



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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6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

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

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

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

Question 1.1

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

A receiver can be appointed –

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

(d) any of the above.

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

Question 1.2

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

- (a) It depends on whether the person with whom the bankrupt transacted is an associate of his or not.
- (b) Two (2) years before the date of the bankruptcy order.

(c) Five (5) years before the date of the petition on which the bankruptcy order was made.

(d) Five (5) years before the date of the bankruptcy order.

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

Question 1.3

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

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

(c) As a matter of common law, the Hong Kong court has the right 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 Bankruptcy Ordinance (Cap 6) ("BO") together with and supplemented by the Bankruptcy Rules (Cap 6A), are the prevailing primary legislations concerning bankruptcy of individuals. Section 4 of the BO specifies the jurisdictional requirements for a person to qualify as a debtor under the BO, such that the Hong Kong court is able to exercise bankruptcy jurisdiction over him/her. To qualify as a debtor under the BO, the person;

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

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?

Section 327 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) ("CWUMPO") empowers the Hong Kong court to exercise its jurisdiction in the winding up of 'unregistered companies', which is defined in section 326 of the CWUMPO to include any company not registered under the prevailing companies legislation in Hong Kong, as well as any registered non-Hong Kong company.

The authoritative judgement on the matter is the decision by the Hong Kong's Court of Final Appeal ("CFA") in *Kam Leung Sui Kwan v Kam Kwan Lai and Others (2015) 18 HKCFAR 501*. In this decision, the CFA further sets forth the requirement to be satisfied by the petitioner before the winding up of such unregistered company can commence in Hong Kong, that the petitioner can demonstrate the company in question is sufficiently connected to Hong Kong by satisfying the following three core requirements;

- there is sufficient connection with Hong Kong, through assets of any nature (such as listing on the Hong Kong Stock Exchange which is usually considered as an asset), or by having link of genuine substance with Hong Kong (such as business activities in Hong Kong), or by having the company's centre of main interest (COMI) in Hong Kong;
- there is reasonable probability that the petitioner would benefit from the winding-up order in Hong Kong (which is usually the case where the company in question has assets in Hong Kong); and
- the Hong Kong court must be able to exercise jurisdiction over at least one person or party interested in the distribution of the company's assets.

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)

Commented [RD(DWH12): (3 marks)

Question 2.3 [maximum 4 marks]

Commented [RD(DWH13)]: (4 marks)

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

Provisional liquidators, as stipulated under section 193 of CWUMPO, are liquidators that are appointed by the court provisionally after a winding-up petition is presented, but before the winding-up order is issued (at which point the court would appoint the final liquidator or the liquidator proper). Application for the appointment of a provisional liquidator can be made following the winding-up petition, but in urgent cases the application for provisional liquidator can be submitted at the same time as the winding-up petition. Application for the appointment of a provisional liquidator must be justified by circumstances warranting the appointment, such as where there are risks that the debtor's assets will otherwise be in jeopardy or will be dissipated. The provisional liquidator will be tasked with preserving the assets in the meantime while the winding-up petition is being adjudicated, and may only realize or sell the assets if warranted for value preservation. Provisional liquidator may also be tasked with facilitating a restructuring proposal (although this purpose cannot be the sole reason for the appointment).

The court may appoint the Official Receiver or any other fit person to be the provisional liquidator, and the court may limit and restrict his/her powers, or impose certain duties to be performed by him/her.

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

Question 3.1 [maximum 5 marks]

Commented [RD(DWH14)]: (4 marks) See below comments

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.

One of the key roles of the liquidator appointed is to act in the interest of the general body of creditors to pursue the optimal realization of the debtor's assets and to distribute them fairly. The appointed liquidator also serves a wider public interest by having the authority to investigate the company's failures and possible misconducts involved in the debtor's past dealings and affairs, such that appropriate actions may be taken by the authorities against the relevant perpetrators. In this regard, unfair preferences which may have taken place, could be set aside by the liquidator, and the successful impeachment of unfair preference transactions would improve the realization of debtor's assets for those creditors who are otherwise unfairly disadvantaged.

Unfair preferences are transactions (such as payment of debt or provision of additional security) which took place at the 'relevant time' and were carried out by an insolvent company, to place certain creditor or guarantor in a better position than otherwise warranted. Section 266B stipulates that the 'relevant time' for unfair preference transactions is two years prior to the commencement of the winding up if the beneficiary of the unfair preference was connected to the company being wound up (other than by reason of only being an employee of the debtor), or six months prior to the commencement of the winding up if the beneficiary was not connected to the company.

The beneficiary of the unfair preferences would be considered a person connected to the company being wound up, if the beneficiary is an 'associate' (within the prescribed meaning sets forth in sections 265B and 265C of CWUMPO) of a director or shadow director of the company, or if the beneficiary is an associate of the company (section 265A of CWUMPO).

To succeed in the application to impeach and set aside such unfair preference transactions, the liquidator shall demonstrate that;

- at the time the unfair preference transaction took place, the debtor was insolvent (unable to pay its debt) or became insolvent because of the transaction being challenged, which criterion is rebuttably presumed in cases where the beneficiary of the unfair preference is a person connected to the debtor; and
- the debtor was influenced by the desire to improve the beneficiary's position in the event of the debtor's insolvent liquidation, which is a difficult criterion to prove given that in preference action the defendant is entitled to rely on genuine pressure (even if it was a moral pressure) exerted, as a defence to rebut the allegation of the desire to prefer.

Commented [RD(DWH15): Presumption of insolvency applies only to transactions at an undervalue, not unfair preferences (s266B(3))

Commented [RD(DWH16): Rebuttable presumption of desire to prefer where beneficiary is a connected person.

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.

Commented [RD(DWH17): (3 marks) Could also have referred to the pre-existing tools (e.g. s.327 and common law developments such as CEFC Shanghai)

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

Following the 1997 handover, the People's Republic of China ("PRC") resumed sovereignty over Hong Kong, as Hong Kong became PRC's Special Administrative Region with high degree of autonomy, including its own legal and judicial system. The Basic Law of Hong Kong, which was promulgated by the PRC, serves as Hong Kong's constitution. The Basic Law stipulates that laws that were previously existed in Hong Kong shall continue to be applicable unless they are declared by the PRC's Standing Committee of the National People's Congress, to have contravened the Basic Law. As such, despite being part of the same country, the insolvency regime and legislation in Hong Kong is autonomous and separate from the ones applicable in Mainland China.

Hong Kong has not adopted the UNCITRAL Model Law on Cross Border Insolvency, and is also not part of any treaties on cross-border insolvencies. Hong Kong's insolvency legislation also lacks provisions dealing with cross-border insolvencies, although the need for legislation addressing the cross-border insolvencies has been identified by the Law Reform Commission as well as by the Hong Kong Companies Judges. More recently in 2018, a consultation paper published by the Department of Justice recognised that there were also no provisions for recognition and assistance between Hong Kong and the Mainland China, and as such consultation exercise would be carried out to address the cross-boundary (rather than cross-border) insolvencies between Hong Kong and Mainland China.

In 2021, the consultation exercise resulted in the record of meeting between representatives of the Supreme Court in the Mainland and the Hong Kong government, which was supplemented by the opinion of the Supreme Court, and sets forth a formal arrangement of mutual recognition of and assistance to insolvency proceedings in certain parts of the Mainland and Hong Kong. The formal arrangement allows Hong Kong officeholders to obtain recognition and assistance in certain part of Mainland China designated as the 'pilot areas' (comprising of Shanghai Municipality, Xiamen Municipality of Fujian Province, and Shenzhen Municipality of Guangdong Province), and vice versa the officeholders from those 'pilot areas' may seek recognition and assistance in Hong Kong for the insolvency proceedings established in these 'pilot areas'.

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.

Statutory provisions regarding scheme of arrangement in Hong Kong are set forth in the Companies Ordinance (Cap 622) ("CO"). The scheme of arrangement provisions in the CO are the only available statutory legislation currently available in Hong Kong for companies seeking to restructure their debts, as there is no other legislation dealing with corporate rescue. The scheme of arrangement in Hong Kong however falls short of providing a comprehensive framework for corporate rescue found in other jurisdictions (such as Chapter 11 framework in the US). Nevertheless, despite the lack of legislation, the courts in Hong Kong had been able to facilitate and support corporate rescues by applying common law principles, and informal work-outs (such as those making use of the so called "London Approach", where bank-lenders work together through steering committees to negotiate and agree debt restructuring scheme with the debtors) are quite common in Hong Kong. There is also a 'formal but non-statutory' guidelines for banks, issued jointly by the Hong Kong Association of Banks ("HKAB") and the Hong Kong Monetary Authority ("HKMA"), that promote supporting and helping corporate debtors facing financial difficulties.

The key drawback of the CO's scheme of arrangement is the lack of moratorium or stay of creditors' action when the scheme is being prepared or discussed, and courts have in the past rejected applications for such moratorium or stay. However, industry practice has been developed to obtain the necessary moratorium by way of section 181 of the CWUMPO (which empowers the court to stay or restrain proceedings against a debtor following a winding up petition). To facilitate a rescue, winding up petition would be presented together with application to appoint provisional liquidators with mandates to investigate the possibility of, and then to devise a restructuring plan, often through scheme of arrangement. The winding up petition would then be followed with application for moratorium or stay of proceedings under section 181 of CWUMPO. More recent development in the amendments to the Rules of the High Court have also now allowed the court, through the court's case management powers, to stay proceedings to aid restructuring.

The developed practice of taking a detour through the winding up petition to pursue scheme of arrangement was somewhat scaled back by the Court of Appeal's decision in *Re Legend International Resorts Limited [2006] 2 HKLRD 192*, whereby the court opined that appointment of provisional liquidators for the sole purpose of a restructuring was not in line with the purpose of winding up (that provide basis for the appointment of the provisional liquidator in the first place). As such, following the court's stance in *Legend*, appointment of provisional liquidator would require more traditional grounds (such as the potential jeopardy in assets), rather than solely relying on the intended rescue or restructuring of the company.

Despite the drawback, the scheme of arrangement provides a statutory mechanism to make binding compromises or arrangements with members and/or creditors of a company, subject to approval or support from the prescribed majorities of the relevant class (which, once approved, will bind even those creditors/members in the relevant class who voted against the scheme). Without the scheme, such compromises would otherwise require unanimous consent from the affected parties.

Generally, launching a scheme of arrangement in Hong Kong would involve the following steps;

- preparation of an explanatory statement, elaborating the background of the company, reason for the scheme, the proposed scheme itself, the effect of the scheme, and whether there are material interests of the company's directors under the arrangement or compromise;

Commented [RD(DWH18): (3.5 marks) Should also mention that due the 'Gibbs' principle, a Hong Kong Scheme will only compromise debts arising from obligations governed by Hong Kong law. This is a possible downside in the modern environment where a sophisticated debtor is likely to have debts due under other governing laws

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

Reference should be made to the majorities required

Commented [RD(DWH19): More common would be a PL and then relying on the mandatory stay in 186

- submission of an application to the court for leave to convene meetings of relevant creditors or members to consider and approve the scheme;
- the scheme meetings take place and results reported to the court;
- where the scheme is approved by the required majority of the relevant parties, another application is submitted to the court to sanction the scheme; and
- where the scheme is sanctioned by the court, the scheme will come into force when registered at the Companies Registry.

Before sanctioning the scheme, the court would have regards to the following matters (as laid out in the authoritative case law on the issue, the High Court's decision in *Re Wheelock Properties Ltd.* [2010] 4 HKLRD 587);

- whether the scheme is for permissible purpose;
- whether the classes were properly constituted, such that all creditors/members designated to a single class have sufficiently similar legal rights, with common interest;
- whether the meeting was duly convened in accordance with directions from the court;
- whether the creditors/members were provided with sufficient information to make an informed decision;
- whether the scheme was approved and supported by a majority in number representing 75% in value of the creditors/members of the respective class, that were present and participated in the voting; and
- whether the court is satisfied that the scheme is something that an intelligent and honest person/member/creditor would reasonably approve.

Additionally, the court would also consider;

- whether the court is satisfied that the relevant class creditors/members were fairly represented, and that the majority had not acted coercively to promote interests that are adverse to such class; and
- if there had been more than one class, whether the court is satisfied that the scheme is fair and equitable as between the classes.

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

Question 4.1 [maximum 4 marks]

Commented [RD(DWH20): (4 marks)]

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

It is not clear from the facts provided whether Mountainview Limited (the "Company") has any indebtedness, and if so whether the Company would be able to simply repay its liabilities by selling off its assets (for instance, where its state of financial difficulties is only in the form of not being profitable). In any case however, the advice provided by Mr Chan's friend is not entirely accurate, as there are numerous alternatives to formal winding up or liquidation, that Mr Chan and may consider. Furthermore, one of the key roles of an appointed liquidator will be to investigate the causes of the Company's failure, the conducts of the directors or parties involved in the Company's past dealings and affairs. In this regard, the liquidator serves a wider public interest as the liquidator will report any misconduct such that appropriate actions may be taken by the authorities against the relevant parties. As such, the liquidator's prescribed role would not warrant a 'friendly' stance towards the Company or Mr Chen.

In case the Company actually has no liabilities, or where the Company has liabilities but it will be able to repay its existing liabilities by selling off its existing assets, then one simple alternative to formal liquidation is for the Company to consider the possibility of ceasing its business and operation, selling off its assets to repay any outstanding liabilities, and then deregistering the Company without going through a liquidation process.

In the event the Company has liabilities and is unable to repay its debt, there is also a possibility to consider pursuing out-of-court informal and consensual work-out, possibly making use of the support accorded by the guidelines jointly issued by HKAB and HKMA, directed at banks in their dealings with debtors facing financial difficulties. The guidelines are "formal but non-statutory" in nature, but adherence to it is being "strongly recommended" and "expected" from banks that are members of HKAB. Based on the guidelines, banks are expected to be supportive to their debtors facing financial difficulties.

Another alternative worth considering where the Company is insolvent, would be the scheme of arrangement mechanism laid out in the CO. The scheme provides a statutory mechanism to make binding compromises or arrangements without having unanimous consent from the affected creditors or members. The Company may seek a moratorium or stay of proceedings by filing a winding up petition and requesting the appointment of provisional liquidators under section 181 of CWUMPO, and request that the provisional liquidator be empowered to investigate and promulgate the restructuring of the Company's indebtedness (but the appointment of the provisional liquidator shall not be solely based on the intended restructuring). Once sanctioned by the court and registered at the Companies Registry, the scheme will come into force and will be binding on all creditors (and members) of the class affected and covered by the scheme, even on those dissenting creditors (and members).

In the event the Company still decides to voluntarily wind up, there will be two alternatives to consider;

- Member's voluntary liquidation ("MVL"), where the Company will be able to settle all of its liabilities within 12 months of the commencement of the liquidation. The MVL requires Mr Chen (as the Company's director) to sign a certificate of solvency, and the Company's shareholders to pass a special resolution for the liquidation and appointment of the liquidators. The liquidation then will commence when the resolution is passed. In an MVL, the liquidator can be someone who is connected to the Company.
- Creditor's voluntary liquidation ("CVL"), where the Company is insolvent. The CVL requires Mr Chen (as the Company's Director) to convene shareholders meeting to pass a special resolution for the liquidation and the appointment of the liquidators. The liquidation then will commence on the date the resolution is passed, but the liquidator will only have limited powers until his/her appointment is confirmed by the creditors at the creditors' meeting, can creditors can nominate and appoint a different liquidator at the first creditors' meeting.

As a director, Mr Chen's fiduciary duty is owed to the Company, but where the Company has become insolvent, Mr Chen has to exercise his fiduciary duty with the best interests of the creditors in mind, and he may be subjected to disqualification order by the authority or legal action by the liquidator if he breaches his fiduciary duty.

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

Commented [RD(DWH21)]: (5 marks) Excellent answer

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.

Despite being stated as a "fixed charge", the charge over receivables granted to GFL is actually a "floating charge". Fixed charges are asset specific, and as soon as the fixed charges are established, the debtor (or the charger, or the charge-grantor) would not be able to deal with the charged assets without the consent of the creditor (or the charge, or the charge-grantee).

Floating charges on the other hand, are charges with the following characteristics;

- (a) the charge is on a class of assets belonging to the charger, present and future;
- (b) the class of assets is one which will still be changing in the ordinary course of business of the charger; and
- (c) it is contemplated by the charge that the charger may still carry on its business in the ordinary way with regards to that particular class of assets, until a 'crystallisation event' occurs and the charger's ability to independently deal with the charge assets would terminate.

The charge over receivables granted to GFL was a charge over a class of assets (rather than specific assets), where the amount of the receivables will still be fluctuating and changing (as GFL continued trading), and the charge itself would have contemplated Kite to maintain ability to carry on its business with regards to such receivables (GFL appears to have limited control over the charged receivables, as the charge was created without opening separate or specific account and Kite was able to collect payments from customers through its normal operating account not held with GFL). As such, GFL's charge is a floating charge despite being named a fixed charge, and courts would be able to look at the actual effects of the arrangement, disregarding the stated name or language used.

As GFL's floating charge was only created recently (it was created "some months ago", which appears to be within one year before the commencement of the winding up), section 267 of the CWUMPO stipulates that such recent floating charge is invalid except for new money/value provided when creating the charge. In this case, given that GFL did not provide new money/value, the charge is void and as such GFL should not have any priority over the realisations of the receivables, and the liquidator should be able to insist that the receiver hand over the realisations from the receivables. Furthermore, it is not clear from the case whether GFL's charge was registered within the prescribed timeframe (sections 334 and 335 of the CO), failing which the charge would be void.

Had the GFL's charge been created outside the 'relevant time' prescribed in section 267A of the CWUMPO (the prescribed relevant time is one year before the commencement of the winding up, as GFL is not connected to Kite), the charge would not be void under section

267 of the CWUMPO. Under this scenario however (also assuming the charge was timely registered), given that the receivables appear to be Kite's only assets, sections 79 and 265 of CWUMPO stipulate that any preferential claim (as prescribed in section 265 of CWUMPO) must first be paid out from the realization of those receivables before GFL's claim as a floating charge holder can be satisfied. However, these prescribed preferential claims under section 265 of CWUMPO do not include costs and expenses of the liquidation.

Additionally, had the charge been created outside the relevant time under section 267A CWUMPO, Kite's liquidator may still look into setting aside GFL's charge altogether, and as such would prevent GFL from having a priority over the realisations from the receivables, based on any of the followings;

- The floating charge that was being stated as (such that it falsely appears to be) a fixed charge, which was created to put GFL in a better position than Kite's other creditors in liquidation, would have been a "fraud on the insolvency laws", and as such the anti-deprivation principles would warrant that such fraudulent contractual arrangement (the charge) to be set aside.
- Although more difficult to prove, the liquidator may also look into whether the granting of the charge over receivables were unfair preferences (sections 266 and 266A CWUMPO), in which Kite was influenced by the desire to improve GFL's position in the event of Kite's liquidation, and the charge was granted when Kite was already insolvent (unable to repay its debt or became unable to repay its debt because of the transaction). Such unfair preference would be voidable if it took place within the relevant time prescribed for such unfair preference transactions (section 266B CWUMPO, which in GFL's case is within six months prior to the commencement of the winding up).
- Given that Kite did not receive any new consideration in granting the charge, the transaction granting the charge was a transaction at an undervalue (sections 265D and 265E CWUMPO), which is voidable if it took place during the relevant time prescribed for such undervalue transactions (section 266B CWUMPO, which is within five years before the commencement of the winding up).

Question 4.3 [maximum 6 marks]

Commented [RD(DWH22)]: (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.

The BVI liquidator can seek assistance from the Hong Kong court, as the court in Hong Kong has been keen to assist foreign insolvency representatives, despite not having any legislation specifically dealing with cross-border insolvency, by resorting to common law principles, and a foreign liquidator’s ability to bring action in Hong Kong on behalf of the company under liquidation, has long been recognised. The BVI liquidator is thus able to launch legal action in Hong Kong, against any defendant(s) within the reach of Hong Kong court’s jurisdiction, without the need for any formal order recognising the BVI liquidation.

The BVI liquidator can also obtain recognition order from the Hong Kong court (which requires a letter of request from the BVI court, requesting assistance from the Hong Kong court), and with such recognition order, the BVI liquidator may seek to exercise his power as a liquidator in Hong Kong, such as requesting production of documents or examination of individuals (such as Mr Qi, Mr Zhang, and Mr Wong), provided that any power sought to be exercised by the BVI liquidator in Hong Kong should not exceed the power that the BVI liquidator has in his/her home jurisdiction. Additionally, banks in Hong Kong would also readily assist the BVI liquidator by providing documents concerning SPL’s bank accounts, without first requiring a Hong Kong court order (however the BVI liquidator will need to first obtain specific recognition order, to deal with the balances in SPL’s bank account).

Furthermore, the BVI liquidator can commence an ‘ancillary’ winding up proceeding against SPL in Hong Kong (while Mr Xu himself can bring a ‘free-standing’ winding up proceedings against SPL in Hong Kong), as the Hong Kong court can exercise its jurisdiction to wind up foreign companies that are not incorporated or registered in Hong Kong (section 327 of the CWUMPO), by satisfying the following three core requirements;

- sufficient connection to Hong Kong (which is likely to be satisfied given SPL has a bank account in Hong Kong, and SPL’s director and book-keeper are residing in Hong Kong);
- reasonable possibility that the winding up would benefit the petitioner (which is likely to be satisfied given the existence of SPL’s bank account in Hong Kong, which a Hong Kong liquidator will be able liquidate and thus help the BVI liquidator collect assets in Hong Kong, or provide a real prospect of financial benefit for Mr Xu as a creditor)
- the Hong Kong court have jurisdiction over at least one person who would have interests in the winding up of SPL to justify engaging the Hong Kong winding up regime (which is

likely to be satisfied if Mr Qi is indeed a resident of Hong Kong – however this third requirement may be dispensed with, where the first two requirements have been strongly satisfied).

With regards to Mr Xu's standing to bring the winding up proceedings in the BVI in the first place, despite the *ipso facto* clause in the FA, the anti-deprivation principle recognised and upheld by Hong Kong would more likely result in the *ipso-facto* clause to be disregarded and considered void by the Hong Kong court. The *ipso facto* clause had obviously been created to provide Mr Qi with an unwarranted advantage over and at the expense of the other creditors of SPL, in the event SPL becomes insolvent, and as such the clause was executed in fraud on the insolvency laws. The Hong Kong court therefore is unlikely to question Mr Xu's standing to bring the winding up proceeding in the BVI on the basis of the existence of the *ipso facto* clause in the FA.

The new co-operation mechanism with Mainland PRC allows Hong Kong officeholders to obtain recognition and assistance in certain part of Mainland China designated as the 'pilot areas' (comprising of Shanghai Municipality, Xiamen Municipality of Fujian Province, and Shenzhen Municipality of Guangdong Province), and vice versa. However, at this stage it is unlikely that the BVI liquidator would have access to this new co-operation mechanism, given that, to make use of this new co-operation mechanism, the BVI liquidator will need to launch a winding up proceeding in Hong Kong and subsequently demonstrate and satisfy the following requirements;

- that SPL's centre of main interests has been located in Hong Kong continuously for at least 6 months (which is unlikely to be satisfied);
- that SPL's principal assets are located in one of the designated pilot areas (which is unlikely to be satisfied given the unknown or uncertain location of SPL's assets); and
- there is a letter of request from the Hong Kong court.

*** End of Assessment ***

TOTAL MARKS: 45.5 out of 50

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