong Kong would become a "Special Administrative Region" of the PRC with

¹ For those who are interested in the court and legal systems that existed in Asia during that period, and up to the Second World War, for the various nations that traded out of China and Japan, see the three-volume work by Hong Kong barrister Douglas Clark: *Gunboat Justice (British and American Law courts in China and Japan (1842-1943))* (Earnshaw Books, 2015).

² After 1981, British Colonies were re-designated as British Dependent Territories (and later still as British Overseas Territories).

³ The full text of the Joint Declaration (and annexures) can be found on the Website of the Constitutional and Mainland Affairs Bureau of the Hong Kong Government: <https://www.cmab.gov.hk/en/issues/joint3.htm>.

“a high degree of autonomy”. The PRC is responsible for Hong Kong’s foreign and defence affairs, but other areas remain the responsibility of Hong Kong itself; for example as to policing, immigration, taxation, and (importantly for our purposes) legal system, which retains the British common law approach.⁴ We will look at the latter in more detail in the section below (“Legal System”, at paragraph 4.1). In short, however, since 1 July 1997, Hong Kong has operated under Deng Xiaoping’s principle of “One Country, Two Systems”.⁵ When referring to the PRC other than Hong Kong, Macau or Taiwan, the convention is to refer to the Mainland.⁶

Geographically, Hong Kong is situated at the Southern tip of the PRC, with its northern land boundary leading to the Shenzhen Special Economic Zone. Hong Kong covers approximately 1,100 km² and notwithstanding the common perception of skyscrapers and other buildings everywhere, less than 25% of that land area is developed, with 40% being country parks.⁷

The Hong Kong Government’s provisional figure for mid-2020 for Hong Kong’s population is a little over 7.5 million.⁸ Not surprisingly, the vast majority (approximately 92%) are of Chinese descent.

As regards its economy, Hong Kong has a free market economy with a straightforward tax structure, with income tax being modest (approximately 15% to 16%). Hong Kong prides itself as a place where it is easy to do business. The IMF identifies Hong Kong as an “Advanced Economy” when publishing its data, such as GDP etc.⁹ The figure given by the IMF for Hong Kong’s last published year (2018) GDP is USD 362.72 billion, giving a GDP *per capita* of just over USD 48,000,¹⁰ ranking it at 23rd worldwide according to the World Bank.¹¹ These figures do not take into account the effects of the COVID-19 pandemic which will no doubt have an effect on Hong Kong as with anywhere else in the world.

The Hong Kong Government, for statistical purposes at least, identifies “Four Key Industries” for Hong Kong as the “driving force of Hong Kong’s economic growth”. These are: (i) Financial Services; (ii) Trading and Logistics; (iii) Tourism; and (iv) Professional and Producer Services.¹²

In terms of political and legislative structure, this is again a product of Hong Kong’s history, having transitioned from a British Colony / Territory to its resumption as part of the PRC. The PRC deals with all foreign policy and nationality issues, but Hong Kong has its own Legislative Council, with 70 members. Half are returned from geographic constituencies and half from “functional constituencies”, such as constituencies representing different professional / employment groups, such as legal; accountancy; retail; financial services; social welfare and a number of others.

⁴ This remains the case (certainly for the purpose of this course) notwithstanding the much-reported National Security Law passed during 2020.

⁵ The history of Hong Kong’s legal system and the resumption of sovereignty by the PRC is obviously a very wide topic and this brief introduction cannot possibly hope to cover it any detail. However, as stated, it is important to know a little of this background in order to understand the legal concepts that will be covered in the main part of this module.

⁶ See, eg, the definition of “Mainland” in s 2 of the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap 597).

⁷ <https://www.gov.hk/en/about/abouthk/facts.htm>.

⁸ Hong Kong Government Census and Statistics Department: <https://www.censtatd.gov.hk/hkstat/sub/bbs.jsp>.

⁹ https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/WEOWORLD/ADVEC.

¹⁰ <https://www.imf.org/external/datamapper/NGDPDPC@WEO/OEMDC/WEOWORLD/ADVEC>.

¹¹ https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?year_high_desc=true.

¹² See Hong Kong Government Census and Statistics Department explanation, at <https://www.censtatd.gov.hk/hkstat/sub/sc80.jsp>.

The head of the Hong Kong Government is the Chief Executive. The Chief Executive holds office for a period of 5 years and is elected by an Election Committee, then formally appointed by the Central People's Government of the PRC. The Election Committee consists of 1,200 members representing various trades, professions, labour groups. At the time of writing (October 2020) the current Chief Executive is Ms Carrie Lam.

The Chief Executive is assisted in his or her duties by the Executive Council (similar to the Cabinet in the UK parliament).

Notwithstanding the resumption of sovereignty by the PRC in 1997, English remains an official language. Pursuant to the Official Languages Ordinance (Cap. 5) both Chinese and English are the official languages of Hong Kong. The Chinese dialect most widely spoken in Hong Kong is Cantonese, whereas in the Mainland the predominant language is Mandarin (also known as Putonghua). Although Putonghua is increasingly heard in Hong Kong, the Hong Kong Government statistic¹³ is that Putonghua is spoken by only 1.9% of the population. Written Chinese in Hong Kong usually uses traditional Chinese characters, whereas in the Mainland, simplified Chinese characters are used. Interestingly, particularly given the difference in the written methods of Chinese and the considerable differences between Cantonese and Putonghua, the Official Languages Ordinance does not define which dialect or written form is the "official Chinese" language of Hong Kong. Legislation, however, is written in traditional Chinese characters.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal system

Before turning to the insolvency laws that apply in Hong Kong, it is necessary to understand the background to Hong Kong's legal system, a product of its history as a former British territory. At first, an explanation of Hong Kong's legal system can sound confusing but in practice, for any practitioner familiar with the English common law system, the position is relatively straightforward. In short, Hong Kong has its own statutory laws (Ordinances) and the system of precedents will apply, with decisions of the superior courts binding the lower courts.

Before the resumption of Chinese sovereignty, the Application of English Law Ordinance (Cap. 88) provided that the common law and rules of equity would apply in Hong Kong (subject to such modifications as necessary). The same Ordinance provided that certain English law statutes would also apply to Hong Kong, although generally, for statutory provisions, Hong Kong would pass its own Ordinances, albeit that those Ordinances would often copy, or at least borrow heavily from, their English law counterparts (sometimes with English law statutes being specifically extended by Orders in Council).

As part of the policy of Hong Kong retaining a high level of autonomy after 30 June 1997, the Basic Law of Hong Kong was promulgated by the PRC. The Basic Law in effect operates as Hong Kong's constitution.¹⁴

¹³ <https://www.gov.hk/en/about/abouthk/facts.htm>. (Note that this figure, the latest published on the government's website, is for 2016).

¹⁴ The full text of the Basic Law can be found here: https://www.basiclaw.gov.hk/en/basiclawtext/images/basiclaw_full_text_en.pdf.

As stated above, Hong Kong became a Special Administrative Region of the PRC at midnight on 30 June 1997 (the Handover) when sovereign rule over Hong Kong was returned to the PRC. After the Handover, the laws of Hong Kong in force as at 30 June 1997 continued to apply in Hong Kong only insofar as they are not declared by the Standing Committee of the National People's Congress (the Standing Committee) to contravene the Basic Law.

In preparation for the Handover, on 23 February 1997, the Standing Committee adopted a decision on the treatment of laws previously in force in Hong Kong. Under paragraph 1 of that decision, the Standing Committee decided that “the laws previously in force in Hong Kong, which include the common law, rules of equity, ordinances, subsidiary legislation and customary law, except for those which contravene the Basic Law, are to be adopted as the laws of Hong Kong”. Almost identical wording is used in Article 8 of the Basic Law.

Under paragraph 2 of the same decision, the Standing Committee decided that the ordinances and subsidiary legislation set out in an Annex to the decision “which are in contravention of the Basic Law” are not to be adopted as the laws of Hong Kong. One of the ordinances set out in that Annex is the Application of English Law Ordinance (Cap. 88) which formerly applied the common law and rules of equity of England to Hong Kong.

Notwithstanding that provision, the Basic Law nevertheless provides that the common law shall continue to apply, which can cause confusion. The non-adoption of the Application of the English Law Ordinance was to ensure that there was no doubt that any English common law or rules developed **after** 30 June 1997 were not to be automatically applied to Hong Kong. That the law in Hong Kong after 30 June 1997 includes rules of common law **then** applicable in Hong Kong has been confirmed by Hong Kong's highest court (the Court of Final Appeal, the CFA)).¹⁵

As discussed further below in the section on Hong Kong's institutional framework, from 1 July 1997, the CFA became the highest appellate court in Hong Kong,¹⁶ in place of the Privy Council of the United Kingdom. The *China Field* decision makes reference, at paragraph 79, to another decision of the CFA,¹⁷ the combined effect making it clear that in terms of actual precedent, the position did not change: decisions of the Privy Council on Hong Kong appeals delivered before 1 July 1997 were (and remain) binding in Hong Kong, whereas other decisions of the Privy Council or House of Lords (and now the Supreme court of the United Kingdom) are of persuasive authority only. That decision added that the Hong Kong court will continue to respect and have regard to decisions of the English courts.

In practice, the courts in Hong Kong will take notice of and give regard to decisions of the English court (in particular the Supreme Court) and indeed of other common law jurisdictions, such as Australia and New Zealand.

It is nevertheless important to remember that Hong Kong is a part of the PRC and that, as noted above, in certain circumstances, the position in Hong Kong will be determined by the PRC and not by Hong Kong's own courts or legislature. In most cases, these situations will be limited to matters of national security, foreign affairs

¹⁵ See *China Field Limited v Appeal Tribunal (Buildings) and Building Authority* (2009) 12 HKCFAR 342.

¹⁶ Save for certain matters which can be referred to the Standing Committee, such as matters relating to defence and foreign affairs.

¹⁷ *Solicitor (24/07) v Law Society of Hong Kong* (2008) 11 HKCFAR 117.

etc. However, one example of this philosophy which impacts on commercial / civil law is a decision relating to sovereign immunity (see paragraph 8.4.2).

As to Hong Kong's insolvency laws, these can be broadly split into two categories. First, as to laws relating to the insolvency of individuals (bankruptcy). Secondly, as to laws relating to corporate insolvency (liquidation).

The key legislation for individual insolvency is contained in the Bankruptcy Ordinance (Cap 6), as supplemented by the Bankruptcy Rules (Cap 6A).

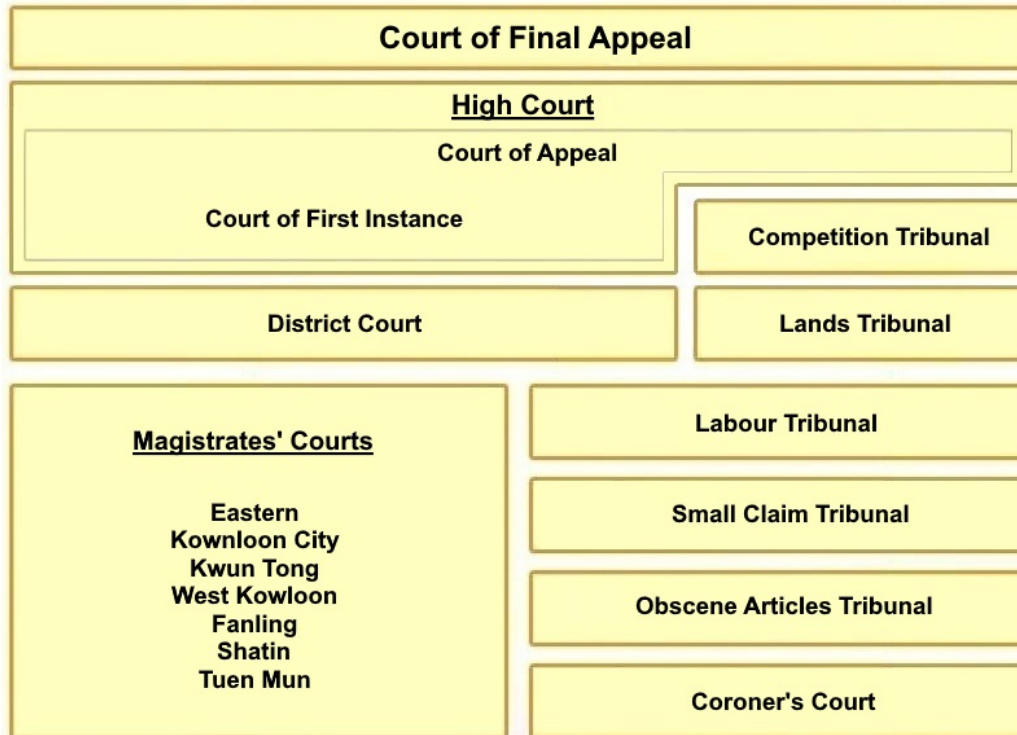
For corporate insolvency, the key Ordinance is the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (usually referred to as CWUMPO), as supplemented by the Companies (Winding Up) Rules (Cap 32H) (CWUR). It is important to note, however, that some of the legislation that will be relevant to practitioners in the insolvency and restructuring field is contained not in CWUMPO, but in the Companies Ordinance (Cap 622). For example, the legislative provisions relating to schemes of arrangement are found in the Companies Ordinance, and not in CWUMPO.

The legislation relating to both individual and corporate insolvency is borrowed from older English legislation. In the case of the key provisions of CWUMPO, for example, these reflect the English statutory position which existed prior to the Insolvency Act 1986. However, there have of course been a number of modifications, particularly in recent years. These will be dealt with in the more detailed sections dealing with the insolvency legislation applicable in Hong Kong.

In addition to the legislation, the courts will apply common law principles and will take guidance from decided authorities. For the reasons set out above, this will include decisions of other common law courts, particularly those of England given that many of the Hong Kong Ordinances have their origins there and the (old) English statutes have similar, and often identical, wording.

4.2 Institutional framework

For civil (that is, not criminal) matters, the court system in Hong Kong consists of various levels of court as well as specialist tribunals (for example, the Labour Tribunal). The Hong Kong Judiciary website describes the Hong Kong court structure as follows:



The level of court where a claimant must commence its claim depends, principally, on the value of the claim, with claims valued at greater than HKD 75,000 but under HKD 3 million¹⁸ (approximately USD 385,000) being commenced in the District Court, with other claims being commenced in the High court. Claims under HKD75,000 are dealt with by the Small Claims Tribunal (which has simplified procedures and legal representation is not permitted).

For the purposes of discussing insolvency and restructuring matters, we need only really consider the High Court. The High Court consists of the Court of First Instance and the Court of Appeal. In addition, there is the Court of Final Appeal, where appeals from the Court of Appeal are heard.

Within the High Court, there are no express sub-divisions dealing with different areas of law, although there are “specialist judges” assigned including, importantly for our purposes, a “companies judge” and one will often hear reference to the “companies court”. In fact, although there is usually only one judge identified as the “companies judge” a number of other judges will also hear applications relating to insolvency and restructuring matters. As well as judges, there are a number of High Court Masters who hear interlocutory matters, particularly “everyday” applications such as applications for extension of time, etc.

An appeal from a decision of a Master is made to a Judge of the Court of First Instance, and appeals from those Judges are made to the Court of Appeal. In turn, the CFA hears appeals from the Court of Appeal, but only where it is certified that the issue is of some significance.

The Hong Kong courts provide a clear system for creditors to enforce their rights.

¹⁸ As from 3 December 2018. Prior to that date, the jurisdictional limit of the District court was HKD 1 million.

A creditor can enforce its rights either within or outside the insolvency regime. The insolvency regime should only be used for creditor claims where there is a clear and undisputed (or undisputable) debt. It is a collective procedure for the benefit of all creditors. If a creditor wishes to bring an action without engaging the insolvency process then it is entitled to do so. However, there are safeguards in place in the legislation to ensure that such a creditor does not obtain an unfair advantage over other creditors if it transpires that the debtor is in fact insolvent and goes into a formal insolvency process before that creditor has completed execution on any judgment.

To enforce its rights outside of the insolvency process, a creditor can commence an action in the District Court or the High Court. Such an action is commenced by writ, which is then served on the debtor defendant. Service is effected by the plaintiff, not by the court. Permission from the court is needed if the defendant is out of the jurisdiction.

After the writ has been served, the debtor needs to file an Acknowledgment of Service, stating whether it intends to defend the claim. If the debtor does not do so, then the creditor can enter a judgment in default. If the debtor does indicate an intention to defend, then there are a number of procedural steps that need to be undertaken in order to take a matter to trial. However, those steps are outside the scope of this outline and will not be dealt with here. That said, for a straightforward (or relatively straightforward) debt claim the most likely course would be for the creditor plaintiff to make an application for summary judgment. This is a procedure by which the court can give judgment where it is appropriate to do so without a full trial of the claim, and based on affidavit evidence. Broadly, the test is that if the plaintiff can readily demonstrate its claim and the defendant cannot demonstrate that it has a defence that is beyond a mere assertion and is no more than “shadowy”, then judgment can be entered.¹⁹

Once a judgment has been entered in favour of a plaintiff, there are a number of mechanisms available to the plaintiff to enforce its judgment. Again, a full exploration of enforcement of judgments is beyond this outline, but common methods for debt claims will be to seek a garnishee order or a charging order. A garnishee order permits the judgment creditor to enforce its judgment against a third party who also owes money to the judgment debtor. The most common use of this procedure is where the defendant has a bank account within the jurisdiction. A charging order gives the judgment creditor a security interest over an asset held by the judgment debtor and is often used where the judgment debtor owns real property within the jurisdiction, but also where the judgment debtor holds shares in a company.

Of greater relevance for this outline, however, is where a creditor seeks to enforce its rights by using the insolvency procedures to put a debtor company into liquidation. The process is dealt with in more detail in the relevant sections below but, broadly, the procedure is as follows:

- A petition to wind up the company would be presented at the High Court Registry.
- A date will be fixed for the first hearing of the petition. Such hearing is always on a Wednesday morning before a Master. At the time of writing the hearing date is typically two months from the date of presentation of the petition.

¹⁹ This is a well settled principle in Hong Kong law, but for a recent example in the Court of Appeal, see *Chan Ping Che v Gao Gunter* [2017] HKEC 1146.

- The petition will need to be served and advertised in accordance with the CWUR.
- Shortly before the first hearing, the petitioner’s lawyers must attend before the Registrar (or Master) at which appointment the court will check that all of the “technical” requirements have been met (principally that the petition has been properly served and advertised). If so, a “Registrar’s Certificate” will be issued. If not, the court will provide a list of requisitions that will need to be complied with before such Certificate is granted (and will usually result in the hearing of the petition being adjourned).
- If the Certificate is granted, then the petitioner can seek a winding up order at the first hearing before a Master in open court.²⁰ If the Registrar’s Certificate has been granted then the winding up order can be made if it is not opposed. If the petition is opposed then the Master has no jurisdiction²¹ to make the order and must, instead, adjourn the petition to be heard before a judge. Ordinarily, such a hearing before the Companies Judge will be fixed for the following Monday.
- If the winding up order is made then a liquidator will subsequently be appointed, with the Official Receiver being appointed as provisional liquidator in the interim. These roles, and the rules relating to appointment, are explored in more detail below.

In terms of the insolvency regime generally, the regulation of liquidators is less formal than in many jurisdictions. For example, there is no formal licence requirement for a person to be appointed as a liquidator and no qualification requirement (save for limited situations²²). The court will, however, consider the experience and resources of proposed appointees and will seek input from the Official Receiver where such factors are in issue.

The Official Receiver is a Government officer who heads the Official Receiver’s Office, a department within the Government.²³ The Official Receiver carries out a number of functions in respect of insolvency matters in Hong Kong.

These functions include acting as a liquidator or trustee in bankruptcy where no “private practice” liquidator or trustee is appointed. In addition, even where a private practice officeholder is appointed, in any compulsory winding up (that is, a court-ordered liquidation), the Official Receiver must be served with any application that is made to court. If the matter is straightforward, the Official Receiver will usually ask for, and be granted, permission to not attend. However, in less straightforward matters the Official Receiver will attend court to make submissions, effectively from a “policy” perspective and in that regard operates an ‘oversight’ role on compulsory liquidations. Similarly, the role of the department generally includes monitoring the conduct of private sector insolvency practitioners to ensure they properly carry out their duties and will follow up on complaints made by creditors, for example.

²⁰ In Hong Kong, hearings are either in Open Court or in Chambers (and if in Chambers either “open to the public” or “not open to the public”). Most hearings relating to insolvency matters are in Chambers and are open to the public, except for applications where it is prudent for the hearing to be in private (for example applications for the appointment of provisional liquidators).

²¹ Section 180A, CWUMPO

²² Section 228A, CWUMPO. There are also provisions restricting certain persons from acting as liquidator (for example, an undischarged bankrupt or someone connected with the company (such as a director, creditor or debtor)) – see Section 262B, CWUMPO

²³ The website of the Official Receiver’s Office is at <https://www.oro.gov.hk/eng/home/home.htm>.

The department also deals with prosecution of insolvency offences (for example, if a bankrupt fails to deliver up assets to his or her trustee) and with the disqualification of directors (liquidators being required to report to the Official Receiver the conduct of directors of the company over which they have been appointed).

From a fiscal perspective, the Official Receiver maintains and operates a Company Liquidation Account, into which all realisations made by a liquidator in a compulsory liquidation must be paid. The Official Receiver monitors collections into and payments out of such account, deducting the proper amount of *ad valorem* duty (very broadly, a small percentage of collections is paid to the Hong Kong Government as General Revenue).²⁴

Finally, the Official Receiver is involved in monitoring Hong Kong legislation relating to insolvency matters and is actively involved in reviewing the same in the context of possible reforms.

Self-Assessment Exercise 1

Question 1

Describe in overview the sources of Hong Kong law, including comment on how Hong Kong's history has shaped its law.

Question 2

A has a claim against B in the sum of HKD 2.5 million. A asks you to issue a writ against B. In which court should you commence those proceedings?

- (a) The Small Claims Tribunal;
- (b) The Companies Court;
- (c) The Court of First Instance of the High Court;
- (d) The District Court.

What other steps could A take if B fails to pay the debt, and in which court?

Question 3

Happy Billion Limited has obtained judgment against Sad Face Limited in the sum of HKD 10 million. SFL holds a bank account with HSBC in Central, Hong Kong and also owns all the issued shares in a private Hong Kong company called Pot of Gold Limited, which itself owns substantial assets. What steps can HBL take to enforce its judgment?

**For commentary and feedback on self-assessment exercise 1, please see
APPENDIX A**

²⁴ See Companies (Fees and Percentages) Order (Cap 32C).

5. SECURITY

5.1 Generally

Security and the rights of secured creditors is a complex subject and a thorough discussion is beyond the scope of this module. However, this section will deal with the subject in overview to introduce, from a Hong Kong law perspective, the main concepts of security and the interaction with insolvency law.

There is no prescribed limit under Hong Kong law as to the forms of security that can be given to creditors. In theory, an instrument can be drafted in any way in an effort to improve the position of the relevant creditor. However, the risk of a creditor creating an entirely novel security instrument is that it may be challenged in the event of insolvency of the debtor.

A creditor with security will ordinarily obtain priority over the debtor's unsecured creditors, although there are certain statutory exceptions (for example, realisations from a floating charge must first be used to meet statutory preferential claims, such as certain employee payments²⁵). Other exceptions may also apply to deny an attempt at giving a creditor priority, for example if the provision purporting to give security is deemed to be a "fraud" on the insolvency legislation it will be void pursuant to the anti-deprivation principle (dealt with further below).

Although there is no prescribed limit on the types of security that can exist under Hong Kong law, the most common types of real security are similar to those seen in other common law jurisdictions, namely:

- pledge;
- lien;
- mortgage; and
- charge.

In addition, common forms of personal security would include guarantees. Quasi-security, such as reservation of title clauses, is also often seen.

5.2 Pledge

A pledge operates by actual or constructive possession of the asset being passed to the creditor. For example, a pledge could be created by delivering to a creditor a negotiable instrument that operates as a document of title, such as a bill of lading. Similarly, a lender financing the importation of goods may obtain security by way of a trust receipt being delivered to him. A pledge carries with it an implied power of sale.

5.3 Lien

A lien can arise where the asset is retained by the creditor until payment is made. It differs from a pledge in that the initial reason for the asset being passed into the

²⁵ CWUMPO, ss 79 and 265(3B). Section 79 provides that the preferential claims must be met out of floating charge realisations even if there is no liquidation at the time. Section 265(3B) clarifies that where there is a liquidation, the preferential claims are paid out of floating charge realisations to the extent that there are insufficient "uncharged" assets available to the liquidator.

possession of the creditor will be for a purpose other than providing security. For example, if a person delivers his car to a garage for repairs, the garage owner may be entitled to exercise a lien over the car until the costs of the repairs have been paid. A lien also differs from a pledge in that there is no implied power of sale, only a power to retain the property pending payment of the indebtedness.

A lien can be a contractual lien or a “common law lien”. The latter does not rely on a contract between the parties and arises as a matter of law. Such a lien can be “general” (that is, it extends to all property held by the lien-holder and not just that property which is the subject of the unpaid work) or a “particular” lien (where the lien is limited). An example of a general lien is that held by a solicitor, whereas as a matter of law (that is, ignoring any contractual terms which exist) a warehouseman will only have a particular lien over the specific goods stored (and for the storage of which payment has not been made).

5.4 Mortgages and charges

Although the terms “mortgage” and “charge” are often used interchangeably, there is a distinct legal difference between the two.

A mortgage involves a transfer to the creditor of ownership of the asset by way of security, with the debtor having the right of redemption by discharging the debt owed and thus being entitled to a re-transfer of ownership. Although most commonly associated with land, at law in Hong Kong a mortgage can exist over any class of asset.

A charge differs from a mortgage in that the ownership remains with the chargor, and the charge operates as an incumbrance over the relevant asset, giving the creditor the right to seek recovery of the indebtedness owed to him by enforcing against the asset charged.

A charge can be a fixed charge or a floating charge.

A fixed charge is a charge in relation to a specific asset and attaches as soon as the charge is created, or the relevant asset is acquired by the debtor. The debtor cannot deal with the asset without the consent of the chargee creditor.

A floating charge is a powerful tool recognised by English (and Hong Kong) law which permits the debtor to continue using the asset or, as is more usual, a class of assets (such as stock or receivables). This recognises that a business could grind to a halt if it could not use its stock in trade to conduct and expand its business. The floating charge operates as an immediate security interest but, until a “crystallisation event” occurs, no specific asset is attached, hence the ability of the debtor to continue using assets within the relevant class. When a triggering event occurs, and the charge crystallises, the debtor company’s right to use the class of assets terminates, and the security becomes a fixed security over those assets in the relevant class in existence at the time of the crystallisation. An instrument creating a floating charge will invariably include provisions that insolvency is a crystallisation event.

The “classic” definition of a floating charge is often given as that of Romer LJ in *Re Yorkshire Woolcombers’ Association Limited*,²⁶ at 295:

²⁶ [1903] 2 Ch 284.

“...I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with.”

The leading English law authority on the subject is now *Re Spectrum Plus Limited*.²⁷

Spectrum confirmed the approach taken by Romer LJ a hundred years earlier, and in particular laid emphasis on the third of the characteristics as being the key criterion when seeking to identify whether an arrangement takes effect as a floating charge. The key question, therefore, is to ask what measure of control the secured creditor has over the relevant assets.

An assignment or sale and purchase of receivables is another common mechanism employed in Hong Kong as a kind of security which is worth exploring briefly, and which sometimes causes difficulty upon the insolvency of the borrower.

In brief, the business concerned gives to its financier an interest in the receivables that it is entitled to receive from its own customers (or a designated group of its customers). This allows the business to receive payment earlier than it would otherwise, thus improving cash flow and taking away credit risk (subject to any provisions for “clawing back” payments or advances made in respect of receivables which turn out to be bad debts).

This type of arrangement will often (but not always) require the business to notify its customers of the financier’s interest in the amount payable by the customer. However, this is not always the case and sometimes is not done when it should be – which leads to difficulties of its own; perhaps because the business does not wish its customers to know that it is relying on financing to conduct its business. Also, the instrument will usually require the borrower to pay into a specific account all receipts from those receivables covered by the security.

The above introduction deliberately refers to the “business” and “financier” rather than to “borrower” and “lender” because the arrangement can be by way of absolute sale of the right to the receivable (still sometimes with a right of recourse / claw-back if debts go bad); or it can be by way of a loan arrangement with the assignment mechanism operating as a security. It is this distinction that has caused difficulties on the insolvency of the “business”. If the arrangement truly is by way of sale, then no registration is required (because no “security” as such has been created; the business has merely sold a right that it has, namely the right to be paid by its customers). On the other hand, if the arrangement is in fact a secured financing arrangement, then the relevant instrument would need to be registered and, if it is not, the arrangement would be void as against a liquidator of the business.

The language used by the parties will not be conclusive. Instead, the court will look at the actual effect of the arrangement. An example of a situation where the court has considered the actual effect of an arrangement and held it to be registrable (and thus

²⁷ [2005] 2 AC 680. See (for a discussion in Hong Kong) *The Almojil* [2015] 3 HKLRD 598.

void as against the liquidators for non-registration) can be found in *Orion Finance Ltd v Crown Financial Management*.²⁸ For a Hong Kong example, see *Hallmark Cards Inc v Yun Choy Ltd*,²⁹ where the liquidators did not succeed, the court determining that the arrangement was an actual sale.

If there is more than one assignee, the issue of priority between them can be troublesome, although the usual position in Hong Kong in the context of assignments of debt would be to follow the *Rule in Dearle v Hall*. This rule states that in the case of a debt, the first equitable assignee of a debt to give notice of assignment to the debtor is given priority.³⁰

5.5 Dealing with security as part of the insolvency process

Generally in Hong Kong, secured creditors (and the security they hold) will not be dealt with as part of the insolvency process. The insolvency process in Hong Kong is intended to be a collective process for the benefit of unsecured creditors, where the officeholder realises for the benefit of those unsecured creditors all available assets of the debtor. Assets subject to security will not be available for realisation by the officeholder.

However, exceptions exist. For example, if a security should have been registered but was not, then the security will be void as against the officeholder (see section 5.6); preferential creditors must be paid out of assets that are subject to a floating charge before such assets can be used to satisfy the holder of the floating charge (unless, if the company is in liquidation, there are sufficient assets to make those payments out of the general estate);³¹ a floating charge that is created within a certain period before the commencement of the liquidation may be void.

A secured creditor submitting a proof of debt can only vote or prove to the extent its claim is unsecured. If the creditor fails to properly value his security, then the security is deemed to be waived and the asset is available for realisation by the liquidator for the benefit of the general body of unsecured creditors.³²

5.6 Registration of security

Security will be void as against a liquidator if it has not been properly registered. Not all security needs to be registered in Hong Kong, although the legislation does contain provisions for registration that apply to a number of common forms of security.

In relation to charges created by companies, Part 8 of the Companies Ordinance (Cap 622) governs registration. Part 8 consists of sections 333 to 356 of that Ordinance.

Section 334 identifies the types of charges that require registration. These include charges over land and book debts, and floating charges over the company's undertaking or property. As prescribed by section 335(5)(a), a charge requiring registration must be registered within one month of the date of its execution.

²⁸ [1996] BCC 621.

²⁹ HCMP 1330 of 2009, 16 June 2009, unreported.

³⁰ See *ABN Amro Bank NV v Chiyu Banking Corp Limited* [2000] 3 HKC 381.

³¹ CWUMPO, ss 79 and 265(3B).

³² CWUR, r 84.

Importantly, if a charge is not registered or is not registered within time,³³ then it is void against a liquidator or a creditor of the company.

Registration of charges created by a company will be registered at the Companies Registry. The Registry can be searched by the public, including via the online search site (ICRIS).³⁴ Separately, any mortgage or charge in respect of real property situated in Hong Kong must be registered with the Land Registry pursuant to the Land Registration Ordinance (Cap. 128), and again this is searchable by the public, including online (the IRIS site).³⁵

As mentioned above, although a floating charge is recognised under Hong Kong law as conferring on the chargee a security interest, attaching at the time of crystallisation, the security is not “absolute” in the same way as a mortgage or a fixed charge. Where the secured creditor holds a mortgage or fixed charge, the creditor is entitled to look to the asset for repayment irrespective of the interests of other creditors.³⁶ However, by statute, where realisations are made out of assets covered by a floating charge, those realisations must first be used to meet claims of preferential creditors.³⁷

Further, pursuant to section 267 of CWUMPO, a floating charge will not be valid if it is entered into within a period of 12 months prior to the commencement of the liquidation and the company was unable to pay its debts at the time the charge was created, or became unable to pay its debts as a consequence of the charge. If the chargee is a person “connected with the company”,³⁸ the 12 months period is extended to two years and there is no requirement to show that the company was insolvent at the time of creation of the charge or as a result of its creation. In either case, the floating charge will still be valid to the extent of any “new money” provided to the company at the time of, or after, the creation of the charge (in consideration for it).

If there is more than one charge over the same asset, the common law rule as to priority is that the earliest in time of creation takes priority. However, this rule is altered in the case of land, where it is the date of registration that determines the order of priority.³⁹ Importantly, section 4 of the same Ordinance should be noted as it provides that a creditor’s charge achieves priority even if, at the time of creation of his charge, he is on notice of another, unregistered, charge over the same property.

5.7 Other important principles

Other legal principles in an insolvency context which will apply where security is given include:

³³ Note, however, that the court can extend the time for registration (s 346).

³⁴ <https://www.icris.cr.gov.hk/cscil/>.

³⁵ <https://www1.iris.gov.hk/eservices/welcome.jsp?language=en>.

³⁶ Subject to the duty of a mortgagee or chargee to act in good faith when exercising a power of sale to obtain a proper price (for discussion on this in Hong Kong see *Esquire (Electronics) Limited v The Hongkong and Shanghai Banking Corporation Ltd* [2007] 3 HKLRD 439).

³⁷ CWUMPO, ss 79 and 265(3B).

³⁸ *Idem*, s s 265A(3) and 265B.

³⁹ See Land Registration Ordinance (Cap 128), s 3. But note s 5: if the charge is registered in time, then the priority goes to the date of creation.

- **The anti-deprivation principle**
 - This was mentioned briefly earlier on as a principle which will not permit a creditor to be put in a better position than other creditors if the mechanism is considered a “fraud on the insolvency laws”.
 - The principle is aimed at preventing parties from using a contractual arrangement to give an advantage to one of the contracting parties in the event of the insolvency of the other.
 - In Hong Kong, the leading case is a 2004 Court of Appeal case⁴⁰ in which the court stated: “...no one can be allowed to derive a benefit from a contract that is in fraud of the insolvency laws...The mischief sought to be avoided by the application of the principle is that of permitting contractual arrangements taking effect which would give the contractors an advantage at the expense of creditors where there was an insolvency.”
 - The issue has been looked at closely by the UK Supreme Court more recently in one of the (many) decisions arising out of the collapse of Lehman Brothers.⁴¹ The court determined that if the arrangements are part of a genuine commercial transaction and not entered into with the intention of creating an advantage on the insolvency of one of the parties, then the arrangements should not be struck down as a consequence of the principle.
- **Double-dipping.** If a debtor goes into insolvency and a creditor of that debtor also holds a guarantee from a third party (perhaps the parent of the debtor), the creditor is entitled to still prove for the full amount in the debtor’s insolvency (and in the guarantor’s insolvency if that entity has also gone into an insolvency process), but is not entitled to actually recover, in aggregate, more than the full amount of his claim.

Self-Assessment Exercise 2

Question 1

Briefly describe the main differences between a fixed and floating charge and how to determine whether a purported fixed charge is in fact fixed.

Question 2

Billion Happy Limited (BH) imports luxury cars into Hong Kong, with a showroom at 88 Kai Tak Street, a property that it owns. BH has borrowed HKD 50 million from Reef Lenders Limited (RL). As security for that loan, BH has granted a mortgage over the Kai Tak property in favour of RL. A supplier of spare parts to BH has not been paid for some time and obtained judgment against BH for HKD 5 million. BH did not satisfy that judgment so the supplier sought and obtained a winding up order against BH. What should the liquidator do in relation to the Kai Tak Street property?

⁴⁰ *Peregrine Investments Holdings Ltd v Asian Infrastructure Fund Management Co Ltd* [2004] 1 HKLRD 598.

⁴¹ *Belmont Pak Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383.

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

As mentioned above, Hong Kong's insolvency law is based on old English legislation. The legislation has nevertheless undergone various amendments over the years, the most recent being in 2017.

There is no unified "insolvency" statute. The principal statutes are:

- The Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32), supplemented by the Companies (Winding Up) Rules (Cap 32H) – which deal with the liquidation of corporate debtors;
- The Bankruptcy Ordinance (Cap 6), as supplemented by the Bankruptcy Rules (Cap 6A) – which deal with the bankruptcy of individual debtors;
- The Companies Ordinance (Cap 622) – which deals with all issues relating to companies other than winding up, but is still relevant as it contains the statutory provisions relating to schemes of arrangement.

The common law applies to supplement and implement the legislation relating to insolvency.

Insolvency laws in Hong Kong are broadly creditor-friendly, with the interests of creditors paramount over those of shareholders.

As explored in more detail below, in Hong Kong, there are compulsory liquidations (being court ordered) and voluntary liquidations (which are commenced without the involvement of the court). However, although there is less court involvement with a voluntary liquidation, the court does maintain an overriding jurisdiction. For example, even in a voluntary liquidation the court can be asked for directions or be asked to exercise any power that it would be able to exercise in a compulsory liquidation.⁴²

Further, although the legislation provides for the appointment (if creditors so desire) of a Committee of Inspection (COI) and although a COI approval is required for a liquidator to take certain steps,⁴³ the liquidator can still have recourse to the court if the COI does not act in a way which he believes is not in the best interests of a liquidation; the role of the COI could be described as a "sounding board" for the liquidator.

6.2 Personal / consumer bankruptcy

There is no express definition of the term "debtor" in the Bankruptcy Ordinance (Cap 6) (BO) but to qualify as a debtor under the BO the debtor must be an individual and, pursuant to section 4 of the BO, must:

⁴² CWUMPO, s 255.

⁴³ See *idem*, ss 199 (compulsory) and 251 (voluntary); and Sch 25.

- (a) be domiciled in Hong Kong;
- (b) be personally present in Hong Kong on the day on which the petition is presented; or
- (c) at any time in the period of three years ending with that day-
 - (i) have been ordinarily resident, or have had a place of residence, in Hong Kong; or
 - (ii) have carried on business in Hong Kong.

6.2.1 *Creditor's bankruptcy petition*

Pursuant to section 6(2) of the BO, a creditor's petition may be presented to the court in respect of a debt or debts if, but only if, at the time the petition is presented-

- (a) the amount of the debt, or the aggregate amount of the debts, is equal to or exceeds HKD 10,000, or such other amount as may be prescribed from time to time;
- (b) the debt, or each of the debts, is for a liquidated sum payable to the petitioning creditor(s) either immediately or at some certain, future time, and is unsecured;
- (c) the debt, or each of the debts, is a debt which the debtor appears either to be unable to pay or to have no reasonable prospect of being able to pay; and
- (d) there is no outstanding application to set aside a statutory demand served under section 6A in respect of the debt or any of the debts.

The word "debts" means any liquidated sum, a debt being a "species of property which may be recoverable by legal process".⁴⁴ Although a slightly grey area, the Hong Kong position is that such a debt need not itself be provable in the bankruptcy.⁴⁵

There are two situations whereby a creditor may present a bankruptcy petition. These are (a) where the creditor has served on the debtor a statutory demand and the debtor has not complied with the terms of the demand; or (b) where execution of a judgment debt against the debtor by the petitioning creditor has been returned unsatisfied in whole or in part.⁴⁶

With respect to relying on a failure to pay a statutory demand, creditors must adhere to the specific rules set out in the BO and Practice Direction 3.1.⁴⁷ For example, the statutory demand must be in the form prescribed by the Bankruptcy Rules (BR) and the statutory demand should be served personally on the debtor. If personal service is not successful, then the creditor should take reasonable steps to bring the demand to the attention of the debtor, including advertising the statutory demand in a newspaper (in Hong Kong or elsewhere, depending on the creditor's belief as to where the debtor is located). In summary, a creditor must do all that is reasonable for the purpose of bringing the statutory demand to the debtor's attention and, if

⁴⁴ *Deutsche Schachtbau v Ras Al-Khaimah National Oil Co* [1990] 1 AC 295.

⁴⁵ *Re Lo Man Hong (a debtor)* [2014] 4 HKLRD 126

⁴⁶ Bankruptcy Ordinance, s 6A(1).

⁴⁷ Practice Directions are guidance notes published by the Judiciary.

practicable in the particular circumstances, to cause personal service of the demand to be effected.⁴⁸

Proper service of the statutory demand on the debtor is a pre-requisite for the commencement of bankruptcy proceedings. If the statutory demand is for payment of a sum under a judgment or order of any court and the creditor knows or believes that the debtor has absconded or is evading service and there is no real prospect of the sum due being recovered by execution or other process, then the demand may be advertised (as stated above) without first attempting personal service.⁴⁹

A bankruptcy order obtained on a statutory demand not properly served may be set aside.⁵⁰

An affirmation of service in respect of the statutory demand must be filed with the High Court Registry. If satisfied, the Registry will then permit the creditor to present a bankruptcy petition against the debtor.

Upon presentation of the petition, the court will provide a return date for the hearing of the petition. As with the statutory demand, a bankruptcy petition should be served on the debtor personally.⁵¹ If personal service is not successful, then the court may permit the petitioner to effect substituted service, for example by advertising the bankruptcy petition in a newspaper published in Hong Kong or where the debtor is located. Note the distinction between a statutory demand (no order required) and a petition (where an order is required to effect substituted service).⁵²

At the hearing of the petition, a certificate signed by the creditor or the creditor's legal representatives must be submitted to the court confirming that the debt on which the petition is founded has not been paid or secured or compounded.⁵³

6.2.2 *Debtor's bankruptcy petition*

Pursuant to section 10 of the BO, a debtor's "self" petition may be presented to the court only on the ground that the debtor is unable to pay his debts. The debtor's petition must be accompanied by a statement of the debtor's affairs, containing information such as particulars of the debtor's liabilities and assets. If it is clear that the debtor is able to pay his debts, the petition has to be dismissed on the ground that it is an abuse of the process of court.⁵⁴

There is no obligation provided for in the BO for a debtor to enter into formal insolvency. That being said, once a petition is presented, the Official Receiver may summon the debtor to attend before him to give such information as he requires. If the debtor fails to meet or co-operate with the Official Receiver to provide the

⁴⁸ Bankruptcy Rules, r 46(2) and see the steps recommended by the court in Practice Direction 3.1 (paras 2.5 to 2.6).

⁴⁹ *Idem*, r 46(3); In *Re Pang Mei Lan May* [2005] 1 HKC 319, the court stated that there must be concrete evidence of absconding and evasion of service.

⁵⁰ *Re Yeung Kwok Ying trading as Owl Night Club, ex parte Hang Lung Bank Limited* HCB 242/1987 [1988] HKLY 55; and see also *Re Lela Tong, ex p Lam Fai* [2011] HKEC 1002.

⁵¹ BR, r 59.

⁵² See BR, r 59; and Practice Direction 3.1.

⁵³ Practice Direction 3.1.

⁵⁴ *Ex parte the Debtor v Allen* [1967] Ch 590, cited in Hong Kong in *Re Chow Man Kwong ex p Chow Man Kwong* [2001] HKLRD 482, 487 and *Re Yau Chin Chi* [2014] HKEC 1070.

necessary information, the debtor will be liable on summary conviction to imprisonment for a term not exceeding six months.⁵⁵

Further (and as described below), there are certain grounds upon which the trustee or one of the bankrupt's creditors may rely in order to object to the automatic discharge of the bankrupt. One of the grounds is that the bankrupt has continued to trade after knowing himself to be insolvent.

The court may at any time after the presentation of a bankruptcy petition either stay any action, execution or other legal process against the property or person of the debtor or allow it to continue on such terms as it may think just.⁵⁶ However, once a bankruptcy order is actually made, there is an automatic stay and no creditor may proceed with or commence any action or other legal proceedings against the bankrupt, unless with the leave of the court and on such terms as the court may impose.⁵⁷

In addition to an automatic stay being imposed upon the making of a bankruptcy order, section 20 of the BO permits a debtor to seek an interim order of the court for a moratorium on proceedings against him while he seeks to reach an arrangement with his creditors as to his debts. The application to court for an interim order may be made where the debtor intends to make a proposal for a voluntary arrangement (see further below). When a voluntary arrangement procedure is initiated and the court grants an interim order, a moratorium is imposed on all civil proceedings against the debtor.

A bankruptcy order takes effect immediately on the day it is pronounced, and not only when it has been sealed by the High court of Hong Kong.⁵⁸

On the date the bankruptcy order is pronounced, the Official Receiver becomes the provisional trustee of the bankrupt and until any other trustee is appointed, the property of the bankrupt vests in the Official Receiver. Except for certain causes of action personal to the bankrupt, such as defamation, all other causes of action which were vested in the bankrupt at the commencement of the bankruptcy, whether for liquidated sums or unliquidated damages, vest in the trustee, and the bankrupt cannot commence any proceedings based on a cause of action which no longer vests in him. If the proceedings have already been commenced, he ceases to have sufficient interest to continue them.

The position as to the date of commencement of the insolvency process is different in bankruptcy to that of the winding up of companies. The winding up of a company by the court is deemed to commence at the time of the presentation of the petition for winding up, not the date the order is made.⁵⁹ That said, with respect to certain actions that may be taken by the trustees in bankruptcy, such as attacking antecedent transactions, the calculation of the "relevant time"⁶⁰ is also the date of presentation of the petition.

⁵⁵ Likewise every person who takes any part in any such obstruction, whether authorised or permitted by the debtor or not, shall be liable to the like penalty – Bankruptcy Ordinance, s 8.

⁵⁶ Bankruptcy Ordinance, s 14.

⁵⁷ *Idem*, s 12.

⁵⁸ *Idem*, s 30.

⁵⁹ CWUMPO, s 184.

⁶⁰ As defined in the Bankruptcy Ordinance, s 50

6.2.3 Individual voluntary arrangement (IVA)

The IVA is an alternative to bankruptcy and an application for IVA may be made by (a) a debtor who has a problem with debt repayment; or (b) an undischarged bankrupt. An IVA involves an application to the court for an Interim Order and if such order is made no bankruptcy petition or other legal proceedings may be taken or continued against the debtor. The debtor is required to make a repayment proposal to the creditors which, on approval, is binding on all creditors.

There are several advantages of IVA as opposed to entering into bankruptcy. Some advantages are:

- (a) the stigma of bankruptcy is avoided;
- (b) the debtor may be able to retain his or her job (for certain jobs, a bankruptcy order could prevent this); and
- (c) the debtor will be free from the restrictions provided under the BO as he has not been made bankrupt.

The procedure for an IVA is fairly straightforward and is as follows: (i) the debtor must find a Nominee; (ii) the debtor must prepare a proposal for the intended Nominee setting out how he intends to repay creditors; (iii) the debtor must submit an up to date Statement of Affairs to the Nominee; (iv) an application is made for an Interim Order; (v) the Nominee must then file a report stating whether in his opinion a meeting of creditors should be fixed to consider the proposal; (vi) a creditors' meeting is held and the creditors decide whether or not to approve the debtor's proposal. The approval or modification of a proposal at a creditors' meeting requires a majority in excess of 75% by value of the creditors present in person or by proxy and voting on the resolution;⁶¹ (vii) the chairman of the meeting will report to the court and Official Receiver and register the relevant details of the IVA.

The IVA procedure is not widely used, with only around 600 cases per year over the past few years.

When an IVA is approved at the creditors' meeting, it constitutes a statutory contract that is binding on every person who has notice of it and is entitled to vote at the meeting, whether or not that person was present or was represented, as if they were a party to the arrangement.

The court may annul a bankruptcy order if at any time it appears to the court that (i) on any grounds existing at the time the order was made, the order ought not to have been made; or (ii) to the extent required by the rules, the provable debts and the expenses of the bankruptcy have, since the making of the order, all been either paid or secured to the satisfaction of the court.⁶² The court may annul a bankruptcy order whether or not the bankrupt has been discharged from the bankruptcy.

It has been consistently held that the court's discretionary power to annul a bankruptcy order should not be exercised except in special circumstances.⁶³

⁶¹ Bankruptcy Rules, rr 122Q and 122R.

⁶² Bankruptcy Ordinance, s 33.

⁶³ *Re Chan Chi Ho Lincoln* [2008] 5 HKLRD 871.

Further, once a bankrupt has been discharged he may apply to court to issue a certificate of his discharge and the discharged bankrupt may require the trustee to advertise notice of the discharge in the Hong Kong Government Gazette and / or in any newspaper in which the bankruptcy was advertised.⁶⁴

6.2.4 Interim trustee

The court may, if it is shown to be necessary for the protection of the estate, at any time after the presentation of a bankruptcy petition and before a bankruptcy order is made, appoint the Official Receiver to be interim trustee of the property of the debtor or of any part thereof, and direct him to take immediate possession thereof.⁶⁵

6.2.5 Special manager

Until a trustee in bankruptcy is appointed the court may, upon application by the Official Receiver or any creditor, appoint a special manager for the debtor's estate and business.⁶⁶ The appointment is usually made when the special nature of the estate, property or business of the bankrupt requires someone with some special skill or knowledge to manage or deal with it effectively.

A special manager appointed by the court can be removed by the Official Receiver at any time if his employment seems unnecessary or unprofitable to the estate and he has to be removed if so required by a special resolution of the creditors.⁶⁷

6.2.6 Final trustee

Upon the making of the Bankruptcy Order, all of the bankruptcy's assets are vested in the trustee.⁶⁸ Following the making of a bankruptcy order, any creditor of the bankrupt may request the provisional trustee to summon a general meeting of the bankrupt's creditors for the purpose of appointing a trustee in place of the Official Receiver. The trustee will conduct investigations into the affairs of the bankrupt and will take control of the assets, including accounting books and records in the case of a trading bankrupt.

The trustee also has the power to administer and realise the bankrupt's assets in order to distribute funds to creditors; commence / defend legal proceedings; and object to an automatic discharge of the bankrupt (described below).

The court may, by warrant addressed to any person or persons named therein, cause a debtor to be arrested and any books, papers, money and goods in his possession or under his control or relating to his affairs to be seized.⁶⁹ This section is, however, rarely used as the threshold applied by the court on such an application is high.

In certain circumstances, the court may make a "criminal bankruptcy order", against a person in respect of an offence (or, as the case may be, that offence and any other relevant offences) committed by that person where the offence has caused loss to others in an amount exceeding HKD150,000.⁷⁰ However, again such orders are rare.

⁶⁴ Bankruptcy Rules, r 92.

⁶⁵ Bankruptcy Ordinance, s 13.

⁶⁶ *Idem*, s 15.

⁶⁷ Bankruptcy Rules, r 155.

⁶⁸ Bankruptcy Ordinance, s 58.

⁶⁹ *Idem*, s 27.

⁷⁰ Criminal Procedure Ordinance (Cap 221), s 84A.

6.2.7 Creditors' claims

A creditor who has proved his debt is entitled to share in the distribution of the bankrupt's assets.⁷¹ Section 34 of the BO and Rule 109 of the BR provide the statutory framework in respect of creditors proving their claims.

A proof of debt is a document by which a creditor puts forward his claim in the prescribed form which must be delivered to the trustee (accompanied by the appropriate fee).⁷²

The form used asks the creditor to identify whether he has any security for the debt claimed and, if so, the estimated value of that security and the date it was given. If security is not "declared" in this way, then it is deemed to have been waived.

6.2.8 Treatment of contracts

6.2.8.1 Executory contracts

There is no special treatment for executory contracts (that is, contracts with ongoing obligations such as a lease) save that a landlord has a limited priority right to distrain upon goods or effects for six months' rent accrued due before the date of the bankruptcy order.⁷³ The goods and effects which the landlord may distrain are those which are on the premises and in the apparent possession of the bankrupt tenant.⁷⁴

6.2.8.2 Employees

Employees are, subject to certain limits, entitled to payment out of the assets of an employer who becomes bankrupt, in preference to most other creditors in respect of arrears of wages, wages in lieu of notice, accrued holiday remuneration and severance payment⁷⁵. Of relevance to employees in the context of insolvency is the Protection of Wages on Insolvency Fund (*PWIF*), which is a fund that has been established pursuant to the Protection of Wages on Insolvency Ordinance (Cap 380). The *PWIF* provides relief in the form of an *ex gratia* payment to employees of insolvent employers (whether corporate or individuals). The Fund enables the employee(s) to obtain, without having to wait until the completion of the insolvency procedure, payment of certain of his entitlements. There are practical issues with the *PWIF* (for example, the *PWIF* will not pay an employee if the (corporate) employer goes into voluntary, as opposed to compulsory, liquidation).

6.2.8.3 Essential contracts

Suppliers of public utilities, such as gas, electricity, water and telecommunications may not make it a condition of providing supply to any officeholder (for example, the trustee in bankruptcy), that any charges unpaid at the date on which the bankruptcy order was made must be paid. However, they may require the officeholder to personally guarantee the payment of charges in respect of post-insolvency supplies.⁷⁶

⁷¹ *Re Hide, ex parte Llyni Coal and Iron Co* (1871) LR 7 Ch 28 at p 32, per James LJ.

⁷² Bankruptcy Rules, r 109.

⁷³ Bankruptcy Ordinance, s 40.

⁷⁴ *Hong Kong Fire Insurance Co Ltd v Kan Chak* (1938) 30 HKLR 37). The right of distress does not make a landlord a secured creditor - *Thomas v Patent Lionite Co* (1881) 17 Ch D 250.

⁷⁵ Bankruptcy Ordinance, s 38.

⁷⁶ *Idem*, s 30E.

6.2.8.4 Statutory set-off

Section 35 of the BO provides for statutory set-off. The features of such set-off are (i) it is mandatory; (ii) it cannot be excluded by any prior agreement between the parties; (iii) its operation does not depend on any step having to be taken by any of the parties; and (iv) it takes place automatically on the bankruptcy date.

Statutory set-off is strictly limited to mutual claims at the date of bankruptcy. There can be no set-off of claims by third parties, even with their consent. To do so would be to allow parties by agreement to subvert the fundamental principle of *pari passu* distribution of the bankrupt's assets.⁷⁷

6.2.9 Void dispositions after bankruptcy

All dispositions made by the bankrupt after the date of presentation of a bankruptcy petition (such period ending with the vesting of the bankrupt's estate in the trustee) are void unless they were made with the consent of the court or they were subsequently ratified by the court⁷⁸ (by a so-called "validation order"). The purpose of this section is to (i) prevent the improper dissipation of the bankrupt's assets once a bankruptcy petition is filed; and (ii) to protect the principle of *pari passu* distribution.

There is a rebuttable presumption that the disposition is harmful to the interests of the general body of creditors. The burden is on the applicant to rebut that presumption⁷⁹ by establishing that the interests of the general body of unsecured creditors are not prejudiced by the disposition. For example, the court may grant the validation order if it is in the interests of the unsecured creditors generally, that the bankrupt's business should be carried on in circumstances where the payments will not reduce the assets available for distribution.⁸⁰

If a disposition was made after presentation of the petition but before the commencement of the bankruptcy order, the disposition is valid if the recipient of the property can establish that he had acted in good faith, for value and without notice of the petition.⁸¹

A transaction is made in "good faith" if the transaction is not tainted with dishonesty.⁸²

For the avoidance of doubt, the protection would not be available if the disposition was made after the commencement of the bankruptcy order.

6.2.10 Impeachable transactions

6.2.10.1 Transactions at an undervalue

If the bankrupt has at a "relevant time" entered into a transaction with any person at an undervalue, the trustee may apply to the court for an order to restore the position to what it would have been if that debtor had not entered into that transaction.⁸³

⁷⁷ *Re Bank of Credit and Commerce International SA (No 8)* [1997] 4 All ER 568, 573, (HL).

⁷⁸ Bankruptcy Ordinance, s 42.

⁷⁹ *Re Chao Sze Bang Frank* [2002] 3 HKLRD 126.

⁸⁰ *Right Time Construction Ltd (in Liquidation)* (HCCW 97/1987). See also *Re Tramway Building & Construction Co Ltd* [1988] 2 WLR 640.

⁸¹ Bankruptcy Ordinance, s 42(4).

⁸² *Re Spratt, ex parte Wilde & Ors* (1986) 67 ALR 485 and in *Butcher v Stead* (1875) LR 7 HL 839 it was held that "good faith" means "without notice that the person paying is doing anything injurious to his other creditor".

⁸³ Bankruptcy Ordinance, s 49.

A debtor enters into a transaction with a person at an undervalue if (i) he makes a gift to that person or he otherwise enters into a transaction with that person on terms that provide for him to receive no consideration; (ii) he enters into a transaction with that person in consideration of marriage; or (iii) he enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the debtor.

The “relevant time” in the context of an alleged transaction at undervalue, is five years.⁸⁴

6.2.10.2 *Unfair preferences*

Where a person is adjudged bankrupt and he has at a relevant time given an unfair preference which is not a transaction at an undervalue, the trustee may apply to the court to restore the position to what it would have been if that debtor had not given that unfair preference.⁸⁵

A debtor gives an unfair preference to a person if (i) that person is one of the debtor's creditors or a surety or guarantor for any of his debts or other liabilities; and (ii) the debtor does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the debtor's bankruptcy, will be better than the position he would have been in if that thing had not been done. It is also a condition that the debtor must have been influenced by a desire to prefer. If the person said to be preferred is an “associate” of the debtor then the “desire to prefer” is presumed to exist (although such presumption is rebuttable).⁸⁶

The term “associate” is defined in section 51B of the BO and includes, but is not limited to, the debtor's spouse, or relative, or the spouse of a relative of the debtor or his spouse.

Proving an “unfair preference” transaction is difficult in Hong Kong because a defendant in a preference action is entitled to rely on the defence that genuine pressure was exerted on the debtor and that it is for this reason that the debtor acted as he did, not from a “desire to prefer”. This is the case even where the presumption of desire applies in transactions involving associates. For example, it has been held⁸⁷ that moral pressure can be as real as commercial pressure and was sufficient to negate the suggestion that the debtor was motivated by a desire to prefer.

In the context of a claim by a trustee for an unfair preference, the “relevant time” is six months, or two years where the person said to have been preferred is an “associate”.

⁸⁴ *Idem*, s 51(1)(a).

⁸⁵ *Idem*, s 50.

⁸⁶ *Idem*, s 50(5).

⁸⁷ *Trustees of the Property of Hau Po Man Stanley (in bankruptcy) v Hau Po Fun Ivy* [2005] 2 HKC 227. In that case, a bankrupt dentist made payments to his sister (who had previously lent money to him) ahead of other creditors, but said he did so only because she and her husband would regularly attend his clinic and disrupt his practice.

6.2.10.3 *Extortionate credit transactions*

When the creditor submits a proof on the basis of a credit transaction, the trustee can apply to reopen the credit transaction on the ground that it is extortionate⁸⁸ if such transaction was entered into not more than three years before the commencement of the bankruptcy. The words “credit transaction” mean a transaction under which the bankrupt obtains a benefit from another under an agreement which postpones payment of the consideration for the benefit.

A transaction is extortionate if, having regard to the risk accepted by the person providing the credit (a) the terms of it are or were such as to require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of the credit; or (b) it otherwise grossly contravened ordinary principles of fair dealing; and it must be presumed, unless the contrary is proved, that a transaction with respect to which an application is made under the section is or, as the case may be, was, extortionate.⁸⁹

The court is given wide powers to interfere with an extortionate credit transaction, including setting aside the whole or part of any obligation created by the transaction; varying the terms of the transaction; requiring any person who is or was party to the transaction to pay to the trustee any sums paid to that person, by virtue of the transaction, by the bankrupt.

6.2.11 *Limited homestead exemption*

To avoid any personal hardship to the bankrupt and to his family, a temporary reprieve is given in respect of the bankrupt’s residence allowing him to continue residing in such premises for a period of six months (which period can be extended by a further period of six months) after the making of the bankruptcy order.⁹⁰

When the bankrupt makes an application for an extension, the onus lies on the bankrupt to establish that there are exceptional circumstances which outweigh the interests of the creditors. The factors taken into account are: (i) the welfare of the bankrupt’s children; (ii) alternative accommodation; (iii) the amount to be realised from the sale of bankrupt’s interest in the family home; (iv) the need for the family to remain in a specific area; (v) hardship caused to an individual creditor by a postponement; and (vi) whether the relevant members of a bankrupt’s family would be able to remain in occupation of the property despite the realisation of the bankrupt’s property.

However, it should be noted that even if the bankrupt is only a part-owner of a property (as tenant in common) the court can still order that the bankrupt’s share of the property should be sold. There are obvious practical difficulties with this, in particular as to the marketability of such an interest. However, trustees have often used the rules in this regard to good effect by selling the interest to the bankrupt’s spouse or other family member.

⁸⁸ Bankruptcy Ordinance, s 71A.

⁸⁹ *Idem*, s 71A(3).

⁹⁰ *Idem*, s 43F.

6.2.12 Priority claims

Sections 37 and 38 of the BO provide for the priority of claims that apply in bankruptcy proceedings. The order of priority is:

- (a) The fees and expenses of the Official Receiver;
- (b) The taxed costs of the petition;
- (c) Remuneration and fees, disbursements and expenses properly incurred by any special manager;
- (d) The costs and expenses of any person who makes the bankrupt's statement of affairs;
- (e) The taxed charges of any shorthand writer appointed to take an examination under the BO;
- (f) The necessary disbursements, costs and remuneration of any private-sector insolvency practitioner acting as provisional trustee or trustee;
- (g) The actual out-of-pocket expenses necessarily incurred by the creditors' committee subject to the approval of the trustee;
- (h) Payment of preferential creditors;
- (i) The debts proved in the bankruptcy are then paid *pari passu*.

6.2.13 Discharge

One of the objectives of bankruptcy is to give the debtor a "fresh start" by releasing him from the burden of his debts and liabilities. A bankrupt can be automatically discharged after four years in cases where he has not previously been adjudicated bankrupt, and five years in cases where he had previously been adjudicated bankrupt.⁹¹ Further, the bankrupt may apply for an early discharge.⁹² The court maintains discretion, in both cases, to refuse a discharge.

A trustee or one of the bankrupt's creditors may make an application to object to the automatic discharge of the bankrupt. The grounds on which an objection may be made include, but are not limited to, the following:⁹³

- (a) that the discharge of the bankrupt would prejudice the administration of his estate;
- (b) that the bankrupt has failed to co-operate in the administration of his estate;
- (c) that the conduct of the bankrupt, either in respect of the period before or the period after the commencement of the bankruptcy, has been unsatisfactory;
- (d) that the bankrupt has continued to trade after knowing himself to be insolvent.

⁹¹ The automatic discharge was only introduced in 1998.

⁹² Bankruptcy Ordinance, ss 30A and 30B.

⁹³ *Idem*, s 30A(4).

It should be noted that even though the bankrupt may be discharged, the bankrupt is not freed from certain obligations and liabilities.⁹⁴ The trustees have the power to continue to administer the assets of a bankrupt even after the bankrupt's discharge from bankruptcy and to realise the bankrupt's assets at any time for the benefit of the creditors.⁹⁵

6.2.14 Small and assetless estates

As a footnote, it should also be noted that if the property of the debtor is not likely to exceed HKD 200,000, the court has jurisdiction to make an order for summary administration.⁹⁶ Where such an order is made, the Official Receiver automatically becomes the trustee in bankruptcy and there is no creditors' meeting at which a private-sector trustee can be appointed. The objective of this simplified provision is to minimise expenses.

Self-Assessment Exercise 3

Question 1 (insolvency system)

Identify the five key pieces of Hong Kong legislation (or subsidiary legislation) that relate to insolvency issues (including schemes of arrangement).

Question 2 (Bankruptcy)

Until he left for Canada 2 years ago, Jack Chan lived in Hong Kong and carried on business there in his own name. He still comes back to Hong Kong to stay with friends from time to time for a holiday. Agnes Wan was a friend of Jack Chan and lent him HKD 100,000 to help with his business, but he never paid her back. Agnes has been told by one friend that she can take action to make Jack a bankrupt. However, another friend has told her that she can't do that because Jack does not live in Hong Kong and the amount due to her is too small. Agnes consults you for advice. Leaving aside commercial considerations (such as costs to be incurred against the likelihood of recovery), which of the following is correct and why?

- (a) The second friend is correct because a person cannot be made bankrupt in Hong Kong unless they are a Hong Kong resident and the debt is in excess of HKD 100,000.
- (b) The second friend is partly correct because a person cannot be made bankrupt in Hong Kong unless they are a Hong Kong resident, but the size of the debt is irrelevant.
- (c) The first friend is correct but the bankruptcy proceeding can only be commenced when Jack is in Hong Kong for one of his visits.
- (d) The first friend is correct and Agnes can invoke the bankruptcy provisions against Jack.

⁹⁴ *Idem*, s 32.

⁹⁵ In *Alan Chung Wah Tang and another v Lee Siu Fung, Siegfried and others* [2017] 1 HKLRD 1155, the Hon Mr Justice Lam referred to s 32(2) of the Bankruptcy Ordinance and stated "s 32(2)(a) makes it clear that an order for discharge "has no effect ... on the functions (so far as they remain to be carried out) of the trustee and the operation of the provisions of this Ordinance for the purposes of carrying out those functions"". The court also stated that "...any assets concealed by a bankrupt prior to his bankruptcy are vested in the trustee and continue to be so vested after and despite discharge" and "Since the functions of a trustee continue after discharge, it is not surprising that the power to order a bankrupt (among others) to attend for private examination under s 29 – a power provided to enable a trustee to carry out his functions – also continues to apply notwithstanding the discharge of bankruptcy."

⁹⁶ Bankruptcy Ordinance, s 112A.

Question 3 (bankruptcy)

Eddie Simmons has been living and working in Hong Kong for a number of years, and borrowed HKD 250,000 from his friend, Brendan Gann, but did not pay him back. Brendan took action and Eddie is now a bankrupt. The trustee has determined that a number of writs have been issued against Eddie. As to assets, there is a small balance in a bank account and a motorcycle registered in Eddie's name. Eddie states that although he admits borrowing the HKD 250,000 from Brendan, he had also done some work for Brendan and issued an invoice in the sum of HKD 75,000, which is unpaid. The trustee asks your advice as to what should be done about the litigation; the assets identified; and what the effect is of the invoice issued to Brendan.

**For commentary and feedback on self-assessment exercise 3, please see
APPENDIX A**

6.3 Corporate liquidation**6.3.1 General**

There is no formal definition of “insolvency” in Hong Kong law. The court will consider both the cash flow test and the balance sheet test as appropriate.⁹⁷

A petition can be presented to wind up a company if (amongst other grounds) it is unable to pay its debts.

Section 178 of CWUMPO defines “inability to pay debts”, as follows:

- “(1) A company shall be deemed to be unable to pay its debts—
- (a) if—
- (i) a creditor, by assignment or otherwise, to whom the company is indebted in a sum then due that equals or exceeds the specified amount,⁹⁸ has served on the company a written demand—
- (A) in the prescribed form requiring the company to pay the sum so due; and
- (B) by leaving it at the registered office of the company; and
- (ii) the company has, for 3 weeks after the service of the demand, neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor;
- (b) if execution or other process issued on a judgment, decree or order of any court in favour of a creditor of

⁹⁷ For example, see *Re K Vision International Investment (HK) Limited* (unreported, HCCW 282/2011, 28 October 2011); and *HCK China Investments Limited and another v Wah Nam Group Limited* (unreported, HCCW 166/2000, 26 July 2000).

⁹⁸ This amount is currently HKD 10,000 (although there are provisions allowing employees to “join together” to petition if each individual’s claim does not meet this threshold).

- the company is returned unsatisfied in whole or in part; or
- (c) if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company.”

There are similar provisions for winding an unregistered (foreign) company.⁹⁹

There are various methods by which a company can enter liquidation, broadly being voluntary or compulsory liquidation. Further, in certain circumstances, a company can be deregistered without going through a liquidation process. Those circumstances include, for example, where all members agree, the company has no liabilities and is not subject to legal proceedings. This is a fairly common procedure in Hong Kong for dealing with “defunct” companies.

As to voluntary liquidations, there are two types: (i) members’ voluntary liquidation;¹⁰⁰ (ii) creditors’ voluntary liquidation.¹⁰¹ There is no value threshold for commencing a voluntary liquidation.

6.3.2 *Members’ voluntary liquidation (MVL)*

The MVL procedure can be used where the company will be able to settle all liabilities within 12 months of the commencement of the liquidation.¹⁰²

It requires the directors of the company to sign a “certificate of solvency” and the shareholders of the company to pass a special resolution for winding up and appointing liquidators.¹⁰³ The MVL commences on the date the resolution for winding up is passed.¹⁰⁴

The appointed liquidators will take over control of the business from the directors of the company and will investigate the affairs of the company and the conduct of the director(s); and realise assets in order to effect payment to the creditors and then shareholders.

The fees of the liquidators will be paid out of the assets of the company. Where there are any surplus assets after paying the liquidators’ fees and expenses, and the company’s debts (if any), such surplus will be distributed to the members of the company.¹⁰⁵

There is no specific qualification as to who can be a liquidator but the appointee is usually an insolvency practitioner such as a solicitor or an accountant. In the context of MVL, the liquidator can be connected with the company; for example, the liquidator could be from the company’s audit firm.

⁹⁹ CWUMPO, s 327(4)(d).

¹⁰⁰ CWUMPO, ss 228 to 239.

¹⁰¹ *Idem*, ss 228 to 233 and 240 to 248.

¹⁰² *Idem*, s 233(1).

¹⁰³ If the company is being wound up pursuant to its Articles, only ordinary resolutions need be passed.

¹⁰⁴ CWUMPO, s 228.

¹⁰⁵ *Idem*, s 256.

6.3.3 Creditors' voluntary liquidation (CVL)

A creditors' voluntary liquidation occurs where the company decides to put itself into voluntary liquidation but is not solvent.¹⁰⁶

The directors (whether by their own volition or at the request of shareholders) will convene a meeting of shareholders in order to pass a special resolution¹⁰⁷ for the winding up of the company. The CVL will commence on the date of passing such resolution.¹⁰⁸ However, a liquidator appointed at the shareholders' meeting has limited powers until his appointment is confirmed at the creditors' meeting¹⁰⁹.

A meeting of creditors will also be convened, for a date not later than 14 days after the meeting of shareholders.¹¹⁰ A statement of affairs of the company should be laid before the meeting.¹¹¹

Notice of the meeting of creditors is to be sent by post to the creditors at least seven days before the day on which the meeting is to be held and must be advertised in the Hong Kong Gazette and in an English language newspaper and a Chinese language newspaper circulating in Hong Kong.¹¹²

Creditors will nominate and vote for the appointment of a liquidator at the first meeting of creditors.¹¹³

Once the decision has been taken to convene meetings of creditors and shareholders, the directors should take steps to protect the assets of the company pending the meeting of creditors.¹¹⁴ Once a company becomes insolvent, although the duties owed by directors remain duties to the company, they must exercise those duties with the best interests of the creditors in mind.¹¹⁵

The main reasons for using the CVL procedure, rather than a compulsory (court) liquidation by a creditor, are costs and timing. In the compulsory procedure, there is a much greater level of court involvement than in the CVL procedure. This can lead to delays and additional costs. A CVL can be commenced quite quickly compared with a compulsory liquidation. Furthermore, *ad valorem* payable on realisations in a compulsory liquidation is not payable in a voluntary liquidation.

6.3.4 Section 228A liquidation – CVL in case of urgency

Section 228A of CWUMPO is used in circumstances where in the directors' opinion a company should be wound up with immediate effect. The directors may resolve to wind up the Company at a meeting of the directors (no shareholders' resolution is required) and deliver to the Registrar a statement certifying that a resolution has been passed to the effect that:

- The company cannot by reason of its liabilities continue its business;

¹⁰⁶ *Idem*, s 233(4).

¹⁰⁷ A special resolution of the members (or of a class of members) of a company means a resolution that is passed by a majority of at least 75% - Companies Ordinance, s 564.

¹⁰⁸ CWUMPO, s 230.

¹⁰⁹ *Idem*, s 243A

¹¹⁰ *Idem*, s 241(a).

¹¹¹ *Idem*, s 241(3A).

¹¹² *Idem*, s 241(1)(b) and (2).

¹¹³ *Idem*, s 242.

¹¹⁴ *Idem*, s 250A(3)

¹¹⁵ See *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co, Ltd* [2020] HKCFI 398.

- They consider it is necessary that the company be wound up and that it is not reasonably practicable for the winding up to be commenced under another section; and
- Meetings of the company's shareholders and its creditors will be summoned to be held not later than 28 days from filing the winding up statement.

To proceed by way of a section 228A liquidation, special reasons must be provided showing the company should be liquidated under this section rather than by any other procedure (namely, the second element identified above). There are stiff penalties if a director chooses to proceed under section 228A when it is inappropriate to do so, for example where there is no urgency or special reasons.¹¹⁶

A provisional liquidator appointed under this provision must consent to his appointment in writing, and must be either a solicitor or a professional accountant.¹¹⁷ An appointment made in contravention of these requirements is void,¹¹⁸ and a person who acts as a provisional liquidator in contravention of those requirements is liable to a fine.¹¹⁹

The rationale is to speed up the appointment of a liquidator in emergency cases, for example where perishable goods are involved. The supervision of the court is not required in such procedure.¹²⁰

6.3.5 **Compulsory liquidation**¹²¹

Compulsory liquidation occurs when a company is wound up by an order of the High Court. The most common circumstance where a company is wound up by the court is when a petition is presented to the court by a creditor on the grounds that the company is unable to pay its debts. However, a company can present a petition to wind up itself, and the court also has jurisdiction to wind up on the petition of a shareholder and on the ground it is just and equitable to do so. The mechanism permits the court to appoint a liquidator who would then take control over the conduct of the company, collect assets and distribute any proceeds. The company has no influence over which liquidator is appointed.

On hearing a winding up petition the court may dismiss it, or adjourn the hearing conditionally or unconditionally, or make any interim order, or any other order that it thinks fit, but the court shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets, or that the company has no assets.¹²² It should also be noted that even if a petitioner is *prima facie* entitled to a winding up order, the court retains a discretion to not make the order, for example to allow a restructuring plan to be implemented if the court is of the view that this appears to be in the best interests of the general body of creditors.¹²³

¹¹⁶ *Re Pedagogic Innovations Ltd* [2014] 2 HKC 388; *Char On Man Peking Fur Factory (Hong Kong) Ltd* [2019] HKCFI 2141.

¹¹⁷ CWUMPO, s 228A(8).

¹¹⁸ *Idem*, s 228A(8A).

¹¹⁹ *Idem*, s 228A(8B). Also, s 262A states the restrictions on persons who may be appointed as provisional liquidator.

¹²⁰ *Re Team Bright Corpn Ltd* [2010] HKCU 2188 (unreported, HCCW 274/2010, 3 October 2010).

¹²¹ CWUMPO, s 177 *et seq.*

¹²² *Idem*, s 180.

¹²³ See, eg, *Re Yueshou Environmental Holdings Ltd* [2014] HKEC 1178; *Re China Solar Energy Holdings Ltd* [2020] HKCFI 481.

It should also be noted that there are certain restrictions on a petition being presented by a contributory or a contingent creditor.¹²⁴

Another issue to take into account when considering presenting a winding up petition is whether the debt upon which the petition is to be based arises under a contract which is subject to an arbitration clause. Until recently the position in Hong Kong had been reasonably well settled: a creditor could still petition and the petition proceedings would not be stayed in favour of arbitration unless the debtor could show that there was a *bona fide* dispute on substantial grounds (being the same test that would be applied for a debtor asserting that winding up proceedings are inappropriate where there was no arbitration clause). However, the Companies Judge then adopted¹²⁵ a more “pro-arbitration” line, following certain developments in the English courts, by which a petition would be stayed in favour of arbitration unless the debt was actually admitted by the debtor. In other words, the threshold of a debtor having to show a *bona fide* dispute on substantial grounds was much diluted. The approach adopted in this decision (usually referred to as the “Lasmos approach” (Lasmos being the name of the petitioner in the case) led to considerable debate and a number of other decisions, a number of which expressed doubt that it is the proper test to apply. In particular, there were comments from the Court of Appeal¹²⁶, albeit *obiter*, which expressed such doubts. There was then a further decision of the Court of First Instance which studied the different approaches in some detail and concluded that a debtor must show there is a *bona fide* dispute on substantial grounds.¹²⁷

A company can petition for its own winding up by passing a special resolution¹²⁸ unless there are special circumstances militating against the making of such an order, namely the majority acted fraudulently or in bad faith in adopting the resolution.¹²⁹ To commence a winding up of itself, the resolution authorising the presentation of the petition must be made by the shareholders. The directors alone cannot effectively pass such a resolution.¹³⁰

There are no express statutory provisions creating an obligation to commence liquidation. Further, there are at present no insolvent trading provisions and the fraudulent trading provisions are difficult to establish. However, directors need to be cautious that they do not breach their fiduciary duties by continuing to trade when the company is insolvent. Further, a director can face criminal liability if employees are not paid. Also in the context of liabilities to employees, as mentioned in the section on personal bankruptcy, an employee may present a petition in order to trigger benefits under the PWIF, noting that such benefits are not triggered by a voluntary liquidation.¹³¹

Alternatives to liquidation are discussed elsewhere, including the appointment of a receiver by a charge-holder (and possibly the court), negotiating a consensual restructuring, or promulgating a scheme of arrangement.

¹²⁴ CWUMPO, s 179(1)(a) to (e).

¹²⁵ *Re Southwest Pacific Bauxite (HK) Ltd* [2018] HKCFI 426.

¹²⁶ *But Ka Chon v Interactive Brokers LLC* [2019] HKCA 873.

¹²⁷ *Re Asia Master Logistics Ltd* [2020] HKCFI 311.

¹²⁸ CWUMPO, s 177(1)(a).

¹²⁹ *Re Comtowell Ltd* [1998] 4 HKC 81.

¹³⁰ *Re Emmadart Ltd* [1979] Ch 540; *Tang Kam-Yip and others v Yau Kung School and others* [1986] HKCU 254 (unreported, CACV71/1985); *Re China Taifeng Beddings Holdings Ltd* [2018] HKCFI 1755.

¹³¹ In some restructuring situations a petition is a useful tool (see the section on corporate rescue) but in others a petition is a hindrance. There can therefore be a conflict between the restructuring and an employee wanting to trigger the PWIF benefits. To deal with this, the court may allow a petition to stand but will stay the petitions until the company is dissolved or in a position to resume as a solvent going concern after a restructuring. This is a so-called *Rena Gabriel* order, named after the decision *Re Rena Gabriel HK Ltd* [1995] HKEC 1063.

In this regard, as noted elsewhere, Hong Kong lacks a formal corporate rescue regime (for example equivalent to the Chapter 11 process available in the US). The only mechanism available to a company seeking to restructure its debts is the scheme of arrangement procedure. Hong Kong law does not provide for a moratorium on creditors' actions while such a scheme of arrangement plan is being processed and in the past the courts have refused applications for such a stay.¹³² However, that decision was before certain amendments to the Rules of the High court, which now provide¹³³ that the court's case management powers include a specific power to stay proceedings and it would appear that the court accepts that a possible winding up is a situation where its discretion could be exercised in that regard.¹³⁴

Liquidation proceedings can result in a moratorium or stay in two situations, being i) a discretionary stay after presentation of the petition but before an order is made, and ii) a compulsory stay after the winding up order is made.

6.3.6 *Discretionary stay*

The court has power to stay or restrain proceedings against a company at any time after the presentation of a winding up petition and before a winding up order has been made.¹³⁵

In the context of a voluntary winding up, an application for a stay can also be made as there is provision which permits the court to exercise, in relation to a voluntary winding up, any powers that the court may exercise if the company were being wound up by the court.¹³⁶ It has been held by the court that this includes an application for a stay of proceedings against the company.¹³⁷

6.3.7 *Mandatory stay*

When a winding up order has been made, or a provisional liquidator has been appointed, no action or proceeding may be proceeded with or commenced against the company, except by leave of the court and subject to such terms as the court may impose.¹³⁸ The Hong Kong court has held that "proceeding" in this context includes arbitration¹³⁹.

Separately, and for completeness, it should be noted that there is a power to stay the liquidation itself.¹⁴⁰ This requires "proof to the satisfaction of the court that all proceedings in relation to the winding up ought to be stayed". The applicant must satisfy the court that it *ought* to grant a stay.¹⁴¹ An application can be made by the

¹³² *Credit Lyonnais v SK Global Hong Kong Ltd* [2003] HKCU 904 (unreported, CACV 167/2003).

¹³³ At RHC Order 1B, r 1(2)(e).

¹³⁴ See *Eastman Chemical Ltd v Heyro Chemical Co Ltd* [2012] HKEC 272. This development may make it more likely that if faced with the situation now, the Hong Kong court would permit a stay to aid a restructuring (say, through a scheme of arrangement), as the English court did in *BlueCrest Mercantile BV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146; but also see *Paloma Co Ltd v Capxon Electronic Industrial Co Ltd* [2020] HKCFI 754 (where a stay was refused because the foreign (Taiwanese) process was a solvent liquidation and not a collective process for the benefit of creditors).

¹³⁵ CWUMPO, s 181.

¹³⁶ *Idem*, s 255.

¹³⁷ *Cheung Ying Lun v Legal Way Ltd* [2013] HKCU 2651.

¹³⁸ CWUMPO, s 186.

¹³⁹ *Re UDL Contracting Ltd* [2000] 1 HKC 390.

¹⁴⁰ CWUMPO, s 209(1).

¹⁴¹ *Krextil Holdings Pty Ltd v Widdows* [1974] VR 689 at 694.

liquidator, the Official Receiver, or any creditor or contributory.¹⁴² The elements the court normally considers are:

- (a) Where there are sufficient assets to pay all the creditors and the expenses of the liquidation, the interests of the members, in addition to those of the creditors and the liquidator, would be considered;¹⁴³ and
- (b) Whether the stay is “conducive or detrimental to commercial morality and to the interests of the public at large”.¹⁴⁴

6.3.8 Appointment of provisional liquidators

“Provisional liquidation” is a commonly used term, but under Hong Kong law it technically does not exist. A company is either in liquidation or it is not. The term is, however, used where provisional liquidators have been appointed pursuant to section 193 of CWUMPO.¹⁴⁵

In overview:

- (a) A provisional liquidator is tasked with preserving assets in the period after the petition is presented but before any order is made,¹⁴⁶ but not actually to realise those assets (save where this might be necessary to preserve their value).¹⁴⁷ Ordinarily, the court appointing a provisional liquidator will permit the provisional liquidator to sell assets only upon a specific application to court being made.
- (b) Such a provisional liquidator can be appointed to help facilitate a restructuring proposal,¹⁴⁸ although that cannot be the sole reason for appointment.¹⁴⁹
- (c) An application to appoint a provisional liquidator may be made any time after a petition has been presented, although in urgent cases the application may be made at the same time as the petition. It has been held that it is wrong to apply for the appointment of a private provisional liquidator under section 193 immediately prior to winding up to avoid having the Official Receiver as provisional liquidator upon the winding up order being made.¹⁵⁰ Further, the court has jurisdiction to appoint provisional liquidators despite the appointment of voluntary liquidators.¹⁵¹
- (d) Where a liquidator is provisionally appointed by the court, the court may limit and restrict his powers by the order appointing him,¹⁵² or terminate the appointment

¹⁴² The company itself has no right to apply for a stay – *Bank Negara Indonesia 1946 v Interasian Traders Finance Ltd* [1980] HKLR 622 (CA).

¹⁴³ *Re Calgary and Edmonton Land Co Ltd* [1975] 1 All ER 1046, at 360C to G.

¹⁴⁴ *Krextile Holdings Pty Ltd v Widdows* [1974] VR 689 at 694 to 695; *Re Hua Hin (S) Co Ltd*, HCMP No 3965 of 1999, 6 December 1999, Yuen J.

¹⁴⁵ See also CWUR, r 28. Confusingly, on a winding up order being made there is also a “provisional liquidator” appointed. The same title is used, but that kind of provisional liquidator has a different role, his appointment being provisional in the sense of being appointed pending the holding of creditors’ meetings.

¹⁴⁶ *Re Weihong Petroleum Co Ltd* [2002] HKCU 1425; *Re Legend International Resorts Ltd* [2006] 3 HKC 565.

¹⁴⁷ *Re MF Global Hong Kong Ltd* [2015] 2 HKC 424, CA.

¹⁴⁸ *China Solar Energy Holdings Ltd (No.2)* [2018] HKCU 938; *Re Kevview Technology (BVI) Ltd* [2002] HKCU 616.

¹⁴⁹ *Re Legend International Resorts Ltd* [2006] 3 HKC 565 at 577.

¹⁵⁰ *Re Kong Wah Holdings Ltd & Anor* [2001] HKCU 423.

¹⁵¹ *Re Texan Industries Ltd (in liq)* [1990] 2 HKC 347.

¹⁵² CWUMPO, s 193(3).

on application by a provisional liquidator, the Official Receiver, a creditor, a contributory, the petitioner or the company.¹⁵³

- (e) There must be sufficient circumstances justifying the appointment, for example if there is a risk that assets will be dissipated, or otherwise be in jeopardy, before a winding up order is made.¹⁵⁴ Factors taken into account by the court include commercial realities, the degree of urgency, the need for the order and the balance of convenience.

6.3.9 Appointment of final liquidators

As to the appointment of liquidators proper (that is, not a provisional liquidator of the type referred to above), this will differ slightly depending on whether the winding up is a voluntary or compulsory liquidation. In a MVL, the appointment will usually be made by the company's resolution passed to commence the winding up. In a CVL, the appointment will be made by resolutions passed at the meetings of contributories and creditors (if the two meetings nominate different liquidators, then the choice of the creditors will prevail). In a compulsory liquidation, following the winding up order, the Official Receiver will be appointed the provisional liquidator of the company unless a provisional liquidator has already been appointed under section 193 of CWUMPO in which case that person will continue in office. Such continuation does not require an application to the court.¹⁵⁵

At this stage, the Official Receiver can outsource small liquidations if the property of the company is not likely to exceed in value HKD 200,000.¹⁵⁶ Additionally in respect of these small estates, the provisional liquidator may apply to the court for an order that the company be wound up in a summary manner, that is, there will be no first meetings of creditors and contributories and the provisional liquidator will be the liquidator without a committee of inspection.

For non-summary liquidations there will be meetings of creditors and contributories where resolutions will be passed to appoint a liquidator. These meetings must be summoned by the provisional liquidator and held within three months after the date of the winding up order.¹⁵⁷ Such meeting will also vote on whether a committee of inspection should be formed.

Notices of the meeting must be given to creditors and must state a time within which the creditors must lodge their proofs in order to entitle them to vote at the first meeting.¹⁵⁸ The notice must also be given to the directors and other officers of the company who in the provisional liquidator's opinion ought to attend.¹⁵⁹

As soon as possible after the first meeting of creditors and contributories have been held the Official Receiver, or the chairman of the meeting, as the case may be, must report the result of each meeting to the court. The court will then make an order appointing the liquidator. Ordinarily, if the meeting of creditors passes a resolution in favour of one liquidator and the meeting of contributories passes a resolution in favour of another, then the choice of the creditors will prevail (provided such nominee

¹⁵³ *Idem*, s 193(6).

¹⁵⁴ *Re Union Accident Insurance Co Ltd* [1972] 1 All ER 1105 at 1109.

¹⁵⁵ *Re Peregrine Investment Holdings Ltd (No 3)* [1999] 3 HKC 183.

¹⁵⁶ CWUMPO, s 194(1A).

¹⁵⁷ *Idem*, s194(1)(b); CWUR, rr 108-111.

¹⁵⁸ CWUR, r 109.

¹⁵⁹ *Idem*, r 110.

has the appropriate experience and resources; if not, the court may appoint the contributories' choice or appoint a liquidator of its own choosing).

There may be circumstances where the holding of meetings of contributories and / or creditors is not practicable. Given this, under section 227A of CWUMPO, the Official Receiver, provisional liquidator or liquidator or any creditor could make an application to seek a "regulating order". Specifically, under section 227B of CWUMPO, the Official Receiver or a provisional liquidator could make an application seeking a regulating order to dispense with the summoning the first meeting of creditors and contributories.

A regulating order is particularly useful in liquidations that involve a large number of creditors, as the costs of hosting a creditors' meeting could be significant and thus detrimental to the interest of the creditors.¹⁶⁰

A provisional Liquidator appointed under section 194 (that is, upon the making of the winding up order) can be regarded as being little different from the liquidator eventually appointed, although his position is temporary. The powers of such provisional liquidators are provided for in sections 199A and 199B of CWUMPO.

6.3.10 Role and powers of liquidator

In overview, the role and powers of a liquidator are to

- (a) wind up the company's business, realising the assets and distributing dividends to interested parties;
- (b) to take over control of the company including its assets and accounting records and investigate the causes of the company's failure and the conduct of those concerned in its dealings and affairs.¹⁶¹ This role serves a wider public interest in enabling the authorities to take appropriate action against those guilty of misconduct in relation to the company;¹⁶²
- (c) investigate transactions or payments made by the company within a certain period prior to the date of winding up to determine whether these transactions should be avoided.

The powers of the liquidator are set out in section 199 and Schedule 25 of CWUMPO. Certain of those powers require approval from a committee of inspection (if appointed) or the court. As to the roles of the Official Receiver, these are dealt with earlier and include an oversight role and monitoring of private-sector liquidators.¹⁶³

In the context of investigations, a liquidator (or provisional liquidator) can apply to the court for an order that any person whom the court thinks capable of giving

¹⁶⁰ As an example, see *Re Guangnan (HK) Supermarket Ltd* [2002] 1 HKLRD 348, where the company had about 520 employee creditors and 950 trade creditors. The provisional liquidator estimated that the costs of holding a creditors' meeting at a commercial venue could be up to HKD 300,000. In the circumstances, with the purpose of saving available assets of the company, the court granted a regulating order that dispensed with the need of hosting a creditors' meeting and appointed the provisional liquidators as liquidators. Note: at the time of this decision s 227B referred to such applications being permissible by the Official Receiver only; the section was later amended to expand the permissible applicants to include a provisional liquidator.

¹⁶¹ *Re Pantmaenog Timber Co Ltd* [2004] 1 AC 158; *Re China Solar Energy Holdings Ltd (No 2)* [2018] 2 HKLRD 338; *Joint & Several Liquidators of China Medical Technologies Inc v KPMG* [2016] JKEC 2942; *Re STX Pan Ocean (Hong Kong) Co Ltd* [2014] HKEC 1601.

¹⁶² *Joint & Several Liquidators of Kong Wah Holdings Ltd v Grande Holdings Ltd* [2006] 9 HKCFAR 766.

¹⁶³ CWUMPO, s 204.

information regarding the affairs or property of the company should attend court and be examined on oath.¹⁶⁴ Pursuant to the same provision, the court can order the delivery up of documents relating to the affairs or property of the company. This power is frequently used by liquidators to piece together important information that can assist in claims being made, recoveries from which swell the assets available for distribution to creditors.

6.3.11 Proof of claims by creditors

In a compulsory liquidation each creditor must submit a formal written proof of debt, unless the court gives directions that the claims of any creditors or class of creditors shall be admitted without proof.¹⁶⁵ There is a prescribed form which must be used.¹⁶⁶

In a CVL there is no strict legal requirement for a formal written proof, but in practice the liquidator will nevertheless usually invite creditors to submit their claims in writing.

As to the claims that are provable, it is provided that “all debts and liabilities, present or future, certain or contingent...shall be deemed to be debts provable”.¹⁶⁷ There are, however, certain exceptions - such as statute-barred debts, debts which could not be sued upon (for example, foreign tax) and debts incurred after the winding up petition was presented, if the creditor had notice of the petition.

The liquidator must adjudicate the proofs of debt received and has the power to reject a proof of debt if he does not regard it as proved to his satisfaction. The liquidator’s decision to reject a proof of debt may be appealed to the court by the relevant creditor within 21 days.¹⁶⁸

It should be kept in mind that a creditor cannot submit a “double-proof”, namely there cannot be two or more proofs for the same debt or liability¹⁶⁹ such that “there is only to be one dividend in respect of what is in substance the same debt”.¹⁷⁰ Note, however, that the rule against double-proof is not offended where a secured creditor proves for the balance (or shortfall) after deducting the amount realised from his security.

6.3.12 Contracts

As to the effects of liquidation on contracts entered into by the company, one role of a liquidator will be to consider such contracts to see, for example, whether they may form part of the company’s assets if the contract can be assigned for value. There are no statutory rules in Hong Kong for the treatment of specific types of contract. However, upon the making of a winding up order employment contracts are automatically terminated.¹⁷¹

Further, there is no general rule for the treatment on insolvency of executory contracts at common law, nor is the position regulated by statute.

¹⁶⁴ *Idem*, s 286B.

¹⁶⁵ CWUR, r 79.

¹⁶⁶ *Idem*, r 80.

¹⁶⁷ CWUMPO, s 263.

¹⁶⁸ CWUR, rr 95 and 102.

¹⁶⁹ *Re Oriental Commercial Bank, ex parte European Bank (1871-72) LR 7 Ch App 99; Re Peregrine Investments Holdings Ltd (No 6) [2008] 2 HKC 606.*

¹⁷⁰ *Re Polly Peck International Plc [1996] 1 BCLC 428.*

¹⁷¹ Certain types of payments owing to employees are preferential and are paid in priority to other creditor claims: CWUMPO, s 265.

A contractual clause that provides for the determination or modification of a contract upon the insolvency of the counterparty will typically be upheld (that is, *ipso facto* clauses), although there are limits to this. For example, a court will not uphold a contract term which results in general creditors being deprived of an asset that would, in the absence of the clause, be used to satisfy their debts; this is called the anti-deprivation principle and has already been discussed above.

This is not to say that every clause which sees an asset falling beyond the reach of general creditors will be struck down. Although the language and effect of a clause will be considered on a case-by-case basis, the courts have developed a set of factors that will assist in determining if the anti-deprivation principle has been violated. Such factors include: (i) is the intention to evade insolvency laws?; (ii) does the clause operate in situations other than upon insolvency?; (iii) is the asset concerned “flawed”? (that is, the interest is subject to the condition that the counterparty remains solvent as opposed to an outright interest which is forfeited upon insolvency).¹⁷²

Additionally, liquidators have a statutory power to disclaim onerous property with leave of the court within 12 months of the commencement of the winding up.¹⁷³ Typically, onerous property concerns leasehold interests, but may also include shares or unprofitable contracts or any other property that is unsaleable or not readily saleable.

The Hong Kong legislation provides for mandatory set-off but does not have a different set of rules or regulations for netting and set-off depending on the type of contract (for example, whether it is a financial contract or otherwise).

The statutory rules for netting and set-off are set out in the Bankruptcy Ordinance, specifically section 35 and are “imported” to apply to corporate insolvency.¹⁷⁴

Statutory set-off occurs automatically upon the insolvency event; it cannot be excluded by agreement between the parties, operates independently of any steps having been taken by the parties and a party cannot take the benefit of the set-off if at the time of giving credit it knew a petition had been presented for the winding up of the company.

The transactions being set-off must constitute credits or debts between the creditor and the insolvent company, those credits or debts must be mutual and the creditor’s claim must be provable in the winding up.

6.3.13 Avoidance of dispositions of property after the commencement of the winding up¹⁷⁵

The purpose of this provision is to preserve the company’s assets for the general body of creditors¹⁷⁶ in the period between the presentation of a winding up petition and the making of a winding up order.

Any disposition of the property of the company, including things in action, and any transfer of shares, or alteration in the status of the members of the company, made

¹⁷² See *Belmont Park Investments PTY Limited v BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc* [2011] UKSC 38.

¹⁷³ CWUMPO, s 268.

¹⁷⁴ *Idem*, s 264.

¹⁷⁵ *Idem*, s 182.

¹⁷⁶ *Super Speed Limited (in liq) v Bank of Baroda* [2015] 2 HKLRD 965.

after the commencement of a compulsory winding up are void, unless the court orders otherwise. The court may make a “validation order” to allow the disposition of assets if such disposition would benefit creditors. Note, that to be caught by the provision, the asset(s) concerned must be beneficially owned by the company. Any assets held on trust by the company do not fall within the ambit of this section.¹⁷⁷

On a practical note, once a winding up petition has been presented the company’s bank account(s) maintained with a Hong Kong bank will be frozen as soon as the bank is aware of the petition. This step is taken by banks to avoid the risk they would otherwise have that they would have to “reimburse” the estate for allowing the disposition.¹⁷⁸

For a solvent company with an on-going business (for example, where the petition is a shareholder’s just and equitable petition), an application for a validation order should not be adversarial.¹⁷⁹ Whereas for an application made by an insolvent company, the court should only make the validation order if it is satisfied that to do so is likely to be of benefit to the general body of creditors.¹⁸⁰ An example is validating the payment of fees to an insolvency professional for the purpose of restructuring the company.¹⁸¹

An application for a validation order can operate retrospectively. The provision preventing the “alteration in the status of the members” is aimed at preventing a holder of part-paid shares transferring those shares to an impecunious transferee, who would not then be in a position to pay the required contribution when called upon to do so. Whether it applies to the issue of new shares, for example, is unsettled.

Further, in a voluntary liquidation, section 232 of CWUMPO provides that any transfer of shares in the company, not being one made to or with the sanction of the liquidator, made after the commencement of a voluntary winding up, will be void.

6.3.14 Avoidance of attachments, sequestration, distress or execution¹⁸²

Any attachment, sequestration, distress, or execution of a judgment put in force against the estate or effects of the company after the commencement of the winding up, is void. Any proceeds arising from the sale of property taken by a judgment creditor after the commencement of winding up should form part of the estate of the company available for payment to creditors generally.

The meaning of “put in force” has been described as where execution proceedings have reached the stage when a creditor becomes a secured creditor. For example, execution is considered to have been “put in force” by entry into possession of a property by a bailiff. The court will in any event usually stay actions to enforce a judgment once the company goes into liquidation,¹⁸³ or where there is a restructuring in progress (for example by way of a scheme of arrangement) the court will usually exercise its discretion to refuse enforcement.¹⁸⁴

¹⁷⁷ *Samuel Tak Lee v Lee Tak Yan* [1999] HKLRD 493.

¹⁷⁸ *Osman Mohammed Arab Wong Tak Man Stephen, Joint and Several Liquidators of AGI Logistics (Hong Kong) Ltd (in compulsory liquidation) v Commissioner of Inland Revenue* [2016] HKCA 524.

¹⁷⁹ *Re Emagist Entertainment Limited* [2012] 5 HKLRD 703; *Re Sure Lead Ltd* [2020] HKCFI 932.

¹⁸⁰ *Re First Dragon Fashion (Hong Kong) Ltd* [2012] 4 HKLRD 703.

¹⁸¹ *China City Construction (International) Company Limited v Value Partners Hong Kong Limited* [2018] HKCFI 2316.

¹⁸² CWUMPO, s 183.

¹⁸³ For example, see *Snee Enterprise v HK Shaoji Trade Co. Ltd* [2016] HKEC 2199.

¹⁸⁴ For examples, see *Paloma Co Ltd v Capxon Electronic Industrial Co Ltd* [2020] HKCFI 754 and *United Asia Finance Ltd v Yiu Tsz Ngai* [2015] 2 HKLRD 189).

The provision only applies to compulsory (not voluntary) liquidations. However, a voluntary liquidator can, as discussed earlier, apply for a stay of execution. In addition, by section 269 of CWUMPO a creditor is not permitted to retain the benefit of any execution against the assets of a company if the company is later wound up and the execution had not been completed at the time of the commencement of the liquidation.¹⁸⁵

6.3.15 *Impeachable transactions*

6.3.15.1 *Unfair preferences voidable in certain circumstances*¹⁸⁶

Similar to the provisions discussed in the section on personal insolvency, an “unfair preference” occurs when an insolvent company acts to place a creditor (or guarantor) in a better position than it would have been upon the company’s insolvency.

The liquidators of a company may make an application to set aside such transactions. This power is exercisable by liquidators appointed in either voluntary winding up or compulsory winding up proceedings. Relevant transactions include granting of security as well as payments etc., where such transactions were entered into during the period of six months prior to the commencement of winding up, or two years where the beneficiary under the transaction was “a person connected to the company”.

It is a requirement for such an application for the liquidator to show that, at the time the asserted unfair preference was given, the company was unable to pay its debts or became unable to pay its debts as a result of the transaction concerned. This criterion is presumed against a recipient who is “a person connected with the company”, although such presumption can be challenged by the recipient. A person is a connected person of the company if he or she is an “associate” of the company or if he or she is an “associate” of a director or shadow director of the company. For a company, “associate” includes, for example, another company which is controlled by the same person as the company being wound up (or that person’s associates).

As with bankruptcy, the liquidator must also prove that the company was “influenced by a desire” to improve that person’s position in the event of a liquidation.

In practice, it is difficult for the liquidator to demonstrate that the company was influenced by a desire to improve the position of that particular creditor. A transaction will not be set aside as an unfair preference “unless the company positively wished to improve the creditor’s position in the event of its own insolvent liquidation”.¹⁸⁷

The difficulties in demonstrating the desire to prefer are illustrated in the *Stanley Hau* case discussed in the personal insolvency section (the principles being the same for corporate liquidations). Nevertheless, there are examples where the court has been prepared to find that the desire to prefer existed; for example where a company gave to its bank a mortgage over an asset and the court considered that there were no good grounds to grant the mortgage and that the company desired to prefer the bank because personal bankruptcy proceedings were being threatened against the company’s directors.¹⁸⁸

¹⁸⁵ Or the date the creditor became aware that a meeting had been called for the passing of a resolution to wind up the company (CWUMPO, s 269(1)(a)).

¹⁸⁶ CWUMPO, ss 266, 266A and 266B.

¹⁸⁷ *Re MC Bacon* [1990] BCLC 324.

¹⁸⁸ *Re Sweetmart Garment Works Limited (in liq)* [2008] 2 HKC 252.

If a transaction is proved to be an “unfair preference” pursuant to section 266 of CWUMPO, the orders which may be made by the court include:

- (a) vesting in the liquidator the property which is the subject of the unfair preference;
- (b) releasing or discharging security given by the company;
- (c) directing any person to pay to the liquidators any benefits received from the company;
- (d) reviving the obligation of any surety or guarantor which had been released or discharged; and
- (e) providing security for the discharge of any obligation imposed by or arising under the order.

6.3.15.2 *Transactions at an undervalue*¹⁸⁹

In the context of company liquidations, this is a new category of vulnerable transaction under Hong Kong law which came into force on 13 February 2017. There are only a few decided cases in Hong Kong on this provision but the same principles as applied to personal bankruptcy will be applied in the liquidation context.¹⁹⁰

A transaction may be set aside when a company enters into such transaction at an undervalue and the company is later wound up. In this context, “undervalue” means a gift or a transaction for no consideration, or a transaction where the value is, in money or money’s worth, significantly less than the consideration provided by the company (or *vice versa*, that is, the company is underpaid for a good or service).

If a transaction is at an undervalue, the court has a wide discretion to make any order it thinks fit in order to restore the company to the position it would have been in if the transaction had not occurred.

It is a defence if the company entered into the transaction in good faith and for the purposes of carrying out its business and at the time there were reasonable grounds for believing that the transaction would benefit the company.

The “relevant time” is that the transaction took place any time within five years before the commencement of the winding up, but only if at the time of the transaction the company was unable to pay its debts or became unable to pay its debts as a result of the transaction.

6.3.15.3 *Floating charge void in certain circumstances*¹⁹¹

A floating charge given by a company is void (except as to “new money” provided) if it is created within two years of the commencement of the winding up (in favour of a person connected to the company) or one year (for any other person).

Please refer to the section on Security for further details.

¹⁸⁹ CWUMPO, ss 266D, 266E and 266B.

¹⁹⁰ *Re Sure Lead* [2019] HKCFI 2914.

¹⁹¹ CWUMPO, ss 267 and 267A.

6.3.16 Fraudulent trading¹⁹²

Any person who knowingly participated in any business of the company carried out with the intent to defraud creditors (or any other person) or for any fraudulent purpose is liable if so determined by a court.

The court may declare that any persons who were knowingly parties to the carrying on of the fraudulent acts are to be personally liable for all or any of the company's debts. The section provides for both civil and criminal liability.¹⁹³

In determining liability, the court makes a subjective assessment as to whether the accused had been dishonest. For a director, he must have known that there was no reasonable prospect of repaying debts as and when they were incurred. However, such actions are very rare. A more common approach would be for a liquidator to pursue a wrongdoing director for breach of fiduciary duty.

6.3.17 Extortionate credit transactions¹⁹⁴

Again this is similar to the position in relation to personal insolvency. Where there has been a transaction involving the provision of credit to the company and, having regard to the risk undertaken by the lender, the terms of the agreement either require "grossly exorbitant" payments to be made or otherwise "grossly contravene" ordinary principles of fair dealing, then a liquidator can apply to either: (i) set aside all or part of the transaction; (ii) vary its terms; (iii) require the person(s) party to the transaction to repay sums to the company; or (iv) surrender property or for accounts to be taken.

There is no requirement that the company was insolvent at the time of entering into the transaction. The relevant time is three years before the date of the winding up order¹⁹⁵ (or date of special resolution to wind up the company).

6.3.18 Disqualification of directors

As stated earlier, one role played by a liquidator is to investigate and consider the conduct of the directors. The liquidator will make a report to the Official Receiver in this regard. If such report indicates that the relevant director is someone who should not be a director, then a disqualification order can be made.¹⁹⁶ The period of a disqualification order ranges from one to 15 years. Note that *de facto* and shadow directors can be the subject of a disqualification order.

Any person who contravenes a disqualification order is guilty of an offence and liable for imprisonment and a fine and such person can also become jointly and severally liable for the company's debts.¹⁹⁷

Some of the grounds for making a disqualification order are:

- (a) conviction of indictable offence,¹⁹⁸

¹⁹² *Idem*, s 275.

¹⁹³ Any person found liable for fraudulent trading can be fined (no stated maximum fine) or imprisoned for up to five years – CWUMPO, ss 168L and 275.

¹⁹⁴ CWUMPO, s 264B.

¹⁹⁵ Note that for most antecedent transactions provisions, the start of the "relation back" period will be the date of presentation of the petition.

¹⁹⁶ CWUMPO, s 168D.

¹⁹⁷ *Idem*, s 168O.

¹⁹⁸ *Idem*, s 168E

- (b) persistent breaches of CWUMPO;¹⁹⁹
- (c) fraud in winding up of a company;²⁰⁰
- (d) unfit director of an insolvent company;²⁰¹
- (e) fraudulent trading;²⁰²
- (f) offences by officers of companies in liquidation;²⁰³
- (g) receiving a penalty for falsification of books;²⁰⁴
- (h) fraud by officers of companies that have gone into liquidation;²⁰⁵
- (i) being found liable for not keeping proper records.²⁰⁶

In addition, a court can prosecute and assess damages to the company occasioned by an officer guilty of misfeasance.²⁰⁷

A further provision in Hong Kong law of which directors need to be aware is in the Employment Ordinance (Cap 57). The provision is not limited to insolvent situations, but most commonly arises in that circumstance. The Employment Ordinance provides that a director may be held criminally liable for the non-payment of wages and other statutory employee entitlements. For example, should a company fail to pay wages to its employees within seven days of the due date, the director(s) responsible are liable for a fine of up to HKD 350,000 and three years' imprisonment.

In addition to these statutory provisions, a director owes fiduciary duties to the company and it is often on the basis of a director breaching these duties that a liquidator can bring claims against directors of insolvent companies.

6.3.19 Priority claims

The statutory order of priority is as follows:

- (a) expenses of the winding up including the liquidator's remuneration;²⁰⁸
- (b) preferential debts;²⁰⁹
- (c) preferential charge on distrained goods;²¹⁰
- (d) payment to general creditors on a *pari passu* basis;

¹⁹⁹ *Idem*, s 168F.

²⁰⁰ *Idem*, s 168G.

²⁰¹ *Idem*, s 168H.

²⁰² *Idem*, s 168L.

²⁰³ *Idem*, s 271.

²⁰⁴ *Idem*, s 272.

²⁰⁵ *Idem*, s 273.

²⁰⁶ *Idem*, s 274.

²⁰⁷ *Idem*, ss 276 and 277.

²⁰⁸ *Idem*, s 256 CWUMPO or, if compulsory, CWUR r 179.

²⁰⁹ As defined in CWUMPO, s 265.

²¹⁰ *Idem*, s 265(5A).

- (e) interest on debts which rank equally;²¹¹
- (f) any debts or sums payable to members;²¹²
- (g) any residual amount to members generally in accordance with their rights and interests.²¹³

Post-liquidation interest is payable only after all unsecured creditors have been paid in full. The priority of any subordinated debt liability will turn on the terms of the agreement. For example, in the *Lehman Brothers* liquidation²¹⁴ a contract provided that the subordinated loans ranked behind liabilities payable “in the insolvency”. A dispute arose as to whether the phrase included the payment of statutory interest and / or non-provable liabilities. The court decided that the phrase meant that the subordinated loans would fall at the very end of the payment waterfall in the event of insolvency. The court further held that although there is no statutory requirement to pay non-provable liabilities when there is a surplus in the liquidation, there was a common law practice that such liabilities would be satisfied.

6.3.20 Company groups

It is of course often the case that a business organised by way of a number of companies in a group structure. However, there is no statutory recognition of corporate groups under Hong Kong law.

That said, in limited circumstances the courts will allow intra-group debt to be “pooled”, particularly if there is some administrative advantage to do so and there is a common liquidator acting for the companies concerned.²¹⁵ Nevertheless, as Hong Kong law gives significant weight to the doctrine of separate corporate personality,²¹⁶ a liquidator needs to exercise caution when accepting appointment over various companies in the same group because of the inherent risk of conflict of interest.

6.3.21 Dissolution

Once a liquidation has been concluded, the company will be dissolved. The relevant procedures are contained in CWUMPO, sections 226A, 227, 239, and 248 and the liquidator is released from office and discharged from any liability in respect of his conduct during the liquidation (but this can be reopened if fraud is later proven).²¹⁷

²¹¹ *Idem*, s 264.

²¹² *Idem*, s 170(1)(g).

²¹³ *Idem*, s 250.

²¹⁴ *The Joint Administrators of LB Holdings Intermediate 2 Limited v The Joint Administrators of Lehman Brothers International (Europe)* [2017] UKSC 38.

²¹⁵ *Re Moulin Global Eyecare Holdings Limited* [2007] HKCU 373.

²¹⁶ It is only in very limited circumstances involving fraud that the corporate veil will be pierced.

²¹⁷ CWUMPO, s 205.

Self-Assessment Exercise 4**Question 1**

Identify the two main types of voluntary liquidation of a company in Hong Kong and describe the key features of the procedures to commence each type. The answer should include commentary on whether any particular circumstances give rise to differences in the procedure.

Question 2

Lucky Gold Limited is a Hong Kong company carrying on business as an importer and exporter of various consumer goods. Nepo Tech Limited supplies IT services to Lucky Gold. Since about 9 months ago when new directors took charge at Lucky Gold, Nepo Tech's invoices have not been paid and the new directors have been quite hostile in their dealings with Nepo Tech, refusing to even discuss the outstanding invoices. Nepo Tech has heard from other suppliers and customers that the new directors have "destroyed" the Lucky Gold business, and there are several legal actions which have been commenced. Nepo Tech have also heard that the new directors are taking steps to "protect" assets from creditors (such as invoicing customers through another entity and ensuring stock does not come through Hong Kong). In these circumstances, Nepo Tech believes there is not much point in just suing Lucky Gold as "it will be at the back of the queue". Instead, Nepo Tech instructs you to advise on what steps should be taken to wind up Lucky Gold, telling you that, on the advice of a friendly business contact, it has already sent what it called a "Companies Act demand" about 3 weeks ago and still no payment has been made. What are the main points of initial advice you should give to Nepo Tech?

Question 3

The liquidator notices that a few months before the liquidation a charge was granted in favour of Dojee Bank over a valuable motor yacht owned by Lucky Gold. The charge is said to be security for a loan made available to Lucky Gold about a year earlier, which facility had been personally guaranteed by Lucky Gold's directors. The liquidator asks you to give guidance on what steps he can take.

Question 4

Fernando Trading Limited is a creditor of Lucky Gold for approximately HKD 2 million and files a proof of debt accordingly. However, the liquidator is reluctant to admit the proof because Roque Limited (which wholly owns Fernando Trading) owes Lucky Gold HKD 5 million and will not respond to any correspondence from the liquidator. He therefore asks if he can set off the debt owed to Fernando against the debt owed by Roque.

**For commentary and feedback on self-assessment exercise 4, please see
APPENDIX A**

6.4 Receivership

Reference to a “receiver” can cause confusion given that the same term is used for different roles. For example, during a litigation matter, the court can appoint a receiver to safeguard certain assets pending the result of the litigation. The court can also appoint a receiver “by way of equitable execution” where other methods of enforcing a judgment are impracticable. Although similar in that in each case the role consists broadly of receiving possession or control of certain assets, there are significant differences in terms of to whom the receiver owes duties, and what powers the receiver has. For this section, we will deal mainly with receivers who are appointed pursuant to a charge, and only briefly with court-appointed receivers.

6.4.1 Appointment out of court

The appointment of a receiver out of court is a remedy available to a secured creditor. The power to appoint a receiver or manager will be contained in a debenture or charge. In the case of a mortgage of land, the power to appoint a receiver is implied under section 50 of the Conveyancing and Property Ordinance (Cap 219) (CPO).

A power of appointment is exercisable only in respect to events specified in the debenture or charge, such as the failure to make payment of principal and / or interest. In the case of a statutory implied power to appoint a receiver under the CPO, the events are specified as “where the mortgage money has become due”.²¹⁸

If a debt is payable on demand, a demand must first be made and the debtor company given enough time to implement payment before a receiver can be appointed. However, in Hong Kong this will generally be interpreted as being only time to “effect the mechanics of payment”, not time to raise the money required to do so.²¹⁹

A company cannot act as a receiver.²²⁰ There is otherwise no specific qualification required, although in practice in Hong Kong, a receiver will be an insolvency practitioner.

The appointment of a receiver must be made in accordance with the terms of the debenture or charge containing the power of appointment. The appointment will generally be made in writing and normally by way of deed. The appointment takes effect when the document of appointment is received and accepted in writing by the receiver.

The powers of a receiver are limited to those given in the debenture or charge under which he is appointed (although again for mortgages of land, the CPO (Fourth Schedule) provides powers which are implied even if not expressed in the instrument). In practice the powers given to a receiver are wide and will include the power to sell the secured asset. In the case of a charge over the whole undertaking of a business the appointment will be of a “receiver and manager”, enabling the appointee to manage the company’s affairs for the benefit of the charge holder. The receiver and manager is appointed with powers of sale and of management pending sale and with full discretion as to the exercise and mode of exercising those powers.

²¹⁸ CPO, s 50(1).

²¹⁹ *Bank of Baroda v Panessar* [1987] Ch335.

²²⁰ CWUMPO, s 297.

The primary duty of the receiver and manager is to the debenture or charge holder, not to the company, even though the receiver is an agent of the company.

The receiver is entitled to be paid out of the assets over which he is appointed and to exercise a lien over those assets pending payment.

When selling the secured property, a receiver owes the same duty on sale as a selling mortgagee, to act in good faith and in accordance with the powers given to him under the debenture or charge. Receivers are free to put the interests of debenture or charge holders first in making any decision as to the course which the receivership will take. This is the case even though this may be disadvantageous to the borrowing company, subject to the overriding requirement that in implementing their decisions in relation both to management and disposal of charged assets, receivers should use reasonable skill and care and be answerable to the company if they do not.

The Transfer of Businesses (Protection of Creditors) Ordinance (Cap. 49), which makes a transferee of a business liable for the debts of the transferor unless notice of the transfer has been given by publication in accordance with the provisions of that Ordinance, does not apply to a transferee where the transfer is effected by a person selling as a receiver appointed under a charge, provided the charge has been registered for not less than a year when the transfer takes effect.

The liquidation of the borrowing company does not affect the receiver's right to hold and / or sell the property or assets secured by the charge under which he is appointed. The realisations made by the receiver out of the assets charged are not available to the liquidator for payment of the liquidation expenses²²¹. As discussed elsewhere, however, such assets must be used to meet claims of preferential creditors, if there are insufficient assets to meet those claims from the uncharged assets available to the liquidator.

The debenture or charge will usually provide that the receiver is to be the attorney of the borrowing company for the purpose of sale. The absence of this specific power will not prevent the receiver assigning in the name of the borrowing company.

The appointment of a receiver will have the effect of crystallising a floating charge. On the appointment of a receiver out of court, the powers of the company's directors are suspended as regards the assets secured under the charge. A receiver appointed out of court is personally liable on the contracts made by him as receiver subject to his right to be indemnified out of the property the subject of the debenture or charge. A receiver may exclude his personal liability.

Within seven days of a receiver or manager being appointed over the property of a company, a statement must be delivered to the Registrar of Companies in relation to the appointment and providing the identity of the receiver or manager.²²²

6.4.2 Appointment of receiver by the court

As stated above, receivers may also be appointed by the court. Such appointment would be in the context of litigation and can be made when it is "just and convenient

²²¹ See *Buchler v Talbot* [2004] 2 AC 298 (the "Leyland Daf" case), as applied in Hong Kong in *Re Good Success Catering Group Ltd* [2007] 1 HKLRD 453; CWUMPO, s 265(3B).

²²² Companies Ordinance, s 348(1).

do so”.²²³ Such an appointment will be made if, for example, the subject matter of the litigation should be preserved pending the outcome of the dispute. The power can be used as a free-standing tool to support proceedings outside of Hong Kong.²²⁴

6.5 Corporate rescue

Save to the extent that schemes of arrangement can be considered as a corporate rescue tool, there is no legislation in Hong Kong specifically dealing with corporate rescue.²²⁵ There are moves afoot to address this lack of legislation (see the section below on “Insolvency Law Reform”) although to date, the flexibility shown by the courts in applying common law principles have enabled a number of corporate rescues in Hong Kong over the years.

However, to reference examples from other jurisdictions, at present there is no equivalent to the Chapter 11 procedure that exists in the US, nor an equivalent to the administration procedure which exists in the UK, nor the voluntary administration procedure in Australia.

Notwithstanding the lack of corporate rescue legislation, informal work-outs are not uncommon in Hong Kong.

There is no set, formal, structure for a consensual work-out in Hong Kong. Many years ago, and in particular in relation to the difficulties caused as a result of the Asian Financial Crisis in 1997 / 1998, it would be common for the principal creditors to consist of a group of banks. For the most part, banks recognised a need to work together to achieve the best outcome, with steering committees being established to formulate a restructuring plan, often consisting in effect of debt re-scheduling and, sometimes, debt-to-equity swap arrangements. The practice broadly followed the so-called “London Approach”.

The position has become more complex with the growth in alternative finance providers (such as private equity and hedge funds), and also with the growth in alternative methods of raising capital, with the issue of debt securities having become more common. The landscape has also changed with the growth of trading in distressed debt (particularly by funds with substantial amounts of capital to invest).

The “Hong Kong Approach to Corporate Difficulties” is a guideline published by the Hong Kong Monetary Authority (HKMA).²²⁶ The guideline was originally issued by the Hong Kong Association of Banks (HKAB) and then re-issued as joint guidelines by HKAB and HKMA. The guidelines were issued in November 1999 and it is perhaps notable that no reference to the guidelines can now be found on the HKAB website. However, it is nevertheless worth briefly reviewing the guidelines as they do give an indication of the approach that has been taken in Hong Kong in the past.²²⁷ Furthermore, the guidelines (reflecting the then practice) will also likely have had some influence on decisions made by the Hong Kong court at that time²²⁸ and is useful background when considering the proposed reforms relating to corporate

²²³ High court Ordinance (Cap 4), s 21L.

²²⁴ *Idem*, s 21M.

²²⁵ For completeness, it is perhaps worth noting that this includes no temporary legislation to deal with situations caused by the COVID-19 pandemic.

²²⁶ <https://www.hkma.gov.hk/eng/publications-and-research/reference-materials/banking/hong-kong-approach-to-corporate-difficulties.shtml>.

²²⁷ The guidelines themselves stating that they “represent accepted practice in the banking community” – but keep in mind that the publication is now 20 years old.

²²⁸ With one directly citing the guidelines (*Credit Lyonnais v SK Global* [2003] HKEC 937).

rescue in Hong Kong because those proposals originated around the same time. It can also be noted that the HKMA made specific reference to the guidelines when making a statement as to how its members should deal with difficulties faced by companies (and in particular SMEs) as a result of the COVID-19 pandemic.²²⁹

The guidelines were described as “formal but non-statutory”, with compliance being “strongly recommended” and “expected” from HKAB members. The guidelines promoted the principle that bank creditors should give support to borrowers in difficulty, and not hastily withdraw facilities, issue writs or appoint receivers, but instead provide additional capital and / or re-schedule existing debts. In practice, there were often difficulties. For one thing, the guidelines did not apply to non-bank creditors, and according to the guidelines “other creditors will have to co-operate by not demanding repayment”. The other creditors did not always see things the same way as the bank creditors (particularly if, for example, the banks (or one or some of them) held a debenture giving a fixed and floating charge over the entire undertaking of the debtor). That issue was amplified with the growth in “other creditors” consisting of financial creditors such as bondholders. Notwithstanding the guidelines do not bind other creditors, the court does retain a discretion to not make a winding up order even when the creditor is *prima facie* entitled to one and will refuse to do so if a genuine restructuring is being promoted and it is reasonably clear that if successful such a restructuring would be to the benefit of the creditors as a whole and the petitioning creditor is simply trying to promote its own position, perhaps by trying to force its debt to be paid ahead of others.²³⁰

An independent financial advisor would usually be appointed (and such appointment is encouraged by the guidelines), but this too in practice led to certain criticisms and difficulties. The reason is that it is the banks who chose the adviser but the appointment was by the borrower and at the borrower’s cost. There were therefore complaints by borrowers of lack of independence and also complaints that they were paying substantial fees to the “banks’ people”.

There is no legislation or other provision permitting bank creditors to obtain priority by providing working capital during a restructuring. The need for such is recognised in the guidelines but they add that for a bank to obtain priority security for new money, the consent of all holders of existing security is needed.

As the guidelines themselves recognise, a work-out of this type requires the agreement of all parties. The guidelines suggest that if a “clear majority” of the bank creditors support a particular plan, the remaining creditors should “explain their objections clearly”, but there is no sanction to be had against the minority who do not support, only a “warning” that, in effect, the shoe may be on the other foot the next time around.

Notwithstanding the lack of corporate rescue legislation *per se*, the flexibility of the common law, combined with the creativity of Hong Kong practitioners and the support of the Hong Kong courts to assist in arriving at practical solutions, resulted in use of the tools that do exist to achieve similar aims. In particular, the scheme of arrangement mechanism has been used for a number of years to effect restructurings. A weakness for using a scheme of arrangement on its own is the lack of any moratorium.²³¹ In part to address this, a practice developed in Hong Kong

²²⁹ <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200206e1.pdf>.

²³⁰ *Re China Solar Energy Holdings Ltd* [2020] HKCFI 481.

²³¹ It remains to be seen whether the type of principle mooted in *Eastman Chemical Ltd v Heyro Chemical Co Ltd* [2012] HKEC 272, permitting a stay under the court’s case management powers, will be further developed in

whereby a petition for the winding up of the company would be presented and an application made for the appointment of provisional liquidators, with specific powers to investigate the possibility of and, if viable, promulgate a restructuring of the company's debts. The moratorium is then obtained by reason of section 182 of CWUMPO. The first reported instance of this method being used is the decision of Yuen J (as she then was) in *Re Keview Technology (BVI) Limited*.²³² That this was a legitimate use of the power to appoint provisional liquidators was affirmed by the Court of Appeal the following year.²³³ By way of further explanation, a scheme of arrangement promulgated in such circumstances would usually provide for the petition to be dismissed on the scheme's successful implementation.

The mechanism of presenting a winding up petition followed by an appointment of provisional liquidators to promulgate a restructuring, often using a scheme of arrangement, became common for a few years until the decision of the Court of Appeal in *Re Legend International Resorts Limited*.²³⁴ In that decision, the Court of Appeal refused to appoint provisional liquidators for the purpose of carrying out a restructuring, on the basis that it was not within the jurisdiction of the court to do so, the relevant legislation²³⁵ permitting the appointment of provisional liquidators "for the purpose of winding up" the company. The court held that an appointment of provisional liquidators solely for the purpose of a restructuring was the very opposite of the "purpose of winding up" the company.

Notwithstanding the court's decision in *Legend* and the wide reporting of the death of provisional liquidator-led restructurings in Hong Kong, there were still a number of restructurings effected using such mechanism. The reason is that the court has never said it was illegitimate to give provisional liquidators the power to explore and promulgate a restructuring if the applicant had also established that there was in the first place good reason to appoint provisional liquidators on the "traditional" grounds of jeopardy to assets. In other words, if it could be demonstrated that there was a jeopardy to assets then there was no reason why the powers of the provisional liquidators so appointed could not include a power to restructure.

That this is the case was confirmed and clarified in a recent (2018) decision where the court was faced with an application to discharge provisional liquidators on the ground that their only remaining duty was to complete a restructuring (the asset in jeopardy, which had permitted their appointment, having by then been secured). The court refused the application and allowed the provisional liquidators to continue.²³⁶

As the scheme of arrangement is an important aspect of restructuring / rescue in Hong Kong (given the current legislation), it is worth exploring in some detail.

A scheme of arrangement is a statutory mechanism under Hong Kong law which allows companies to make binding compromises or arrangements with their members and / or creditors (or any class of them), including adjustment of debts owed to its creditors or reduction of share capital. The statutory regime for schemes of arrangement in Hong Kong is contained in Part 13, Division 2 of the Companies Ordinance (namely sections 668 to 677). The court procedure relating to the

the context of schemes, to echo the kind of assistance given by the English courts in *BlueCrest Mercantile BV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146, as discussed earlier.

²³² [2002] 2 HKLRD 290.

²³³ *Re Luen Cheong Tai International Holdings Ltd* [2003] 2 HKLRD 719.

²³⁴ [2006] 2 HKLRD 192.

²³⁵ CWUMPO, ss 192 to 194.

²³⁶ *China Solar Energy Holdings Ltd* [2018] HKCFI 555.

applications necessary to effect a scheme of arrangement is governed by O.102 r 2 and r 5 of the Rules of the High court (RHC).²³⁷

The Hong Kong court will take guidance from English law cases in respect of schemes as the wording of the legislation there is very similar. This is notwithstanding the fact that there are some (important) procedural differences. In the context of schemes, the leading Hong Kong case is the CFA judgment of *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (UDL).²³⁸

The main distinction between schemes of arrangement in Hong Kong and in England is one of procedure. For example, Practice Statement of the Chancery Division of the (English) High Court on 15 April 2002 (and further Practice Directions which came into force on 1 October 2007) relating to applications to the court under the Companies Act 1985, section 425 and the Companies Act 2006, section 895.²³⁹ This is a departure from the previous three stage process as per *Re Hawk Insurance Co Ltd*,²⁴⁰ which is still in force in Hong Kong, as described below.

Further, the practice in England requires the applicant to circulate a “creditors’ issue letter” (often called the “practice statement letter”) to inform scheme creditors on a confidential basis that the applicant is proposing to apply to court to seek an order convening meetings for a scheme of arrangement and giving details of the scheme. This practice is not followed in Hong Kong.

For debt restructuring purposes, a scheme of arrangement enables companies and their creditors to compromise or adjust debts if stipulated majorities of the relevant creditors approve such compromise or adjustment and the court sanctions such arrangement. Without a scheme of arrangement, a company would need to obtain the approval of 100% of the relevant creditors to contractually vary the debt. Schemes are therefore necessary where a company seeks to adjust debts with many creditors at the same time in circumstances where it would be difficult or impossible to seek unanimous consent of all creditors. Schemes are also useful where there may be hold-out creditors who seek an unfair advantage (for example, additional payment) as against a substantial majority of similarly ranked creditors.

In summary, in order for a scheme of arrangement to become effective, the following procedures or stages are required to take place (each of which are further described below):

- (a) an application is made (by originating summons) for leave to convene meetings of the relevant creditors to consider, and if thought fit, approve the schemes. Such application is heard by the court (the convening hearing) whereat the court will give directions for giving notice of and advertising such meetings (the scheme meetings);
- (b) the scheme meetings take place and the results of such meeting(s) are reported to the court; and

²³⁷ The application and interpretation of the RHC will often be guided by the commentary in “Hong Kong Civil Procedure” (the HKCP).

²³⁸ (2001) 4 HKCFAR 358. UDL is a decision of the CFA dealing specifically with schemes of arrangement.

²³⁹ Civil Procedure (Amendment Rules 2007 (SI/2007/2204)) and Chris Howard and Bob Hedger, *Restructuring Law & Practice* (2nd Edition)(London: LexisNexis) (2014), “Chapter 7: Schemes of Arrangement as a Restructuring Tool”, 7.214, “I Scheme Process and Procedure”, p.511. (hereinafter referred to as Howard & Hedger “Restructuring Law & Practice” (2014)).

²⁴⁰ [2001] EWCA Civ 241.

(c) an application is made by petition for the court to sanction the scheme.

The *UDL* decision referred to above is a decision of the CFA in which that court confirmed that the correct approach is that three-stage process.

The initial application is made by *ex parte*²⁴¹ originating summons²⁴² and can be made by the debtor company (or a member, creditor or liquidator of the debtor company) seeking an order²⁴³ for leave to convene a meeting of the scheme creditors to vote whether or not to approve the scheme of arrangement. For the purpose of this module, we will deal only with a creditors' scheme and not members' schemes. The originating summons will have to identify the classes of creditors whose rights are sought to be adjusted by the scheme. The focus is on "rights" creditors enjoy rather than what "interests" they have, as explained in the passage set out below from the CFA's decision in *UDL*. All scheme creditors have the same rights to participate in and vote at the creditors' meeting, regardless of whether they are Hong Kong based or not. Paragraph 27 of *UDL* states:

"(1) It is the responsibility of the company putting forward the Scheme to decide whether to summon a single meeting or more than one meeting. If the meeting or meetings are improperly constituted, objection should be taken on the application for sanction and the company bears the risk that the application will be dismissed.

(2) Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting.

(3) The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.

(4) The question is whether the rights which are to be released or varied under the Scheme or the new rights which the Scheme gives in their place are so different that the Scheme must be treated as a compromise or arrangement with more than one class.

(5) The court has no jurisdiction to sanction a Scheme which does not have the approval of the requisite majority of creditors voting at meetings properly constituted in accordance with these principles. Even if it has jurisdiction to sanction a Scheme, however, the court is not bound to do so.

(6) The court will decline to sanction a Scheme unless it is satisfied, not only that the meetings were properly constituted and that the proposals were approved by the requisite majorities, but that the result of each meeting fairly reflected the views of the creditors concerned. To this end it may discount or disregard altogether the votes of those who, though entitled to vote at a meeting as a member of the class concerned, have such personal or special interests in supporting the proposals that their views cannot be regarded as fairly representative of the class in question."

²⁴¹ *Re Hawk Insurance* [2001] EWCA Civ 241 at p.242, *UDL*, p.365, [12]-[14].

²⁴² O.102 r 2(1) RHC, and HKCP, O.102, 102/2/2, p 1529.

²⁴³ Pursuant to the Companies Ordinance, s 670(1).

An affirmation must accompany the application²⁴⁴ to explain the background to the scheme and must, amongst other things, exhibit a copy of the draft explanatory statement, a copy of the draft scheme document, a copy of the notices of the scheme meetings, a copy of the proxy forms, and draft advertisement to be published.

The explanatory statement is a document required by section 671 of the Companies Ordinance and must explain the effect of the scheme and must state any material interests of the company's directors (in whatever capacity) under the arrangement or compromise and the effect of the arrangement or compromise on those interests. The court will also expect the explanatory statement to give sufficiently detailed information for the relevant creditors to be properly informed to enable them to reach a sensible decision on the scheme.²⁴⁵

At the Convening Hearing, the Hong Kong court will decide whether to make an order allowing a meeting of the relevant creditors to be convened to discuss and vote on the proposed scheme. The constitution of the classes of scheme creditors will not be considered until the sanction hearing (discussed below) with effect that the applicant bears the risk that the application for sanction could be dismissed at the later stage if classes were not properly constituted.²⁴⁶ Broadly speaking, the Hong Kong court will consider the following matters at the convening hearing:

- (a) jurisdiction (where the debtor is not incorporated in Hong Kong), albeit this issue will be considered more closely at the sanction hearing; and
- (b) the appropriateness of the explanatory statement, scheme document and notices.

It should be noted here that this represents a substantial difference between the procedure in Hong Kong and in England. Subsequent to the Practice Statement in England referred to above, the English Court will also consider at the convening hearing whether classes are properly constituted. In UDL, the CFA examined this difference, and determined as follows:

“14. It might be thought singularly unhelpful to leave the question whether the meetings were correctly convened to the third stage, by which time a wrong decision by the company at the outset will have led to a considerable waste of time and money. But in my opinion the practice is a sound one. *The only alternative would be to require notice of the initial application to be made inter partes and for notice of the application together with a copy of the Scheme to be given to everyone potentially affected by it, with the risk of incurring the costs of a contested hearing and possible appeals before it could be known whether the Scheme was likely to attract sufficient support in any event. The present practice ensures that those advising the company take their responsibility seriously, since an error on their part will be fatal to the Scheme. At the same time it leaves the question, which goes to the jurisdiction of the court to sanction the Scheme, to be decided at the appropriate time, that is to say when the court is asked to sanction it. By then the outcome of the meeting or meetings will be known and the question, which will no longer be hypothetical, can be argued between*

²⁴⁴ HKCP, H5B/2 p 378, and see also O.38 r 2, O.41 RHC.

²⁴⁵ *Re Heron International NV* [1994] 1 BCLC 667.

²⁴⁶ For an example, see *S Megga Telecommunications Ltd* [2003] 2 HKLRD 583.

the appropriate parties, that is to say the company on the one hand and those who object to the Scheme on the other.” (Emphasis added.)

When considering the explanatory statement the Hong Kong court must be satisfied that the creditors have been given a sufficient explanation of the scheme and its effects,²⁴⁷ and the court may refuse to grant leave to convene the meeting if the explanatory statement is inadequate.²⁴⁸

Where a scheme is put forward and the most likely alternative is the winding up of the company, creditors proposed to be bound by the scheme should be given sufficient details concerning their estimated return in such liquidation, for example by way of an independent liquidation analysis and the expected duration of that process. Where it is assumed that the company will continue trading following implementation of the scheme, the explanatory statement should include some information concerning the proposed business of the debtor going forward. A failure to disclose relevant information may result in the scheme not being approved unless that failure was not sufficiently material to be said to have affected the decision on voting on the scheme.²⁴⁹

If the court grants leave to convene a scheme meeting, the court will need to be satisfied that notice of the meeting will be delivered to, or otherwise brought to the attention of, scheme creditors.

The court will also appoint the chairman of the scheme meeting, who is then directed to report to the court on the outcome of the scheme meeting prior to the sanction hearing. Other directions which the court may make include orders to amend or revise certain parts of the explanatory statement.

The creditors whose rights are to be affected by the scheme are entitled to attend (in person or by proxy) and ask questions regarding the proposed scheme at the creditors’ meeting. The scheme is considered approved by the scheme creditors’ meeting only if it is supported by a majority in number representing at least 75% by value of the creditors present and voting (in person or by proxy).²⁵⁰ The test will be applicable to each class of scheme creditor where the scheme creditors are divided into different classes.

Non-consenting creditors can be bound by the terms of the scheme only if they are within a class where the requisite majorities of scheme creditors have voted to approve the scheme.²⁵¹

It is not uncommon in restructurings for the debtor company to seek support of as many creditors as possible (and certainly key creditors) in advance of the scheme meetings, often by way of promising a “consent fee” (or similar) for undertaking to vote in favour of the scheme, with such arrangements being recorded in a restructuring support agreement. Provided all creditors to whom the scheme will apply have an equal right to participate in such an arrangement, the court will not find this objectionable.²⁵²

²⁴⁷ *Kansa General International Insurance Co Ltd* [1999] 2 HKLRD 429 at 437.

²⁴⁸ For example, see *Re KB (Asia) Ltd (No 2)* [2014] HKEC 1192.

²⁴⁹ *China Light Power Co Ltd and CLP Holdings* [1998] 1 HKC 170; *Kansas General International Insurance Co Ltd* [1999] 3 HKLRD 94.

²⁵⁰ Companies Ordinance, s 674(1)(a)-(b); and see *Re PCCW Ltd* [2009] HKEC 738 (re “splitting” votes).

²⁵¹ As to the effect of non-consenting creditors whose debts are governed by a law other than Hong Kong law, see the section on cross-border insolvency.

²⁵² *Re Winsway Enterprises Holdings Ltd* [2017] 1 HKLRD 1; *Re Kaisa Group Holdings Ltd* [2017] 1 HKLRD 18.

If the relevant creditors vote at the scheme meeting to approve the scheme, with the statutory majorities being attained, the applicant is then required to file a petition seeking the court's sanction of the scheme, namely at the sanction hearing. The petition will include²⁵³ details of the company, why the scheme has been proposed, the results of voting at the scheme meetings.

The petition must also be supported by an affirmation proving the posting of the notices convening the meeting, the form of proxy and affirming to the contents of the petition.²⁵⁴

If the statutory majorities approving the scheme are not attained, then the court has no jurisdiction to sanction the scheme. However, even if the statutory majorities are attained, the court is not bound to sanction the scheme. The issues which the court will consider at the sanction hearing are summarised in *Re Wheelock Properties Ltd*, per Harris J.²⁵⁵

"8. In deciding whether or not to sanction a scheme of arrangement the court has regard to the following matters:

- (a) whether a scheme is for a permissible purpose...;
- (b) whether members who are called on to vote as a single class have sufficiently similar legal rights that they can consult together with a view to their common interest at a single meeting;
- (c) whether the meeting was duly convened in accordance with the court's directions;²⁵⁶
- (d) whether members have been given sufficient information about a scheme so as to enable them to make an informed decision whether or not to support it;²⁵⁷
- (e) whether a majority in number representing 75% in value of the members [or creditors] present and voting agree to the arrangement;²⁵⁸ and
- (f) the discretionary element of the sanctioning process and in particular whether the court is satisfied that a scheme is one that an intelligent and honest man acting in respect of his interests as a member of the class within which he votes, might reasonably approve.²⁵⁹"

The court will also want to be satisfied that the relevant class of scheme creditors was fairly represented and the statutory majority were acting *bona fide* and not coercing the minority in order to promote interests adverse to those of the class.²⁶⁰ If there is more than one class, the court should also satisfy itself that the arrangement is fair and equitable as between classes, in light of their respective legal rights.²⁶¹

Further, where the debtor considers that the only realistic alternative to the successful implementation of the scheme is for it to be placed in liquidation, then the

²⁵³ See O.102 r 5 RHC and HKCP, Part H Extract, H5B/2, p 379, for further details on this requirement.

²⁵⁴ See O. 102 r 5 RHC, HKCP, p 1553.

²⁵⁵ [2010] 4 HKLRD 587 at pp 590-591. Although this case was concerned with a scheme of arrangement between members of the company, the principles are equally applicable to a scheme of arrangement between a company and its creditors and have been repeated in recent decisions. For example, see *Mongolian Mining Corp* [2018] HKCFI 2035.

²⁵⁶ *Re China Light & Power Co Ltd* [1998] 1 HKLRD 158, per Le Pichon J at p 168E-F.

²⁵⁷ *Ibid.*

²⁵⁸ *Ibid.*

²⁵⁹ *Buckley on the Companies Acts* (14th ed, 1981) p 473; *Re PCCW Ltd*, paras.33-38.

²⁶⁰ *Re PCCW Ltd* [2009] at [34], [113], [123].

²⁶¹ *Re Central Pacific Minerals NL* (2002) FCA 239.

relevant rights of creditors to be compared are those which would arise in an insolvent liquidation.

If the Hong Kong court sanctions a scheme, it will take effect in Hong Kong once a certified copy of the Hong Kong court's order sanctioning the scheme has been registered by the Registrar of Companies for Hong Kong.²⁶² The scheme will then apply to (and be binding according to its terms upon) all the scheme creditors in the relevant class or classes, irrespective of whether or not they attended the creditors' meeting or meetings and whether or not they voted in favour of the scheme.

Note, however, one qualification to this statement is that at common law²⁶³ a scheme of arrangement seeking to compromise or vary an existing debt will only have real and substantive effect if the debt is discharged under the law governing the debt. A scheme will also be effective as against any creditor participating in it. This would include creditors voting on the scheme or, for example, accepting payment from or new instruments created by the scheme.²⁶⁴ This principle has been applied by the Hong Kong courts²⁶⁵ (and in modern decisions of the English courts).²⁶⁶

One further issue that is worth mentioning in the context of schemes (as it has become increasingly common) is the issue of dealing with the obligations of third parties, such as guarantors. Conceptually it is not immediately obvious that releases in favour of such parties should be available through the scheme mechanism (given it is a statutory arrangement between the parties to it). However, the practice has developed whereby a company through a scheme may cause the release of its creditors' claims under guarantees provided by third parties where the guarantees are in respect of the debt being compromised under the scheme. This position is now well established under English law.²⁶⁷

The Hong Kong court has followed the same path and permitted third party releases in appropriate circumstances²⁶⁸ (for example, see the *Kaisa* and *Winsway* decisions), for example where they are:

- (a) closely connected with the scheme creditors' rights as creditors against the scheme company;
- (b) are personal and not proprietary rights; and
- (c) if exercised and leading to a payment by the third party guarantor, would result in a reduction of the scheme creditors' claims against the company.

²⁶² Companies Ordinance, s 674(6).

²⁶³ *Anthony Gibbs & Sons v Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399.

²⁶⁴ See *Rubin v Euro Finance SA* [2013] 1 AC 236.

²⁶⁵ *LDK* at [49] - [52]; *Hong Kong Institute of Education v Aoki Corp* [2004] 2 HKLRD 760.

²⁶⁶ *Re PrimaCom Holdings GmbH* [2013] BCC 201, *Re Apcoa Parking Holdings GmbH* [2014] 2 BCLC 285, both mentioned in *LDK*.

²⁶⁷ *Re Lehman Brothers International (Europe) (in administration) (No 2)* [2009] EWCA Civ 1161, [2010] Bus LR 489, per Patten LJ: "It seems to me entirely logical to regard the court's jurisdiction as extending to approving a scheme which varies or releases creditors' claims against the company on terms which require them to bring into account and release rights of action against third parties designed to recover the same loss. The release of such third party claims is merely ancillary to the arrangement between the company and its own creditors".

²⁶⁸ For example, in *Winsway* and *Kaisa* (*supra* - [2017] 1 HKLRD 1 and [2017] 1 HKLRD 18); and *Re China Singyes Solar Technologies Holdings Ltd* [2020] HKCFI 467.

The releases must also be “related to and essential”²⁶⁹ to the scheme. A rationale is that if the guarantee claims were permitted to remain then this could very well defeat the object of the scheme.

Self-Assessment Exercise 5

Question 1 (receivership)

A lender holds a charge over the borrower’s assets and wishes to appoint a receiver. The proposed receiver suggests using his service company as the appointment-taker. The lender asks you how to go about making the appointment and when it will become effective. Advise the lender.

Question 2 (corporate rescue)

A company owes money to a number of banks and other creditors and cannot pay on time, but the directors are convinced that the business is viable and that the cash-flow issue is short term. What broad overview could you give to the directors or creditors as to possibilities to rescue the company?

Question 3 (corporate rescue)

The management of the company believe that the financial creditors (including banks, noteholders and convertible bond holders) will agree to swap their current debt for new instruments with later maturity (thus allowing the company to get through its present cash flow difficulty). Some of the creditors have already said they will support such a deal if they are paid a 1% “consent fee”. The management ask you about the legal issues involved in connection with the proposed plan and how it could be effected.

**For commentary and feedback on self-assessment exercise 5, please see
APPENDIX A**

7. CROSS-BORDER INSOLVENCY LAW

Save for the winding up of foreign incorporated and unregistered companies (dealt with below), Hong Kong’s insolvency legislation does not contain any provision dealing with cross-border insolvency.²⁷⁰ Hong Kong has not adopted the UNCITRAL Model Law on Cross-Border Insolvency²⁷¹ and Hong Kong is not a party of any international treaties or bilateral agreements that deal with cross-border insolvency.²⁷²

²⁶⁹ *Re Lehman Brothers (Europe) International (in administration)* [2009] at [62].

²⁷⁰ See para 11 of *The Joint Official Liquidators of A Company v B and Another* [2014] 4 HKLRD 374 (*A Co v B*). Since the decision of *A Co v B*, certain amendments were made to the CWUMPO but those amendments also do not contain any provisions dealing with cross-border insolvency.

²⁷¹ See para 11 of *A Co v B*, *supra* note 254.

²⁷² per information published by the Department of Justice in Hong Kong - <https://www.doj.gov.hk/eng/laws/treaties.html>.

Although Hong Kong lacks a statutory framework to deal with cross-border insolvency, the Hong Kong court has always followed common law principles in this regard. For example, a foreign liquidator's right to bring an action in Hong Kong (in the name of the company) has long been recognised.²⁷³ No formal order recognising the foreign liquidator is necessary for such purpose. In passing in that regard, practical consideration should be given to provisions²⁷⁴ which allow a defendant to require a plaintiff company (which includes a company incorporated outside Hong Kong)²⁷⁵ to provide security for costs if there is reason to believe that the plaintiff company will be unable to pay a successful defendant's costs. Unless contrary evidence is shown, the fact that the company is in liquidation is *prima facie* evidence that the plaintiff company is unable to pay the costs.

Traditionally, the Hong Kong court has been keen to assist foreign representatives by relying on common law principles. For example, the court has assisted foreign rehabilitation proceedings by refusing to allow enforcement of a judgment against Hong Kong assets of such company. In this regard, the court has adopted a 2-stage approach by which it dealt with the issues of liability and enforcement separately. In short, even if liability is established, the court will refuse enforcement against assets situated in Hong Kong if it considers that, through comity, it should assist the foreign rehabilitation proceedings. For example, the court has stayed garnishee proceedings issued against a company which was subject to bankruptcy proceedings in the PRC.²⁷⁶

Common law developments in the context of cross-border insolvency are dealt with further below. First, however, there are the legislative provisions referred to above dealing with winding up of non-Hong Kong companies.

Provided certain requirements are met, the Hong Kong court can exercise its jurisdiction to wind up companies that are not incorporated or registered²⁷⁷ in Hong Kong. This is important in Hong Kong because the majority of companies that are listed on the Hong Kong Stock Exchange are foreign companies. According to the *HKEX Fact Book 2019*,²⁷⁸ there are 2,071 companies listed on the Exchange as at the end of 2019 and only 209 (or 10.1%) were Hong Kong incorporated companies. By contrast, there were 1,084 (over 52%) companies listed in Hong Kong but incorporated in the Cayman Islands.

In this regard, Part X of CWUMPO is titled "Winding up of unregistered companies". An "unregistered company" is defined in section 326 of the CWUMPO as a company not registered under the companies legislation. Although a little confusing given the title of Part X, section 326(2) of CWUMPO makes clear that this includes a "registered non-Hong Kong company".²⁷⁹ The circumstances in which an unregistered company may be wound up are as follows:²⁸⁰

²⁷³ See *Re Irish Shipping* [1985] HKLR 437.

²⁷⁴ Order 23 of the Rules of the High court (Cap 4A) and Companies Ordinance, s 905.

²⁷⁵ See Companies Ordinance, s 905(3).

²⁷⁶ *CCIC Finance v GITIC* [2005] 2 HKC 589 (albeit this being a 2001 decision); but note the court will refuse the stay where the foreign process is not a collective process being conducted for the benefit of all creditors – *Paloma Co Ltd v Capxon Electronic Industrial Co Ltd* [2020] HKCFI 754).

²⁷⁷ A foreign company is required to be registered under Pt 16 of the Companies Ordinance (Cap 622) if it has a place of business in Hong Kong.

²⁷⁸ This was the most recent available at the time of preparation of the text for this module.

²⁷⁹ A non-Hong Kong company with a place of business in Hong Kong and registered with the Registrar of Companies under the Companies Ordinance, s 776.

²⁸⁰ CWUMPO, s 327.

- (a) If the company is dissolved or has ceased to carry on business, or is carrying on business for the purpose of winding up its affairs;
- (b) If the company is unable to pay its debts; and
- (c) If the court is of the opinion that it is just and equitable that the company should be wound up.

In order to wind up an unregistered company in Hong Kong, the petitioner must satisfy the court that the company in question is sufficiently connected to Hong Kong by satisfying the “three core requirements” set out in the CFA’s decision in *Re Yung Kee*.²⁸¹ The three core requirements are:

- (a) there must be sufficient connection with Hong Kong, (not necessarily meaning the presence of assets within the jurisdiction);
- (b) there must be a reasonable possibility that the winding up order would benefit those applying for it; and
- (c) the court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company’s assets.

If sufficient connection is established via the three core requirements, the jurisdiction to wind up will remain even after the matters giving rise to that original connection have ceased to exist.²⁸² This is to prevent unregistered companies from, for example, removing assets from Hong Kong so as to argue that the three core requirements are not satisfied.

As to the first requirement, assets could be assets of any nature.²⁸³ If there are no assets, a link of genuine substance between the company and the jurisdiction such as business activities carried out by the company within the jurisdiction would be considered.²⁸⁴ If the winding up arises out of a shareholders’ dispute, the court will look at the shareholders’ connection with Hong Kong.²⁸⁵

As to the second requirement, it must be shown that the liquidation would benefit the petitioner and in most cases it would be easier for this requirement to be met if there are assets in Hong Kong. For example, in *Re Solar Touch Ltd*²⁸⁶ the petitioner’s purpose was to appoint liquidators to carry out investigations in the PRC. The court commented that the PRC court would not recognise the winding up order and thus the petitioner could not satisfy this requirement.

The court has held the second core requirement cannot be dispensed with, nor can it be moderated. For example a PRC company listed in Hong Kong had no assets in Hong Kong and argued that the second requirement could not be met in the context of a petition presented against it. It therefore sought to seek an injunction preventing the petitioner from presenting a petition.²⁸⁷ The court held that the petitioner would

²⁸¹ *Kam Leung Sui Kwan v Kam Kwan Lai and Others* (2015) 18 HKCFAR 501.

²⁸² *Penta Investment Advisers v Allied Weli Development Ltd* (unreported, CACV 58/2016, 18 July 2017).

²⁸³ *Re Irish Shipping Ltd* [1985] HKLR 437.

²⁸⁴ *Re China Medical* [2014] 2 HKLRD 997.

²⁸⁵ *Re Gottinghen Trading Limited* [2012] 3 HKLRD 453.

²⁸⁶ [2004] 3 HKLRD 15.

²⁸⁷ Unlike in respect of personal bankruptcy, there is no procedure for setting aside a statutory demand made against a company; the only remedy is for the company to seek an injunction restraining the presentation of the petition (or its advertisement if already presented).

still benefit from the presentation of the winding up petition in that the petitioner's benefit would be the leverage created by the prospect of a winding up petition, thus "forcing" the respondent company to repay the debt.²⁸⁸

On the face of it, this decision seems to deviate from the traditional view that the Companies court should not be used as a means of bringing improper pressure to bear upon a debtor company.²⁸⁹ It is probably best explained by its exceptional facts, with the court being highly critical of the company's conduct.²⁹⁰ It should also be noted that at first instance, the court considered this a moderation of the second core requirement. However, the Court of Appeal said that this was not a moderation, nor was one needed: the benefit was made out in its own right on the petitioner's case (adding that there was no evidence that the petitioner was not really seeking a winding up order, and also held it would only be improper pressure to use the petition mechanism where the debt is disputed).

As to the third requirement, the petitioner would have to show that there are persons with sufficient connection with Hong Kong that would have sufficient economic interest in the winding up of the company to justify making an order which will engage the Hong Kong winding up regime.²⁹¹ A creditor cannot satisfy the third requirement by simply presenting the petition. The creditor must be subject to the court's jurisdiction by virtue of doing "something more".²⁹² The Court of Appeal²⁹³ confirmed that the third core requirement must be met unless the connection with Hong Kong is sufficiently strong and the benefits to creditors are sufficiently substantial.

The jurisdiction to wind up a company that is not incorporated in Hong Kong can apply to a "free standing" Hong Kong liquidation or can be used to commence an ancillary liquidation in Hong Kong where there is a principal liquidation elsewhere (most likely in the company's place of incorporation²⁹⁴ but possibly in another relevant jurisdiction, with which the company has sufficient connection²⁹⁵). In dealing with ancillary liquidations, the court has applied the "modified universalism" approach,²⁹⁶ being that the liquidation in Hong Kong will generally be treated as ancillary in the sense that the functions of the liquidator would be to collect assets in

²⁸⁸ *Shandong Chenming Paper Holdings Ltd v Arjowiggings HKK2 Ltd* [2017] 4 HKLRD 84 (CFI) and [2020] HKCA 670 (CA).

²⁸⁹ See, eg, *Re Rightop Investment Ltd* [2003] 2 HKLRD 13.

²⁹⁰ The company had a secondary listing in Hong Kong and it was clearly solvent with the means to pay the debt (determined as due by an arbitration award), even though it held no assets in Hong Kong. It had simply refused to pay the debt and argued that proceedings should be taken in the PRC instead. Harris J made the following comments to justify why this case called for a "moderation" of the second core requirement (noting that the Court of Appeal considered no "moderation" of the requirement was in fact involved): "The Company wishes to take advantage of Hong Kong's financial system and the legal system that underpins it. Hong Kong's legal system and courts provide investors both domestically and internationally with confidence in the reliability and integrity of the financial system. The Company's refusal to honour the Award shows disregard for the integrity of our legal system and, in a non-technical sense at least, contempt for the High court of Hong Kong... There is a public interest in steps being taken to remedy this conduct and to disabuse other Mainland companies of the idea that they can take the benefit of access to Hong Kong's financial system without the burden of complying with our laws. In the circumstances of this case the obvious and appropriate step is the winding up of the Company in Hong Kong and the delisting of its H shares."

²⁹¹ *Re China Medical* [2014] 2 HKLRD 997.

²⁹² For example, having a place of residence in Hong Kong, employment, having obtained a Hong Kong judgment or having a place of business. See para 47 of *Re China Medical* [2014] 2 HKLRD 997.

²⁹³ *Re China Medical* [2018] HKCA 111.

²⁹⁴ *Re Information Security One Ltd* [2007] 3 HKLRD 780.

²⁹⁵ *The Joint Administrators of African Minerals Limited (in administration) v Madison Pacific Trust Limited* [2015] 4 HKC 215, para 9. In this case, the court appeared to accept (without having to decide the point) that the Hong Kong courts can, in principle, recognise liquidators appointed in a jurisdiction other than the place of incorporation. Note, however, that more recent cases all refer to the principal liquidation being in the place of incorporation (eg *Quest Investments Ltd v Lee Wai Tung* [2020] HKCFI 1516).

²⁹⁶ See, eg, *Re Pioneer Iron and Steel Group* (Unreported, HCCW 322/2010, 6 March 2013).

Hong Kong, to settle a list of Hong Kong creditors and to transmit the assets and the list to the principal liquidators to enable a dividend to be declared and paid.²⁹⁷ However, in appropriate cases the court will not limit the powers of the Hong Kong “ancillary” liquidator to dealing with only Hong Kong assets.²⁹⁸

In granting an ancillary winding up order in Hong Kong, the court will still have to be satisfied that the “three core requirements” are met. The court has held²⁹⁹ that there is no basis for adopting a less stringent approach in assessing the “three core requirements” for an ancillary liquidation in Hong Kong. Liquidators appointed in an ancillary liquidation in Hong Kong would enjoy powers that are exercisable under CWUMPO and CWUR. Traditionally, ancillary liquidations were commonly pursued to give foreign representatives powers in Hong Kong. However, it is now more common for practitioners to seek recognition of their foreign appointment, and assistance by such recognition mechanism, instead of pursuing ancillary liquidations. However, the powers then exercisable may be more restricted than those which a “Hong Kong liquidator” would enjoy, so an ancillary liquidation would still be a useful tool when the full range of powers is needed.

As stated earlier, Hong Kong has always applied common law principles to recognise and assist foreign insolvency procedures. That this is the case, and continued after the Handover, was confirmed by the CFA.³⁰⁰

As also mentioned above, traditionally foreign officeholders had commenced ancillary liquidation proceedings if steps needed to be taken here. However, in *A Co v B* (a 2014 decision), the court dealt with an application by liquidators appointed in the Cayman Islands who sought, *inter alia*, a Hong Kong order to recognise their appointment and an order for the production of documents from certain (unnamed) respondents.³⁰¹ The court stated the following:

“18. In my view the Hong Kong Companies court can and should adopt a similar approach to applications for recognition and assistance to that described in paragraph 60 of Kawaley J’s judgment.³⁰² The Companies court may pursuant to a letter of request from a common law jurisdiction with a similar substantive insolvency law make an order of a type which is available to a provisional liquidator or liquidator under Hong Kong’s insolvency regime. For this reason I granted the orders referred to at the beginning of this decision.”

Shortly after the *A Co v B* decision, the Privy Council gave its opinion in *Singularis Holdings v PricewaterhouseCoopers*³⁰³ which explored and clarified that the common law power of assistance exists where the power sought to be exercised: (a) exists in the jurisdiction of principal liquidation; and (b) the power exists in the assisting jurisdiction (the Singularis Principle).³⁰⁴ The Singularis Principle and the *A Co v B* decisions have given rise to a number of similar cases in recent years promoting modified universalism in Hong Kong.

²⁹⁷ *Re Pioneer Iron and Steel Group* (Unreported, HCCW 322/2010, 6 March 2013), para 30.

²⁹⁸ *Re Zhu Kuan Group Limited* [2004] HKEC 1857.

²⁹⁹ *Re Pioneer Iron and Steel Group Company Limited* Unreported, HCCW 322/2010, 6 March 2013.

³⁰⁰ *Chen Li Hung and Another v Ting Lei Miao and Others* (2000) 3 HKCFAR 9, which recognised bankruptcy trustees appointed in Taiwan.

³⁰¹ By reason that the nature of the application was confidential in nature, see para 1.

³⁰² *In Re Founding Partners Global Fund Ltd* [2011] Bda LR 22.

³⁰³ [2014] UKPC 36.

³⁰⁴ See para 6 of *Re BJB Career Education Co Ltd* [2017] 1 HKLRD.

However, it is important to note that this does not mean that the Hong Kong court will not carefully consider the underlying principles each time it is asked to assist. As an example, when faced with an application by administrators appointed in England, who sought an order to recognise their appointment and extend the moratorium imposed in England in order to prevent certain security being enforced in Hong Kong, the court refused.³⁰⁵ The court emphasised that the recognition of foreign insolvency processes is limited by the extent to which the type of order sought is available in Hong Kong. Given that there is no equivalent administration process and the equivalent moratorium is not available in Hong Kong, the court could not make a recognition order the effect of which would restrain the security agent from enforcing the security.

Particularly given the development of the recognition of foreign officeholders in the wake of *Singularis*, but also arising from a number of cases where the Hong Kong court has been asked to sanction schemes of arrangement promoted by foreign companies, there have been a number of recent authorities dealing with cross-border insolvency issues. These include:

- (a) *Re China Medical Technologies Inc*;³⁰⁶
- (b) *The Joint Official Liquidators of A Co v B*;³⁰⁷
- (c) *Kam Leung Sui Kwan v Kam Kwan Lai and Others*;³⁰⁸
- (d) *Joint Administrators of African Mineral Ltd (in administration) v Madison Pacific Trust Ltd*;³⁰⁹
- (e) *Re Centaur Litigation SPC*;³¹⁰
- (f) *Re Winsway Enterprises Holdings Ltd*;³¹¹
- (g) *Re Kaisa Group Holdings Ltd*;³¹²
- (h) *Re BJB Career Education Co Ltd*;³¹³
- (i) *Re Shandong Chenming Paper Holdings v Arjowiggins HKK2 Ltd*;³¹⁴
- (j) *Re China Solar Energy Holdings Ltd*;³¹⁵
- (k) *Re Z-Obee Holdings Ltd*;³¹⁶
- (l) *Re Joint Liquidators of Supreme Tycoon Limited*;³¹⁷

³⁰⁵ *The Joint Administrators of African Minerals Limited (in administration) v Madison Pacific Trust Limited & Shandong Steel Hong Kong Zengli Limited* [2015] 4 HKC 215.

³⁰⁶ [2014] 2 HKLRD 997.

³⁰⁷ [2014] 4 HKLRD 374.

³⁰⁸ (2015) 18 HKCFAR 501.

³⁰⁹ [2015] 4 HKC 215.

³¹⁰ Unreported, HCMP 3389/2015, 10 March 2016.

³¹¹ [2017] 1 HKLRD 1.

³¹² [2017] 1 HKLRD 18.

³¹³ [2017] 1 HKLRD.

³¹⁴ [2017] 4 HKLRD 84.

³¹⁵ [2018] 2 HKLRD 338.

³¹⁶ [2018] 1 HKLRD 165.

³¹⁷ [2018] 1 HKLRD 1120.

(m) *Re CW Advanced Technologies Limited*;³¹⁸ and

(n) *Re Moody Technology Holdings Ltd.*³¹⁹

In order to obtain a recognition order, a foreign representative must present a “letter of request” issued by the foreign court to the Hong Kong court requesting assistance. Although there is scope for arguing that the common law principles do not require such a formal request, the practice of the court in Hong Kong is that such request must be obtained.

One important recent development relates to PRC liquidations. As cited above, when the Hong Kong court gave its first written decision in respect of recognition (the *A v B* case), the court referred to a request from a “common law jurisdiction with a similar substantive insolvency law”. However, the court has on at least two occasions now recognised the appointment of officeholders appointed in the Mainland (PRC)³²⁰ notwithstanding that the PRC is not a common law jurisdiction. The court was nevertheless satisfied that PRC insolvency law provided for a collective process. It should be noted, however, that in the *CEFC* decision, the court commented on the fact that under PRC law, for other proceedings (including from Hong Kong) to be recognised in the PRC there is the need for reciprocity. In that context, while recognising the appointment the court commented (*obiter*) that “while the principles that govern common law recognition and assistance did not require reciprocity to be demonstrated, the extent to which greater assistance should be provided to Mainland Chinese administrators in future would be decided on a case-by-case basis and the development of recognition was likely to be influenced by the extent to which the court was satisfied that the Mainland promoted a unitary approach to transnational insolvencies”.³²¹ As an aside, it is also perhaps worth mentioning that as yet, there has been no direct recognition of a US chapter 11 process in Hong Kong.

Banks in Hong Kong should readily assist foreign representatives by providing documents in relation to the company’s own accounts even without the foreign representative having to first obtain a Hong Kong court order.³²²

The court has also granted recognition orders to permit foreign officeholders to then seek production of documents or examination of individuals in Hong Kong.³²³ In considering such applications, the Hong Kong court compared the scope of the relevant provisions between Hong Kong and the requesting jurisdiction in accordance with the *Singularis* Principle. With commonly encountered jurisdictions (in a Hong Kong context, the two most common would likely be the Cayman Islands and the British Virgin Islands) the court has become reasonably comfortable that recognition should be given. This is reflected in the fact that a “standard order” that a foreign representative could expect to obtain in Hong Kong has been developed,³²⁴ although

³¹⁸ [2018] 3 HKLRD 552.

³¹⁹ [2020] HKCFI 416.

³²⁰ *Re CEFC Shanghai International Group Ltd (Mainland Liquidation)* [2020] HKCFI 167; and *Re Liquidator of Shenzhen Everich Supply Chain Co Ltd* [2020] HKCFI 965.

³²¹ *Ibid*, paragraph 33.

³²² *Bay Capital Asia Fund LP (In Official Liquidation) v DBS Bank (Hong Kong) Unreported, HCMP 3104/2015, 2 November 2016*. See *Re Rennie Produce (Aust) Pty Ltd (unreported, HCMP, 3560/2016, 26 August 2016)* for sample order for the production of documents.

³²³ See, eg, *Re BJB Career Education Co Ltd* [2017] 1 HKLRD; *Re Centaur Litigation SPC* (unreported, HCMP 3389/2015, 10 March 2016).

³²⁴ This was annexed to the *Centaur* decision but was further refined in the *Pacific Andes* matter (HCMP 3560 / 2016).

this order can be departed from where appropriate.³²⁵ However, it is important to note that the order is limited by a proviso that any power sought to be exercised in Hong Kong must be subject to the powers available to the liquidators in their “home” jurisdiction. In the context of investigations, this is important because, for example, the Cayman legislation permitting examination³²⁶ is much more restrictive than its Hong Kong equivalent.³²⁷ As noted above, in these circumstances, a foreign office holder may be best advised to seek an “old fashioned” ancillary liquidation rather than a recognition order.

Further, if foreign representatives wish to exercise power to deal with Hong Kong assets (such as balances in Hong Kong bank accounts), the court has said that the liquidator should apply for a specific recognition order for this purpose.³²⁸ The argument against this was that if foreign officeholders are entitled to request banks to provide bank account documents without a court order (as in the *Bay Capital* case above), then they could similarly request banks to transfer any credit balance without a court order. The court rejected this argument, emphasising the need to balance the foreign representative’s need for convenience and the need for court supervision which creditors may expect and concluded that if foreign representatives propose to take possession of assets in Hong Kong, it would be appropriate for them to first obtain a recognition order for that purpose.

That decision now represents the practice but it is not easy to understand. Given that the court has long recognised the ability of a foreign liquidator to bring an action in Hong Kong in the name of the company without a court order, why should such a liquidator need an order to make demand for (and receive payment of) a debt, a “bank balance” being in law a debt owed by the bank to the account holder (that is, the company)?³²⁹

Further, the court will sometimes face a situation where the insolvency laws of the place of the principal liquidation conflict with the assisting or ancillary jurisdiction. The fact that the regimes are not identical should not prevent the court from assisting.³³⁰ It does not appear that the Hong Kong court has yet been required to deal with these issues directly³³¹ but it is likely that the English law approach would be adopted. By way of example in a slightly different context,³³² the court recently³³³ permitted a Hong Kong liquidator to deal with a certain asset in the PRC in such a way that full effect was not given to the *pari passu* principle. This was because, in short, PRC regulations would only permit the asset to be distributed in a certain way within the PRC and not all of the company’s creditors were able to receive payment there. The court permitted the liquidator to, in effect, treat the PRC asset as a separate pool and to distribute it accordingly, treating it as a flawed asset. Although in a different context, the decision is illustrative of the fact that in appropriate circumstances the

³²⁵ For example, see *Re Rare Earth Magnesium Technology Group Holdings Ltd* [2020] HKCFI 2260.

³²⁶ Cayman Companies Law (2018 revision), s 103.

³²⁷ CWUMPO, s 286B.

³²⁸ *Re China Lumena New Materials Corp (in Provisional Liquidation)* [2018] HKCFI 276.

³²⁹ *Foley v Hill* [1848] 2 HL Cas 28 as applied in Hong Kong in *Najeeb Bardissy v Joaquim D’Souza and Others* (unreported, HCA 9298/1994, 21 January 1999).

³³⁰ For examples dealt with in the English court see *Re HIH* [2008] 1 WLR 852; and *Re BCCI (No. 10)* [1993] BCLC 1490.

³³¹ There was some exploration of the issues in *Re Russo-Asiatic Bank* (1929-30) 24 HKLR 16 but it is not very instructive for a modern situation given the exceptional facts of that case (liquidation of a Hong Kong branch of a Russian bank which had been assumed by the Soviet Government) with a liquidators of the Shanghai branch claiming to be the principal liquidation – the court refused).

³³² Namely, not an ancillary liquidation but concerning a difficulty faced by a Hong Kong liquidator in collecting in assets from another jurisdiction (PRC).

³³³ *Re GITIC* (unreported, HCMP 2638/2017, 10 October 2018).

court will permit a liquidator to deviate from certain requirements with which a Hong Kong liquidator would normally have to comply, and is thus similar to the situations previously dealt with by the English court in the context of ancillary liquidations (where remitting assets abroad may result in English rules not being complied with).

As stated above, in addition to recognising foreign liquidations and the appointment of foreign liquidators, the court will also, according to the principles of comity, assist other insolvency processes, including rehabilitation procedures. The approach adopted is generally to permit a claimant to obtain judgment but to restrain it from enforcing that judgment. Examples are the staying of Hong Kong garnishee proceedings in aid bankruptcy proceedings in the PRC;³³⁴ to assist rehabilitation proceedings in Japan;³³⁵ and provisional liquidators appointed in the Cayman Islands;³³⁶ and to permit a restructuring by provisional liquidators appointed in Bermuda.³³⁷

One difficulty with relying on common law developments can be that it is perhaps more difficult to predict how new situations will be dealt with. This can be illustrated by a case where the court had cause to consider the recent changes in the Singapore restructuring legislation, namely whether the moratorium created in Singapore should be recognized in (and extended to) Hong Kong.³³⁸ Ultimately, the matter developed such that the court did not need to make a decision in this regard. Nevertheless, the court commented that it was unclear as to whether the Singapore procedure is a collective insolvency proceeding for common law recognition purposes. Likewise, the court again³³⁹ raised the uncertainty of whether it could recognise foreign insolvency proceedings where the foreign jurisdiction concerned is not the country of incorporation of the company.

The ability of a Hong Kong officeholder to be recognised or take action elsewhere is also important. Provided that any necessary approval is sought (which will depend on whether the liquidation is compulsory or voluntary), a Hong Kong liquidator is entitled to “bring or defend any action or other legal proceedings in the name and on behalf of the company”.³⁴⁰ The wording used in this provision is wide and it is not stated to restrict proceedings as proceedings commenced in Hong Kong.³⁴¹ Obviously, whether the court of the jurisdiction where such action is taken will recognise the liquidator’s power to do so is a matter for the law of that jurisdiction. An obvious example in the Hong Kong context is the ability of an officeholder to take steps in the PRC. Notwithstanding some successes, and certain assistance from the PRC courts,³⁴² recognition in the PRC remains a common difficulty for Hong Kong officeholders.

In England, practitioners are assisted by section 426 of the Insolvency Act 1986 which provides that the English court shall assist courts in relation to insolvency matters where those courts are within the specified list of jurisdictions as set out in the Act. Those countries mainly consists of Commonwealth or former Commonwealth jurisdictions. Notwithstanding that Hong Kong is now part of the PRC, the list still

³³⁴ *CCIC Finance v GITIC* [2005] 2 HKC 589, reported in 2005 but judgment published on 31 July 2001.

³³⁵ *Aoki* [2004] 2 HKLRD 760.

³³⁶ *Skillsoft Asia Pacific Pty Ltd v Ambow Education Holding Ltd* [2014] 1 HKLRD 520.

³³⁷ *Re Z-Obee Holdings Ltd* [2018] 1 HKLRD 165.

³³⁸ *Re CW Advanced Technologies Limited* [2018] 3 HKLRD 552.

³³⁹ See earlier discussion regarding the *African Minerals* decision.

³⁴⁰ See CWUMPO, Sch 25.

³⁴¹ *American Express International Banking Corp v Johnson* [1984] HKLR 372.

³⁴² For example, see *Sino-Environment Technology Corp Ltd v Thumb Env-Tech Group (Fujian) Co Ltd* (2014) Min Si Zhong Zi No 20 – where the Supreme court upheld the right of a foreign officeholder (in that case a Judicial Manager appointed in Singapore) to control PRC subsidiaries of the company concerned.

includes Hong Kong.³⁴³ Since the Handover in 1997, the English court has at least on one occasion in applied this section in favour of a Hong Kong liquidation.³⁴⁴

In addition to the recognition of foreign officeholders here in Hong Kong, or of Hong Kong officeholders elsewhere, it should also be kept in mind that there may be parallel insolvency proceedings for the same company commenced in different jurisdictions and it is not necessarily the case that the same insolvency practitioner would be appointed to act as the common officeholder. In order to ensure that related proceedings are carried out in a consistent manner, the Hong Kong court will, in appropriate circumstances, adopt the use of protocols to help coordinate the activities of the parallel proceedings. The protocol will provide guidelines agreed between different officeholders in different jurisdictions.³⁴⁵

Liquidators in Hong Kong are entitled to make an application³⁴⁶ to seek authorisation from the court to enter into and implement a cross-border protocol with foreign officeholders. In doing so, the court takes a “supervisory role” and would usually accept the judgement of the insolvency practitioners in entering into these protocols.³⁴⁷

Another important consideration in relation to cross-border insolvency is the use of the scheme of arrangement procedure in respect of non-Hong Kong companies. In order to obtain sanction of a scheme of arrangement in Hong Kong, the applicant must show (i) that the court has jurisdiction to do so in respect of that company; and (ii) that the scheme would be effective in the sense that the scheme would be recognised by other relevant jurisdictions. This is a recurring issue in practice given that many companies that are listed on the Hong Kong Stock Exchange are foreign companies and also because contracts can of course be governed by non-Hong Kong law (and with modern debt instruments, that is often the case).³⁴⁸ In order to give full effect to a Hong Kong scheme, recent scheme of arrangement cases³⁴⁹ showed that parallel schemes have been promulgated in multiple jurisdictions, such as:

- (a) the place of incorporation of the company;
- (b) in the case of public companies, the jurisdiction in which they are listed; and
- (c) the jurisdiction of the governing law of a debt.

Broadly speaking, in terms of scheme of arrangements, the Hong Kong court has followed the developments in English cases closely in this regard.³⁵⁰ However, the need for a parallel scheme in the place of incorporation has recently been questioned

³⁴³ By The Co-Operation of Insolvency Courts (Designation of Relevant Countries and Territories) Order 1986, SI 1986 No. 2123.

³⁴⁴ *Re The New China Hong Kong Capital Ltd.* [2003] EWHC 1573. As the “Hong Kong” included at the time of the legislation is of a different status to Hong Kong as it is now, this decision is perhaps susceptible to review.

³⁴⁵ For an example of the use of protocols in Hong Kong, see *Re Jinro (HK) International Ltd* [2003] 3 HKLRD 459

³⁴⁶ CWUMPO, s 200(3).

³⁴⁷ See *Re Akai Holdings Ltd (in Compulsory Liquidation)* (unreported, HCCW 50/2000, 6 February 2004).

³⁴⁸ A scheme implemented and sanctioned in Hong Kong would not have the effect of discharging a debt that is governed by a foreign law (the “Gibbs principle” referred to above). This principle has been applied in *Re LDK Solar Co, LTD (in provisional liquidation)* [2015] 1 HKLRD 458 in a scheme context.

³⁴⁹ *Re Winsway Enterprises Holdings Ltd* [2017] 1 HKLRD 1; *Re Kaisa Holdings Limited* [2017] 1 HKLRD 18; and *Re Mongolian Mining Corp* [2018] 5 HKLRD 48.

³⁵⁰ Such as *PrimaCom Holdings GmbH v Credit Agricole* [2013] BCC 201 and *Re Magyar Telecom BV* [2015] 1 BCLC 418.

by the Hong Kong court, with the court saying that this “is the very antithesis of cross-border insolvency cooperation”.³⁵¹

As to jurisdiction, where a company is not incorporated in Hong Kong the court has held that the test to sanction a scheme is that “there must be a sufficient connection of the foreign company with Hong Kong (but this does not necessarily mean presence of assets within the jurisdiction).”³⁵²

It is generally understood that although the “sufficient connection” test in Hong Kong is not identical to the test of where a company has its “centre of main interest” or an “establishment”,³⁵³ in practice the factors that the Hong Kong court will consider in determining “sufficient connection” are similar to those which are applied in other jurisdictions. For instance in *LDK*, the Hong Kong court applied rules stated in an English decision³⁵⁴ noting that “a principal concern of the court should be whether there are connecting factors with the jurisdiction so that the scheme, if approved, will have a substantive effect”. Examples are:

- (a) the presence of substantial assets belonging to the company proposing a scheme with its creditors, such as Hong Kong subsidiaries, and Hong Kong bank accounts;
- (b) the presence of a sufficient number of creditors in the jurisdiction subject to the personal jurisdiction of the court; and
- (c) whether the scheme seeks to discharge or adjust debts governed by Hong Kong law.

Other criteria which have been considered in the Hong Kong courts to establish whether there is sufficient connection with Hong Kong for purposes of effecting a scheme of arrangement are:

- (a) registration in Hong Kong as a non-Hong Kong company under the relevant part of the Companies Ordinance;
- (b) the presence of directors resident in Hong Kong;
- (c) dealings with shareholders in Hong Kong, such as the holding of annual general meetings in Hong Kong; and
- (d) board meetings of the debtor (and perhaps its subsidiaries) are held in Hong Kong and all administrative matters relating to the debtor are discussed and decided in Hong Kong.

In relevant situations, where schemes of arrangement are not available in a foreign jurisdiction, recognition of the Hong Kong scheme should be sought (for example a recognition pursuant to Chapter 15 of the US Bankruptcy Code) and expert evidence would have to be adduced in Hong Kong to address how that foreign jurisdiction would give effect to the Hong Kong scheme despite not having formal recognition

³⁵¹ *Re Da Yu Financial Holdings Ltd* [2019] HKCFI 2531.

³⁵² *Re LDK Solar Co Ltd* [2015] 1 HKLRD 458. Considering *Re Yung Kee* and applying *Re Drax Holding Ltd* [2004] 1 BCLC 10, that the consideration should be limited to the issue of “sufficient connection” (ie, that it should be enough to satisfy only the first of the 3 core requirements set out in the CFA’s *Yung Kee* decision discussed elsewhere.

³⁵³ The term used for the purposes of Chapter 15 of the US Bankruptcy Code.

³⁵⁴ *Re Magyar Telecom BV* [2013] EWHC 3700 (Ch).

procedures or, if there are such procedures, that they would likely be given effect in the relevant circumstances.

Self-Assessment Exercise 6

Question 1

Approximately what percentage of companies listed on the Stock Exchange of Hong Kong are incorporated somewhere other than Hong Kong?

Question 2

With a number of companies carrying on business in Hong Kong being incorporated outside of Hong Kong, what legislation (if any) exists to enable the winding up of such a company in Hong Kong?

Question 3

Cyberbay MedTech Limited (Cyberbay) is a company incorporated in the Cayman Islands and is listed on the Stock Exchange of Hong Kong. It has a leased office in Hong Kong with several employees based there, as well as a Hong Kong incorporated subsidiary which serves as an intermediate holding company for the main businesses in the Mainland. Cyberbay has defaulted on obligations under certain Notes. The Noteholders have successfully applied to the Cayman Court for the appointment of joint provisional liquidators (JPLs) on a “light touch” basis, with those JPLs having powers to investigate and to promulgate a restructuring if one is viable. The JPLs have approached you in Hong Kong to ask whether they can exercise their powers to effect a restructuring in Hong Kong and, if so, how they could do so?

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

In Hong Kong, foreign judgments from certain jurisdictions can be recognised pursuant to statute. For others, the judgment creditor needs to bring an action at common law to enforce the judgment.

8.1 By statute

The relevant statutes are:

- (a) Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap 319) (FJREO);
- (b) Foreign Judgments (Restriction on Recognition and Enforcement) Ordinance (Cap 46);
- (c) Judgments (Facilities for Enforcement) Ordinance (Cap 9) – in force prior to the Handover to facilitate enforcement with the United Kingdom.

There is a statutory registration scheme for foreign judgments under FJREO, which facilitates recognition and enforcement of judgments on the basis of reciprocity. If a foreign judgment is registrable under FJREO, it is not open to the judgment creditor to enforce such judgment at common law.³⁵⁵

Once registered under FJREO, the judgment has the same force and effect as a Hong Kong judgment for the purpose of enforcement.

A foreign judgment is registrable under FJREO if it is a final and conclusive judgment of a superior court of a jurisdiction to which FJREO extends and there is payable under the judgment a sum of money, not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty.³⁵⁶

The application must be made within six years of the date of the original judgment.³⁵⁷

The judgment must not have been wholly satisfied and must be enforceable by execution in the country of the original court. If a judgment has been satisfied in part, it can be registered to the extent of the unpaid balance.³⁵⁸ Where the judgment debt is expressed in a currency other than Hong Kong Dollars (HKD), the judgment must be registered as if it were a judgment in HKD on the basis of the exchange rate as at the date of registration. If the judgment is given in parts, the court can exclude any parts of the judgment if those parts are deemed unregistrable, without having effect on those parts that are registerable.

Interest is payable on the registered judgment.³⁵⁹

Prior to the Handover, certain parts of the legislation extended enforcement to Commonwealth countries³⁶⁰ and thus fall foul of being “a privilege conferred on the United Kingdom or other Commonwealth countries or territories, other than provisions giving effect to reciprocal arrangements”³⁶¹ and no longer have effect.³⁶² As a result, Commonwealth judgments must now be enforced by common law unless the relevant jurisdiction is listed in FJREO as a jurisdiction that offers reciprocity. In that regard, there have been debates surrounding the designation of “Commonwealth countries” in FJREO and whether this is also caught by the legislation “outlawing” benefits conferred on Commonwealth countries. However, based on the facts that (i) a number of non-Commonwealth countries are included in FJREO and (ii) many Commonwealth countries are not, the better view is that countries are not being afforded a “privilege” by being part of the Commonwealth as such.³⁶³

³⁵⁵ Foreign Judgments (Reciprocal Enforcement) Ordinance, s 8. Although a doubtful decision, there is a recent Hong Kong decision which held that this provision extends to a prohibition on presenting a bankruptcy (and by extension a winding up) petition on the basis of a statutory demand if that demand is based on a foreign judgment: *Re James Chor Cheung Wong* [2018] HKCFI 585.

³⁵⁶ *Idem*, s 3(2).

³⁵⁷ *Idem*, s 4(1); E3/0/14, Hong Kong Civil Procedure 2018.

³⁵⁸ Foreign Judgments (Reciprocal Enforcement) Ordinance, s 4(4).

³⁵⁹ The interest rate applied to judgment debts in Hong Kong is prescribed by the Judiciary and the prevailing rate at any particular time can be found at:

https://www.judiciary.hk/en/court_services_facilities/interest_rate.html (it has been 8.00% for some time but an announcement has just been made that as from 1 January 2019 it will rise to 8.088%).

³⁶⁰ The Foreign Judgments (Reciprocal Enforcement) (Application to the Commonwealth) Order (Cap 319B).

³⁶¹ Interpretation and General Clauses Ordinance, s 2A(2)(b).

³⁶² See E3/0/11, Hong Kong Civil Procedure 2018; para 9.103, *The Conflict of Laws in Hong Kong*.

³⁶³ Para 9.099, Johnston & Harris, *The Conflict of Laws in Hong Kong* (2017).

The relevant schedules specifying countries to which FJREO applies include Australian courts, a number of Commonwealth or former Commonwealth countries³⁶⁴ and a number of other countries.³⁶⁵

A “superior court” means a court “having unlimited jurisdiction in civil and criminal matters”.³⁶⁶

To apply to register a judgment that falls within the statutory scheme, the judgment creditor must make an *ex parte* application to a Master of the Court of First Instance³⁶⁷ exhibiting the foreign judgment and stating on affidavit the relevant details, including (amongst other things) that the judgment remains unsatisfied and that it could be enforced in the country of the original court.

If the application is successful, the court will grant an order giving leave for the foreign judgment to be registered on behalf of the judgment creditor and specify a time within which any application shall be made for the registration to be set aside.³⁶⁸

After registration, the judgment debtor would be informed of the registration and the foreign judgment can be enforced in the same way as any Hong Kong judgment. Leave is not required for service of this notice out of jurisdiction.³⁶⁹

The judgment debtor may apply by summons to the court to set aside the registration on a number of grounds within a specific period of time³⁷⁰ (as stated in the notice). On hearing of such application, the court may order the trial of any issue between the judgment creditor and the judgment debtor and impose any terms that it thinks fit. In particular, the judgment debtor may be required to provide security as a condition of challenging the registration.³⁷¹

In order to set aside the registration of a foreign judgment, the judgment debtor needs to satisfy the court that the:

- (a) judgment is not a judgment to which the provisions of FJREO apply or was registered in contravention of the provisions of FJREO;
- (b) foreign court had no jurisdiction in the circumstances of the case;
- (c) judgment debtor did not receive notice of the original proceedings (in the foreign court) in sufficient time to enable him to defend the proceedings;
- (d) judgment was obtained by fraud;³⁷²
- (e) enforcement of the judgment would be contrary to Hong Kong public policy. The fact that the liability is one not available in Hong Kong does not stop the judgment from being registered; or

³⁶⁴ Bermuda, Brunei, India, Malaysia, New Zealand, Singapore and Sri Lanka.

³⁶⁵ Belgium, France, Germany, Italy, Austria, The Netherlands and Israel.

³⁶⁶ Cap 319A, para 4(b).

³⁶⁷ RHC, Order 71, r 2.

³⁶⁸ Order 71, r 5(1), 5(3).

³⁶⁹ Order 71, r 7(3).

³⁷⁰ FJREO, s 6.

³⁷¹ Order 71, r 9(3).

³⁷² *Malcolm Maydwell v WFM Motors Pty Ltd* [1997] HKLRD 739 held that the registration of a foreign judgment will be set aside if it had been obtained by fraud. However, the judgment debtor needs to present evidence of at least a *prima facie* case of fraud. Once the judgment debtor has done so, the court may direct a preliminary issue to be heard.

(f) rights under the judgment are not vested in the applicant for the registration.

Restrictions under section 3 of the Foreign Judgments (Restrictions on Recognition and Enforcement) Ordinance (Cap 46) also apply. This section refers to where the foreign judgment was obtained in breach of a jurisdiction agreement for resolution of disputes.

8.2 By common law action

Where a foreign judgment cannot be registered under FJREO, it may be enforced by common law. An action “upon any judgment” must be brought within 12 years after the date on which the foreign judgment became enforceable.³⁷³ However, that provision refers to Hong Kong judgments only and since an action upon a foreign judgment is an action in debt, the relevant period is six years.³⁷⁴

A foreign judgment itself may form the basis of a cause of action since the judgment may be regarded as creating a debt between the parties to it. The requirements for enforcement of a non-Hong Kong judgment were summarised in *Korea Data Systems Co Ltd & Anor v Chiang Jay Tien & Anor*³⁷⁵ and it is well-established that a foreign judgment for a monetary sum may be enforced if the judgment is final and conclusive on the merits.

Such a judgment must be for a fixed sum (not being a sum payable in respect of taxes, fines or other charges) and must also come from a “competent” court (as determined by the private international law rules applied by the Hong Kong courts).

It should be noted that a foreign judgment does not have to originate from a common law jurisdiction in order to benefit from the common law rules. Neither is reciprocity a requirement under the common law. Hence, a judgment originating from a jurisdiction which does not recognise a Hong Kong judgment may still be recognised and enforced by the Hong Kong courts provided that all the relevant requirements at common law are met.

In terms of procedure, the plaintiff issues a writ endorsed with a short statement of claim (the writ needs only to recite the judgment not the underlying dispute that led to the judgment). If the judgment debtor chooses to defend, it is likely that the matter would be disposed of by summary judgment.

The court will then decide whether the defendant has any *bona fide* defence such that the enforcement action ought to go to trial. These potential defences are very similar to the grounds for setting aside the statutory registration of a foreign judgment set out above and include matters of public policy, lack of jurisdiction of the court of origin, fraud, and breach of natural justice.³⁷⁶

³⁷³ Limitation Ordinance (Cap 347), s 4(4).

³⁷⁴ *Shenzhen Tian He Jian Sang Electronic Holdings Co Ltd v Hong Kong Jian Sang Electronics (Group) Ltd* [2008] 4 HKLRD 314; see also E3/0/8, Hong Kong Civil Procedure 2018. Note: In the case of *Motorola v Uzan*, it was held that the commencement of the limitation period was postponed as a result of the defendants’ deliberate concealment of assets.

³⁷⁵ [2001] 3 HKC, following *Nouvion v Freeman* (1889) 15 App Cas 1.

³⁷⁶ For example this will include giving false evidence or intimidation by violence in order to obtain a favourable judgment; in the case of *WFM Motors PTY Limited v Malcolm Maydwell* (7 December 1995, HCMP 1778 of 1995) the court stated that “the question is not whether the decision of the foreign court was correct...however, where fraud is alleged it is permissible in an appropriate case to examine the evidence to consider whether or not the evidence given at the trial was fraudulent.”

8.3 Special rules for recognition of Mainland judgments

Following the Handover in 1997, Mainland China is no longer a “foreign country” and therefore any rules as to enforcement of a “foreign” judgment would not apply. In July 2006, the “Arrangement on Reciprocal Recognition and Enforcement of Judgment in Civil and Commercial Matters by the courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties’ Concerned” was signed between the Department of Justice (HK) and the Supreme People’s Court (Mainland).

The Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap 597) (MJREO) came into force on 1 August 2008 to give effect to the above arrangement. MJREO is modelled on FJREO and enforcement in Hong Kong is by way of registration of Mainland money judgments. In the Mainland, the arrangement came into effect on 1 August 2008 by way of a judicial interpretation dated 3 July 2008 promulgated by the Supreme People’s court.

In this context “Mainland” means any part of China other than Hong Kong, Macau and Taiwan. Macanese and Taiwanese judgments can only be enforced by way of common law recognition.

The arrangement only applies in certain circumstances:

- (a) **Commercial contracts:** MJREO only applies to enforcement of money judgments on disputes arising out of commercial contracts. Non-commercial contracts such as matrimonial or employment contracts, or contracts for personal consumption are excluded;
- (b) **Valid agreement on choice of Mainland court:** a Mainland judgment is only enforceable in Hong Kong if the underlying agreement gives exclusive jurisdiction to the relevant Mainland court;
- (c) **Money judgments from a designated court:** Judgments in respect of payment of any tax, fine or penalty are excluded. However, costs orders are registrable. In Hong Kong, only Mainland judgments from designated courts stated in the legislation³⁷⁷ are recognised. In the Mainland, money judgments from any Hong Kong court are recognised;
- (d) **Final and conclusive judgments:** The judgment to be enforced has to be final and conclusive and have been given after the commencement of Cap 597. In order to prove that a Mainland judgment is final and conclusive, the applicant may produce a certificate from the original Mainland court or other evidence (for example, an enforcement notice from a Mainland court). In the Mainland, a copy of the judgment in Hong Kong certified by a Hong Kong court and a certificate that the judgment is enforceable by way of execution in Hong Kong are required. Where any document submitted to a People’s Court of the Mainland is not in the Chinese language, a duly certified Chinese translation shall be submitted as well.

As (a) and (b) in particular restrict the utility of the legislation in many commercial cases, the Supreme Court (of the Mainland) and the Hong Kong Government have signed (in 2019) a further arrangement (the “Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the

³⁷⁷ Cap 597, Sch 1.

Mainland and of the Hong Kong Special Administrative Region”). This Arrangement will, amongst other things, remove the requirement for an exclusive jurisdiction clause and will extend enforcement to non-money judgments. However, at the time of writing, the Arrangement is not yet in force.

An application must be made within two years from the date from which the judgment takes effect, or in cases where there is a specified period within which the judgment ought to have been performed, within two years from the last day of such period.

If a Mainland judgment is registrable under Cap 597, it can only be enforced by registration pursuant to that legislation. It is not open to the judgment creditor to enforce such Mainland judgment at common law.

8.4 Other issues to consider in the context of enforcing foreign judgments

8.4.1 Unrecognized governments – Taiwanese judgments

In 1999, the Court of Appeal considered a common law principle that certain acts and orders of an unrecognised government might be recognised by the Hong Kong courts, provided that the relevant acts did not directly recognise the unrecognised government and held that this was not contrary to public policy.³⁷⁸ The court stated that there was no difference between a bankruptcy order and a judgment on a sum claimed in the sense that neither involved recognition of the Taiwanese government as a matter of public international law.

The CFA subsequently confirmed³⁷⁹ that the courts of Hong Kong would give effect to orders of non-recognised courts where the following are satisfied:

- (a) the rights covered by those orders were private rights;
- (b) giving effect to such orders accorded with the interests of justice, the dictates of common sense, and the needs of law and order; and
- (c) Giving them effect would not be inimical to the sovereign’s interests or otherwise contrary to public policy.

8.4.2 Sovereign immunity

Hong Kong will apply the rule of absolute sovereign immunity³⁸⁰. This change in Hong Kong’s law after the Handover came when a fund sought to enforce two arbitral awards in Hong Kong against the Democratic Republic of Congo (DRC) in respect of which it had obtained an order allowing it to enforce the awards as a judgment of the court. The DRC applied to set aside the order on the basis of absolute state immunity and that the Hong Kong courts therefore had no jurisdiction. By a 3-2 majority, the CFA held that the doctrine of state immunity was absolute and it was not open to the courts to “adopt a legal doctrine of state immunity which recognises a commercial exception” and which is “different from the principled policy practiced by the PRC.”

³⁷⁸ *CEP New Asia Co Ltd v Wong Kwong Yiu* [1993] 3 HKLRD 697 – a case involving a judgment obtained in Taiwan.

³⁷⁹ *Chen Li Hung & others v Ting Lei Miao & Others* [2000] 1 HKLRD 252.

³⁸⁰ *Democratic Republic of the Congo v FG Hemisphere Associates LLC* (2011) 14 HKCFAR 41.

8.4.3 *Fraud exception to summary judgment*

In Hong Kong, it is expressly stated³⁸¹ that the summary judgment mechanism does not apply to any claim based on an allegation of fraud. However, that rule does not prohibit the plaintiff from getting a summary judgment to enforce a foreign judgment of a claim based on fraud because the cause of action in the Hong Kong action is enforcement of foreign judgment instead of fraud itself.³⁸²

8.4.4 *Is a summary or default judgment “final and conclusive”?*

The phrase “final and conclusive” is understood to mean “final and conclusive on the merits” of the case.³⁸³ In the context of enforcement of a foreign judgment, a default judgment may be final and conclusive and on the merits until it is set aside, provided it is *res judicata* in the foreign legal system. As set out in the *Fabiano* decision, “the possibility of appeal to a higher court and the fact that the judgment is currently under appeal do not alter its finality”. If the Defendant wanted to protect its position, an application for stay of execution would be necessary.³⁸⁴

In the *Fabiano* case, the court also stated that “on the merits” meant judgment pronounced by a foreign court of competent jurisdiction according to its established procedure in which the whole merits of the case were open to the parties, however much they may have failed to take advantage of them was final and could not thereafter be disputed.³⁸⁵

However, if the judgment is provisional or *nisi* (in that the judicial system provides for a procedure to enable the parties to re-argue their case before the same court pronouncing the judgment which would enable the same court to set aside the judgment or alter it), such a judgment is not final.

8.4.5 *Insolvency judgments*

Whether insolvency judgments (for example judgments avoiding certain transactions) enjoy a different regime is something that was considered by the Privy Council in *Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc*³⁸⁶ in the affirmative. However, this was then overturned by the Supreme court.³⁸⁷ The key principles decided by the Supreme Court in *Rubin* are that enforcement of insolvency proceedings are to be treated in the same manner as other foreign judgments and that participation in the foreign insolvency proceedings is likely to be sufficient to determine that a party has submitted to that court. In the circumstances, “insolvency orders” as such were not given “better recognition”. There is no Hong Kong authority on the issue.³⁸⁸

³⁸¹ RHC, Order 14, r 1(2)(b).

³⁸² For example, in the case of *Motorola Solutions Credit Co LLC v Kemal Uzan* [2016] HKEC 1365, the plaintiff sought to enforce a US judgment on fraud.

³⁸³ *Fabiano Hotels Ltd v Profitmax Holdings Inc & Ors* [2017] HKC 1997.

³⁸⁴ In the Canadian case of *Four Embarcadero Center Venture et al v Mr Greenjeans Corp et al* (1988) 64 OR (2d) 746, the Plaintiffs obtained a default judgment in California and the Defendants appealed but did not apply for a stay of execution. In that case, the court stated that a “foreign judgment that has gone by default is no less final or enforceable than a judgment rendered after a full trial” and that “an action may be commenced in Ontario to enforce a foreign money judgment that is final ... notwithstanding that it is under appeal where there is no stay of enforcement”. Finally it was stated that in order to safeguard the rights of a judgment debtor, he or she should apply for a stay of execution of the judgment until the outcome of the appeal.

³⁸⁵ See also *Carl Zeiss Stiftung v Rayner & Keeler Ltd (No 2)* [1967] 1 AC 853 and *Nouvion v Freeman* (1889) 15 App Cas 17.

³⁸⁶ [2006] 3 WLR 689.

³⁸⁷ *Rubin v Eurofinance* [2012] UKSC 46.

³⁸⁸ *Re CW Advanced Technologies Limited* [2018] HKCFI 1705.

Self-Assessment Exercise 7**Question 1**

Earlsfort Trading Limited (ETL), a BVI incorporated company, has obtained judgment from the English High Court in the sum of USD10 million against Harcourt International Limited (HIL), a Hong Kong incorporated company. The contract between ETL and HIL contained an arbitration clause requiring disputes to be submitted to arbitration in London. You are approached by ETL to advise it on its options to enforce the judgment in Hong Kong. Advise ETL.

Question 2

Ignoring the reference to an arbitration clause, would the advice to ETL be different if the judgment had been obtained in the Shanghai court rather than the English court?

**For commentary and feedback on self-assessment exercise 7, please see
APPENDIX A**

9. INSOLVENCY LAW REFORM

As will be clear from large parts of this module, an important component of Hong Kong's insolvency law is development through the common law, which constantly evolves.

The principal legislation has been in existence for some time, and is largely based on the UK legislation prior to enactment there of the Insolvency Act 1986. The legislation has been amended from time to time including, most recently, in 2017 when the legislature added the provisions relating to transactions at an undervalue³⁸⁹ and the requirements for proposed liquidators to make disclosure statements to help avoid conflicts of interest.³⁹⁰

However, as to legislation, there are two glaring gaps in Hong Kong, namely (i) as to corporate rescue; and (ii) as to cross-border insolvency issues. In both cases, there have been moves to effect reforms, which reforms are still under consideration.

9.1 Corporate rescue

Legislation to deal with corporate rescue has been mooted for many years. It first came under consideration following recommendations by the Law Reform Commission in 1996. This led to a Corporate Rescue Bill being introduced into the Legislative Council (Legco) in 2001. The broad thesis of the Bill is that the system would remain creditor focused. Suggestions of a Chapter 11-type debtor-in-possession system did not gain traction and were not adopted. Under the Bill, a "provisional supervisor" could be appointed, with a view to exploring restructuring or other rehabilitation procedures.

³⁸⁹ CWUMPO, s 265E.

³⁹⁰ CWUMPO, s 262A *et seq.*

Although the Bill did provide for a moratorium to permit the provisional supervisor to carry out a restructuring there were a number of other points which caused difficulty. For example, a provisional supervisor would assume personal liability for employment contracts; it was necessary to get the consent of major secured creditors before application to appoint a provisional supervisor could be made; and insolvent trading provisions (which were also included in the bill) drew a lot of criticism from business groups.³⁹¹

After a number of rounds of discussion, the Bill formally lapsed from Legco's schedule in July 2004. However, over the past few years the Bill³⁹² has been sporadically revived with various comments being made by the Secretary for Financial Services and the Treasury Bureau (FSTB), in March and October 2017 and further comments from the Legco Panel on Financial Affairs (in March 2018) suggesting it would be introduced in Legco's then current session (which ended in July 2018).³⁹³ That did not happen, and the Legco website now suggests it will be in the 2018/2019 legislative year.³⁹⁴ Again, this did not happen but yet further consultation has been sought during 2020 but with little apparent enthusiasm, with the same elements which have caused difficulty still appearing in the draft Bill. This is despite several other jurisdictions addressing their legislation regarding corporate rescue as a result of the COVID-19 pandemic, with Hong Kong's own Companies Judge commenting as follows:

“As is well known, other than schemes of arrangement Hong Kong has no legislation that provides for corporate debt restructuring or rehabilitation. This unsatisfactory state of affairs has been the subject of much invariably adverse comment for two decades now. It is brought into unforgiving focus by the economic problems that Covid-19 is causing. It makes it all the more important that the courts of Hong Kong and the Special Administrative Region's practitioners rise to the challenges we now face to find, within the flexibility of the common law, mechanisms to address the financial problems companies face. It is fortunate that great strides have been made in this regard in recent years as illustrated by the authorities referred to earlier in this decision. That having been said it is clearly desirable that some steps are taken immediately to improve the legislative position. Immediate (by which I mean the kind of alacrity shown in other major financial centres around the World in the last couple of months) amendment to section 193 of [CWUMPO] to provide expressly for provisional liquidators to be given restructuring powers is desirable.”³⁹⁵

9.2 Cross-border issues

As long ago as 1999, a Law Reform Commission paper suggested that legislation be introduced in relation to cross-border insolvency (advocating a provision similar to the English provision in section 426 of the Insolvency Act 1986). Further, on more than one occasion the current Hong Kong Companies Judge has commented that the issue of cross-border insolvency should be looked at by the legislature.³⁹⁶ In March

³⁹¹ The concern was that this would discourage people from becoming directors and thus dampen Hong Kong's “entrepreneurial spirit”.

³⁹² The text of which can be found at: <https://www.legco.gov.hk/yr00-01/english/bills/c025-e.pdf>.

³⁹³ See Legco paper CB91)625/17-18(1).

³⁹⁴ <https://www.legco.gov.hk/yr18-19/english/bc/bc1819.htm#toptbl>.

³⁹⁵ *Re China Oil Gangran Energy Group Holdings Ltd* [2020] HKCFI 825.

³⁹⁶ Most recently in *Re CW Advanced Technologies Limited* [2018] HKCFI 1705.

2017, the Secretary for the FSTB stated that the Government was “...taking steps to consider how best we can further facilitate corporate insolvency work that involves cross-border jurisdictional issues”. However, there have as yet been no steps taken in Legco in relation to the subject.

There have been comments made as to the possible adoption of the UNCITRAL Model Law on Cross-Border Insolvency. However, there has still been no official announcement to that effect and it is understood that the relevant legislative department considers that the corporate rescue legislation should be given priority.

Importantly, however, in a consultation paper published by the Department of Justice in July 2018,³⁹⁷ it was recognised that there were no provisions for recognition and assistance between Hong Kong and the Mainland in relation to corporate insolvency and restructuring (nor personal bankruptcy) and that “this is far from satisfactory”. The paper goes on to say that, given the specialist nature of the area, a separate consultation exercise on “cross-boundary”³⁹⁸ will be established to consider mutual recognition of and assistance in cross-boundary corporate insolvency matters as between Hong Kong and the Mainland. Again, however, there has been no apparent progress from the legislature, with the only progression resulting from the decisions of the court mentioned earlier.³⁹⁹ One interesting ramification will be whether the arrangement will extend to insolvency orders made in a company’s jurisdiction of incorporation (for example, the Cayman Islands) and then recognised in Hong Kong.

10. USEFUL INFORMATION

Commonly used or useful publications and websites in Hong Kong include:

- (a) Butterworths Hong Kong Company Law (Winding Up and Miscellaneous Provisions) Handbook (Third Edition);
- (b) Butterworths Hong Kong Bankruptcy Law Handbook (Fifth Edition);
- (c) The Hong Kong Corporate Insolvency Manual (Fourth Edition);
- (d) The Hong Kong e-Legislation website (<https://www.elegislation.gov.hk/>);
- (e) The Hong Kong Judiciary website (<https://www.judiciary.hk/en/home/index.html>);
- (f) Website of the Official Receiver’s Office; (<https://www.oro.gov.hk/eng/home/home.htm>);
- (g) The Basic Law (<https://www.basiclaw.gov.hk/en/facts/index.html>).

³⁹⁷ Proposed Arrangement Between Hong Kong and the Mainland on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters.

³⁹⁸ Note the subtle change of wording from “cross border”, presumably to avoid any suggestion that Hong Kong and the Mainland are separate countries.

³⁹⁹ *Re CEFC Shanghai International Group Ltd (Mainland Liquidation)* [2020] HKCFI 167; and *Re Liquidator of Shenzhen Everich Supply Chain Co Ltd* [2020] HKCFI 965.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES**Self-Assessment Exercise 1****Question 1**

Describe in overview the sources of Hong Kong law, including comment on how Hong Kong's history has shaped its law.

Question 2

A has a claim against B in the sum of HKD 2.5 million. A asks you to issue a writ against B. In which court should you commence those proceedings?

- (a) The Small Claims Tribunal;
- (b) The Companies Court;
- (c) The Court of First Instance of the High Court;
- (d) The District Court.

What other steps could A take if B fails to pay the debt, and in which court?

Question 3

Happy Billion Limited has obtained judgment against Sad Face Limited in the sum of HKD 10 million. SFL holds a bank account with HSBC in Central, Hong Kong and also owns all the issued shares in a private Hong Kong company called Pot of Gold Limited, which itself owns substantial assets. What steps can HBL take to enforce its judgment?

Commentary and Feedback on Self-Assessment Exercise 1**Question 1**

You should refer to Hong Kong's statutory regime contained in Ordinances and that it is a common law system. Prior to 1 July 1997, Hong Kong was under British rule and English law applied, with Privy Council decisions on Hong Kong appeals binding and other authorities persuasive. After the Handover, the Basic Law provided that the common law as at that date would continue to apply. The *China Field* decision should be referred. A more detailed response would also refer to the Basic Law removing any "privileges" that were previously afforded to the UK or any Commonwealth jurisdictions and that the common law in Hong Kong continues to develop by drawing on decisions of English and other Commonwealth courts.

Question 2

Answer (d) is correct.

As the claim is for a liquidated amount, and if there is no real basis for disputing the debt, A could also present a winding up petition to start liquidation proceedings. Such a petition would need to be presented to the High Court.

Question 3

- 1) Garnishee of the HSBC bank account, and
- 2) Charging Order over the shares.

Self-Assessment Exercise 2**Question 1**

Briefly describe the main differences between a fixed and floating charge and how to determine whether a purported fixed charge is in fact fixed.

Question 2

Billion Happy Limited (BH) imports luxury cars into Hong Kong, with a showroom at 88 Kai Tak Street, a property that it owns. BH has borrowed HKD 50 million from Reef Lenders Limited (RL). As security for that loan, BH has granted a mortgage over the Kai Tak property in favour of RL. A supplier of spare parts to BH has not been paid for some time and obtained judgment against BH for HKD 5 million. BH did not satisfy that judgment so the supplier sought and obtained a winding up order against BH. What should the liquidator do in relation to the Kai Tak Street property?

Commentary and Feedback on Self-Assessment 2**Question 1**

- Fixed charge attaches from its creation and use of the asset is restricted;
- Floating charge permits use of asset and thus improves working capital;
- Enforcement of fixed charge stands wholly outside liquidation;
- Enforcement of floating charge outside liquidation, but:
- Realisations used to pay preferential creditors (unless the liquidator holds sufficient other (non-charged) assets to meet these payments); and
- Voidable as against a liquidator if created within a certain time before liquidation (6 months, or 2 years if charge is “connected”), except as to new money lent.

Question 2

First, the liquidator would need to check if the mortgage is properly registered (at Companies Registry and Land Registry). If no, void against the liquidator and property is part of the estate. If yes, RL is able to enforce its security outside the liquidation and liquidator would not be able to get the property into the estate. If the amount outstanding to RL is greater than value of property, RL is still able to prove in the liquidation for its shortfall.

If RL does prove, must value its security and exclude from proof of debt (if vote for whole, security waived);

If RL able to prove, this would further affect the supplier’s return because in respect of its shortfall RL would still rank alongside the supplier on distribution to unsecured creditors (*pari passu* principle).

If the amount outstanding to RL is less than the value of the property, RL should be paid in full and the balance of the sale proceeds of the property would be available for the general body of creditors.

Self-Assessment Exercise 3

Question 1 (insolvency system)

Identify the five key pieces of Hong Kong legislation (or subsidiary legislation) that relate to insolvency issues (including schemes of arrangement).

Question 2 (Bankruptcy)

Until he left for Canada 2 years ago, Jack Chan lived in Hong Kong and carried on business there in his own name. He still comes back to Hong Kong to stay with friends from time to time for a holiday. Agnes Wan was a friend of Jack Chan and lent him HKD 100,000 to help with his business, but he never paid her back. Agnes has been told by one friend that she can take action to make Jack a bankrupt. However, another friend has told her that she can't do that because Jack does not live in Hong Kong and the amount due to her is too small. Agnes consults you for advice. Leaving aside commercial considerations (such as costs to be incurred against the likelihood of recovery), which of the following is correct and why?

- (a) The second friend is correct because a person cannot be made bankrupt in Hong Kong unless they are a Hong Kong resident and the debt is in excess of HKD 100,000.
- (b) The second friend is partly correct because a person cannot be made bankrupt in Hong Kong unless they are a Hong Kong resident, but the size of the debt is irrelevant.
- (c) The first friend is correct but the bankruptcy proceeding can only be commenced when Jack is in Hong Kong for one of his visits.
- (d) The first friend is correct and Agnes can invoke the bankruptcy provisions against Jack.

Question 3 (bankruptcy)

Eddie Simmons has been living and working in Hong Kong for a number of years, and borrowed HKD 250,000 from his friend, Brendan Gann, but did not pay him back. Brendan took action and Eddie is now a bankrupt. The trustee has determined that a number of writs have been issued against Eddie. As to assets, there is a small balance in a bank account and a motorcycle registered in Eddie's name. Eddie states that although he admits borrowing the HKD 250,000 from Brendan, he had also done some work for Brendan and issued an invoice in the sum of HKD 75,000, which is unpaid. The trustee asks your advice as to what should be done about the litigation; the assets identified; and what the effect is of the invoice issued to Brendan.

Commentary and Feedback on Self-Assessment Exercise 3**Question 1**

- 1) Bankruptcy Ordinance (Cap 6);
- 2) Bankruptcy Rules (Cap 6A);
- 3) Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32);
- 4) Companies (Winding Up) Rules (Cap 32H);
- 5) Companies Ordinance (Cap 622).

Question 2

(d) is the correct answer because section 4 of the Bankruptcy Ordinance sets out the jurisdiction; this includes where the person has carried on business in Hong Kong within the last 3 years. The value threshold for a bankruptcy petition is only HKD 10,000 (section 6 of the Bankruptcy Ordinance).

Question 3

Litigation is stayed on the making of the bankruptcy order (section 12 Bankruptcy Ordinance);

The assets vest in the trustee (section 58, Bankruptcy Ordinance) and the assets should be realised to pay the costs of the bankruptcy and then make returns to creditors;

There is a statutory, mandatory, set-off of the debts between Eddie and Brendan if it is established that both debts are genuine and between the same parties (and not, for example, if the services had been to a company operated by Brendan rather than Brendan himself).

Self-Assessment Exercise 4**Question 1**

Identify the two main types of voluntary liquidation of a company in Hong Kong and describe the key features of the procedures to commence each type. The answer should include commentary on whether any particular circumstances give rise to differences in the procedure.

Question 2

Lucky Gold Limited is a Hong Kong company carrying on business as an importer and exporter of various consumer goods. Nepo Tech Limited supplies IT services to Lucky Gold. Since about 9 months ago when new directors took charge at Lucky Gold, Nepo Tech's invoices have not been paid and the new directors have been quite hostile in their dealings with Nepo Tech, refusing to even discuss the outstanding invoices. Nepo Tech has heard from other suppliers and customers that the new directors have "destroyed" the Lucky Gold business, and there are several legal actions which have been commenced. Nepo Tech have also heard that the new directors are taking steps to "protect" assets from creditors (such as invoicing customers through another entity and ensuring stock does not come through Hong Kong). In these circumstances, Nepo Tech believes there is not much point in just suing Lucky Gold as "it will be at the back of the queue". Instead, Nepo Tech instructs you to advise on what steps should be taken to wind up Lucky Gold, telling you that, on the advice of a friendly business contact, it has already sent what it called a "Companies Act demand" about 3 weeks ago and still no payment has been made. What are the main points of initial advice you should give to Nepo Tech?

Question 3

The liquidator notices that a few months before the liquidation a charge was granted in favour of Dojee Bank over a valuable motor yacht owned by Lucky Gold. The charge is said to be security for a loan made available to Lucky Gold about a year earlier, which facility had been personally guaranteed by Lucky Gold's directors. The liquidator asks you to give guidance on what steps he can take.

Question 4

Fernando Trading Limited is a creditor of Lucky Gold for approximately HKD 2 million and files a proof of debt accordingly. However, the liquidator is reluctant to admit the proof because Roque Limited (which wholly owns Fernando Trading) owes Lucky Gold HKD 5 million and will not respond to any correspondence from the liquidator. He therefore asks if he can set off the debt owed to Fernando against the debt owed by Roque.

Commentary and Feedback on Self-Assessment 4**Question 1**

Members' Voluntary Liquidation

- Company must be able to pay all liabilities within 12 months;
- Directors must sign a "certificate of solvency" to that effect;
- Shareholders' meeting called;
- Special resolution (75%) needed.

Creditors' Voluntary Liquidation

- Company cannot continue by reason of its liabilities;
- Shareholders' meeting (called by directors or requisitioned by shareholders);
- Special resolution (75%) needed;
- Liquidation commences on passing of shareholders' resolution;
- Meeting of creditors to be fixed for a date not more than 14 days after the members' meeting;
- Notice of creditors' meeting to be sent and advertised;
- Bonus: one reason for CVL is no *ad valorem* payable to Government
- If urgency, s 228A procedure can be used, namely:
 - *Directors' resolution that company cannot by reason of its liabilities continue its business;*
 - *Winding up statement filed at Companies Registry to commence;*
 - *Provisional liquidator appointed pending meetings;*
 - *The statement must declare that it is not reasonably practicable for the winding up to be commenced under another section (must be good reasons, otherwise directors can be prosecuted);*
 - *Meetings of shareholders and creditors to be summoned within 28 days of filing winding up statement.*

Bonus for referring to deregistration being an option in appropriate circumstances.

Question 2

Winding up will not put Nepo Tech at the "front of the queue", even as petitioner; all unsecured creditors will rank the same.

Check that the "Companies Act demand" satisfies the requirements for a statutory demand under CWUMPO (section 178 CWUMPO and CWUR r 3A, 3B):

- Over HKD10,000;
- In the prescribed form;
- Was "served" by leaving an original at the registered office of Lucky Gold.

If it does not, may need to make another SD (but would need to wait another 21 days to rely on it and it appears there may be some urgency, so could consider relying on the "otherwise prove insolvent" provision – but evidence of this is needed).

Advice on procedural steps from issuing petition to getting liquidator appointed:

- Petition, service, advertising
- Hearing of petition (NB: still in discretion of court whether to make order);
- Creditors' meetings up to 3 months later (with OR as provisional liquidator in the meantime but likely little action taken in that time).

As for the other litigation claims, they would not be able to retain execution / attachment after commencement of the winding up (which is the date of presentation of the petition).

Issuing a petition would only give grounds for a discretionary stay (until winding up order made).

Issuing a petition would also trigger the void disposition regime under section 182 so liquidator can claw back if order made.

Given this and the other factors (ie, reference to “hiding” or diverting of assets), could consider making application to appoint provisional liquidators. Test for appointing PL:

- Likely that the petitioner is entitled to a winding up order;
- Assets in jeopardy.

If such application is successful, mandatory stay immediately (section 186) and “active” office holder in place straightaway.

Liquidator will have powers to investigate (wide powers under section 286B) and claw back any transactions at undervalue or preferences, or (given the facts stated) bring actions against the directors for breach of fiduciary duty.

Question 3

Unfair preference rules apply to charges as well as to payments.
 No new money, so no reason for bank to be given a charge in May 2018;
 Appears it may be a preference influenced by the desire to “save” the directors from the PGs;
 Was within six months of commencement, so within the relevant time period.

NB: these facts are almost identical to those in the case of *Sweetmart Garments* referred to in the footnotes of the text.

Question 4

The liquidator cannot use the set-off provisions under section 264 CWUMPO (applying section 35 BO) as there is no mutuality of parties.

He should admit the proof and separately sue Roque for the HKD 5 million.
 If he does reject on this basis, Fernando would have 21 days (rule 95 of CWUR) to appeal; and this could be dangerous for the liquidator: in these circumstances, could possibly lead to a personal costs order.

Self-Assessment Exercise 5

Question 1 (receivership)

A lender holds a charge over the borrower’s assets and wishes to appoint a receiver. The proposed receiver suggests using his service company as the appointment-taker. The lender asks you how to go about making the appointment and when it will become effective. Advise the lender.

Question 2 (corporate rescue)

A company owes money to a number of banks and other creditors and cannot pay on time, but the directors are convinced that the business is viable and that the cash-flow issue is short term. What broad overview could you give to the directors or creditors as to possibilities to rescue the company?

Question 3 (corporate rescue)

The management of the company believe that the financial creditors (including banks, noteholders and convertible bond holders) will agree to swap their current debt for new instruments with later maturity (thus allowing the company to get through its present cash flow difficulty). Some of the creditors have already said they will support such a deal if they are paid a 1% “consent fee”. The management ask you about the legal issues involved in connection with the proposed plan and how it could be effected.

Commentary and Feedback on Self-Assessment Exercise 5**Question 1**

A company cannot be a Receiver (section 297, CWUMPO) so the individual will have to take the appointment.

The appointment must be made in accordance with the charge document, and will ordinarily be by deed.

The appointment takes effect when the receiver accepts in writing.

The receiver will have powers to collect in and realise the charged assets.

The receiver’s duty is to collect in the assets for the charge holder but owes a residual duty to the chargor (ie, Cannot just sell the assets charged at “any” price). If the borrower also goes into liquidation, the receiver must pay the borrower’s preferential creditors out of the realisations (unless there are sufficient uncharged assets available).

Question 2

No corporate rescue legislation.

Creditor with an undisputed debt entitled to a winding-up order, but court retains overall discretion.

A creditor might consider applying for appointment of a provisional liquidator (PL) under CWUMPO section 193 – this would give a moratorium and thus breathing space for negotiations with creditors (and a PL can promulgate a Scheme of Arrangement).

However, the PL appointment is only likely to be possible if assets are in jeopardy; if the purpose is only to effect a restructuring, the application will fail (per the *Legend Resorts* decision).

Need to consider whether appointment of a PL would “scare off” stakeholders (including potential “white knight” investors) from any restructuring.

Bank creditors should comply with HKMA guidelines (but with other, non-bank, financial creditors around, why should they?).

Question 3**Scheme of Arrangement**

- Acts as a court sanctioned compromise or arrangement which binds all creditors of the relevant class (even those who vote against it).
- The scheme can “cancel” the existing instruments and replace with the new instruments.
- The Consent fee is probably okay, but must be offered to all creditors.
- The creditors must be in the same “class” otherwise the court has no jurisdiction to sanction.
- As liquidation appears to be the alternative, the rights compared are those each creditor would have on liquidation. Therefore, the fact that some appear to have conversion rights should not matter. However, the court will also look at the rights given on exit of the scheme as well, so they must also be the same.

Procedure

- An Explanatory Statement must be prepared setting out the background to the company, why a scheme is needed, and the proposed scheme itself;
- Application made to the court for permission to convene meetings of scheme creditors;
- If leave is given, notice of the meeting must be given to all creditors in the relevant class(es);
- At the meeting, the proposed scheme must be supported by the majority in number representing at least 75% in value of those creditors attending (in person or by proxy) and voting;
- The result of the meeting is then reported to court and a sanction hearing is held;
- The court will sanction if it is satisfied the classes are properly constituted (NB: in Hong Kong that question is only addressed at this stage) and it is considered that the scheme is one which an “intelligent and honest creditor might reasonably approve”;
- The scheme takes effect when registered at the Companies Registry;

Note that the scheme can only bind creditors if the debt is governed by Hong Kong law or the relevant creditor takes part in the scheme

Self-Assessment Exercise 6**Question 1**

Approximately what percentage of companies listed on the Stock Exchange of Hong Kong are incorporated somewhere other than Hong Kong?

Question 2

With a number of companies carrying on business in Hong Kong being incorporated outside of Hong Kong, what legislation (if any) exists to enable the winding up of such a company in Hong Kong?

Question 3

Cyberbay MedTech Limited (Cyberbay) is a company incorporated in the Cayman Islands and is listed on the Stock Exchange of Hong Kong. It has a leased office in Hong Kong with several employees based there, as well as a Hong Kong incorporated subsidiary which serves as an intermediate holding company for the main businesses in the Mainland. Cyberbay has defaulted on obligations under certain Notes. The Noteholders have successfully applied to the Cayman Court for the appointment of joint provisional liquidators (JPLs) on a “light touch” basis, with those JPLs having powers to investigate and to promulgate a restructuring if one is viable. The JPLs have approached you in Hong Kong to ask whether they can exercise their powers to effect a restructuring in Hong Kong and, if so, how they could do so?

Commentary and Feedback on Self-Assessment Exercise 6**Question 1**

Only 10.1% are incorporated in Hong Kong, so 90.9% are registered elsewhere.

Question 2

Section 327 CWUMPO. Need to refer to the three core requirements:

- sufficient connection with Hong Kong, but this does not necessarily have to consist of the presence of assets within the jurisdiction;
- reasonable possibility that the winding-up order would benefit those applying for it; and
- The court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company’s assets;

Question 3

The Hong Kong court will generally recognise the ability of an office holder appointed in the company’s jurisdiction of incorporation to take steps in the name of the company.

However, any moratorium etc. in place in the place of appointment will not extend to HK (for example, if there are any trade creditors bringing actions here). That said, the court will “support” a foreign rehabilitation process by, for example, allowing the trade creditor to proceed to judgment but ordering a stay on any enforcement.

In the context of a possible restructuring, the JPLs could negotiate with creditors in Hong Kong and put forward a scheme of arrangement.

Although a provisional liquidator cannot be appointed in Hong Kong on a “light touch” basis (that is, solely to pursue a restructuring), conducting a restructuring is still a power that a Hong Kong-appointed provisional liquidator can have (if other grounds for the appointment exist) (*Z Obee*).

The court will have jurisdiction in respect of the scheme if the “connection with Hong Kong” requirements are met (for example, see *LG; Kaisa; Winsway*). Given the listing in Hong Kong and the existence of the head office (with employees) and the Hong Kong subsidiary, this is likely sufficient.

The JPLs would need to be recognised in Hong Kong to take action here that relates to exercise of powers as officeholders *per se* (rather than take actions in the name of the company), for example the ability to obtain orders for examination.

No legislation to recognise a foreign liquidation or foreign liquidators.

Common law principles have, however, been used (and developed) to allow a foreign liquidator to be recognised in Hong Kong where this will assist the foreign liquidation.

Needs a letter of request from the court where the appointment was made.

Principle is that court will make an order permitting the officeholder to take steps in Hong Kong as if appointed here, provided that the power sought to be exercised is available in both the original jurisdiction and in Hong Kong (the *Singularis* principle).

The JPLs would be able to obtain documents from banks in Hong Kong (being the company's own documents) (*Bay Capital*).

In respect of examining any Hong Kong based parties with relevant information, there are wide powers in the Hong Kong legislation permitting the JPLs to obtain an order for examination (section 286B CWUMPO) BUT it would also be necessary to examine whether the power would exist in Cayman (for a person not directly connected with the Company (such as a director) the legislation is much narrower there).

Given the hurdle imposed by the *Singularis* principle in this regard, it may be that the JPLs should consider an ancillary liquidation in Hong Kong (rather than a recognition of the Cayman appointment).

Self-Assessment Exercise 7

Question 1

Earlsfort Trading Limited (ETL), a BVI incorporated company, has obtained judgment from the English High Court in the sum of USD10 million against Harcourt International Limited (HIL), a Hong Kong incorporated company. The contract between ETL and HIL contained an arbitration clause requiring disputes to be submitted to arbitration in London. You are approached by ETL to advise it on its options to enforce the judgment in Hong Kong. Advise ETL.

Question 2

Ignoring the reference to an arbitration clause, would the advice to ETL be different if the judgment had been obtained in the Shanghai court rather than the English court?

Commentary and Feedback on Self-Assessment 7**Question 1**

Need to consider whether UK within Cap 319, permitting registration of a judgment. It is not; therefore common law enforcement would be necessary. Can enforce a judgment at common law by issuing a writ, the cause of action being the debt created by the foreign judgment. Limited defences open to HIL (judgment obtained by fraud, against Hong Kong public policy, etc.).

Judgment not enforceable if obtained in breach of an agreement to submit disputes otherwise than by proceedings in the court giving the judgment (section 3 of the Foreign Judgments (Restrictions on Recognition and Enforcement) Ordinance).

Facts refer to an arbitration clause:

- If ETL proceeded straight to court action, then the judgment would not be enforceable;
- However, if ETL obtained an arbitral award first and the English judgment was then obtained on the back of that award, the judgment would be enforceable;
- The facts do not say when the judgment was obtained: if more than six years ago, enforcement would be time barred.
- ETL would ordinarily then be able to proceed by way of summary judgment.

Question 2

Yes. ETL would then need to ensure that the requirements of the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap 597) are complied with. Note that this would require:

- the judgment to be in relation to a commercial contract;
- there to be a valid agreement on choice of Mainland court;
- money judgment
- final and conclusive (ordinarily producing a certificate of such from the Mainland court)
- Within 2 years



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