



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

**HONG KONG**

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

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

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

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

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
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5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
6. The final submission date for this assessment is **31 July 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.**

#### **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.**

#### **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.

**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).

**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

(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.

(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 asset, 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 debtor must be an individual and have carried on a business. Per section 4 of the Bankruptcy Ordinance ("BO"), they must:

1. Be domiciled in Hong Kong;
2. Be personally present in Hong Kong on the day the petition is presented; or, at any time in the 3 years ending with that day; and
3. Have been ordinarily a resident or have had a Hong Kong place of residence.

### 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?

As seen in the CFA's decision in *Re Yung Kee*<sup>1</sup>:

1. there must be sufficient connection with Hong Kong (does not have to mean assets);
2. There must be a reasonable possibility that the winding up order would benefit those applying for it; and
3. The court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets.

If the above are established, there is jurisdiction to wind up.

### Question 2.3 [maximum 4 marks]

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

- A provisional liquidation does not technically exist in Hong Kong legislation, however, it is used when provisional liquidators are appointed pursuant to section 193 of CWUMPO.
- The provisional liquidator is appointed to preserve assets (but not realise) in the period after the presentation of a petition but prior to any order. An order must be made if any assets need to be realized.
- The application to appoint can be made any time after a petition has been presented. But may also be made on an urgent basis at the same time as the petition.
- Typically, the provisional liquidator is appointed to facilitate a restructuring proposal, however, this cannot be the only reason for the appointment.

**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):** (1.5 marks). Some elements here, but appears to be some misunderstanding; and last part is confusing (see notes)

**Commented [RD(DWH12):** Not correct; an individual can be made a bankrupt whether or not (s)he carried on a business

**Commented [RD(DWH13):** There is wording missing here

**Commented [RD(DWH14):** (2.5 marks). The core requirements are there but see note below

**Commented [RD(DWH15):** The court does have jurisdiction (s.327) but the core requirements go to the exercise of that jurisdiction

**Commented [RD(DWH16):** (3 marks). Should mention that powers are as prescribed by the court (powers depend on circumstances); and see note below

**Commented [RD(DWH17):** I do not think it could be said that 'typically' appointed for restructuring. Preservation of assets in jeopardy is more typical

<sup>1</sup> Kam Leung Sui Kwan c Kam Kwan Lai and Others (2015) 18 HKCFAR 501

- A Provisional Liquidator can be appointed if there is a risk of the disposition of assets before the winding up order is made – i.e. on a urgency basis. In this situation, the court will consider the commerciality of the appointment and the facts around the purported urgency.

### 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.

- Applies to liquidators of either voluntary or compulsory winding up and the relevant section reference is CWUMPO ss266, 266A and 266B.
- The liquidator needs to show that at the time of the unfair preference being given, the company was unable to pay its debts or that it was unable to pay its debts due to the transaction in question. Noting that this is an automatic presumption if the transaction involved a connected party (i.e. an associate of a director or shadow director), however, this may be challenged.
- The liquidator must also prove that the company was “influenced by a desire” to improve the recipient’s position and the company “positively wished to improve the creditor’s position in the event of its own insolvent liquidation.”<sup>2</sup> – Please note that this can be difficult in Hong Kong because a defendant is entitled to rely on the defence that genuine pressure had been exerted over the company which led to the payment – rather than the company’s “desire to prefer” the creditor. This was seen in the Hau Po Man Stanley case where significant was placed by the creditor over the company on moral grounds.<sup>3</sup>

**Commented [RD(DWH18):** (2.5 marks) Need to say “why”. Reason is the pari passu principle and that all creditors should be treated fairly amongst themselves. Should also state time limits and distinction between connected and unconnected parties; and requirement that party ‘preferred’ is a creditor (or surety)

**Commented [RD(DWH19):** Presumption of insolvency applies only to transactions at an undervalue, not unfair preferences (s266B(3))

#### 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.

This statement is generally correct, however, it is slowly changing to recognize more Mainland representatives. There is a May 2021 arrangement between Hong Kong and certain areas of the Mainland PRC in relation to a pilot program to test a new co-operation mechanism between the two jurisdictions. This was necessary as Hong Kong’s insolvency laws do not provide for cross-border insolvency, except in the case of winding up foreign incorporated companies and unregistered companies, and as Hong Kong has not adopted UNICTRAL Model Law or set up any bilateral agreements/treaties. Accordingly, Hong Kong courts have generally applied common law principals to assist foreign representatives.

Notwithstanding the fact that the PRC is not a common law jurisdiction, Hong Kong has given at least two recognition appointment orders recently to Mainland representatives on the basis that the PRC insolvency law provided for a collective process. However, despite such, any future recognition applications will be decided

**Commented [RD(DWH20):** (5 marks)

<sup>2</sup> Re MC Bacon [1990] BCLC 324; and in Hong Kong Osman Mohammed Arab v Cashbox Credit Services [2017]

<sup>3</sup> Trustees of the Property of Hau Po Man Stanley (in Bankruptcy) v Hau Po Fun Ivy [2005] 2 HKC 227

on a case-by-case basis<sup>4</sup> which is unhelpful for future applications. It appears that Hong Kong courts are concerned with the extent to which the PRC would apply reciprocal provisions and promote a unitary approach. Whilst the common law principals do not require reciprocity, it is often commented by Hong Kong judges that there is a need for reciprocity.

The May 2021 pilot program would be beneficial if effective as often a Cayman Islands registered company, will be listed in Hong Kong and operated out of subsidiaries in the Mainland – leading to limited connections with Hong Kong. The Hong Kong court needs to believe the petitioner will benefit from a Hong Kong winding up order. The debtors COMI must also have been in Hong Kong continuously for at least 6 months.

**Commented [RD(DWH21):** This sentence has a bit of internal inconsistency as highlighted but no marks deducted. It is a point which will be worked out shortly!

### 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.

**Commented [RD(DWH22):** (4.5 marks) Note below re majorities. Also, as classes are important, should outline requirements (similarity of legal rights, not interests)

As Hong Kong has no formal corporate rescue regime e.g. US Chapter 11, a scheme of arrangement is the only option. The court procedure for a scheme is governed by O.102 and r.5 of the Rules of the High Court.

The steps are:

1. An application is made by originating summons for leave to convene the meetings to approve the schemes.
  - a. This can be made by the debtor company or a member, creditor or liquidator.
  - b. An affirmation must accompany the application, explain the background and providing the draft explanatory statement, scheme documents, notices of the scheme, proxy forms and draft adverts. The explanatory statement will assist in disclosing any material director interests.
  - c. The Hong Kong court will then make its order at the Convening Hearing after it has considered the documents, and its jurisdiction.
  - d. This process is positive as it ensures that the court is satisfied that the creditors have been given sufficient explanation about the scheme and its effects.
2. The scheme meetings take place and are reported to the court.
3. An application is made for the court to sanction the scheme.

Pro for the Company – A scheme allows companies to make a binding compromise/arrangement with its members and or creditors (or class of creditor). It is necessary when a company wants to compromise or adjust its debtors. However, certain majority approvals need to be approved and the court will need to sanction such. Without a scheme the company would need to obtain 100% approval to contractually vary its debts. As such, a scheme makes a compromise possible in the situation where there is a hold-out by a particular creditor.

Pro for creditors – All scheme creditors can participate, not just Hong Kong based ones. Also, creditors who rights are to be affected are entitled to attend the meeting and ask questions.

<sup>4</sup> Re CEFC Shanghai International Group Ltd (Mainland liquidation) [2020] HKCFI 167; and re Liquidator of Shenzhen Everich Supply Chain Co Ltd [2020] HKCFI 965.



At least 75% in value of the creditors present and voting (including by proxy) must approve the scheme (on a per class basis if applicable). However, the court can still not sanction the scheme for certain reasons i.e., if members have not been given sufficient information to be an informed decision – this is a ‘pro’ for creditors to ensure their rights are protected and looked after as the court will look to ensure the arrangement is fair and equitable between the classes with consideration to their respective legal rights.

**Commented [RD(DWH23)]:** Majority in number, representing...

However, per common law, a scheme to compromise a debt will only have effect if the debt is discharged under the law governing the debt – so this would often be a ‘con’ from the company’s perspective as it may have to apply to the US for recognition of these scheme if the creditor documentation is New York governed.

It is also beneficial for the company in a scheme as third-party guarantors are also, in practice, released – if the releases are “related to and essential” to the scheme.

Unfortunately, one ‘con’ for the company is that Hong Kong law does not provide for a moratorium on creditor’s actions while a scheme plan is being processed and courts have refused such applications. Noting, the flipside that this would be a pro for creditors. However, as a “Pro” (for the company) recent changes to the Rules of the High court, now provide the court with a specific power to stay proceedings. The court may also stay actions to enforce a judgment once the scheme is in place.

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

##### **Question 4.1 [maximum 4 marks]**

**Commented [RD(DWH24)]:** (2.5 marks) Should also advise that if company is insolvent owes duties to creditors ahead of the company

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.

Mr. Chan should assess his company’s financial position, however based on the facts it appears the company is unable to pay its debts. As such, a member’s voluntary liquidation is not available, however, either a creditors’ voluntary liquidation (“CVL”) or court process would be available. The friend is incorrect, Mr. Chan’s only option is not only a court process.

As director, he can convene a meeting of shareholders to pass a special resolution (75% majority) to wind up the company. The CVL will commence upon the passing of the resolution. Following such, a meeting of creditors will be convened. Will awaiting such, Mr Chan should protect the assets of the company.

If the company is insolvent as indicated in the question, Mr. Chan should go down the CVL path urgently rather than allowing the company to trade whilst as insolvent to prevent any kind of personal liability for wrongful trading. Noting however, that there are no present insolvent trading provisions, but the director may breach his fiduciary duties by continuing. If he also has unpaid employees it may also lead to criminal issues. A CVL is often more cost and time efficient than a court process.

If urgent, Mr. Chan himself as director can also wind up the company with no shareholder's resolution required, if he satisfies certain criteria per s228A of the CWUMPO. There are penalties if this is used improperly. In this situation, there are no indications that perishable assets or similar are involved so it seems unlikely that this would be an available option.

Under a CVL, Mr. Chan would be able to find the liquidator, however, the subsequent meeting of creditors will be convened, at which point creditors will nominate and vote for the appointment of a liquidator. As such, Mr. Chan's 'friendly' liquidator may not be appointed.

Alternatively, Mr. Chan can go down the route of a compulsory liquidation, whereby a petition can be present by the company itself to wind up by order of the High Court. However, Mr Chan would have no influence over which liquidator is appointed. As such, Mr. Chan's 'friendly' liquidator may not be appointed. Further the liquidator will be an officer of the court and as such, cannot turn a blind eye to any fraud or improper transactions and would have ethical obligations. Even in a voluntary liquidation, the court can exercise any powers that it would be able to exercise in a compulsory liquidation, should any actions or similar be brought to the court's attention.

**Commented [RD(DWH25):** In any event, should also advise Mr. Chan that Liquidators should be neutral and carry out their duties (including investigation of how the company has been run/conduct of directors) irrespective of who appoints/nominates them

**Commented [RD(DWH26):** But 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)

**Commented [RD(DWH27):** Same for all liquidators (even if appointed in a voluntary)

#### 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.

#### Fixed vs Floating

In relation to the charge itself, it is said to be a fixed charge. However, it appears to me that it is a floating charge. The liquidator would need to confirm the charge is a proper 'fixed charge' and I have set out the following points to assess such:

- A fixed charge attaches from creation and use of the asset is restricted.

**Commented [RD(DWH28):** (5 marks) (for completeness see note below)

- This does not seem to be the case for Kite as no separate bank accounts were created e.g. a trade finance account or similar. A fixed charge would require Kite to obtain permission from GFL to utilize the asset.
- A floating charge permits use of the asset and improves working capital.
  - This appears to be the case as Kite was able to use the funds for normal trading business and there were no restrictions over how the cash is used.
  - Per *Re Yorkshire Woolcomber's Associate Limited* and *re Spectrum Plus Limited* – it appears Kite granted a charge on its present and future assets, it would be changing from time to time, and the company carried on its business in the ordinary way in relation to the charged asset.

#### Voidability

In addition, the charge, if a fixed charge over book debts or if a floating charge, should also be registered within 1 month of execution otherwise it can be void under a liquidation scenario. This has not been confirmed in the facts given.

Further, a floating charge is void if created within 1 year of the commencement of the liquidation (2 years if associated party). It appears, on the basis that this is a floating charge which was created several months ago, that it may in fact be void.

Commented [RD(DWH29)]: Except as to any new money

Notwithstanding the fact that the charge may likely be void, in relation to the question:

- If the charge is deemed to be a fixed charge – the realizations cannot be used to settle any liquidation expenses and the liquidator will only be entitled to surpluses after GFL is paid in full.
- If the charge is deemed to be a floating charge – the realizations can only be used to pay preferential creditors and not other expenses of the liquidation or unsecured creditors. The realizations, after payment of the preferential creditors, will go to GFL; only after GFL is paid can the liquidation estate be entitled to any surplus.

#### Unfair Preference

For completeness, it is possible that GFL received an unfair preference via this fixed charge over receivables per CWUMPO ss266, 266A and 266B.

- The liquidator needs to show that at the time of the unfair preference being given, Kite was unable to pay its debts. This is possible given that GFL was troubled by the business's direction. Further, the liquidator would need to show that Kite was "influenced by a desire" to improve GFL's position and that Kite "positively wished to improve the creditor's position in the event of its own insolvent liquidation."<sup>5</sup> Based on the facts, I am not sure this is evident that Kite wanted to prefer GFL, rather they may have provided the security to ensure continued trade and financing.
- Further GFL would be able to rely on the defence that genuine pressure had been exerted over Kite which led to the fixed charge, rather than Kite having a "desire to prefer" GFL. This was seen in the *Hau Po Man Stanley* case where significant was placed by the creditor over the company on moral grounds.<sup>6</sup> Whilst the Hong Kong

<sup>5</sup> Re MC Bacon [1990] BCLC 324; and in *Hong Kong Osman Mohammed Arab v Cashbox Credit Services* [2017]

<sup>6</sup> *Trustees of the Property of Hau Po Man Stanley (in Bankruptcy) v Hau Po Fun Ivy* [2005] 2 HKC 227

court has examples of a company providing a mortgage being an unfair preference<sup>7</sup>, it appears there were likely good grounds for GFL to provide the fixed charge so that it could continue trading.

#### 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.

<sup>7</sup> Re Sweetmart Garment Works Limited (in liq) [2008] 2 HKC 252

**Commented [RD(DWH30):** (1 mark) for exploring ancillary liquidation (but see note below). Also:

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 – 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].

The liquidator could apply for recognition in Hong Kong. This would assist with realizing the Hong Kong bank account. Depending on the location of the Mainland assets, this may also assist – only if the location is one within the new May 2021 co-operation pilot program for recognition.

Commented [RD(DWH31)]: Text below goes to ancillary rather than recognition of BVI

As seen in the CFA's decision in *Re Yung Kee*<sup>8</sup>:

1. There must be sufficient connection with Hong Kong.
  - a. In this situation, there are Hong Kong assets i.e. the bank account. Further, the liquidator could show genuine substance via the fact that the accounting is carried out in Hong Kong and it seems even the management by Mr Qi and Mr Zhang is carried out in Hong Kong.
  - b. Further, this appears to be a quasi-shareholder's dispute – as such the court will give weight to the fact that the Mr Qi (and assuming Mr Xu) are Hong Kong residents.
2. There must be a reasonable possibility that the winding up order would benefit those applying for it.
  - a. This should be satisfied as the bank account is located in Hong Kong, which would benefit the BVI liquidator.
  - b. However, if it turns out that the Hong Kong bank account has minimal/no funds and the only assets are PRC assets, it is not likely this will be satisfied; unless the PRC assets are located in one of the new May 2021 pilot program areas on the Mainland.
  - c. Even if it is determined that the bank account (along with all other assets) vest in the shareholder per the FA, then this would still be satisfied as he is a Hong Kong resident and the order would benefit him.
3. The court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets.
  - a. If the only creditor is Mr Xu, Mr Xu would need to reside in Hong Kong – however, this is not clear from the question.
  - b. Based on the facts however, it appears the liquidator has doubt as to Mr. Xu's standing as creditor – this would need to be rectified prior to making any application as if there are no other Hong Kong creditors then this would not be satisfied.
  - c. Per the FA, all assets vest in Mr Qi – as such, Mr Q (a Hong Kong resident) is also interested in the distribution of the assets

I believe all three will be satisfied and as such, there is jurisdiction to wind up in Hong Kong. Further, it is commonly agreed by Hong Kong courts that the appointment process in the BVI is appropriate such that if the BVI court ordered the petition, then it is valid.

**\* End of Assessment \***

**TOTAL MARKS: 36.5 out of 50**

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<sup>8</sup> *Kam Leung Sui Kwan c Kam Kwan Lai and Others* (2015) 18 HKCFAR 501