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]: Incorrect (0 marks) - 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 (see 6.2.2 of text) and s.51(1)(a) Bankruptcy Ordinance

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 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.

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 asset, such that there would be no uncharged assets for the liquidator to meet the preferential claims out of uncharged assets

(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.

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.

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

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

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

Question 1.6

Select the **correct** answer:

Hong Kong legislation provides a statutory definition of insolvency in –

(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?

For the Hong Kong court to be able to exercise its bankruptcy jurisdiction over a person, under Section 4 of the Bankruptcy Ordinance (Cap 6), the debtor must:

a) Be domiciled in Hong Kong;

b) Be personally present in Hong Kong on the day on which the petition is presented; or

c) At any time in the period of three years ending with that day:
   a. Have ordinarily been resident, or have had a place of residence in Hong Kong; or
   b. Have carried on business in Hong Kong.

Question 2.2 [maximum 3 marks]

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

There are three core requirements that enable the Hong Kong court to exercise its jurisdiction to wind up a non-Hong Kong Company. These requirements were set out in the case Kam Leung Sui Kwan v Kam Kwan Lai and Others (2015) 18 HKCFAR 501 and are identified below:

a) There must be sufficient connection with Hong Kong. Sufficient connection does not have to mean consisting of the presence of assets within the jurisdiction;

b) There must be a 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 assets.

Question 2.3 [maximum 4 marks]

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

A provisional liquidator technically does not exist under Hong Kong law as the Company can either be in liquidation or not. However, it is referred to where provisional liquidators are appointed pursuant to Section 193 of The Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) ("CWUMPO"). That is, where they are tasked with preserving assets in the period after the petition is presented but before

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]: (3 marks). Complete

Commented [RD(DWH12]: (3 marks). Good full answer

Commented [RD(DWH13]: (3.5 marks). A full and good answer, save for the slight misunderstanding per note below

Commented [RD(DWH14]: Not quite right: a provisional LIQUIDATOR exists, a provisional LIQUIDATION does not

any order is made. The aim may not be to actually realise those assets, unless to preserve their value.

Provisional liquidators can be appointed to help facilitate a restructuring proposal, however, this cannot be the reason alone. There must be an urgency to preserve assets.

The application may be made at any time after a petition is presented, but in urgent situations, it may be made at the same time as the petition.

The appointment of a provisional liquidator must be justifiable, for example in situations above to preserve assets from the risk of dissipation, prior to a winding up order being made. The court will consider situations such as commercial realities, the urgency, the need for the order and any balance of convenience.

A provisional liquidation under Section 193 of CWUMPO may be useful as it provides for a moratorium, thereby giving space for negotiations between the Company and creditors.

The provisional liquidator can also promulgate a Scheme of Arrangement as a means of restructuring which is not ordinarily available in Hong Kong laws. However, as stated prior, this alone is not sufficient for a successful appointment.

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

Question 3.1 [maximum 5 marks]

Commented [RD(DWH15]: (5 marks) Good answer

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.

An unfair preference occurs when an insolvent company makes an action to place a creditor (or guarantor) in a better position that it would have been upon the company's insolvency.

A liquidator is able to take action to challenge an unfair preference in either a voluntary winding up or a compulsory winding up, and these transactions can include granting of security as well as payments. The relevant time period of a relevant transactions is six months prior to the commencement of a winding up. In situations where the beneficiary was a connected person (being someone who is an associate of the company, an associate of a director, or a shadow director), then the relevant period is two years.

The liquidator can take action on the unfair preference as it will put the beneficiary in a better position than other creditors if the company was being wound up. That is, it is a means of by-passing the pari passu distribution. The liquidator has a duty to be fair to creditors within the same class.

The liquidator will need to show that 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 this unfair preference.

It should also be noted that an associate can include another company that is controlled by the same individual(s) controlling the company being wound up.

The difficulty in this action is that the liquidator must prove that the company was influenced by a 'desire' to improve the beneficiary's position, in the event of its own insolvent liquidation.

However, some examples of when this situation occurs include where a company gave its bank a mortgage over an asset, and there was no receipt of 'new money', or any good grounds for granting the mortgage.

Under Section 266 of CWUMPO, if it is proved that an unfair preference occurred, the court may order:

a) Vesting the property in the liquidator;

b) Releasing or discharging security given by the company;

c) Directing any person to pay the liquidator any benefits received from the Company;

d) Reviving the obligation of sureties or guarantors which had been released or discharged; and

e) Providing security for the discharge of obligations imposed by or arising under the order.

The liquidator therefore has the ability to claw back any transactions where unfair preferences were given.

Question 3.2 [maximum 5 marks]

Commented [RD(DWH16]: (2.5 marks) You mention the common law but also should mention that there is the statutory provision permitting the HK court to wind up foreign companies (s.327 CWUMPO)

Answer is a bit jumbled

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.

The statement stands correct in some regard, namely that for the most part, the legal systems differ across the Mainland and Hong Kong, and there is a need for recognition across the two territories (with specific requirements), which indicate, that although there is one country, there is indeed formal arrangements to deal with cross border insolvency.

Hong Kong does not have specific legislation for dealing with cross-border insolvency, nor has it adopted UNCITRAL Model Law on cross-border insolvency, nor became a party of any international treaties dealing with cross-border insolvency. That being said, the Hong Kong court will generally recognize the ability of an officeholder appointed within a company's jurisdiction of incorporation to take necessary steps in relation to that company

Mainland is typically responsible for Hong Kong's foreign and defence affairs, but other affairs remain the responsibility of Hong Kong. On this basis, Hong Kong has predominantly adopted British Common Law approach for other matters, however, after the resumption of sovereignty by the Mainland on 1 July 1997, Hong Kong operates under the principle of One Country, Two Systems.

In light of this, Hong Kong's approach to insolvency differs from Mainland, but this does not mean that there are no arrangements to deal with cross-border insolvency. Notwithstanding the lack of statutory framework for cross-border insolvency, the

courts have followed common law principles in this regard. Furthermore, Hong Kong courts have been keen to assist foreign representatives by relying on these common law principles.

Although Mainland is not a common law jurisdiction, there exists the May 2021 arrangement between Hong Kong and certain areas of Mainland, that is, areas designated as pilot areas, for a new co-operative mechanism between Hong Kong and Mainland. This mechanism allows for Hong Kong office holders to obtain recognition and assistance in those pilot areas, and for Mainland office-holders to obtain recognition and assistance in Hong Kong.

These pilot areas include: Shanghai Municipality; Xiamen Municipality of Fujian Province; and Shenzen Municipality of Guangdong Province.

In relation to recognizing Mainland judgements, following this mechanism, Mainland is no longer considered a "foreign country", and the Mainland Judgements (Reciprocal Enforcement) Ordinance (Cap 597) ("MJREO") which came into force on 1 August 2008 allows for recognition in certain circumstances. Namely:

a) The enforcement of money judgements which arises out of commercial contracts;
b) For a judgement to be enforceable in Hong Kong, the underlying agreement must give jurisdiction to the relevant Mainland court;
c) Only Mainland judgements from designated courts are recognized;
d) The judgement must be final and conclusive and given after the commencement of Cap 597.

Proceedings that can be recognized are insolvency proceedings and include proceedings under CWUMPO or the CO and include compulsory liquidations, creditor's voluntary liquidations and schemes of arrangement, promoted by a liquidator or provisional liquidator.

The Center of Main Interest ("COMI"), for a recognition in Mainland, needs to be in Hong Kong, and includes the place of incorporation, or where the principal assets are located. Similarly, for recognition in Hong Kong, the COMI in Mainland needs to be in a pilot area.

Finally, a letter of request is needed from the court in the territory requesting recognition, to the court in the target territory.

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.

The Scheme of Arrangements ("Scheme") is essentially Hong Kong's only statutory tools for corporate rescue, and provisions are found in the Companies Ordinance (Cap 622).

It should be noted that a moratorium is not provided by the use of a Scheme alone, and as such, a scheme is typically used together under a Provisional Liquidation.

A scheme of arrangement is a statutory mechanism under Hong Kong law that allows companies to make a binding compromise with their members and/or creditors (or any class of them). It allows a company and its creditors to compromise or adjust

Commented [RD(DWH17]: Not relevant to this

Commented [RD(DWH18]: (2 marks) Some elements are there but the answer does not show a good understanding. Should also explain classes and the Gibbs principle

debts if it approved by majority of creditors representing 75% or more in value of claims.

The regime for this scheme is captured in Part 13, Division 2 of the Companies Ordinance.

The approach taken in Hong Kong for this process, as noted above, is via a petition for winding up where an application to appoint a provisional liquidator is made. In so doing, a moratorium is obtained. Subsequently, the provisional liquidator can promulgate a Scheme.

However, for an application for a Scheme to be approved, it cannot be for the sole purpose of restructuring as this has been seen by the Court of Appeal as defeating the purpose of winding up a company. A basis however for the appointment of a provisional liquidation in the first place, is that there must be an urgency to preserve assets. This means that there is a two step process for a Scheme – first with the successful appointment of a provisional liquidator to preserve the assets; followed by an application by the provisional liquidator to the court for a Scheme.

The applicant will need to obtain leave from the court to convene a meeting of creditors to consider and approve the Scheme. Following this application, if successful, a meeting is held for this purpose, after which the results are reported to the Court for the Court's sanction.

An application for a Scheme will need to be accompanied by an affirmation outlining the background of the Scheme and include an explanatory statement of the effects of the Scheme. The explanatory statement must give creditors sufficient information to make an informed, sensible decision on the Scheme. The expected return to creditors will also need to be provided.

The Scheme takes effect if approved and registered by the Registrar of Companies.

A Scheme is useful in situations where it would be difficult to seek unanimous consent from creditors to adjust debts or make a compromise. Similarly, a Scheme is useful in situations where creditors attempt to hold-out to seek an unfair advantage against a substantial majority of similar ranked creditors. A major benefit of the Scheme is that if successful, it binds all creditors (or a class thereof), for which the Scheme was proposed, regardless of whether they voted in favor of the Scheme.

The drawback to a scheme is that the risk of the application failing is high. That is, the company will bear the risk that the application is dismissed; and, even if the results of the meeting is successful, the court is not bound to sanction it.

The burden is on the applicant to satisfy the court that the meeting was properly advertised, notice given, and meeting duly convened. The applicant will also need to satisfy the court that the relevant approvals were obtained. The process may also be costly through the entire application process, providing notice and convening the meetings, along with requiring analysis on the potential return to creditors so that they may make an informed decision.

Finally, another issue with a Scheme is the issue of availability for the release of third parties, namely guarantors, whereby there are guarantees in respect of the compromised debts.

Commented [RD(DWH19]: A PL is not a necessary element

Commented [RD(DWH20]: This confuses a scheme with applicatiion to appoint PL

Commented [RD(DWH21]: Why?

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

Question 4.1 [maximum 4 marks]

Commented [RD(DWH22]: (4 marks) Good answer. 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)

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.

As Mountainview Limited (the "Company") is in financial difficulties, there are several procedures in place, available to Mr. Chan.

Firstly, the extent of the financial difficulties will need to be determined – that is, if the Company is currently unable to pay its debt and is considered 'insolvent', or whether Mr. Chan expects that if the Company continues to operate then it will become insolvent, but it currently is not. Under Section 178 of CWUMPO, a debtor is unable to pay its debts if it has not satisfied a statutory demand after 3 weeks of service; if execution or process issued on a judgement is unsatisfied; and if it is proved to the Court that the company is unable to pay its debts, while considering contingent and prospective liabilities.

Mr. Chan can get ahead of future potential issues by winding up the Company, however, this does not necessarily mean that Mr. Chan needs to go to the Court, which undoubtedly will incur much cost than the Company is likely able to afford.

However, prior to providing advice, more information should be obtained on the Company's affairs as the advice from the friend raises concern by the reference that a liquidator should be obtained who will not look too closely into the Company's affairs. While this is not evidence that the Company has engaged in nefarious acts, Mr. Chan will want to ensure a proper wind-down to avoid any implications in the future.

Regardless of the route taken, or whether the liquidator is 'friendly', the Liquidator has a duty to properly review the affairs of the Company.

There are two options for winding-up outside of the court system.

Firstly, by way of a Members' Voluntary Liquidation ("MVL"), where it is anticipated that the Company can settle its liabilities within 12 months. It is noted that the Company is in difficulty, however the extent of this difficulty must be assessed to determine if this is a viable option.

Under an MVL, the directors will sign a certificate of solvency, and the shareholders will pass a special resolution to wind-up the company. This is likely the quickest, and cheapest option. Similarly, if Mr. Chan prefers a "friendly" liquidator, then this option is the most appropriate as there is no specific qualification for a liquidator, however, the appointee is usually an insolvency practitioner, and can be connected to the Company.

If the directors are unable to sign a statement of solvency, or if the Company is insolvent, then a second option outside of court is through a Creditors' Voluntary Liquidation ("CVL").

Under a CVL, the directors will convene a meeting of shareholders to pass a special resolution to wind-up the Company, however, a liquidator appointed by this method only has limited powers until a subsequent meeting, held by the creditors, to affirm his appointment is convened. Under this approach, the creditors may appoint their own liquidator. The meeting of creditors is convened within 14 days of the meeting of members.

As directors, Mr. Chan will need to ensure that steps are taken to preserve the assets of the Company once the decision is made to convene a meeting of shareholders and creditors, and holds a duty to the Company and its creditors in mind. Mr. Chan will have a fiduciary duty to not trade while the Company is insolvent.

Should the Court route be used, an application may be made by the Company, or by a creditor, and is much more costly. For this option, a petition is filed with the Court, and if successful, may allow for a provisional liquidator to be appointed in situations where there is an urgency to protect assets. Where a final liquidator is appointed by the Court (or a provisional liquidator), there is a stay on proceedings that may be brought against the Company, including from other creditors, which may provide some breathing room.

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.

From the case above, there are a few factors worth exploring, namely, fixed vs floating charge, an unfair preference, and a preferential claim.

The first issue, is the issue around the charge and whether it was appropriately created. The type of asset charged are the receivables of Kite Limited ("Kite"), in favor of GFL.

The liquidator will want to consider whether the charge should be void on the basis that the asset was incorrectly charged as a fixed charge, or whether it should have been a

Commented [RD(DWH23]: (2.5 marks) Along the right lines and includes some of the salient elements.

More completely, an outline of the thought process for the main points of the advice that should be given to the liquidator:

>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

Commented [RD(DWH24]: Unlikely to be void - just that it will take effect as a floating charge only

floating charge. A fixed charge is in relation to specific assets, while a floating charge is one applied over assets that changes or non-constant assets. As receivables fluctuate with the ongoing operation of a business, it is likely that this should have been a floating charge.

This is substantiated by the definition given in the case of Romer LJ in Re Yorkshire Woolcomber's Association Limited, where it was determined that a floating charge is one with three characteristics: it is a charge on a class of assets of the company present and future; the class is one which, in the ordinary course of business changes from time to time; and the company may carry on its business in the ordinary way, until some future steps are taken on behalf of those interested in the charge.

The second aspect to be addressed is that of an unfair preference.

As noted in the case, Kite has had financial difficulties, and it is assumed that both Kite and GFL were aware that Kite was not, or at some future point, would not be able to meet its obligations to GFL and other creditors.

An unfair preference occurs whereby, at a relevant time, an insolvent debtor makes an action to make a creditor in a better position that it would have been upon the company's insolvency. As noted above, with the financial difficulties, it is likely that Kite was insolvent, and nonetheless, the charge may have placed it in a position that it became insolvent.

The relevant time is 12 months prior to the commencement of a winding up.

Commented [RD(DWH25]: 6 months

The burden of proof for the liquidator is high in relation to proceedings in relation to unfair preferences, as the liquidator will need to prove that the company was influenced by a desire to improve the beneficiary's position. That being said, it is likely that the liquidator will have a good case, as the charge was made at a time when Kite was in financial difficulty, and there was no advancement of new monies.

Should the liquidator be successful, the Court may vest the property with the Liquidator; release or discharge the security; or direct the benefits of the security be paid to the liquidators to name a few.

Upon a successful proceeding by the liquidator, GFL will be considered an unsecured creditor, the assets will be available to the Liquidator and be distributed in the prescribed priority, namely to the liquidator's fees and expenses, preferential debts followed by payments to unsecured creditors pari passu. Interest on GFL's funding will fall below payments to unsecured creditors.

In the event that the liquidator is unsuccessful in bringing claims based on above, the liquidator will want to consider whether proceeds in the receivership are available to the liquidator.

Realizations made by the receiver are not available to the liquidator for the liquidation expenses, however, they made be used to meet claims of preferential creditors. These include payments due to employees.

The liquidator will therefore need to rely on GFL's settling its debts, and any surplus being handed over to the liquidator. As such, the liquidator should consider initiating proceedings as outlined above.

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;

(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.

Prior to addressing the possible steps that can be taken in Hong Kong, the liquidator should consider pursuing action against Mr. Qi on the basis of fraudulent trading, with the issue that the Company carried out business with the intent to defraud Mr. Xu. Mr. Qi may also become personally liable.

Commented [RD(DWH26]: (4.5 marks) Good answer. For completeness:

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.
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 ... [1]

Commented [RD(DWH27]: Would not need the (difficult) statutory provision. SPL did have $20m now it has nothing. L to investigate/pursue as appropriate

In pursuing steps in Hong Kong, the facts of the case must be considered. These include the fact that SPL is a BVI Company, the FA is governed by Hong Kong Law, and there are possibly assets in Mainland.

The first issue in relation to actions that can be taken in relation to SPL is in relation to the validity of the appointment of a Liquidator on the basis that there is a clause in the FA that states if SPL becomes insolvent, all provisions are void, and all assets automatically vest with Mr. Qi.

While this is a clause in the FA, the courts will not uphold a contract term which results in general creditors being deprived of an asset that would, in the absence of the clause, be used to satisfy their debts, under the anti-deprivation principle.

The anti-deprivation principle applies where a creditor is put in an unfair position compared to other creditors if the mechanism is considered a 'fraud on the insolvency laws'. The principle aims at preventing parties from using contractual arrangements to give an advantage to one of the contracting parties in the event of insolvency.

Factors that the court will consider to determine if the anti-deprivation principle is violated include:

a) If the intention is to evade insolvency laws;
b) If the clause operates in situations other than upon insolvency;
c) If the asset concerned if flawed, or subject to condition that the counter-party remains solvent.

Based on the criteria above, and the clause of the FA, it is clear that the anti-deprivation rule is violated. That is, the structure of the clause is aimed at keeping the company solvent as, by definition, if the company becomes insolvent and the debt becomes void, technically the company is no longer insolvent. Similarly, the clause is specifically applicable in situations only where the company becomes insolvent.

Commented [RD(DWH28]: ?

On the basis outlined above, the clause may be considered void and as such, the liquidator's appointment will be valid. The liquidator should however consider application to the court for an order to this effect.

Commented [RD(DWH29]: Would get BVI advice but most likely would wait for any challenge from Qi et al

With the liquidator's appointment being valid, and the Company being a BVI Company, the next step is conducting proceedings in Hong Kong, the first of which will require the recognition of the foreign appointment.

While there are no insolvency legislations in Hong Kong dealing with cross-border insolvency, the court has always followed common law principles, allowing a foreign liquidator the right to bring an action in Hong Kong in the name of the company. For this, there is no requirement for an order for formal recognition. The consideration however, will need to be in relation to costs and as such, security will need to be furnished.

There are some provisions captured in Part X of CWUMPO for the winding up of companies not registered under the companies legislation, and include circumstances where:

a) The company is dissolved or has ceased to carrying on business, or is carrying on business for winding-up purposes;
b) If the company is unable to pay its debts; and
c) If the court is of the opinion that it is just and equitable.

The court will need to be satisfied that there is sufficient connection of the company with Hong Kong, and there are three requirements for this:

a) There must be sufficient connection;
b) There must be a reasonable possibility that the winding up order would benefit the applicant;
c) The court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets.

In relation to the first point, the Company entered the transaction by way of an FA governed by Hong Kong Law, implying that it carried out this business activity in Hong Kong. Similarly, it can be argued that there is a dispute with the shareholder, being Mr. Qi, and the court can consider the shareholders' connection. Mr. Qi is believed to be a Hong Kong resident.

In relation to the second requirement, and as noted above, there are grounds for belief that the transaction was made with the intention to defraud Mr. Xu, who is a creditor of the Company. As the liquidator is acting within the best interest of the Company to secure assets for its creditors, it is within the interest of the petitioner to bring a claim in Hong Kong.

In addition, there is evidence that the Company has a bank account in Hong Kong, along with books and records as the independent director and bookkeeper both live in Hong Kong.

On the third requirement, the court will need to be satisfied that there are persons with sufficient connection in Hong Kong and that there is an economic interest in winding up the company.

As all parties appear to be of Hong Kong, and the contract is governed by Hong Kong law, and the assets are in Hong Kong, there may be sufficient grounds. The Liquidator can therefore apply for an ancillary winding up order. Alternatively, traditional recognition can be obtained although the powers will not be the same.

The foreign representative will have the powers to deal with bank accounts in Hong Kong.

For reasons that will be stated below, the preference should be to launch ancillary winding up proceedings on the basis that an order will be obtained in Hong Kong.

It is noted from the case that assets are believed to be located in Mainland. As such, the liquidator will need a means of pursuing these assets.

Under the May 2021 arrangement between Hong Kong and certain pilot areas of the Mainland, a co-operative mechanism exists for allowing Hong Kong office holders to obtain recognition and assistance in those pilot areas. Some investigation will need to be done to determine the location of the assets.

Proceedings that can be recognized in Mainland include proceedings under CWUMPO or the CO, including winding up. However, for successful recognition, the COMI is required to be Hong Kong. Despite the Company being a BVI company, from the facts of the case, it is evident that all decisions, actions and business were conducted out of Hong Kong, and for this reason, the liquidator may argue that Hong Kong is the COMI.

The liquidator will need to arrange for a letter of request from the court in Hong Kong to the Mainland court.

As briefly mentioned above, the preference should be to seek ancillary proceedings as this will be necessary for recognition in Mainland.

*** End of Assessment ***

TOTAL MARKS: 39 out of 50

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Page 14: [1] Commented [RD(DWH26] Robin Darton 18/08/2022 11:39:00

(4.5 marks) Good answer. For completeness:

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

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

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].