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**SUMMATIVE (FORMAL) ASSESSMENT: MODULE 8C**

**HONG KONG**

This is the **summative (formal) assessment** for **Module 8C** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

**The mark awarded for this assessment will determine your final mark for Module 8C**. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

**INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT**

**Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.**

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.

2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way**. **DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.

3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).

4. You must save this document using the following format: **[studentID.assessment8C]**. An example would be something along the following lines: 202122-336.assessment8C. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentID” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked**.

5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words**.

6.The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

7. Prior to being populated with your answers, this assessment consists of **8 pages**.

**ANSWER ALL THE QUESTIONS**

**QUESTION 1 (multiple-choice questions) [10 marks in total]**

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and mark your selection on the answer sheet by highlighting the relevant paragraph **in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

**Any reference to “CWUMPO” in the questions below means the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32).**

**Question 1.1**

Select the **correct answer** to the question below:

A receiver can be appointed –

* 1. only pursuant to a charge over shares.
	2. only by the court.
	3. only pursuant to a legal mortgage over land.
	4. any of the above.

**Question 1.2**

When a trustee in bankruptcy is appointed, she may seek to unwind a transaction of the bankrupt if the transaction was entered into at an undervalue. **What is the “look-back” period** for such actions (that is, what are the oldest transactions that the trustee can look at in order to be able to take such action):

1. It depends on whether the person with whom the bankrupt transacted is an associate of his or not.
2. Two (2) years before the date of the bankruptcy order.
3. Five (5) years before the date of the petition on which the bankruptcy order was made.
4. Five (5) years before the date of the bankruptcy order.

**Question 1.3**

Which of the following **is correct** in describing whether the Hong Kong court can make a winding up order against a company that is not incorporated in Hong Kong:

* 1. The Hong Kong court can wind up such a company only if a director resides in Hong Kong.
	2. The Hong Kong court has no jurisdiction to wind up such a company.
	3. As a matter of common law, the Hong Kong court has the right wind up such a company.
	4. The Hong Kong court has a statutory jurisdiction to wind up such a company, and can exercise that jurisdiction if certain requirements are met.

**Question 1.4**

Select the **correct** answer:

A receiver is appointed over the entirety of a company’s assets and the company goes into liquidation. Assuming the charge under which the receiver is appointed (and the receiver’s appointment cannot be challenged), realisations made by the receiver:

1. must first be used to satisfy the costs and expenses of the liquidator.
2. must first be used to satisfy the whole of all claims by employees but no other claims.
3. must first be used to satisfy the claims of preferential creditors as described in the relevant section of CWUMPO.
4. will be kept entirely by the receiver for the benefit of the charge holder irrespective of what claims, preferential or otherwise, exist against the company.

**Question 1.5**

Select the **correct** answer:

The date of commencement of liquidation for a Creditor’s Voluntary Liquidation is:

1. the date on which the creditors pass a resolution to wind up the company.
2. the date on which the court approves the appointment of liquidators.
3. the date on which the members pass a special resolution to wind up the company.
4. the date on which notice of the liquidator’s appointment is registered at the Companies Registry.

*NB: for distinction between members’ resolution and creditors’ resolution in this context see sections 228(2) and 230 CWUMPO.*

**Question 1.6**

Select the **correct** answer:

Hong Kong legislation provides a statutory definition of insolvency in –

1. the Companies Ordinance (Cap 622).
2. the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32).
3. the Companies (Winding Up) Rules (Cap 32H).
4. none of above.

**Question 1.7**

Select the **correct** answer:

In a compulsory winding up, there is a mandatory stay of litigation claims against the company:

1. from the date on which the petition is presented.
2. from the date of commencement of the liquidation.
3. from the date of the winding up order.
4. There is no statutory provision for a mandatory stay; whether the claimant can continue is a matter for the court’s discretion.

**Question 1.8**

Select the **correct** answer:

In a compulsory winding up, at the first meeting of creditors where a resolution is proposed for the appointment of a liquidator, a creditor holding security from the company:

* 1. is not allowed to vote.
	2. can vote and the whole amount of its claim is counted.
	3. can vote if it has valued its security and the amount that is counted is the difference between its claim and that value.
	4. must get special permission from the chairperson of the meeting to vote.

**Question 1.9**

In considering what previous court decisions are binding on the Hong Kong courts, which of the following statements **is correct**?

1. A 1995 decision of the English House of Lords is binding.
2. A 1993 decision of the UK Privy Council on an appeal from Hong Kong is binding.
3. A 1996 decision of the UK Privy Council on an appeal from the Cayman Islands is binding.
4. None of the above because they all pre-date the Handover in 1997.

**Question 1.10**

A liquidator appointed in another jurisdiction wants to seek Hong Kong recognition of his appointment. Which of the following **is correct**?

1. He must make an application to the High Court of Hong Kong using the provisions of the UNCITRAL Model Law.
2. He must first seek permission from the Ministry of Justice in Beijing.
3. No recognition is possible.
4. None of the above.

**QUESTION 2 (direct questions) [10 marks]**

**Question 2.1 [maximum 3 marks]**

What are the jurisdictional requirements as regards a debtor for the Hong Kong court to be able to exercise its bankruptcy jurisdiction over that person?

The jurisdictional requirements to be satisfied by a debtor prior to the presentation of a bankruptcy petition are for it to be:[[1]](#footnote-1)

1. Domiciled in Hong Kong;
2. Personally present in Hong Kong on the day on which the petition is presented; or,
3. At any time in the period of 3 years ending with that day:
	1. Been ordinarily resident, or has had a place of residence, in Hong Kong; or,
	2. Carried on business in Hong Kong.

**Question 2.2 [maximum 3 marks]**

What are the “core requirements” that enable the Hong Kong court to exercise its jurisdiction to wind up a non-Hong Kong company?

In its decision of *Kam Leung Sui Kwan v Kam Kwan Lai & Ors FACV 4/2015,* the Court of Final Appeal confirmed that the following three “core requirements” must be met to enable the Hong Kong court to exercise its jurisdiction to wind up a non-Hong Kong company:[[2]](#footnote-2)

1. There must be a sufficient connection with Hong Kong;
2. There must be a reasonable possibility that a winding up order would benefit the applicants; and,
3. The Court must be able to exercise jurisdiction over one or more persons in the distribution of the relevant company’s assets.

**Question 2.3 [maximum 4 marks]**

When can a provisional liquidator be appointed, and in what circumstances and for what purposes?

A provisional liquidator may be appointed by the court at any time after the presentation of a winding-up petition and before the making of a winding-up order.[[3]](#footnote-3) In urgent cases, the application to appoint a provisional liquidator may be made at the same time as the winding-up petition.

Prior to the appointment of a provisional liquidator, the court must be satisfied that:[[4]](#footnote-4)

1. There is a good *prima facie* case for the winding-up order; and,
2. The company’s assets are in jeopardy.

A provisional liquidator may be appointed for the following purposes:

1. To preserve the company’s assets to ensure their availability for distribution should a winding-up order be made, but not to realize them;[[5]](#footnote-5) and,
2. To explore a restructuring of the company although this cannot be the sole purpose.[[6]](#footnote-6)

The court may limit and restrict the powers of a provisional liquidator.[[7]](#footnote-7) However, it should be noted that the provisional liquidator may apply to court for additional powers including permission to sell the company’s assets should, for example, the sale be necessary to preserve the value of such assets.

**QUESTION 3 (essay-type questions) [15 marks in total]**

**Question 3.1** **[maximum 5 marks**]

Describe why you think a liquidator is able take action to challenge an unfair preference and set out what a liquidator must show to succeed in such a claim.

Section 266 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance explicitly states that the section applies in relation to a company if the company goes into liquidation and that if the company has given an unfair preference, the liquidator may apply to the court to restore the position to what it would have been if the company had not given that unfair preference.[[8]](#footnote-8) It is therefore through this section that a liquidator is able to take action to challenge an unfair preference.

A company gives an unfair preference to a person (being one of the company’s creditors or a surety / guarantor for any of the company’s debts or other liabilities) if the company does anything or suffers anything to be done which has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position that person would have been in if that thing had not been done.[[9]](#footnote-9)

In order for an alleged unfair preference to be eligible for court application, the transaction must have been entered into at a time in the period of six months ending with the day on which the winding up of the company commencement. If the transaction was entered into with a person who is connected with the company, the time period increases to two years.[[10]](#footnote-10)

In addition, the liquidator is required to show the following in the court application:

1. The company was unable to pay its debts or became unable to pay its debts in consequence of the unfair preference.[[11]](#footnote-11)
2. The company was influenced, in deciding to give the unfair preference, by a desire to put the recipient into a better position than it otherwise would have been in an insolvent liquidation.[[12]](#footnote-12) If the recipient is connected with the company, such desire is presumed.[[13]](#footnote-13)

It should be noted that in practice, it is difficult to demonstrate a company’s influence to desire. However, the court has shown that it is prepared to consider whether such desire exists of which the onus is on the liquidator to show (as mentioned above).

**Question 3.2 [maximum 5 marks]**

Hong Kong has limited formal arrangements to deal with cross-border insolvency. Given that Hong Kong and the Mainland are one country, does this statement stand correct for the Mainland? Discuss.

In May 2021, a new arrangement concerning mutual recognition and assistance between Hong Kong and certain courts of the Mainland was signed into being (**“the Cooperation Mechanism”**). The Cooperation Mechanism provides the necessary procedures required by Hong Kong office holders (liquidators and provisional liquidators) to obtain recognition and assistance by the Intermediate People’s Courts in the following three pilot cities in the Mainland:[[14]](#footnote-14)

1. Shenzhen;
2. Shanghai; and,
3. Xiamen.

The Cooperation Mechanism also provides the procedures to Mainland officeholders (administrators in Mainland bankruptcy proceedings) to obtain recognition and assistance in Hong Kong.[[15]](#footnote-15)

Prior to the Cooperation Mechanism, the Hong Kong Courts were willing to recognize administrators appointed in the Mainland however, there were no reciprocal examples of the Mainland granting formal recognition of a foreign liquidator. Therefore, despite Hong Kong and the Mainland being one country, the Cooperation Mechanism was an important development in the area of cross-border insolvency between them.[[16]](#footnote-16)

For completeness, in respect of Hong Kong proceedings, the Hong Kong Court will require a letter of request and evidence of the officeholder’s claim against assets held in one of the three pilot areas mentioned above. Should the Hong Kong Court agree that one of the three pilot areas is the appropriate jurisdiction to recover a company’s assets, the letter of request is likely to be granted.[[17]](#footnote-17)

**Question 3.3 [maximum 5 marks]**

The scheme of arrangement is, in essence, Hong Kong’s only statutory tool for corporate rescue. Describe it, listing the pros and cons.

Section 669 of the Companies Ordinance provides that a scheme of arrangement can be proposed to be entered into by a company with its creditors or members or any class of them, as the case may be.[[18]](#footnote-18) For illustrative purposes, schemes of arrangement can include the adjustment of debts owed to creditors or the consolidation or division of shares of different classes, for example.[[19]](#footnote-19)

Pros include:

1. A scheme of arrangement is approved at a meeting of creditors or members, as the case may be, where the majority in number (i.e. more than 50%) representing at least 75% in value of the creditors or members (again, as the case may be) present and voting, in person or by proxy, agree to the scheme.[[20]](#footnote-20) Without access to the scheme of arrangement, the approval of 100% of the creditors or members, as the case may be, would likely be required to implement a restructuring or reorganization. In the scenario of a company with many creditors, it would be next to impossible to obtain unanimous approval from all such creditors, especially from those with minimal economic interest in a reorganization or restructuring.
2. Dissenting creditors or members can be bound by a scheme of arrangement assuming the requisite majorities (in number and value) vote in favor of the scheme. Therefore, such dissenting creditors’ ability to block a scheme is limited.
3. Assuming the requisite approvals are received by the creditors or members or any class of them, as the case may be, the Court may sanction a scheme of arrangement. Upon sanction, the scheme of arrangement is binding on all creditors or members or any class of them, as the case may be, subject to the scheme even if a particular creditor(s) or member(s) did not attend and vote at the meeting(s).[[21]](#footnote-21)

Cons include:

1. There is no moratorium available with standalone schemes of arrangement. However, it is commonplace for a scheme of arrangement to be proposed and implemented during the provisional liquidation of the company during which the moratorium becomes available.
2. In the case where the requisite majorities (in number and value) of any one class of creditors or members, as the case may be, are not obtained, the scheme of arrangement cannot proceed to court sanction.

In respect of the requisite majorities, it should be noted that even if such majorities are obtained, the court still has discretion to not sanction the scheme.

**QUESTION 4 (fact-based application-type question) [15 marks in total]**

**Question 4.1 [maximum 4 marks]**

Mr Chan is the sole director of Mountainview Limited, which is a Hong Kong incorporated company. Mr Chan comes to you and tells you that the company has financial difficulties and is unlikely to be able to continue in business. A friend has told him that his only option is that he must go to court to wind up the company, and that he should ensure he appoints a “friendly” liquidator who will not investigate the company’s affairs too closely. Mr Chan asks whether his friend is correct and to advise him generally on what he should do and his position as a director.

Based on the facts of the case, Mountainview Limited (**“Mountainview”**) appears to be insolvent. In such instances, there would be two options to liquidate and dissolve Mountainview: 1) a creditors’ voluntary liquidation; and, 2) a compulsory (court) liquidation.

**Director Duties**

In respect of directors, there is no statutory obligation to commence a liquidation when a company has financial difficulties and is unlikely to be able to continue in business (i.e. there are currently no statutory provisions against insolvent trading). While there are provisions against fraudulent trading, there is a high threshold required to establish this. However, directors may be held personally liable for a breach of their fiduciary duty to act in the best interests of the company by continuing to trade during insolvency. More seriously, a director may be subject to criminal liability in the scenario where employees are unable to be paid.[[22]](#footnote-22)

**Creditors’ Voluntary Liquidation (“CVL”)**

A company may be wound up voluntarily if, amongst other things, it resolves by special resolution to do so.[[23]](#footnote-23) In the instance where a certificate of solvency has not been issued on behalf of the company, the winding up is referred to as a CVL.[[24]](#footnote-24) Mr. Chan would have to convene a meeting of shareholders during which the special resolution is passed by a majority of at least 75% for the winding up of Mountainview.[[25]](#footnote-25) The winding up would commence at the time of the passing of the special resolution.[[26]](#footnote-26) However, a liquidator appointed by the special resolution has limited powers until such appointment is approved at a meeting of creditors.[[27]](#footnote-27)

Once the decision has been taken to convene meetings of creditors and shareholders, Mr. Chan should take steps to protect the assets of Mountainview pending the meeting of creditors.[[28]](#footnote-28) As alluded to above, given that Mountainview appears to be insolvent or likely to become insolvent, Mr. Chan must keep the interests of creditors in mind when exercising his duties as director.

The primary advantages of using the CVL procedure, rather than a compulsory (court) liquidation, discussed below, relate to costs and timing. For example, the court involvement during the course of compulsory liquidations is much more than that during a CVL which can lead to delays and additional costs. In addition, duties on realizations are applicable in compulsory liquidations but not in CVLs.[[29]](#footnote-29)

Mr. Chan should also keep in mind that the liquidator may apply to the court to exercise, amongst other things, all or any of the powers which the court might exercise if Mountainview were being wound up by the court.[[30]](#footnote-30) Such powers can include the granting of a stay of proceedings against Mountainview.[[31]](#footnote-31)

**CVL in case of urgency**

If the director(s) has formed the opinion that the company cannot by reason of its liabilities continue its business, they may pass a resolution that the company be wound up and that meetings of the company and its creditors be summoned.[[32]](#footnote-32) Therefore, if Mr. Chan is of the opinion that Mountainview should be wound up with immediate effect, such resolutions can be passed without the requirement of a shareholders’ resolution.

Specific reasons in support of an urgent CVL must be included in the resolutions (and the winding-up statement to be delivered to the Registrar).[[33]](#footnote-33) Urgent CVLs are utilized in cases where the appointment of a liquidator is required in short order such as where there are perishable goods to be dealt with and/or disposed of.[[34]](#footnote-34) Further information would be required from Mr. Chan to confirm the type(s) of goods and/or services Mountainview deals with to see whether Mountainview would be eligible for an urgent CVL.

**Compulsory (Court) Liquidation**

A compulsory liquidation is one where a company is wound up by court order. One of the circumstances in which a company may be wound up by the court is if the company is unable to pay its debts.[[35]](#footnote-35) An application to wind up a company can be presented either by the company or by any creditor or creditors.[[36]](#footnote-36) In this scenario, Mountainview appears to qualify for a compulsory liquidation given that it is unlikely to be able to continue in business.

A company can, by special resolution, resolve for the company to be wound up by the court. Therefore, the resolution has to be passed by the shareholders of Mountainview.[[37]](#footnote-37) Therefore, Mr. Chan does not have the sole ability to resolve to wind up Mountainview by the court.

At any time after the presentation of a winding up petition and before the granting of a winding up order, the company (or any creditors or contributory) may apply to stay or restrain proceedings against the company.[[38]](#footnote-38) In addition, the court may also appoint a provisional liquidator over the company during this period.[[39]](#footnote-39) The provisional liquidator will have the power to take into his custody, or under his control, and preserve all assets of the company.[[40]](#footnote-40)

It should be noted that unlikely a voluntary liquidation, 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.[[41]](#footnote-41) Therefore, Mr. Chan can gain comfort in this respect should this route be taken for Mountainview.

**Investigations**

Mr. Chan should be aware that one of the mandated roles of a liquidator is to investigate transactions or payments made during the relevant period (as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance) to determine whether such transactions or payments should be avoided.[[42]](#footnote-42) This role also encompasses investigating and considering the conduct of the director. As such, it is not appropriate to appoint a “friendly” liquidator that will not fulfill the statutory role to investigate.

**Question 4.2 [maximum 5 marks]**

Kite Limited is a Hong Kong incorporated company involved in an import / export business. It buys goods on its own account from suppliers in Mainland China, then sells them on to buyers in Europe at a mark-up. The company has been in difficulty for some time, for example due to reducing margins; unfavourable credit terms leading to a mis-match between the dates on which Kite must pay its suppliers and the dates on which it gets paid by its buyers, thus affecting Kite’s cashflow; European buyers going straight to Mainland suppliers, etc.

Goshawk Financial Limited (GFL) is one of Kite’s lenders. Having been troubled by the way Kite’s business has been heading, some months ago GFL insisted that Kite execute a charge over its receivables, also insisting that the charge was stated to be a “fixed charge”. Kite agreed and executed the document. No separate account was opened and Kite continued to trade with its customers as before, with money being paid into and out of its normal operating account (not held with GFL).

Recently, GFL appointed a receiver pursuant to the charge executed in its favour. The company has also been wound up on a petition presented by another creditor and a liquidator appointed. The receivables appear to be Kite’s only assets. The liquidator asks for your advice on whether she can insist that the receiver hand over realisations he makes in order that the costs and expenses of the liquidation can be met and the unsecured creditors paid at least a partial dividend.

**Security**

At the outset, the liquidator should be made aware that under Hong Kong law, there is no limit to the types or forms of security that a creditor can utilize.[[43]](#footnote-43) For the purposes of this question however, fixed charges and floating charges will be discussed.

In respect of fixed charges, charges are made over a specific asset(s) with attachment being automatic. During the period of a fixed charge, the chargee creditor has authority over the asset(s) and the debtor therefore cannot deal with it without consent.[[44]](#footnote-44)

In respect of floating charges, charges are made over an asset or class of assets (including stock and receivables, for example) which the debtor is still permitted to use. This is because no attachment is made against any specific asset or class of assets until an event occurs (as would be listed in the security agreement) triggering the enforcement (or “crystallization”) of the floating charge over such asset(s). At this point, the debtor then loses the authority to deal with the charged assets and the charge becomes a fixed charge over the asset(s).[[45]](#footnote-45)

The liquidator should be aware that secured finance arrangements are required to be registered in a certain period of time after execution. The liquidator must therefore confirm such registration because if it is not, then the arrangement would be void as against him / her.[[46]](#footnote-46)

It should be noted that in practice, the security agreement in respect of receivables would require the debtor to receive or transfer related payments into a specific account.[[47]](#footnote-47) Based on the facts of the case, this was not done by Kite and is not clear whether it was expected by GLF.

**Receivers**

Charge documents usually provide the secured creditor with the remedy of appointing a receiver out of court over the charged assets.[[48]](#footnote-48) The powers conferred upon a receiver are also detailed in such charge documents and usually include the power to sell the charged asset(s).[[49]](#footnote-49)

The receiver has a primary duty owed to the charge holder, rather than the company. In addition, the receiver is entitled to payment of its costs and expenses out of the charged assets and is entitled to exercise a lien over such assets until payment is otherwise made.[[50]](#footnote-50)

For completeness, in respect of floating charges, the appointment of a receiver has the effect of triggering the enforcement of (or “crystallizing”) a floating charge.[[51]](#footnote-51)

**Liquidation**

The liquidation of Kite does not affect the receiver’s right to take possession of and/or sell the charged assets. Any realizations made out of the charged assets are not available to the liquidator to satisfy the costs and expenses of the liquidation or any dividends, partial or otherwise, to unsecured creditors.[[52]](#footnote-52) However, if the assets of Kite available for payment of general creditors (i.e. not subject to a charge) are insufficient to satisfy payment to preferential creditors, such preferential creditors will have priority to the use of charged assets to satisfy the payment.[[53]](#footnote-53)

As mentioned above, if a charge is not registered (or registered within the prescribed time), the charge will be void as against the liquidator. The liquidator will have access to the Companies Registry in which the charge would have been registered.

However, the liquidator should note that if the charge is considered to be a floating charge (as appears to be the case with Kite), if such charge was created at a time in the period of 12 months ending with the day on which the winding up commenced and Kite was unable to pay its debts or became unable to pay its debts as a result, the charge is invalid.[[54]](#footnote-54)

**Question 4.3 [maximum 6 marks]**

Mr Xu entered into a Framework Agreement (FA) with his business associate, Mr Qi. The FA is governed by Hong Kong law. The idea was to develop a resort project in Fiji. The FA provided that Mr Qi would incorporate a BVI company to purchase a 100% interest in the project from its original owners. To this end, Mr Qi incorporated Sunrise Pacific Limited (SPL) in the BVI. He was (and remains) the sole director and shareholder of SPL, telling Mr Xi that this was necessary because the original developers of the resort trusted him and him alone. The FA provided that Mr Xu would inject USD 20 million into the project by advancing that sum to SPL. The FA also provided that if the project could not be developed and sold on to a buyer within a period of two (2) years from the date of the FA, then SPL will pay a sum of USD 22 million to Mr Xu (representing a return of his investment plus USD 2 million to represent interest).

Mr Xu remitted the USD 20 million to SPL but over the months that followed became concerned that the project was not progressing, with many excuses coming from Mr Qi. He subsequently discovered that the project had not even started (and may be a scam entirely). More than two (2) years has passed since the date of the FA and SPL did not pay any money to Mr Xu. Mr Xu therefore obtained a winding up order over SPL in the BVI.

The BVI liquidator appointed has identified:

* + 1. There is a clause in the FA that states that if SPL becomes insolvent then all other provisions (including the requirement to pay Mr Xu) are void, and all assets automatically and immediately vest in Mr Qi in order to repay shareholder loans Mr Qi has made;
		2. SPL has a (supposedly independent) director, Mr Zhang, who lives in Hong Kong; and SPL also has a book-keeper, Mr Wong, who lives in Hong Kong. Neither Mr Zhang nor Mr Wong are replying to emails from the liquidator;
		3. SPL has a bank account at a bank in Hong Kong;
		4. It is not known where Mr Qi is currently, but it is believed he is a Hong Kong resident;
		5. SPL is believed to have assets in the Mainland, but the liquidator is not sure where these assets are located.

**The liquidator asks for your advice on what steps he can take in Hong Kong**, including as regards a concern he has that Mr Xu in fact had no standing to bring the winding up proceedings in the first place given the clause in the FA at (a) above. The liquidator has also read about a new “co-operation mechanism” between Hong Kong and the Mainland that he would like to use in respect of (e) above.

**Contracts**

In respect of contracts, there is no statute addressing the treatment on insolvency of executory contracts. In addition, there is no general rule in this regard at common law. However, clauses that modify a contract upon insolvency (known as *ipso facto* clauses) as appears to be the case in the FA, are usually upheld.[[55]](#footnote-55)

The liquidator should be aware of the anti-deprivation principle which, in summary, prohibits a creditor from being in a better position than other creditors if the clause(s) is considered a “fraud on the insolvency laws”. The aim of the principle is to avoid giving an advantage to any one of the contracting parties due to the insolvency of the other.[[56]](#footnote-56) In this case, this principle would avoid Mr. Xu being deprived of assets that would otherwise be used to satisfy the repayment of the funds invested.

In determining whether the anti-deprivation principle has been violated, the courts have developed the following factors to assist in such determination:[[57]](#footnote-57)

1. Is the intention to evade insolvency laws?
2. Does the clause operate in situations other than upon insolvency?
3. Is the assets concerned “flawed”?

**Standing**

As a result of the anti-deprivation principle, the *ipso facto* clause in this case is not likely to be permitted. The Court will therefore be satisfied that Mr. Xu has standing as a creditor of SPL to bring the winding up proceedings against SPL.

**Winding up of Unregistered Companies**

In this case, SPL has a BVI appointed liquidator so the use of an ancillary liquidation is likely. However, the liquidator should note that any unregistered company (such as SPL) may be wound up in the following circumstances:[[58]](#footnote-58)

1. If the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs;
2. If the company is unable to pay its debts;
3. If the court is of opinion that it is just and equitable that the company should be wound up.

The petitioner must also satisfy the court that SPL is sufficiently connected to Hong Kong by satisfying the following “three core requirements” as approved by the Court of Final Appeal:[[59]](#footnote-59)

1. There must be a sufficient connection with Hong Kong, but this does not necessarily have to consist in the presence of assets within the jurisdiction. SPL has a bank account at a bank in Hong Kong which would satisfy this requirement.
2. There must be a reasonable possibility that the winding up order would benefit those applying for it. If it can be proven that there are assets of SPL located in one of the pilot areas of the Mainland, the court may be satisfied that this requirement is met.
3. The court must be able to exercise jurisdiction over one or more persons in the distribution of SPL’s assets. For the purposes of this case, it is assumed that Mr. Xu is a resident of Hong Kong is a creditor of SPL based on the funds advanced from the outset. As such, this requirement would be expected to be met.

As mentioned above, in addition to winding up unregistered companies, the courts also have jurisdiction to commence ancillary liquidations in Hong Kong as would be the case in this scenario. In addition, foreign liquidators can also apply to the courts for recognition of the foreign appointment. However, the powers available through recognition are more limited than through liquidation. For example, the power to utilize the new Cooperation Mechanism between Hong Kong and the Mainland (discussed in further detail below) is only available to Hong Kong liquidators. This power appears critical in this case assuming such assets can be identified.

**Investigations**

The powers available to officeholders (either through a Hong Kong winding up or recognition of a foreign appointment) include the production of documents and examination of individuals in Hong Kong.[[60]](#footnote-60) The liquidator can therefore utilize such powers to advance its investigations and asset recovery efforts.

**Assets in Hong Kong**

In this case, SPL holds a bank account at a bank in Hong Kong. Based on common practice, it is expected that the Hong Kong bank will provide information and documentation to the liquidator without the requirement to be recognized through a court order. However, the liquidator should keep in mind that he will not be able to deal with any identified assets, including any remaining cash balance in the Hong Kong bank account, without having been formally recognized by the court.[[61]](#footnote-61) For the avoidance of doubt, the power to deal with assets are also available to Hong Kong liquidators.

**Assets in the Mainland**

There is an arrangement in place concerning mutual recognition and assistance between Hong Kong and certain courts of the Mainland (**“the Cooperation Mechanism”**). The Cooperation Mechanism provides the necessary procedures required by Hong Kong office holders (liquidators and provisional liquidators) to obtain recognition and assistance by the Intermediate People’s Courts in the following three pilot cities in the Mainland:[[62]](#footnote-62)

1. Shenzhen;
2. Shanghai; and,
3. Xiamen.

The Hong Kong Court will require a letter of request and evidence of the officeholder’s claim against assets held in one of the three pilot areas mentioned above. Should the Hong Kong Court agree that one of the three pilot areas is the appropriate jurisdiction to recover a company’s assets, the letter of request is likely to be granted.[[63]](#footnote-63)

The liquidator will have to prove that SPL’s center of main interest (**“COMI”**)is in Hong Kong. The COMI generally means the place of incorporation which in this case would be the BVI. However, other factors are considered including the place of principal office and the place of principal business.[[64]](#footnote-64) The facts of the case mention that SPL’s director, Mr. Zhang, lives in Hong Kong and that SPL’s bookkeeper, Mr. Wong, lives in Hong Kong. This would suggest that the principal office and/or place of principal business are likely located in Hong Kong. This may be sufficient to satisfy the court that SPL’s COMI is in fact in Hong Kong.

In respect of the Mainland, if SPL’s principal assets are in in one of the pilot areas, the Hong Kong officeholder may apply for recognition of and assistance in that pilot area through the Cooperation Mechanism. In this case, it is not yet clear where in the Mainland the assets are located. Further investigations in this regard will have to be conducted.

**\* End of Assessment \***

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8. *Idem*, s 266. [↑](#footnote-ref-8)
9. *Idem*, s 266A(1). [↑](#footnote-ref-9)
10. *Idem*, s 266B(1). [↑](#footnote-ref-10)
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