



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

**HONG KONG**

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

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

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

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

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
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6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

Commented [DB1]: ???

## 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(DWH2)]:** 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(DWH3)]:** 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(DWH4):** 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(DWH5):** 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(DWH6):** 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(DWH7):** 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(DWH8):** 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(DWH9):** 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(DWH10):** Correct (1 mark) – The *China Field* decision confirmed that pre-1997 decisions of the Privy Council on appeals from Hong Kong were and remain binding (section 4.1 of text).

### Question 1.10

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

- (a) He must make an application to the High Court of Hong Kong using the provisions of the UNCITRAL Model Law.
- (b) He must first seek permission from the Ministry of Justice in Beijing.

(c) No recognition is possible.

(d) None of the above.

## QUESTION 2 (direct questions) [10 marks]

### Question 2.1 [maximum 3 marks]

What are the jurisdictional requirements as regards a debtor for the Hong Kong court to be able to exercise its bankruptcy jurisdiction over that person?

Although “debtor” is not defined within the Bankruptcy Ordinance (Cap 6), Section 4 provides conditions to be satisfied in respect of a debtor. Section 4 states 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, Hong Kong; or
  - ii. has carried on business in Hong Kong.

Section 4(2) further sets out that in reference to a debtor carrying on business, this includes:

- a) the carrying on of business by a firm or partnership of which the debtor is a member; and
- b) 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]

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

In *Kam Leung Sui Kwan v Kam Kwan Lai and Others (2015) 18 HKCFAR 501*, the Court of Final Appeal set out three core requirements a petitioner must satisfy in order for the Hong Kong court to exercise its jurisdiction to wind up a non-Hong Kong company:

- a) there must be sufficient connection with Hong Kong;
- b) there must be a reasonable possibility that a winding up order would benefit the petitioner;
- c) 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]

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

Pursuant to Section 193 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (“CWUMPO”), 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. A creditor petitioning for the winding-up of a company may, in certain circumstances, believe that the assets of the company are in jeopardy. A creditor may petition at the same time as a winding-up petition for the appointment of a provisional liquidator to protect and safeguard the assets of the company until the winding-up petition has been heard and decided. In *Re Union Accident Insurance Co Ltd [1972] 1 All ER 1105 at 1109*, it was held that as an appointment of a provisional liquidator is a serious step for a

**Commented [RD(DWH11):** Correct (1 mark) – Hong Kong has not enacted UNCITRAL; the Ministry of Justice in Beijing would not be involved (“1 country, 2 systems”); the courts have developed a practice of giving recognition to foreign office holders in certain circumstances.

**Commented [RD(DWH12):** (3 marks)

**Commented [RD(DWH13):** (3 marks)

**Commented [RD(DWH14):** (3 marks). Should refer to powers being prescribed by the Court and need to show likely to be wound up when petition is heard

court to take because it is likely in many cases to have a terminal effect and that there should be sufficient circumstances justifying the appointment that the person petitioning should provide.

A provisional liquidator may also be appointed in a voluntary liquidation. Section 228A of the CWUMPO sets out a special procedure for voluntary winding up of company urgently. The majority of the directors, may, if they have formed the opinion that the company cannot by reason of its liabilities continue its business —

- a) pass a resolution to the effect that—
  - i. the company cannot by reason of its liabilities continue its business;
  - ii. they consider it necessary that the company be wound up and that the winding up should be commenced under this section because it is not reasonably practicable for it to be commenced under another section of this Ordinance; and
  - iii. meetings of the company and of its creditors will be summoned for a date not later than 28 days after the delivery of a winding-up statement to the Registrar;
- b) cause a meeting of the company to be summoned for a date not later than 28 days after the delivery of a winding-up statement to the Registrar; and
- c) appoint a person as the provisional liquidator in the winding up of the company with effect from the commencement of the winding up.

A provisional liquidator appointed under Section 228A must have consented in writing to their appointment and that person must be a solicitor or a certified public accountant. A provisional liquidator appointed under Section 228A shall—

- a) unless a liquidator is sooner appointed, hold office until a meeting of the creditors of the company summoned under this section or, if that meeting is adjourned, any adjourned meeting, may allow;
- b) take into his custody or under his control all the property and things in action to which the company is or appears to be entitled; and
- c) be entitled, out of the funds of the company, to such remuneration as the committee of inspection or, if there is no such committee, the creditors, may fix and to reimbursement of expenses properly incurred by him, but he shall not be liable, and no civil action or other proceedings shall lie against him, in respect of acts properly done by him.

### 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 266B of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (“CWUMPO”) sets out provisions for the avoidance of unfair preference in corporate insolvencies. An unfair preference arises where where (i) a payment has been made to a creditor in the period leading up to the commencement of the winding up, and (ii) the effect of that payment is to put the creditor in a better position than other creditors when the liquidation starts. Once a liquidation commences, a liquidator may review transactions within the two years preceding the liquidation for transactions with associates of the company and six months for transactions with any other persons.

In making a claim for a transaction of unfair preference, the liquidator must show that at the time the unfair preference was given, the company was unable to pay its debts or became unable to pay its debt from a result of the transaction. This is presumed for a transaction with

**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

**Commented [RD(DWH16):** Or surety

a connected person pursuant to Section 266 of the CWUMPO which sets out that a company which has given an unfair preference to a person connected with the company (otherwise than by reason only of being its employee) at the time the unfair preference was given is presumed. This however, can still be challenged by the recipient of the transaction.

Claims for transactions of unfair preferences made to non-associates are rarely made out due to the difficulties a liquidator faces in proving to the court's satisfaction that a transaction was indeed an unfair preference. When a liquidator brings an application to the court to claim a transaction of unfair preference, the defendant is entitled to rely on the defence that genuine pressure was exerted on the company and the transaction was not borne on the desire to prefer. In *Trustees of the Property of Hau Po Man Stanley (in bankruptcy) v Hau Po Fun Ivy [2005] 2 HKC 227* it was held that moral pressure can be as real as commercial pressure and was sufficient to negate the suggestion that the debtor company was motivated by a desire to prefer.

### 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.

Insofar as Hong Kong and the Mainland are concerned, neither provide statutory regimes for dealing with cross-border insolvency. Hong Kong has continued to follow common law principles when dealing with cross-border insolvency and are in fact keen to assist the foreign representatives. The Mainland, on the other hand, is a civil law system and does not use common law. The Mainland has enacted the [Enterprise Bankruptcy Law \("EBL"\)](#) in 2006 which has one article in relation cross-border insolvency. Article 5 of the EBL sets out that on outbound cross-border insolvency, a Chinese bankruptcy proceeding binds the company's assets worldwide, having a universal effect while for inbound insolvency, a foreign bankruptcy judgment could be recognised and enforced in the Mainland if the foreign company has assets located in the Mainland, subject to the condition that there is either a treaty or the principle of reciprocity between the Mainland and the foreign country, and that the foreign bankruptcy judgment should not breach the general principles of Chinese law, undermine the Mainland's sovereignty, securities and public interests, or violate Chinese creditors' legal rights.

Just recently, in May 2021, a cooperative mechanism was introduced for the mutual recognition of and assistance to insolvency proceedings between the Courts of the Mainland and Hong Kong. This new mechanism promotes cooperation between Hong Kong and Mainland Courts and bridge the difference in the way Hong Kong and the Mainland deal with cross-border insolvency involving insolvency proceedings in Hong Kong and the Mainland. While the cooperative mechanism is only applicable to the pilot areas of Shanghai, Xiamen and Shenzhen, it may prove to be a valuable mechanism to facilitate the universalist approach for cross-border insolvency between Hong Kong and the Mainland.

### 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.

A scheme of arrangement is a statutory, binding compromise reached between the company and its members and/or its creditors. The statutory regime for a scheme of arrangement is set out in Part 13, Division 2 of the Companies Ordinance (Cap 622). A company, its creditors, its members or the liquidator, in the case of a company being wound up, can make

**Commented [RD(DWH17):** (3.5 marks) Could also have referred to the pre-existing tools (e.g. s.327 and common law developments such as CEFC Shanghai)

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

**Commented [RD(DWH18):** This section is well written but outside the scope of this module, being for Hong Kong

**Commented [RD(DWH19):** (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)



an application to the court under Section 670 to convene a meeting of the company and its members and/or creditors to consider the scheme of arrangement. Once a meeting is ordered under Section 670, every notice summoning the meeting that is sent to a creditor or member must be accompanied by an explanatory statement that must comply with the following:

- a) must explain the effect of the arrangement or compromise; and
- b) must state—
  - i. any material interests of the company's directors, whether as directors or as members or as creditors of the company or otherwise, under the arrangement or compromise; and
  - ii. the effect of the arrangement or compromise on those interests, in so far as the effect is different from the effect on the like interests of other persons.
- c) if the arrangement or compromise affects the rights of the company's debenture holders, an explanatory statement must give the like explanation as respects the trustees of any deed for securing the issue of the debentures as it is required to give as respects the directors.

The court will also appoint a chairman for the meeting, to report to the court on the results of the meeting prior to the sanction hearing. At the meeting, a scheme is approved by the creditors if a majority in number representing at least 75% in value of the class of creditors present and voting (in person or by proxy) or approved by the members if at least 75% vote in favour of the scheme. Once the meeting has been held, the applicant who petitioned for the meeting, will again petition to the court to sanction the scheme of arrangement. The sanction of a scheme of arrangement is to the court's discretion even if the majorities were properly obtained. Once a scheme of arrangement is sanctioned by the court, the scheme will apply to all scheme creditors or members whether or not they voted in the meeting.

The pros of a scheme of arrangement include:

- a) The only tool available for the rescue and restructuring of distressed companies in Hong Kong and an alternative to liquidation where a restructuring may provide a better return to creditors;
- b) Schemes are useful for companies seeking to restructure debts with as many creditors as possible where it would be otherwise difficult to obtain 100% approval or unanimous consent from all creditors;
- c) The ability to cram down on dissenting or minority creditors once the scheme is sanctioned by the court; and
- d) A non-Hong Kong company can also utilise a scheme of arrangement as long as it can be proven that it has sufficient connection with Hong Kong.

Cons of a scheme of arrangement include:

- a) Significant cost involved as the launching and sanctioning of a scheme of arrangement is supervised by the courts; and
- b) No automatic moratorium to protect the company while seeking to propose a scheme of arrangement.

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

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

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

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

whether his friend is correct and to advise him generally on what he should do and his position as a director.

A company that has financial difficulties may consider corporate liquidation or corporate restructuring. There are two types of liquidation namely compulsory liquidation and voluntary liquidation (further divided into members' voluntary liquidation and creditors' voluntary liquidation). As a compulsory liquidation involves petitioning to the courts for a winding-up order, this may involve higher legal costs. For a more cost-effective method of entering liquidation, a voluntary liquidation may be considered. As the company has financial difficulties, a members' voluntary liquidation may not be suitable as it requires the company to be solvent upon commencement of winding-up. With a creditors' voluntary liquidation, Mr Chan can call for an Extraordinary General Meeting for the purposes of passing a resolution to wind-up the company and thereafter call for a meeting of creditors to confirm the appointment of a liquidator.

If there is a possibility of restructuring the company and allowing the business to continue thereafter, Mr Chan can consider proposing a scheme of arrangement to the company's creditors. The statutory regime of a scheme of arrangement is set out in Part 13, Division 2 of the Companies Ordinance (Cap 622).

As an officer of the court, a liquidator is an independent party of the company and as provided under the Companies (Winding Up and Miscellaneous Provisions) Ordinance, will investigate past transactions or payments that have been detrimental to the interests of the company's creditors.

#### 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.

In *Re Yorkshire Woolcombers Association Limited*, a floating charge was defined by Romer LJ as:

"...I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would

**Commented [RD(DWH21):** Also, a company cannot petition on the basis of a resolution by directors alone (Emmadart) and there is no indication that Mr. Chan is (necessarily) the only shareholder)

**Commented [RD(DWH22):** i.e. tell Mr Chan he should consider that there is no such thing as a 'friendly liquidator'

**Commented [RD(DWH23):** (4.5 marks) Could also mention checking registration requirements; and whether could be an unfair preference

be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."

In considering receivables, it is a class of assets of a company present and future, is changing from time to time in the course of business and the company may carry on its business in the ordinary way until some future step is taken affecting this. While GFL had stated the charge to be fixed, it has all the characteristics of being a floating charge. It was also held in *National Westminster Bank plc v Spectrum Plus Limited and others* [2005] UKHL 41, "the essential characteristic of a floating charge which distinguished it from a fixed charge was that the asset subject to the charge was not finally appropriated as a security for the payment of the debt until the occurrence of some future event and in the meantime the chargor was left free to use the charged asset and to remove it from the security." Considering this, the liquidator should seek to have the charge be recharacterised to a floating charge. If this fails and the charge is still considered a fixed charge, all proceeds from the realisation will go to GFL as a secured creditor.

Further, Section 226 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance sets out that a floating charge will not be valid if it was created within 12 months preceding the commencement of the liquidation and the company was unable to pay its debt at the time the charge was created. A floating charge created within the 12 months can only be valid to the extent of "new money" provided to the company at the time or after creation of the charge. From the facts provided, there was no new money provided in connection with the charge and it was instead made because GFL was worried with the direction of the business. The liquidator should thus consider to have the floating charge void. If the floating charge is void, the receivership will be discharged, GFL will be an unsecured creditor with other creditors of Kite Limited and the cost and expenses of the liquidation can be paid out from the realisation of the receivables. In the event the floating charge is not void, preferential creditors must be paid out of the assets before the floating charge holder as there are insufficient assets. Unfortunately, the costs and expenses of the liquidation and a partial dividend to unsecured creditors cannot be made if the floating charge is not void.

#### 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:

**Commented [RD(DWH24):** Section 267

**Commented [RD(DWH25):** Doesn't meant there was no new money. Often with receivable financing there will be ongoing loans, not just one lump sum

**Commented [RD(DWH26):** (4.5 marks) See below, also:

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

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

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

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

Obtain documents from the company's bank (Bay Capital)

Bring an action against Mr. Qi (perhaps for breach of fiduciary duty) (Irish Shipping – but see recent decision of Nuoxi Capital which creates some uncertainty)

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

Need to investigate

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

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

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

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

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

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

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

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

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

☒ → there must be sufficient connection with Hong Kong, (not necessarily meaning the presence of assets within the jurisdiction);

☒ → there must be a reasonable possibility that the winding up order would benefit those applying for it; and

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

o → The liquidator could therefore make an application for an ancillary liquidation and it may then be possible that the new mechanism can be utilised (subject to the other criteria being met) – the mechanism making it clear that the COMI of the debtor (COMI in Hong Kong being a requirement) does not necessarily require the company to be incorporated in Hong Kong. [the answer may be because where, as here, the company is already in liquidation in its jurisdiction of incorporation, the liquidation here would be ancillary]

- (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.

An ipso facto clause is a provision in commercial contracts that allow one party to terminate a contract in the event of an insolvency or potential insolvency. The provision in the Framework Agreement (“FA”) that all other provisions are void and the assets automatically vest in Mr Qi to repay shareholder loans is in essence an ipso facto clause. Under Hong Kong Law, a contracting party can rely on an ipso facto clause. However, the Hong Kong courts will not uphold a contract term which deprives general creditors of the insolvent’s assets, that would otherwise be used to satisfy them, if the clause did not exist. This is also in line with the anti-deprivation rule that is a common law doctrine dating back to the 18<sup>th</sup> century. In applying the rule, it is necessary to look at substance over form and to consider whether the clause amounted to an illegitimate attempt to evade the relevant bankruptcy law. In *Peregrine Investments Holdings Ltd v Asian Infrastructure Fund Management Co Ltd [2004] 1 HKLRD 598*, the court stated: “...no one can be allowed to derive a benefit from a contract that is in fraud of the insolvency laws...The mischief sought to be avoided by the application of the principle is that of permitting contractual arrangements taking effect which would give the contractors an advantage at the expense of creditors where there was an insolvency.” The liquidator should therefore have the provision set aside in order to proceed with the orderly liquidation of SPL.

As there are no statutory provisions for cross-border insolvency in Hong Kong law, common law applies to **recognition** of foreign officeholders. It was further affirmed in *Joint Official Liquidators of A Co v B & C* that the Hong Kong courts, if issued with a formal letter of request to provide assistance from a foreign court, may recognise foreign insolvency proceedings and provide assistance in their discretion in accordance with the principle of modified universalism. In Hong Kong, foreign liquidators have been granted orders with a range of terms to support their investigation in the country and these can include:

- a) the freezing and/or seizure of assets, books and accounts of a foreign company located in Hong Kong;
- b) the oral examination of officers and other parties located in Hong Kong in relation to the affairs of the foreign company; and
- c) the production of documents and information by creditors of the foreign company and other parties located in Hong Kong.

**Commented [RD(DWH27)]:** Some steps could be taken without recognition (e.g. documents from bank (Bay Capital)), sue Mr Qi

The liquidator of SPL should therefore seek for a recognition order from the Hong Kong courts to assist in his investigation of the officers of SPL as well as to inquire into the bank account in Hong Kong.

The new co-operation mechanism between Hong Kong and the Mainland allows insolvency representatives appointed in Hong Kong to apply for recognition and assistance in the pilot areas of Shanghai, Xiamen and Shenzhen and vice versa. The cooperation mechanism applies to collective insolvency proceedings commenced in Hong Kong and will only apply to proceedings in which the debtor's centre of main interest is in Hong Kong continuously for at least 6 months. There also must be a connection between the debtor and the pilot areas e.g. company's principal assets are located in the pilot area or it has a place of business there. As the liquidator of SPL was appointed in BVI and SPL was incorporated in BVI, the cooperation mechanism would not be helpful. Furthermore, the liquidator is unaware of the location of the assets and as the cooperation mechanism only applies to three areas of the Mainland, this again would not be helpful. The liquidator should instead seek for recognition and entitlement to deal with the company's assets in the Mainland by applying directly to the courts of the Mainland.

**\* End of Assessment \***

**TOTAL MARKS: 43.5 out of 50**

Commented [RD(DWH28)]: Could do ancillary liquidation

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(4.5 marks) See below, also:

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

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

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

Whether L is properly appointed would be a matter for BVI law

L will be able to take certain steps in Hong Kong without a formal recognition order

Obtain documents from the company's bank (Bay Capital)

Bring an action against Mr. Qi (perhaps for breach of fiduciary duty) (Irish Shipping – but see recent decision of Nuoxi Capital which creates some uncertainty)

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

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

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

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

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

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

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

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

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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].