



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 8C

HONG KONG

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

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

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

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

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentID.assessment8C]**. An example would be something along the following lines: 202122-336.assessment8C. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentID” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
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6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

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

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

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

Question 1.1

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

A receiver can be appointed –

- (a) only pursuant to a charge over shares.
- (b) only by the court.
- (c) only pursuant to a legal mortgage over land.

(d) any of the above.

Commented [RD(DWH1)]: Correct (1 mark) – A ‘receiver’ can be appointed by the court or under a charge document (whether over shares or land, or indeed other assets).

Question 1.2

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

- (a) It depends on whether the person with whom the bankrupt transacted is an associate of his or not.
- (b) Two (2) years before the date of the bankruptcy order.
- (c) Five (5) years before the date of the petition on which the bankruptcy order was made.**
- (d) Five (5) years before the date of the bankruptcy order.

Commented [RD(DWH2)]: Correct (1 mark) – s.49 and s.51(1)(a) Bankruptcy Ordinance (section 6.2.10.1 of text). Although the commencement of a bankruptcy is the date of the order, most of the provisions dealing with the trustees’ ability to challenge earlier transactions use the date of the petition as the starting point of the ‘relation-back’ period. For some provisions, the time period changes depending on whether the other party to the transaction is connected to the bankrupt, but not for transactions at an undervalue.

Question 1.3

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

- (a) The Hong Kong court can wind up such a company only if a director resides in Hong Kong.
- (b) The Hong Kong court has no jurisdiction to wind up such a company.

(c) As a matter of common law, the Hong Kong court has the right to wind up such a company.

(d) The Hong Kong court has a statutory jurisdiction to wind up such a company, and can exercise that jurisdiction if certain requirements are met.

Commented [RD(DWH3)]: Correct (1 mark) – s.327 CWUMPO (section 7 of text).

Question 1.4

Select the **correct** answer:

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

(a) must first be used to satisfy the costs and expenses of the liquidator.

(b) must first be used to satisfy the whole of all claims by employees but no other claims.

(c) must first be used to satisfy the claims of preferential creditors as described in the relevant section of CWUMPO.

(d) will be kept entirely by the receiver for the benefit of the charge holder irrespective of what claims, preferential or otherwise, exist against the company.

Commented [RD(DWH4)]: Correct (1 mark) – see section 6.4.1 of text. Note the question refers to the charge being over all of the company's assets, such that there would be no uncharged assets for the liquidator to meet the preferential claims out of uncharged assets.

Question 1.5

Select the **correct** answer:

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

(a) the date on which the creditors pass a resolution to wind up the company.

(b) the date on which the court approves the appointment of liquidators.

(c) the date on which the members pass a special resolution to wind up the company.

(d) the date on which notice of the liquidator's appointment is registered at the Companies Registry.

Commented [RD(DWH5)]: Correct (1 mark) – s.230 CWUMPO (section 6.3.3 of text). Note, however, that a liquidator has limited powers pending the creditors' meeting.

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

Question 1.6

Select the **correct** answer:

Hong Kong legislation provides a statutory definition of insolvency in –

(a) the Companies Ordinance (Cap 622).

(b) the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32).

(c) the Companies (Winding Up) Rules (Cap 32H).

(d) none of above.

Commented [RD(DWH6)]: Correct (1 mark) – see section 6.3.1 of text.

Question 1.7

Select the **correct** answer:

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

- (a) from the date on which the petition is presented.
- (b) from the date of commencement of the liquidation.
- (c) from the date of the winding up order.
- (d) There is no statutory provision for a mandatory stay; whether the claimant can continue is a matter for the court's discretion.

Commented [RD(DWH7)]: Correct (1 mark) – s.186 CWUMPO (section 6.3.7 of text); the mandatory stay also applies if a provisional liquidator is appointed.

Question 1.8

Select the **correct** answer:

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

- (a) is not allowed to vote.
- (b) can vote and the whole amount of its claim is counted.
- (c) can vote if it has valued its security and the amount that is counted is the difference between its claim and that value.
- (d) must get special permission from the chairperson of the meeting to vote.

Commented [RD(DWH8)]: Correct (1 mark) – Rule 84 CWUR (section 5.5 of text).

Question 1.9

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

- (a) A 1995 decision of the English House of Lords is binding.
- (b) A 1993 decision of the UK Privy Council on an appeal from Hong Kong is binding.
- (c) A 1996 decision of the UK Privy Council on an appeal from the Cayman Islands is binding.
- (d) None of the above because they all pre-date the Handover in 1997.

Commented [RD(DWH9)]: Correct (1 mark) – The *China Field* decision confirmed that pre-1997 decisions of the Privy Council on appeals from Hong Kong were and remain binding (section 4.1 of text).

Question 1.10

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

- (a) He must make an application to the High Court of Hong Kong using the provisions of the UNCITRAL Model Law.
- (b) He must first seek permission from the Ministry of Justice in Beijing.

(c) No recognition is possible.

(d) None of the above.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks]

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

The requirements for a debtor to be made subject to the jurisdiction of the Hong Kong court are set out in section 4 of the Bankruptcy Ordinance, and are as follows:

- (a) The debtor must be domiciled in Hong Kong; or
- (b) Is personally present in Hong Kong on the day on which the petition is presented; or
- (c) At any time in the period of 3 years ending with that day- (i) has been ordinarily resident, or has had a place of residence, in Hong Kong, or (ii) has carried on business in Hong Kong.

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Question 2.2 [maximum 3 marks]

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

The core requirements that enable the Hong Kong court to exercise its jurisdiction to wind up a non-Hong Kong company are set out in section 327 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (“CWUMPO”) and are as follows:

- (a) Sufficient connection with Hong Kong, but this does not necessarily have to consist of the presence of assets within the jurisdiction;
- (b) Reasonable possibility that the winding-up order would benefit those applying for it; and
- (c) The court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company’s assets¹.

Question 2.3 [maximum 4 marks]

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

As summarized in the case of China Solar Energy Holdings Limited HCCW 108/2015, [2018] HKCFI 555, provisional liquidators can be appointed for matters associated with a winding-up, including asset preservation, but not solely for restructuring when the matters associated with a winding-up are absent. Following their appointment, provisional liquidators can carry out restructuring, even when that becomes their sole remaining function.

Where the matters associated with a winding-up are absent, in particular where the company’s assets are not in jeopardy, it would not be appropriate to order a provisional liquidation, despite the company’s general need for a restructuring².

¹ INSOL Guidance Text Module 8C Hong Kong, chapter 7; Kam Leung Sui Kwan v Kam Kwan Lai and Others (2015) 18 HKCFAR 501.

² <https://www.hk-lawyer.org/content/provisional-liquidators%E2%80%99-role-and-powers-clarified>

Commented [RD(DWH10): Correct (1 mark) – Hong Kong has not enacted UNCITRAL; the Ministry of Justice in Beijing would not be involved (“1 country, 2 systems”); the courts have developed a practice of giving recognition to foreign office holders in certain circumstances.

Commented [RD(DWH11): Correct with all elements (3 marks)

Commented [RD(DWH12): The core requirements are correct but answer mis-states the origin (2.5 marks)

Commented [RD(DWH13): Although s.327 is the statutory basis, the core requirements are not set out there; they are common law and were clarified/confirmed in the CFA’s Yung Kee decision

Commented [RD(DWH14): (3 marks). A more complete answer should identify that the PL’s powers are as prescribed by the court, and the need to show urgency. The answer should also be clearer that ordinarily the applicant must show jeopardy to assets.

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

Question 3.1 [maximum 5 marks]

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

A liquidator is able to take action to challenge an unfair preference because it would inequitable for them to not be able to claw-back or recover assets that were improperly paid out of an insolvent company, and which should instead be properly applied to the company's debts.

In any application to set aside such transactions, the liquidator must show that, in relation to a person connected to the company, at the time the unfair preference was given, the company was unable to pay its debts or became unable to pay its debts as a result of a transaction concerned.

The liquidator must also prove that the company was "influenced by a desire" to improve that person's position in the event of a liquidation. A transaction will not be set aside as an unfair preference "unless the company positively wished to improve the creditor's position in the event of its own insolvent liquidation" and a person does not "desire" all of the "necessary consequences of his actions"^{3 4}.

Question 3.2 [maximum 5 marks]

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

Yes and no-because there is not a wholesale provision dealing with cross-border insolvency between Hong Kong and the Mainland.

Following the so-called Sino-British Joint Declaration, signed in 1984 and ratified in 1985, Hong Kong was ceded to the PRC in 1997. However, it then became a "Special Administrative Region" of the PRC, with a "high degree of autonomy"⁵. The PRC is responsible for issues of defence and foreign affairs, but since 1 July 1997, Hong Kong has operated under Deng Xiaoping's principle of "One Country, Two Systems", which allows Hong Kong to retain its own legal system⁶, separate and distinct from the PRC.

As of May 2021, there is an arrangement between Hong Kong and certain areas of the Mainland, which stems from a Record of Meeting between the PRC Supreme Court and the Hong Kong Government. It is a pilot mechanism for co-operation between Hong Kong and the Mainland on cross-border insolvencies between the two jurisdictions. The arrangement currently provides for Hong Kong officeholders to obtain recognition and assistance in Shanghai, Xiamen and Shenzhen and vice versa for PRC officeholders of those areas⁷. Other than this pilot scheme, there is currently no general reciprocity in place between Hong Kong and the Mainland.

³ Re MC Bacon [1990] BCLC 324; and in Hong Kong Osman Mohammed Arab v Cashbox Credit Services Ltd [2017] HKEC 2435.

⁴ INSOL Guidance Text Module 8C Hong Kong, chapter 6

⁵ INSOL Guidance Text Module 8C Hong Kong, chapter 3

⁶ INSOL Guidance Text Module 8C Hong Kong, chapter 3

⁷ INSOL Guidance Text Module 8C Hong Kong, chapter 7

Commented [RD(DWH15)]: (2.5 marks). Note error below. Should also state time limits and distinction between connected and unconnected parties; and requirement that party 'preferred' is a creditor (or surety)

Commented [RD(DWH16)]: This element is not limited to connected persons

Commented [RD(DWH17)]: (3 marks) Should mention that there is the statutory provision permitting the HK court to wind up foreign companies (s.327 CWUMPO).

Should mention that HK court has assisted in PRC insolvencies (e.g. CEFC Shanghai)

Should mention some of the main elements that are needed to use the new mechanism as is not a wholesale provision (e.g. COMI for 6 months in Hong Kong, need for letter of request)

Question 3.3 [maximum 5 marks]

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

A Hong Kong scheme of arrangement acts as a court sanctioned compromise, binding on all creditors or the relevant class, including those who voted against it. The regulatory structure for such schemes of arrangements is set out in section 166 of CWUMPO⁸.

A company in financial difficulties usually begins the scheme process with the help of its professional advisors (usually its solicitors and insolvency practitioners). A proposal to compromise the company's debts (and often to allow for continued operations under new ownership) is presented to the company's creditors and shareholders. A compromise usually entails creditors accepting less than they are owed in full and final settlement of any claims they may have against the company⁹.

At an initial court hearing, the court decides whether to grant leave for the scheme proponent to convene meetings of creditors. Meetings of creditors are convened for a vote on the proposed scheme. A majority, i.e. over 50% in number, representing at least 75% in value of creditors present and voting at a creditors' meeting must vote in favour of the proposed scheme for it to be approved. If there are multiple classes of creditors whose debts would be compromised pursuant to the scheme, all classes must approve the scheme. Following creditors' approval of the scheme, the scheme proponent submits the scheme to the court for final approval¹⁰.

At a second court hearing, the court checks compliance with the statutory requirements and that the proposed scheme of arrangement between the company and its creditors is fair¹¹.

The key advantages of a Hong Kong scheme are less publicity compared to other insolvency procedures, lower legal fees due to less court involvement, large write down of existing debts, potential for directors to remain in control of the company, potential for the company to continue to trade whilst being restructured, avoiding liquidation, potentially getting out of contractual terms which require unanimous agreement on various issues (their potentially being superseded by lower approval thresholds within the scheme) and the fact that, once completed, a scheme creates an arrangement that is legally binding on all creditors¹². Additionally, a scheme may be sanctioned by the Hong Kong court even if it concerns a foreign company, (i.e. not Hong Kong registered) if there is a "sufficient connection" between that foreign company and Hong Kong¹³.

The potential disadvantages of a scheme are cost (as, although it is likely to be less costly than a purely court administered process, it is still expensive), the potential of difficulty in having other jurisdictions recognize the scheme and the lack of automatic moratorium.

⁸ <https://www.briscoewong.com/wp-content/uploads/2020/06/Guide-Schemes-Arrangement-Hong-Kong2.pdf>

⁹ <https://www.briscoewong.com/wp-content/uploads/2020/06/Guide-Schemes-Arrangement-Hong-Kong2.pdf>

¹⁰ <https://www.lw.com/thoughtLeadership/restructuring-and-insolvency-in-hong-kong#:~:text=Hong%20Kong%20law,going%20through%20a%20winding%20Dup.&text=A%20workout%20compries%20contractual%20arrangements%20between%20a%20debtor%20company%20and%20its%20creditors>

¹¹ [ibid]

¹² <https://www2.deloitte.com/ie/en/pages/finance/solutions/schemes-of-arrangement.html>

¹³ <https://www.lw.com/thoughtLeadership/restructuring-and-insolvency-in-hong-kong#:~:text=Hong%20Kong%20law,going%20through%20a%20winding%20Dup.&text=A%20workout%20compries%20contractual%20arrangements%20between%20a%20debtor%20company%20and%20its%20creditors>

Commented [RD(DWH18)]: (4 marks) Should also mention that due the 'Gibbs' principle, a Hong Kong Scheme will only compromise debts arising from obligations governed by Hong Kong law. This is a possible downside in the modern environment where a sophisticated debtor is likely to have debts due under other governing laws

Also, as classes are important, should outline requirements (similarity of legal rights, not interests)

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

Question 4.1 [maximum 4 marks]

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

Firstly, I would advise Mr Chan that if he is aware that the company is in financial difficulties and is unlikely to be able to continue in business, and he is contemplating winding up the company, he must consider whether members' voluntary liquidation or creditors' voluntary liquidation is appropriate. MVL is appropriate if the company will be able to settle all liabilities within 12 months of the commencement of the liquidation¹⁴. CVL is appropriate where the company is not solvent¹⁵. I would further advise Mr Chan that if he believes the company has no reasonable prospect of avoiding insolvency that under case law he owes his fiduciary duties to the creditors of the company, and must consider their interests in his decision making and that he could, in some circumstances face personal liability..

Secondly, I would advise Mr Chan that winding up is not the only option available to a Hong Kong company that is insolvent or near insolvency. Informal workouts or schemes of arrangements are the two main ways a Hong Kong company might restructure its debt without being wound up¹⁶.

An informal workout is a flexible plan and consists of contractual agreements between a debtor company and its creditors. As it is an out of court process, it can be attempted at any time, even at the same time as a scheme of arrangement.

A scheme of arrangement is a court-sanctioned arrangement between a debtor company and all its creditors (or a class of creditors). The arrangement is given statutory effect to bind such creditors even if they did not consent to the arrangement. Companies in liquidation can still use a scheme.

In relation to the view of Mr Chan's friend that he should appoint a "friendly" liquidator who will not investigate the company's affairs too closely, I would advise Mr Chan to disregard such advice immediately, because to select a "friendly" liquidator, the description of which suggests a liquidator who would not act in accordance with their professional and other duties, and for the reason suggested, would be in breach of Mr Chan's duties to the company, and the liquidator would be acting in breach of his own duties also:

1. As a director of a company in the insolvent zone, Mr Chan has a duty as a director of the company to preserve the assets of the company to make them available for distribution to creditors as a whole. In so doing, he must act bona fide in what he believes to be the best interests of the company¹⁷.

¹⁴ CWUMPO s 233 (1)

¹⁵ Idem s 233 (4)

¹⁶ <https://www.lw.com/thoughtLeadership/restructuring-and-insolvency-in-hong-kong#:~:text=There%20is%20currently%20no%20provision, pay%20all%20creditors%20in%20full.>

¹⁷ <https://www.mondaq.com/hongkong/shareholders/994844/personal-liability-of-directors-director-duties-when-trading-in-the-insolvency-zone#:~:text=As%20a%20company%20enters%20the,best%20interests%20of%20the%20company.>

Commented [RD(DWH19): (3.5 marks)

To be complete first piece of advice is that it is not correct that Mr. Chan "must" go to court. The voluntary liquidation options should be discussed. (For completeness, could add that a company cannot petition on the basis of a resolution by directors alone (Emmadart) and there is no indication that Mr. Chan is (necessarily) the only shareholder)

No indication in the question of shareholding structure so should add that a voluntary liquidation will need a special resolution (at least 75% of shares)

Commented [RD(DWH20): As you state above, as the company is likely insolvent, duties are to creditors

2. Any liquidator of a Hong Kong company has a duty to protect and realise that company's assets and distribute the proceeds to creditors and shareholders, in accordance with the statutory rules on distribution. This includes a duty to report Mr Chan to the Official Receiver's Office if his conduct has breached his duty as a director of the company.

Question 4.2 [maximum 5 marks]

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

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

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

We are told that GFL has the benefit of a fixed charge over Kite's receivables. Therefore, without further facts, the primary view is that GFL is a secured creditor, and is entitled to look to the asset, i.e. Kite's receivables, for repayment, irrespective of the interests of other creditors, including in the liquidation. This is subject to the duty of a chargee to act in good faith when exercising a power of sale to obtain a proper price (*Esquire (Electronics) Limited v The Hong Kong and Shanghai Banking Corporation Ltd* [2007] 3 HKLRD 439).¹⁸

However, we are also told that GFL insisted on the fixed charge because it was troubled by the way that Kite's business was heading. This fact raises concerns surrounding the anti-deprivation principle, which will not permit a creditor to be put in a better position than other creditors if the mechanism is considered a "fraud on the insolvency laws".¹⁹

The leading Hong Kong authority on this principle is the Hong Kong Court of Appeal authority of *Peregrine Investments Holdings Ltd v Asian Infrastructure Fund Management Co Ltd* [2004] 1 HKLRD 598. The collapse of the Lehman Brothers²⁰ has also contributed to the learning on the topic. In summary, if the fixed charge arrangement is part of a genuine commercial transaction and not entered into with the intention of GFL creating an advantage on the insolvency of Kite, then the arrangement is likely to be upheld.

¹⁸ INSOL Guidance Text Module 8C Hong Kong, chapter 5.6

¹⁹ INSOL Guidance Text Module 8C Hong Kong, chapter 5.7

²⁰ *Belmont Pak Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383.

Commented [RD(DWH21): (1 mark) the anti-deprivation principle is an interesting idea but unlikely to be relevant; that principle would usually apply only if a contract included a term that changed rights upon insolvency.

The answer does correctly identify that assets subject to a charge stand outside the liquidation and are not available to the liquidator. However, unfortunately, the answer misses the main points of the advice that should be given to the liquidator. These are:

>First step in any such situation is to check the validity of the charge – execution, registration etc

>Say 'fixed charge' but court will look at substance : *Spectrum*. Here, can use the receivables so floating charge more likely

>When entered into? Within time period that means may be void against liquidator unless new money (s.267, 267A)
>If any of the above, L can ignore and insist on being handed all of the receivables

>Next to consider: was it an unfair preference (security can be UP – see *Sweetmart*)? If so, L may also be able to get receivables. Say 'may' because would need to make application and notoriously difficult to show company was influenced by desire to prefer.

>If charge is valid (as floating charge), L cannot lay claim to the receivable (*Leyland Daf* case) except for preferential creditors (s.265(3B)) – note only asset so there will not be any 'free assets' in estate to meet those

We are also told that Kite did not open a separate account in relation to the receivables subject to fixed charge, and instead kept it in the company's general operating account, where payments were made in and out in the ordinary course of business. This creates several issues. Firstly, the receivables should have been put into a separate account and use of that asset restricted in terms of payments out. The mixing of fixed charge receivables might mean that a forensic accountant needs to confirm, for example, what sums were paid in relation to the charged receivables.

Now that the company is under liquidation, the fixed charge stands outside of the liquidation, and GFL's receiver can keep the realisations made from the receivables (if identified) insofar as it is needed to meet the balance owed. The GFL-appointed receiver is under a duty to sell the assets appropriately and to remit the balance to the liquidator, after GFL's loan is repaid. The liquidator cannot insist on the receiver handing over the realisations from the sale of the receivables prior to GFL's loan being paid, unless the entire transaction is successfully challenged on the basis of the anti-deprivation principle.

Question 4.3 [maximum 6 marks]

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

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

The BVI liquidator appointed has identified:

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

Commented [RD(DWH22)]: (2.5 marks) See comments below. Also, this answer gets too bogged down in a possible fraud claim (including against individuals where no indication of evidence against them). Remember this is an insolvency module. Answer sought relates to steps a foreign L can take (and whether recognition needed); also need some detail on the new Mainland mechanism.

Outline of elements should be included is as follows (not all would be needed for full marks):

Question asks that advice be given to L; answer should be written accordingly

The FA clause that all provisions (including repayment to Xu) are void if SPL insolvent is almost certainly void due to the anti-deprivation principle

Whether L is properly appointed would be a matter for BVI law L will be able to take certain steps in Hong Kong without a formal recognition order

Obtain documents from the company's bank (Bay Capital)

Bring an action against Mr. Qi (perhaps for breach of fiduciary duty) (Irish Shipping – but see recent decision of Nuoxi Capital which creates some uncertainty)

IF can find him; also query if has assets (litigation worthwhile?). Need to investigate

L should obtain a recognition order to take other steps that 'belong' to an office-holder as opposed to the company itself (e.g. examination of individuals):

The Hong Kong court is receptive to such applications from legal systems similar to Hong Kong (BVI is one)
The Hong Kong court will need the originating court (BVI) to make a letter of request

The powers that the liquidator can then exercise in Hong Kong must be powers that he has as a liquidator in the home (i.e. BVI) jurisdiction and that he would have if appointed as a liquidator here in Hong Kong (the Singularis principle)

Note that although the jurisdiction to examine in Hong Kong's legislation is a broad one (s.286B), some jurisdictions restrict the power to examine to officers or closely related parties, so this should be checked carefully, certainly as regards Mr. Wong (no suggestion he is an officer). Need to check with BVI lawyers. [nb, some development in more recent cases re basis on which examination powers are exercised]

Re **possible assets in the Mainland** and the new "co-operation mechanism":

o The location of the assets should be identified: at present the mechanism only applies if the debtor's (SPL's) principal assets in the Mainland are in a pilot area or it has a place of business in such an area. The pilot areas are Shanghai, Xiamen and Shenzhen

o In any event, the mechanism only applies to proceedings commenced under the specifically identified Hong Kong legislation (CWUMPO, CO etc.). It is therefore unlikely that the liquidator could use the mechanism via a recognition application (i.e. he is 'only' a BVI liquidator which the Hong Kong court has recognised for the purpose of taking certain steps in Hong Kong; he is not appointed under a proceeding commenced under CWUMPO or CO).

o However, the Hong Kong court does have jurisdiction to wind-up non-Hong Kong companies (s.327) if the core requirements are satisfied. These are:

☒ there must be sufficient connection with Hong Kong, (not necessarily meaning the presence of assets within the jurisdiction);

☒ there must be a reasonable possibility that the winding up order would benefit those applying for it; and

☒ the court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets. ... [1]

(e) SPL is believed to have assets in the Mainland, but the liquidator is not sure where these assets are located.

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

- (a) In relation to the FA clause that all assets vest in Mr Qi upon insolvency of the company there are good reasons to suspect the entire dealing is a fraudulent one perpetrated by Mr Qi against Mr Xu, including this contractual provision, the delay and lack of answers. As the FA is subject to Hong Law, Mr Xu is likely to have commenced a civil fraud claim in Hong Kong to have the FA declared void on account of fraud, and to obtain an order from the Hong Kong court against both SPL and its directing mind, MR Qi, for the return of his loan. It would certainly seem a more logical route than trying to enforce what appears to be an FA permeated by fraud. Once the FA is voided, it becomes a matter of Mr Xu seeking to recover a judgment debt of US\$20m from SPL and Mr Qi. Mr Xu may have then issued a statutory demand in the BVI pursuant to the debt, and then made an application before the BVI court to wind up SPL after the demand was not satisfied or challenged. We are told the liquidator was appointed by an order of the BVI court, which is why this scenario seems the most likely. It is surprising, therefore, that the liquidator is concerned that Mr Xu did not have standing to apply for the winding up order. He will have been a valid creditor of SPL because of the loan, and would have had grounds under BVI law to apply for the order. In any event, the liquidator is bound to investigate matters thoroughly and obtain appropriate legal advice if he/she suspects that the appropriate rules haven't been complied with.
- (b) The liquidator should consider whether to issue a fraud claim in Hong Kong, against the “independent director” and book-keeper of SPL, who we are told are Hong Kong based, or, if a fraud claim was already commenced to declare the FA void and to obtain an order for return of the loan, to include these individuals in that claim, on the basis that they either knowingly participated in the fraudulent business of the company or were negligent and facilitated a fraud against Mr Xu. These persons should be pursued for personal liability for the company's debt to Mr Xu²¹. It is also possible for these persons to be fined or imprisoned for up to five years, if found liable for fraudulent trading.
- (c) I assume that the liquidator is either a sole BVI liquidator, as we are not told that he/she is a joint liquidator. As a foreign representative, if he wishes to deal with the Hong Kong based asset of SPL (i.e. the bank account), the liquidator will need to apply for a specific recognition order²². It may make sense to appoint a joint liquidator who is a Hong Kong qualified liquidator, to assist with recovering assets in HK and the Mainland and proceedings thereto.
- (d) If Mr Qi is a Hong Kong resident, he can still be included in any fraud or other claims in Hong Kong, as his residency provides a sufficient tie for proceedings to commence against him in that jurisdiction.
- (e) If SPL's assets in the Mainland are in a pilot area, then the liquidator may consider whether he/she can apply for recognition and assistance pursuant to the recent co-operative mechanism. If the assets are not in a pilot area, or it is not possible to determine where the assets are located, such that a search of some kind is necessary in the Mainland, then it is imperative that the liquidator obtain advice from

Commented [RD(DWH23)]: The FA clause that all provisions (including repayment to Xu) are void if SPL insolvent is almost certainly void due to the anti-deprivation principle

Commented [RD(DWH24)]: No indication he took this route; question says he wound up SPL and we are advising the liquidator thereof

(in any event, the action you describe would not be straightforward and the remedy unlikely to be as described; but that is beyond the scope of this module)

Commented [RD(DWH25)]: L may be concerned that there is a risk he was not properly appointed. That would be BVI law

Commented [RD(DWH26)]: What evidence is there?

Commented [RD(DWH27)]: Possible but an unlikely route

Commented [RD(DWH28)]: But could seek bank docs without an order (Bay Capital)

Commented [RD(DWH29)]: Yes, but the Hong Kong-based IP will still be a BVI-appointee; this will not allow him or her to use CWUMPO provisions

²¹ CWUMPO s 275, ss168L.

²² Re China Lumena New Materials Corp (in Provisional Liquidation) [2018] HKCFI 276.

PRC counsel as soon as possible as to how the assets may be traced and recovered.

*** End of Assessment ***

TOTAL MARKS: 35 out of 50

(2.5 marks) See comments below. Also, this answer gets too bogged down in a possible fraud claim (including against individuals where no indication of evidence against them). Remember this is an insolvency module. Answer sought relates to steps a foreign L can take (and whether recognition needed); also need some detail on the new Mainland mechanism.

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o The liquidator could therefore make an application for an ancillary liquidation and it may then be possible that the new mechanism can be utilised (subject to the other criteria being met) – the mechanism making it clear that the COMI of the debtor (COMI in Hong Kong being a requirement) does not necessarily require the company to be incorporated in Hong Kong. [the answer is may be because where, as here, the

company is already in liquidation in its jurisdiction of incorporation, the liquidation here would be ancillary – it is yet to be tested whether the Mainland courts will take issue with this. However, for the purpose of this assessment, marks will be awarded for identifying a s.327 winding up as a possible method of accessing the new cooperation mechanism].

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