



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

**HONG KONG**

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

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

## **INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT**

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

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentnumber.assessment8C]**. An example would be something along the following lines: 202021IFU-314.assessment8C. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentnumber” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
6. The final submission date for this assessment is **31 July 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)]:** 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

### 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.

## 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.

Proceedings (including arbitration proceedings) commenced by a creditor against a company may be subject to a moratorium or stay in compulsory liquidations proceedings in two situations:

- (i) a discretionary stay: The Court has the power to stay or restrain proceedings against a company at any time after the presentation of a winding up petition but before an order has been made (see CWUMPO, s. 181); and
- (ii) a compulsory or mandatory stay: When a winding up order has been made, no action or proceeding may be proceeded with or commenced against the company, except by leave of the Court and subject to such terms as the Court may impose (see CWUMPO, s. 186). For these purposes "proceeding" shall include any arbitration proceedings (see *Re UDL Contracting Ltd [2000] 1 HKC 390*).

Accordingly, the creditor's civil action (if ongoing) may be subject to a discretionary stay following presentation of the winding up petition in respect of the company, or a mandatory stay if a winding up order is made in respect of the company, which would prevent the creditor from continuing to pursue such action. Save that, the creditor may seek leave of the Court to continue to pursue the action against the company, notwithstanding the mandatory stay in force.

### 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.

**Commented [RD(DW-H10)]:** 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 Correct (1 mark). See for example the *Irish Shipping* case

**Commented [RD(DW-H11)]:** 2 marks out of 3. Should also mention the restrictions on retaining attachments etc. (s.183)

**Commented [RD(DW-H12)]:** 4 marks out of 4. A good, comprehensive answer. But care should be taken when referring to section numbers, particularly as an urgent CVL is usually referred to as 'a 228A'.

A company can go into liquidation in Hong Kong by way of compulsory or voluntary liquidation. There are two types of voluntary liquidations: (i) members' voluntary liquidation; and (ii) creditors' voluntary liquidation. The methods are briefly summarised below:

(i) Members' Voluntary Liquidation:

This process is used when the company is solvent.

The process is commenced by a special resolution to wind up the company and appoint liquidators (and takes effect from the date the resolution for winding up is passed). This is a solvent liquidation procedure which may be used where the company will be able to settle all liabilities (in full) within 12 months of the commencement of liquidation – and the directors of the company are required to sign a 'certificate of solvency' confirming the same. There is no value threshold for a company to commence voluntary liquidation. There is no specific qualification as to who can be a liquidator but the appointee is usually an insolvency practitioner such as a solicitor or accountant and can be connected with the company (e.g. liquidator may be from the company's audit firm).

(ii) Creditors' Voluntary Liquidation: (CVL)

This process is used when the company is not solvent (or where the directors are not prepared to sign a 'certificate of solvency').

The process is commenced by the directors (acting by their own volition or upon request by shareholders) convening a meeting of shareholders to pass a special resolution for the winding up of the company. 14 days following the shareholders meeting (at which it is resolved to wind up the company), a creditors meeting must also be convened – notice being sent by post to creditors at least 7 days before the meeting and advertised in the Hong Kong Gazette and in an English and China language newspapers with circulation in Hong Kong) at which: (i) the appointment of liquidators will be confirmed; and (ii) a statement of affairs will be provided. The liquidation will be deemed to be commenced on the date of the shareholders resolution, but the liquidators powers will be limited until his/their appointment is confirmed by at the creditors meeting.

(iii) Section 288A of CWUMPO:

Commented [RD(DW-H13)]: Should be 228A

This process may be used in circumstances where in the opinion of the directors of the company the company should be wound up with immediate effect.

The process is commenced by the directors resolving to winding up the company – no shareholders resolution is required – and delivering to the Registrar a statement certifying that a resolution has been passed which provides that: (a) the company cannot by reason of its liabilities continue its business; (b) the directors consider it necessary that the company be wound up and it is not reasonably practicable for the winding up to be commenced under another section; and (c) meetings of the company's shareholders and creditors will be summoned to be held not later than 28 days of the filing of the statement. A special reason must be provided to show why the company should be liquidated under section 228A rather than a different procedure and a director may be liable for penalties if he inappropriately proceeds under section 228A when there is no special reason or urgency.

(iv) Compulsory Liquidation:

This process is most frequently commenced by a creditor petitioning for the winding up of the company on the basis that it is unable to pay its debt. A company can also present a petition for its winding up by passing a special resolution (but not by a directors resolution alone), and a shareholder may also petition for the winding up of a company on the grounds that it is just and equitable to do so. The company enters into liquidation upon order of the High Court for the winding up of the company.

The main reason for using a CVL procedure, rather than a compulsory (Court) liquidation by a creditor is cost and timing – in the compulsory (Court) liquidation, there is much greater court involvement which can lead to delay and additional costs. In comparison, a CVL can be commenced more quickly – by shareholder resolution.

Section 288A liquidation may be used in limited circumstances – where it is necessary for liquidation to be commenced (and liquidators to be appointed) in a very short time line (or 'emergency') – e.g. where perishable goods are involved.

**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 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?

Yes, it is possible for an interim officeholder to be appointed in the period following the presentation of a winding up petition and the making of a winding up order pursuant to Section 193 of CWUMPO – such officeholder being described as a 'provisional liquidator', notwithstanding as a matter of Hong Kong law such term does not technically exist.

Pursuant to Section 193 of CWUMPO, an application to appoint a provisional liquidator may be made any time after a petition has been presented – and in urgent cases, may be made at the same time as the petition.

There must be sufficient circumstances to justify the interim appointment. For example, the Court may make an order to appoint a provisional liquidator if it is satisfied that:

- (i) there is a risk that assets will be dissipated or otherwise in jeopardy, before a winding up order is made (see *Re Union Accident Insurance Co Ltd* [1972] 1 All ER 1105) – the provisional liquidator being under a duty to preserve assets in the period after the petition is presented but before any order is made (but not to actually realise such assets, unless necessary to preserve their value); and
- (ii) as an ancillary matter, that the provisional liquidator may help in facilitating a restructuring proposal (although that cannot be the sole reason underpinning the appointment) (see *Re Weihong Petroleum Co Ltd* [2002] HKCU 1425; *Re Legend International Resorts Ltd* [2006] 3 HKC 565; *Re MF Global Hong Kong Ltd* [2015] 2 HKC 424, CA; *China Solar Energy Holdings Ltd (No. 2)* [2018] HKCU 98 and *Re Kevview Technology (BVI) Ltd* [202] HKCU 616).

**Commented [RD(DW-H14):** 2 ½ marks out of 3. The term 'provisional liquidator' does exist. It is 'provisional liquidation' which is a misnomer. Also, appears certain of the answer is copied/pasted from the guidance text.



In determining whether to make an order appointing a provisional liquidator the Court will consider a number of factors including, by way of example, the degree of urgency, the need for such order, the commercial reality and the balance of convenience.

It has been held that it is wrong to apply for the appointment of a private provisional liquidator immediately prior to winding up to avoid having the Official Receiver as provisional liquidator (see *Re Kong Wah Holdings Ltd & Another* [2001] HKCU 423).

The Court may limit the provisional liquidator's powers or terminate the appointment upon an application by: (i) a provisional liquidator; (ii) the Official Receiver; (iii) a creditor; (iv) a contributory; or (v) the petitioner.

### **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.

There is no legislation in Hong Kong which specifically deals with corporate rescue save for Part 13 Division 2 of the Companies Ordinance which sets out the statutory provisions in respect of schemes of arrangement – in particular, there is no process under Hong Kong law akin to Chapter 11 in the United States or administration under English law. However, notwithstanding, the Hong Kong Courts have adopted a flexible approach in applying common law principles which has enabled a significant number of informal work-outs (i.e. corporate rescues) to be undertaken in Hong Kong.

A 'workout' is an out of court, contractual arrangement between a company and its creditors which may be undertaken at any time. It is highly flexible – the terms of the relevant plan will be tailored to the particular circumstances of the company (and its creditors).

There is no formal / set structure for effecting a consensual workout in Hong Kong – rather the practice has developed over time in response to particular market events (e.g. the Asian Financial Crisis in 1997 / 1998) and has adapted over time to reflect market participants (e.g. to reflect the rise in alternative debt providers, distressed funds, etc.).

Guidelines called the "Hong Kong Approach to Corporate Difficulties" were published by the Hong Kong Monetary Authority ("**HKMA**") (and originally published by the Hong Kong Association of Banks ("**HKAB**")) setting out formal but non-statutory guidance for the implementation of a consensual workout, with compliance being 'strongly recommended' and 'expected' from HKAB members, and therefore assist in effecting corporate rescue. In summary, the Guidelines promote the principle that bank creditors should support borrowers in financial difficulty, and should not withdraw facilities, take action to wind up and/or enforce security (including the appointment of receivers), and should provide additional capital and/or agree to refinance / re-schedule debts.

In theory, the Guidelines present a clear advantage to debtor companies dealing with bank creditors – they can be relatively comfortable that, in principle, bank creditors will not take precipitate action (including the enforcement of any security) immediately upon the onset of financial distress and in general, can expect to be supported by bank creditors.

**Commented [RD(DW-H15)]:** 6 marks out of 7. A good answer. Could have added reference to the *Gibbs* principle and the court's role at sanction: reviews the position, not a rubber stamp.

However, although the Guidelines do provide that "other creditors will have to co-operate by not demanding repayment", crucially they do not apply (i.e. bind) to non-bank creditors. This is a material 'gap' in the effectiveness of such Guidelines, particularly given the rise in non-bank creditors including bond holders and non-bank lenders. There is a risk that these parties will take a materially different position to the banks – particularly, if they do not have the benefit of security (which would typically be granted to banks and afford them protection of some recovery).

Notwithstanding the limitations with the Guidelines, the Court retains the discretion not to make a winding up order, even when a creditor is on the face of it entitled to one, in circumstances where: (i) a genuine restructuring is being promoted; (ii) it is reasonably clear that a restructuring would be to the benefit of the creditors as a whole; and (iii) the petitioning creditor is acting to promote its own interest ahead of others. The Court's exercise of discretion in this regard offers a key protection to a debtor company from precipitate creditor action.

In a corporate rescue situation, it is common for an independent financial advisor to be appointed. Whilst on the face of it, this would offer a key protection to both the debtor company and the creditors in ensuring that a 'fair value' is struck, with a degree of independent oversight of the corporate rescue plan. In fact, this system is subject to criticism – notwithstanding that the fees of the independent financial advisor are paid for by the debtor company, the financial advisor is selected by the bank creditors. This has led to the concern that the financial advisors are not truly independent and have alliances with the bank creditors.

In addition, and as a result of the lack of statutory provisions in respect of corporate rescue procedures in Hong Kong, no provision is made for banks to be able to provide working capital during and in order to effect a corporate rescue process on a priority basis. Whilst the Guidelines do provide that a bank creditor may obtain priority security for any new money, all existing security holders must consent to such arrangement. This represents a clear disadvantage of the current system – it is frequently the case that additional working capital is required in order to effect a corporate workout, and banks will be reluctant to provide such additional financing to a debtor company in distress without some comfort that its new money is secured over assets in priority to other lenders. Moreover, it will be practically impossible to obtain unanimous consent from existing secured lenders to the grant of new security for new money (i.e. why would such lenders agree to subordinate their claims to the same security, and potentially reduce their recovery from such assets in the event that the workout is not successful).

A further disadvantage is that the Guidelines envisage that any workout agreement requires the consent of all affected parties. Whilst the Guidelines provides that any dissenting creditor must explain their objections to the workout plan, the Guidelines do not provide any mechanism to bind and/or sanction a dissenting creditor (i.e. there is no statutory ability to 'cram down' dissenting creditors in order to implement a workout) – this can have the effect of providing a dissenting minority creditor with disproportionate power / control to be able to block a restructuring and may prevent a debtor company from being able to effect a workout which is otherwise approved the majority (in number and value) of creditors. Conversely, this arrangement does afford minority creditors protection from a corporate rescue plan being forced through by majority creditors notwithstanding their objections.

Finally, another disadvantage of the current system of effecting a corporate rescue, on its own, in Hong Kong is that there is no automatic moratorium or stay on creditor actions, whilst the plan is being negotiated and/or implemented. Accordingly, there is no 'breathing space' for a debtor company from creditors commencing or continuing actions against the debtor company, whilst the rescue plan is being formulated and/or agreed.

To address this lacuna, a practice has developed in Hong Kong whereby a petition to wind up the debtor company is presented together with an application for the appointment of a provisional liquidator – such provisional liquidator being appointed, amongst other things, for the purposes of considering and/or facilitating the implementation of a restructuring. However, this practice has been somewhat limited as a result of the decision in *Re Legend International Resorts Limited* [2006] 2 HKLRD 192 – in which the Court held that a petitioner must show that it is necessary to appoint a provisional liquidator for one of the 'traditional reasons' (i.e. to protect or preserve a company's assets) and refused to appoint a provisional liquidator for the purposes of carrying out a restructuring of the company. Notwithstanding this decision, a number of companies have still managed to use this practice to appoint a provisional liquidator in a restructuring situation.

As noted above, Hong Kong law does contain provisions in respect of schemes of arrangement, which are supplemented by common law principles which are broadly adopted from English case law save for certain key differences: (i) the 3-stage procedure used in Hong Kong differs from the process adopted in the United Kingdom; and (ii) there is no requirement to send creditors a Practice Statement letter (i.e. a letter informing them that a proposal is on foot to apply to Court for permission to convene meetings for the purposes of considering, and if thought fit, approving a scheme of arrangement).

The key advantage of a scheme of arrangement for a debtor company is that it enables a debtor company and its creditors (or members, or any class of them (as applicable)) to compromise debts without requiring the unanimous (100%) consent of the affected stakeholders – rather the scheme is approved by a majority in number representing a least 75% by value of the creditors present and voting. In practice, this threshold is much more achievable. This provides the debtor company with the ability to 'cram down' dissenting creditors and prevents minority creditors from having a blocking stake (in most circumstances, subject to classing). Conversely, this may be a disadvantage to creditors – which will not be able to adopt a blocking position (as it would in a consensual work out).

Moreover, pursuant to a scheme of arrangement, a company may be able to obtain third party releases from relevant parties (i.e. a guarantor may be released from obligations if the debt is being compromised pursuant to the scheme) (subject to certain requirements).

For the reasons set out above, the lack of statutory corporate rescue procedure has both advantages and disadvantages. Practitioners in Hong Kong have adopted innovative and flexible solutions to issues which might otherwise be prevented by statute – but there are clear disadvantages (including the lack of provisions dealing with security for DIP financing and lack of moratorium). Schemes of arrangement, by comparison, do offer practical advantages to a debtor company, but they can be costly to implement, and can operate to deprive minority and/or dissenting creditors of the opportunity to object to the arrangement.

### **Question 3.1.2 [maximum 2 marks]**

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

There is currently no statutory legislation regarding corporate rescue (save for Part 13 division 2 of the Companies Ordinance which relates to schemes of arrangement) in Hong Kong.

The introduction of legislation to address corporate rescue has been proposed and discussed for many years. A corporate rescue bill was introduced into the Legislative Council in 2001

Commented [RD(DW-H16)]: 1 mark out of 2.

following recommendations by the Law reform Commission in 1996 (the “Corporate Rescue Bill”).

The Corporate Rescue Bill proposed a system that would remain 'creditor focussed' and included a proposal for a US Chapter 11-type debtor in possession system – in particular, the Corporate Rescue Bill provided for the appointment of a 'provisional supervisor' to consider restructuring or other rehabilitation procedures, but did not include a moratorium. Moreover, the Corporate Rescue Bill contained certain 'problematic' provisions, including: the provisional supervisor assuming personal liability for employment contracts; the requirement for consent of a majority of secured creditors before any application to appoint a provisional supervisor may be made; and insolvent trading provisions which business groups argued would dampen Hong Kong's 'entrepreneurial spirit'.

The Corporate Rescue Bill did not 'gain traction' and was not implemented and subsequently lapsed from the Legislative Council's schedule in 2004. More recently, the Corporate Rescue Bill has been revived - in March and October 2017 the Secretary for Financial Services and the Treasury Bureau have commented on the draft Corporate Rescue Bill, and in March 2018 further comments were made by the Legislative Council's Panel on Financial Affairs, and it was suggested that the Legislative Council would introduce the Bill in July 2018 and then in the 2018/2019 legislative year - that did not happen.

Further consultation has been sought in 2020, but with little enthusiasm – the same elements of the Corporate Rescue Bill proving problematic. Despite other jurisdictions addressing corporate rescue procedures as a result of the COVID-19 pandemic, the Legislative Council has still not acted in Hong Kong. This has led to the Hong Kong Companies Judge to comment on the 'unsatisfactory state of affairs'.

### Question 3.2 [maximum 6 marks]

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 does not have any statutory framework to address cross-border insolvency, nor has Hong Kong adopted the UNCITRAL Model Law on Cross-Border Insolvency and/or is party to any international treaty or bilateral agreement dealing with cross-border insolvency. However, the Hong Kong Courts have followed common law principles to support foreign officeholders and foreign insolvencies – with the Court of Final Appeal confirming that this continued after the Handover (see *Chen Li Hung and Another v Ting Lei Miao and Others (2000) 3 HKCFAR 9*) – as well as applying the principles of comity to assist other insolvency processes, including rehabilitation procedures.

In particular, the Hong Kong Court has dispensed with the need for a foreign liquidator to commence ancillary proceedings in Hong Kong in order to take steps in Hong Kong – all that is required is a letter of request from the foreign Court requesting assistance. See *A Co v B*, in which the Hong Kong Court dealt with an application by Cayman Islands liquidators for a Hong Kong Order to recognise their appointment and an order for the production of documents and in which the Court held that: “*The Companies Court may pursuant to a letter of request from a common law jurisdiction with a similar substantive insolvency law make an order of a type which is available to a provisional liquidator or liquidator under Hong Kong's insolvency regime.*” The Hong Kong Court has accordingly, removed a procedural hurdle – the need for local proceedings to be commenced in Hong Kong. Notably, the scope for relief is not unlimited – and will be limited to the extent to which the type of order sought is available in Hong Kong.

**Commented [RD(DW-H17):** This is not correct; a DIP system was not included and has no support in Hong Kong

**Commented [RD(DW-H18):** 4 marks out of 6. A good answer but Part X CWUMPO (and the core requirements) should also be referred to. Also see comments below.

**Commented [RD(DW-H19):** Not quite – will still be useful in some circumstances; for example if the *Singularis* principle prevents what want to do

**Commented [RD(DW-H20):** ... AND the originating jurisdiction (*Singularis*)

More recently, the Hong Kong Court has recognised the appointment of officeholders in the Mainland – notwithstanding that PRC is not a "common law jurisdiction" (as referred to in *A Co v B*) – the Court being satisfied that PRC insolvency law nevertheless provided for a collective process. However, in *Re CEFC Shanghai International Group Ltd (Mainland Liquidation)* [2020] HKFC 167, the Court commented on the need for reciprocity in the PRC as a matter of PRC law, and that whilst common law recognition and assistance principles did not require reciprocity, the extent to which greater assistance would be provided in future to PRC officeholders would be considered on a case by case basis and subject to the Court's satisfaction that the Courts of the Mainland were promoting a unitary approach to translational insolvencies.

Moreover, the Hong Kong Court:

- (i) has held that banks in Hong Kong should readily assist foreign representatives by providing documents in relation to a company's own accounts, without the need for a foreign representative to first obtain a Hong Kong Court order (see *Bay Capital Asia Fund LP (in Official Liquidation) v DBS Bank (Hong Kong)*, unreported, HCMP 3104/2015);
- (ii) has granted recognition orders to permit foreign officeholders to seek production of documents or examination of individuals in Hong Kong (see *Re BJB Career Education Co Ltd* [2017] 1 HKLRD). The Court will consider whether such provisions are available as a matter of Hong Kong law, and in respect of frequently encountered jurisdictions (e.g. Cayman and British Virgin Islands) has become relatively comfortable in providing recognition to the officeholder. The recognition order will nonetheless, be limited to the powers available as a matter of foreign law;
- (iii) has recognised a foreign liquidator's right to bring an action in Hong Kong in the name of the debtor company, without any formal order recognising the foreign liquidator for this purpose (see *Re Irish Shipping* [1985] HKLR 437);
- (iv) has assisted foreign rehabilitation proceedings by refusing to allow enforcement of a judgment against the debtor company's Hong Kong assets. The Hong Kong Court has adopted a two stage process to address liability and enforcement (separately). Even if liability is established, the Hong Kong Court will refuse enforcement against assets in Hong Kong if it considers that, through comity, it should assist the foreign rehabilitation proceedings (see *CCIC Finance v GITIC* [2005] 2 HKC 589); and
- (v) has adopted protocols to help co-ordinate the activities of parallel proceedings.

However, the Hong Kong Court has ordered that, in order of an officeholder to deal with any Hong Kong assets, it will be necessary for such officeholder to apply for a specific recognition order for that purpose (see *Re China Lumena New Materials Corp (in Provisional Liquidation)* [2018] HKCFI 276). Whilst such power was conferred by the Hong Kong Court, it does require the officeholder to make a further application.

One issue with relying on common law developments is that it may be difficult to predict how new situations will be dealt with by the Hong Kong Court.

#### **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

**Commented [RD(DW-H21):** 4 marks out of 4. An excellent answer.

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?

It is understood from the fact pattern set out above that the receiver has been appointed over all the assets and undertaking of PTM pursuant to the terms of the security instrument in relation to the floating charge (and that this has been done effectively in accordance with its terms).

In such circumstances, the receiver will be entitled to be paid out of the assets of PTM over which he is appointed and/or the realisations resulting from the sale thereof, and will be entitled to exercise a lien over such assets and/or realisations pending payment.

Critically, the appointment of a liquidator (and the company's liquidation) will not affect the receiver's right to hold and/or sell the property or assets of PTM (being all the assets and undertaking of PTM) pursuant to the terms of the security agreement creating the floating charge. In other words, the receiver will not be under any obligation to transfer such assets and/or realisations to the liquidator.

Moreover, the realisations made by the receiver out of the assets charged (if any) are not available to the liquidator for the payment of liquidation expenses. However, pursuant to Sections 79 and 265(3B) of CWUMPO, any realisations must first be used to satisfy the claims of preferential creditors, if there are insufficient assets to meet those claims from the uncharged assets (which will be the case, given all assets and undertaking of PTM is subject to the floating charge).

The liquidator may consider whether it is appropriate to challenge the validity of the floating charge (such that it may be possible to obtain possession and/or control of PTM's assets and undertaking, or realisations therefrom from the receiver). For example, on the grounds that: (i) the appointment of the receiver was not made in accordance with the terms of the security agreement (i.e. not in writing); and/or (ii) the receiver sought to exceed the powers conferred pursuant to the security agreement (i.e. the receiver does not have the power to sell PTM's assets).

In particular, if the floating charge:

- (i) was not properly registered at the Companies Register within 1 month of execution (in accordance with Sections 334 and 335(5)(a) of CWUMPO); or
- (ii) was entered into during the protected period, namely either the 12 months before the commencement of the liquidation at a time when the company was unable to pay its debts, or became unable to pay its debts (if the third party chargee, who was granted the floating charge, was not connected with PTM), or the 2 years prior to the commencement of the liquidation if the third party chargee was "connected with the company" (section 265A(3) and 265B and 267 of CWUMPO),

it may not be valid and may be considered void. If so, the receiver's appointment and rights to deal with the assets subject to the invalid floating charge will also be considered void and the liquidator may deal with the assets as part of the insolvency estate.

**Question 4.2 [maximum 4 marks]**

**Commented [RD(DW-H22)]:** 3 ½ marks out of 4. A good answer but if a floating charge, could also refer to realisations being available for preferential creditors. Also, for TC, the anti-deprivation principle should be explored (probably as first in line).

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.

The liquidator should consider the following issues when dealing with HF and TC:

- (i) The liquidator should consider whether a 'fixed charge' was properly created by the Receivables Purchase Agreement (the "RPA").

A fixed charge is a charge in relation to a specific asset and attaches as soon as the charge is created. If a fixed charge was properly created in respect of the receivables, then BH as debtor would not be entitled to deal with the asset without the consent of HF.

Pursuant to the fact pattern outlined above, it appears that certain receivable were paid into an account in HF's name (although BH has continued to be able to use the receivables for working capital purposes), but that by extension certain payments continued to be paid to BH.

In respect of the receivables paid into HF's bank account it would appear that HF does have a sufficient degree of control over the use of receivables (once paid into its account) by BH (see *Re Spectrum Plus Limited*). However, the same cannot be said for those paid into BH's own account.

There is a risk that such arrangement may be a floating rather than fixed charge.

- (ii) The liquidator should consider whether the RPA provides for a 'sale' arrangement or loan arrangement with assignment operating as a security. This question is relevant as to whether or not the arrangement should be registered.

The matter is further complicated by the fact that payments were not made / are not referable to particular invoices.

- (iii) The liquidator should consider whether RPA was registered.

Given that it appears that a fixed (if not a floating charge) was created by the RPA it should have been registered at the Companies Registry within 1 month of its creation. If it was not registered, then that part of the RPA (or to the extent that loan arrangement provided thereunder operated as security) may not valid and will be void as against a liquidator or creditor of BH.

- (iv) The liquidator should require TC to provide evidence of the arrangement entered into between TC and BH.

For example, the liquidator should confirm whether the arrangement was recorded in writing and/or there is any evidence to support TC's claim that it has a real, valid and binding agreement with BH, which predates BH's liquidation.

To the extent TC is unable to provide evidence satisfactory to the liquidator, the liquidator may deny TC's claim on the basis that there is insufficient evidence that the agreement is real or valid as a matter of fact.

- (v) The liquidator should consider the timing of BH's entry into the RPA and/or the arrangement with TC. In particular, the liquidator should consider whether the arrangement may be challenged on the basis that it was entered into during the 'protected period'.

If either arrangement was entered into during the protected period, namely:

- (a) in the 12 months before the commencement of the liquidation at a time when BH was unable to pay its debts, or became unable to pay its debts (if HF and TC are not connected to BH), or
- (b) in the 2 years prior to the commencement of the liquidation (if HF and BC are connected to BH), or
- (c) after the commencement of the compulsory winding up of BH,

they *may* not be valid and may be considered void, unless HF and/or TC applied for a validation order from the Court.

- (vi) If the transactions were entered into in the 'relevant time' (as noted above), the liquidator should consider whether the RPA and/or BH's arrangement with TC constitute impeachable transactions.

- (a) "Transaction at an undervalue"

Does either transaction constitute a 'transaction at an undervalue' pursuant to Section 266 of CWUMPO?

If the liquidator can show that either agreement provided HF or TC with assets of BH as a gift or at an undervalue (i.e. for insufficient consideration) then the liquidator can apply to the Court to set aside the transaction. The Court has a wide discretion to make any order it thinks fit to restore BH to the position it would have been in but for any transaction at an undervalue. .

Based on the information available, it would appear that the transaction entered into with TC may constitute a transaction at an undervalue – it appears that upon BH's liquidation (being the applicable trigger event), BH's ownership in cars purportedly transferred to TC for no consideration.

- (b) "Unfair Preferences"

Does either transaction constitute an 'unfair preference' pursuant to Section 266 of CWUMPO – in other words, does either transaction have the effect of putting HF and/or TC in a better position than it would otherwise have been in the liquidation of BH?



Based on the information available, it appears that the transaction entered into with TC may constitute an 'unfair preference' – it appears that TC was put into a better position than it would have been in had the arrangement not been entered into (in that is purportedly acquired ownership of cars for no consideration).

The liquidator must determine whether or not BH was influenced by a desire to prefer TC and/or HF when entering into such transactions – which is not easy to prove.

In the event that the liquidator can prove that the transaction with TC and/or the RPA was an unfair preference the liquidator may apply to set aside the transaction(s).

(c) "Extortionate Credit Transaction"

The liquidator should consider whether the RPA constitutes an extortionate credit agreement. If so, the liquidator may apply to the Court to set aside all or part of the RPA and/or to vary the RPA.

**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.

Hong Kong does not have any statutory framework to address cross-border insolvency, nor has Hong Kong adopted the UNCITRAL Model Law on Cross-Border Insolvency and/or is party to any international treaty or bilateral agreement dealing with cross-border insolvency. However, the Hong Kong Courts have followed common law principles to support foreign officeholders and foreign insolvencies – with the Court of Final Appeal confirming that this continued after the Handover (see *Chen Li Hung and Another v Ting Lei Miao and Others* (2000) 3 HKCFAR 9).

As an initial step, the JPLs would need to be recognised in Hong Kong in order to take action in Hong Kong that relates to the exercise of powers as officeholders per se (i.e. rather than commencing an action in the name of the company) – in other words, the JPLs may apply for a recognition order in Hong Kong. This will require the JPLs to make an application to the Cayman Islands Court for a letter of request – this letter of request will be addressed from the Cayman Court to the Hong Kong Court, requesting the Hong Kong Court's assistance. Although, strictly, as a matter of common law principles a letter of request is not required, the practice has developed in the Hong Kong Court that such request must first be obtained.

**Commented [RD(DW-H23)]:** 6 marks out of 7. For full marks, you could have added, e.g., the ability to sue or get the company's own documents without recognition order; consideration of whether any progress can be made by taking control of (or winding up) the Hong Kong subsidiary. Actions against recipients?

The Hong Kong Court will generally recognise an officeholder appointed by the Court in the jurisdiction in which the debtor company is incorporated (here the Cayman Islands).

Once the JPLs have been recognised, they may seek an order from the Hong Kong Court to examine Mr Pottinger (being based in Hong Kong) pursuant to Section 286B of CWUMPO for the purposes of obtaining relevant information in respect of Cyberbay's accounting irregularities (and the disappearance of its Chairman).

In determining whether to grant such an order, the Hong Kong Court will consider the scope of the provisions under Hong Kong law and the Cayman Islands Companies Act (2021 Revision) (i.e. compare the powers of examination afforded to officeholders in Hong Kong and the Cayman Islands) – this is the so-called "Singularis principle" arising from *Singularis Holdings v PricewaterhouseCoopers* [2014] UKPC 36. The Hong Kong Court's order will be limited to any powers available to the JPLs in the Cayman Islands.

In this regard, Section 103 of the Companies Act (2021 Revision) is more restrictive than equivalent provisions under Hong Kong law (see Section 286B of CWUMPO). Section 103(1) of the Companies Act (2021 Revision) provides that a 'relevant person' is any person who: (a) has made or concurred with the statement of affairs; (b) is or has been director or officer of the company; (c) is or was a professional service provider to the company; (d) has acted as controller, advisor or liquidator of the company or receiver or manager of its property; or (e) has been concerned or has taken part in the promotion or management of the company. In order to obtain an order for examination of Mr Pottinger from the Hong Kong Court, it would be necessary for the JPLs to prove to the satisfaction of the Hong Kong Court that Mr Pottinger is (or was) a relevant person falling within Section 103(1) of the Companies Act (2021 Revision). Based on the information provided, it does not appear that Mr Pottinger would fall within these categories of person and accordingly, it is unlikely that the Hong Kong Court will make an order permitting the JPLs to examine him.

Alternatively, in order to have access to the full range of powers afforded to liquidators under Hong Kong law, the JPLs could apply for ancillary liquidation proceedings to be commenced in Hong Kong in respect of Cyberbay. In making such application, the Hong Kong Court will need to be satisfied: (a) that there is a sufficient connection to Hong Kong (e.g. assets or a link of genuine substance between Cyberbay and the jurisdiction, such as business activities); (b) a reasonable possibility that the winding up order would benefit those applying for it (e.g. the liquidation would benefit the petition, this may include access of the JPLs to broader powers under Hong Kong law); and (c) the Hong Kong Court must be able to exercise jurisdiction over one or more person interested in the distribution of Cyberbay's assets. If the JPLs were able to satisfy the Hong Kong Court that these three requirements are met, then it would have access to the powers exercisable under CWUMPO and CWUR, including the broader rights of examination (including persons who were not directors - see Section 286).

In order to obtain information relating to Cyberbay's operations in Hong Kong, the JPLs may consider whether any other parties located in Hong Kong may have any useful information including Cyberbay's banks. Strictly speaking, any such documents would constitute the company's property and it should be provided to the JPLs without need for the JPLs to seek an order from the Hong Kong Court. Additionally, the JPLs could apply for a specific recognition order to deal with any of Cyberbay's assets which are located/held in Hong Kong.

**TOTAL: 43 MARKS OUT OF 50**

**\* End of Assessment \***