



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

**HONG KONG**

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

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

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

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

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

## ANSWER ALL THE QUESTIONS

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

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

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

#### Question 1.1

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

A receiver can be appointed –

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

**(d) any of the above.**

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

#### Question 1.2

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

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

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

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

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

#### Question 1.3

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

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

(c) As a matter of common law, the Hong Kong court has the right wind up such a company.

(d) The Hong Kong court has a statutory jurisdiction to wind up such a company, and can exercise that jurisdiction if certain requirements are met.

**Commented [RD(DWH3):** Correct (1 mark) – s.327 CWUMPO (section 7 of text).

#### Question 1.4

Select the **correct** answer:

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

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

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

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

**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.

## 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?

There is no express definition of the term “debtor” in the Bankruptcy Ordinance (Cap 6)(BO). However, to qualify as a debtor under the BO the debtor must be an individual and, pursuant to section 4 of the BO, must:

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

### Question 2.2 [maximum 3 marks]

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

In order to wind up an unregistered company in Hong Kong, the petitioner must satisfy the court that the non-Hong Kong company is sufficiently connected to Hong Kong by satisfying the “three core requirements” set out below. These 3 core requirements was discussed in the CFA’s decision in *Re Yung Kee*.

- (a) **there must be sufficient connection with Hong Kong, (not necessarily meaning the presence of assets within the jurisdiction).** The assets referred here could be of any nature i.e. a listing in Hong Kong stock exchange. If there are no assets, link of genuine substance between the company and the jurisdiction such as business activities carried out by the company within the jurisdiction would be considered. The connection can be a shareholders’ connection as well if the winding up arises from shareholders disputes.
- (b) **there must be a reasonable possibility that the winding up order would benefit those applying for it.** In recent years, the court will expect to receive expert evidence that there is real prospect of a material financial benefit to creditors from realisation of the listing if the second core requirement is to be satisfied on that ground.
- (c) **the court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company’s assets.** The creditors presenting the petition must be subject to the court jurisdiction by virtue of having a place of residence in Hong Kong, employment, having obtained a Hong Kong judgement or having a place of business.

If sufficient connection is established via the three core requirements, the jurisdiction to wind up will remain even after the matters giving rise to that original connection have ceased to exist. This is to prevent unregistered companies from, for example, removing assets from Hong Kong so as to argue that the three core requirements are not satisfied.

**Commented [RD(DWH10):** Correct (1 mark) – Hong Kong has not enacted UNCITRAL; the Ministry of Justice in Beijing would not be involved (“1 country, 2 systems”); the courts have developed a practice of giving recognition to foreign office holders in certain circumstances.

**Commented [RD(DWH11):** (3 marks)

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

**Question 2.3 [maximum 4 marks]**

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

Provisional liquidation" is a commonly used term, but under Hong Kong law it technically does not exist. A company is either in liquidation or it is not. The term is, however, used where provisional liquidators have been appointed pursuant to section 193 of CWUMPO.

A provisional liquidator can be appointed in the following circumstances:

1. Voluntary liquidation pursuant to section 228A of CWUMPO.
  - the directors may resolve to wind up the company at the meeting of the creditors when they are of the opinion that the company should be wound up with immediate effect by the reason of its inability to continue business and appoint a person as the provisional liquidator in the winding up of the company with effect from the commencement of the winding up.
2. Compulsory winding up by court
  - An application to appoint a provisional liquidator may be made any time after a petition has been presented, although in urgent cases the application may be made at the same time as the petition. The Court may appoint a provisional liquidator at any time after the presentation of the petition and before the making of the winding up order.

The provisional liquidator is appointed for various purposes, amongst others are as follows:

- The court may limit and restrict the provisional liquidator's powers by the order of appointing him (CWUMPO Section 193).
- The purpose of appointing a provisional liquidator pending the winding up order is to preserve the assets of the company (except where it is necessary to preserve the value by realizing it, the provisional liquidator shall make an application to the court for such disposal).
- Provisional liquidator can also be appointed to help facilitate a restructuring proposal, although that cannot be the only reason for appointment
- There must be sufficient circumstances justifying the appointment of provisional liquidator, for example if there is a risk that assets will be dissipated, or otherwise be in jeopardy, before a winding up order is made. Factors taken into account by the court include commercial realities, the degree of urgency, the need for the order and the balance of convenience.
- The court may also terminate the appointment of provisional liquidator on an application by provisional liquidator, the Official Receiver, a creditor, a contributory, the petitioner or the company.
- The court has jurisdiction to appoint provisional liquidators despite the appointment of voluntary liquidators.

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

**Question 3.1 [maximum 5 marks]**

**Commented [RD(DWH13):** (4 marks). Good answer, but should really also refer to need to show likely that the company will be wound up on hearing of petition

**Commented [RD(DWH14):** (3.5 marks) Need to say "why". Reason is the pari passu principle and that all creditors should be treated fairly amongst themselves. Also, see note below

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.

Pursuant to section 266 of CWUMPO, unfair preference happens when an insolvent company give preference to a particular creditor, surety or guarantor by allowing them to be in a better position than it would have been upon the company's insolvency. If the unfair preference was given during the relevant time, the liquidator may make an application to the court to restoring the position to what it would have been if the company had not given that unfair preference. This power is exercisable by liquidators appointed in either voluntary winding up or compulsory winding up proceedings.

The relevant time referred herein is 6 months prior to commencement of winding up if the unfair preference was given to a connected person and for non-connected person is 2 years prior to commencement of winding up.

Commented [RD(DWH15)]: Other way round

In order for the liquidator of the company to make an application to restore the position, the liquidator must satisfy the court that at the time the asserted unfair preference was given, the company was unable to pay its debts or became unable to pay its debts as a result of the transaction concerned. Further the liquidator also must prove that the company was "influenced by a desire" to improve that person's position in the event of a liquidation. 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, unless the contrary is shown, to have been influenced by desire. Generally, it is difficult to prove that the unfair preference was given due to "it was influenced by a desire" to improve the position of that creditor. The difficulties in demonstrating the desire were discussed in the Stanley Hau case.

When the liquidator succeeds in proving an unfair preference was given, the court may make an order on the application of the liquidator to:

- vesting in the liquidator the property which is the subject of the unfair preference;
- releasing or discharging security given by the company;
- directing any person to pay to the liquidators any benefits received from the company;
- reviving the obligation of any surety or guarantor which had been released or discharged; and
- providing security for the discharge of any obligation imposed by or arising under the order.

### Question 3.2 [maximum 5 marks]

Commented [RD(DWH16)]: (4.5 marks) A bit confusing at the start

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.

Hong Kong's insolvency legislation does not contain any provision dealing with cross border insolvency. Hong Kong has not adopted the UNCITRAL Model Law on Cross-Border Insolvency, and is not a party of any international treaties that deal with cross- border insolvency. Further, there are also no bilateral agreements with other countries. Even though there is lack in legislation to deal with cross border insolvency, the Hong Kong court always followed common law principles. Usually Hong Kong Court has been. Keen to assist foreign representatives by relying on common law principles.



Since the Handover in 1997, the English court has at least on one occasion applied this section

**Commented [RD(DWH17):** No, this is the UK provision that has been applied

Mainland mean any part of china other than Hong Kong, Macau and Taiwan. Getting recognition in the PRC usually will be difficult for Hong Kong officeholders over the years. However, the Hong Kong court with certain assistance from the PRC courts addressed certain of these issues by way of common law development and there is now the co-operation mechanism. As regard to the common law developments, when the Hong Kong court gave its first written decision in respect of recognition (the A v B case), the court referred to a request from a "common law jurisdiction with a similar substantive insolvency law".

The Hong Kong court has on at least two occasions now recognised the appointment of officeholders appointed in the Mainland (PRC) notwithstanding that the PRC is not a common law jurisdiction. The court was nevertheless satisfied that PRC insolvency law provided for a collective process. As regards to the common law, the court on CEFC decision commented that under PRC law, for other proceedings (including from Hong Kong) to be recognised in the PRC there is the need for reciprocity.

In that context, while recognising the appointment the court commented that "while the principles that govern common law recognition and assistance did not require reciprocity to be demonstrated, the extent to which greater assistance should be provided to Mainland Chinese administrators in future would be decided on a case-by-case basis and the development of recognition was likely to be influenced by the extent to which the court was satisfied that the Mainland promoted a unitary approach to transnational insolvencies.

In May 2021, a new arrangement namely the co-operation mechanism between Hong Kong and certain areas of the Mainland PRC were introduced. This originating from records of meeting between representatives of the Supreme Court in the Mainland and of the Hong Kong Government. The "record of meeting" is stated to be based on furthering the intent of Article 95 of the Basic Law which provides that "The Hong Kong Special Administrative Region may, through consultations and in accordance with law, maintain juridical relations with the judicial organs of other parts of the country, and they may render assistance to each other. The new arrangement refer to mutual recognition of and assistance to "bankruptcy proceedings" between Hong Kong and the Mainland. The certain areas of the Mainland PRC have been designated as pilot areas for new co-operation mechanism between Hong Kong and Mainland. The record of meeting is substituted by an opinion of the Supreme Court which includes the following:

A) The certain areas of the Mainland PRC which are designated as pilot areas are as follows:

- Shanghai Municipality
- Xiamen Municipality of Fujian Province, and
- Shenzhen Municipality of Guangdong Province

b) The proceedings fall under the new arrangements are any collective insolvency proceedings commenced under CWUMPO or the CO and includes compulsory liquidations, creditors' voluntary liquidations and schemes of arrangement which are promoted by a liquidator or provisional liquidator;

c) The debtor's centre of main interest must be in Hong Kong, with the Opinion stating that "Centre of main interests" for these purposes generally means the place of incorporation of the debtor but adding "at the same time, the people's court shall take into account other factors including the place of principal office, the principal place of business, the place of principal assets etc. of the debtor. When a Hong Kong Administrator applies for recognition and

assistance, the centre of main interests of the debtor shall have been in the Hong Kong Special Administrative Region continuously for at least 6 months".

d) If the debtor's principal assets in the Mainland are in a pilot area, or it has a place of business or a representative office in a pilot area, the Hong Kong Administrator may apply for recognition of and assistance to the Hong Kong Insolvency Proceedings in accordance with this Opinion."

e) A letter of request from the Hong Kong court is necessary.

This new arrangement provides a mechanism for Hong Kong officeholders to obtain recognition and assistance in those areas of the Mainland, and for Mainland office-holders to obtain recognition and assistance in Hong Kong.

### 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.

Scheme of Arrangement allows companies to make binding compromises or arrangements with their members and / or creditors (or any class of them), including adjustment of debts owed to its creditors or reduction of share capital. The legislative provisions relating to schemes of arrangement are found in the Companies Ordinance and Rules of the High Court. This is only mechanism available for corporate rescue in Hong Kong.

Despite the only formal mechanism available in the Companies Ordinance, the informal work-outs are quite common in Hong Kong. However, there is no set, formal, structure for such consensual work-out. Back in 1999 Hong Kong Monetary Authority together with Hong Kong Association of Banks have issued a guideline called "Hong Kong Approach to Corporate Difficulties". This guideline do give an indication of the approach that has been taken in Hong Kong in the past and furthermore, the guidelines will also likely have had some influence on decisions made by the Hong Kong court at that time and is useful background when considering the proposed reforms relating to corporate rescue in Hong Kong because those proposals originated around the same time.

The flexibility of the common law, combined with the creativity of Hong Kong practitioners and the support of the Hong Kong courts to assist in arriving at practical solutions, resulted in use of the tools that do exist to achieve similar aims despite the lack of corporate rescue legislation as compare to the other region. One of the weakness of the Scheme of Arrangement is it does not provide the company a protection from actions taken by creditors against the company while the company work-out the scheme of arrangement. In order to overcome this weakness and at the same time having advantage to restructure the debts the subject company usually present a petition of winding up of the company and an application for appointment of provisional liquidator will be made for to to investigate the possibility of and, if viable, promulgate a restructuring of the company's debts. The moratorium is then obtained by reason of section 182 of CWUMPO.

The scheme of arrangement is only be effective if the following procedures or stages are completed:

- an application is made for leave to convene meetings of the relevant creditors to consider, and if thought fit, approve the schemes. Such application is heard by the court (the

**Commented [RD(DWH18)]:** (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)  
Should reference the court involvement, scrutiny of explanatory statement etc

- convening hearing) whereat the court will give directions for giving notice of and advertising such meetings (the scheme meetings);
- the scheme meetings take place and the results of such meeting(s) are reported to the court; and
  - an application is made by petition for the court to sanction the scheme.

There are pros and cons around in applying the scheme or arrangement.

The company which are going for scheme of arrangement still expose to the actions taken by the creditors as there is no moratorium on creditors from taking actions against the subject company. However, the Rules of the High court have subsequently been amended which now provide the court's case management powers include a specific power to stay proceedings.

Insolvency is not required for a scheme of arrangement and can be used when a scheme is sanctioned by the court under a liquidator or a private Liquidator is appointed. The company's management can implement the scheme.

Schemes also overcome the issue of where certain creditor may be holding out, to seek unfair advantage like additional payments as against other majority of creditors of similar ranking.

For debt restructuring purposes, a scheme of arrangement allows companies and their creditors to compromise or adjust debts if stipulated majorities (majority in number representing at least 75% by value of the creditors present and voting) of the relevant creditors approve such compromise or adjustment and the court sanctions such arrangement. However, without a scheme of arrangement, a company would need to obtain the approval of 100% of the relevant creditors to contractually vary the debt. Schemes are therefore necessary where a company seeks to adjust debts with many creditors at the same time in circumstances where it would be difficult or impossible to seek unanimous consent of all creditors. Schemes are also useful where there may be hold-out creditors who seek an unfair advantage (for example, additional payment) as against a substantial majority of similarly ranked creditors.

One further issue that is worth mentioning in the context of schemes (as it has become increasingly common) is the issue of dealing with the obligations of third parties, such as guarantors. Conceptually it is not immediately obvious that releases obligations of third parties such as guarantors in favour of such parties should be available through the scheme mechanism (given it is a statutory arrangement between the parties to it). However, the practice has developed whereby a company through a scheme may cause the release of its creditors' claims under guarantees provided by third parties where the guarantees are in respect of the debt being compromised under the scheme. This position is now well established under English law.

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

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

**Commented [RD(DWH19):** (4 marks) but see note below

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 Mr. Chan's information Mountainview Limited has financial difficulties and is unlikely to be able to continue in business. Mr. Chan have the following options:

1. Voluntary liquidation
2. Compulsory liquidation
3. Scheme of Arrangement

1. There are two type of voluntary liquidation and the mode will be determine based on the solvency test.

#### A. Members' Voluntary Liquidation

Company can be wound up voluntarily by members when the directors declared that the company is able to settle all liabilities within 12 months from the commencement of the liquidation by signing "certificate of solvency". Thereafter the shareholders will be passing a special resolution for winding up of the company and appointing liquidator. The liquidation commences on the date the special resolution is passed by shareholders. The liquidator will take control of the business of the company from the director and will investigate the affairs of the company and the conduct of the director(s); and realise assets in order to effect payment to the creditors and then shareholders. The liquidator's fees will be paid out of the assets of the company. The surplus after paying liquidator's fees and expenses and the company's creditors. Such surplus will be distributed to the shareholders of the company.

#### B. Creditors Voluntary liquidation

As compare to members voluntary liquidation, creditors voluntary liquidation happens when the company is insolvent and the company decides to put itself into voluntary liquidation. The directors will convene a meeting of shareholders in order to pass a special resolution for the winding up of the company. The liquidation will commence on the date the special resolution passed by the company. Subsequent to the meeting of shareholders, a creditors meeting will be convened within 14 days after the meeting of shareholders. The company required to give the notice of the creditors meeting atleast 7 days before the meeting and the notice must be advertised in Hong Kong gazette, English and Chinese newspapers. For the purpose of the creditors meeting a statement of affairs of the company should be laid to the creditor and the director shall appoint one of their number to attend the meeting. During the creditors meeting the creditors will nominate and vote for the appointment of a liquidator. The creditors nominated liquidator will prevail if the nomination is different from the company's nomination.

It also important to note that once the company have decided to convene the shareholders and creditors meeting, the directors should take steps to protect the assets of the company pending the meeting of creditors. The reason being once the company is become insolvent the director's duties should be for the best interest of the creditors. The CVL process is less costs and time-consuming compare to compulsory liquidation. A ad valorem duty payable on realisations in a compulsory liquidation is not payable in a voluntary liquidation.

The company also can opt for appointment of provisional liquidator by going through section 228A when there is a case of urgency. The rationale is to speed up the appointment of a liquidator in emergency cases, for example where perishable goods are involved

2. Compulsory liquidation

Compulsory liquidation occurs when a company is wound up by an order of the High Court following a petition presented at court. The most common ground to file petition is when the company is unable to pay its debts. A company can present a petition to wind up itself, and the court also has jurisdiction to wind up on the petition of a shareholder and on the ground it is just and equitable to do so. In this case the court will appoint a liquidator who would then take control over the conduct of the company, collect assets and distribute any proceeds. The company has no influence over which liquidator is appointed. In a compulsory liquidation, following the winding up order, the Official Receiver will be appointed the provisional liquidator of the company unless a provisional liquidator has already been appointed under section 193 of CWUMPO in which case that person will continue in office. Such continuation does not require an application to court.

### 3. Scheme of arrangement

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

Generally the role and powers of liquidators appointed through voluntary and compulsory will be the same which are as follow:

- a) wind up the company's business, realising the assets and distributing dividends to interested parties;
- b) to take over control of the company including its assets and accounting records and investigate the causes of the company's failure and the conduct of those concerned in its dealings and affairs. This role serves a wider public interest in enabling the authorities to take appropriate action against those guilty of misconduct in relation to the company
- c) investigate transactions or payments made by the company within a certain period prior to the date of winding up to determine whether these transactions should be avoided.

The powers of the liquidator are set out in section 199 and Schedule 25 of CWUMPO. Certain of those powers require approval from a committee of inspection (if appointed) or the court.

Despite the mode of appointment of liquidator, the liquidator act impartially and should be independent. As such appointing a friendly liquidator does not make any difference as the appointed liquidator is required to perform his duties in accordance with companies act.

#### 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(DWH20):** But a company cannot petition on the basis of a resolution by directors alone (Emmadart) and there is no indication that Mr. Chan is (necessarily) the only shareholder)

**Commented [RD(DWH21):** (4.5 marks) All good points, but not in the nature of advice

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.

The liquidator needs to consider the following issues:

- A. Registration of the charge
- B. Is the charge fixed or floating in nature?
- C. Preferential claims paid through floating charge realisations
- D. Validity of the floating charge in case of liquidation
- E. Unfair preferences

The issues are discussed below:

A. Registration of charge

Section 334 requires the charges to be registered. These includes books debts/receivables. The charges which are not registered properly in Hong Kong can be void by the liquidator and the liquidator can claim back the charged assets. Pursuant to section 335 the charge which required registration shall be registered within 1 month of the date of its execution.

B. Is the charge fixed or floating in nature

Kite have granted receivables as fixed charge. Fixed charge is charge in relation to specific assets and the debtor cannot deal with the assets without the consent of the chargee creditor. Receivables should be classified as floating charge. The debtor can continue use the floating charge during the business operation. The floating charge operates as an immediate security interest but, until a crystallisation event occurs hence the ability if the debtor to continue using the assets within the relevant time. Further in this case GFL have allowed the debtor to continue trade with its customers as before using its normal operating account without separate account being opened. By conduct of GFL, the charge should classified as floating charge.

**Commented [RD(DWH22):** Can be possible (segregated account; bank permission needed to use etc.) but would be rare

C. Preferential claims paid through floating charge realisation

CWUMPO section 79 provides that the preferential claims must be met out of floating charge realisations even if there is no liquidation at the time. Section 265(3B) clarifies that where there is a liquidation, the preferential claims are paid out of floating charge realisation to the extent that there insufficient "uncharged" assets available to the liquidator. GFL have tried to create preference over the preferential creditors by creating fixed charge.

**Commented [RD(DWH23):** ...because court will consider substance over form

D. Validity of floating charge in case of liquidation

Floating charge that is created within a certain period before the commencement of the liquidation may be void. Pursuant to section 267 and 267A of CWUMPO, a floating charge given by a company is void (except as to “new money” provided) if it is created within two years of the commencement of the winding up (in favour of a person connected to the company) or one year (for any other person). The company was wound up after the charge was created as such it is important to note the period between the charge created and the commencement of winding up of Kite.

#### E. Unfair preferences

unfair preference occurs when an insolvent company acts to place a creditor (or guarantor) in a better position than it would have been upon the company’s insolvency. The liquidators of a company may make an application to set aside such transactions. The relevant transactions include granting of security as well as payments etc., where such transactions were entered into during the period of six months prior to the commencement of winding up, or two years where the beneficiary under the transaction was “a person connected to the company”. The liquidator require to prove that, at the time the unfair preference was given, the company was unable to pay its debts or became unable to pay its debts as a result of the transaction concerned. If a transaction is proved to be an unfair preference pursuant to section 266 of CWUMPO, the orders which may be made by the court include:

- vesting in the liquidator the property which is the subject of the unfair preference;
- releasing or discharging security given by the company
- directing any person to pay to the liquidators any benefits received from the company;
- reviving the obligation of any surety or guarantor which had been released or discharged; and
- providing security for the discharge of any obligation imposed by or arising under the order

In this case the liquidator can void the charge and realise the assets for the unsecured creditors.

#### 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 Xu 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.

**Commented [RD(DWH24)]:** If L wins

**Commented [RD(DWH25)]:** (4 marks) Most elements present but disjointed

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The 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.

Hong Kong always followed common law principles where no formal order is required for recognition of foreign Liquidator in Hong Kong. The liquidator must give a letter of request to the Hong Kong court, issued by the foreign court and request for recognition and assistance.

Commented [RD(DWH26): Consistent?

By virtue of the FA is governed by Hong Kong law it has established a connection to Hong Kong and hence laws of Hong Kong will apply.

In *A Co v B* (a 2014 decision), the court dealt with an application by liquidators appointed in the Cayman Islands who sought, inter alia, a Hong Kong order to recognise their appointment and an order for the production of documents from certain (unnamed) respondents. The court stated the following:

“18. In my view the Hong Kong Companies court can and should adopt a similar approach to applications for recognition and assistance to that described in paragraph 60 of *Kawaley J’s* judgment.<sup>329</sup> The Companies court may pursuant to a letter of request from a common law jurisdiction with a similar substantive insolvency law make an order of a type which is available to a provisional liquidator or liquidator under Hong Kong’s insolvency regime. For this reason I granted the orders referred to at the beginning of this decision.”

The liquidator may also seek for recognition order to permit the foreign liquidator to seek production of documents or examination of individuals in Hong Kong such as the director, Mr Zhang and Mr Wong who is a book-keeper who lives in Hong Kong

In *Bay Capital Asia Fund LP (In Official Liquidation) v DBS Bank (Hong Kong) Unreported*, HCMP 3104/2015, 2 November 2016. See *Re Rennie Produce (Aust) Pty Ltd* (unreported, HCMP, 3560/2016, 26 August 2016) the court have given stated that the banks in Hong Kong should readily assist foreign representatives by providing documents in relation to the company’s own accounts even without the foreign representative having to first obtain a Hong Kong court order.



A “standard order” that a foreign representative could expect to obtain in Hong Kong has been established in Centaur decision but was further refined in the Pacific Andes matter (HCMP3560/2016). It is important to note that the order is limited by a proviso that any power sought to be exercised in Hong Kong must be subject to the powers available to the liquidators in their “home” jurisdiction.

If the foreign liquidator wishes to exercise power to deal with Hong Kong assets (such as balances in Hong Kong bank accounts), the liquidator should apply for a specific recognition order for this purpose. Even though the foreign liquidator is allowed to obtain bank account documents without court order, in order to balance the foreign representative’s need for convenience and the need for court supervision which creditors may expect and concluded that if foreign representatives propose to take possession of assets in Hong Kong, it would be appropriate for the foreign liquidator to first obtain a recognition in order to deal with the Hong Kong assets.

As for the contract entered by the company, the liquidator is required to consider the contracts whether they may form part of the company’s assets if the contract can be assigned for value. There are no rules for treatment on insolvency of executory contracts at common law. A contractual clause that provides for the determination or modification of a contract upon the insolvency of the counterparty will typically be upheld (that is, ipso facto clauses), although there are limits to this. Generally the court will not uphold a contract term which results in general creditors being deprived of an asset that would, in the absence of the clause, be used to satisfy their debts; which is called the anti-deprivation principle.

This is not to say that every clause which sees an asset falling beyond the reach of general creditors will be struck down. Although the language and effect of a clause will be considered on a case-by-case basis, the courts have developed a set of factors that will assist in determining if the anti-deprivation principle has been violated. Such factors include:

- (i) is the intention to evade insolvency laws?
- (ii) does the clause operate in situations other than upon insolvency?;
- (iii) is the asset concerned “flawed”?

In this case, it is evident by the clause in FA which 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, was solely for the benefit the shareholder and not the creditors.

As the FA clause is contravening to the anti-deprivation principle and further the liquidator has the power to disclaim the onerous contract, this should address the liquidator’s concern highlighted in (a) above.

The Liquidator can **claim assets from the Mainland** under the cooperation mechanism after recognition in Hong Kong.

**Commented [RD(DWH27):** Only if in pilot areas and other provisions met

In May 2021, a new arrangement namely the co-operation mechanism between Hong Kong and certain areas of the Mainland PRC were introduced. This originating from records of meeting between representatives of the Supreme Court in the Mainland and of the Hong Kong Government. The “record of meeting” is stated to be based on furthering the intent of Article 95 of the Basic Law which provides that “The Hong Kong Special Administrative Region may, through consultations and in accordance with law, maintain juridical relations with the judicial organs of other parts of the country, and they may render assistance to each other. The new arrangement refer to mutual recognition of and assistance to “bankruptcy proceedings” between Hong Kong and the Mainland. The certain areas of the Mainland PRC have been

designated as pilot areas for new co-operation mechanism between Hong Kong and Mainland. The record of meeting is substituted by an opinion of the Supreme Court which includes the following:

B) The certain areas of the Mainland PRC which are designated as pilot areas are as follows:

- Shanghai Municipality
- Xiamen Municipality of Fujian Province, and
- Shenzhen Municipality of Guangdong Province

b) The proceedings fall under the new arrangements are any collective insolvency proceedings commenced under CWUMPO or the CO and includes compulsory liquidations, creditors' voluntary liquidations and schemes of arrangement which are promoted by a liquidator or provisional liquidator;

c) The debtor's centre of main interest must be in Hong Kong, with the Opinion stating that "Centre of main interests" for these purposes generally means the place of incorporation of the debtor but adding "at the same time, the people's court shall take into account other factors including the place of principal office, the principal place of business, the place of principal assets etc. of the debtor. When a Hong Kong Administrator applies for recognition and assistance, the centre of main interests of the debtor shall have been in the Hong Kong Special Administrative Region continuously for at least 6 months".

d) If the debtor's principal assets in the Mainland are in a pilot area, or it has a place of business or a representative office in a pilot area, the Hong Kong Administrator may apply for recognition of and assistance to the Hong Kong Insolvency Proceedings in accordance with this Opinion."

e) A letter of request from the Hong Kong court is necessary.

This new arrangement provides a mechanism for Hong Kong officeholders to obtain recognition and assistance in those areas of the Mainland, and for Mainland office-holders to obtain recognition and assistance in Hong Kong.

The liquidator first needs to obtain recognition in Hong Kong using the common law principles and also the connection to Hong Kong. These is because the FA is governed under the Hong Kong law and further the director and book keeper reside in Hong Kong and also the company has bank account in Hong Kong.

Once the recognition order obtained which includes production of documents and examination of director Mr Zhang and Mr Wong who is a book-keeper, the liquidator can review the books and records of the company to identify the assets of the company. Once the location of the assets has been identified in Mainland he can then apply for recognition in the mainland and realize the assets for the benefit of the creditors. The cash in the bank account in Hong Kong also can be realized once the liquidator obtain the recognition order from Hong Kong court to deal with the assets of the company in Hong Kong.

**\* End of Assessment \***

**TOTAL MARKS: 44.5 out of 50**

**Please note that the marker for this assessment has flagged possible copying with student 606. I have checked and you both work for the same company. I realise of course that you may have worked together, but this is the risk you take if answers are**

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similar or the same. At this point no action is being taken; however, if other markers flag a similar issue I will have no choice but to investigate further by appointing a sub-committee of the Course Committee to look into this. David Burdette (Course Leader)