



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.

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

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

Question 1.4

Select the **correct** answer:

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

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

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

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

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

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

Question 1.5

Select the **correct** answer:

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

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

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

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

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

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

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

Question 1.6

Select the **correct** answer:

Hong Kong legislation provides a statutory definition of insolvency in –

(a) the Companies Ordinance (Cap 622).

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

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

(d) none of above.

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

Question 1.7

Select the **correct** answer:

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

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

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

Question 1.8

Select the **correct** answer:

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

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

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

Question 1.9

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

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

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

Question 1.10

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

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

(c) No recognition is possible.

(d) None of the above.

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

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks]

Commented [RD(DWH11): (3 marks)

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

The jurisdictional requirements are that the debtor must be an individual, and pursuant to s. 4 of the Bankruptcy Ordinance be (a) domiciled in Hong Kong (HK); (b) be personally present in HK on the day on which the petition is presented to the court; or (c) at any time during a three year period up to the date the petition is presented, either (i) have been ordinarily resident or have had a place of residence in HK or (ii) have carried on business in HK.

Question 2.2 [maximum 3 marks]

Commented [RD(DWH12): (3 marks)

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

According to the 2015 Court of Final Appeal’s decision in *Kam Leung Sui Kwan v Kam Kwan Lai and Others* [2015] 18 HKCFAR 501 (*Re Yung Kee*), the 3 core requirements to satisfy the court that the company in question is sufficiently connected to HK are:

1. There must be sufficient connection with HK, but not necessarily in terms of assets within the jurisdiction;
2. There must be a reasonable possibility that the winding up order will benefit those applying for a winding up order; and
3. The court must be able to exercise jurisdiction over 1 or more persons interested in the distribution of the assets.

Question 2.3 [maximum 4 marks]

Commented [RD(DWH13): (3 marks). Should refer to powers being prescribed by the Court and need to show likely to be wound up when petition is heard. Also see notes below

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

Under s. 193 CWUMPO, a provisional liquidator (PL) can be appointed at any time after a petition has been presented and in urgent cases, at the same time as the petition. The Official Receiver can be appointed as provisional liquidator in the interim.

Commented [RD(DWH14): “interim” between what 2 events?

It is wrong to appoint a PL immediately prior to winding up to avoid having the Official Receiver as provisional liquidator upon the winding up order being made (*Re Kong Wah Holdings Ltd & Anor* [2001] HKCU 423).

1. Company’s voluntary liquidation under s. 228A CWUMPO (CVL): the directors resolve to wind up the company at a directors’ meeting (no shareholders’ resolution is required) and deliver a statement to the Registrar explaining why the company must be liquidated:
 - a. The company cannot continue its business in light of its liabilities;

- b. The directors consider it necessary that the company be wound up and it is not reasonably practicable for the winding to be commenced under another section of CWUMPO; and
- c. Shareholders and creditors' meetings will be summoned and held not later than 28 days from the filing of the winding up statement.

The PL must consent to his or her appointment and must either be a solicitor or professional accountant. Failure to abide by these requirements will mean the appointment is void and the person acting as PL may be fined.

The reason for CVL is to speed up the appointment of a liquidator in emergency circumstances, for example where perishable goods are involved. No court supervision is required.

2. PLs appointed under s. 193 CWUMPO are required to:
 - a. Preserve assets (but not realise assets unless the court's consent is obtained upon application) in the period between the presentation of a petition for winding up and before any order is made by the court; and/or
 - b. Help facilitate a restructuring proposal but that cannot be the sole reason for appointment, as it is likely that assets are in jeopardy. Sections 192-194 CWUMPO permit the appointment of PLs "for the purpose of winding up" the company (*Re Legend International Resorts Limited* [2006] 2 HKLRD 192).
3. Whilst a little confusing, upon a winding up order being made, a "provisional liquidator" is also appointed albeit with a different role – pending the holding of creditors' meetings. (CWUR r. 28).

Commented [RD(DWH15): Have powers, not "required to"

Commented [RD(DWH16): Rule 28 deals with pre-winding up order PLs

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

Question 3.1 [maximum 5 marks]

Commented [RD(DWH17): (4.5 marks)

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

Pursuant to ss. 266, 266A and 266B CWUMPO, when a company facing insolvency gives an unfair preference to a creditor or guarantor before it is wound up, it intends to prefer a particular creditor or guarantor or surety over other creditors. Relevant transactions include payments and granting of security entered into during the 6 month period prior to the commencement of winding up or 2 years prior to the winding up if the beneficiary of the transaction is an "associate". This term is adopted from the personal bankruptcy context under s. 51B of the Bankruptcy Ordinance (BO), giving rise to various problems with the definition being used in a corporate context. An "associate" under the BO includes but is not limited to the debtor's spouse or relative, or the spouse of a relative of the debtor or his/her spouse.

Liquidators' overarching duty

The liquidators may apply to the court to set aside such a transaction in a voluntary winding up or a compulsory winding up. They must show that:

1. 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. This criteria is presumed against a recipient who is "a person connected with the

- company” or an “associate” of the company, including an “associate” of a director or shadow director of the company, and
2. The company was “influenced by a desire” to improve that person’s position in the event of a liquidation (*Re MC Bacon* [1990] BCLC 324 and *Osman Mohammed Arab v Cashbox Credit Services Ltd* [2017] HKEC 2435).

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.

Since the Handover on 1 July 1997, Hong Kong has operated under the principle of “One Country, Two Systems”. As a Special Administrative Region, Hong Kong has been responsible for its legal system and retains the British common law approach, which is different from the civil law system in place in mainland China. Hong Kong’s insolvency legislation does not contain any provisions dealing with cross-border insolvency and it is not a party to any international treaties that deal with cross-border insolvency and it is not a party to any bilateral agreements with other countries. Instead, the Hong Kong court has followed common law principles, and a foreign liquidator’s right to bring an action in Hong Kong is well recognised (*Re Irish Shipping* [1985] HKLR 437, *Re Joint Liquidators of Nuoxi Capital Ltd* [2021] HKCFI 572).

By contrast, China has adopted an ad hoc cross-border collaboration provision in Article 5 of its Enterprise Bankruptcy Law of 2006 empowering certain Chinese courts to grant assistance to foreign bankruptcy (i.e. corporate bankruptcy) proceedings. Article 5 contains two paragraphs: the first is on outbound cross-border insolvency, stating that a Chinese bankruptcy proceeding binds the company’s assets worldwide, having a universal effect, and the second paragraph concerns inbound insolvency, articulating that a foreign bankruptcy judgment could be recognised and enforced in China if the foreign company has assets located in China, subject to the condition that there is either a treaty or the principle of reciprocity between China and the foreign country, and that the foreign bankruptcy judgment should not breach the general principles of Chinese law, undermine China’s sovereignty, securities and public interests, or violate Chinese creditors’ legal rights. As at August 2021, only a handful of Chinese courts have granted assistance to foreign bankruptcy proceedings (*Globalized Cross-Border Insolvency Law: The Roles Played by China*, by Zinian Zhang, European Business Organization Law Review (2021)). Note that Article 5 does not apply to Hong Kong.

A significant development occurred in May 2021, when a cooperation mechanism came into effect between Hong Kong and certain pilot areas in mainland China (i.e. Shenzhen, Shanghai and Xiamen), providing a means for Hong Kong officeholders to obtain recognition and assistance from the courts in the pilot areas, and vice-versa (**Arrangement**). This Arrangement only applies to Hong Kong, and not to any other jurisdiction (including Taiwan or Macau), and originated from a [record of meeting](#) between representatives of the Supreme Court in the Mainland and the Hong Kong Government. The record of meeting refers to Hong Kong appointed liquidators or provisional liquidators in insolvency proceedings being entitled to apply for recognition in the Mainland and for Mainland administrators to apply for recognition in Hong Kong. The record is supplemented by an [opinion of the Supreme Court](#) and a [practical guide](#) issued by the Hong Kong Government. The Hong Kong insolvency proceedings include compulsory winding up, creditors’ voluntary winding up and schemes of arrangement promoted by a liquidator or provisional liquidator and sanctioned by the Hong Kong Court.

Commented [RD(DWH18): Presumption of insolvency applies only to transactions at an undervalue, not unfair preferences (s266B(3))

Commented [RD(DWH19): Rebuttable presumption of desire to prefer where beneficiary is a connected person.

Commented [RD(DWH20): (2.5 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, appointments made in Hong Kong only, need for letter of request)

Could also have referred to the pre-existing tools (e.g. s.327 and common law developments such as CEFC Shanghai)

Commented [RD(DWH21): Section 327 CWUMPO?

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.

An Explanatory Statement must be prepared setting out the background to the company, why the scheme is proposed and the proposed scheme itself. Once the company has finalised a proposal to be presented to its shareholders and/or creditors, an application must be made to the court for the court's approval to convene meetings of each class of shareholders and/or creditors to be affected by the scheme of arrangement. The classes of creditors must be properly described in the application for court approval and incorrect constitution of classes will lead to the scheme failing due to lack of jurisdiction at the sanction stage, even if it is passed at the duly convened meeting. Unlike England, Hong Kong lacks any mechanism to require the court to address issues of class constitution prior to the relevant meetings being held.

In order for the scheme to be put into effect, it is necessary for each respective meeting to approve the proposed scheme by both (i) a numerical majority of more than 50% and (ii) a majority of 75% in value. Following such approval, the scheme is again put before the Court for final sanction. The court will have regard to various considerations when considering whether or not to sanction the scheme, including whether those attending and voting at each meeting fairly represent the relevant class and that the relevant majority have in each case acted bona fide and not promoted interests adverse to the class they purport to represent.

Once the scheme has received final sanction by the court, a copy of the relevant court order must be registered with the Hong Kong Registrar of Companies for the scheme to become effective. Note that the scheme can only bind creditors if the debt is governed by Hong Kong law or the relevant creditor takes part in the scheme.

Pros

- Hong Kong lacks any formal procedure aimed at rescuing companies, which can be found in some other common law jurisdictions, such as administration in England and Wales, Chapter 11 procedures in the US or judicial management in Singapore. In Hong Kong, only a scheme of arrangement is aimed at preserving a company as an ongoing concern.
- PLs and liquidators can implement a scheme of arrangement to attempt to rescue the company in Hong Kong.
- Court-sanctioned compromise or arrangement which binds all creditors or the relevant class, even those who vote against it.
- The scheme can replace existing debt instruments and replace them with new instruments.
- A consent fee may be offered to all creditors to encourage them to approve the scheme.
- The scheme of arrangement procedure can also be used by the shareholders and creditors of a company to try and reach a binding agreement.

Cons

1. Time consuming process involving the need for court sanction.
2. The initiation of procedures to implement a scheme of arrangement does not provide the benefit of a moratorium on creditor actions prior to the scheme becoming effective, which may encourage rogue conduct by creditors pending court sanction of the scheme.
3. The appointment of a PL to attempt a corporate rescue using a scheme of arrangement must first of all be necessary to protect the assets of the company

Commented [RD(DWH22)]: (4.5 marks) Should also mention that due to 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

where the same are in jeopardy and would remain so without the immediate appointment of the PL, and that a winding up order will be sought if the corporate rescue fails.

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.

There are several options for Mr Chan to consider.

The first option, if Mountainview Ltd is still solvent even though it has financial difficulties, is the Members’ Voluntary Liquidation (MVL) (s. 233(1) CWUMPO). If Mountainview will be able to settle all liabilities within 12 months of commencement of liquidation, it can use the MVL procedure and does not have to ask the court to wind up the company, which would be a more costly and time consuming process, and would take matters out of Mr Chan’s hands.

As sole director, Mr Chan must sign a “certificate of solvency” and the shareholders must pass a special resolution (i.e. passed by at least a 75% majority of the shareholders per s. 564 of the Companies Ordinance) for winding up and appointing a liquidator. The MVL commences on the date the resolution for winding up is passed (s. 228 CWUMPO).

The appointed liquidator can be a private liquidator who does not need to have any specific qualification (although usually the liquidator is an insolvency practitioner such as a solicitor or accountant) and who can be connected to the company (e.g. someone from the audit firm of Mountainview and who are already familiar with the company and its finances), will take control of the business and will investigate the affairs of Mountainview and Mr Chan’s conduct, and realise assets in order to pay the creditors, the liquidators’ fees and then the shareholders, in that order of priority (s. 256 CWUMPO).

The second option, if Mountainview is not able to settle its liabilities within 12 months and is not solvent, is that it can put itself into voluntary liquidation by way of a Creditors’ Voluntary Liquidation (CVL) (s. 233(4) CWUMPO). This option is more time consuming and expensive than the first option. As sole director, Mr Chan can convene a shareholders’ meeting to pass a special resolution for winding up Mountainview because the company cannot by reason of its liabilities continue its business. The CVL will commence on the date of passing of this resolution (s.230 CWUMPO). A winding up statement must be filed at Companies’ Registry declaring that it is not reasonably practicable for the winding up to be commenced under another section of the CWUMPO. Note that if there is no such good reason, Mr Chan may be prosecuted.

A provisional liquidator may be appointed at the shareholders’ meeting with limited powers until his or her appointment is confirmed at the creditors’ meeting, as the creditors will nominate and vote for the appointment of a liquidator at the first creditors’ meeting. A meeting of creditors must be convened not later than 14 days after the meeting of shareholders (s. 241(a) CWUMPO) and a statement of affairs of the company will be provided at the meeting (s. 241(3A) CWUMPO).

Commented [RD(DWH23)]: (3 marks)

First piece of advice is that it is not correct that Mr. Chan “must” go to court. (For completeness, could add that 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)

No indication in the question of shareholding structure so should add that a voluntary liquidation will need a special resolution (at least 75% of shares)

Liquidators should be neutral and carry out their duties (including investigation of how the company has been run/conduct of directors) irrespective of who appoints/nominates them. Importantly, should also advise Mr. Chan that Liquidators should be neutral and carry out their duties (including investigation of how the company has been run/conduct of directors) irrespective of who appoints/nominates them

Commented [RD(DWH24)]: This only for the s.228A ‘emergency’ procedure

Notice of the creditors' meeting must be sent by post to creditors at least 7 days beforehand and must be advertised in the Hong Kong Gazette and a Chinese language newspaper in Hong Kong (ss. 241(1)(b) and (2) CWUMPO). Pending the meeting, as sole director Mr Chan should take steps to protect the assets of the company – once Mountainview is insolvent, even though Mr Chan owes duties to the company, he must exercise those duties with the best interests of the creditors in mind (s. 250A(3) and see also *Cyberworks Audio Video Technology Ltd v Mei Ah* [2020] HKCFI 398).

The least desirable option is the course of action would be to let the situation continue so that a creditor applies to the court for a compulsory liquidation, which is more costly and time consuming because of the involvement of the court. Further, ad valorem duty payable on any realisations in a compulsory liquidation is not payable in a voluntary liquidation.

Question 4.2 [maximum 5 marks]

Kite Limited is a Hong Kong incorporated company involved in an import / export business. It buys goods on its own account from suppliers in Mainland China, then sells them on to buyers in Europe at a mark-up. The company has been in difficulty for some time, for example due to reducing margins; unfavourable credit terms leading to a mis-match between the dates on which Kite must pay its suppliers and the dates on which it gets paid by its buyers, thus affecting Kite's cashflow; European buyers going straight to Mainland suppliers, etc.

Goshawk Financial Limited (GFL) is one of Kite's lenders. Having been troubled by the way Kite's business has been heading, some months ago GFL insisted that Kite execute a charge over its receivables, also insisting that the charge was stated to be a "fixed charge". Kite agreed and executed the document. No separate account was opened and Kite continued to trade with its customers as before, with money being paid into and out of its normal operating account (not held with GFL).

Recently, GFL appointed a receiver pursuant to the charge executed in its favour. The company has also been wound up on a petition presented by another creditor and a liquidator appointed. The receivables appear to be Kite's only assets. The liquidator asks for your advice on whether she can insist that the receiver hand over realisations he makes in order that the costs and expenses of the liquidation can be met and the unsecured creditors paid at least a partial dividend.

Assuming the appointment of an individual as the receiver is in accordance with the terms of the relevant security document and that the receiver accepted the terms of appointment, the receiver has powers of sale and management pending sale over Kite Ltd's receivables. It is likely that the security document provides that the receiver is acting as agent of Kite Ltd. The receiver's primary duty is to GFL and not the company and his or her fundamental role is to collect the receivables in order to satisfy the debt owed to GFL. The receiver is also entitled to be paid out of the realisations.

As such, the liquidation of Kite Ltd does not affect the receiver's right to hold and/or sell the receivables secured by the charge, and the realisations made by the receiver out of the receivables are not available to the liquidator to meet the costs and expenses of the liquidation and pay a partial dividend to unsecured creditors (see *Buchler v Talbot* [2004] 2 AC 298, applied in the Hong Kong case *Re Good Success Catering Group Ltd* [2007] 1 HKLRD 453 and s. 265(3B) CWUMPO).

Question 4.3 [maximum 6 marks]

Commented [RD(DWH25): (0.5 marks) for mentioning Leyland Daf and how charged assets not available to L but needs to go further:

An outline is

- >First step in any such situation is to check the validity of the charge – execution, registration etc
- >Say 'fixed charge' but court will look at substance : Spectrum. Here, can use the receivables so floating charge more likely
- >When entered into? Within time period that means may be void against liquidator unless new money (s.267, 267A)
- >If any of the above, L can ignore and insist on being handed all of the receivables
- >Next to consider: was it an unfair preference (security can be UP – see Sweetmart)? If so, L may also be able to get receivables. Say 'may' because would need to make application and notoriously difficult to show company was influenced by desire to prefer.
- >If charge is valid (as floating charge), L cannot lay claim to the receivable (Leyland Daf case) except for preferential creditors (s.265(3B)) – note only asset so there will not be any 'free assets' in estate to meet those

Commented [RD(DWH26): (4 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... [1]

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

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

The BVI liquidator appointed has identified:

- (a) There is a clause in the FA that states that if SPL becomes insolvent then all other provisions (including the requirement to pay Mr Xu) are void, and all assets automatically and immediately vest in Mr Qi in order to repay shareholder loans Mr Qi has made;
- (b) SPL has a (supposedly independent) director, Mr Zhang, who lives in Hong Kong; and SPL also has a book-keeper, Mr Wong, who lives in Hong Kong. Neither Mr Zhang nor Mr Wong are replying to emails from the liquidator;
- (c) SPL has a bank account at a bank in Hong Kong;
- (d) It is not known where Mr Qi is currently, but it is believed he is a Hong Kong resident;
- (e) SPL is believed to have assets in the Mainland, but the liquidator is not sure where these assets are located.

The liquidator asks for your advice on what steps he can take in Hong Kong, including as regards a concern he has that Mr Xu in fact had no standing to bring the winding up proceedings in the first place given the clause in the FA at (a) above. The liquidator has also read about a new "co-operation mechanism" between Hong Kong and the Mainland that he would like to use in respect of (e) above.

With regards to (a), the issue as to whether Mr Xu had standing or not to bring the winding up proceedings in the first place in the BVI does not, at present, affect the liquidator's right to bring an action in Hong Kong in the name of SPL under common law, as no one has challenged the appointment of the liquidator and SPL was wound up in the BVI. Although Hong Kong lacks a statutory framework on cross-border insolvency, the Hong Kong court has consistently followed common law principles in this regard.

In any event, the relevant term in the FA, which is governed by Hong Kong law, might not be upheld by the Hong Kong court because of the anti-deprivation principle. The key point is

whether upholding that clause would result in depriving creditors of an asset that would, in the absence of the clause, be used to satisfy their debts and may be considered to be “in fraud of the insolvency laws” (see *Peregrine Investments Holding Ltd v Asian Infrastructure Fund Management Co Ltd* [2004] 1 HKLRD 598). The anti-deprivation principle is aimed at preventing parties from using a contractual arrangement to give an advantage to one of the contracting parties in the event of insolvency of the other party.

The liquidator may apply to pursue an ancillary liquidation proceeding in Hong Kong, which would give him or her powers exercisable under CWUMPO and CWUR, or he or she may seek recognition of his or her appointment in the BVI and seek the court’s assistance by such recognition mechanism. The liquidator will have to provide a letter of request from the BVI court, being the court where his or her appointment was made. The powers available to the liquidator in the latter scenario are more restricted than in the former, so an ancillary liquidation may be a more useful tool when the full range of powers is needed.

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

It would be important to know if SPL is listed on the Hong Kong Stock Exchange (HKSE), as the vast majority of listed companies are not incorporated or registered in Hong Kong (HKEX Fact Book 2020) or has a place of business in Hong Kong and is registered in Hong Kong, as required under Part 16 of the Companies Ordinance (Cap 622).

As SPL has a bank account in Hong Kong, it might have a place of business in Hong Kong and be registered with the Registrar of Companies (s. 776 Companies Ordinance). If so, the liquidator could apply to the court to wind up SPL as an unregistered company under Part X, s. 326 of CWUMPO as an ancillary liquidation, provided the 3 core requirements laid out in the Court of Final Appeal’s decision in *Re Yung Kee* are met:

1. There must be sufficient connection with Hong Kong (not necessarily requiring assets in the jurisdiction – a listing on the HKSE is sufficient)
2. There must be a reasonable possibility that the winding up order would benefit those applying for it (the HKSE listing and the presence of SPL’s bank account may be sufficient if there are substantial funds in it, although the liquidator must show that there is a real prospect of a material financial benefit to creditors from the realisation of assets (*China Huiyuan Juice Group Limited* [2020] HKCFI 2940)); and
3. The court must be able to exercise jurisdiction over one or more persons interested in the distribution of the assets (this will be met if the connection with Hong Kong is sufficiently strong and the benefits to creditors sufficiently substantial (*Re China Medical* [2014] 2 HKLRD 997)).

With regards to (b) and (d), the liquidator can apply to the Hong Kong court for an order that Mr Zhang and Mr Wong, both of whom reside in Hong Kong and have been ignoring emails from the liquidator, should attend court and be examined on oath about the affairs of SPL and what happened to the USD 20 million paid by Mr Xu to SPL, particularly as the project did not even start, and seek production of documents in this regard. Note, however, that any power sought to be exercised in Hong Kong must be subject to the powers available to the liquidator in the BVI, being the liquidator’s home jurisdiction (the *Singularis* principle in *Singularis Holdings v PricewaterhouseCoopers* [2014] UKPC 36). The same powers can be applied vis-à-vis Mr Qi if he is indeed a resident of Hong Kong and is physically located in Hong Kong.

With regards to (c), once recognised as a foreign officeholder, the liquidator could apply to the Hong Kong court for a specific recognition order to deal with SPL’s Hong Kong assets, such as its Hong Kong bank account and require the bank to provide bank account documents (see *Re China Lumena New Materials Corp (in Provisional Liquidation)* [2018] HKCFI 276).

With regards to (e), once the liquidator has commenced a winding up procedure in Hong Kong sanctioned by the Hong Kong court, he or she may apply for recognition of the liquidation in the Mainland under the Arrangement, if SPL's assets are or may be located in any of the 3 pilot areas, being Shenzhen, Shanghai and Xiamen. The Intermediate People's Court in those 3 areas can provide assistance to locate and freeze SPL's assets.

*** End of Assessment ***

TOTAL MARKS: 37 out of 50

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(4 marks)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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