



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.
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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.

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.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks]

Commented [RD(DWH11): (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 jurisdictional requirements to be satisfied by a debtor prior to the presentation of a bankruptcy petition are for it to be:¹

- a) Domiciled in Hong Kong;
- b) 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:
 - a. Been ordinarily resident, or has had a place of residence, in Hong Kong; or,
 - b. Carried on business in Hong Kong.

Question 2.2 [maximum 3 marks]

Commented [RD(DWH12): (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?

In its decision of *Kam Leung Sui Kwan v Kam Kwan Lai & Ors FACV 4/2015*, the Court of Final Appeal confirmed that the following three “core requirements” must be met to enable the Hong Kong court to exercise its jurisdiction to wind up a non-Hong Kong company:²

1. There must be a sufficient connection with Hong Kong;
2. There must be a reasonable possibility that a winding up order would benefit the applicants; and,
3. The Court must be able to exercise jurisdiction over one or more persons in the distribution of the relevant company's assets.

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?

A provisional liquidator may be appointed by the court at any time after the presentation of a winding-up petition and before the making of a winding-up order.³ In urgent cases, the application to appoint a provisional liquidator may be made at the same time as the winding-up petition.

¹ The Bankruptcy Ordinance (Cap 6), Section 4.

² Norridge, Richard, Whitehead, Damien, Copeman, Julian, Thomas, Gareth, and Geiser, Dominic, “*Hong Kong Court of Final Appeal clarifies the law in respect of shareholders’ petitions to wind up foreign companies on just and equitable grounds*”, at <https://hsfnnotes.com/asiadisputes/2015/11/12/hong-kong-court-of-final-appeal-clarifies-the-law-in-respect-of-shareholders-petitions-to-wind-up-foreign-companies-on-just-and-equitable-grounds/>, accessed 12 May 2022.

³ The Companies (Winding Up and Miscellaneous Provisions) Ordinance, Section 193(1).

Prior to the appointment of a provisional liquidator, the court must be satisfied that:⁴

1. There is a good *prima facie* case for the winding-up order; and,
2. The company's assets are in jeopardy.

A provisional liquidator may be appointed for the following purposes:

1. To preserve the company's assets to ensure their availability for distribution should a winding-up order be made, but not to realize them;⁵ and,
2. To explore a restructuring of the company although this cannot be the sole purpose.⁶

The court may limit and restrict the powers of a provisional liquidator.⁷ However, it should be noted that the provisional liquidator may apply to court for additional powers including permission to sell the company's assets should, for example, the sale be necessary to preserve the value of such assets.

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

Question 3.1 [maximum 5 marks]

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

Section 266 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance explicitly states that the section applies in relation to a company if the company goes into liquidation and that if the company has given an unfair preference, the liquidator may apply to the court to restore the position to what it would have been if the company had not given that unfair preference.⁸ It is therefore through this section that a liquidator is able to take action to challenge an unfair preference.

A company gives an unfair preference to a person (being one of the company's creditors or a surety / guarantor for any of the company's debts or other liabilities) if the company does anything or suffers anything to be done which has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position that person would have been in if that thing had not been done.⁹

In order for an alleged unfair preference to be eligible for court application, the transaction must have been entered into at a time in the period of six months ending with the day on

⁴ Lam, Howard, Innes, Flora and Wong, Jeffrey, "Restructuring and Insolvency in Hong Kong", at <https://www.lw.com/thoughtLeadership/ALB-asia-insolvency-restructuring-handbook-hong-kong-2020#:~:text=A%20provisional%20liquidator%20may%20also,winding%20Dup%20order%20is%20made,> accessed 14 May 2022.

⁵ Ng, Ludwig and Woo, Eric, "Did Ad Valorem Fee Have to be Paid on Assets Realized by Provisional Liquidators in Compulsory Liquidation which is Converted into Creditor's Voluntary Liquidation?", at [https://www.onc.hk/en_US/publication/did-ad-valorem-fee-have-to-be-paid-on-assets-realized-by-provisional-liquidators-in-compulsory-liquidation-which-is-converted-into-creditor-s-voluntary-liquidation?category=22&page=8,](https://www.onc.hk/en_US/publication/did-ad-valorem-fee-have-to-be-paid-on-assets-realized-by-provisional-liquidators-in-compulsory-liquidation-which-is-converted-into-creditor-s-voluntary-liquidation?category=22&page=8) accessed 14 May 2022.

⁶ Lam, Howard, Innes, Flora and Wong, Jeffrey, "Restructuring and Insolvency in Hong Kong", at <https://www.lw.com/thoughtLeadership/ALB-asia-insolvency-restructuring-handbook-hong-kong-2020#:~:text=A%20provisional%20liquidator%20may%20also,winding%20Dup%20order%20is%20made,> accessed 14 May 2022.

⁷ The Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 193(3).

⁸ *Idem*, s 266.

⁹ *Idem*, s 266A(1).

Commented [RD(DWH14): Although this will almost always be the case it is not a 'must'. Another reason may be, for example, if there is no management

Commented [RD(DWH15): (4 marks) Need to say "why". Reason is the pari passu principle and that all creditors should be treated fairly amongst themselves

which the winding up of the company commencement. If the transaction was entered into with a person who is connected with the company, the time period increases to two years.¹⁰

In addition, the liquidator is required to show the following in the court application:

1. The company was unable to pay its debts or became unable to pay its debts in consequence of the unfair preference.¹¹
2. The company was influenced, in deciding to give the unfair preference, by a desire to put the recipient into a better position than it otherwise would have been in an insolvent liquidation.¹² If the recipient is connected with the company, such desire is presumed.¹³

It should be noted that in practice, it is difficult to demonstrate a company's influence to desire. However, the court has shown that it is prepared to consider whether such desire exists of which the onus is on the liquidator to show (as mentioned above).

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.

In May 2021, a new arrangement concerning mutual recognition and assistance between Hong Kong and certain courts of the Mainland was signed into being (“the **Cooperation Mechanism**”). The Cooperation Mechanism provides the necessary procedures required by Hong Kong office holders (liquidators and provisional liquidators) to obtain recognition and assistance by the Intermediate People's Courts in the following three pilot cities in the Mainland:¹⁴

1. Shenzhen;
2. Shanghai; and,
3. Xiamen.

The Cooperation Mechanism also provides the procedures to Mainland officeholders (administrators in Mainland bankruptcy proceedings) to obtain recognition and assistance in Hong Kong.¹⁵

Prior to the Cooperation Mechanism, the Hong Kong Courts were willing to recognize administrators appointed in the Mainland however, there were no reciprocal examples of the Mainland granting formal recognition of a foreign liquidator. Therefore, despite Hong Kong and the Mainland being one country, the Cooperation Mechanism was an important development in the area of cross-border insolvency between them.¹⁶

¹⁰ *Idem*, s 266B(1).

¹¹ *Idem*, s266B(2).

¹² *Idem*, s266(4).

¹³ *Idem*, s266(5).

¹⁴ Hudson, Richard and Wu, Judy, “Milestone in Hong Kong-Mainland China cross border insolvency: Mutual recognition of and assistance to insolvency proceedings between Hong Kong and Mainland China”, at <https://www.deacons.com/2021/05/31/milestone-in-hong-kong-mainland-china-cross-border-insolvency-mutual-recognition-of-and-assistance-to-insolvency-proceedings-between-hong-kong-and-mainland-china/>, accessed 30 June 2022.

¹⁵ *Ibid*.

¹⁶ *Ibid*.

Commented [RD(DWH16): (4.5 marks) Should have added a couple of the details (e.g. need for COMI, only applies to HK appointments etc.)

For completeness, in respect of Hong Kong proceedings, the Hong Kong Court will require a letter of request and evidence of the officeholder's claim against assets held in one of the three pilot areas mentioned above. Should the Hong Kong Court agree that one of the three pilot areas is the appropriate jurisdiction to recover a company's assets, the letter of request is likely to be granted.¹⁷

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.

Section 669 of the Companies Ordinance provides that a scheme of arrangement can be proposed to be entered into by a company with its creditors or members or any class of them, as the case may be.¹⁸ For illustrative purposes, schemes of arrangement can include the adjustment of debts owed to creditors or the consolidation or division of shares of different classes, for example.¹⁹

Pros include:

1. A scheme of arrangement is approved at a meeting of creditors or members, as the case may be, where the majority in number (i.e. more than 50%) representing at least 75% in value of the creditors or members (again, as the case may be) present and voting, in person or by proxy, agree to the scheme.²⁰ Without access to the scheme of arrangement, the approval of 100% of the creditors or members, as the case may be, would likely be required to implement a restructuring or reorganization. In the scenario of a company with many creditors, it would be next to impossible to obtain unanimous approval from all such creditors, especially from those with minimal economic interest in a reorganization or restructuring.
2. Dissenting creditors or members can be bound by a scheme of arrangement assuming the requisite majorities (in number and value) vote in favor of the scheme. Therefore, such dissenting creditors' ability to block a scheme is limited.
3. Assuming the requisite approvals are received by the creditors or members or any class of them, as the case may be, the Court may sanction a scheme of arrangement. Upon sanction, the scheme of arrangement is binding on all creditors or members or any class of them, as the case may be, subject to the scheme even if a particular creditor(s) or member(s) did not attend and vote at the meeting(s).²¹

Cons include:

1. There is no moratorium available with standalone schemes of arrangement. However, it is commonplace for a scheme of arrangement to be proposed and implemented during the provisional liquidation of the company during which the moratorium becomes available.
2. In the case where the requisite majorities (in number and value) of any one class of creditors or members, as the case may be, are not obtained, the scheme of arrangement cannot proceed to court sanction.

In respect of the requisite majorities, it should be noted that even if such majorities are obtained, the court still has discretion to not sanction the scheme.

¹⁷ Hudson, Richard, "Hong Kong's first application for recognition of and assistance to liquidators in Mainland China", at <https://www.deacons.com/2021/08/04/hong-kongs-first-application-for-recognition-of-and-assistance-to-liquidators-in-mainland-china/>, accessed 30 June 2022.

¹⁸ Companies Ordinance, s 669.

¹⁹ *Idem*, s 668(1).

²⁰ *Idem*, s 674.

²¹ *Idem*, s 673.

Commented [RD(DWH17): (4 marks) Should also mention that due the 'Gibbs' principle, a Hong Kong Scheme will only compromise debts arising from obligations governed by Hong Kong law. This is a possible downside in the modern environment where a sophisticated debtor is likely to have debts due under other governing laws
Also, as classes are important, should outline requirements (similarity of legal rights, not interests)

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

Question 4.1 [maximum 4 marks]

Commented [RD(DWH18): (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.

Based on the facts of the case, Mountainview Limited (“Mountainview”) appears to be insolvent. In such instances, there would be two options to liquidate and dissolve Mountainview: 1) a creditors’ voluntary liquidation; and, 2) a compulsory (court) liquidation.

Director Duties

In respect of directors, there is no statutory obligation to commence a liquidation when a company has financial difficulties and is unlikely to be able to continue in business (i.e. there are currently no statutory provisions against insolvent trading). While there are provisions against fraudulent trading, there is a high threshold required to establish this. However, directors may be held personally liable for a breach of their fiduciary duty to act in the best interests of the company by continuing to trade during insolvency. More seriously, a director may be subject to criminal liability in the scenario where employees are unable to be paid.²²

Creditors’ Voluntary Liquidation (“CVL”)

A company may be wound up voluntarily if, amongst other things, it resolves by special resolution to do so.²³ In the instance where a certificate of solvency has not been issued on behalf of the company, the winding up is referred to as a CVL.²⁴ Mr. Chan would have to convene a meeting of shareholders during which the special resolution is passed by a majority of at least 75% for the winding up of Mountainview.²⁵ The winding up would commence at the time of the passing of the special resolution.²⁶ However, a liquidator appointed by the special resolution has limited powers until such appointment is approved at a meeting of creditors.²⁷

Once the decision has been taken to convene meetings of creditors and shareholders, Mr. Chan should take steps to protect the assets of Mountainview pending the meeting of creditors.²⁸ As alluded to above, given that Mountainview appears to be insolvent or likely to become insolvent, Mr. Chan must keep the interests of creditors in mind when exercising his duties as director.

The primary advantages of using the CVL procedure, rather than a compulsory (court) liquidation, discussed below, relate to costs and timing. For example, the court involvement during the course of compulsory liquidations is much more than that during a CVL which can

²² Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 37.

²³ Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 228(1)(b).

²⁴ *Idem*, s 233(4).

²⁵ Companies Ordinance, s 564(1).

²⁶ Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 230.

²⁷ *Idem*, s 243A(1).

²⁸ *Idem*, s 250A(3).

lead to delays and additional costs. In addition, duties on realizations are applicable in compulsory liquidations but not in CVLs.²⁹

Mr. Chan should also keep in mind that the liquidator may apply to the court to exercise, amongst other things, all or any of the powers which the court might exercise if Mountainview were being wound up by the court.³⁰ Such powers can include the granting of a stay of proceedings against Mountainview.³¹

CVL in case of urgency

If the director(s) has formed the opinion that the company cannot by reason of its liabilities continue its business, they may pass a resolution that the company be wound up and that meetings of the company and its creditors be summoned.³² Therefore, if Mr. Chan is of the opinion that Mountainview should be wound up with immediate effect, such resolutions can be passed without the requirement of a shareholders' resolution.

Specific reasons in support of an urgent CVL must be included in the resolutions (and the winding-up statement to be delivered to the Registrar).³³ Urgent CVLs are utilized in cases where the appointment of a liquidator is required in short order such as where there are perishable goods to be dealt with and/or disposed of.³⁴ Further information would be required from Mr. Chan to confirm the type(s) of goods and/or services Mountainview deals with to see whether Mountainview would be eligible for an urgent CVL.

Compulsory (Court) Liquidation

A compulsory liquidation is one where a company is wound up by court order. One of the circumstances in which a company may be wound up by the court is if the company is unable to pay its debts.³⁵ An application to wind up a company can be presented either by the company or by any creditor or creditors.³⁶ In this scenario, Mountainview appears to qualify for a compulsory liquidation given that it is unlikely to be able to continue in business.

A company can, by special resolution, resolve for the company to be wound up by the court. Therefore, the resolution has to be passed by the shareholders of Mountainview.³⁷ Therefore, Mr. Chan does not have the sole ability to resolve to wind up Mountainview by the court.

At any time after the presentation of a winding up petition and before the granting of a winding up order, the company (or any creditors or contributory) may apply to stay or restrain proceedings against the company.³⁸ In addition, the court may also appoint a provisional liquidator over the company during this period.³⁹ The provisional liquidator will have the power to take into his custody, or under his control, and preserve all assets of the company.⁴⁰

²⁹ Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 34.

³⁰ Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 255(1).

³¹ Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 38.

³² Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 228A(1).

³³ *Idem*, s 228A(2).

³⁴ Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 35.

³⁵ Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 177(1)(d).

³⁶ *Idem*, s 179(1).

³⁷ *Idem*, s 177(1)(a).

³⁸ *Idem*, s 181.

³⁹ *Idem*, s 193(1).

⁴⁰ *Idem*, s 197.

It should be noted that unlikely a voluntary liquidation, when a winding up order has been made, or a provisional liquidator has been appointed, no action or proceeding may be proceeded with or commenced against the company, except by leave of the court.⁴¹ Therefore, Mr. Chan can gain comfort in this respect should this route be taken for Mountainview.

Investigations

Mr. Chan should be aware that one of the mandated roles of a liquidator is to investigate transactions or payments made during the relevant period (as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance) to determine whether such transactions or payments should be avoided.⁴² This role also encompasses investigating and considering the conduct of the director. As such, it is not appropriate to appoint a “friendly” liquidator that will not fulfill the statutory role to investigate.

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.

Security

At the outset, the liquidator should be made aware that under Hong Kong law, there is no limit to the types or forms of security that a creditor can utilize.⁴³ For the purposes of this question however, fixed charges and floating charges will be discussed.

In respect of fixed charges, charges are made over a specific asset(s) with attachment being automatic. During the period of a fixed charge, the chargee creditor has authority over the asset(s) and the debtor therefore cannot deal with it without consent.⁴⁴

⁴¹ *Idem*, s 186.

⁴² Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 41.

⁴³ *Idem*, p 11.

⁴⁴ *Idem*, p 13.

Commented [RD(DWH19)]: (3 marks) Well written and most of the elements are present but it must be remembered that this is an advice to L. Need to show:
>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

In respect of floating charges, charges are made over an asset or class of assets (including stock and receivables, for example) which the debtor is still permitted to use. This is because no attachment is made against any specific asset or class of assets until an event occurs (as would be listed in the security agreement) triggering the enforcement (or “crystallization”) of the floating charge over such asset(s). At this point, the debtor then loses the authority to deal with the charged assets and the charge becomes a fixed charge over the asset(s).⁴⁵

The liquidator should be aware that secured finance arrangements are required to be registered in a certain period of time after execution. The liquidator must therefore confirm such registration because if it is not, then the arrangement would be void as against him / her.⁴⁶

It should be noted that in practice, the security agreement in respect of receivables would require the debtor to receive or transfer related payments into a specific account.⁴⁷ Based on the facts of the case, this was not done by Kite and is not clear whether it was expected by GLF.

Receivers

Charge documents usually provide the secured creditor with the remedy of appointing a receiver out of court over the charged assets.⁴⁸ The powers conferred upon a receiver are also detailed in such charge documents and usually include the power to sell the charged asset(s).⁴⁹

The receiver has a primary duty owed to the charge holder, rather than the company. In addition, the receiver is entitled to payment of its costs and expenses out of the charged assets and is entitled to exercise a lien over such assets until payment is otherwise made.⁵⁰

For completeness, in respect of floating charges, the appointment of a receiver has the effect of triggering the enforcement of (or “crystallizing”) a floating charge.⁵¹

Liquidation

The liquidation of Kite does not affect the receiver's right to take possession of and/or sell the charged assets. Any realizations made out of the charged assets are not available to the liquidator to satisfy the costs and expenses of the liquidation or any dividends, partial or otherwise, to unsecured creditors.⁵² However, if the assets of Kite available for payment of general creditors (i.e. not subject to a charge) are insufficient to satisfy payment to preferential creditors, such preferential creditors will have priority to the use of charged assets to satisfy the payment.⁵³

As mentioned above, if a charge is not registered (or registered within the prescribed time), the charge will be void as against the liquidator. The liquidator will have access to the Companies Registry in which the charge would have been registered.

⁴⁵ *Idem*, p 13.

⁴⁶ *Idem*, p 14.

⁴⁷ *Idem*, p 14.

⁴⁸ *Idem*, p 52.

⁴⁹ *Idem*, p 53.

⁵⁰ *Idem*, p 53.

⁵¹ *Idem*, p 54.

⁵² *Idem*, 54.

⁵³ Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 265(3B).

Commented [RD(DWH20)]: Only if floating charge

However, the liquidator should note that if the charge is considered to be a floating charge (as appears to be the case with Kite), if such charge was created at a time in the period of 12 months ending with the day on which the winding up commenced and Kite was unable to pay its debts or became unable to pay its debts as a result, the charge is invalid.⁵⁴

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.

⁵⁴ *Idem*, s 267(2).

Commented [RD(DWH21): (5 marks) Could have explained recognition better (and what can be done even without a recognition order)

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

Contracts

In respect of contracts, there is no statute addressing the treatment on insolvency of executory contracts. In addition, there is no general rule in this regard at common law. However, clauses that modify a contract upon insolvency (known as *ipso facto* clauses) as appears to be the case in the FA, are usually upheld.⁵⁵

The liquidator should be aware of the anti-deprivation principle which, in summary, prohibits a creditor from being in a better position than other creditors if the clause(s) is considered a “fraud on the insolvency laws”. The aim of the principle is to avoid giving an advantage to any one of the contracting parties due to the insolvency of the other.⁵⁶ In this case, this principle would avoid Mr. Xu being deprived of assets that would otherwise be used to satisfy the repayment of the funds invested.

In determining whether the anti-deprivation principle has been violated, the courts have developed the following factors to assist in such determination:⁵⁷

1. Is the intention to evade insolvency laws?
2. Does the clause operate in situations other than upon insolvency?
3. Is the assets concerned “flawed”?

Standing

As a result of the anti-deprivation principle, the *ipso facto* clause in this case is not likely to be permitted. The Court will therefore be satisfied that Mr. Xu has standing as a creditor of SPL to bring the winding up proceedings against SPL.

Winding up of Unregistered Companies

In this case, SPL has a BVI appointed liquidator so the use of an ancillary liquidation is likely. However, the liquidator should note that any unregistered company (such as SPL) may be wound up in the following circumstances:⁵⁸

1. If the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs;
2. If the company is unable to pay its debts;
3. If the court is of opinion that it is just and equitable that the company should be wound up.

The petitioner must also satisfy the court that SPL is sufficiently connected to Hong Kong by satisfying the following “three core requirements” as approved by the Court of Final Appeal:⁵⁹

1. There must be a sufficient connection with Hong Kong, but this does not necessarily have to consist in the presence of assets within the jurisdiction. SPL has a bank account at a bank in Hong Kong which would satisfy this requirement.
2. There must be a reasonable possibility that the winding up order would benefit those applying for it. If it can be proven that there are assets of SPL located in one of the pilot areas of the Mainland, the court may be satisfied that this requirement is met.

⁵⁵ Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 43.

⁵⁶ *Idem*, p 17.

⁵⁷ *Idem*, p 43.

⁵⁸ Companies (Winding Up and Miscellaneous Provisions) Ordinance, s 327(3).

⁵⁹ Tang, Alexander, “Cross border insolvency – The Court of Final Appeal clarifies the second core requirement in Shandong Chenming case”, at [https://www.shlegal.com/docs/default-source/news-insights-documents/2022/briefingnote---cross-border-insolvency---the-court-of-final-appeal-clarifies-the-second-core-requirement-in-the-shandong-chenming-case-\(final\).pdf?sfvrsn=ca88e35b_0](https://www.shlegal.com/docs/default-source/news-insights-documents/2022/briefingnote---cross-border-insolvency---the-court-of-final-appeal-clarifies-the-second-core-requirement-in-the-shandong-chenming-case-(final).pdf?sfvrsn=ca88e35b_0), accessed 29 July 2022.

3. The court must be able to exercise jurisdiction over one or more persons in the distribution of SPL's assets. For the purposes of this case, it is assumed that Mr. Xu is a resident of Hong Kong is a creditor of SPL based on the funds advanced from the outset. As such, this requirement would be expected to be met.

As mentioned above, in addition to winding up unregistered companies, the courts also have jurisdiction to commence ancillary liquidations in Hong Kong as would be the case in this scenario. In addition, foreign liquidators can also apply to the courts for recognition of the foreign appointment. However, the powers available through recognition are more limited than through liquidation. For example, the power to utilize the new Cooperation Mechanism between Hong Kong and the Mainland (discussed in further detail below) is only available to Hong Kong liquidators. This power appears critical in this case assuming such assets can be identified.

Investigations

The powers available to officeholders (either through a Hong Kong winding up or recognition of a foreign appointment) include the production of documents and examination of individuals in Hong Kong.⁶⁰ The liquidator can therefore utilize such powers to advance its investigations and asset recovery efforts.

Assets in Hong Kong

In this case, SPL holds a bank account at a bank in Hong Kong. Based on common practice, it is expected that the Hong Kong bank will provide information and documentation to the liquidator without the requirement to be recognized through a court order. However, the liquidator should keep in mind that he will not be able to deal with any identified assets, including any remaining cash balance in the Hong Kong bank account, without having been formally recognized by the court.⁶¹ For the avoidance of doubt, the power to deal with assets are also available to Hong Kong liquidators.

Assets in the Mainland

There is an arrangement in place concerning mutual recognition and assistance between Hong Kong and certain courts of the Mainland ("**the Cooperation Mechanism**"). The Cooperation Mechanism provides the necessary procedures required by Hong Kong office holders (liquidators and provisional liquidators) to obtain recognition and assistance by the Intermediate People's Courts in the following three pilot cities in the Mainland:⁶²

1. Shenzhen;
2. Shanghai; and,
3. Xiamen.

The Hong Kong Court will require a letter of request and evidence of the officeholder's claim against assets held in one of the three pilot areas mentioned above. Should the Hong Kong

⁶⁰ Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 72.

⁶¹ *Idem*, p 72.

⁶² Hudson, Richard and Wu, Judy, "*Milestone in Hong Kong-Mainland China cross border insolvency: Mutual recognition of and assistance to insolvency proceedings between Hong Kong and Mainland China*", at <https://www.deacons.com/2021/05/31/milestone-in-hong-kong-mainland-china-cross-border-insolvency-mutual-recognition-of-and-assistance-to-insolvency-proceedings-between-hong-kong-and-mainland-china/>, accessed 30 June 2022.

Court agree that one of the three pilot areas is the appropriate jurisdiction to recover a company's assets, the letter of request is likely to be granted.⁶³

The liquidator will have to prove that SPL's center of main interest ("COMI") is in Hong Kong. The COMI generally means the place of incorporation which in this case would be the BVI. However, other factors are considered including the place of principal office and the place of principal business.⁶⁴ The facts of the case mention that SPL's director, Mr. Zhang, lives in Hong Kong and that SPL's bookkeeper, Mr. Wong, lives in Hong Kong. This would suggest that the principal office and/or place of principal business are likely located in Hong Kong. This may be sufficient to satisfy the court that SPL's COMI is in fact in Hong Kong.

In respect of the Mainland, if SPL's principal assets are in in one of the pilot areas, the Hong Kong officeholder may apply for recognition of and assistance in that pilot area through the Cooperation Mechanism. In this case, it is not yet clear where in the Mainland the assets are located. Further investigations in this regard will have to be conducted.

*** End of Assessment ***

TOTAL MARKS: 44.5 out of 50

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⁶³ Hudson, Richard, "Hong Kong's first application for recognition of and assistance to liquidators in Mainland China", at <https://www.deacons.com/2021/08/04/hong-kongs-first-application-for-recognition-of-and-assistance-to-liquidators-in-mainland-china/>, accessed 30 June 2022.

⁶⁴ Darton, Robin, *Module 8C Guidance Text: Hong Kong*, INSOL International (2021), p 76.

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