INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
in INTERNATIONAL INSOLVENCY LAW

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).

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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 2021**. The assessment submission portal will close at **23:00 (11 pm) GMT on 31 July 2021**. 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:

As a lawyer practising Hong Kong law, you are asked to advise a client on a tricky legal issue. There are no Hong Kong authorities dealing with the issue but there is a 1985 decision from the English House of Lords more or less directly on point. It has not been cited in the Hong Kong court. Can you rely on it in forming your advice?

(a) Yes, because it is a House of Lords decision pre-dating the Handover in 1997 so is binding on the Hong Kong court.

(b) No, because all decisions of the English court ceased to have any relevance in Hong Kong after the Handover in 1997.

(c) Yes, it is not binding as such but the decision will form part of the common law as at the date of the Handover in 1997 and would be persuasive as the common law at that date forms part of Hong Kong law.

Commented [RD(DW-H1]: Correct (1 mark). The decision would be persuasive

(d) No, because the decision is from the House of Lords and not a Privy Council decision on appeal from Hong Kong.

Question 1.2

Realisations from a floating charge will always be paid in full to the holder of that charge, even if the company granting the charge goes into liquidation. (You may assume that the floating charge is not open to challenge by the liquidator).

(a) This statement is true because a creditor by way of a floating charge will always stand entirely outside of the liquidation.

(b) This statement is untrue because all of the costs of the liquidation must always be paid first out of those realisations.

(c) This statement is untrue because creditors with a statutory preferential claim must first be paid out of those realisations (unless the same can be paid out of uncharged assets).

Commented [RD(DW-H2]: Correct (1 mark). Option (a) is not correct due to the rules on payment of preferential creditors; (b) is not correct because the charged assets are not available to the liquidators

(d) This statement is untrue because **both** (b) **and** (c) are correct (that is, the costs of the liquidation must always be paid first out of those realisations and thereafter creditors with a statutory preferential claim must first be paid out of the realisations).

Question 1.3

Upon a bankruptcy order being made against an individual, that individual remains free to deal with his assets provided he reports to his trustee in bankruptcy after doing so.

(a) This statement is true.

(b) This statement is untrue because upon bankruptcy the bankrupt's assets are vested in the trustee.

(c) This statement is untrue because although the assets remain the bankrupt's own he must obtain permission from the trustee before dealing with those assets.

Commented [RD(DW-H3]: Correct (1 mark). Bankruptcy differs in this regard from corporate insolvency in Hong Kong. In the latter, the company remains the owner and there is no automatic vesting.

Question 1.4

A petition to wind up a company on grounds of insolvency can be presented when a company is unable to pay its debts. Section 178 of CWUMPO provides three circumstances in which a company shall be deemed to be unable to pay its debts. **Which one of the following** is one of those circumstances?

(a) A creditor has properly served a demand (statutory demand) in the prescribed form and the company has, for three weeks after service, neglected to pay the sum demanded.

(b) Where the statutory definition of "insolvency" (appearing elsewhere in the same Ordinance) is satisfied.

(c) Where the company is insolvent according to its balance sheet.

(d) Where a judgment has been made against the company.

Commented [RD(DW-H4]: Correct (1 mark). The key thing to remember is that there is no statutory definition of "insolvency" in the relevant Hong Kong legislation

Question 1.5

When a company goes into liquidation, the role of the liquidator is to:

(a) Realise the company's assets, adjudicate the proofs of debt submitted by those claiming to be creditors and distribute dividends to creditors.

(b) Investigate transactions entered into by the company to determine whether there are any that can be impeached pursuant to the legislation (or otherwise).

(c) Investigate the cause(s) of failure of the company and the conduct of the directors.

(d) All of the above.

Commented [RD(DW-H5]: Correct (1 mark). The role of the liquidator is a broad one.

Question 1.6

A winding up Petition was presented on 1 April 2019 and the winding up order was made on 5 June 2019. After her appointment the liquidator discovers that a payment was made by the company to a third party on 5 April 2019. Which of the following provisions is **most likely** to be considered by the liquidator (and should be her **first** consideration)?

(a) Void dispositions after the commencement of winding up - pursuant to section 182 of CWUMPO.

(b) Unfair preferences - pursuant to sections 266, 266A and 266B of CWUMPO.

Commented [RD(DW-H6]: Correct (1 mark). The other options are also possible but (a) should easily be the first option to look at because the legislation deems the transaction to be void (the commencement of the winding up being 'backdated' to the date of the petition). It would be for the recipient to persuade the court that the payment could be retained. For the others, the liquidator would have to prove certain elements.

(c) Transactions at an undervalue – pursuant to sections 266B, 266D, 266E of CWUMPO.

(d) Fraudulent trading – pursuant to section 275 of CWUMPO.

Question 1.7

Select the **correct** answer:

A receiver appointed pursuant to a charge created by a company (A) over its assets in favour of its bank (B), acts as:

(a) Agent of the company granting the charge – in this case A.

(b) Agent of the company appointing him – in this case B.

(c) An officer of the court.

(d) An employee or officer of the Official Receiver's Office.

Question 1.8

Between them, CWUMPO and the Companies Ordinance (Cap 622) (CO) provide a comprehensive statutory regime relating to corporate rescue.

(a) This statement is true – the provisions of these two statutes provide a comprehensive package of provisions relating to corporate rescue.

(b) This statement is untrue – CWUMPO alone provides a comprehensive regime for corporate rescue as well as for liquidations.

(c) This statement is untrue – CO alone provides for such a regime.

(d) This statement is untrue – Hong Kong has no comprehensive statutory regime for corporate rescue.

Question 1.9

Select the **correct** answer:

Part X of CWUMPO gives the Hong Kong court jurisdiction to wind up non-Hong Kong companies in certain circumstances. Aside from this section, other provisions relating to cross-border insolvencies are contained in:

(a) The UNCITRAL Model Law on Cross-Border Insolvency as adopted in Hong Kong.

(b) Parts of CWUMPO other than Part X.

(c) Guidance in common law judicial decisions.

(d) The Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap 319).

Question 1.10

Select the **correct** answer:

Commented [RD(DW-H7]: Correct (1 mark). It should be remembered that the receiver also owes duties to the charge-holder (here, B), but acts as agent of the chargor

Commented [RD(DW-H8]: Correct (1 mark). Although the CO contains provisions for schemes of arrangement, those provisions could not be said to be "*a comprehensive statutory regime relating to corporate rescue*". As one example, there is no moratorium.

Commented [RD(DW-H9]: Correct (1 mark). Hong Kong has not enacted the Model Law; part X is the only part of CWUMPO dealing with the subject matter; and Cap 319 deals only with enforcement of foreign judgments

A liquidator appointed by the Cayman Islands court over a Cayman incorporated company believes that the company has a legal action it should pursue against defendants in Hong Kong. Leaving aside any potential jurisdictional challenges as regards the action itself (for example, the presence of an arbitration clause), the liquidator:

(a) must first obtain an ancillary winding up order in Hong Kong.

(b) can commence the litigation in the name of the company without further order in Hong Kong.

(c) Must first seek a recognition order in Hong Kong and must obtain a letter of request from the Cayman court for such purpose.

(d) Must first seek a recognition order in Hong Kong and can do so based solely on the Cayman winding up order and without a letter of request.

Commented [RD(DW-H10]: Incorrect (0 marks). Although a foreign liquidator may need to get a recognition order to carry out certain tasks, commencing litigation in the name of the company is not one of them (see the *Irish Shipping* case

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks]

Commented [RD(DW-H11]: 2 marks out of 3. The answer should also refer to the fact that any attachment etc. by way of enforcement is void if obtained after the petition is presented (s.183).

Describe the effects of the compulsory liquidation of a company upon a creditor who is pursuing the company by way of a civil action.

In order to deal with the effects, a distinction needs to be made between the application to court for a liquidation order and the actual granting of the liquidation order [Guidance Text par 6.3.5 page 34]. A court order requesting a pause in existing civil action may be granted, which means that a creditor involved in civil debt collection will only be affected by the liquidation prior to an actual liquidation order being made, if an order to this effect is obtained between the time of "the presentation of a winding up petition and before a winding up order has been made" [Guidance Text par 6.3.6 page 34]. As such, the granting of the order is "discretionary" at this stage and without such an order, the creditor is free to proceed with the litigation [Guidance Text par 6.3.5 page 34]. However, the creditor involved in enforcement litigation will be affected once the liquidation order is granted by the court as "a compulsory stay" comes into effect and the creditor will not be able to proceed with the litigation [Guidance Text par 6.3.7 page 34]. Contrary to the position where an order is needed to stay proceedings (obtain the "moratorium"), the creditor would have to obtain a court order granting him permission to proceed with litigation against the company once a liquidation order has been made [Ibid]. It is important to note that this "mandatory stay" also comes into operation once "a provisional liquidator has been appointed", which means that the moratorium could become applicable earlier that the date of the order for liquidation of the company [Guidance Text paras 6.3.7 and 6.3.8 pages 34 and 35]. This could occur as early as the application for liquidation to court, in which case the creditor would be affected immediately, save with the leniency of the court [Ibid].

Question 2.2 [maximum 4 marks]

Commented [RD(DW-H12]: 4 marks out of 4. A good, complete, answer

Identify each method by which a company can go into liquidation in Hong Kong and briefly describe the circumstances in which each method would usually be implemented.

Companies may subject themselves to liquidation proceedings (so-called "voluntary liquidation") [Guidance Text par 6.3.1 page 30]. The decision to initiate voluntary liquidation proceedings lies solely with the company (or, more accurately, its shareholders on advice of the directors) [Guidance Text paras 6.3.2 and 6.3.3 pages 30 and 31]. Two forms of voluntary liquidations exist under section 233 of the CWUMPO: the members' voluntary liquidation

(which applies when a company is solvent) and the creditors' voluntary liquidation (which applies when the company is insolvent) [Ibid]. In the first instance, the shareholders authorise the initiation of liquidation proceedings (by way of a "special resolution" which is 75%) on the advice of the directors that the company is indeed solvent (the directors issue a signed "certificate of solvency") [Guidance Text par 6.3.2 page 30]. The test in this regard is the prevalence of funds to pay all debts within for the next year ("the company will be able to settle all liabilities within 12 months of the commencement of the liquidation") [Ibid]. In the second instance, the shareholders authorise the initiation of liquidation proceedings (by way of a "special resolution") on the advice of the directors that the company is insolvent (the directors provide the shareholders with a "statement of affairs of the company" [Guidance Text par 6.3.3 page 31, see also page 84 which notes that the process is initiated once the shareholders vote in favour thereof (resolution passed)]. The meeting of shareholders called for purposes of voting on the initiation of the procedure may be on the initiative of either the directors or the shareholders themselves [Ibid]. Another manner in which a company may enter liquidation proceedings is on notice to the Registrar after the directors have decided that the "company should be wound up with immediate effect" (a section 228A CWUMPO liquidation") [Guidance Text par 6.3.4 page 31]. Directors would embark on this course of action where the company is commercially insolvent and its insolvency prevents it from trading and the section 228A-approach is the only viable option to initiate liquidation proceedings [Guidance Text par 6.3.4 pages 31 and 32]. The liquidation proceedings are commenced on advice of the directors to the Registrar (by way of "a statement certifying that a resolution has been passed" and confirming in this statement that the three requirements/grounds/reasons for commencement have been satisfied) [Guidance Text par 6.3.4 pages 31]. In these circumstances, the director's resolution is taken prior to commencement and the shareholders' resolution is not needed – probably as time is of the essence in cases that warrant the use of the section 228A procedure [Guidance Text par 6.3.4 pages 31 and 32].
Companies may also be subjected to liquidation proceedings after a court order to this effect has been made – in this case, and irrespective of whether the debtor or its shareholders or creditors approached the court for such an order, it is known as a "compulsory liquidation" [Guidance Text par 6.3.5 page 32]. A creditor may approach the court with a request to place the company in liquidation where there is evidence that "the company is unable to pay its debts" (see section 178 of the CWUMPO quoted in Guidance Text par 6.3.1 page 29) [Ibid]. The company or a shareholder may approach the court with a request to place the company in liquidation where there is evidence that "it is just and equitable to do so" [Ibid]. Where the company approaches the court, it must be authorized by the shareholders to do so (by way of a "special resolution") [Guidance Text par 6.3.5 page 33]. The state of the assets of the company is irrelevant to determine the success of the application, hence the above are the grounds upon which an order for liquidation can be given [Guidance Text par 6.3.5 page 32].
As a side note: A company may also follow the procedures set out in its founding documents (its "Articles") to liquidate itself or a company may "deregister without going through a liquidation process" – the latter is thus not relevant to this set of facts as liquidation is not entered into [Guidance Text par 6.3.2 page 30 and footnote 103]

Question 2.3 [maximum 3 marks]

Commented [RD(DW-H13]: 3 marks out of 3. Again another comprehensive answer

Where a creditor presents a petition for the compulsory winding up of a company, a court hearing date is fixed approximately two (2) months after the date of presentation. Does Hong Kong law permit an officeholder to be appointed in the meantime (that is, during this interim period of two months before the petition is heard)? If "yes", in what circumstances? If "no", what is the policy reason for not permitting such appointment?
It is possible to request the court to appoint a provisional liquidator (not the same as the "provisional liquidator" that holds office after the liquidation order is granted and until a final liquidator is chosen) [Guidance Text 6.3.8 page 35 (see also footnote 145)]. A request to this effect will be granted if there is an overall need to protect the property in the estate or its value [Ibid, see also Guidance Text 6.3.8 page 36: "there is a risk that assets will be dissipated, or

otherwise be in jeopardy, before a winding up order is made"]. Accordingly, the authority of the provisional liquidator is limited to what is essential to "preserve" the property in the estate, which means that sales will only be allowed if the value of the estate will otherwise decrease due to loss of value of the asset if retained by the company during the interim period referred to in the question (and only with the court's permission to do so) [Ibid]. The court considers "commercial realities", whether time is of the essence, whether an order appointing a provisional liquidator is necessary, and "the balance of convenience" before granting (or not granting) the order [Guidance Text 6.3.8 page 36]. Instances where an order will not be granted (other than not meeting the requirements set out above) is where the request will amount to an abuse or circumvention of the legal process – such as where the rationale of a provisional liquidator is to pre-empt the entry of the Official Receiver as such once the court grants the liquidation order because the provisional liquidator "appointed under section 193 of CWUMPO … will continue in office" [Guidance Text paras 6.3.8 and 6.3.9 pages 35 and 36]. In addition, if the only motivation for a provisional liquidator is based on the need for assistance with a restructuring proposal, the court will not grant the request [Ibid].

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

Question 3.1 [maximum 9 marks]

Question 3.1.1 [maximum 7 marks]

Commented [RD(DW-H14]: 6 ½ marks out of 7. A very good answer; full marks if had referred to the limitation on schemes posed by the *Gibbs* principle

Describe Hong Kong law as it applies to corporate rescue, discussing any advantages / disadvantages to the current system.

In the absence of a legislative regime to deal with all forms of corporate rescue, the system is fragmented – it incorporates provisions of the common law together with the scheme of arrangement provided for in the Companies Ordinance as dealt with by the courts of Hong Kong [Guidance Text par 6.5 pages 49 and 51]. Although the disadvantage is that the system may have missed out on opportunities to align with international best practices [Guidance Text par 9.1 page 77], the advantage is that the creativity of those involved in an attempt to rescue a company, is not limited to the provisions of stoic legislation and the adaptability of the common law enables the design of schemes that suit the merits of each case [Guidance Text par 6.5 page 50]. An example is the use of an order for the stay of proceedings to allow a provisional liquidator to review the viability of restructuring of a company for whom an application for liquidation had been presented to the court [Guidance Text par 6.5 pages 50 – 51]. However, this process must be a secondary purpose of the application for a provisional liquidator and an order staying proceedings against the company [Guidance Text par 6.5 page 50]. The process is frequently used to design and implement a scheme of arrangement [Ibid]. The absence of a rescue procedure that allows for a moratorium and the forced use of a procedure in a manner that is not its primary purpose, is a shortcoming of the regime because there is only a moratorium for companies where it can be shown that "the 'traditional' grounds of jeopardy to assets" exist [Guidance Text par 6.5 page 51]. Some uncertainty exists as some courts have not relieved the provisional liquidator of his duties where the risk to assets had passed and restructuring remained the only purpose [Ibid].

The scheme of arrangement is the law-based rescue regime [Guidance Text par 6.5 pages 51 and 52]. Hong Kong courts rely on the decisions of English courts for direction due to the similarities between the laws pertaining to schemes of arrangements in the two jurisdictions [Guidance Text par 6.5 page 52]. The scheme of arrangement holds some benefit over informal workouts (which are nevertheless prevalent in Hong Kong – see Guidance Text par 6.5 page 49) in that a scheme may be implemented even if all creditors do not approve of the changes [Guidance Text par 6.5 page 52]. In this manner, so called "hold-out creditors" are prevented from defeating a plan approved by the required majority [Guidance Text par 6.5 pages 52 and 55]. The scheme of arrangement is the only rescue mechanism regulated by legislation and is court-driven in that the procedure is initiated by way of a court application

and the final scheme, approved by the creditors, must also be authorised by the court (at a subsequent "sanction hearing" conducted) [Guidance Text par 6.5 pages 51, 52, 53 and 54]. Meetings of creditors occur subject to the directions of the court, and the court is appraised of the outcome of these meetings [Guidance Text par 6.5 page 52]. The court has indicated that it does have a discretion when it comes to the approval of the scheme in order to protect the rights of creditors: "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." [Guidance Text par 6.5 page 53].
The above ruling by the court was made (probably due to the creditor-friendly nature of the Hong Kong insolvency system – see Guidance Text par 6.1 page 17) notwithstanding that creditors are bound to the scheme once approved, which approval is dependent on the acceptance by "a majority in number representing at least 75% by value of the creditors present and voting … [T]he test will be applicable to each class of scheme creditor where the scheme creditors are divided into different classes." [Guidance Text par 6.5 page 55].
The disadvantage of the scheme is that it involves several formal steps and court approval that will only be granted if due process were followed, which is not necessary in informal workouts, but it advantageously does allow for a manner to deal with dissenting creditors who are in the minority [Guidance Text par 6.5 page 52]. However, it does not provide for a moratorium hence the legal leaps referred to above [Guidance Text par 6.5 page 50].
The Hong Kong rescue regime thus allows for informal workouts and schemes of arrangements to assist debtors who wish to restructure: limited options when one considers the possibilities and procedures available in foreign jurisdictions such as the US, UK or Australia [Guidance Text par 6.5 page 49]

Question 3.1.2 [maximum 2 marks]

Discuss the possible reforms that have been (or are) under consideration with regard to corporate rescue.

The first all-encompassing issue raised for consideration during law reform revolved around the need for comprehensive laws to deal with all aspects of corporate rescue [Guidance Text par 9.1 pages 76 and 77]. The overall orientation of the system had to be considered, thus whether it should be ("remain") creditor-oriented or become debtor-focused (with the resultant processes formulated in line with this proposed change – such as "debtor-in-possession" proceedings) [Guidance Text par 9.1 page 76]. After discussions and drafting, the former prevailed [Ibid].
The second main aspect was the appointment, role and powers of the insolvency practitioner involved in liquidation and the corporate rescue process [Guidance Text par 9.1 page 77]. First, the proposal was made that provisional liquidators should be authorized to opt for restructuring as opposed to the liquidation of the company [Ibid]. Second, the provisional rescue operative should be able to rely on a statutory stay of proceedings against the company in order to enable him to properly reorganise the company [Ibid]. As indicated above, the lack of a stay of proceedings and the ability to obtain a court order to this effect only in some instances is a shortcoming of the system which has resulted in creative manners to obtain one for a company who wishes to restructure [see question 3.1.1 above] Although the latter constituted a proposal in draft legislation, the issues raised against the supporting provisions in response to this proposal were too difficult to overcome (eg "assum[ption] of personal liability for employment contracts", important secured creditors needed to support the retention of a provisional practitioner; and "insolvent trading provisions") [Ibid].

Question 3.2 [maximum 6 marks]

Commented [RD(DW-H15]: 1 ½ marks out of 2. Only misses that the reforms did propose a moratorium.

Commented [RD(DW-H16]: 3 ½ marks out of 6. The answer should also deal with the Part CWUMPO jurisdiction to wind up non-Hong Kong companies and the core requirements. Also, there is the *Bay Capital* decision permitting the liquidator to get the company's own documents without recognition

Although Hong Kong has little specific legislation dealing with cross-border insolvency, the Hong Kong courts have supported foreign insolvencies through the common law. Discuss.

As Hong Kong as not adopted laws "to recognise a foreign liquidator or foreign liquidations" [Guidance Text page 89], common law considerations, such as the authority of liquidators in foreign insolvency matters to institute proceedings in Hong Kong (on behalf of the debtor company), are acknowledged and applied by Hong Kong courts in matters relating to insolvency proceedings instituted in foreign jurisdictions [Guidance Text par 7 page 59]. This consideration occurs due to the absence of legislation or treaties regulating same [Guidance Text par 7 page 58]. However, the same common law principles have been adapted by Hong Kong courts to require the foreign representative who want to take action in Hong Kong as an insolvency practitioner to present "a letter of request" from the foreign appointing court [Guidance Text par 7 pages 62 and 89]. The initial approach was to limit the recognition based on a request to common law jurisdictions, but the Hong Kong court has recognised insolvency proceedings of China [Guidance Text par 7 pages 62 and 64]. In addition, the assistance granted to the foreign liquidator must align with options available in both the foreign jurisdiction and Hong Kong – an interpretation of the common law adopted from the 2014 UK Privy Council *Singularis*-case [Ibid]. The *Singularis*-approach signals that the Hong Kong courts follow a "modified universalism" approach [Guidance Text par 7 page 62]. The courts have also based their approach on "comity" [Guidance Text par 7 page 59].

The Hong Kong court's assistance, founded in common law provisions, has manifested in many ways. The court has assisted foreign insolvency practitioners notwithstanding that the foreign proceedings have not been recognised in Hong Kong [Guidance Text par 7 page 59]. Litigation in Hong Kong to obtain assets to settle a debt have been adjudicated in a manner that allows "liability to be established" but precludes "enforcement" in the face of foreign rehabilitation proceedings [Ibid]. In a similar fashion, the courts have prevented the court ordered payment of garnishees where the debtor was subject to insolvency proceedings in China [Ibid]. Practitioners from foreign jurisdictions have had the proceedings successfully recognised (subject to *Singularis*, meaning that the court must "compare[…] the scope of the relevant provisions between Hong Kong and the requesting jurisdiction") in order obtain information in Hong Kong and interview people [Guidance Text par 7 page 64]. Similarly, foreign practitioners must obtain recognition prior to apportioning assets [Guidance Text par 7 page 65].

The reliance on the common law principles is not without it challenges – mainly because of the lack of certainty regarding future cases [Guidance Text par 7 page 66]. Three examples serve to illustrate the point: the first, where the laws of Hong Kong and those of the foreign jurisdiction are misaligned; the second, where the court needs to determine whether "foreign insolvency proceedings" can be recognised as such where there is uncertainty as to whether they qualify as "collective insolvency proceeding[s] for common law recognition purposes"; and the third, where non-domestic entities were subjected to proceedings in countries where they were not incorporated [Guidance Text par 7 pages 65 and 66]. It is observed that the UK will be considered for guidance in this regard [Ibid].

Although there is a general trend to support foreign insolvencies [Guidance Text par 7 page 59] there are procedural and substantive limits as indicated above. However, the assistance is not limited: "[I]n 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 processes." [Guidance Text par 7 page 66]

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

Question 4.1 [maximum 4 marks]

A receiver is appointed pursuant to a floating charge over all the assets and undertaking of Pacific Tin Mines Limited (PTM), a Hong Kong company. Shortly after the receiver's

Commented [RD(DW-H17]: 2 marks out of 4. The first step is to examine validity of the charge. For example, s.267; registration. A liquidator can also recoup costs reasonably incurred in realizing charged assets, but in reality only if does so before being aware of the receiver or with the receiver's consent. Also, see note below

appointment, PTM is put into liquidation. The liquidator writes to the receiver and asks her to hand over all assets (or realisations from assets) of PTM under her control so that the liquidator can pay the costs and expenses of the liquidation and make a distribution to PTM's unsecured creditors. You are asked to advise the liquidator. What (if any) assets or realisations should be handed over by the receiver?

Legal position: The first applicable legal position pertaining to secured creditors and their rights to the proceeds of assets over which a floating charge exists, is as follows: "[R]ealisations from a floating charge must first be used to meet statutory preferential claims" and "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" [Guidance Text paras 5.1 and 5.5 pages 11 and 14, and footnote 25]. In addition, "[t]he appointment of a receiver will have the effect of crystallising a floating charge" [Guidance Text par 6.4.1 page 48] which determines the final set of identifiable/specific assets over which the secured creditor holds security and whose proceeds are available for settlement of the creditor's debt [Guidance Text par 5.4 page 12].
Application: The effect of the aforementioned is that the assets or proceeds of those assets, that are the subject of the security, are only available for payment of *statutory preferential creditors* in the case of the debtor's liquidation. Here, the liquidator intends to pay the *unsecured creditors* with the funds received. She would thus have to indicate whether she refers to the general unsecured creditors or any creditor that does not hold a security (which will then include statutory preferential creditors) [see eg Guidance Text par 6.3.19 page 44]. I am going to proceed and assume that she means the general creditors. The second caveat is that the funds are only available in the event that there are not enough unencumbered assets in the estate (and there is no indication in the facts that this is the case although it is only relevant if the reference to unsecured creditors includes statutory preferential creditors as the class of creditors that the liquidator aims to pay with the money received). The first ground of dispute is that the liquidator does not have a claim to the assets (or proceeds) to pay *unsecured* creditors, as the facts indicate.
Legal position: The second applicable legal position is that assets or the proceeds thereof "are not available to the liquidator for payment of the liquidation expenses" [Guidance Text par 6.4.1 page 48, see footnote 222 for the legislative provision (section 348(1) of the Companies Ordinance)].
Application: The effect of the aforementioned is that the liquidator is not entitled to the funds based on the intention to recover the *costs and expenses of liquidation*, as indicated in the set of facts. Although costs and expenses enjoy priority payment in liquidation, these expenses do not fall under the scope of "preferential debts" (such as employees) [see Guidance Text paras 5.1 and 6.3.19 pages 11 and 44].
Notwithstanding the above, the fact that a receiver was appointed and the debtor subsequently subjected to liquidation proceedings, has no impact on "the receiver's right to hold and/or sell the property or assets secured by the charge under which he is appointed" [Guidance Text par 6.4.1 page 48]. The receiver may thus sell the assets (thus there is no ground for the liquidator of PTM to demand delivery of the assets, at most, the proceeds may be requested albeit not in this case). The receive also has a form of security over the assets – a lien – to secure payment of the receiver herself for the services that she rendered as such [Guidance Text par 6.4.1 page 48]. Therefore, in the absence of any indication that there is a need for the funds to pay statutory preferential creditors (and how much) and there are no or inadequate unencumbered assets, OR the claims of the secured creditor (in this case the charge holder) and receiver have been settled using the funds generated by the sale of the security and there are funds left [see page 81], the liquidator of PTM has no ground to demand the delivery of the assets of funds thereof.

Question 4.2 [maximum 4 marks]

Commented [RD(DW-H18]: I found this a bit confusing.

Commented [RD(DW-H19]: 1 ½ marks out of 4. See note below. Also, it should be clearer on challenging the possible floating charge (if security, sounds like would not be fixed: BH has free access to the funds it seems – *Spectrum Plus*). For TC: anti-deprivation principle

A liquidator is appointed over luxury car dealer Billion Happy Limited (BH) and learns that BH has recently been granted a facility by Hammerhead Finance Co Limited (HF). HF has shown the liquidator a document entitled "Receivables Purchase Agreement", claiming that all accounts receivables due from BH's customers therefore belong to HF. The document also asserts that as an alternative to ownership of the receivables, HF has a fixed charge over the receivables. Advances from HF to BH were sporadic and could not necessarily be matched to invoices. Further, some customers of BH had paid certain invoices to an account with HF, but which account BH then operated for working capital purposes.

Telford Co Limited (TC) contacts the liquidator of BH to say that TC had been helping BH sell its cars to wealthy businessmen on the Mainland. TC shows the liquidator an agreement asserting that if BH goes into liquidation then it is deemed that immediately before the liquidation, all cars held at BH's showrooms belong to TC.

The liquidator asks for your thoughts on what issues she should consider when dealing with HF and TC.

In respect of HF and TC, the liquidator should consider whether the agreements with BH should not be set aside as impeachable transactions [see generally Guidance Text par 6.3.15 pages 41–42]. The liquidator would then be able to set aside the rights of HF and TC respectively over the assets or funds in question or restore the debtor to its pre-agreement position [Guidance Text par 6.3.15 page 42].

In respect of HF, the transaction may be reviewed against the legal prescriptions of transactions "at undervalue" as there is no indication of the monetary relation between the facility granted by HF and the receivables sold by BH [Guidance Text paras 6.2.10.1 and 6.3.15.2 pages 25 and 42 (note that the principles in respect of individuals are similar for companies – see Guidance Text par 6.3.15.2 page 42)]. In particular, the facts indicate that payments from the creditor were "sporadic and could not necessarily be matched to invoices" and that the funds paid to HF were circulated back to BH (meaning that BH was using its own money and not that of HF). The liquidator should determine the exact date of the agreement with HF because the correlation of the date of agreement with the date of liquidation must be five years for this transaction to be voidable [Guidance Text par 6.2.10.1 page 25]. The facts indicate that it was recent, thus the liquidator can look into the matter. The liquidator should determine the value received by BH against the value obtained by HF to determine if there is a serious misalignment (meaning that it was a "transaction where the value [was], in money or money's worth, significantly less than the consideration provided by the company" [Guidance Text par 6.3.15.2 page 42]. Lastly, the liquidator would have to review the company's financial affairs to determine if BH was already struggling financially ("unable to pay its debts") at the time of the agreement with HF or whether the agreement caused BH's financial struggles ("became unable to pay its debts" – which is probable given the loss of the receivables against "sporadic payment") [Ibid].

In respect of TC, the liquidator should consider reviewing the transaction against the legal prescriptions of undue preferences [Guidance Text par 6.3.15.1 page 41]. The fact that the benefit of ownership was dependent on the liquidation of the debtor, may be indicative of a "desire to prefer" TC in insolvency: there is no indication that BH had any reason to grant this benefit to TC [Ibid]. TC may be viewed as an "associate" due to its involvement in BH's business (TC is "a person connected with the company", which will allow the liquidator to deal with the transaction (the agreement to transfer ownership) even if the agreement was entered into two year prior to BH's liquidation [Ibid]. The liquidator would be able to determine that BH was already insolvent (already "unable to pay its debts") when the agreement was made (the second option of causing insolvency is irrelevant as the agreement only took effect just prior to the company's liquidation, making the former more applicable) [Ibid]. It is clear that BH put TC in a position that "it would [not] have been upon the company's insolvency" [Ibid]. The wording of the agreement makes it clear that "the company was influenced by a desire to improve the position of" its business partner, TC – the agreement was drafted in such a

Commented [RD(DW-H20]: I do not see why this creates an undervalue – the bank is advancing money to BH and it is using the money. Not a circular arrangement. What we need to establish is (as stated) whether the receivable are sold or whether the bank is making advances against security.

manner that TC became the owner of the assets immediately prior to insolvency (and not, for example, if BH defaulted on any payment due to TC for eg selling the stock) [Ibid].

Question 4.3 [maximum 7 marks]

Cyberbay MedTech Limited (Cyberbay) is a Cayman Islands company listed on the Stock Exchange of Hong Kong. This company appeared in the self-assessment questions in your guidance text, where you were asked to consider the steps that the Cayman-appointed officeholder might take in an effort to restructure the company's indebtedness due to holders of certain Notes. The joint provisional liquidators (JPLs) have now uncovered concerns about accounting irregularities in its Mainland operations and there are also press reports that the founder and Chairman has disappeared in the Mainland and cannot be contacted.

Upon further investigation, it appears that the Chairman's disappearance certainly looks as if it is linked to the "accounting irregularities" with large sums of money (raised from the issue of the Notes and the bank borrowing) being paid to entities with no apparent real business with Cyberbay. There is an individual in Hong Kong, Mr Pottinger, who is a friend and business associate of the Chairman. It is believed that Pottinger has information that will help shed light on the payments. The JPLs ask you if there is anything they can do in Hong Kong in this regard. Advise them.

This is a cross-border matter in which the question is the extent to which the court in Hong Kong can grant an order allowing for the interrogation of Mr Pottinger in relation to the affairs of Cyberbay, who is subject to liquidation proceedings in the Cayman Islands. The courts in Hong Kong have allowed foreign liquidators, subsequent to the necessary steps for recognition and an order to this effect, to question people in Hong Kong [Guidance Text par 7 page 64]. In this case, recognition is essential as it relates to a function exercised by the liquidators of the Cayman Islands proceedings [Guidance Text page 89]. The analysis followed by the courts in this regard is the following (adapted against the background of the facts given): The requirement is that the same process must be available in terms of the laws of Hong Kong and the Cayman Islands (where the foreign proceedings are taking place) [Guidance Text par 7 page 64]. Based on previous decisions relating to the Cayman Islands as one of the "commonly encountered jurisdictions", "the court has become reasonably comfortable that recognition should be given" [Ibid]. The court has acknowledged that there is some similarity between the processes and powers relating to the examination of persons, but that this correlation is limited and an order to this extent will only encompass the narrow overlap where Hong Kong and Cayman Island law overlap (are the same) [Ibid]. As such, the scope of interrogations in Hong Kong is broader that in the Cayman Islands and because recognition orders only relate to those aspects of the law that align in both foreign and domestic law, the powers of the JPLs will be limited upon recognition [Ibid]. As such, the JPLs have two options: apply for recognition and bear in mind that the court order will restrict their powers to those features of examinations that are present in both Hong Kong and Cayman Islands law [the so-called "Singularis Principle" – see Guidance Text par 7 pages 62 and 64].; or institute concurrent liquidation proceedings in Hong Kong, based on Hong Kong law and use the less "restrictive" provisions relating to examination under Hong Kong law [Guidance Text par 7 page 65 and 89].
In order for Cyberbay to be wound up in Hong Kong in an ancillary manner (considering the proceedings taking place in the Cayman Islands – see Guidance Text par 7 page 62), taking into account that it is a foreign company because it is neither incorporated nor registered in Hong Kong (the listing on the Hong Kong Stock Exchange is irrelevant for this exercise – the facts state that it is a Caymans Island company) [Guidance Text par 7 page 59], the following requirements need to be met even in the event where "an ancillary winding up order " is requested from the court in Hong Kong:

1. A ground for the liquidation of the company must exist (in this case, it would probably be that the Cyberbay has either "ceased to carry on business" or is "carrying on

Commented [RD(DW-H21]: 4 ½ marks out of 7. Should mention certain rights without recognition (e.g. start an action; get company's own documents). Could liquidate/take control of HK subsidiary; action against recipient

Commented [RD(DW-H22]: Letter of request should be mentioned.

business for the purpose of winding up its affairs" or "is unable to pay its debts" (considering the liquidation proceedings taking place in the Cayman Islands);
2. A link with Hong Kong must exist in the form of a "sufficient connection with Hong Kong" (in this regard, the listing on the Stock Exchange and the presence of business activities conducted in the leased premise together with the presence of the subsidiary as per the Guidance Text page 88);
3. The court order must be of consequence meaning that "there must be a reasonable possibility that the winding up order would benefit those applying for it" (in this regard, the question must be whether the court will allow the request simply on the basis of the need to examine Mr Pottinger, who may drastically change the course of events of the main proceedings and may also affect the proceedings in Hong Kong) [Guidance Text par 7 pages 60 and 61]; and
4. "[T]he court must be able to exercise jurisdiction over on or more persons interested in the distribution of the company's assets" (here, there are employees of the company situated in Hong Kong who will benefit from the proceeds of the assets as per the Guidance Text) [Guidance Text par 7 pages 60 and 61].

Should the order for winding up be granted (as an "ancillary" process to that of the Cayman Islands), and an order for the examination of Mr Pottinger, the latter may be effected using the "wide powers in the Hong Kong legislation" [Guidance Text page 88]. In this regard, the choice will depend on the substance of the difference between the provisions of Hong Kong and the Cayman Islands pertaining to examination and information recovery, and whether there is a need for the broader provisions of the Hong Kong legislation in this particular case [Guidance Text page 88].

Bibliography: INSOL International *Module 8C Guidance Text Hong Kong* 2020/2021 INSOL International: London ("Guidance Text")

TOTAL: 37.5 MARKS OUT OF 50

*** End of Assessment ***