



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 8C

HONG KONG

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

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

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

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

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
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3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
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6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

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

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

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

Question 1.1

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

A receiver can be appointed –

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

(d) any of the above.

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

Question 1.2

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

- (a) It depends on whether the person with whom the bankrupt transacted is an associate of his or not.
- (b) Two (2) years before the date of the bankruptcy order.
- (c) Five (5) years before the date of the petition on which the bankruptcy order was made.

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

Commented [RD(DWH2): Incorrect (0 marks) - 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 (see 6.2.2 of text) and s.51(1)(a) Bankruptcy Ordinance

Question 1.3

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

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

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

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

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

Question 1.4

Select the **correct** answer:

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

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

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

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

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

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

Question 1.5

Select the **correct** answer:

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

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

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

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

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

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

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

Question 1.6

Select the **correct** answer:

Hong Kong legislation provides a statutory definition of insolvency in –

(a) the Companies Ordinance (Cap 622).

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

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

(d) none of above.

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

Question 1.7

Select the **correct** answer:

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

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

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

Question 1.8

Select the **correct** answer:

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

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

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

Question 1.9

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

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

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

Question 1.10

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

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

(c) No recognition is possible.

(d) None of the above.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks]

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

Pursuant to section 4 of the Bankruptcy Ordinance, in order for the Hong Kong court to exercise its bankruptcy jurisdiction over a debtor, the debtor must be an individual and:

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

The Hong Kong court can exercise its jurisdiction to wind up companies that are not incorporated or registered in Hong Kong if three core requirements are met. In order to exercise this jurisdiction, the Hong Kong court must be satisfied that:

- (i) there is a sufficient connection with Hong Kong which does not necessarily mean the presence of assets within the jurisdiction;
- (ii) there is a reasonable possibility that the winding up order would benefit those applying for it; and
- (iii) it is able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets.

In terms of the sufficient connection, the company's assets could be assets of any nature and if there are no assets, a link of genuine substance between the company and Hong Kong such as business activities carried out by the company in Hong Kong would be considered.

A court will not act in vain and for the second requirement, it must be shown that the liquidation would benefit the petitioner. The court has held that this requirement cannot be dispensed with or moderated but ordinarily it would be easier to satisfy this requirement if the company has assets in Hong Kong. The situation becomes somewhat more difficult if the company has no assets in Hong Kong because it becomes more difficult to prove that the liquidation will benefit the petitioner.

For the third requirement, the Hong Kong court must be satisfied that there are persons with sufficient connection with Hong Kong that would have sufficient economic interest in the

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)

winding up of the company to justify making an order pursuant to the winding up process in Hong Kong.

Question 2.3 [maximum 4 marks]

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

Provisional liquidation does not technically exist under Hong Kong law but is generally used where a provisional liquidator has been appointed under section 193 of CWUMPO. A provisional liquidator can be appointed at any time after a petition for the liquidation of a company has been made and before it is determined. In urgent cases, an application for an appointment of a provisional liquidator can be made at the same time as the petition for the liquidation of the company.

Before making an order to appoint provisional liquidators, the court must be satisfied that there are sufficient circumstances justifying the appointment of a provisional liquidator. These instances may include those where there is a risk that the company's assets will be dissipated before the winding up order is made or where there is a need for supervision and control.

A provisional liquidator may be appointed to preserve the company's assets between the period after his appointment and the making of a liquidation order. A provisional liquidator may also be appointed to help facilitate a restructuring proposal although this cannot be the only reason for his appointment. In certain restructuring proposals, the debtor company will be wary of sharing otherwise detrimental and/or confidential and/or privileged information with its creditors but may be more comfortable doing so with a provisional liquidator who will then be able to report back to the court and subject to certain non-disclosure agreements, the creditors, on the progress of the restructuring proposals.

There are therefore numerous benefits in the appointment of provisional liquidators.

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

Question 3.1 [maximum 5 marks]

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

An 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. These acts may be voidable in certain circumstances and may be challenged by a liquidator who may make an application to set them aside. A liquidator is able to take action to challenge an unfair preference as these typically reduce the pool of assets available for distribution to the creditors of the company in an insolvency.

A liquidator may challenge an unfair preference in either voluntary or compulsory winding up proceedings. A liquidator is able to challenge an unfair preference where the transaction occurred within a period of six months prior to the commencement of the winding up or in the case of a person connected to the company, two years.

In order for the liquidator to challenge an unfair preference, the liquidator must satisfy the court that at the time the unfair preference/transaction occurred, the company was insolvent

Commented [RD(DWH13): (3.5 marks). Should refer to powers being prescribed by the Court and need to show likely to be wound up when petition is heard

Commented [RD(DWH14): (5 marks)

or became insolvent as a result of the unfair preference. However, the threshold is much lower when the transaction is made with a person who is connected to the company. Where a person is connected to the company it is presumed that there was an unfair preference although the recipient of the transaction may challenge that presumption. The liquidator must also prove that the company was influenced by a desire to improve the recipient's position in the event of a liquidation.

If the liquidator is successful in his application to set aside a transaction on the basis that it was an unfair preference, the court may make orders including:

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

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.

Hong Kong and the Mainland may be considered as one country, however, Hong Kong still applies the common law and whereas there are limited formal arrangements to deal with cross-border insolvency, the Hong Kong courts have been ready to apply common law rules in order to offer assistance in cross-border insolvency matters. This is not necessarily the case with the Mainland and judgments/insolvency proceedings in Hong Kong are typically easier to obtain recognition and enforcement abroad.

The Hong Kong courts have often offered assistance to foreign representatives using common law principles. By way of example, the Hong Kong courts have used common law principles to recognize a foreign liquidator's right to bring an action in Hong Kong, rendering assistance to foreign restructuring/reorganisation proceedings by refusing to allow enforcement of a judgment against Hong Kong assets of a company and stayed garnishee proceedings issued against a company which was subject to bankruptcy proceedings in the PRC.

Recently, there has also been implemented a new arrangement between Hong Kong and certain areas of the Mainland to facilitate cooperation in insolvency matters between Hong Kong and the designated areas. The arrangement provides a mechanism for Hong Kong officeholders to obtain recognition and assistance in the designated areas in the Mainland and reciprocal recognition and assistance in Hong Kong to officeholders from the Mainland. This is a major development because as highlighted above, the Hong Kong courts have been keen to offer assistance to foreign insolvency proceedings whereas it is not so easy to obtain recognition of an appointment in the Mainland. Therefore, technically, an appointee in the Mainland could seek recognition in Hong Kong under this new arrangement and then seek recognition and assistance in other jurisdictions based on the application of common law principles by the Hong Kong courts and the courts in other common law jurisdictions.

Commented [RD(DWH15)]: (2 marks) 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)
And Could also have referred to the pre-existing tools (e.g. s.327 and common law developments such as CEFC Shanghai)

Therefore, whereas it may be said that Hong Kong and the Mainland are one country, they have very different legal systems which provide for different mechanisms for recognition and assistance in foreign insolvency proceedings.

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 formal procedure provided under sections 668 to 677 of the Companies Ordinance of Hong Kong which enables companies to make binding compromises or arrangements with their members and/or creditors or any class of them. As the wording of the legislative provisions in Hong Kong and the United Kingdom is similar, the Hong Kong courts will generally look to English case law for guidance on how to deal with applications for schemes of arrangements.

A scheme of arrangement may be used by a company to facilitate debt restructuring, the adjustment of debts owed to its creditors or reduction of the company's share capital. A scheme enables a company and its creditors to compromise or adjust debts subject to the scheme of arrangement obtaining the necessary majority approval of relevant creditors. The advantage of a scheme in this regard is that it may be supported by the stipulated majority (that is, the majority in number representing at least 75% in value of those creditors attending (in person or by proxy) and voting) whereas without a scheme of arrangement the company would need to obtain 100% approval from its creditors in order to implement the proposed debt restructuring. A scheme of arrangement is also useful to curtail attempts by hold out creditors who seek to obtain an advantage from the company in order to agree to a proposed restructure. Non-consenting creditors can be bound by the terms of the scheme if they are within a class where the requisite majorities of scheme creditors have voted to approve the scheme.

However, one must be cautious about a scheme of arrangement as (i) the scheme can only bind creditors if the debt which is sought to be compromised is governed by Hong Kong law or the relevant creditor takes part in the scheme and (ii) there sometimes is an issue of dealing with the obligations of third parties such as guarantors who are not a party to the scheme of arrangement.

In order for a scheme of arrangement to become effective there is a three stage test process which must be employed as confirmed by the Court of Final Appeal in *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin*. Firstly, the company must make an application to the court for permission to convene meetings of the relevant creditors to consider and approve the scheme. In support of its application, the company must provide evidence by way of affirmation containing an explanatory statement, a copy of the draft scheme document and notices and advertisements given to creditors. Thereafter, if the court grants permission, the scheme meeting will take place and the result of the meeting must be communicated to the court. Provided that the company receives the necessary majority approval from the relevant creditors (as outlined above), the company is then required to make an application to the court for the sanctioning of the scheme. However, if the company does not receive the necessary approval from its creditors, the court has no jurisdiction to sanction a proposed scheme. Additionally, even if the company receives the necessary approval and satisfies the other prescribed requirements, the court still retains a discretion as to whether to sanction a scheme and is therefore not bound to do so. The court will typically sanction the scheme if it is satisfied the classes of creditors were properly constituted and it is considered that the scheme is one which an intelligent and honest

Commented [RD(DWH16): (4 marks) A good answer but misses one important feature: no 'built-in' moratorium whilst the restructuring progresses

creditor might reasonably approve. The scheme becomes effective upon its registration at the Companies Registry.

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

Question 4.1 [maximum 4 marks]

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

Based on the facts of this case, Mr Chan should consider exploring the possibility of (i) a members voluntary liquidation, (ii) creditors voluntary liquidation or (iii) pursuing a scheme of arrangement.

A members voluntary winding up can be used where the company will be able to settle all liabilities within 12 months of the commencement of the liquidation. We are not provided with enough details to ascertain whether the company will be able to do so, however, we are aware that the company “is unlikely to be able to continue in business”. In the circumstances, it may be that this option would not be a viable one for Mr Chan.

The second option is that Mr Chan could consider a creditors voluntary liquidation of the company. This procedure is useful where the company is insolvent and decides to put itself in liquidation. To employ this procedure, Mr Chan as the sole director of the company, should convene a meeting of shareholders at which they ought to consider passing a special resolution for the winding up of the company. If the shareholders are in agreement, the necessary resolution can be passed appointing the liquidator. Following his appointment, the liquidator who has limited powers at this time, will be required to convene a creditors’ meeting within 14 days of his appointment at which he is required to present a statement of affairs to the creditors. Thereafter, there are certain procedural steps that must be taken by the liquidator. The advantage of using the creditor’s voluntary liquidation procedure rather than having to go through a compulsory court liquidation is that it is much cheaper and quicker for a creditors voluntary winding up. Additionally, stamp duty payable on realizations in a compulsory liquidation is not payable in a creditors voluntary liquidation. Therefore, this would be a cheaper and quicker option for Mr Chan if he considers that the company is unlikely to be able to continue in business and will be insolvent. In terms of appointing a friendly liquidator, liquidators, whether court appointed or not, are professionals of the highest integrity and owe fiduciary duties to the company. Therefore, the liquidator once appointed will be under a duty to investigate the affairs of the company so Mr Chan would not be able to avoid this.

The third option available to Mr Chan is to consider whether the company could enter into a scheme of arrangement with its creditors and/or members. The scheme of arrangement is a formal procedure provided by the Companies Ordinance, however, it could be useful if Mr Chan proposes to restructure or reorganize Mountainview Limited in the near future. However, this would require approval from the majority of the company’s creditors representing at least 75% in value of those creditors attending (in person or by proxy) and voting). If Mr Chan pursues this route then it is likely to be more expensive and time consuming than the creditors voluntary liquidation.

Commented [RD(DWH17): (3.5 marks) Good answer but should add that a company can petition for its own winding up but not on the basis of a resolution by directors alone (Emmadart) and there is no indication that Mr. Chan is (necessarily) the only shareholder)

Should also advise that if company is insolvent owes duties to creditors ahead of the company

Mr Chan ought to ensure that he employs the right option based on the particular circumstances before him so that he is not personally liable towards the company for matters such as insolvent trading or breach of fiduciary duties.

Commented [RD(DWH18)]: No insolvent trading provisions in HK

Question 4.2 [maximum 5 marks]

Commented [RD(DWH19)]: (4.5 marks) Well written answer to which could have added: check registration of security; and consider whether could have been an unfair preference

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.

The first question is whether the charge over the receivables is a fixed or floating charge. In the case of *Re Spectrum Plus Limited* the court confirmed a three characteristic test for whether a charge is a floating charge. A charge is a floating charge: (i) if it is a charge on a class of assets of a company present and future, (ii) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time, and (iii) if 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. On the facts of the case, the charge although called a fixed charge, satisfies the first and second characteristics as it is over receivables which are present and future assets and the company continued to trade with its customers (which is expected in the import/export business) using its normal operating account. In relation to the third characteristic, the future step to be taken by GFL was the appointment of a receiver which it did. In the circumstances, the charge granted by Kite Limited was in fact a floating charge despite being termed a fixed charge.

The liquidation of Kite Limited does not affect the receiver's right to hold and/or sell the charged property, in this case, the company's receivables. The court has stated in *Buchler v Talbot* and applied in *Re Good Success Catering Group Ltd* that realisations made by the receiver out of the charged assets are not available to the liquidator for payment of the liquidation expenses. As a result, the liquidator cannot insist that the receiver hand over realisations made upon the sale of the company's receivables to meet the costs and expenses of the liquidation.

Additionally, the receiver owes a duty to GFL to act in good faith and to put GFL's interests first while ensuring that he uses reasonable skill and care when exercising his duties. As a result, there is no obligation on the receiver to make any of the realisations available to the

liquidator to pay a partial dividend to the unsecured creditors. However, considering that the company is also in liquidation, pursuant to sections 79 and 265(3B) of CWUMPO, the realisations from the assets sold by the receiver pursuant to the floating charge must be used to meet claims of preferential creditors (if any) if there are insufficient assets to meet those claims from the uncharged assets available to the liquidator. In this scenario, the receivables appear to be Kite's only asset therefore it is clear that the uncharged assets (of which there are none) will be insufficient to pay the preferential creditors. If there are any preferential creditors, then the liquidator can insist that the realisations be handed over by the receiver to pay the preferential creditors.

It is also important for the liquidator to note that where a floating charge is entered into within a period of 12 months prior to the commencement of the liquidation and the company was insolvent at the time or became insolvent as a consequence of the charge, pursuant to section 267 of CWUMPO, the floating charge will not be valid unless to the extent that new money has been provided to the company as a result of the charge. From the facts of the case, it is not clear whether Kite Limited was insolvent at the time it granted the floating charge although it was going through financial difficulties. It is also not clear whether the company became insolvent as a result of the granting of the floating charge to GFL and there is also no evidence that Kite Limited received any new money as a result of granting the floating charge. It is however clear that the floating charge was granted "some months ago" which suggests that it was granted within the 12 months period. As a result, it is likely that the liquidator will be able to make a successful application to the court to set aside the floating charge granted in favour of GFL.

Question 4.3 [maximum 6 marks]

Mr Xu entered into a Framework Agreement (FA) with his business associate, Mr Qi. The FA is governed by Hong Kong law. The idea was to develop a resort project in Fiji. The FA provided that Mr Qi would incorporate a BVI company to purchase a 100% interest in the project from its original owners. To this end, Mr Qi incorporated Sunrise Pacific Limited (SPL) in the BVI. He was (and remains) the sole director and shareholder of SPL, telling Mr Xi that this was necessary because the original developers of the resort trusted him and him alone. The FA provided that Mr Xu would inject USD 20 million into the project by advancing that sum to SPL. The FA also provided that if the project could not be developed and sold on to a buyer within a period of two (2) years from the date of the FA, then SPL will pay a sum of USD 22 million to Mr Xu (representing a return of his investment plus USD 2 million to represent interest).

Mr Xu remitted the USD 20 million to SPL but over the months that followed became concerned that the project was not progressing, with many excuses coming from Mr Qi. He subsequently discovered that the project had not even started (and may be a scam entirely). More than two (2) years has passed since the date of the FA and SPL did not pay any money to Mr Xu. Mr Xu therefore obtained a winding up order over SPL in the BVI.

The BVI liquidator appointed has identified:

- (a) There is a clause in the FA that states that if SPL becomes insolvent then all other provisions (including the requirement to pay Mr Xu) are void, and all assets automatically and immediately vest in Mr Qi in order to repay shareholder loans Mr Qi has made;

Commented [RD(DWH20)]: (5 marks)

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

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

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

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

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

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

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

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

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

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

The powers that the liquidator can then exercise in Hong Kong must be powers that he has as a liquidator in the home (i.e. BVI)

jurisdiction and that he would have if appointed as a liquidator here in Hong Kong (the Singularis principle)

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

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

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

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

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

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

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

- o 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].

- (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.

As a preliminary point, the liquidator’s concern at (a) above will need to be addressed. It is clear that in the absence of clause (a), Mr Xu would be considered as a creditor of SPL and would therefore be entitled to bring the winding up petition. Based on the terms of the FA, it appears that the clause was inserted by Mr Qi in order to provide a benefit for himself to the detriment of potential creditors of SPL. In the case of *Peregrine Investments Holdings Ltd v Asian Infrastructure Fund Management Co Ltd*, the Hong Kong Court of Appeal stated that the court will not uphold a clause in a contract where it is intended to deprive creditors of assets that would, in the absence of such a clause, be available to satisfy the creditors’ debts. In this case, it can be argued that the clause in favour of Mr Qi was inserted in order to deprive creditors of SPL in the event in of its insolvency. Therefore, it is likely that the court will not find the clause binding on Mr Xu. However, although not binding on Hong Kong, the UK Supreme Court has recently stated in *Belmont Pak Investments Pty Ltd v BNY Corporate Trustee Services Ltd* that if the clause was inserted as part of a genuine commercial transaction and not entered into with the intention of creating an advantage on the insolvency of one of the parties, then the arrangements should not be struck down as a consequence of the anti-deprivation principle. Therefore, the question of whether Mr Xu had standing to bring the winding up petition would depend on how the court interprets clause (a). In the circumstances, it is likely to find that the clause was in breach of the anti-deprivation principle.

Assuming that the court finds that Mr Xu had standing to bring the winding up petition and the liquidator has been properly appointed, as a starting point, it is first important to recognize that SPL is a BVI company, the winding up order was obtained in the BVI Court and the liquidator is a BVI appointed liquidator. Therefore, in order for the liquidator to take any steps in Hong Kong, he would need to first obtain recognition of his appointment in Hong Kong and seek the assistance of the Hong Kong court.

The liquidator may seek recognition of his assistance in Hong Kong and assistance from the Hong Kong court pursuant to common law. In the case of *Singularis Holdings v Pricewaterhouse Coopers*, the Privy Council stated that in order for a foreign liquidator to be recognized and provided assistance by the Hong Kong Court, the court must be satisfied that the power sought to be exercised or the assistance required: (i) exists in the jurisdiction of principal liquidation; and (ii) the power exists in the assisting jurisdiction. It is therefore important to consider whether each and any step to be taken by the liquidator concerns a power that exists in both the BVI and Hong Kong, however, it has been said that the insolvency regimes in BVI and Hong Kong are similar and the courts in both jurisdictions frequently offer assistance to officeholders from these jurisdictions.

Commented [RD(DWH21): Some steps could be taken without recognition (e.g. documents from bank (Bay Capital)), sue Mr Qi

In respect of (b), the liquidator may need to seek an ancillary liquidation order in Hong Kong to provide him with specific powers to conduct investigations to ascertain whether Mr Zhang is in fact a director of SPL and also whether Mr Wong is the bookkeeper of SPL. Similarly, the liquidator may need to do this for (d) in order to determine whether Mr Qi actually lives in Hong Kong as the liquidator may be able to pursue Mr Qi for personal liability in relation to the debt owed by SPL. The Hong Kong court can exercise its jurisdiction to wind up companies that are not incorporated or registered in Hong Kong if three core requirements are met. In order to exercise this jurisdiction, the Hong Kong court must be satisfied that:

- (i) there is a sufficient connection with Hong Kong which does not necessarily mean the presence of assets within the jurisdiction;
- (ii) there is a reasonable possibility that the winding up order would benefit those applying for it; and
- (iii) it is able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets.

Based on the facts of the case, it is very likely that the three core requirements will be satisfied so that the Hong Kong courts will be able to wind up SPL so that there is an ancillary liquidation order in Hong Kong to enable the liquidator to conduct further investigations.

In terms of (c) and dealing with the funds in the bank account by SPL in Hong Kong, the court in *Re China Lumena New Materials Corp (in Provisional Liquidation)* has said that the liquidator must make an application to the Hong Kong court for a specific recognition order for this purpose.

As it relates to (e), the liquidator, once recognized in Hong Kong, could then seek recognition and assistance from the Mainland pursuant to the new co-operation arrangement between Hong Kong and the Mainland. The arrangement provides a mechanism for Hong Kong officeholders to obtain recognition and assistance in certain designated areas in the Mainland. Provided that the area in the Mainland that the liquidator seeks recognition and assistance from is one of those designated in the co-operation agreement, the liquidator will be able to make use of this arrangement. In the event that the liquidator obtains recognition in the Mainland pursuant to the co-operation agreement, the liquidator will then be able to conduct investigations in order to locate any assets owned by SPL in the Mainland.

Ultimately, the options available to the liquidator will depend on him obtaining recognition in Hong Kong, following which he can take the various steps identified above in order to locate and realise assets owned by SPL in order to distribute those to the company's creditors including Mr Xu.

*** End of Assessment ***

TOTAL MARKS: 42.5 out of 50

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