



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.

Commented [RD(DWH3): Incorrect (0 marks) – s.327 provides a statutory basis to wind up such a company (section 7 of text)

(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.

Question 1.4

Select the **correct** answer:

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

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

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

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

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

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

Question 1.5

Select the **correct** answer:

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

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

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

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

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

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

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

Question 1.6

Select the **correct** answer:

Hong Kong legislation provides a statutory definition of insolvency in –

(a) the Companies Ordinance (Cap 622).

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

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

(d) none of above.

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

Question 1.7

Select the **correct** answer:

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

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

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

Question 1.8

Select the **correct** answer:

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

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

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

Question 1.9

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

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

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

Question 1.10

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

- (a) He must make an application to the High Court of Hong Kong using the provisions of the UNCITRAL Model Law.
- (b) He must first seek permission from the Ministry of Justice in Beijing.
- (c) No recognition is possible.
- (d) None of the above.

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?

[Type your answer here

Section 4 of the Bankruptcy Ordinance (Cap 6) provides that a bankruptcy petition shall not be presented to the court unless the debtor:

- (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.

In reference to paragraph (c)(ii) above, the carrying on business includes (1) the carrying on of a business by a firm or partnership of which the debtor is a member, and (2) the carrying on of business by an agent or manager for the debtor or for such a firm or partnership.]

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?

[Type your answer here

In order to wind up a non-Hong Kong company in Hong Kong, the petitioner must satisfy the court the court that the company in question is sufficiently connected to Hong Kong by satisfying the following three core requirements as set out in the case of *Kam Leung Sui Kwan v Kam Kwan Lai and Others* (2015) 18 HKFAR 501 (“*Re Yung Kee*”):

- (1) there must be sufficient connection with Hong Kong, (not necessarily meaning the presence of assets within the jurisdiction);
- (2) there must be a reasonable possibility that the winding up order would benefit those applying for it; and
- (3) the court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company’s assets.

In the case of *Re Yung Kee*, the Court of First Instance dismissed the petition on jurisdictional grounds as follows:

Commented [RD(DWH13): From here: good stuff but not needed for a short question such as this.]

- (a) on the relief under section 168A, because YKHL had not established a “place of business in Hong Kong, and accordingly, was neither a “non-Hong Kong company” nor a “specified corporation” within the specified laws (section 2 and section 168A of Cap 622);
- (b) on the winding up of YKHL, because the company did not have sufficient connection with Hong Kong.

The Court of Final Appeal (“CFA”) rejected the argument that the inclusion of a share transfer or registration office, in the definition of “place of business” under section 341 of Cap 32 (now section 774 of Cap 622) shows that a “place of business” may include a place where the company carries on purely administrative activities, which were the only activities of YKHL. The CFA ruled that section 341 does not define “place of business” but extends its ordinary meaning to include places which would otherwise not normally be regarded as places of business. The CFA also ruled that while business is not confined to commercial transactions or transactions which create legal obligations, there is no reason to suppose that it covers purely internal activities in the governance of the company itself; and there is nothing in fact

or law which requires a company which does not carry on business at all to have a place of business (leaving aside the share transfer and registration office) somewhere.]

Question 2.3 [maximum 4 marks]

Commented [RD(DWH14)]: (4 marks)

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

[Type your answer here

Section 193 of CWUMPO provides, amongst others, the following:

- (1) the court may appoint a liquidator provisionally at any time after the presentation of a winding-up petition and before the making of a winding-up order in respect of a company;
- (2) the court may appoint either the official receiver or any other fit person to be the provisional liquidator;
- (3) where a liquidator is provisionally appointed by the court, the court may limit and restrict his powers by the order appointing him; and
- (4) a provisional liquidator appointed pursuant to section 193 must perform the duties that may be imposed on the provisional liquidator by the court.

In addition, section 28 of the CWUR, a provisional liquidator is also appointed by the court in a winding up order pending the holding of creditors' meetings.

As enunciated in the case of *Re Union Accident Insurance Co Ltd*. [1972] 1 All EP 1105 at 1109, a provisional liquidator cannot be appointed on a baseless petition such that the appointment can be when (a) a petition discloses a prima facie case, and (b) that there were circumstances that require that a provisional liquidator ought to be appointed.

A provisional liquidator is tasked with preserving assets during the period of appointment, which is after the petition is presented but before any order is made. The asset preservation task does not generally cover realization of assets, unless to do so would preserve the value of the assets on the best interest of the beneficiaries as enunciated in the case of *Re MF Global Hong Kong Ltd* [2015] 2 HKC 424, CA. In certain circumstance, the court may permit the provisional liquidator to sell assets only upon specific application to court being made. In addition, a provisional liquidator can also be appointed to help facilitate a restructuring proposal as set out in the case of *China Solar Energy Holdings Ltd (No. 2)* [2018] HKCU 938 and *Re Keview Technology (BVI) Ltd* [2002] HKCU 616, but such reason is not the exclusive or sole reason as enunciated in the case of *Re Legend International Resorts Ltd* [2006] 3 HKC 565 at 577.

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

Question 3.1 [maximum 5 marks]

Commented [RD(DWH15)]: (2.5 marks) Need to say "why". Reason is the pari passu principle and that all creditors should be treated fairly amongst themselves. Answer a bit jumbled

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.

[Type your answer here

The powers of the liquidator in winding up are set out in Section 199 and Schedule 25 of the CWUMPO. Pursuant to Schedule 25, the liquidator is tasked to do all other things as may be necessary for the winding up the affairs of the company and distributing its assets. This gives the liquidator statutory basis of its authority to act on behalf of the company on the collation of the assets of the company in the best interest of the beneficiaries.

Commented [RD(DWH16)]: Not relevant to this

A transaction entered into that is done with unfair preference is voidable in certain circumstances, and the liquidator may take action on behalf of the company to void or set aside such transaction and take back control of the assets back to the company.

Pursuant to section 266A of the CWUMPO, a company gives an unfair preference to a person if (a) that person is (i) one of the company's creditors, or (ii) a surety or guarantor for any of the company's debts or other liabilities; and (b) 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. For purposes of item (b), a company goes into insolvent liquidation if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up. The said provision likewise sets out that the fact that something has been done pursuant to the order of any court does not, without more, prevent the doing or suffering of that thing from constituting the giving of an unfair preference.

Pursuant to section 266B of the CWUMPO, the relevant time for purposes of unfair preference which is not a transaction at an undervalue and is given to a person who is connected with the company (otherwise than by reason only of being its employee), at a time in the period of 2 years ending with the day on which the winding up of the company commences; and in any other case of unfair preference which is not a transaction at an undervalue, at a time in the period of 6 months ending with the day on which the winding up of the company commences.

Premises considered, the liquidator must show the following to succeed the claim:

- (a) at the relevant time of the transaction, the company was unable to pay its debts or became unable to pay its debts as a result of the relevant transaction. This is presumed against a recipient who is a person connected with the **company**;
- (b) the company was influenced by a desire to improve that person's position in the event of a liquidation; and
- (c) the transaction is done within the relevant time; 6 months in general, or 2 years if with associate.

The unfair preference claim is also available for a trustee in a personal bankruptcy.]

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.

[Type your answer here

Both Hong Kong and the Mainland have limited statutory laws dealing with cross-border insolvency matters, but the similarity is not because Hong Kong and Mainland are one country but because of wide range of **reasons, likely political.**

The Mainland being an independent country has wider capabilities to enact laws and/or enter into treaties on matters of cross-border insolvency.

As for Hong Kong, Article 1 of the Basic Law of Hong Kong provides that the Hong Kong Special Administrative Region ("Hong Kong SAR") is an inalienable part of the People's Republic of China, and Article 2 provides that Hong Kong SAR has authority to exercise a high degree of autonomy and enjoy executive, legislative and independent judicial power, including that of final adjudication, in accordance with the provisions of the Basic Law. Also, Article 151 of the Basic Law allows Hong Kong SAR, to maintain and develop relations and conclude and implement agreements with foreign states and regions and relevant international organization

Commented [RD(DWH17): Presumption of insolvency applies only to transactions at an undervalue, not unfair preferences (s266B(3))

Commented [RD(DWH18): Rebuttable presumption of desire to prefer where beneficiary is a connected person.

Commented [RD(DWH19): (2 marks) Mentions the new system but does not say how it works (e.g. pilot areas, COMI in HK needed, HK appointees only, letter of request). Also Should mention that HK court has assisted in PRC insolvencies (e.g. CEFC Shanghai) by common law

Commented [RD(DWH20): ?

in the appropriate fields, including the economic, trade, financial and monetary, shipping, communications, tourism, cultural and sports fields, but the same but the said article also requires that the Hong Kong should use the official name as using "Hong Kong, China". Due to political sensitivity on the part of some people from Hong Kong, it is my view that that qualification on the use of the official name might affect the way Hong Kong deals with foreign relations.

On recent developments, however, as set out in the Record of Meeting between the PRC Supreme Court and Hong Kong Government signed on 14th May 2021, the Supreme People's Court and the Government of Hong Kong have reached certain consensus in relation to mutual recognition of and assistance to bankruptcy (insolvency) proceedings between the courts of the Mainland the Hong Kong SAR on certain pilot areas in the Mainland and with Hong Kong SAR. To implement the said Record of Meeting, the Supreme People's Court has promulgated a set of opinion which provides detailed guidance to the relevant Mainland courts on implementation of the Record of Meeting. The said opinion provides for, amongst others, the list of key pilot cities (namely, Shanghai, Xiamen and Shenzhen) on the recognition of and assistance to Hong Kong Insolvency Proceedings, as defined under the Opinion.]

In summary, while Hong Kong lacks a statutory framework to deal with cross-border insolvency, the Hong Kong court has followed common law principles on matters of cross-border insolvency matters. In addition, Hong Kong is still the part of the specified list of jurisdictions set out in the Insolvency Act 1986 of the United Kingdom whereby the English court shall provide assistance to courts in relation to insolvency matters.

Commented [RD(DWH21)]: Relevance to the Mainland?

Question 3.3 [maximum 5 marks]

Commented [RD(DWH22)]: (4.5 marks) Reference should be made to the majorities required

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

[Type your answer here

The scheme of arrangement (the "Scheme") in Hong Kong is a statutory mechanism that is pursuant to the Companies Ordinance, particularly Part 13, Division 2 which provides for arrangements and compromises, and on procedural side it is governed by the rules of the High Court Order 102, rules 2 and 5.

The Scheme allows companies to make binding compromises or arrangements with their members and/or creditors (or any class of them), including adjustments of debts owed to its creditors or reduction of share capital.

The Scheme is largely patterned with the scheme of arrangement enforced in England, except on matters of procedures. In Hong Kong, in order for a Scheme to become effective, the following 3-stage process needs to be complied with (not necessarily followed in England):

- (1) an application is made, by originating summons, for leave to convene meetings of the relevant creditors to consider, and if thought fit, approve the Scheme. Such application is heard by the court, which is the convening hearing, whereat the court will give directions for giving notice of and advertising such meetings, the Scheme meeting);
- (2) the Scheme meeting take place and the result of such meeting is reported to the court; and
- (3) an application is made by petition for the court to sanction the Scheme.

The above 3-stage process is discussed in the case of UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin (2001) 4 HKCFAR 358. In the said case, the appeals were brought by creditors who object to the scheme of arrangement in relation to 7 companies in the UDL Group. The schemes were amongst those sanction by an order of the court. UDL Holdings Ltd ("Company") and 24 direct subsidiaries sought the court' sanction for schemes of arrangement with their respective creditors. The 25 schemes were identical terms and formed

part of a global scheme. A single composite document was circulated to creditors setting out the reason for the schemes, their effect, and a recommendation to creditors to vote in their favour. Pursuant to an order of the court, separate court meetings were held for the Company and 24 direct subsidiaries. The court was asked to direct separate class meetings of preferential and internal creditors, but following the established practice, decline to give any direction leaving those who proposed the scheme to call separate class meetings. There was only one court meeting was held by each of the 25 companies, and in each case the creditors voted in favour of the scheme by more than the requisite 75%. It was enunciated that all scheme creditors have the same rights to participate in and vote at the creditors' meeting, and the focus is on "rights" rather than "interest" the creditors have.

The weakness of the Scheme is on the lack of statutory moratorium mechanism. While traditionally the downside of Hong Kong's Scheme of Arrangement is that it does not provide for a moratorium on creditors' action while such scheme plan is being processed, the current rule allows stay by court order pursuant to Rules of the High Court Order 1B, r1(2)(e), which provides that the court may by order stay the whole or part of any proceedings or judgment either generally or until a specified date or event.

The advantage on the use of common law as framework for the scheme of arrangement is that it allows flexibility on latest common law developments which could be representative of the current global insolvency climate. For example, in April 1998, the Hong Kong Association of Banks ("HKAB") issued guidelines codifying the principles governing corporate debt restructuring and workouts, which have been revised and extended and re-issued in the form of joint guidelines by the HKAB and the Hong Monetary Authority. It is noted that the HKMA is a strong supporter of the guidelines and is prepared to act as a mediator if differences of views threaten the successful conclusion of a workout. In my view, while the guidelines has no statutory mandate, given the common law framework in Hong Kong, it remains a useful tool in dealing with corporate rescue mechanism as the Scheme.

In addition to the weakness (to some extent) of the Scheme, the Scheme can only bind creditors if the debt is governed by Hong Kong law or the relevant creditor takes part in the Scheme.

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

Question 4.1 [maximum 4 marks]

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

[Type your answer here]

Mr Chan's friend is **partly correct** is recommending that Mr Chan has the option to go to court to wind up the company. However, that is not his only option. While Mr Chan can arrange for the creditors' voluntary liquidation ("CVL"), he may also consider deregistration of the company or explore scheme of arrangement.

For the CVL, Mr Chan can call a shareholders' meeting to approve the proposed CVL by reason that the company cannot continue due to its liabilities.

Commented [RD(DWH23)]: (2.5 marks) See below. Should also advise that if company is insolvent owes duties to creditors ahead of the company

Commented [RD(DWH24)]: But the friend's advice was he "must" go to court

Deregistration is generally simple, inexpensive and quick method to dissolve a company. However, this is usually available when a company is clear from any debts and legal issues. Therefore, while the company has liabilities, Mr Chan may not resort to deregistration. The other strategy could be to enter into a scheme of arrangement and thereafter apply for deregistration of the company.

Commented [RD(DWH25)]: only

On the selection of the liquidator, Mr Chan has to engage and appoint a qualified liquidator. Mr Chan should be made aware that it is part of the duties of the liquidator to look into the actions and decisions of Mr Chan, being the sole director of the company, and some actions could be nullified in the course of the winding up process by reason of being a transaction undervalue and/or there exist unfair preferences at the relevant time. Also, Mr Chan should be advised that the liquidator may find some irregularities in Mr Chan's actions as director that may have legal repercussions.]

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.

Commented [RD(DWH26)]: (0.5 marks) Correct to consider registration and unfair preference, but needs to go further:

An outline is

- >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

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.

[Type your answer here

The liquidator may apply to court to declare that the fixed charge constitute an unfair preference.

Commented [RD(DWH27)]: Correct to consider but would need more evidence before equate to Sweetmart

In a similar case of Sweetmart Garment Works Limited (in liquidation) [2008] 2 HKC 252, the liquidator was successful in claiming a judgment that there was unfair preference in executing the mortgage. In the said case, the court concluded;

- (a) the bank did not place any real commercial pressure on the company, although there were complaints regarding non payment;
- (b) the court did not accept that the bank had paced any "moral pressure";
- (c) it does not appear that there could have been any real prospect of the company trading on through its difficulties, given the critical steps taken by the creditors as a whole and the extent of the debts owing to them. Therefore it could be said that the mortgage was granted to preserve the ongoing commercial relationship with the bank;
- (d) the loan granted by the bank against the mortgage did not involve fresh credit being given to the company. Therefore, the company did not benefit in any tangible way from the granting of the mortgage;

(e) even though bankruptcy proceedings had been threatened against the directors of the company, the directors still elected to offer the vessel as security. This is strong evidence of a desire to prefer the bank.

Based on the indirect evidence, the court ruled that the company was influenced by a desire to preferring the bank in granting the mortgage in question.

In the case of Kite Limited, there are limited facts but if the liquidator could prove the following then he would be successful in clawing back the assets of Kite Limited subject to fixed charge in favor of GFL:

- (a) at the relevant time of the transaction, the company was unable to pay its debts or became unable to pay its debts as a result of the relevant transaction. This is presumed against a recipient who is a person connected with the company;
- (b) the company was influenced by a desire to improve that person's position in the event of a liquidation; and
- (c) the transaction is done within the relevant time; 6 months in general, or 2 years if with associate.]

Also, the liquidator may have to check if the fixed charge is registered, and if it is not then it will be void as against the liquidator and the assets becomes part of the pool of the estate within the disposal of the liquidator.

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;

Commented [RD(DWH28)]: (2 marks)

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

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

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

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

Obtain documents from the company's bank (Bay Capital) Bring an action against Mr. Qi (perhaps for breach of fiduciary duty) (Irish Shipping – but see recent decision of Nuoxi Capital which creates some uncertainty)

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

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

The Hong Kong court is receptive to such applications from legal systems similar to Hong Kong (BVI is one)

The Hong Kong court will need the originating court (BVI) to make a letter of request

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

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

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

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

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

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

- ▣ there must be sufficient connection with Hong Kong, (not necessarily meaning the presence of assets within the jurisdiction);
- ▣ there must be a reasonable possibility that the winding up order would benefit those applying for it; and

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

- o The liquidator could therefore make an application for an ancillary liquidation and it may then be possible that the new mechanism can be utilised (subject to the other criteria being met) – the mechanism making it clear that the COMI of the debtor (COMI in Hong Kong being a requirement) does not necessarily require the company to be incorporated in Hong Kong. [the answer is may be because where, as here, the company is already in liquidation in its jurisdiction of incorporation, the liquidation here would be ancillary – it is yet to be tested whether the Mainland courts will take issue with this. However, for the purpose of this assessment, marks will be awarded for identifying a s.327 winding up as a possible method of accessing the new cooperation mechanism].

(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.

[Type your answer here

1. On the liquidator's option to take action in Hong Kong, the Hong Kong court generally recognizes duly appointed office holder in company's jurisdiction of incorporation to take steps in the name of the company;
2. The clause in the FA that provides that if SPL becomes insolvent then all other provisions becomes void and all assets would be vested on Mr Qi to repay the shareholders loan Mr Qi has made, this can be avoided on the ground that it violates anti-deprivation principle
3. On the enforcement of the winding up order obtained in BVI, foreign judgments can be recognized in Hong Kong pursuant to statute, or the judgment creditor needs to bring an action at common law to enforce the judgment. Pursuant to Section 4 of the [Foreign Judgments \(Reciprocal Enforcement\) Ordinance \(Cap 319\)](#), a person, being a judgment creditor under a judgment to which the provisions of the ordinance apply, may apply to the court of first instance at any time within 6 years after the date of the judgment to have the foreign judgment registered in Hong Kong. Once registered in Hong Kong, the foreign judgment will have the same force and effect as a Hong Kong judgment for the purpose of enforcement; and
4. On the Supreme People's Court's Opinion on Taking Forward a Pilot Measure in relation to the recognition of and assistance to insolvency proceeding in the Hong Kong SAR, it provides that the Supreme People's Court designates the people's court in Shanghai, Xiamen and Shenzhen to take forward pilot measures on recognition of and assistance to "Hong Kong Insolvency Proceedings". The said opinion defines "Hong Kong Insolvency Proceedings" as the collective insolvency proceedings commenced in accordance with the CWUMPO and the Companies Ordinance of Hong Kong. In the case of SPL, however, Mr Xu has obtained the winding order in BVI. Also, it is essential to determine which part of the Mainland the assets of SPL are located.

As a matter of legal strategy, I would also recommend that the liquidator probe onto the actions of Mr Qi who is the sole director of SPL. If there is any wrongdoings, a case can be filed in Hong Kong against Mr Qi.

*** End of Assessment ***

TOTAL MARKS: 33 out of 50

Commented [RD(DWH29)]: Not relevant to this

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