



**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)]:** Incorrect (0 marks) - For some provisions, the time period changes depending on whether the other party to the transaction is connected to the bankrupt, but not for transactions at an undervalue

#### **Question 1.3**

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

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

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

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

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

#### Question 1.4

Select the **correct** answer:

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

- (a) must first be used to satisfy the costs and expenses of the liquidator.
- (b) must first be used to satisfy the whole of all claims by employees but no other claims.
- (c) must first be used to satisfy the claims of preferential creditors as described in the relevant section of CWUMPO.

(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)]:** Incorrect (0 marks) – see section 6.4.1 and 5.5 of text: preferential creditors are paid out of assets subject to a floating charge (unless the company is in liquidation and there are sufficient assets to make those payments out of the general estate). 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.

**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?

Pursuant to Section 4 of the Bankruptcy Ordinance (Cap 6) (**BO**), the Hong Kong courts may exercise bankruptcy jurisdiction over a person if such person is: (1) domiciled in Hong Kong; (2) personally present in Hong Kong on the day of the presentation of the Petition; or (3) at any time in the period of three years ending with the date of presentation of the petition, (i) have been ordinarily resident or have had a place of residence in Hong Kong; or (ii) have carried on business in Hong Kong.

It must also be noted that the Bankruptcy jurisdiction is extended only to an "individual" as a debtor under the BO.

### 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?

Section 327 under Part X of the Companies Winding-up and Miscellaneous Provisions Ordinance (Cap 32) (**COWUMPO**) provides that an unregistered company may be wound up if it is, among other things, if the company has ceased to do business or unable to pay its debts or if the court believes it is just and equitable to do so.

In order to exercise its jurisdiction, three core requirements are to be met to wind up a foreign unregistered company as laid down in the Court of Final Appeal's (**CFA**) decision in *Kam Leung Siu Kwan v. Kam Kwan Lai*<sup>1</sup>:

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

### Question 2.3 [maximum 4 marks]

Commented [RD(DWH13)]: (3.5 marks). Should refer to need to show likely to be wound up when petition is heard

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

A Provisional Liquidator (**PL**) can be appointed at any point after a winding-up petition has been presented in the court (or in some cases where there is urgency, even along with the winding-up petition) where it is necessary to preserve the assets of the company and if they are in jeopardy and would remain so without the immediate appointment of a PL.

Usually, the PL would not actually realize the assets but such powers can be granted by the court on application by the PL and if necessary to protect the assets. A PL can also be appointed to facilitate a restructuring of the company or in instances of corporate

<sup>1</sup> [2015] 18 HKCFAR 501

rescue such as administering a restructuring proposal or scheme of arrangement. However, as laid down in *Re Legend International Resorts Ltd*<sup>2</sup> (**Legend**) suggests that restructuring cannot be the sole purpose for appointment of a provisional liquidator. This position has since been clarified further by Justice Harris in the Court of First Instance (**CFI**) decision in *China Solar Energy Holdings Limited*<sup>3</sup> wherein it was held that a PL can be appointed for matters associated with a winding-up, which could include asset preservation the intended result for such appointment could also be the avoidance of winding-up of a company.

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

#### Question 3.1 [maximum 5 marks]

Commented [RD(DWH14)]: (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.

An unfair preference takes place when a specific creditor/s or guarantor is given a preference by the insolvent company in that it is put in a position better than it would have been upon the company's insolvency. This includes transactions such as granting of security, making payments et al.

A liquidator's key duties include realizing the company's assets and maximizing the return for all the creditors. A liquidator is empowered to conduct investigations and review past decisions/ operations of the company. This includes the power to set aside any such unfair preference transactions to ensure just and equal treatment of all relevant creditors. Section 266B of the Companies Ordinance (Cap 32) (**CO**) provides for the avoidance of unfair preferences in corporate insolvencies.

In order for an unfair preference claim to succeed against a creditor/ person, the following aspects will need to be established by the liquidator:

1. It is essential that the company must have been insolvent at the time of the transaction or become insolvent as a consequence.
2. The transactions should occur within the look back period of 6 months before commencement of liquidation. For a person connected with the company, the lookback period is 2 years before commencement of liquidation. A person is considered to be connected to the company if he/she is an 'associate' of the company or an associate of the company's director/shadow director. This includes another company which is being controlled by the insolvent company or its associate.
3. The debtor company should have a 'desire to improve the creditor's position'. In cases relating to connected persons, there is a statutory rebuttable presumption that the debtor company was influenced by a desire to improve the creditor's position. However, it has been particularly challenging for the liquidators to establish 'a desire to prefer' to the court's satisfaction, in transactions relating to persons who are not connected/ non-associates to the debtor company.

Also, a defendant in a preference action is entitled to rely on the defence that genuine pressure was exerted on the debtor (even where the rebuttable presumption of desire applies in transactions involving associates). In *Trustees of the Property of Hau Po Man Stanley (in bankruptcy) v Hau Po Fun Ivy*<sup>4</sup>, it was held that moral pressure can be as real as commercial pressure and therefore was sufficient to refute the claim of unfair

<sup>2</sup> [2006] 3 HKC 565

<sup>3</sup> HCCW 108/2015, [2018] HKCFI 555,

<sup>4</sup> [2005] 2 HKC 227

preference. However, the courts have in some instances, allowed an unfair preference claim as in the case of *Re Sweetmart Garments Works Limited (in Liq)*<sup>5</sup> wherein a mortgage given by the debtor company over an asset to a bank was considered to be without proper grounds and with an intention to prefer the bank as personal bankruptcy proceedings were being threatened against the directors of the debtor company.

**Question 3.2 [maximum 5 marks]**

Commented [RD(DWH15)]: (4.5 marks) see note below

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 is a special administrative region (*Hong Kong SAR/ HK*) of the Mainland China (i.e. *People's Republic of China/ PRC*). It operates under the 'One Country Two Systems' model. This means that while Hong Kong SAR is a part of the Mainland, it operates under a separate legal system (common law) from that of PRC.

While it is correct that apart from winding-up foreign incorporated and unregistered companies, Hong Kong lacks a statutory framework to deal with cross-border insolvency, and neither has it adopted the UNCITRAL Model Law on Cross-Border Insolvency, there has recently (i.e. in 2021 last year) been a mutual co-operation arrangement between Mainland and Hong Kong. The key features of this mechanism are as follows:

Commented [RD(DWH16)]: Should mention that HK court has assisted in PRC insolvencies (e.g. CEFC Shanghai)

1. General overview: PRC and HK had agreed to enter into a co-operation mechanism for cross-border insolvency cases in both jurisdictions. HK's Secretary for Justice, Teresa Cheng SC and Vice-President of the Supreme People's Court (**SPC**) Yang Wanming, signed the record of meeting concerning mutual recognition of and assistance to insolvency proceedings between the courts of the PRC and HK (**arrangement**). An Opinion was issued by the SPC (**Opinion**) which sets out the features of the arrangement.
2. Designated Pilot cities: The SPC designated three PRC cities, **Shanghai, Xiamen and Shenzhen** as pilot areas to bolster the PRC-HK Insolvency Co-operation arrangement, given the large no. of PRC-HK bankruptcy cases in these cities (**pilot areas**). If the debtor's principal assets are in within the jurisdiction of these pilot areas, the Intermediate People's Court in these cities shall have jurisdiction over cross-border insolvency assistance cases heard subject to the procedure provided in the Opinion;
3. Scope and Applicability (COMI): The arrangement relates to proceedings in which the Centre of Main Interests of the Debtor (**COMI**) has for a period of **6 months, been in HK**. Although COMI generally means the place of incorporation other factors such as the location of the principal office, management, business operations, property and assets are all considered relevant for the determination of COMI. This means that recognition of HK insolvency proceedings relating to companies incorporated in other jurisdictions may also be granted;
4. Application for recognition and assistance: The HK liquidators can apply to the relevant Intermediate People's Courts in the pilot areas for recognition and assistance of compulsory winding-up, creditors' voluntary winding-up, corporate debt restructuring proceedings as well as a scheme of arrangement sanctioned by the HK High Court. The application should, *inter alia*, be accompanied by a letter of request for recognition

<sup>5</sup> [2008] 2 HKC 252



and assistance issued by the HK High Court, materials showing that the debtors' COMI is in HK and evidence showing that the debtor's principal assets or place of business is in the pilot areas in PRC. The PRC administrators, on the other hand, may apply to the HK High Court for recognition of bankruptcy liquidation, reorganisation and compromise proceedings under the Enterprise Bankruptcy Law of the PRC. The HK government has issued a Practical Guide setting out the procedures and forms of application for the PRC Administrators to obtain recognition and assistance from the HK courts;

5. What happens once recognition is granted by the PRC court? (Ref. Article 10 - 20, Opinion)

Once the PRC courts recognise the HK insolvency Proceedings, the application for the recognition of the HK liquidators will be decided upon at the same time. Consequences of such recognition will *inter alia* (i) invalidate the payment of debts made by the debtor to individual creditors, (ii) suspension of any civil action or arbitration involving the debtor (that has started but not yet concluded), (iii) measures for preserving the property of the debtor shall be lifted and the procedure for execution shall be suspended.

Upon application from the HK Liquidators, the PRC courts may allow the HK liquidators to perform certain duties in the PRC which includes taking over the property, documents and other data of the debtor, deciding on debtor's day to day internal management, managing and disposing of debtor's property etc. However, the liquidators should not perform their duties beyond the scope of the PRC Enterprise Bankruptcy Law as well as the bankruptcy laws in HK.

It must be noted that the bankruptcy property of the debtor in PRC shall first satisfy the preferential claims under the law of PRC. The remainder of the property is to be distributed in accordance with the HK Insolvency proceedings.

6. Review of the decision of the people's court: After the concerned Intermediate People's court has made a decision, the HK liquidators or the interested party may apply to the People's court at the next higher level for review within 10 days from the date of service of the decision. The details of such review procedure have not been provided in the Opinion.

**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.

General overview: While there are several mechanisms to restructure the debts of a company such as debt rescheduling, debt for equity swaps, informal workouts, reorganisation of the company's share capital, the Hong Kong CO (Sections 668 – 677) only provides for a statutory mechanism for the implementation of a scheme of arrangement (**Scheme**) as a corporate rescue tool. A Scheme allows companies to make binding arrangement/ compromise with the creditors (or class of creditors) and its members, which usually allows the company additional time to repay its debt and gets it out of the cash liquidity situation. Courts in Hong Kong (coupled with the practical and creative solutions by legal practitioners and guidance/adoption of common law) have over the years, have led to Schemes being a useful tool to effect a restructuring of the company.

**Commented [RD(DWH17):** (4.5 marks) A good answer but could also mention that due the 'Gibbs' principle, a Hong Kong Scheme will only compromise debts arising from obligations governed by Hong Kong law. This is a possible downside in the modern environment where a sophisticated debtor is likely to have debts due under other governing law

Process<sup>6</sup>: There are several steps from the formulation of a plan to a Scheme being implemented, effective and adopted by the company and its members and creditors. The following steps need to be undertaken:

1. Restructuring and Support agreement (RSA): While this is not a formal part of the process required under the CO, the companies endeavoring to restructure its debt usually enter into a lock up arrangement/ RSA with the creditors of the company to in order to ascertain creditor support. There is also, usually, an incentive fee/ consent fee provided to the creditors who enter into the RSA and vote in favor of the restructuring at the Scheme meeting (as explained further below).
2. Convening application: An originating summons is made before the Hong Kong court to convene meetings of the relevant creditors to consider and if tough fit, approve the Scheme (or schemes as the case maybe). The court will then at the convening hearing, give directions for the conduct of the meetings, advertisements and notice of scheme meeting. It is expected that the evidence in support of this application have the draft scheme, explanatory statement so that the court can review these and may also include orders to revise/ amend certain terms. The court will also appoint a Chairperson of the Scheme meeting so that she/he can report the results of the meeting.
3. Scheme Meeting: The Scheme will be considered approved by the scheme creditors only when it is supported by a majority in number representing a 75% by value of the creditors present and voting. This test is applicable to each class of creditors if there are separate classes.
4. Sanction Hearing: Once the requisite majorities have been obtained as above in the scheme meeting and the Scheme has been duly approved by the creditors, an application to obtain sanction from the court will be required to be filed. This application would include, among others, the reason for the Scheme being proposed, results of the scheme meeting (usually in the form of a chairperson's report), evidence of notice of scheme meeting being sent and due procedures being followed. In deciding to sanction a Scheme, the court will have regard to the several matters such as composition of class of creditors has been proper (i.e. they have similar legal rights to be able to consult each other, whether the meeting was duly convened in accordance with court directions, requisite creditor approvals and statutory majorities have been obtained, and its discretionary power that the Scheme is one that an '*intelligent and honest man acting in respect of his interests as a members of the class within which he votes, might reasonably approve.*'

#### Pros and Cons:

##### Advantages for restructuring by way of a Scheme:

1. A Scheme, once approved and sanctioned by the Court binds all creditors and/or its members in the relevant class or classes, including secured creditors. This would prevent disgruntled creditors of the specific class from making winding-up applications in the court.
2. Under the CO, even a non-Hong Kong company (i.e. a company incorporated in another jurisdiction such as BVI, Cayman Islands, Bermuda etc.) can also restructure its debts through a Hong Kong Scheme under the CO. Having said that, due considerations need to be taken if the debt is governed by foreign law/ several creditors are located in the place of incorporation of the company. In such instances, parallel scheme of arrangement may be the more appropriate route.

<sup>6</sup> Several authorities provide guidance in terms of the procedures and considerations to obtaining sanction of a Scheme from the Hong Kong Court. Some of the key authorities are (1) *Udl Argos Engineering & Heavy Industries Co. Ltd. v Li Oi Lin* (2001) 4 HKCFAR 358, (2) *Re Wheelock Properties Ltd* [2010] 4 HKLRD 587 (3) *Re PCCW Ltd* HCMP2382/2008.

3. A company can continue to trade (or in the event the trading of a company is suspended, it can resume trading after the implementation of the scheme) while a restructuring is ongoing. This ensures that the company continues its business operations and allows it to recoup quicker post restructuring.
4. As a Scheme is an agreement between the company, its creditor and members, such form of restructuring has lesser likelihood of attracting any negative publicity and a loss of reputation, especially when compared to winding-up of the company.
5. The purposes for which a scheme of arrangement can be used are extensive and can range from capital reorganisation, debt rescheduling, debt for equity swaps, demergers or statutory mergers and several forms of restructuring.
6. Both solvent and insolvent companies can use Schemes.
7. Generally, Schemes offer a flexible approach to revive a company undergoing financial/ liquidity issues with relatively lesser approvals and processes.

Challenges:

1. One of the key challenges of effecting a Hong Kong Scheme is that there is no statutory moratorium while promulgating a Scheme. However, over the years, practitioners initiate a winding-up petition along with seeking the appointment of 'provisional liquidators' for, among other things, restructuring purposes.
2. The level of court involvement and the statutory process under the CO, may render a Scheme of arrangement very expensive taking into account the financial and legal support required to implement a scheme.
3. While some jurisdictions such as the US (Chapter 15 of the US Bankruptcy Code) may be open to recognition of schemes of arrangements, all jurisdictions do not necessarily have mechanisms of common law developed to offer recognition to a Hong Kong Scheme. In fact, a Hong Kong scheme may not even be enforceable in some of the countries. This not only creates issues such as risk of creditor action in such jurisdictions, it also adds on the expense and uncertainty of the complete effectiveness of the Scheme.
4. A scheme of arrangement does not result in an automatic moratorium and so an insolvent company may be advised to enter into administration to provide it with the breathing space required to agree the terms of the scheme.

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

**Question 4.1 [maximum 4 marks]**

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

It appears that Mr Chan's friend may not have provided correct advice. There are several routes under Hong Kong law to close down the company and its business operations. However, in order to ascertain the best possible route to achieve the desired results for Mr Chan, we should ask Mr Chan for some more details in relation to present situation of the company such as:

1. Whether the company is insolvent (in that the liabilities are larger than its assets) or just some financial difficulties as mentioned by Mr Chan?

**Commented [RD(DWH18)]:** (2.5 marks) see notes below. Also, should advise that if company is insolvent owes duties to creditors ahead of the company; and 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 (i.e. no such thing as a 'friendly' liquidator)

2. Do all shareholders agreeable for a company to be wound-up? Is the company and its member agreeable to cease all business operations? Can a special resolution of shareholders be obtained confirming that they wish to wind up the company or the company can consider to restructure its debt?
3. Are there any creditor actions or statutory demands served on the company which have not been paid by the company?
4. What properties/ real assets are situated in Hong Kong?

Based on an assessment of the above questions, the following options are available with Mr. Chan to shut down the company:

1. **De-registration:** Section 750 of the CO provides for the deregistration of a company. It is a simple and straightforward procedure of dissolving a Hong Kong company. It is preferred because it does not involve any court or liquidator involvement. The costs of deregistration are also much lower. However, the following requirements need to be met:
  - All members (shareholders) of the company should agree to the deregistration;
  - The company did ceased business for more than 3 months immediately before the commencement of the deregistration;
  - The company is solvent i.e. it has no outstanding liabilities ; and
  - The company's or its subsidiaries' assets do not consist of any immovable property situated in Hong Kong.

From the above facts, we understand that the company operating, however, considering the benefits of a wind down by deregistration, Mr Chan can explore the possibility of ceasing business operations and shutting down the company by this route, subject to of course all of the above requirements being met.

2. **Voluntary Winding-up:** A company can be voluntarily wound up by its members, creditors and even directors, subject to compliance with the relevant statutory provisions under the CO. There are several reasons for a company to be voluntarily wound up, which among other things include when decided by the shareholders that by reasons of its liabilities or when a special resolution is passed by the shareholders to wind up the company or if the company should be wound up or under special circumstances by decision of the directors. When a resolution is passed, a winding up is deemed to commence on the passing date of the resolution.

The advantage of a voluntary winding-up up over a compulsory winding up is that upon passing the resolution, while the company shall cease to carry out its business, there is still an exception that it can continue operations as long as it is required for the beneficial winding-up of the company. For a mandatory winding-up, all business is to cease as soon as the winding-up order is granted and all acts done after the order are deemed to be invalid. Also, different from a mandatory winding-up, where the liquidator is an officer of the court, in a voluntary winding-up he is an agent of the company and can also be removed by a member's special resolution.

However, it must be noted that for a members' voluntary winding-up (MVL), the directors will have to issue a certificate of solvency which prove that the directors (in this instance the sole director Mr Chan) are of the opinion that the company will be able to pay its debts in full within a maximum of 12 months from the passing of the resolution. This must be presented to the members before passing the winding-up resolution.

For a Creditor's voluntary winding-up (CVL), it is exercised when the company decides to put itself into voluntary liquidation but it is not solvent and thus, no solvency certificate is required. For CVL, both a shareholders meeting wherein a creditors'

winding-up shall be proposed, and creditors meeting should be arranged (on the same day or the following day).

Depending on what is the status of the company and response to queries posed to Mr Chan above, a voluntary winding-up is a viable option to wind down a company. It must be noted and informed to Mr Chan that CVL (and even MVL) would call for certain procedural steps to be taken such as advertisements (for creditors' meeting) and registration of the appointment of liquidator etc.

### 3. Voluntary winding-up according to Section 228A COWUMPO

If the directors (sole director in this case) of a company are of the opinion that the company cannot continue its business by reason of its liabilities, the directors may approach the companies registry (after passing a directors' resolution to such effect) to wind up the company as the company is undergoing financial difficulties and by reason of its liabilities is unable continue its business, the directors consider it as necessary that the company be wound-up and it is not reasonably practicable for the winding-up to be commenced in another way, and meetings of the shareholders and the creditors should be held not later than 28 days from filing this winding-up statement.

The directors will also need to appoint a liquidator, after which the winding-up continues as a normal voluntary winding-up. This may make the process quicker and may be beneficial to ensure the assets of the company are protected as, usually the directors of the company will have better knowledge of the financial situation of the company which may make it speedier than investigations by shareholders or creditors.

### 4. Compulsory Winding-up:

A compulsory winding up is essentially a court winding-up. As per the CO, a petition to can be filed by the company itself (although, usually a company would prefer to exercise one of the above options), its creditors, its contributors, the Financial Secretary, the Registrar, or by the Official Receiver. A winding up commences when the petition is filed to the court.

Usually, the petitioner will nominate the liquidators but the liquidators will be appointed by the Court whose powers are also determined by the court order. A petitioner may also seek for appointment of provisional liquidators if necessary to preserve the assets of the company. In a compulsory winding-up, there usually will be, among other things, periodic meetings of creditors, liquidators may be required to prepare regular reports etc. This method of winding-up involves court involvement and sanctions and may turn out to be very expensive.

There is also a summary procedure for a compulsory winding-up by the court if the property of the company does not exceed HK\$ 200,000.

### **Question 4.2 [maximum 5 marks]**

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

**Commented [RD(DWH19):** But 228A should only be used when it is the only option; otherwise penalties for director

**Commented [RD(DWH20):** But a company cannot petition on the basis of a resolution by directors alone (Emmadart) and there is no indication that Mr. Chan is (necessarily) the only shareholder) - shareholder support therefore needed

**Commented [RD(DWH21):** (4.5 marks) Also may be an unfair preference

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

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

In order to ascertain whether the liquidator is entitled to the realizations made by the receiver, we will first to understand the nature of the charge:

A fixed charge is a charge in relation to a specific asset and attaches as soon as the charge is created, or the relevant asset is acquired by the debtor. The debtor cannot deal with the asset without the consent of the charge creditor. However, a floating charge permits the debtor to continue using the assets (or a class of assets). Unless a specific event occurs i.e. crystallization event, no asset is attached to such charge.

Another important aspect to understand is the category of creditor GFL will fall under. Generally, in Hong Kong, secured creditors and the security they hold will not be dealt with as part of the insolvency process and the assets subject to security will not be available for realization by the liquidator/ office holder.

Even though GFL requested for and considers its obtained a 'fixed charge' over the receivables of Kite, the nature of charge cannot be determined by what it's termed. The language used by the parties will not be conclusive and the court will look at the actual effect of the arrangement. As per *Re Spectrum Plus Limited* (a landmark authority on this subject), the key question to ask is what measure of control the secured creditor has over the relevant asset class.

#### Fixed/Floating Charge

1. While a separate bank account indicates that a fixed charge was intended to be created, GFL did not open a separate bank account over the receivables of Kite;
2. GFL allowed Kite to continue trading through its usual operating account and there is no indication that Kite notified its customers of such financing arrangement, this also should have been a requirement if the charge was intended to be fixed;

These factors indicate that the charge was structured in way that was intended to be a floating charge. There are two implications to this, (1) if the floating charge was created within a certain period before the commencement of the liquidation (usually 12 months<sup>7</sup> (and if with a connected person, it could be 2 years) subject to the statutory requirements), it would be void and (2) preferential creditors (which includes the expenses of liquidation) will be paid before the such assets can be used to satisfy the holder of the floating charge i.e. GFL in this case.

#### Registration

Security will be void against a liquidator if it has not been properly registered. As per Section 335(5)(a), a charge requiring registration must be registered within one month of the date of its execution. Unless an agreement is by way of actual sale (which this does not appear to be in this case), a secured financing agreement needs to be registered, else it will be deemed to

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<sup>7</sup> Section 267 of COWUMPO

be void as against the liquidator of the company<sup>8</sup>. There is no indication whether the agreement between Kite and GFL had been registered, so the liquidator may in fact apply for the receivables to be a part of the liquidation estate and exercise preferential rights over the same.

#### 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:

- 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;
- 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;
- SPL has a bank account at a bank in Hong Kong;
- It is not known where Mr Qi is currently, but it is believed he is a Hong Kong resident;
- 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.

#### Standing of Mr Xu:

<sup>8</sup> *Orion Finance Ltd v. Crown Financial Management* [1996] BCC 621

**Commented [RD(DWH22)]:** (1.5 marks) What about recognition; steps L could take without formal order (bank docs - Bay Capital) etc.

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

Section 327 of COWUMPO provides that a Non Hong Kong/ unregistered company (i.e. includes a company incorporated outside Hong Kong) may be wound up if it is, among other things, if the company has ceased to do business or unable to pay its debts or if the court believes it is just and equitable to do so.

Commented [RD(DWH23)]: Re standing of Mr Xu?

In order to exercise its jurisdiction, three core requirements are to be met to wind up a foreign unregistered company as laid down in the CFA decision in *Kam Leung Siu Kwan v. Kam Kwan Lai*<sup>9</sup>:

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

Considering point (b) to (d), 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. SPL has a bank account at a bank in Hong Kong and that Mr Qi is currently believed to be a Hong Kong resident. This indicates that the sufficient connection requirement would be met considering the above factors, Mr Xu does appear to have standing.

#### PRC-HK Mutual Co-operation Arrangement:

In terms of liquidators' queries in relation to realising assets in Mainland, this could be possible given the assets are in the pilot cities (Shanghai, Xiamen and Shenzhen) as there has been a very recent Mutual co-operation mechanism between the PRC and Hong Kong.

The first step should be for the PRC courts to recognise the HK insolvency proceedings, which would, *inter alia*, require the COMI of SPL to be in Hong Kong for the preceding 6 months. While COMI is usually the place of incorporation of the company, recently judges have taken a broader approach where COMI is determined through several other factors such as where the business operations i.e. principal place of business of a company is located. Given the facts of this case (as further elaborated above in terms of sufficient connection to HK), it is likely that the PRC courts would recognise the Hong Kong insolvency proceedings. Once the PRC courts recognise the HK insolvency Proceedings, the application for the recognition of the HK liquidators will be decided upon at the same time. Consequences of such recognition will *inter alia* (i) invalidate the payment of debts made by the debtor to individual creditors, (ii) suspension of any civil action or arbitration involving the debtor (that has started but not yet concluded), and most importantly (iii) measures for preserving the property of the debtor shall be lifted and the procedure for execution shall be suspended.

Upon application from the HK Liquidators, the PRC courts may also allow the HK liquidators to perform certain duties in the PRC which includes taking over the property, documents and other data of the debtor, managing and disposing of debtor's property etc.

It must be noted that the bankruptcy property of the debtor in PRC shall first satisfy the preferential claims under the law of PRC. The remainder of the property is to be distributed in accordance with the HK Insolvency proceedings.

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<sup>9</sup> [2015] 18 HKCFAR 501



\* End of Assessment \*

TOTAL MARKS: 40 out of 50

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

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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)

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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).

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☐ 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].