



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

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

#### **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).
- (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).

**Commented [RD(DW-H2)]:** Incorrect (0 marks). Whilst (c) is correct, (b) is not: a liquidator cannot look to the floating charge realisations for the costs of the liquidation (see the *Leyland Daf* case (applied in Hong Kong in *Good Success Catering*

### 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.

**It is noted that the CO provides for schemes of arrangement which can be considered as a corporate rescue tool, but there is no legislation in Hong Kon specifically dealing with 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).

**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

### Question 1.10

Select the **correct** answer:

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):** Correct (1 mark). See for example the *Irish Shipping* case

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

#### Question 2.1 [maximum 3 marks]

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 a compulsory liquidation, after the presentation of the petition to wind up the company, and before the winding up order has been granted by the court, the company or any creditor or contributory may apply to the court, in which their action or proceeding is pending, for a stay of proceedings, namely a discretionary stay (section 181, CWUMPO). It is for the court discretion whether to stay or restrain the civil actions brought the creditor of the company.

After the winding up order has been made, or provisional liquidator has been appointed, no proceeding or any action can be commenced or proceeded against the company without the leave of the court and subject to the terms set by the court, namely a compulsory stay (section 186, CWUMPO).

Notwithstanding the above, it is noted that Hong Kong law includes a provision which permits the court to make an order which allows a creditor to have an advantage over other creditors for instance in a case where that creditor has funded or given an indemnity, in respect of costs of steps taken in order to protect the assets of the company or to achieve recoveries.

**Commented [RD(DW-H11):** 2 marks out of 3. The answer should also refer to the restriction on a creditor retaining any attachment etc. (s.183)

#### Question 2.2 [maximum 4 marks]

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.

One of the main types of formal procedure available in Hong Kong is liquidation. The methods by which a company can go into liquidation are as follows:

A members' voluntary liquidation (MVL) – can be used when the company will be able to settle all its liabilities and debts in full within a period not exceeding of 12 months from the commencement of the liquidation. In MVL, the directors of the company need to sign a certificate of solvency declaring that they made a full inquiry into the affairs of the company, and therefore have formed the opinion that the company will be able to pay its debt within the

**Commented [RD(DW-H12):** Correct but not relevant to the question

**Commented [RD(DW-H13):** 4 marks out of 4. The comment at the end as to arbitration is a grey/developing area but not needed for the answer in any event.

period mentioned above. The shareholders need to pass a special resolution to wind up the company and to appoint a liquidator who can be connected with the company. Once the resolution has passed the MVL commences. It is noted that in MVL the appointed liquidators will take control of the business, investigate the affairs of the company and the directors conduct, realise assets, and pay creditors and shareholders.

A creditors' voluntary liquidation (CVL)- will occur where the company decides to put itself into voluntary liquidation but is not solvent, i.e the directors will not sign a certificate of solvency. In order to pass a special resolution for the winding up of the company a meeting of shareholders is required to be convened by the director of the company. If a liquidator is being appointed at the shareholders meeting, his powers are limited until his appointment is confirmed at the creditors meeting which will need to be convened no later than 14 days after the shareholders' meeting (pursuant to sections 241(a)) and a statement of affairs of the company should be laid before the meeting. A notice should be advertised in the newspaper as well be posted to creditors 7 days before the meeting. At the first meeting of creditors, the creditors should nominate, and vote for the appointment of a liquidator. The CVL commences on the date of passing of the members' resolution for winding up. CVL is less costly and quicker than compulsory liquidation and there is less involvement of the court.

CVL in case of urgency (sections 228A)- is used where the directors believe that the company should be wound up immediately. The rationale is to speed up the appointment of a liquidator in emergency cases for instance where perishable goods are involved. In a CVL a supervision of the court is not required. The CVL is initiated by a directors' meeting, without a shareholders' meeting, at which the directors may resolve to wind up the company and subsequently deliver to the Registrar a statement which certifies the passed resolution as well as that the company cannot by reason of its liabilities continue its business; the directors consider it necessary that the company be wound up and that it would not be reasonably practicable for the company to be wound up under other sections or procedures prescribed by the legislation; and meetings of shareholders and creditors will be summoned to be held no later than 28 days from the filing of the winding up statement. The provisional liquidator appointed under sections 228A must consent in writing to his appointment. Once the winding up statement has been delivered to the Hong Kong Registrar of Companies the winding up commences.

Compulsory liquidation- occurs when the company is wound up by an order of the High Court. A petition to wind up the company can be presented by a creditor, the company itself or shareholder. Pursuant to section 177 of the CWUMPO, the grounds for the Court to wind up the company in a compulsory liquidation are as follows, when the most common one is by a creditor petition which states that the company is unable to pay its debts. Other grounds being the company has by special resolution resolved that the company be wound up by the Court (unless for instance the majority acted fraudulently or in bad faith in adopting the resolution); does not commence its business within a year from its incorporation or suspends its business for a whole year; has no members; the memorandum and articles provide that the company is to be dissolved; the Court believes that it is just and equitable that the company should be wound up. It is noted that in Compulsory liquidation the Court may appoint a liquidator who will take control of the business, realise assets, and distribute the proceeds. If the court is of the view that a restructuring plan to be implemented appears to be in the best interest on the creditors it is for the court discretion to not grant the order. It should also be noted that in case of petition which based on debt that arose under contract subject to arbitration, the petition would be stayed in favour of the arbitration unless the debtor admitted the debt.

**Question 2.3 [maximum 3 marks]**

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

**Commented [RD(DW-H14):** 2 marks out of 3. Should mention (given its importance) that a PL can be appointed to restructure, but not only for that purpose.

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?

Generally, in Hong Kong, the winding up of the company by the court commences at the time of the filing of the winding up petition. Following the presentation of the petition at the office of the Registrar, who shall appoint the time and place at which the petition is to be heard (sections 23 of the CWUR), and prior to the hearing of the petition, and upon proof by affidavit of sufficient grounds for the appointment of a provisional liquidator, the Court, if it thinks fit, and upon such terms as in the opinion of the court shall be just and necessary, may appoint a provisional liquidator to safeguard the assets of the company (section 28 of the CWUR and section 193 of the CWUMPO). It is noted that the court can appoint the Official Receiver or any other fit person to be the provisional liquidator.

If the petitioner creditor is of the opinion that the assets of the company are at risk of dissipation or be in jeopardy, for example, he can apply to the court, after the filing/presentation of the winding up petition, for the appointment of a provisional liquidator to safeguard the assets of the company prior to the hearing of the petition. Other factors taken by the court are commercial realities, the degree of urgency, the need for the order and the balance of convenience. In addition, the petitioner creditor needs to deposit with the Official Receiver the sum of \$3,500 towards the fees and expenses of the Official Receiver in connection with such appointment. Additional sums may be required to be deposited when necessary.

The provisional liquidator, appointed by the court, may take over control of the company including its assets in accordance with the order. The order appointing the provisional liquidator shall state the nature and a short description of the property of which the provisional liquidator is ordered to take possession, and the duties to be performed by him. The provisional liquidator who was appointed prior to the making of the winding up order, will continue to act as the provisional liquidator on the winding up order being made.

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

#### Question 3.1 [maximum 9 marks]

##### Question 3.1.1 [maximum 7 marks]

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

Hong Kong law lacks any formal corporate rescue regime or legislation specifically dealing with corporate rescue, such as can be found in any other common law jurisdictions, for instance, the equivalent to Chapter 11 in the US or administration procedure in the UK. A company that seeks to restructure its debt can go through the route of entering a private debt restructuring agreement with its major creditors or scheme of arrangement under the Companies Ordinance (Cap. 622), which can be seen as aimed at preserving a company as an ongoing concern. It is noted that informal work-outs are not uncommon in Hong Kong. It is noted that during the COVID-19 pandemic businesses were and still facing huge financial challenges still struggling to survive as a result of the lack of rescue legislation.

Disadvantages to the current system:

- the implementation of a scheme of arrangement in Hong Kong is a time-consuming process which involves a Court sanction. I.e an application to convene creditors meeting to approve the scheme, subsequently application to the court for directions,

**Commented [RD(DW-H15):** ...but only if a winding up order is subsequently made.

**Commented [RD(DW-H16):** 5 ½ marks out of 7. A full answer but given the importance of schemes, should add the majorities required to pass a scheme, and the limitations imposed by the *Gibbs* principle. Also, that court retains discretion to not wind up if a restructuring looks possible.



reporting to the court of the results of the creditors meeting, application to the court to sanction the scheme. In addition, there are various requirements for supporting documents to accompany the application such as detailed explanatory statements which satisfied the court that the creditors have been given sufficient explanation of the scheme and its effects as well as notification and delivery requirements.

- the benefit of moratorium on creditor actions against the company prior to the scheme becoming effective is not provided in the Hong Kong law. This can promote creditors to act in a certain way which may not be encouraged if a moratorium was in place. While the company pursues sanction of the scheme. For instance, creditors may still bring proceedings against the company or seek to wind it up, and as a result risking the effectiveness of any restructuring plan or corporate rescue. This also can lead to a worse outcome for all interested parties where there is a genuine prospect that the restructured business would be able to trade out of its difficulties.
- To address the moratorium issues, the appointment of provision liquidator (pursuant to section 193 of the CWUMPO) in order to achieve corporate rescue is necessary, however the provision liquidator's power to attempt a corporate rescue can be given to him if it is proved that an immediate appointment is must to protect the assets of the company, otherwise the assets are at risk of dissipation, for instance and that an order to wind up the company will be sought if the corporate rescue will fail. It is noted that following the court of appeal decision in *Re Legend International Resort* to not appoint a PL just on the basis to promote a scheme of arrangement, this mechanism became less common and the use of "the purpose of winding up" pursuant to sections 192-194 is more used. In addition, with regard to the moratorium, in the past the court refused to grant application for such stay<sup>1</sup>. Today, after certain changes to the Rules of the High Court, the court's case management powers include a power to stay proceedings and it appears the court accepts that a winding up is a situation where the court can exercise its discretion. This development may make it more reasonable that the court would permit a stay to support restructuring.

Commented [RD(DW-H17)]: This is a bit confusing

#### Advantages:

- the proposal of a scheme of arrangement is not limited to companies in financial difficulties or potential insolvency and can be used, for example, for the reduction of share capital or adjustment of debts owed to creditors. At any time, under Hong Kong's scheme of arrangement procedure, the company, its shareholders, creditors, or liquidator whether applicable (and as provided by the court in relation to PL, are free to attempt to reach a binding agreement in the form of scheme of arrangement.
- scheme of arrangement requires the approval of majority of the relevant creditors and court sanction. Without the scheme the company would need to obtain approval of 100% of the relevant creditors to contractually vary the debt which would be difficult or impossible where the company wants to adjust debt with many creditors.
- Scheme is useful when hold out creditors seek an unfair advantage as against a substantial majority of similarly ranked creditors.
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In a case of bank creditors, they would need to comply with HKMA guidelines. The approach that was taking in the past was that the guidelines themselves stating that they represent accepted practice in the banking community, for instance the guidelines promoted the principle that bank creditors should give support to borrowers in difficulty and not for example hastily withdraw facilities for credit but instead provide additional assistance such as capital or rescheduling of existing debts.

#### Question 3.1.2 [maximum 2 marks]

Commented [RD(DW-H18)]: 1 ½ marks out of 2. See below

<sup>1</sup> Credit Lyonnais v Global Hong Kong Ltd (2003)

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

Today there are moves underway to address the lack of corporate rescue legislation, however until today, the Hong Kong Courts have been using the common law principles to facilitate corporate rescue. The first consideration regarding possible reforms in relation to corporate rescue was following the recommendation by the Law Reform Commission in 1996 which led to a proposed Corporate Rescue Bill which was introduced into a Legislative Council (Legco) in 2001. In theory, the Bill proposes that the system should remain creditors focused and suggestions of debtor in possession system, similar to Chapter 11 in the US did not appeal nor adopted. The creditor-friendly approach is similar to the current insolvency regime in Hong Kong; however a debtor-in-possession approach would be more likely to preserve the company as a going concern.

Commented [RD(DW-H19)]: Why?

The Bill proposes that a provisional supervisor would be appointed to explore restructuring of any other rehabilitation procedures. The insolvent or likely to become insolvent company, company, the liquidator, or provisional liquidator can initiate provisional supervision. Both Hong Kong and registered non-Hong Kong companies (with court approval) will be able to do so. The Bill provided the benefit of moratorium in order for enable the provisional supervisor to perform restructuring (however, it is noted that the proposed moratorium does not apply to other jurisdictions, so creditors will be able to commence proceedings outside Hong Kong), however, some difficulties in the form of personal liability of the provisional supervisor in an employment contracts, the consent of major secured creditors prior to applying for the appointment of the provisional supervisor and insolvent trading provision such as the responsibility of the director of a company for insolvent trading of the company if the company owes a debt whilst it is insolvent and he at the material time knew that the company was or become insolvent- all these created difficulties with the proposed Bill. In 2004, after numerous discussions, the Bill expired. Over the past number of years various comments have been made to the Bill by the Secretary for Financial Services and the Treasury Bureau in 2017; by the Legco Panel and the Legco website in 2018 and now expired, which suggested reintroduction of the Bill. Additional consultation during 2020 were requested, however it is noted that the same difficulties discussed above are still in the draft Bill. It is also noted the Hong Kong Companies judge admitting the issue of lack of corporate rescue legislation for over few decades now, despite of the big economic problem brought by the Covid-19 pandemic, however complimenting the desirable efforts and steps taking to improve the legislative position, such as the amendment to section 193 of the CWUMPO which provides restructuring powers to the PL.

Commented [RD(DW-H20)]: No moratoriums are effective extra-territorially as a matter of course. Hence advantage of, e.g. the Model Law.

The Hong Kong Government has recently announced its plan to re-introduce the Bill into the Legislative Council in early 2021. Again, the Bill aims to introduce a statutory corporate rescue procedure and insolvent trading provisions into Hong Kong law. If the Bill is passed, it will be a significant step in the development of the corporate insolvency regime in Hong Kong which will also bring Hong Kong to be equal with other common law countries.

### Question 3.2 [maximum 6 marks]

Commented [RD(DW-H21)]: 5 ½ marks out of 6. Full marks if mentioned protocols and that concepts extend to schemes.

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.

Hong Kong's insolvency legislation does not contain any provision dealing with cross-border insolvency (apart from winding up of foreign incorporated and unregistered company). Hong Kong has not adopted the UNCITRAL Model Law on Cross-border Insolvency and is not part of any international treaties or bilateral agreements in relation to Cross-border Insolvency. The Hong Kong courts have always followed the common law principles and made significant progress in establishing a common law framework for the recognition of foreign insolvency proceedings and the administration of creditors' claims in Hong Kong. For instance, and as

discuss in Irish shipping (1985), a foreign liquidator's rights, on behalf on the insolvent company, to bring actions in Hong Kong has long been recognised and no formal order to recognise the foreign representative is needed. With regards to foreign rescue proceedings, the Hong Kong, traditionally assists by, for instance, refusing to allow enforcement of judgement against Hong Kong assets of company in rehabilitation process, if it believes that, through comity, it can assist with the rescue proceedings.

There are no statutory provisions in Hong Kong covering the recognition, or even assistance, of insolvency procedures commenced in other jurisdictions. Because of this, the area of cross-border insolvency law is far from straightforward. However, the judiciary has been keen to use (in appropriate circumstances) common law rules and provisions to assist, including recognition of receivers appointed by foreign courts and the creation of protocols to deal with situations where courts of elsewhere are also involved in the insolvency proceeding.

Along with the common law developments in relation to cross border, there are various legislative provisions which deal with winding up of non-Hong Kong company. The Hong Kong court can exercise its jurisdiction and wind up a foreign company that is not incorporated or registered in Hong Kong, subject to certain terms as set up in sections 327 of the CWUMPO such as 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; it is unable to pay its debts; the court is of opinion that it is just and equitable that the company should be wound up. Three core requirements were set up by the Final Court of Appeal in the case of Yung Kee in order to wind up an unregistered company: sufficient connection with Hong Kong such as assets, business activities (in the case of China Medical), reasonable possibility that the order would benefit those petitioners applying for it and the court must be able to exercise jurisdiction over one of the interested parties in the distribution of the debtor's assets such as having a place of residence in Hong Kong, employment, having place of business, and that must be met unless the connection with Hong Kong is sufficiently strong and the benefit to creditors is sufficiently solid. In Information Security One the court provided for ancillary liquidation in Hong Kong where there was a principal liquidation elsewhere. In this case the court will apply modified universalism approach (Re Pioneer Iron), and the Hong Kong proceedings will be treated in way that enables the principal liquidators to declare and pay dividend. It is noted that now it is more common for foreign representative to seek recognition in Hong Kong. In the case of Joint Official Liquidators of A Co v B it was confirmed that the Hong Kong Companies Court, can recognise foreign insolvency proceedings and provide assistance in their discretion in accordance with the principle of modified universalism, if issued with a formal letter of request to provide assistance from the foreign court. With respect to recognition order and order to produce document, the court in A Co v B, adopted a judgment of Kawaley by which pursuant to letter of request from a common law jurisdiction with similar substantive insolvency law, make an order, similar to the one available to a liquidator in Hong Kong. It is noted that although some may argue that the common law principles do not require such formal letter of request, the practice in Hong Kong is such that the letter must be obtained. In addition, the PC in Singularis clarified that the common law power of assistance exists in the jurisdiction which sought the order and where the liquidators are and in the assisting jurisdiction. Important to note that the court will consider the underlying principles when asked to assist for instance, whether the type of order sought is also available in Hong Kong. The Hong Kong courts can provide recognition order to permit examination or production of documents situated in Hong Kong (BJB Career) in a case whether the relevant provisions in the requesting jurisdiction in accordance with Singularis principle discussed above. Important to also note that the powers in the order sought should also be available in the liquidator's home jurisdiction.

Nevertheless, in the case of CEFC Shanghai International Group Limited the Court for the first time granted recognition and assistance to bankruptcy administrators appointed to a Chinese company (not a common law jurisdiction). Notwithstanding the above the position in Hong

**Commented [RD(DW-H22)]:** Recognition of foreign court-appointed receivers (as opposed to liquidators) is a bit of a grey area.

Kong is that assistance will not be provided to a foreign insolvency administrator unless the orders sought is available to an insolvency representative under Hong Kong's laws given the courts are bound by the limits of their statutory and common law powers. Also noted that even if the regimes are not identical, the court can still assist (HIH 2008)

In a case of bank (Bay Capital Asia), even without a recognition order, the bank should assist with providing documents in relation to the company's account. Note that when relying on common law developments it is more difficult to predict how new situation will be dealt with. The courts also support foreign proceedings by protocols which help coordinate the activities of parallel proceedings.

In summary, Hong Kong's common law recognition process is benefiting foreign liquidators and creditors. Foreign liquidations have been recognised and foreign liquidators have obtained various orders to support their investigations and maximise the assets available for creditors in the foreign liquidation.

#### **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 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?

A floating charge is a form of security which is said to float over various categories of assets and the company is permitted to deal with the charged assets in the ordinary course of business. Once a receiver is appointed under the term of the debenture the floating charge crystallises and becomes fixed and all the assets covered by the floating charge are now form part of the fixed security of the charge holder. The main effect of the appointment of a liquidator during the conduct of a receivership is that it terminates the receiver's power to act as an agent of the company, although not all his powers as receiver cease.

It is important to check when the floating charge was created. Pursuant to sections 267 and 267A, if the floating charge was created in favour of any person other than a person connected with the company, within a period of 12 months before the commencement of the winding up of PTM, and the company was unable to pay its debt at that time or became unable as a consequence of the charge, it may be invalid, unless to the extent any new monies, or the company was solvent at the time of the granting of the charge. For a connected person, the relevant period is 2 years.

Pursuant to section 79 of the CWUMPO, realisation from the floating charge made by the receiver must first be used to meet preferential claims, such as certain employee payments. Even if the company is not in liquidation, the debts, which in every liquidation are under the provisions of Part V relating to preferential payments to be paid in priority, shall, according to their respective priorities under section 265, be paid out of any assets coming to the hands of the receiver taking possession as aforesaid in priority to any claim for principal or interest in respect of the debentures. Pursuant to section 265 (3B) once there is a liquidation in place, preferential claims are paid out of the floating charge realisation unless there are sufficient assets to make those payments out of the general estate. It is noted that when a triggering

**Commented [RD(DW-H23)]:** 3 ½ marks out of 4. Should also check registration of security. And if refer to s.79 and s.265(3B), remember that s.79 only applies where no liquidation.

event occurs (such as insolvency) and the charge crystallises, the debtor company's rights to use the class of assets terminates and the security becomes a fixed charge security over those assets in the relevant class in existence at the time of crystallization (an instrument creating a floating charge will invariably include provision that insolvency is a crystallisation event).

The receiver is entitled to be paid out of the assets over which he was appointed and to exercise a lien over those assets pending payment. When the receiver has paid the preferential creditors out of floating charge realisations and accounted to the charge holder for the balance of those assets, any surplus amounts are then paid to the company and in our scenario to the liquidator. The appointed liquidator can indemnify the receiver in respect of any unsatisfied claims of preferential creditors.

The liquidation of PTM does not affect the receiver's rights to hold or sell the assets secured by the charge under which he is appointed. The realisation made by the receiver out of the assets charged are not available to the liquidator for payment of the liquidation expenses. Such assets must be used to pay preferential creditors if there are insufficient assets from the uncharged assets.

#### **Question 4.2 [maximum 4 marks]**

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.

HF has a fixed charge in relation to the specific assets- receivable. A fixed charge means that the debtor cannot deal with it without the consent of the charge creditor. The creditor is entitled to look at the assets for repayment irrespective of the interests of other creditors and the use of the asset is restricted. Enforcement of fixed charge stands wholly outside the liquidation so HF will not be able to submit a proof of debt and will need to pursue it separately. If the security has properly been registered it can be forced outside the liquidation and the liquidator will not be able to get the property into the estate.

A fixed charge over the receivable is a common mechanism in Hong Kong as a kind of security which can sometimes cause difficulties upon the insolvency of the company. There are 2 scenarios to distinguish between, whether the Receivables Purchase Agreement, was entered by way of absolute sale of the right to the receivable with the right of rescue or claw-back if debt go bad, or by way of a loan arrangement with the assignment mechanism operating as a security. If all accounts receivables due from BH's customers therefore belong to HF that means that HF has an ownership over the receivable and no security is needed as BH sold a right that it had namely the right to be paid by its own customers. In the second scenario where the document also asserts that as an alternative to ownership of the receivables, HF has a fixed charge over the receivables, and the arrangement is actually a secured financing

**Commented [RD(DW-H24)]:** 2 ½ marks out of 4. Could be more concise as is intended to be advice. Main point is sale v security. If security, also need to consider control exercised so could be a floating not fixed charge. Extortionate credit transaction provisions rarely used.

agreement whereby HF has the right to seek recovery of the indebtedness owed to it by enforcing against the receivable as long as it was registered, otherwise would be void against the liquidator. The court will need to look at the actual effect of the arrangement to determine whether there is a sale or secured financing agreement such as in Orion Finance and Hallmark Cards whereby in the latter the court determine that the arrangement was a sale, and the liquidator did not succeed.

Assets subject to security will not be available for the liquidator for realisation, however if a security should have been registered but was not than it is voidable against the liquidator and the money from the receivable in the case of HF will be part of the liquidation estate.

Section 264- Extortionate credit transaction should be considered. A transaction is extortionate if it occurred in the last 3 years prior to the commencement of the winding up; having regard to the risk accepted by HF who providing the credit, the terms of it require grossly exorbitant payments to be made (whether unconditionally or in certain contingencies) in respect of the provision of credit; or it otherwise grossly contravenes ordinary principles of fair dealing; then the liquidator can apply to set aside the transaction to repay sums to the company or surrender property or other account to be taken.

Impeachable transaction, such as unfair voidable, can be considered in the case of HF given HF is a creditor with a fixed charge and granting a security is considered transactions. It should also be that BH does anything which has the effect of putting HF into a position which, in the event of liquidation, will be better than the position HF would have been in if that thing had not been done. The liquidator can apply to set aside the transaction if it entered during the period of 6 months prior to the commencement of the winding up (2 years if connected person). The court will consider if the BH was influenced when decided to give the unfair preference. Impeachable transaction will not be considered in relation to TC since TC is not a creditor nor a guarantor of any of its debt pursuant to sections 266A.

With respect to TC, the liquidator will need to consider the contract entered between BH and TC and consider whether it form part of BH's assets or any value that can be assigned to it. Note that there are no statutory rules in Hong Kong for treatment of specific contracts. In the scenario presented in the question, there is a contractual clause that provides for the transfer of BH assets to TC if BH goes into liquidation. The court will not uphold the contract term as it results in general creditor being disadvantaged and denied of the assets that would in the absence of the clause be used to satisfy their debts. This being the anti-deprivation principle which do not permit a creditor to be put in a better position than other creditors if the mechanism is considered a fraud on insolvency laws. In this scenario TC would be put in a better position given that all the cars which are the main assets would belong to it.; the principle also aims to prevent advantage to one party in the event of insolvency, which again would happen if the asset would be belong to TC (also mentioned in Peregrine Investment v Asian). However not every clause in the contract which causes asset to fall beyond the reach of the other creditors automatically will be disqualified. The UK Supreme Court in Belmont Park v BNY determined that "if the arrangements are part of genuine commercial transaction and not entered into with the intention of creating an advantage on the insolvency ...that it should not be struck down". Sets of factors had been developed to assist with the determination of the same being the intention to evade insolvency law, operation of the clause in other scenarios except insolvency and whether the asset is flawed.

The liquidator should also check if there is an additional assignee as that may cause an issue of priority between them which can be troublesome. The test would be who is the first equitable assignee of the debt to give notice of assignment to BH and the same would have priority.

**Question 4.3 [maximum 7 marks]**

**Commented [RD(DW-H25)]:** 3 marks out of 7. A lot of the relevant elements are covered but the answer is a bit confusing to follow, and suggests it is not fully understood. Could also consider taking control of the HK subsidiary, and taking action against the recipients.

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.

The ability of the JPLs appointed in the Cayman Islands, the jurisdiction of incorporation, to take steps in the name of the company, will generally be recognised by the Hong Kong court. However, in order for the JPLs to action in Hong Kong in relation to exercising their powers as JPLs per se, they would first need to be recognised in Hong Kong, for instance, the ability to investigate Mr Pottinger.

In our case the JPLs have been appointed in Cayman Islands, however not yet applied for recognition in Hong Kong. Additional facts are now that there are accounting irregularities which may result in the note holders/ creditors to utilising sections 327 of the CWUMPO whereby, a company incorporated outside of Hong Kong may be wound up at the discretion of the Hong Kong court if, among other things, the company is unable to pay its debts. In the case of company incorporated offshore (Cayman Islands) who nonetheless conduct all its business in Hong Kong (as is the case with Cyberbay), where an application is made for recognition and assistance by the JPLs after a winding-up petition has been presented in Hong Kong under section 327 it is unlikely that the Hong Kong court will grant recognition and assistance to the JPLs unless the agreement of the petitioning creditor (and any other creditors supporting the winding up application) has been obtained in advance. Even if winding up proceedings have not yet been commenced in Hong Kong, if the JPLs recognition application is made in circumstances where (a) a statutory demand has been served by a creditor or (b) creditors have voiced their opposition to the appointment of JPLs for restructuring purposes, these factors would need to be disclosed to the Hong Kong court. In such circumstances, it is likely that the court would direct that the recognition application be served on those parties so that they could appear and oppose the recognition application if they wanted to. Therefore, to the extent the JPLs wish to go down the PL route, I would recommend doing it sooner rather than later in order to have the best chance of getting the JPLs recognised in Hong Kong before any of Cyberbay's creditors take steps towards filing a winding up petition in relation under section 327 (either by serving a statutory demand, or actually commencing winding up proceedings).

It is also important to note that if/when the Hong Kong court does recognise the PLs, there will not be an automatic stay on winding up or other proceedings in Hong Kong. Instead, the PLs would be required to apply to the Hong Kong court for an order staying the particular proceedings on a case by case basis.

The JPLs can obtain a winding up order in Cayman and subsequently seek recognition. A letter of request from the Cayman Court is required. Another option is to appoint a liquidator in Hong Kong to a non-Hong Kong company due to the fact that Hong Kong does not have a comprehensive statutory framework providing for the recognition of overseas insolvencies and

has not enacted the UNCITRAL the Model Law which can create uncertainty which can result in substantial delay and cost.

Once the winding up commences there is an automatic stay of legal proceedings against the insolvent company, the avoidance of execution and attachments and the investigative powers granted to Hong Kong liquidators to enquire into the affairs of the company by examining its directors and others.

Pursuant to sections 327 (3) Cyberbay, a non-Hong Kong company may be wound up in Hong Kong if it proves the company is unable to pay its debts; or the court is of opinion that it is just and equitable that the company be wound up. There must be sufficient connection with Hong Kong which exist given the company is listed in Hong Kong, employees and Hong Kong subsidiary (CFA's decision in Re Yung Kee); it is reasonable possible that the winding up order would benefit the creditors who apply for it.

It is noted that if a Cyberbay, is already in liquidation in its place of incorporation, a liquidation in Hong Kong will generally be treated as ancillary to it – the functions of the Hong Kong liquidator being framed by Court order accordingly, to provide that he is to collect in the Hong Kong assets, to settle a list of Hong Kong creditors and to transmit the assets and the list to the principal liquidators in Cayman to enable a dividend to be declared and paid. the Hong Kong liquidation will be governed and conducted in accordance with Hong Kong insolvency law, but in cooperation with the overseas liquidation process.

If assuming that the founder and Chairman is also a director, it owes a fiduciary duty to the company and it is often on the basis of a director breaching these duties that the liquidator can bring claim against the director when the company is insolvent.

The director may be subject to both civil and criminal penalties and a disqualification order if as he engaged in fraudulent trading. It is noted that the civil and criminal penalties apply to any persons who were knowingly parties to the fraudulent trading, and not necessarily being limited to directors). Given the large sums of money been paid to entities with no apparent real business with Cyberbay it can be determined that fraudulent trading occurred as the business of the company was carried by the Chairmen with the intention to defraud creditors or for any fraudulent purpose.

The applicable civil penalty is that the Court may determine that the Chairmen who was knowingly party to the fraudulent carrying on of the company be personally responsible, without any limitation of liability. Noted that civil penalty will only be applicable if the fraudulent trading becomes apparent in the course of the winding-up of the company.

The liquidators can use section 286B for the examination of connected person, however since Mr Pottinger he is not directly connected with the company the legislation is much narrower. Under 286 B (4) (d) a person whom the court thinks capable of giving information concerning the promotion, formation, trade, dealings, affairs or property of the company may be subject to an order of examination.

With regard to the bank borrowing- the liquidator would be able to obtain the company documents from bank in Hong Kong (bay capital).

In addition, as in the case if BJB, the court can grant order to the foreign liquidators to seek production of documents or examination if individual in Hong Kong. Note that the court will compare the relevant provision in Cayman as the requesting jurisdiction in accordance with Singularis case. In addition, the Cayman legislation permit examination- section 103 of the Companies Act 2021 where the same is more restricted in Hong Kong (section 286B described above). Note that both compulsory liquidator or PL can apply to the court for an order that any



person whom the court thinks capable of giving information regarding the affairs or property of the company should attend court and be examined on oath.

| **TOTAL: 38.5 MARKS OUT OF 50**

**\* End of Assessment \***