The Hong Kong Corporate Insolvency Manual

Third Edition

Charles D Booth, Stephen Briscoe, ELG Tyler

The Hong Kong Corporate Insolvency Manual has emerged as the leading resource for accounting and legal professionals working in the field. The Manual addresses the latest significant developments in insolvency law and practice.

The latest edition expands on the discussion of Hong Kong corporate insolvency law, the PRC Bankruptcy Law and cross-border insolvency, with specific reference to the BVI and the Cayman Islands.

The authors have taken a practical approach to corporate insolvency, drawing upon illustrations from Hong Kong practice and providing checklists to assist professionals handling the day-to-day administration of insolvencies.

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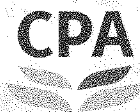

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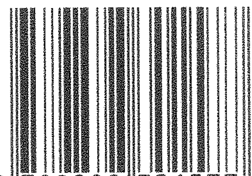

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The contribution of the late Professor Philip Smart to the First Edition of this publication is acknowledged with gratitude.

Hong Kong Corporate Insolvency Manual

Third Edition

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Legislation included in this work is current as at November 2015.

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- Briscoe Wong Ferrier's version of checklists for MVLs, CVLs and Compulsory Liquidations
- Tanner De Witt's Specimen Powers of a Provisional Liquidator appointed pursuant to s 193
- The Official Receiver's Office's Panel A Rules: Rules for Admission of Firms and Persons for Taking-up Appointment of Liquidators or Special Managers in Non-Summary Court Winding-up Cases

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Foreword to the Third Edition

This is the Third Edition of the *Hong Kong Corporate Insolvency Manual*. ELG Tyler has also joined the author team to work on this edition. The last edition was published in 2009. The variety of issues that come before the Hong Kong Companies Court continues to grow and the need for practitioners to have access to a comprehensive, but approachable, guide to the current state of the law and practice in Hong Kong in the area of corporate insolvency has never been greater. The new edition of the *Manual* fulfills that need admirably and should be on the book shelf of all local lawyers as well as members of the Hong Kong Institute of Certified Public Accountants.

The value of the *Manual* is illustrated by a chapter of particular interest to me, Chapter 15, which deals with cross-border insolvency. Cross-border insolvency is of increasing importance and in Chapter 15, the authors provide a lucid explanation of how the law is developing, and I anticipate will continue to develop, to deal with the issues that arise in a transnational context.

Hong Kong's success is largely dependent on the maintenance and development of its status as a major commercial and financial centre. This requires an effective regulatory environment and that in turn requires knowledgeable and diligent professionals. The authors have provided a valuable contribution to ensuring that Hong Kong professionals have access to the information they need in the area of corporate insolvency.

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Jonathan Harris

Judge of the Court of First Instance, High Court
Companies and Insolvency Court

Hong Kong
November 2015

Foreword to the Second Edition

Insolvency practice is a growth industry in Hong Kong.

As late as the early and mid 1990s, insolvency work was handled by the Official Receiver's Office and a few firms in the private sector. The Official Receiver contracted out work only on an ad hoc basis, where there were substantial liquidations.

The change came with the panel schemes set up by the Official Receiver. The Panel A Scheme was introduced in 1996, for the purpose of contracting out compulsory liquidations where the assets were in excess of HK$200,000, on a rota basis to panel members. Two years later came the Panel B Scheme (later known as the Panel T Scheme), extending the contracting out to summary cases of liquidation with assets of less than HK$200,000.

Amendments were made to the Companies Ordinance in 2000 to enable the Official Receiver to continue with the contracting out of summary liquidations, and to the Bankruptcy Ordinance in 2005 (which came into operation in December 2007) to empower the Official Receiver to outsource bankruptcy cases to the private sector where the value of the estate is unlikely to exceed HK$200,000.

Insolvency work is now handled largely by the private sector. Work has grown by leaps and bounds with the several financial crises Hong Kong has gone through since 1997. Creditors nowadays have taken a more proactive approach with increased involvement in the administration.

Although Hong Kong does not have a separate organisation of insolvency practitioners, with its own regulations of technical and ethical standards and guidance, the trend is towards increasing specialisation, with the building up of expertise and inter-action with practitioners abroad.

There is clearly a need for practitioners in this field to equip themselves with knowledge, whether academic or practical, to deal with the many different kinds of tasks they are called on to perform in the administration of an insolvent estate.

The Hong Kong Institute of Certified Public Accountants published the *Hong Kong Corporate Insolvency Manual* in 2002, and a companion volume the *Hong Kong Personal Insolvency Manual* in 2003. They were developed from the study materials prepared by BPP Financial Education Ltd for the insolvency examinations run by the Joint Insolvency Examination Board in England and used as teaching materials in the insolvency diploma course organised by the Institute. These *Manuals* are much more than teaching materials. They deserve a far wider readership.

The updated *Manuals* in 2009 would be a most welcome addition to the library of insolvency practitioners. The authors must be commended on their industry in collating new materials and their analytical insight into the developments in the law.

The clarity of presentation in the *Manuals* is second to none. For easy assimilation, materials are often given in note form or bullet points, supplemented by topic overviews, tables for comparison, practical summaries and checklists. For case law, the cases chosen are mostly local decisions of the past ten years. Stages in the insolvency regime, corporate and personal, are comprehensively covered. Practical suggestions abound.

The *Manuals* are excellent as a work of induction, a first port of call, a ready reference, a checklist, a source of practical guidance. They should prove to be the standard work for insolvency practitioners in Hong Kong.

Susan SH Kwan

Judge of the Court of First Instance, High Court of Hong Kong
Judge in charge of the Companies and Bankruptcy List

August 2009

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Foreword to the First Edition

It is a great honour to be asked to write the Foreword for the *Hong Kong Corporate Insolvency Manual*. This work is highly practical and contains a considerable amount of important background information. I have little hesitation in saying that if the reader cannot find what he is looking for in this book, he is unlikely to find it anywhere. I am sure the *Manual* will become a standard reference used by practitioners, jurists and others alike.

The publication of a comprehensive reference work on corporate insolvency comes at a timely moment. Not only has insolvency law become an important aspect of commercial law but the Asian economic downturn of the late 1990s followed by the current financial turmoil can only lead to an increasing flow of insolvency work involving the biggest as well as the smallest companies. This work fills an important gap in the growing range of Hong Kong legal textbooks. The authors are to be particularly congratulated because their industry, despite the demands of their normal working lives, has produced a work of undoubted utility.

Anthony Rogers

The Court of Appeal
Hong Kong

August 2009

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Preface to the Third Edition

The *Hong Kong Corporate Insolvency Manual* has its origin in unpublished materials that were first used as the text for the students undertaking the inaugural Diploma in Insolvency Course in 2000/2001, offered by the then Hong Kong Society of Accountants ('HKSA'). The First Edition of this *Manual* was published in 2002 by the HKSA, and the sister volume, the *Hong Kong Personal Insolvency Manual* followed in 2003. The Second Edition of this *Manual* was published in 2009 and the Second Edition of the *Hong Kong Personal Insolvency Manual* a year later, being published by the renamed Hong Kong Institute of Certified Public Accountants. In 2013–2014, the course was rebranded as the Professional Diploma in Insolvency. LexisNexis is publishing this Third Edition of this *Manual*, which will accompany the 10th cohort of the Diploma Course. The Diploma Course has proved popular and has become an important part of the Hong Kong insolvency training and professional development framework, and this *Manual* has become a reference book for many insolvency professionals and university students in Hong Kong. We welcome the collaboration with LexisNexis and are optimistic that with LexisNexis' extensive distribution network, this *Manual* will now be able to reach a broader readership outside Hong Kong.

In the years following the publication of the Second Edition of this *Manual*, we decided to hold off on a Third Edition until we would be able to discuss the enactment of Hong Kong's highly anticipated modern corporate rescue scheme in the form of provisional supervision. Alas, we could await no longer – and it is unfortunate that yet again we must make reference to the absence of any material progress on the introduction of such a scheme in Hong Kong. We understand that a new bill relating to provisional supervision and insolvent trading will be introduced to the Legislative Council ('LegCo') in the session that starts in mid-2016, but this is by no means certain and it is looking increasingly likely that this legislation may never see the light of day. The same is true in the area of cross-border insolvency law – here too Hong Kong addressed the problems early on with detailed law reform reports and many public consultations – before any other jurisdiction in the Asia-Pacific as a matter of fact – but nothing has been done since and any fundamental law reform in the near future involving the adoption of the UNCITRAL Model Law on Cross-Border Insolvency is very unlikely. In the absence of legislative initiatives, the development of Hong Kong law in these areas is reliant on the creativity of Hong Kong insolvency practitioners and the receptiveness of the Hong Kong judiciary to take us forward.

That is not to say that there has been no legislative action since the publication of the Second Edition of this *Manual*. The key change has been the hiving off of the winding-up provisions from Hong Kong company law. On 3 March 2014, the then existing Companies Ordinance was split into two. The Companies Ordinance was introduced as Chapter 622 of the Hong Kong legislative framework to deal with the 'living' side of Hong Kong's corporate environment, leaving the winding-up and other provisions in Chapter 32 in the now awkwardly named Companies (Winding Up and Miscellaneous Provisions) Ordinance (referred to throughout this Third Edition as C(WUMP)O). Section numbers in C(WUMP)O remain the same as they were in the old CO, which we will refer to in this Third Edition as the Former CO. To make this *Manual* more readable, section numbers without a statutory reference refer to C(WUMP)O (eg, s 301), but statutory references are given for all sections in other ordinances (eg, BO, s 51B).

A recent review of the winding-up provisions of C(WUMP)O, as part of a wider review of the Companies Ordinance, has recently been completed, and it is expected that legislation will be passed into law before the end of the LegCo session ending in mid-2016. Readers should be aware that some of the winding-up provisions discussed in this Third Edition are likely to be changed when the new law comes into operation in 2017; therefore, throughout this Third Edition, we make reference where appropriate, to areas where the legislation relating to winding-up is likely to change and discuss what the implications of those changes might be.

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In the years since the publication of the Second Edition, there has been a substantial body of new case law, much of which is addressed in this Third Edition. In the Preface to the Second Edition, reference was made to the significant developments in the use of s 221 under the Former CO. The most significant trend that stands out over the last 6 years is the expansion of Hong Kong jurisprudence in the field of cross-border insolvency, much of which relates not so much to issues involving the PRC, but rather to issues arising in Hong Kong cases involving insolvencies commenced in Caribbean jurisdictions such as the Cayman Islands and the BVI. This new case law is covered in the expanded Chapter 15 on the subject of cross-border insolvency. We have also included Appendix 10, which contains a bullet-point summary of the key features of the insolvency and corporate recovery regimes in the Cayman Islands and the BVI.

In Chapter 6, we have expanded the discussion of litigation funding to reflect its greater use in, and importance for, insolvency. This section now includes an analysis of recent cases and the important policy arguments that arise in relation to the topic. Chapter 6 has been renamed 'Liquidators' Investigations and Litigation Funding' to demonstrate the increasing significance of third-party funding for insolvency litigation. We have also expanded the discussion of PRC bankruptcy law in Chapter 14. This chapter has also been renamed; it is no longer appropriate to talk about the new Chinese bankruptcy law, as the law has been in operation for over 8 years, so the chapter is now entitled 'PRC Bankruptcy Law'. This chapter discusses in more detail the areas in which bankruptcy law on the books in the PRC differs from the actual practice, what is called the 'implementation gap'. Of course, throughout this *Manual*, we have inserted many more cases and expanded the discussion of those areas of law and practice of particular relevance to practitioners.

As with the previous Editions of this *Manual*, this Third Edition has also benefitted from the input provided by many members of the insolvency profession in Hong Kong. We would like to thank James Wood of Lipman Karas for his assistance with updating the cross-border insolvency chapter and Chai Ridgers of Harneys for his help in vetting Appendix 10 (which summarises the insolvency and corporate recovery regimes in the BVI and the Cayman Islands). We are also grateful to several others: Patrick Cowley of KPMG who helped fill in some gaps in the chapter on remuneration, with particular reference to the many important developments arising from the Lehman Brothers cases; Wong Teck Meng of Briscoe Wong Ferrier, who edited the section dealing with the far from straightforward calculations involved in adjudicating claims by the PWIF; and Rupert Purser of Turnaround Asia, who offered his comments on the litigation funding section. Tanner De Witt has been kind enough to allow us to reproduce a set of specimen powers of provisional liquidators and Briscoe Wong Ferrier has allowed the use of their version of checklists for MVLs, CVLs and Compulsory Liquidations.

We would also like to thank Garrett Halydier, who is serving as Professor Booth's Research Assistant at the William S Richardson School of Law at the University of Hawai`i at Manoa, and whose diligent work assisting with researching Hong Kong law and editing and proof reading at the latter stages of the production of the *Manual* was invaluable. Thanks also to Jiamu Sun, an Associate in Sheppard Mullin's Beijing office, who assisted with researching Chinese insolvency law.

Charles D Booth
Stephen Briscoe
ELG Tyler

November 2015

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PREFACE TO THE SECOND EDITION

We write this Preface with a sense of sadness, resulting from the premature death of our friend Philip Smart on 17 June 2008. Philip was a distinguished scholar, an excellent researcher, and our collaborator on the First Edition of this *Hong Kong Corporate Insolvency Manual* in 2002. Philip was dedicated to the education and training of insolvency professionals in Hong Kong, which is why he agreed to serve as lead editor of the First Edition of this *Manual*, as a co-author of the sister volume (the *Hong Kong Personal Insolvency Manual*, which followed in 2003), and as Co-Director of the Diploma in Insolvency course launched in 2000-2001. We miss Philip dearly and have dedicated this Second Edition to him.

The Diploma course has run on four occasions and has proved invaluable as a tool for training those who want to develop their skills in the fields of insolvency and corporate recovery. However, the two Hong Kong insolvency *Manuals* have not been updated since their initial publication. In the interim, much has changed in the world of corporate insolvency and we have now taken the opportunity to remedy this by bringing this corporate insolvency text up to date and expanding its scope. In recent years, there has been no shortage of insolvency cases in Hong Kong, and we have drawn heavily upon those examples. In particular, there has been a sea of change in the way that liquidators have used their previously under-utilised powers of examination pursuant to s.221 of the Companies Ordinance. There have also been major changes in the way in which provisional liquidation and schemes of arrangement are used to facilitate corporate rescue (in the absence of a formal legislative framework), as well as in the way that liquidators' remuneration is agreed.

The basic structure of the book remains the same, although we have reformatted some of the material, leading to the inclusion of an additional chapter. We have also included two new chapters – Chapter 14, focusing on the new PRC bankruptcy law, and Chapter 15, focusing on cross-border insolvency. It is increasingly rare to have a medium- or large-sized corporate insolvency in Hong Kong without PRC or cross-border insolvency issues. Hong Kong insolvency practitioners need to have a basic understanding of the PRC insolvency regime and the new PRC bankruptcy law, which came into operation on 1 June 2007. Similarly, they must be familiar with the basic issues that arise in cross-border insolvencies. These two new chapters are intended to address those needs. All told, the text in the Second Edition is close to 50% longer than in the First Edition.

In preparing this edition, we were struck on numerous occasions by the slow pace of corporate insolvency law reform in Hong Kong. A formal corporate rescue framework is still not in place, and the myriad of proposed changes to insolvency law generally, which were recommended by the Law Reform Commission over a decade ago, also have not yet been enacted. As we write this Preface, another insolvency law reform initiative is underway. Phase II of the Companies Ordinance Rewrite is scheduled to review the liquidation provisions of the Companies Ordinance. In addition, a public consultation document on a revised version of the provisional supervision corporate rescue procedure is scheduled for publication within the next few months. We hope that years of discussion and consultation will finally lead to the enactment of an effective, modern insolvency law framework in Hong Kong for liquidation, corporate rescue, and cross-border insolvency.

As noted in the Preface to the First Edition, an increasing volume of case law is available free of charge online at sites such as the Hong Kong Legal Information Institute ('HKLII') (http://www.hklii.org) and the Hong Kong Judiciary website at http://www.legalref.judiciary.gov.hk. Again, wherever possible we have used local case law examples for which reports can be found at either of the above sites.

Any volume such as this is inevitably a collaborative effort, and it is pleasing that we have received assistance from all those that we have approached for help. We would like to extend our special thanks to Ian De Witt of Tanner De Witt, who provided assistance in a number of important areas of corporate insolvency law and procedure, and to Alan Tang of Grant Thornton for his comments on

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the preliminary version of the chapter on the new PRC Bankruptcy Law. We would also like to thank the many insolvency practitioners who provided assistance in relation to specific insolvency matters on which they have been involved, including the following: Chris Dobby of Lovells; Ludwig Ng of Or Ng & Chan; Richard Tollan of Mayer Brown JSM; Susan Kendall of Baker & McKenzie; and Wong Teck Meng of Briscoe & Wong.

We are grateful to Gall & Lane for allowing us to include as one of the Appendices the specimen powers of a provisional liquidator, and to Briscoe & Wong Ltd for allowing their checklists to be included. We are also grateful to BPP for granting permission to adapt their English materials for use in the First Edition of this publication.

We are also grateful for the helpful suggestions provided by Professor Andrew Keay of the University of Leeds. Professor Keay has been retained by the HKICPA to conduct a review of the Diploma course and the course teaching materials, which include the *Manual*. Similarly, we would like to thank Lee Aitken, an Associate Professor in the Faculty of Law at the University of Hong Kong and our Diploma course Co-Director, and Professor Ted Tyler for their constructive comments provided as part of a technical review of the *Manual*.

We would also like to thank Ms Stephanie Chan, a student in the Faculty of Law at the University of Hong Kong. Without Stephanie's cheerful and diligent assistance, the authors would have struggled to meet the deadline to finalise this volume. We are greatly indebted to Kathina Chan, Stephen's secretary at Briscoe & Wong who has worked tirelessly on finalising the text.

Last, but certainly not least, a huge vote of thanks to Alison Wilde and Yvonne Ching at the HKICPA. The publication of this book has been timed to ensure that it is available for the commencement of the next Diploma course in September 2009. The fact that this Second Edition has become a reality is due in great part to their enthusiasm, organisational skills, hard work and all-round support.

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Charles D Booth
Stephen Briscoe

August 2009

Preface to the First Edition

Several years ago, the Hong Kong Society of Accountants ('HKSA') approached two of us (Philip Smart and Charles D Booth) about the possibility of writing insolvency manuals to serve as the primary course materials for an upper-level training course for insolvency practitioners in Hong Kong. We agreed and set about adapting and expanding for use in Hong Kong the Study Notes prepared by BPP Financial Education Ltd ('BPP') for the JIEB exams in England. These new materials were prepared in time for the HKSA's Diploma in Insolvency course, which ran for the first time in 2000–2001. Over a dozen of Hong Kong's most experienced insolvency practitioners participated as instructors in the course and we are grateful for their comments and observations on practice in Hong Kong, many of which have been incorporated into this *Manual*.

Working with insolvency practitioners on the HKSA's Diploma in Insolvency course made it apparent that there was a need for a more extensive treatment of Hong Kong insolvency law and practice. Accordingly, and with the benefit of the input of Stephen Briscoe, this *Manual* began to take shape. (A sister volume, the *Hong Kong Personal Insolvency Manual* will follow in early 2003.) Our task has been made somewhat easier by the fact that, over the last few years, there has been no shortage of insolvency cases in Hong Kong, and we have drawn heavily upon these examples. We have also been fully aware that, unlike in some other jurisdictions, in Hong Kong insolvency practitioners are invariably accountants (not lawyers) and generally do not have access to law reports or a law library. Nevertheless, a wealth of material is now available (free of charge) via the internet. Readers will see that, wherever possible, we have used local case law examples which are available on-line through the newly establish Hong Kong Legal Information Institute ('HKLII') (see http://www.hkill.org). (Readers may also be interested to note that the Judiciary in Hong Kong also has established a most useful web site through which recent judgments may be accessed: see http://legalref.judiciary.gov.hk.)

We would like to take the opportunity to extend our appreciation to Ms Wendy Chiu, Senior Research Assistant in the Asian Institute of International Financial Law ('AIIFL') in the Faculty of Law at the University of Hong Kong. Without Wendy's invaluable assistance, not to mention diligence and practice, this volume would certainly have been delayed by weeks or even months. Our thanks also to Ms Flora Leung, the Secretary of AIIFL, who helped particularly with the original manuscript. Special thanks are also due to the staff in the HKSA's Education and Training Department for their support and encouragement throughout this project. We are also grateful to BPP for granting permission to adapt their English materials, and to RSM Nelson Wheeler Corporate Advisory Services Ltd for kindly allowing us to make use of the firm's checklists for this *Manual*.

Mr Booth and Mr Smart would also like to acknowledge the financial assistance provided by the Hong Kong Research Council through its funding of a research project entitled 'Moving from a Planned Economy to a Market Economy: The Development of a New Insolvency System in Mainland China and its Cross-Border Impact' (Ref: HKU 7167/01H) (Principal Investigator: Charles D Booth: Co-investigators: Zhang Xian Chu, Associate Professor, Faculty of Law, the University of Hong Kong, Professor Wang Wei Guo, Dean of the Department of Economic Law, China University of Politics and Law, and Philip Smart). This grant is funding the services of Ms Wendy Chiu, and this *Manual*, with its focus on Hong Kong insolvency law and procedures, will offer a helpful point of departure from which the investigators will analyse the laws and procedures of mainland China.

Philip Smart
Charles D Booth
Stephen Briscoe

August 2002

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About the Authors

Charles D Booth is a Professor of Law at the William S Richardson School of Law at the University of Hawai`i and is the Founding Director of the Institute of Asian-Pacific Business Law ('IAPBL'). He is a Co-Designer and a Co-Director of the Professional Diploma in Insolvency Course run by the HKICPA. He is also a Special Counsel at Sheppard Mullin and a Senior Advisor at Burford Capital. He taught in the Faculty of Law at the University of Hong Kong from 1989 to 2005 and has been teaching and writing about Hong Kong and Chinese insolvency law for more than 25 years. He has served as a consultant on insolvency and commercial law reform projects for many international organisations including the World Bank, the Asian Development Bank, the EBRD, the OECD, the ABA-UNDP, and the IDLO. He has been involved in projects in China, Hong Kong, Vietnam, Mongolia, and Vanuatu, and in Europe and Asia generally.

Stephen Briscoe has worked full-time on insolvency, corporate recovery and corporate advisory assignments since 1973. He worked for 11 years for the Official Receiver in the United Kingdom before moving into private practice and has considerable experience in investigations, liquidations, and trading receiverships, particularly in the manufacturing, service and leisure industries. He has practised in Hong Kong since 1997 where he has acted as liquidator or receiver of several hundred insolvent companies.

He is a Co-Director of the Professional Diploma in Insolvency Course run by the HKICPA. He is the convenor of the technical committee of the Restructuring and Insolvency Faculty of the HKICPA, and is on the editorial board of the monthly INSOL Electronic Newsletter. He has written a number of articles in INSOL magazine, the RIFEC insolvency newsletter and regularly speaks at conferences and seminars. He is also a board director of INSOL International.

He is the managing director of Briscoe Wong Ferrier, which specialises in corporate recovery, including restructuring; liquidations and receiverships; corporate advisory assignments; and forensic accounting and litigation support in Hong Kong, the PRC and a number of offshore jurisdictions.

ELG Tyler was formerly Professor of Law at the University of Hong Kong and City University of Hong Kong, District Judge Hong Kong, Senior Assistant Law Officer, Commercial 111 (Companies Ordinance Rewrite team), Department of Justice HKSARG.

Professor Tyler came to Hong Kong in 1985 from Australia. He was a professor at the University of Hong Kong from 1985 to 1991, when he became a District Court Judge. He returned to academia in 1994 to City University of Hong Kong and retired from there back to Australia in 2005. In 2007 he returned to Hong Kong to a temporary position in the Commercial Unit, Civil Division, and Department of Justice working on the Companies Ordinance Rewrite (the new Companies Ordinance was passed in July 2012). He subsequently worked on the Improvement of Corporate Insolvency Law exercise until the completion of his contract at the end of 2014 when he retired back to Australia. Professor Tyler has lectured and written on Hong Kong Company Law for the past 25 years.

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Section 237 is very rarely used to effect the reconstruction of a company in voluntary liquidation. Schemes of arrangement under what is now Part 13, Division 2 of the CO (previously Former CO, s 166) normally are used though they are still fairly uncommon. Another option, in theory, would be an arrangement under s 254, sanctioned by a special resolution and acceded to by 3/4 in number and value of the creditors. It is also possible that the proposed provisional supervision regime might, if it becomes law in the future, be considered a method by which to effect a reconstruction in appropriate circumstances.[14]

14 See, generally Chapter 11.

Chapter 3

Creditors' Voluntary Liquidation

3.1 Introduction

Hong Kong appears to be somewhat unusual when compared with other similar jurisdictions in that the majority of insolvent liquidations (some 60% in the last 6 years), are undertaken under the supervision of the court rather than through alternative out-of-court processes.

If a company is insolvent and the directors can see no way of avoiding liquidation, ie the company cannot trade out of its difficulties and/or the directors cannot realistically expect the company to be rescued, then the directors should take steps to cease trading and place the company into liquidation. The only option available to the directors and shareholders of an insolvent company, in the absence of a creditor petitioning to the court, is to place the company under a CVL. It is often the case that creditors are not yet aware of the company's difficulties and are therefore unlikely to petition. Moreover, even if a creditor starts the winding-up process immediately when the company ceases trading, it is still likely to take several months for the winding-up order to be made. Even then, that still does not mean that a liquidator can take office and start dealing with the affairs of the company. If the company has assets, the Official Receiver will convene meetings of creditors and contributories, which in most cases will take a further two months. It is then necessary to report the outcome of the meetings to the court and in many cases for a determination hearing to be held to approve the appointment of the liquidators. In practice, the time from the start of the process to the appointment of the liquidator can often take up to 6 or 8 months.

The CVL procedure shortcuts this process and a liquidator can be appointed in a matter of two or three weeks or, if the s 228A procedure is used, in a matter of hours, if it is necessary to protect the assets of an insolvent company. Often the value of the assets of a company can deteriorate in value significantly if they are not dealt with on a timely basis and this makes the CVL process much better from the perspective of the creditors. Additionally, certain of the statutory fees charged by the Official Receiver's Office, which are paid out of the assets of the company, are materially lower in a CVL than in a compulsory liquidation. This has the benefit of enhancing the return to creditors. In 2014, 131 CVLs were started.

3.2 General

(1) Definition

(i) Section 233(4): a CVL occurs where a company in GM passes a special resolution to go into voluntary liquidation and no certificate of solvency has been filed by the directors; as the company is not solvent, the creditors have control of the liquidation (rather than the members being in control);

(ii) Section 237A: where the liquidation commences as an MVL (a certificate of solvency having been filed), but the liquidator is now of the opinion that the

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company will be unable to pay its debts in full within the period stated in the certificate under s 233; or

(iii) Section 228A: where the directors have used the special procedure to put the company into provisional liquidation.

(2) For full details of the appropriate procedures to be followed at the various stages of a CVL, reference should be made to *Appendix 2, Creditors' Voluntary Liquidation Checklists, A–N*.

3.3 Meeting of Members (Shareholders)

(1) A meeting of the members (shareholders) of the company must be called so that a special resolution to wind up the company can be considered and passed. The resolution most commonly passed is that pursuant to s 228(1)(c), which is where the company cannot by reason of its liabilities continue its business.[1]

(2) Any special resolution must be set out in full in the notice calling the general meeting.

(3) Notice of meeting

(i) a special resolution generally requires 14 days' notice period (CO, s 571 (1)(b)(i));

(ii) this can be reduced with the agreement of a 95% majority of all shareholders entitled to attend and vote (CO, s 571(3)(b)).[2]

(iii) Note: that under the Former CO, s 116(1)(a), where 95% of the shareholders approved a shorter period of notice, there was nevertheless a 7-day minimum notice period required where a CVL was commenced under s 228(1)(b); but in relation to a s 228(1)(c) resolution, no 7-day minimum period of notice was specified in s 116(1)(a). The 7-day minimum period requirement no longer applies under the new CO.

Note: where a company uses the written resolution procedure, no previous notice to members is required and the date of the written resolution is treated as the date of a meeting of the company (s 548(4)). Section 548 expressly applies to special resolutions (s 548(3)). It would appear, however,[3] that notice of the creditors' meeting must still be given (s 241). The written resolution procedure does not fit easily with the requirement in s 241 that notice of the creditors' meeting must be sent out by post when notices calling the shareholders' meeting are sent out because the written resolution procedure does not involve any notice of the calling of a meeting of shareholders. Accordingly, the safer practice has been to convene an actual meeting of shareholders, rather than to use the written resolution procedure. The current proposals for amendments to corporate insolvency provisions intend to provide that ss 241 to 248 shall not apply where an MVL has become a CVL.

1 In the alternative, a special resolution under s 228(1)(b) might be passed, where the company resolves by special resolution that the company be wound up voluntarily.

2 This is known as 'Consent to Short Notice'.

3 See *Re YK Engineering & Piling Ltd* [2004] HKCU 1107 (unreported, HCCW 674/2004, 20 September 2004).

(4) The function of the members' meeting is to resolve to wind up the company and to nominate a liquidator.

(5) Creditors' meeting

(i) It must be held on the same day as the meeting of members or on the next day (s 241).

(ii) However, the English case, *Re Centrebind Ltd*,[4] demonstrated that even if this did not occur, the acts of the members' meeting remained valid – including the appointment of the members' liquidator, who had full powers to sell assets. Abuses are possible whereby an unscrupulous liquidator could arrange cut-price sales of assets to companies controlled by the management of the company in liquidation. *Re Centrebind Ltd* has not yet been reversed by legislation in Hong Kong. However the requirement introduced in 2003 that the liquidator must be a solicitor or certified accountant reduces the likelihood of abuse (s 22A(8)(b)).

(6) Procedure (*excepting* CO, ss 548 to 561 written resolutions)

(i) The directors call a meeting of the members/shareholders to pass the special resolution on 14 days' notice (or such shorter period as allowed).[5] In practice, the proposed liquidator will usually assist and advise the company in complying with its statutory obligations.

(ii) The meeting passes the special resolution: 75% of those attending, or represented by proxy, and voting must vote in favour.

(iii) The special resolution is filed with the Registrar within 15 days (CO, s 622). In practice, the filing is usually done by the liquidator appointed by the members at the meeting.

(iv) Notice of the resolution is given by advertising it in the *Gazette* within 14 days of it being passed. The proposed liquidator will also usually arrange for the necessary advertisements to be placed in the *Gazette* and local newspapers. Alternatively, advertisements in physical newspapers can be replaced by advertisements in online publications that are also classed as newspapers. These online publications are usually cheaper than physical publications and the cost savings can be passed on to creditors.

3.4 Convening a Meeting of Creditors (Section 241)

(1) The company must send notice of the meeting by post to all creditors at the same time as summoning the shareholders' meeting; the notice must also be advertised in the *Gazette* and in one Chinese language and one English language newspaper.

(2) The meeting must be held on the same day as the members' meeting, or on the next day (s 241(1)).

(3) Creditors' right to information

Under s 241(3), the directors must lay a full statement of the company's affairs as well as a list of creditors (and the estimated amount of their claims) before the

4 *Re Centrebind Ltd* [1966] 3 All ER 889.

5 See Chapter 3.3(3).

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meeting.[6] The proposals that are to be presented to LegCo will provide for the proposed liquidator to provide more information to the creditors, but this relates to his suitability to act as liquidator as opposed to providing adequate information to creditors about the affairs of the company.

(4) In practice, some IPs provide too little information to creditors at the meeting. It is expected that in due course the HKICPA will issue guidelines to its members regarding the information that should be made available to creditors at a s 241 meeting.

3.5 Conduct of the Section 241 Creditors' Meeting

(1) Place of meeting

CWUR, rule 116, states that the meeting should be held at the most convenient place for the majority of interested parties. In practice, the meeting should also be held at a time convenient for creditors. Now that working on Saturdays has become less common, the practice of holding meetings on Saturday mornings appears to have ceased. However, it may still be appropriate, in the right circumstances, to hold a meeting on a Saturday morning, for example where the majority of creditors are members of the public who may find it difficult to attend a meeting during office hours.

(2) Matters relating to the meetings

In relation to the s 241 meeting:

(i) before notices are sent out, the company should be advised to notify any secured creditors entitled to appoint a receiver that a s 241 meeting is to be convened;

(ii) the list of creditors should be complete (including eg banks, Inland Revenue Department, hire purchase creditors, lessors and former lessors and utilities; contingent creditors should also be included); if there are creditors in foreign jurisdictions, efforts should be made to ensure that they receive proper notice either by sending notices by fax or by email as well as by post;

(iii) notice of the meeting should be despatched no later than the date on which notices are despatched to shareholders;

(iv) advertisement of the meeting should also be carried out as soon as possible;

(v) copies of the notice convening the shareholders' meeting need not generally be circulated to creditors. However, it is useful for notice of the s 241 meeting to make reference to the convening of the shareholders' meeting as creditors will not, from the date of that notice, be able to retain the benefit of any execution or attachment against the liquidator;[7]

(vi) notice of the meeting should be sent to solicitors or debt collection agencies known to be acting for creditors; and

(vii) notice of the shareholders' meeting should be sent to all bailiffs etc known to be interested in the company.

(3) Proxies

Proxies sent out with notice of the s 241 meeting should incorporate the name of the company and the date of meeting (CWUR, rule 133).

(i) Invalid proxies:

(a) those lodged after 4.00 pm on the day before the s 241 meeting is due to take place (CWUR, rule 139(2));

(b) those incorrectly completed in a *material* way; and

(c) those not signed by the principal or a person authorised by him (in which case the nature of his authority must be stated).

(ii) Proxies should not be rejected because of a minor error in their completion, provided that:

(a) the form of proxy sent with the notice, or a substantially similar form, has been used; and

(b) the following matters are clear:

- the identity of the creditor and the proxy holder;
- the nature of the proxy holder's authority; and
- the instructions given to the proxy holder.

(iii) Fax transmission of a proxy is acceptable (CWUR, rule 139(2A)).

At present, there are no specific provisions for proxies sent by email to be accepted as valid for the purpose of a s 241 meeting. Previously, before statutory provisions were implemented to allow for proxies sent by fax to be accepted at a meeting, it was common practice among IPs to accept a faxed proxy, if at the meeting the original was produced by the creditor. At the very least there seems no reason why this practice should not be applied to proxies sent by email. In practice, if a proxy is submitted by email in a timely manner, there seems to be no reason why it should not be accepted.

(4) Claims submitted by creditors

(i) In a CVL, formal proofs of debt are not required. Moreover, there is no rule that these must be submitted by a deadline. They can be submitted at the meeting itself.

(ii) Admission or rejection of a claim for voting purposes at the meeting is the responsibility of the Chairman (usually a director of the company) who should:

(a) check that the claim identifies the creditor and the amount claimed; and

(b) admit the claim for the lower of the amount stated or the amount considered by the company to be due to the creditor.

Note: there is a risk that a creditor who claims a higher amount may be dissatisfied and attempt to delay or disrupt the meeting. It is therefore prudent for the statement of affairs handed out to the creditors to contain an acknowledgment that the inclusion of a creditors' claim in the statement

6 The LRC proposed in the *July 1999 Report*, at p 123, reforms to what is currently s 241 to bring it into line with the practice in England and Wales under the Insolvency Act 1986 (UK), but these have not been acted upon.

7 See s 269(1)(a).

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of affairs for a particular amount does not prevent a creditor claiming in the liquidation for a higher amount, if proper evidence of the claim can be provided.

(iii) The proposed liquidator can advise the Chairman (but again should be conscious of any perceived conflict of interest).

(iv) All claims and proxies should be made available for inspection by any person entitled to attend and vote.

(5) Attendance

(i) Attendance at the creditors' meeting is required by the following:

(a) a director to act as the Chairman (s 241(4));

(ii) Others who may attend the creditors' meeting include:

(a) creditors;

(b) the proposed liquidator(s) nominated by shareholders at their GM;

(c) representatives of creditors (persons holding themselves out as such should be allowed admittance and permitted to ask questions, in the absence of contrary evidence); and

(d) other persons admitted by the Chairman.

Note: The Chairman has the discretion to admit others (for example shareholders and the press), but should take into account the views of the creditors present.

(6) Information to be provided at the creditors' meeting

At the meeting, creditors should be provided with the following information:

(i) A summary or copy of the directors' statement of affairs, together with an explanation of the contents of that statement to be given verbally (or by way of a written report).

(ii) Details of any prior involvement the proposed liquidator may have had with the company, or its directors.

(iii) In relation to the prior GM (of shareholders):

(a) the venue of the meeting and the date that the notice of the GM was despatched, explaining how the notice period was waived if it was called on short notice;

(b) the resolutions passed;

(c) if a liquidator was nominated at the GM and if so his identity; and

(d) whether the GM was adjourned without resolving to wind up the company.

(iv) In relation to the s 241 meeting:

(a) any costs paid by the company in connection with organising the meeting; and

(b) any costs in relation to the preparation of the directors' statement of affairs.

(v) A brief report on the company's relevant trading history. Apart from the formalities, this should include the directors' reasons for the failure of the company as well as:

(a) extracts from any audited, or if none, draft accounts produced for periods covering the previous 3 years; and

(b) a deficiency account reconciling the most recent balance sheet with any deficiency shown in the statement of affairs.

Note: the proposed liquidator will have to rely on information obtained from company personnel and company accounts and records. At this stage he is not expected to have conducted an investigation to ensure this information is accurate.

(7) Conduct of the meeting

(i) A director chairs the meeting, but the proposed liquidator may conduct it. If so, he should explain to the meeting that this is being done on behalf of the directors and that the 'report is their responsibility'. The Chairman remains arbiter on all procedural matters.

(ii) Creditors and their representatives should sign an attendance register that should be available for later inspection.

(iii) CWUR, rule 123: the quorum for the meeting is 3 creditors (or all the creditors, if there are less than 3 in total); if a quorum is not present within half an hour, the meeting should be adjourned to a date not less than 7 and not more than 21 days later.

(iv) Creditors or representatives speaking should be asked to identify themselves.

(v) Questions put by creditors should generally be answered, unless eg they are prejudicial to the liquidation or any answer given is likely to be slanderous if subsequently proved incorrect.

(vi) Proper minutes of the meeting should be kept, signed by the Chairman of the meeting, and retained by the liquidator as part of the records of the liquidation.

Occasionally, it transpires that the director appointed to be the Chairman of the meeting fails to attend as required. In these circumstances, the meeting may elect one of their number to act as Chairman or failing that, some other person. The failure of the director to attend and chair the meeting does not invalidate the outcome of the meeting or resolutions passed thereat. See *Re Salcombe Hotel Development Co Ltd (UK)* [1991] BCLC 44.

3.6 Business of Creditors' Meeting

(1) Function of the meeting

(i) the Chairman presents the company's statement of affairs;

(ii) creditors are given an opportunity to ask questions of the Chairman;

(iii) the creditors nominate their liquidator or joint liquidators;

(iv) the creditors may vote for the establishment and composition of a committee of inspection; and

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CHAPTER 6

LIQUIDATORS' INVESTIGATIONS AND LITIGATION FUNDING

6.1 INTRODUCTION

The main objectives of a liquidator's investigations are obvious: he must seek to uncover and secure all of the company's assets and be able to assess the validity of the claims of the creditors, as well as be able to identify the reasons for the insolvency. An appropriate level of investigation is also required so that the liquidator can provide reports as necessary, whether to the court, the Official Receiver, the committee of inspection or the creditors generally.

The liquidator's investigations into the company's affairs, and the reasons for its insolvency, will often start with the statement of affairs provided by the directors[1] and an examination of the company's accounting records and associated documents, including all computerised information, as well as the company's minute books.[2] Claims submitted by creditors may also reveal transactions that are not disclosed in the statement of affairs or the company's accounting records, and may open up completely new lines of investigation. In any event, the liquidator will have to exercise his professional judgment to ensure that any investigations are appropriate and proportionate to the size and complexity of the winding up. At an early stage of the liquidation, the liquidator should: (1) identify those aspects of the company's affairs that require investigation; and (2) establish a programme that will enable him to be satisfied that all material areas are dealt with.

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6.2 INSOLVENCY GUIDANCE NOTES

In recent years, the HKICPA has become increasingly involved in efforts to improve the training and education of insolvency practitioners and has implemented a system of Insolvency Guidance Notes ('IGNs').

To date, IGNs have been issued dealing with the following subjects.

IGN 1 – Scope

IGN 2 – Liquidators investigation into the affairs of an insolvent company

IGN 3 – Preparation of insolvency officeholders' receipts and payments accounts

IGN 4 – Disqualification of directors – statutory reports[3]

The IGNs are aimed at providing guidance to insolvency practitioners in much the same way as Statements of Insolvency Practice ('SIPs'), issued by the Association of Business Recovery Professionals ('R3') in the United Kingdom.

At the moment, they are by no means as extensive in either scope or detail as those in the United Kingdom. Because they are issued by the HKICPA, strictly speaking, they are

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1 See Chapter 4.7(5).

2 Details of appropriate procedures that may be followed by the liquidator are set out in, for example, *Appendix 6, Compulsory Liquidation Checklists, E, Investigations.*

3 Copies of the IGNs are attached as *Appendix 7.*

only applicable to its members. However, it is to be expected that any person who acts as an IP in Hong Kong would follow the guidance.

The guidance notes point out to HKICPA members that:

> … failure to follow the IGNs may put a member at risk of having to justify his or her actions in answer to a complaint against him or her.

IGN 2 deals with the investigatory work that should be undertaken following the liquidator's appointment.

(1) Objectives of IGN 2

To set out a minimum standard procedure for carrying out the duty to investigate the affairs of the company (whether there are substantial assets or not). Creditors should be confident that the duty has been discharged.

(2) Objectives of the liquidator's investigation:

(i) To determine the assets and liabilities of the company.

(ii) To review the conduct, decisions and actions of the directors and determine the cause(s) of the failure.

(iii) To determine (if necessary with the benefit of legal advice) whether any transactions can be set aside.

(iv) To uncover any rights of action that the company or the liquidator may have against third parties.

Note: It is not the prime role of the liquidator to investigate possible criminal offences. However, should any potential offences be uncovered, the liquidator should report them to the Secretary for Justice in a voluntary liquidation and to the Official Receiver in a winding up by the court (s 277). In addition, in an appropriate case, information might be supplied to the SFC, the ICAC, the CCB, or the Stock Exchange.

(3) Questioning management

The following may need to be questioned:

(i) directors and 'shadow' directors (particularly with a view to verifying the statement of affairs);

(ii) former directors (in the previous 3 years);

(iii) the company secretary;

(iv) other senior personnel (eg managers); and

(v) the company's accountant and auditor.

Note: information provided by creditors can also prove useful.

(4) Accounting and other information

(i) The last audited balance sheet and P&L account should be obtained:

(a) Compare fixed and current asset values in the statement of affairs with those in the balance sheet: can any material movements be explained?

(b) Is there a material difference between the deficiency shown in the statement of affairs and the position in the audited accounts (after taking into account matters such as writing down the value of assets)? If so, consider preparing a deficiency account, as well as a trading profit and loss account;

(c) Ascertain what transactions the company was involved in, or negotiating, at the time of the commencement of the liquidation.

(ii) Obtain the books and records of the company since last audited accounts:

(a) Examine transactions outside the normal course of business, particularly unexplained expenditure and receipts;

(b) Especially examine transactions with connected persons and associated companies (were these at arm's length?); and

(c) In particular, look at transactions involving the directors (for example, where they personally guarantee the company's indebtedness to the bank – a reduction in an overdrawn loan account in the run up to the liquidation may imply a preference in favour of the guarantor).

(iii) Obtain all documentation relating to security over the company's assets and check the validity of charges (registration, etc).

(iv) Where a receiver has previously been appointed, check the validity of the appointment.

(v) Collate supporting documentation for fixed assets and current assets (eg book debts) to facilitate their subsequent realisation or recovery.

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(5) Obtain the company's statutory and minute books and compare with results of company search

(6) Potential actions by the liquidator

(i) Misfeasance proceedings against company officers for misapplication of company property or breaches of fiduciary duty;[4]

(ii) Fraudulent trading;[5]

(iii) Voidable transactions, ie unfair preferences, void dispositions, fraudulent conveyances, extortionate credit transactions, and invalidation of floating charges created within 12 months of the commencement of the winding up;[6]

(iv) Disguised return of capital to shareholders;[7]

(v) Section 301: unlawful distributions to members;

(vi) Sections 536 to 538: directors entering into contracts with their own company; and

(vii) Sections 500 to 504: unlawful loans to directors.

Re Halt Garage (1964) Ltd [1982] 3 All ER 1016 should be borne in mind where it appears that one or more shareholders/directors have been drawing substantial remuneration but not actively carrying out any functions. The two directors and shareholders of the company were H and W. H was in control of the business but W also used to work in the business and drew directors' fees at a certain level.

4 Discussed in Chapter 6.3.
5 See Chapters 7.8 and 7.9.
6 See Chapter 7.
7 *Re Halt Garage (1964) Ltd*; and *Aveling Barford Ltd v Perion Ltd*, below.

However, W became sick and ceased to work at all for the company, or play any real part in its affairs. Nevertheless, for 2 years during her illness she continued to be remunerated at a substantial rather than nominal level (although that level was later lowered somewhat). During this period the company was making substantial losses. The English court held that W's 'remuneration' could be recovered from her by the liquidator (except in respect of an amount that was a proper award of remuneration merely for holding the office of director). In other words, the court held that although the payments were labelled 'directors' remuneration', they were, in reality, disguised returns of capital to W (at a time when the company was insolvent).

Another example where a liquidator recovered in a case described as involving a disguised return of capital is *Aveling Barford Ltd v Perion Ltd* [1989] BCLC 626. AB was controlled by Dr Lee Kin Tat, who also controlled P. AB had made substantial losses and was not in a position to make a distribution (for instance, by declaring a dividend) to its shareholders, although the company's assets did, at the time, exceed its liabilities. AB owned a block of land that had been valued at a certain price. AB sold that land at approximately half the valued price to P, which later resold it at a very substantial profit. AB later went into liquidation. The English court held that the sale by AB to P was not a genuine exercise of the company's powers but was a sale, at an undervalue, to enable Dr. Lee to obtain an unauthorised return of capital. P was held by the court to be a constructive trustee of the proceeds of the (second) sale.

Note: any action against a director or other defendant pre-supposes that the director or other defendant is worth suing (eg the potential defendant is not insolvent or otherwise judgment proof).

6.3 Liquidator's Investigations – Some Practical Guidance

(1) Introduction

This section is not intended to be a checklist of the work that a liquidator should undertake in protecting and realising the assets of the company and investigating the conduct of the directors and the reasons for the company's failure. Rather, the purpose is to look at some of the practical steps that a liquidator should take to ensure that there is full compliance with statutory and other obligations.

(2) Immediate post-appointment issues

(i) Books and records

Immediately following his appointment, the liquidator should take steps to safeguard, collate, and store the accounting records of the company. These records are likely to be needed by the liquidator for the purpose of his investigations. When they are being boxed up, it is important to ensure that a detailed schedule is maintained of the records that have been placed in storage and exactly where they are within the storage system. This can be quite a labour-intensive exercise in the early days of an administration, but efficient access to the company's records at a later date, when the records are no longer stored at the office of the liquidators, can be of considerable assistance to the cost-effective running of the liquidation.

In certain situations, consideration may need to be given to continuing to use former accounting staff, under the supervision of the liquidators, to bring the accounting records up to date. This can be particularly useful where there is a large volume of accounts receivable that require accurately accounting for before the liquidator can properly pursue their collection.

(ii) Electronic records

It is equally important to ensure that the electronic records of the company are properly secured. At the very least, a complete backup of all the electronic accounting records should be made. There may also be a case for making a forensic copy of the electronic records, as this could be used for evidential purposes in the event of proceedings being brought by the liquidator at a later date.

Once the backup/forensic copy has been made, it should then be safely stored away from the liquidator's premises and a further copy used for the purposes of the liquidator's investigations.

The records of the company can be used to assist the liquidator in pursuing actions for the recovery of undisclosed assets and actions against directors, in dealing with proofs of debt for dividend purposes and in providing information to the Official Receiver in the event of prosecution proceedings and/or disqualification against the directors. In one case, where the Official Receiver was contemplating prosecuting the directors for a failure to keep proper books of account, the proceedings had to be dropped when it came to light that the company's IT assets had been sold soon after the date of the winding-up order, but no copy of the information contained on them had been made.

Steps should also be taken to ensure recovery of the employee records (to be able to calculate the various claims of employees) and the statutory records such as the minute book. The minute book can often be informative for what it does not show. In practice it is rare for minutes to contain anything other than routine matters, with little or no reference to major decisions affecting the running of the business. On the other hand, the absence of minutes supporting material transactions can, in certain circumstances, be of assistance to the liquidators. In the context of a liquidation that might take place several years after the event at issue, it may be difficult for a director to justify the circumstances surrounding the disposal of an asset if there is no contemporaneous board minute setting out the reasons for the disposal.

(iii) Securing assets

Immediately following his appointment, the liquidator should take steps to secure all the company's assets as a matter of urgency. Invariably, the liquidator will instruct professional agents to assist him in this process, but the responsibility remains that of the liquidator.

It is one of the responsibilities of the directors to assist the liquidator in establishing the whereabouts of all the company's assets. In addition, the liquidator should compare the assets disclosed by the directors in the statement of affairs with those disclosed in the last set of the audited accounts. Any discrepancies should be addressed as a matter of urgency to ensure that any undisclosed assets are recovered.

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Most assets in Hong Kong are capable of being secured without too much difficulty. However, there will always be some situations that will create difficulties. For example, a construction company working on a government contract may well have plant and machinery of significant value on the site where work is being done. Unfortunately, it is almost certain that the liquidator will be unable to immediately recover the plant and equipment. The standard terms of government contracts mean that the plant and machinery must remain on site for as long as it is deemed necessary, in order to facilitate completion of the contract. In such a situation, the liquidator can best protect the interests of the creditors by ensuring that a full inventory of the plant and equipment on site is undertaken immediately following his appointment. Ultimately, when the contract has been completed it will be for the contractor running the site to account to the liquidator for the plant and equipment.

It is frequently the case that a company has physical assets situated in the PRC. These are usually factories in which the company has an interest, either as the owner of the Wholly Foreign-Owned Enterprise ('WFOE') or as a partner in an Equity Joint Venture ('EJV'). There are likely to be insurmountable problems when trying to recover these assets for the benefit of the Hong Kong creditors. If the PRC court has sealed the premises, no one will be allowed to have access to the assets on the site. Eventually, those assets are likely to be sold by the court with very little prospect that there will be any surplus for the liquidator in Hong Kong.

However, it may be that there are accounting records of the company situated on those premises. In those circumstances, the liquidators should make an effort to obtain access to the premises to at least conduct a review of the accounting records, although it is most unlikely that the court will allow any of the records to be removed.

The liquidator must also take steps to ensure that any assets that are the property of third parties are immediately identified and, provided the liquidator is satisfied as to the third-party title to them, that they are returned to the beneficial owner as soon as possible.

Accounts receivable are often one of the key classes of assets of many companies. The liquidator should ensure that he recovers all the relevant hard and soft copy accounting records relating to the accounts receivable so he can maximize recoveries from that source. If the company has a large number of accounts receivable, it may be cost-effective for the liquidator to employ, on a short-term basis, former employees of the company whose knowledge of the accounts receivable, customers, and accounting procedures to assist in enhancing recoveries.

(iv) Insuring assets

Once the company's assets have been identified, steps should be taken to insure them as appropriate. Insurance designed specifically for insolvency practitioners is available in Hong Kong and should be utilised where appropriate. However, there may be situations where the standard insurance available may need to be extended. For example, a liquidator removing assets from particular premises may be required by the owner of the premises to take out additional insurance to cover the possibility of damage to the premises. Furthermore, there may be assets such as aircraft or ships where specialist insurance cover will have to be purchased.

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(v) Sale of assets

The liquidator should carefully consider, in conjunction with his agents, the best method by which the assets of the company should be disposed of. Some assets are best sold by way of auction or tender, whilst for others a sale by private treaty may result in greater recoveries. Crucial to any sale process is that it is seen to be fully transparent. It is also essential that the liquidator can show that the best possible value in the circumstances has been created from the disposal of the assets by fully exposing them to the market.

(a) Public auction

In theory an auction is an open transparent process that should lead to the highest offer for a particular asset. However it is not the ideal method of disposing of every type of asset and there is always the risk of collusion between potential purchasers, the effect of which is to drive down the eventual realisable value of the asset. In a liquidation context, it will tend to work best where there are many items for sale with none of them having a material value. Difficulties arising in auctions in Hong Kong involve the time that it takes for the process to be completed and the costs of transporting and storing assets whilst the goods are catalogued and advertised for sale.

(b) Private treaty

Sales by private treaty typically take place where interested parties have had the opportunity to view and inspect the asset and are then asked to submit their highest offer to the liquidator's agent. The agent then executes the sale and accounts to the liquidator for the proceeds. This works well for the sale of items such as office furniture, whose relatively low value often means that the relatively high costs of removal and storage make it more commercial to sell the items *in situ* with the purchaser picking up such costs. Motor vehicles are another class of asset often sold by private treaty.

(c) Private tender

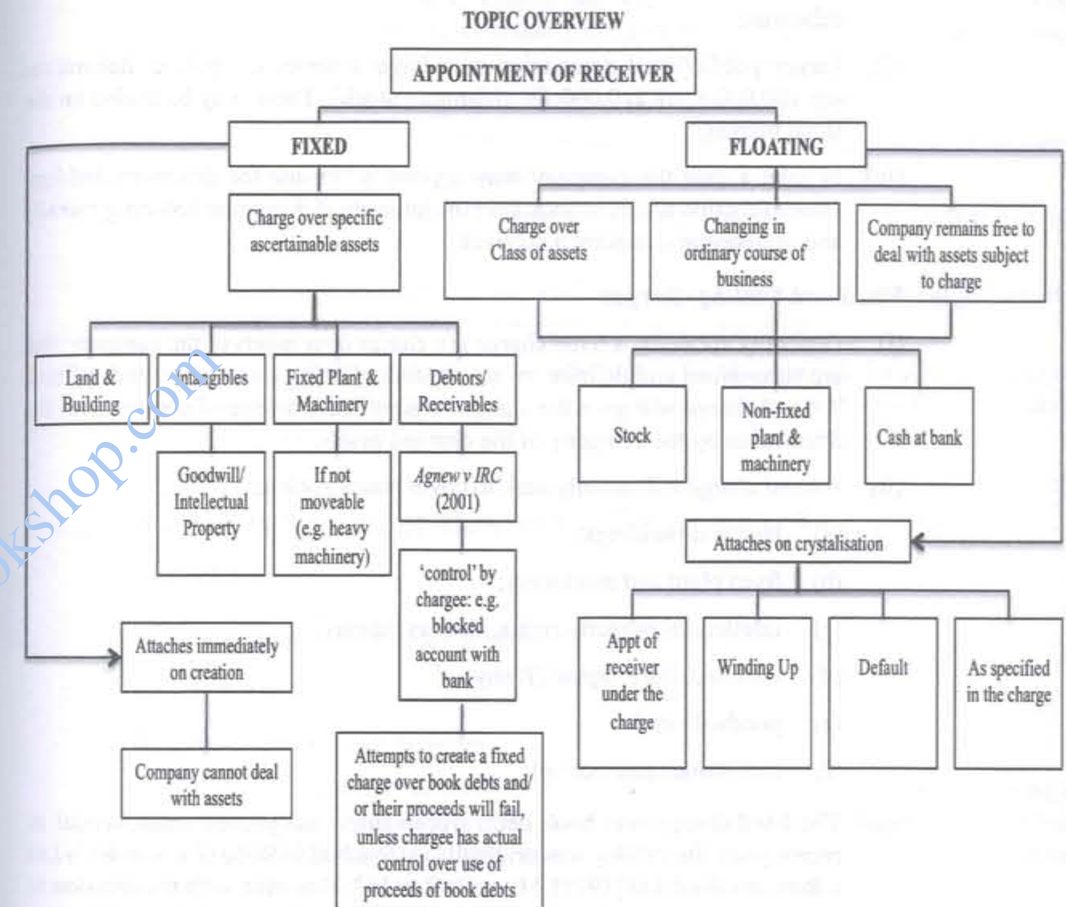
Sales by private tender are usually a very cost-effective and transparent process for disposing of a variety of assets. In broad terms the liquidators will prepare a 'prospectus' setting out the assets available for sale. The information in the prospectus will vary depending on the nature of the asset that is being offered for sale, but it should be sufficient to enable potential purchasers to make a decision as to whether they wish to make an offer and, if so, how much to offer. It is essential that the liquidator ensure that everything is done to bring the assets to the attention of all potential purchasers.

It may be that information will be made available to potential purchasers through a 'data room', and in appropriate circumstances interested parties will also be given the opportunity to make a site visit to 'kick the tyres'.

The documentation should also include a form to enable potential purchasers to indicate the level of their offer. In some circumstances, purchasers will be asked to tender the whole of the purchase price by way of a banker's draft; in other situations they will be asked to pay a deposit.

Chapter 10

Charges and Receivership



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10.1 Introduction and Terminology

(1) Borrowers and lenders

Example: Company X borrows money from Bank Y. Bank Y requires the company to issue a debenture (eg a debt instrument or security document in favour of the Bank). The debenture is secured by fixed and floating charges. Of course, any creditor, not just a lender, can take a charge to secure the relevant indebtedness.

(i) Company X is the borrower. It is referred to as the mortgagor or chargor.

(ii) Bank Y is the lender. It is referred to as the mortgagee, chargee, or charge holder.

(iii) A debenture is a written acknowledgement of a debt. It is often in a standard form presented by the bank to the company on a 'take it or leave it' basis.

(iv) A charge is an interest in a company's property created in favour of a creditor. In the above example, Company X has granted Bank Y an interest (a 'bundle of rights') over the charged assets. One of those rights will be to appoint a receiver should Company X, for example, default in repayment of the loan.

(2) Debentures

(i) In the above example, Company X has issued a 'single' or a 'banker's' debenture.

(ii) Larger public/listed companies may issue a series of 'public' debentures (eg 100,000 x HK$10,000 6% debenture stock). These may be traded on the stock market.

(iii) In such a case the company may appoint a 'trustee for debenture holders' whose function will be to look after the interests of debenture holders generally and, if necessary, appoint a receiver.

(3) Fixed and floating charges

(i) Generally speaking, a fixed charge is a charge over assets of the company that are ascertained and definite, or are capable of being ascertained and defined. A fixed charge will give the chargee a significant degree of control over the disposition by the company of the charged assets.

(ii) A fixed charge will usually seek to cover assets such as:

(a) land and buildings;

(b) fixed plant and machinery;

(c) intellectual property rights, such as patents;

(d) uncalled share capital (if any);

(e) goodwill; and

(f) receivables (see below).

(iii) The fixed charge over book debts (receivables) has proved controversial in recent years. Its validity was originally established in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142. However, with the decision in *Agnew v IRC* [2001] UKPC 28, [2001] 2 AC 710, [2001] 3 WLR 454 (often referred to as the *Brumark* case) and *Re Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680, [2005] 4 All ER 209, that situation has fundamentally changed. Fixed charges over book debts will – in the light of the decisions in *Brumark* and *Spectrum Plus* – now be rare. It should be noted that the label put on the charge by the parties is not conclusive. The court may decide that what has been labelled as a fixed charge is in reality a floating charge. It is clear after the above cases that: (a) where the company remains free to deal with the (uncollected) book debts (eg by assigning or factoring them) a court will hold that the charge is floating, as the freedom to deal with the assets is one of the hallmarks of the floating charge; and (b) in relation to the proceeds of the book debts, if the company remains free to deal with the money received, the court will hold that the charge is floating.

If a bank wishes to create a fixed charge over book debts, it will be necessary that the company establishes and operates a 'blocked account'. The proceeds must be paid into a designated account and the company is not (in practice as well as in law) allowed to deal with sums in the account without the bank's prior written approval. Attempts to separate uncollected book debts from the proceeds of realisation (and create a fixed charge over the former and a floating charge over the latter) will fail after *Brumark*. In practice, it appears that invoice discounting and factoring have taken the place of the fixed charge over book debts.

(iv) In brief, a floating charge has, according to Romer LJ in *Re Yorkshire Woolcombers' Association Ltd* [1903] 2 Ch 284, the following three characteristics:

(a) it is a charge that 'hovers' over a class of assets present and future;

(b) those assets change from time to time in the ordinary course of business of the company; and

(c) the company remains free to carry on business in the usual way in relation to those assets (until 'crystallisation').

(v) Stock in trade and non-fixed plant and machinery would normally be covered by a floating charge (as would receivables, see above).

(vi) In practice, the security documentation will often provide for a fixed charge on the assets listed in (ii) above and a floating charge on the rest of the company's property.

10.2 The Distinction Between Fixed and Floating Charges

(1) Definitions and assets covered

See Chapter 10.1.

(2) When the charge attaches

(i) A fixed charge attaches to the charged property when it is created (assuming it is validly registered).[1] The effect of this is that the company is no longer free to dispose of the charged property and will need to seek authorisation from the charge holder before realising or dealing with the charged property.

(ii) A floating charge only attaches to the charged property on 'crystallisation'. Until crystallisation the company remains free to dispose of the charged property and requires no authorisation from the charge-holder to do so. Crystallisation typically occurs:

(a) on cessation of the company's business;

(b) on liquidation of the company;

(c) on a receiver being appointed under the charge;

(d) on the happening of an event specified in the charge causing crystallisation, for example;

- where another charge-holder appoints its own receiver;
- where some other specified default by the borrower occurs; or

1 See Chapter 10.3(2).

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- upon the charge-holder giving notice to the company in accordance with the terms of the charge to convert the charge into a fixed charge.[2] Such clauses were of greater relevance in the past as a lender, by crystallising the charge, converted it into a fixed charge and thus could obtain priority over the preferential creditors. This is no longer possible as s 265(3B) now refers to a charge which *as created* was a floating charge.

(3) Priority: preferential creditors

(i) Where a company is in liquidation, preferential creditors have priority over the proceeds of realisation of the assets secured by any floating charges (s 265(3B)) and this includes any charge which was created as a floating charge, regardless of whether it has since been converted into a fixed charge by crystallisation. The holder of a fixed charge is not covered by s 265(3B).

(ii) Where a company is not in liquidation, s 79 provides that a receiver appointed by the holder of a charge which as created was a floating charge has a duty to pay the preferential creditors in priority to his appointer.[3]

(4) Validity: s 267

(i) This rule only applies to floating charges (which expressly includes any charge created as a floating charge). It does not apply to fixed charges.

(ii) It provides that a floating charge:

- created within 12 months prior to the commencement of the winding up;
- at a time when the company is insolvent;
- is invalid except to the extent that 'new money' is provided to the chargor at the time the charge is created or subsequently.[4]

(iii) 'New money' will often have been provided by a bank merely by the turnover of the company's bank account: for the operation of the rule in *Clayton's Case* (1816) 1 Mer 572, 35 ER 781, [1814–23] All ER Rep 1.[5]

(iv) The proposals from the Improvement of Corporate Insolvency Law exercise include extending the look back period for floating charges created in favour of persons connected with the company to 2 years and expanding the scope of the exemption by broadening the forms of consideration for the creation of valid charges.[6]

10.3 Priority of Charges

(1) Contractual arrangements

(i) Where there is more than one secured creditor, they may (at least in certain circumstances) validly agree between themselves as to the order in which they will rank should the company default.

2 *Re Brightlife Ltd* [1987] Ch 200, [1986] 3 All ER 673.
3 See further, Chapter 10.3(4).
4 See *Re Dream Asia Ltd* [2003] 2 HKLRD 287, [2003] 3 HKC 222.
5 See Chapter 7.5.
6 See Consultation Conclusions (28 May 2014) Appendix III Chapter 5 Item C, published on the Financial Services and Treasury Bureau website (www.fstb.gov.hk).

(ii) A lender may often make it a condition of granting a loan that the company does not create any charges ranking in priority to its own security. It may require, for instance, that no subsequent fixed charges are created that take in priority to its own floating charge (a so-called 'negative pledge clause'). Such clauses bind the company as a matter of contract, but are of little use against third parties, unless the third party has actual knowledge of the clause. Moreover, registration of a floating charge does not constitute constructive notice of the terms and conditions in the security documentation. Indeed, even where details of the negative pledge clause itself have been included in the registered particulars, this does not give constructive notice to later chargees. See *ABN Amro Bank NV v Chiyu Banking Corp* [2001] 2 HKLRD 175, [2000] 3 HKC 381.

(2) Validity

(i) For a lender to rank as other than unsecured, the charge must be valid (and registered).

(ii) Section 335 of the CO requires that (most) company charges be registered within 1 month after the date of creation.

(iii) Section 334 of the CO lists the types of charges that should be registered; it includes, but is not limited to, all charges on land, any charge on book debts (fixed or floating) and any floating charges. If a charge is not so registered, it is void against the liquidator or any creditor of the company (subject to late registration).

(iv) If, however, the Registrar of Companies permits registration outside the 1 month period, the charge *is* nonetheless validly registered.[7] This is because the Registrar's certificate of registration is *conclusive* evidence of compliance (CO, s 344(4)). The one exception is where there is fraud.[8]

(v) In theory, it is the obligation of the company (acting through its officers) to register the charge, but registration may be effected by any person interested in the charge, and in practice the lender's solicitors will generally register the charge.

(vi) The validity of a floating charge may be challenged under s 267 (see above). Although there is no similar 12-month rule in relation to fixed charges, such a charge created within 6 months of liquidation could be challenged as an unfair preference.[9] However, it would need to be shown that the company was insolvent at the time of, or as a result of, the giving of the charge and that there was a 'desire' on the part of the directors to improve the position of the lender. If the granting of a secured debenture by the directors was motivated, as is often the case, by an intention to prevent the bank from calling in the overdraft, or taking some other enforcement measures, the requisite subjective desire will be absent: see *Re MC Bacon Ltd* [1990] BCLC 324.

(3) General position

(i) Assuming that registration requirements have been complied with, the normal order of payment would normally be:

7 *Re Esal Commodities Ltd* [1989] BCLC 59.
8 See *Sun Tai Cheung Credits Ltd v Attorney General* [1987] 2 HKC 13.
9 See Chapter 7.2.

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(a) costs;

(b) any fixed charge;

(c) the preferential creditors; and

(d) the bank under the floating charge.

Any surplus is paid to the company acting through its liquidator, or if the company is not in the process of winding up, and appears solvent, to the directors.

(ii) *IRC v Goldblatt* [1972] Ch 498, [1972] 2 All ER 202 makes it clear that a receiver has a duty to pay the preferential creditors and may be liable for a breach of that duty. One aspect of this is that where a receiver receives a number of offers from potential purchasers to acquire the business and assets of the company, a factor he will wish to take into account will be the extent to which each offer takes into account the position of the preferential creditors.

Where there is more than 1 floating charge (over the same class of assets) the normal rule is that they rank according to their respective dates of creation (at least where the floating charges crystallise at the same time, eg upon the company going into liquidation).

(4) Receivers and section 79

(i) Where a company is not in liquidation, but a receiver has been appointed, s 79 appears to give the company's preferential creditors priority over any floating charges.[10] Despite what seems to be the clear intent behind s 79, on 2 occasions the courts in England have been asked to determine whether preferential creditors rank ahead of *all* floating charge holders or only ahead of those who appoint receivers.[11]

(ii) In *Griffiths v Yorkshire Bank plc* [1994] 1 WLR 1427, the court interpreted the relevant words – 'in priority to any claims for principal or interest in respect of the debentures' – as meaning in priority to the debenture under which the receiver was appointed *only*.

(iii) In contrast, *Re H & K Medway Ltd* [1997] 2 All ER 321 held that the section should be interpreted to mean that the preferential creditors rank ahead of *all* debentures with floating charges. Both cases are High Court cases (and not in any event binding in Hong Kong) but arguably *Medway* is to be preferred, as it emphasises protecting preferential creditors.

10.4 Receivership: Outline

(1) Types of receiver

A receiver may be appointed:

(i) in relation to land pursuant to s 50 of the Conveyancing and Property Ordinance (Cap 219);

(ii) by the court; or

10 Where a company is being wound up, s 265(3B) makes it clear that the preferential creditors have priority.

11 The legislation in the United Kingdom and Hong Kong are essentially the same.

(iii) out of court, in accordance with the terms of a debenture or charge.

It is only this last category of receiver with which this Chapter is concerned. The practice is for a lender making an appointment (in accordance with the debenture) to appoint a receiver and manager.

(2) Disqualification

An undischarged bankrupt (s 297A) cannot be appointed as a receiver (or a receiver and manager) of the company's property; neither can any body corporate (s 297). A person subject to a disqualification order cannot act as a receiver/manager (s 168D).

(3) Notice of appointment and statement of affairs

Section 299 requires that where a receiver or manager of the property of a company has been appointed, every business letter and invoice etc of the company shall reveal the relevant appointment; eg 'XYZ Widgets Ltd (in receivership)'.

Section 348 of the CO specifies that where, *inter alia*, a person appoints a receiver or manager, notice must be sent within 7 days to the Registrar of Companies. Notification upon the receiver/manager *ceasing to act* is also mandatory (CO, s 350(3)). Details as to the form of notification are to be found in *Butterworths Hong Kong Company Law Handbook* (LexisNexis Hong Kong, 17th edn, 2015) at paras [348.02] and [350.02].

The company must also be informed at once upon the appointment of a receiver or manager by the holder of a floating charge over all or substantially all the company's property (s 300A). As to the form of notice used in practice: see *Butterworths Hong Kong Company Law (Winding Up and Miscellaneous Provisions) Handbook* (LexisNexis Hong Kong, 2014) at para [300A.03].

Informing the company triggers the requirement that the directors and secretary (and other persons identified in s 300B(2)) must within 14 days of receipt of the notice (or such longer period as may be allowed by the court or by the receiver) supply the receiver with a statement of affairs of the company in accordance with s 300B.

Where the receiver is appointed on behalf of the holders of a debenture secured by a floating charge, the receiver must within 2 months of receipt of the statement of affairs:

(i) send a copy of the statement of affairs, together with any comment thereon, to the Registrar and to the court (s 300A(1)(c)(i));

(ii) send a copy of a summary of the above to the Registrar (s 300A(1)(c)(i));

(iii) send a copy of the comments to the company or, if he does not see fit to make any comments, send a notice to that effect to the company (s 300A(1)(c)(ii)); and

(iv) send a copy of the summary to the trustee for the debenture holders who made the appointment and to all such debenture holders of whose addresses he is aware (s 300A(1)(c)(iii)).

A receiver who is appointed under the powers contained in any instrument (including powers contained in any enactment: see s 302A) will be under the same statutory obligations to deliver the documents to the parties set out in (i) to (iv) above, with the exception to the court in (i).

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10.5 Duties and Powers of Receivers

(1) Duty to the company

The appointment of a receiver will always in practice specify that the receiver is an agent of the company. This is a peculiar type of 'agency' since the receiver is trying to bring about a situation in which the secured debt (and interest) will be repaid to the debenture holder – even if this results in the commercial death of the company. Moreover, it must be stressed that, although described as the company's agent, the receiver in no way accepts instructions from the directors or shareholders of the company.

It is settled that decisions taken in good faith by a receiver to protect the interests of the debenture holder cannot be impeached even though such actions are directly disadvantageous to the company – eg selling the company's only income-producing assets (*Downsview Nominees Ltd v First City Corp Ltd* [1993] AC 295, [1993] 3 All ER 626) (PC).

This duty of a receiver includes:

(i) a duty to act in good faith, including when selling charged assets;

(ii) a duty to exercise powers for the proper purpose; namely, to achieve repayment of the debt and interest (*Downsview*);

(iii) a duty in equity (not tort law) to exercise due diligence in seeking to bring about a situation in which repayment occurs (*Medforth v Blake & Ors* [2000] Ch 86, [1999] 3 All ER 97, [1999] EWCA Civ 1482 (26 May 1999) (BAILII) (CA(Eng));

(iv) a duty to take reasonable care to ensure that a proper price is obtained for assets. See also *Silven Properties Ltd v Royal Bank of Scotland* [2004] 4 All ER 484, [2003] EWCA Civ 1409 (21 October 2003) (BAILII) (CA(Eng)).

Nevertheless, there is no duty to carry on the business of the company and the receiver may simply sell off the assets. But where the receiver has elected to carry on the business, he has to manage it with due diligence (*Medforth v Blake*, above).

(2) Other duties

In addition to the obligations in relation to reporting (above), the receiver is under a statutory duty to pay preferential creditors.[12] The receiver may not purchase charged assets.

Duties owed to the company as mentioned above will also be owed to anyone else with an interest in the equity of redemption (*Medforth v Blake*, above).

(3) Powers

For precise details in any given case it will be necessary to look to the terms of the debenture or appointment document (or the court order, where the appointment is made by the court), but these will normally include a power to collect, sell and manage the charged assets. A receiver appointed out of court may apply to the court for directions in connection with the performance of his functions (s 298A(1)).

12 See the discussion of s 79 in Chapter 10.2(3). For reporting requirements in relation to the disqualification of directors, see Chapter 12.4.

10.6 Accounts

A receiver appointed, *inter alia*, in respect of debentures secured by a floating charge over all or substantially all of the company's property, must at yearly intervals – and upon ceasing to act – deliver an abstract in the specified form showing his receipts and payments during the relevant period, together with the aggregate amounts of his receipts and of his payments during all preceding periods since his appointment, to the following (s 300A(2)):

(i) the Registrar of Companies;

(ii) the company;

(iii) any trustee for the debenture holder(s) on whose behalf he was appointed; and

(iv) all known debenture holders.

The receiver must supply the abstracts within 2 months after the respective dates (or such longer period as the court may allow).

Note: similar obligations are imposed on the receiver appointed under the powers contained in any instrument; for details see ss 300A(3)(b) and 301.

10.7 Contracts

(1) Contracts not terminated

The appointment by a debenture holder of a receiver does not of itself terminate contracts that the company has previously entered into (including employment contracts).

Actions taken by a receiver, eg selling the company's income-producing assets, may cause the company to breach its contracts with third parties (eg to supply processed items). On the other hand, the third party's remedy in damages against the company may be worthless for all practical purposes. There is nothing to prevent the receiver from acting in such a way, unless the third party has already acquired an equitable interest in the property in question.

Example: A Ltd owns a piece of land and, on 1 March 2002, contracts to sell it to B. On 12 March 2002, a bank appoints a receiver under a floating charge. In equity, the land already 'belongs' to B, so it will fall outside the charged assets and not be available to the receiver.

(2) Contracts entered into by a receiver

Where a receiver is appointed out of court, he is personally liable on any contract entered into by him in the performance of his functions (s 298A(2)). The receiver, however, is entitled to an indemnity out of the assets subject to the charge. He can also expressly exclude personal liability in the terms of the contract itself and in practice will always do so.

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time to mature, but practitioners at least now have available to them a set of modern tools with which to try to facilitate the rescue of distressed companies and to handle the efficient winding up of those that have no future. Time will tell whether the new law takes hold and achieves its potential.[17]

17 For further analysis of the EBL and its development, see Booth, Charles D, 'Drafting Bankruptcy Laws in Socialist Market Economies: Recent Developments in China and Vietnam', (2004) 18(1) *Columbia Journal of Asian Law* 93; Booth, Charles D, 'The 2006 PRC Enterprise Bankruptcy Law: The Wait is Finally Over', (2008) 20 *Singapore Academy of Law Special Issue* 275.

CHAPTER 15

CROSS-BORDER INSOLVENCY

15.1 INTRODUCTION

Traditionally, cross-border insolvency issues have arisen primarily in two ways – from 'inbound' transactions and from 'outbound' transactions. In the Hong Kong context, an inbound transaction arises when a foreign representative administering a foreign corporate insolvency proceeding seeks to gain possession of the foreign debtor's assets in Hong Kong, seeks the recognition and co-operation of the Hong Kong courts to enable him to discharge his duties or seeks a turnover of assets from a Hong Kong insolvency proceeding to the foreign proceeding. The foreign representative may also seek to wind up the foreign company in Hong Kong. An inbound transaction can also occur when a creditor (either Hong Kong or foreign) petitions for the winding up of the foreign company in Hong Kong.

An outbound transaction is the reverse, wherein a liquidator appointed in a Hong Kong winding up goes abroad to gain possession of the Hong Kong debtor's assets, seeks the recognition or co-operation of the foreign courts, or seeks a turnover of assets from a foreign insolvency proceeding to the Hong Kong winding up. The Hong Kong liquidator may seek to have the Hong Kong company wound up in each foreign jurisdiction in which it has assets.

Increasingly, however, cross-border insolvencies have arisen in a third way – as part of a worldwide or regional corporate group collapse in which a parent company and each (or some) of its subsidiaries (and perhaps related companies) files for liquidation or tries to restructure in its respective jurisdiction. In such a situation, it would usually not be the foreign company that is to be liquidated or rescued in Hong Kong, but rather the Hong Kong subsidiary of a foreign company.

Historically, insolvency regimes have generally focused on domestic concerns and cross-border co-operation with other jurisdictions was not a high priority. Most jurisdictions lacked an effective legislative framework for resolving cross-border insolvency issues, which led to uncertainty when cross-border insolvency arose. However, except for a few relevant provisions in Part X of C(WUMP)O for the winding up of unregistered companies, Hong Kong still lacks a comprehensive legislative framework for resolving cross-border insolvency issues. Nevertheless, Hong Kong actually pursues co-operation in cross-border insolvency matters through the flexible application of English common law principles. However, such an approach also leads to uncertainty – as well as high costs – since litigation is the norm in the resolution of these matters. Decades ago, when cross-border issues in Hong Kong insolvencies were infrequent, such an approach was not overly problematic. However, at present, it is increasingly rare for the liquidation of a middle- or large-size Hong Kong company not to involve cross-border insolvency issues, especially regarding assets or production facilities in the PRC. Similarly, it is increasingly common when Asian companies collapse for the foreign debtor to have corporate assets in Hong Kong or to have some other connection with Hong Kong.

Since the publication of the Second Edition of this *Manual* in mid-2009, there has been a significant increase in the number of cross-border liquidations where there is a connection,

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albeit sometimes a little tenuous, with Hong Kong. Increasingly, these cross-border insolvencies have involved offshore holding companies incorporated, in particular, in the BVI and the Cayman Islands, and occasionally other exotic jurisdictions, that have a connection with Hong Kong leading to the filing of insolvency applications to the Hong Kong courts. These cases are but part of the increasing trend for Asian businesses to utilise a corporate structure that has a BVI or Cayman Islands holding company.[1] Given this trend, we have included brief overviews of the BVI and Cayman Islands insolvency provisions and processes in *Appendix 10*.

Lastly, cross-border corporate group collapses, and especially cross-border corporate rescues, are especially difficult to administer under the current legislative framework. At present, the best method available for handling the insolvency of corporate groups is through the use of cross-border agreements or protocols.

15.2 Approaches for Resolving Cross-Border Insolvency Issues

Over the years, two approaches have developed for resolving cross-border insolvency disputes: the 'territoriality' approach and the 'universality' approach. Although these two approaches are not applied in a pure form by the judiciary in any country, they are useful tools for understanding the debate about how to resolve cross-border insolvency issues. We have also seen the rise of the concept of 'modified universalism' both in Hong Kong and other common law jurisdictions.

At one end of the spectrum is the least co-operative approach, the 'territoriality/plurality' approach, which focuses on domestic concerns and the adjudication of the *res* or property within a jurisdiction's borders. Under the strict application of this approach, an insolvency administrator appointed in the domestic proceeding is limited to administering the assets within the jurisdiction's borders under the local insolvency law. Similarly, the courts in other jurisdictions reject requests for co-operation on the ground that each court should adjudicate the debtor's assets located within its respective jurisdiction. Thus, the result of general acceptance of the territoriality approach is that full-scale insolvency proceedings are commenced in every jurisdiction in which a failed corporate debtor has assets.

The territoriality approach benefits local, fast-moving creditors and allows local creditors to avoid the inconvenience and expense of being forced to travel abroad to prove their claims. However, the downside of this approach is that the multiplicity of insolvency proceedings results in duplicative, extra administrative expenses and lower distributions to creditors and leads to unequal levels of payments to creditors participating in different proceedings.

At the other end of the spectrum is the most co-operative approach, the 'universality/unity' approach, pursuant to which there is one main, worldwide full insolvency proceeding in which all creditors participate and which the courts in all other countries recognise and assist. Where possible, the substantive law of the main proceeding is applied, and creditors worldwide share equally. One form of assistance might well be the commencement of limited, 'secondary' proceedings to resolve local matters in other jurisdictions and to assist the main proceeding. Full-blown insolvency case need not be commenced in each jurisdiction in which the debtor's assets are located.

1 Including, eg, the recent steps taken by Li Ka-shing to restructure Cheung Kong (Holdings) and Hutchison Whampoa through the use of Cayman Islands holding companies.

A less extensive form of the universality approach is 'modified universalism', pursuant to which jurisdictions recognise foreign insolvency proceedings, but still allow domestic, independent insolvency proceedings to proceed. Under this approach, each jurisdiction applies its own substantive insolvency law, but nevertheless exercises its discretion to co-operate with the foreign jurisdiction where possible, and perhaps to order the turnover of property to the overseas court or provide other relief to the foreign office holder. This has been the approach traditionally adopted by the Hong Kong courts under their common law approach.[2]

15.3 Recognition of Foreign Insolvencies

(1) There are no statutory provisions in C(WUMP)O or the CO that govern the recognition of foreign insolvencies. The guiding principles regarding recognition may be found in the case law. There are not many Hong Kong cases discussing this topic (although there has been an increasing number over the last few years), but the Hong Kong courts also take note of applicable English cases.

(2) Hong Kong law draws a distinction between the recognition of foreign bankruptcies and the recognition of foreign liquidations.

(3) As a rule, Hong Kong courts will recognise a foreign winding-up order made in the place of the company's incorporation.[3] However, this is not the sole ground of recognition, and additional criteria include the following:

(i) that the company carries on business within the jurisdiction of the foreign court;

(ii) that the company submits to the insolvency jurisdiction of the foreign court; or

(iii) that a liquidation is unlikely to take place in the jurisdiction in which a company is incorporated.

(4) Even where one of these criteria is satisfied, the court may refuse to grant recognition where:

(i) the recognition of the foreign insolvency would be contrary to Hong Kong public policy;

(ii) the foreign insolvency decree was made as a result of fraud or is in breach of the rules of natural justice; or

(iii) the foreign insolvency proceedings are an attempt to enforce a foreign penal or revenue law.

The *Joint Administrators of African Minerals Ltd (in administration) v Madison Pacific Trust Ltd* [2015] 4 HKC 215, is an example of a recent case in which the Hong Kong court declined to provide assistance to foreign office holders, in this case, Administrators appointed by the English court.

2 For a more detailed discussion of these approaches for resolving cross-border insolvency issues, see Booth, Charles D, 'The Transnational Aspects of Hong Kong Insolvency Law', (1995) 2 *Southwestern Journal of Law & Trade in the Americas* 1, 5–7; Booth, Charles D, 'Living in Uncertain Times: The Need to Strengthen Hong Kong Transnational Insolvency Law', (1996) 34 *Columbia Journal of Transnational Law* 389, 393–396. See also Tang, Alan CW, *Insolvency in China and Hong Kong* (Sweet & Maxwell Asia 2005).

3 For a recent decision following this rule, see the decision of Harris J in *Joint Official Liquidators of A Co v B* [2014] 4 HKLRD 374, [2014] 5 HKC 152.

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Madison Pacific Trust Ltd, which is incorporated in Hong Kong, where it also carries on business, was the security agent in respect of a financing agreement and the Administrators sought, by way of a letter of request from the English court, to restrain the enforcement of security over the shares. More specifically, the Administrators sought the:

> recognition of the English administration proceedings and an order restraining the enforcement of the security without the agreement of the Administrators or order of the High Court of England pending determination in London of whether the moratorium applies extra-territorially (para 8).

The Hong Kong court said (at para 11) that:

> although … the Hong Kong Court can take a generous view of its power to assist a foreign liquidation process this is limited by the extent to which the type of order sought is available to a liquidator in Hong Kong under our insolvency regime and common law and equitable principles.

The Hong Kong court quoted extensively from the Privy Council's decision in *Singularis Holdings Limited v PricewaterhouseCoopers* [2014] UKPC 597 and followed its analysis governing the provision of common law assistance in cross-border insolvency cases, in short (also at para 11):

> the principle of modified universalism is part of the common law, but it is necessary to bear in mind, first, that it is subject to local law and local public policy and, secondly, that the court can only ever act within the limits of its own statutory and common-law powers.

Applying this principle to the facts of the case, the Hong Kong court went on to point out that Hong Kong does not have the equivalent of the UK administration process and does not have statutory provisions providing for a moratorium on enforcement in respect of a secured debt (para 12). Therefore, the Hong Kong court refused the Administrators' application.

(5) Foreign reorganisations may be recognised as cases involving foreign liquidations.

In *Felixstowe Dock and Railway Co v United States Lines Inc* [1989] QB 360, the English court recognised the insolvency of a US company reorganising under Chapter 11 of the US Bankruptcy Code, treating the case as one involving the recognition of a foreign liquidation.

However, in *Modern Terminals (Berth 5) Ltd v States Steamship Co* [1979] HKLR 512, the court relied on bankruptcy law precedent in deciding whether to recognise a rehabilitation of a US company under Chapter XI of the US Bankruptcy Act of 1898.

The better approach is that of *Felixstowe Dock*.

15.4 Options Available to Foreign Representatives for Gathering Information and Protecting Assets of Foreign Debtors in Hong Kong

In the typical cross-border insolvency case, the foreign representative comes to Hong Kong to seek to secure assets, gather information and/or gain the assistance of the Hong Kong courts. In pursuing his goals, he may find himself in conflict – or in a race – with local creditors.

(1) Non-insolvency options

(i) A foreign order vesting title in a foreign trustee operates to vest in the foreign trustee movable property in Hong Kong that is not subject to prior attachment, execution, or valid charge – provided that the foreign law extends to the property located in Hong Kong.

Although title usually does not vest in a foreign liquidator (in comparison to a foreign trustee in bankruptcy), the Hong Kong courts will usually recognise the powers of a foreign liquidator appointed by the court in the place of the company's incorporation (or where there is more than one proceeding in respect of the company, the foreign liquidator appointed in the main proceeding in the jurisdiction where the company has its centre of main interests), to represent a foreign company in Hong Kong and deal with its assets in Hong Kong,[4] subject to any pre-existing attachment, execution or charge – again, provided that the foreign law extends to the property located in Hong Kong.

(ii) Hong Kong courts have the inherent jurisdiction to assist a foreign representative from any jurisdiction, including by recognising their appointment and powers over the insolvent company's assets.

(iii) The foreign representative may commence civil proceedings, seek injunctive relief, seek a declaration regarding the effect of foreign insolvency proceedings, try to recover debts, and submit a proof of debt in a Hong Kong insolvency.[5]

In *CCIC Finance Ltd v Guangdong International Trust & Investment Corp* [2005] 2 HKC 589, an issue arose as to whether a PRC bankruptcy order should be recognised and enforced in Hong Kong. The issue arose in the context of the attempts by CCIC Finance Ltd ('CCIC') to enforce a garnishee order against Guangdong International Trust & Investment Corp ('GITIC'), an SOE in the midst of bankruptcy in the PRC. The Hong Kong court considered differing viewpoints as to the extraterritorial scope of PRC insolvency law. The court was not convinced by CCIC's expert witnesses that PRC bankruptcy law was not extra-territorial in scope and concluded that:

> the GITIC liquidation is being pursued, without challenge, on the basis of a universal collection and distribution of assets and … the paramount principle of *pari passu* distribution is strictly being adhered to.

The court granted recognition to the PRC insolvency law and refused to allow CCIC's application for a garnishee order absolute to proceed.

The Hong Kong court's reasoning that led to its conclusion that the PRC insolvency law was universal in scope is unconvincing. Today, in the aftermath of the enactment of the EBL, PRC bankruptcy law is universal in scope in outbound transactions,[6] but this was not the position in 2001 when the *CCIC* case was decided.[7] Nevertheless, the *CCIC* case has recently been

4 But see *Joint Official Liquidators of A Co v B*, above, in which Harris J took the position that since a foreign liquidation has no automatic consequence in respect to the property of the foreign company in Hong Kong, the foreign liquidator needs to make an application for an order vesting him with title to the property in Hong Kong (para 6).
5 See *Re Kowloon Container Warehouse Co Ltd* [1981] HKLR 210.
6 See Chapter 14.11.
7 See Booth, Charles D, 'The 2006 PRC Enterprise Bankruptcy Law: The Wait is Finally Over', (2008) 20 *Singapore Academy of Law Special Issue* 275, 311–312.

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cited by the Privy Council in both *Rubin v Eurofinance SA* [2013] 1 AC 236 and *Singularis*, above as an example of common law cross-border assistance.

(iv) The foreign representative may provide a 'letter of request' to the Hong Kong court requesting assistance.

The recent case of *The Joint Official Liquidators of A Co v B*, above, concerned a Cayman Islands company where liquidators had been appointed. They wanted production orders in respect of Hong Kong-based persons to compel them to produce documents relevant to the Cayman liquidators' investigations. In this case, the Cayman liquidators came to Hong Kong armed with a 'letter of request' from the Cayman court. The Hong Kong court said that it would give effect to the letter of request by making a production order provided that:

- the liquidator is properly appointed in the place of the company's incorporation;
- the letter of request is from a common law jurisdiction with a similar substantive insolvency law regime;
- the order sought is available under Hong Kong law; and
- the order sought is in relation to seeking information and documents, rather than assets.

All the conditions having been fulfilled, Harris J made the order.[8]

The authors are aware that this case has been relied up as authority in recent successful applications for orders recognising the authority and powers of foreign liquidators in Hong Kong, for example to enable them to take control of the insolvent company's assets in Hong Kong.

(2) Winding-up option

Foreign companies (non-Hong Kong companies) in Hong Kong are wound up as unregistered companies pursuant to the provisions in Part X of C(WUMP)O.

As can be seen from the discussion in part (1) above, a foreign representative has a variety of non-insolvency options available to reach the assets of a foreign company in Hong Kong and, thus, in many cases may not need to file a winding-up petition.

However, a foreign representative should consider filing, or procuring the insolvent company to file, a winding-up petition in the following situations: where unsecured creditors would benefit from the application of the stay or of a liquidator's avoidance or investigatory powers as provided for under C(WUMP)O.

There is no provision in C(WUMP)O that expressly authorises a foreign representative to commence a winding up in Hong Kong of the foreign company (or foreign estate) that he represents. Nevertheless, the practice in Hong Kong has been for the courts to allow petitions by foreign representatives on behalf of the foreign companies. In the Second Edition of this *Manual* we stated:

> Therefore, where a foreign representative decides that it would be beneficial to wind-up the foreign company in Hong Kong, he must either convince one of the foreign company's creditors to file a petition, or petition himself on behalf of the foreign company. The latter approach is more common and was adopted recently *Re Information Security One Ltd* [2007] 3 HKLRD 780, [2007] 4 HKC 383.

8 Harris J mentions in his decision that this is the first case of which he is aware in which a foreign liquidator has made an application of this sort, but noted that there are reports of similar applications in the 1990s relating to the collapse of the Bond Group.

In this 2007 case, Kwan J ordered the winding up of an unregistered company on a petition filed by its Cayman Islands liquidators. However, it appears that this approach may now be called into question in the light of the recent decision by Harris J in *Pioneer Iron and Steel Group Co Ltd* [2013] HKCU 507 (unreported, HCCW 322/2010, 6 March 2013). In this recent case, the liquidators of a BVI company filed a petition in Hong Kong to have the company wound up. The company's sole shareholder and sole director opposed the filing of the petition and sought to strike it out. One of the grounds was that the BVI liquidators lacked *locus standi* under s 179(1) of the Former CO. Harris J accepted this reasoning and stated (at para 13) that:

> [i]t seems to me quite clear that the Petition should, and could have been, issued naming 'the Company (in liquidation) as the Petitioner'.

Until this issue is resolved by the Hong Kong courts or by statutory amendment,[9] the safer route for foreign liquidators would be to procure the foreign company to file a petition in the form set forth by Harris J, namely 'the Company (in liquidation)'. In essence, the liquidator will act on behalf of the company in filing the petition, but the foreign company itself will be the petitioner. Also, of course, another option is for the liquidator to find a creditor to file the petition.[10]

(3) The applicable provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32)

Part X of C(WUMP)O is entitled 'Winding Up of Unregistered Companies' and contains the relevant provisions for winding up foreign companies.

(i) Section 326

Section 326(1) defines 'unregistered company' to include 'any partnership, whether limited or not, any association and any company', with the exception of the following:

(a) a company registered under C(WUMP)O or its predecessor Ordinances;

(b) a partnership, association or company with less than 8 members which is not a foreign partnership, association, or company;

(c) a partnership registered in Hong Kong under the Limited Partnership Ordinance (Cap 37).

Section 326(2) provides that an unregistered company also includes a registered non-Hong Kong company.

In *Re MKI Corp Ltd* [1995] 2 HKC 79, MKI Corp Ltd ('MKI'), a company incorporated in Bermuda, had established a place of business in Hong Kong and had registered under Part XI of the Former CO. When the SFC petitioned for the winding up of MKI, MKI argued that the power to wind up unregistered companies under ss 326 and 327 of the Former CO did not extend to companies registered under that

9 As one of the authors of this *Manual* suggested almost 2 decades ago: Booth, Charles D, 'Living in Uncertain Times: The Need to Strengthen Hong Kong Transnational Insolvency Law', (1996) 34 *Columbia Journal of Transnational Law* 389, 404.

10 Which ironically was the result in *Pioneer Iron and Steel Group* when 2½ years into the case, Harris J allowed a creditor with a significant claim against the company to be substituted as petitioner.

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ordinance. The High Court found that MKI had misconstrued the legislation and that MKI could be wound up as an unregistered company.

In the aftermath of this case, in 1997, s 326(2) was added to the Former CO (and retained in C(WUMP)O) 'for the avoidance of doubt' to make it clear that companies such as MKI could be wound up. Further amendment was made to the language in this subsection in 2004.

(ii) Section 327

Section 327 provides that subject to the provisions of Part X, any unregistered company may be wound up under C(WUMP)O, subject to the exceptions and additions mentioned in s 327. For example, an unregistered company may not be wound up voluntarily under C(WUMP)O (pursuant to s 327(2)).

Section 327(3) provides that an unregistered company may be wound up:

(a) if the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs;

(b) if the company is unable to pay its debts [as defined in s 327(4)];

(c) if the court is of opinion that it is just and equitable that the company should be wound up.

Section 327(4) sets out the manner in which the unregistered company's inability to pay its debts may be proved, including the company's failure to make payment within three weeks in response to a statutory demand served on the company at its principal place of business.

Note: It is important to remember that creditors may petition to wind up unregistered companies. It was a creditor that petitioned for the liquidation of the Macanese company, the Zhu Kuan Group Co Ltd, which is discussed in detail in Chapter 15.4(4)(v).

Most foreign companies that are wound up in Hong Kong are wound up under s 327.

(iii) Section 327A

Foreign companies may also be wound up under s 327A, although such cases are quite rare. This section, which is entitled, 'Oversea companies may be wound up although dissolved', provides as follows:

> Where a company incorporated outside Hong Kong which has been carrying on business in Hong Kong ceases to carry on business in Hong Kong, it may be wound up as an unregistered company under this Part [X], notwithstanding that it has been dissolved or otherwise ceased to exist as a company under or by virtue of the laws of the place of its incorporation.

The language in the title of this section is confusing because the term 'oversea company' generally refers to a foreign company that has established a place of business in Hong Kong, but a company incorporated outside Hong Kong need not have an established place of business in Hong Kong to carry on business in Hong Kong.

(iv) Other provisions

Section 328 expansively defines 'contributory' for the purposes of the winding up of an unregistered company. Sections 329 and 330 also apply to contributories.

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Section 329 is entitled 'Power of court to stay or restrain proceeding' and provides that in the case of an unregistered company, where a creditor makes an application to stay or restrain, the provisions of C(WUMP)O with respect to staying and restraining actions and proceedings against a company from the time of the presenting of a winding-up petition until the making of a winding-up order shall extend to actions and proceedings against any contributory of the company.

Section 330 provides that where a winding-up order for an unregistered company has been made, no action or proceeding shall be proceeded with or commenced against any contributory of the company in respect of any debt of the company, except by leave of the court, and subject to such terms as the court may impose.

Section 331 provides that the provisions in Part X with respect to unregistered companies shall be in addition to the provisions in C(WUMP)O, but not in restriction of any provisions in C(WUMP)O. As so drafted, this provision appears to overlap, and even conflict, with the language of s 327.

(4) Jurisdiction to wind up an unregistered company

(i) With the exception of the reference in s 327A to '[w]here a company incorporated outside Hong Kong which has been carrying on business in Hong Kong ceases to carry on business in Hong Kong', Part X of C(WUMP)O is silent as to the jurisdictional connection that must exist between a foreign company and Hong Kong for a foreign company to be wound up in Hong Kong. The result is that the jurisdictional criteria are not fixed, but can vary from case to case. This lack of a clear jurisdictional test is one of the major weaknesses of Part X and leads to unnecessary and expensive litigation.

(ii) Presence of assets test

Historically, the jurisdiction to wind up a foreign company in Hong Kong, as in England, was based on the presence of assets.[11]

The Hong Kong case, *Re Irish Shipping* [1985] HKLR 437, involved the filing of a winding-up petition by the Irish liquidator for Irish Shipping Ltd. against the company under s 327. The liquidator claimed jurisdiction on the basis of the 'imminent arrival' in Hong Kong of the debtor's ship, the Irish Rowan. As it turned out, there were in fact assets of the foreign debtor in Hong Kong at the time of the filing of the petition. However, in *obiter,* the court stated:

> the liquidator is not precluded from presenting a petition before the asset is within the jurisdiction. It is sufficient to found jurisdiction if there are assets here when the petition is heard.

Surely this is wrong: jurisdiction must exist when the petition is presented.

(iii) Sufficient connection test

On the basis of the English decision in *Re A Company (No 00359 of 1987)* [1988] 1 Ch 210, it became generally accepted that assets need not be present in the jurisdiction, and that:

11 See *Banque des Marchands de Moscou v Kindersley* [1951] Ch 112; *Re Compania Merabello San Nicholas SA* [1973] Ch 75.