Corporate Insolvency and Restructuring -
A creditor’s perspective
This booklet provides introductory information for clients who are creditors of insolvent companies in or near liquidation.

While every effort has been made to ensure the accuracy of the information contained in this booklet, it is only a summary and should not be relied upon as a substitute for detailed advice in individual cases.

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Introduction
Credit transactions of every kind are the lifeblood of a developed economy such as that of Hong Kong. In theory, these transactions are conducted as the word “credit” suggests, in the faith that the relevant obligations will be honoured in due course. However, experience shows that such faith is from time to time misplaced.

Insolvency occurs where credit transactions break down as a result of the debtor’s inability to meet its obligations as they fall due. The insufficiency of assets for this purpose gives rise to competition between those having claims against the insolvent.

The law of insolvency seeks to deal with those problems in three main areas, namely:

- The collection and protection of the remaining assets of the insolvent.
- The investigation of transactions occurring prior to the insolvency with a view to deciding whether they should be avoided (or set aside) in the interests of the general body of creditors.
- The fair distribution of those assets in accordance with the rights of the various creditors and recognised social objectives.

It should also be mentioned that not all liquidations are concerned with insolvent entities. The shareholders of a solvent and even wealthy company may wish to wind-up its affairs and procure the distribution of its assets. Liquidations which start and finish as members’ voluntary liquidations seldom give rise to serious difficulties and accordingly fall outside the scope of this booklet.

Corporate insolvency
Available procedures
There are essentially three available procedures in Hong Kong. The most appropriate procedure depends on the trading status of the company and in particular whether its assets and goodwill permit the continuation of a viable business.

The procedures are:

- Liquidation
- Receivership
- Scheme of Arrangement

Liquidation
The term liquidation is the most commonly used expression to identify the process whereby the assets of a limited company are realised and the company ultimately dissolved. A further expression which has the same meaning is the statutory term winding-up.

There are two types of liquidation; voluntary liquidation and compulsory liquidation. Voluntary liquidations are divided into two further categories; members’ voluntary liquidation and creditors’ voluntary liquidation.

Members’ voluntary liquidation
A members’ voluntary liquidation is a solvent liquidation in which all the debts of the company are paid in full and the shareholders receive a return on the capital to which they have subscribed. Before any such procedure is initiated, it is necessary for the directors of the company to issue a certificate of solvency in the specified form.
Creditors’ voluntary liquidation

A creditors’ voluntary liquidation is a procedure for the winding up of an insolvent company. It is initiated by the directors and shareholders but is subject to the overall control by the creditors and the court. It is the most efficient method of winding up an insolvent company and this procedure is therefore adopted in the majority of insolvent liquidations.

Compulsory liquidation

A winding-up by the court is also known as a “compulsory” liquidation. It is initiated by an application to the court known as a “petition” presented by an interested party who is normally a creditor of the company. This type of liquidation is supervised by the court and the Official Receiver’s office (a government department).

Which procedure?

Of the two types of insolvent liquidation, a creditors’ voluntary liquidation is usually more advantageous to creditors than a compulsory liquidation largely because of both cost and time.

Generally, unless the creditors wish the Official Receiver to investigate the affairs of the company, or have reason to believe that the liquidator chosen may not be impartial, the interests of the creditors will be best served by supporting a creditors’ voluntary liquidation rather than insisting upon a compulsory liquidation.

Receivership

Receivership is, generally, only available to secured creditors who hold valid mortgages / debentures over the assets of a company. However, it is also available by court application, in circumstances where no such security is held and the assets of a company are in jeopardy.

The role and function of a receiver or receiver and manager (“Receiver”) is similar (but at the same time different) to that of a liquidator. Broadly, a Receiver realises the assets of a company and distributes the proceeds of sale to parties holding valid security, not the general body of creditors.

A Receiver normally has the power to manage and run any business in order to maximise the realisation of the assets. The appointment of a Receiver will crystallise any floating charge into a fixed charge.

This topic is covered in more detail in our booklet concerning security and receivership.

Scheme of arrangement

This is a court approved procedure whereby the creditors of a company approve the terms of a proposal or scheme to satisfy the liabilities of the company in full or in part. These schemes are supervised by a trustee or administrator who is usually an insolvency practitioner.

The mechanics of these arrangements are cumbersome and generally a scheme is only cost effective where the major creditors of the company (usually its banks) fully support the proposals.
Commencement of proceedings

If the directors become aware that the company is insolvent, they should convene meetings of shareholders and creditors to put the company into liquidation.

Failure to do so, may result in the directors and other knowing parties incurring personal liability for the company’s debts and perhaps being disqualified from acting as a director of any Hong Kong company for a period of up to 15 years.

The directors usually instruct an insolvency practitioner (an accountant or lawyer) to convene the necessary meeting of creditors and to address the meeting on behalf of the directors.

Several weeks usually elapse between the directors’ decision to put the company into liquidation and the meeting of shareholders and creditors. During this time, the company will probably cease trading, especially if it is operating at a loss. If it can continue trading without obtaining further credit, it may do so to enable it to conclude existing contracts and possibly facilitate the disposal of the company’s business as a whole.

Shareholders’ meeting

The shareholders’ must meet (often by proxy) to pass an extraordinary resolution that the company be wound up and that the person nominated by the directors be appointed as liquidator. The resolution requires a 75% majority.

The shareholders’ appointment of a liquidator may be overruled by the creditors, although if the creditors cannot agree as to who should act as liquidator, the shareholders’ nomination remains valid.

Generally 14 days notice must be given of the meeting of shareholders (unless there is consent to short notice by the shareholders). The company is in liquidation from the time when the shareholders’ resolution has been passed. The shareholders’ meeting usually takes place within 14 days of (but at least 7 days before) the creditors’ meeting.

Special procedure - Section 228A Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (“C(WUMP)O”)

A special procedure is available in circumstances where the majority of the directors at a meeting of the board have formed the opinion that the company cannot by reason of its liabilities continue its business.

The directors must authorise one of the directors to make a winding-up statement verifying that the company cannot continue its business. The statement must be filed with the Registrar of Companies within seven days of the date it was made.

The company is in liquidation from the date of delivery of the statement and certain other documents to the Registrar of Companies.

However, it should be noted that this procedure can only be used as a last resort, in cases where it is not reasonably practicable for the winding-up to be commenced under another section of the C(WUMP)O.

Statement of affairs

The directors of the company must make a statement of the company’s affairs showing its assets, debts and liabilities. The statement must also contain a list of the creditors of the company and an estimate of the amount of their claims, the security (if any) held by any creditor and the date when the relevant security was given, and other information as may be appropriate.
Creditors' meeting
A meeting is held to enable the creditors to consider nominating a liquidator other than the liquidator appointed by the shareholders. The meeting also considers whether to appoint a Committee of Inspection (see “Committee of Inspection” below).

A notice must be sent to every known creditor.

Proxy forms
A proxy form is enclosed with the notice of the meeting. Unless the creditor is a private individual or sole trader who wishes to attend the meeting personally, it is essential that a proxy form be completed and lodged at the company’s registered office by the time stated in the notice, usually not later than 4 pm on the day before the creditors’ meeting.

The proxy form appears straightforward, but in practice many are incorrectly completed and as a consequence, the creditor is not permitted to vote. In any case of doubt, it is advisable to seek professional assistance in completing and lodging the form.

If any creditor wishes to send a representative to the meeting to vote on the creditor’s behalf, the name of the representative should be noted as the proxy holder. If the creditor is uncertain as to which representatives will attend the meeting, alternative representatives should be named. A proxy should not be given in the name of the Official Receiver or the liquidator.

A creditor may state on the proxy form whether he wishes his representative to use his own discretion and vote as he thinks fit (a General Proxy) or where the proxy holder must vote according to a specific direction of the creditor which must be clearly stated on the form (a Special Proxy). In the latter case, the proxy enables a creditor to vote in a pre-determined manner (eg. for the appointment of a named person as liquidator).

Accountants or solicitors can attend the meeting of creditors as proxy holders and vote on behalf of their clients. A corporate creditor can give an authority under its seal permitting a named individual to vote at the meeting of creditors without a proxy. In practice, this is not often done.

A liquidator must not obtain or procure proxies in his favour by solicitation.

Procedure of the meeting
The resolutions that can be passed at the creditors meeting are for the nomination of the liquidator, the appointment of a committee of inspection and where joint and several liquidators are appointed, the division of duties between them.

The quorum for the creditors’ meeting is three. There is no statutory procedure for a creditors’ meeting.

The creditors’ resolution must be passed by a majority in value of those present (in person or by proxy) and voting. A creditors’ nomination takes precedence over that of the shareholders, but if the creditors fail to pass a resolution, the liquidator appointed by the shareholders remains in office.

There is a right of appeal within seven days if the shareholders and the creditors reach different decisions.

In practice, creditors who do not accept the results of the meeting usually petition for the compulsory winding-up of the company as described at “Compulsory liquidation / winding-up by the Court” below.

Liquidators
A liquidator in a creditors’ voluntary liquidation is commonly an accountant specialising in insolvency work. However, he can also be a lawyer specialising in this area.
Powers, duties and obligations

The powers and duties of a liquidator are essentially:

- to realise the company’s assets
- to agree and pay the claims of the creditors of the company
- to pay any surplus funds to the shareholders according to their respective entitlements (also known as “pari passu”).

His remuneration is fixed by the Committee of Inspection, or if there is no committee, by the creditors as a whole. The basis of his remuneration can be considered at the first creditors’ meeting.

The liquidator must publish his appointment and must call annual meetings for creditors and shareholders until the liquidation is completed.

It is his duty to realise all company’s assets including those which may arise by reason of litigation.

Committee of Inspection

At the creditors’ meeting, the appointment of the Committee of Inspection is considered. This is a supervisory committee whose powers commence when the liquidator issues a certificate of its constitution. Its duties include:

- the fixing of the liquidator’s remuneration;
- sanctioning of the payment of classes of creditors in full or compromises with creditors;
- sanctioning compromises with shareholders or debtors;
- sanctioning the sale of the company’s business for shares in another company; and
- deciding on the disposal of the company’s books and papers.

A Committee of Inspection is usually dispensed with in small liquidations.

Creditors’ position

A liquidation of this type normally indicates that there are insufficient assets to pay all the creditors in full or that the directors are unable to comply with the requirements regarding a certificate of solvency.

The appointment of a liquidator effectively stops any legal action by unsecured creditors against the assets of the company and moreover, creditors who have commenced legal proceedings are unable to enforce judgments unless the enforcement action was completed before the commencement of the winding-up.

The claims of Hong Kong and foreign creditors rank equally in law. Creditor’s claims are time-barred if at the commencement of the liquidation they are older than six years in respect of ordinary debts or older than 12 years in respect of debts arising under certain legal documents.

Claims are agreed by reference to the amount due at the date of the commencement of the liquidation. It should be noted that unliquidated tort claims, for example a claim for damages for negligence are not provable in a liquidation unless judgment has been awarded prior to the date of liquidation.
Priority of claims

- secured creditors holding fixed charge security such as legal or chattel mortgages;
- the liquidator’s costs and remuneration;
- preferential creditors;
- creditors secured by a floating charge;
- unsecured creditors; and
- (if in a solvent liquidation) claims for post-liquidation interest.

If, unexpectedly, any funds remain after all creditors are paid, these are distributed to the shareholders. The position of each of the above classes is complex and is beyond the scope of this booklet.

Secured creditors

The types of security and methods of enforcement are described in our separate publication on security and receivership. In brief, a secured creditor may:

- retain his security and not take part in the liquidation process;
- either realise or value his security and claim for the balance not satisfied on the realisation or valuation; and/or
- surrender his security and claim as an unsecured creditor.

Preferential creditors

Preferential creditors can be divided into three categories:

- claims due to employees on termination of employment;
- debts payable to the Government; and
- matters relating to insurers.

If there are insufficient funds to pay preferential creditors in full, they are paid “pari passu” or pro rata according to the value of the claim.

Creditors secured by a floating charge

The floating charge holder will only receive a payment from the proceeds of the charged assets after taking into account the costs of realising the assets and the claims of any preferential creditors.

If any surplus remains after discharging the charge holder, it is paid to the unsecured creditors.

Unsecured creditors

When all preferential creditors have been paid in full and the amounts due to any floating charge holders have also been paid, the remaining funds are distributed pari passu among the remaining unsecured creditors.

Method of claiming

Creditors’ claims must be made in writing to the liquidator. A liquidator may require that the claim be verified by affidavit.

The notice to creditors will specify a limited period (usually one month) within which claims should be made. In addition, creditors may claim at any time until a final date has been given by the liquidator (in the notice of intention to make the final distribution), although they may not be able to participate in any earlier interim distributions, if the funds remaining in the liquidator’s hands do not permit this.
Distribution to creditors

In a large or complex liquidation, the liquidator may only be able to realise the assets slowly, or he may be unable to agree to all the claims of the creditors. Under these circumstances, he may make interim distributions to the creditors.

A creditor who does not submit his proof of debt in time to participate in any interim distribution is entitled to receive that or earlier distributions provided there are sufficient funds available. If, however, the liquidator has distributed all the funds in his hands, the creditor has no recourse against the liquidator, even if the liquidator was aware of the creditor's claim.

Creditors' rights to information

The liquidator reports the progress of the winding-up to the committee of inspection and also reports annually to meetings of creditors and shareholders of the company. Although annual meetings should be held, these are not usually of great importance and creditors need not normally attend unless they are dissatisfied with the progress of the liquidation. Most liquidators provide creditors (on request) with copies of the reports presented at these meetings together with summaries of their receipts and payments account.

Aggrieved parties / directions

The liquidator, any contributory or creditor may apply to the court to determine any question arising in the winding-up.

Termination of the liquidation

When all the assets have been realised and all funds have been distributed, the liquidator must convene a final meeting with both the shareholders and creditors. These meetings are normally held on the same day and within a week, the liquidator must send a copy of his final receipts and payments account to the Register of Companies.

Compulsory liquidation / winding-up by the Court

The compulsory liquidation procedure is conducted under the control of the Official Receiver and the court. It is substantially more formal than a voluntary liquidation.

This mode of liquidation is particularly suitable if:

- the directors do not initiate insolvency proceedings;
- the creditors believe that there are matters which the Official Receiver, as an independent official, should investigate particularly concerning the directors' conduct of the company's affairs;
- the outside creditors are unable to agree with the directors as to who should act as liquidator but cannot force a nominee agreed between them on the company; or
- the assets are insufficient to pay a professional liquidator's fees

Commencement of the process - the petition

The process commences with the presentation of a petition to the court. A petition may be presented by a creditor or the company itself. A shareholder can also present a petition on the grounds of justice or equity where no other alternatives are available (for example, in the case of a deadlocked dispute between shareholders).

There are several grounds on which a petition can be presented, but the most important ground is that the company is unable to pay its debts. Inability to pay debts is defined as where:
• a creditor is owed the sum of HK$10,000 or more and has made a statutory demand for payment and the company has failed to pay, secure or compound the debt within 21 days;
• a judgment creditor has been unable to enforce a judgment against the company; or
• it is proved to the satisfaction of the court that the company is unable to pay its debts taking into account contingent and prospective liabilities of the company.

Creditors should bear in mind that it may be costly to wind-up a company compulsorily even if the petition is undefended. Although some of the legal costs may be recovered from the realisations in the liquidation, the directors’ reluctance to put the company to voluntary liquidation may indicate that there are insufficient assets to meet such costs.

Court hearing and winding-up order
At the court hearing, the company may oppose the petition and present its own proposals for the payment of the debt or set out the reasons why it considers the debt is not due. Any creditor can appear at the hearing and can support or oppose an order being made. Creditors are usually represented by barristers and solicitors.

In practice, most petitions are undefended. In many cases the company is not even represented. If an order for the compulsory liquidation of the company is made, it has an immediate effect; the company legally ceases except for the purposes of winding-up. The powers of the directors cease and all employees are discharged.

Provisional liquidators and special managers
At any time after the petition has been presented, the petitioning creditor may apply to the court for the appointment of the Official Receiver or an alternative insolvency practitioner as provisional liquidator until the petition can be heard by the court. The purpose of such an appointment is to protect the company’s assets during that interim period. The court may limit and restrict the powers of any provisional liquidator.

If the company is continuing to trade, the Official Receiver will sometimes apply to the court for the appointment of a special manager, frequently an insolvency practitioner, to manage the company and its business until the petition is heard. A special manager’s powers are laid down by the court order appointing him. In practice, he frequently becomes the liquidator after the necessary meeting of creditors.

Appointments of a provisional liquidator or special manager are comparatively rare and, in practice, are limited to large companies. They are necessary on occasion mainly because a substantial period of time - often many weeks - can elapse between the presentation of the petition and the actual court hearing.

The Official Receiver (“OR”)
On the making of a winding-up order the OR usually becomes the liquidator. The OR is an officer of the court. Nonetheless, the court may appoint any other person as it thinks fit.

The OR conducts the preliminary stages of the liquidation. He must summon (within three months of the winding-up order) separate meetings of the creditors and shareholders to determine whether an application is to be made to appoint a liquidator in his place. In cases not concerning the public interest, the OR will nominate a person (usually an accountant) from a professional firm which has satisfied certain criteria laid down by the OR. This is known as the “Panel Scheme”.

Statement of affairs
The officers of the company must lodge a statement with the OR within 28 days of, where a provisional liquidator is appointed before the making of a winding-up order, the date of his appointment, or in a case where no such appointment is made, the date of the winding-up order, detailing the company's assets and liabilities. The OR and the court have the power to extend this period, and in practice, it is often several months before the statement of affairs is lodged. If the officers do not prepare the statement, they can be fined.

Creditors are entitled, on payment of a fee, to inspect the statement of affairs and to have a copy or extract of it.

Creditors' meeting
The purpose of the meeting is for the creditors to decide whether someone should be appointed liquidator in the place of the OR. The meeting also considers whether to appoint a committee of inspection.

Notices and proxies
The OR will send a notice convening the meeting to every known creditor together with a claim form, known as the "proof of debt", and a proxy form. A creditor who wishes to vote at the meeting must lodge his proof of debt and proxy form within the time stated in the notice unless he is a creditor in his own right attending the meeting personally.

The rules regarding proxy forms are similar to those in voluntary liquidations except that a proxy in favour of the OR, who acts as chairman of the meeting, will normally be used in support of the nomination of the majority of the creditors present at the meeting.

Procedure of the meeting
At the meeting, the OR will give a brief resumé of the directors' explanations for the failure of the company which should also summarise the assets and liabilities of the company. He will refer to the Panel Scheme and ask the creditors whether they wish to nominate a liquidator other than himself.

If the meeting does not express a preference as to the choice of liquidator, then an appointment will be made in accordance with a roster made pursuant to the Panel Scheme. However, if the creditors appoint the OR as liquidator, he will advise the creditors that his role is only one of regulation and as such he will apply to the court to appoint a special manager in accordance with the Panel Scheme.

Two or more independent liquidators may be appointed to act jointly. An absolute majority of those present (in person or by proxy) at the meeting and entitled to vote is required for a nomination.

The meeting of the creditors can also appoint a committee of inspection to act with the liquidator. When no such appointment is made, the OR will fulfil the committee's role.

Liquidator
In practice, if the company's assets are below HK$200,000, it is unlikely that it will be a commercial proposition for a professional liquidator (who is usually remunerated by a percentage of the assets) to accept the appointment. In these circumstances, it is possible for the company to be wound up in a summary manner. If, however, the assets are of substantial value, or it appears that any particular expertise is required in the realisation of the assets, it is in the interests of the creditors to appoint a professional liquidator mainly because the considerable pressure on the OR's office limits his efficiency in difficult or time consuming cases.

If the creditors resolve that a professional liquidator should be appointed in place of the OR, the OR will file a notice of the liquidator's appointment with the court, and the liquidator will then be empowered to act.
Committee of Inspection

The description and role of the committee of inspection set out above in relation to creditors’ voluntary liquidation, also applies in compulsory liquidation, subject to greater formality. This formality includes the requirement that the Committee must sanction any litigation or the carrying on by the liquidator of the company’s business.

Assets available for the creditors

The assets available to the creditors in a winding-up by the court include all the company’s assets held at the commencement of the winding-up and acquired during the course of liquidation.

The commencement of the winding up is the date of the presentation of the petition. Payments made by the company after the presentation of the petition are void unless the court orders otherwise.

Fixed and floating charges granted within various periods specified by the C(WUMP)O may be invalid and the liquidator must ascertain whether these charged assets can be released for the benefit of the creditors generally. Other available assets include those realisable by the reversal of certain transactions performed by the company prior to its insolvency and the proceeds of other litigation. These are further described in “Asset collection” below.

Disclaimer of onerous property

The liquidator (in any type of liquidation) has a right under the C(WUMP)O to disclaim any property or unprofitable contract of the company. If this property is disclaimed, then the rights and obligations of the company in respect of that property come to an end.

This provision is of particular importance to secured creditors who have a mortgage over land and property. In these cases, it is generally necessary for the secured creditor to apply to the court for a vesting order, which transfers ownership in the mortgaged property to the creditor so that their interest is fully protected.

Set-off

A detailed explanation of this topic is beyond the scope of this booklet. However, in essence, set-off arises where there have been mutual credits, mutual debts or other mutual dealings between a debtor and his creditor. In these circumstances, an account must be taken of what is due from each party to the other in respect of these dealings and only the balance can be claimed or paid on either side respectively.

Schemes of arrangement

This is a procedure whereby a company is able to make a compromise or other arrangement with its creditors and/or members. Once approved by the court, it is legally binding. These arrangements are used to bring about the reconstruction of a company or a group of companies.

An arrangement to restructure a company’s capital or debt is known as a “scheme”. Schemes can be of two kinds: they can be formal or informal.

Informal scheme

An informal scheme is effectively an agreed variation to the contractual relationship between the debtor and creditor. The terms of the variation will differ according to the particular circumstances of each matter. However it is not uncommon for the agreement to include a freeze (or moratorium) on the payment of the interest and perhaps capital. Any informal scheme needs to be approved by all the creditors of the insolvent company. Experience shows that this is often very difficult to achieve.
Formal scheme

The following procedure is undertaken:

- the scheme is proposed by the company to its creditors;
- a creditors’ meeting takes place (the meeting may be held at the order of the court, or may be held without order) at which the proposal is considered. If it is approved by one half of the creditors in number and three-fourths in value attending at the meeting, the scheme will then be put to the court for approval;
- the court will consider the scheme. Creditors have standing to make submissions in favour of or against the scheme; and
- if the court approves the scheme, it will be binding on all creditors.

Whether the scheme includes secured creditors depends on the proposals being made. However, in the normal course, only unsecured creditors are bound by the scheme.

If there are different classes of creditors, separate meetings (and approvals) are required for each class. It can sometimes be troublesome to determine what constitutes a “class” for this purpose.

One problem with proceeding with a formal scheme is that there is no moratorium on creditor action during its preparation. A solution is to accompany preparation of the scheme with provisional liquidation, which will result in the desired moratorium. The courts, however, are becoming less receptive to the use of a provisional liquidation in this context.

Asset collection

One of the immediate problems that concerns any insolvency practitioner who has been appointed as liquidator or receiver is his ability to collect the assets of the company for realisation. It is not uncommon for the insolvent company to have dissipated assets in an attempt to frustrate the course of the insolvency process.

This problem has been recognised by the legislature and various powers have been given to liquidators to find and recover such property. The ability of a receiver is much more restricted. However, it may be possible to make an application to the court seeking specific powers if it is shown to be in the interests of the receivership.

The statutory powers which have been given to liquidators are concerned with finding and recovering all the assets of the insolvent entity.

Delivery up

At any time after the making of a winding-up order, the court may require any trustee, receiver, banker, agent or officer of the company to deliver, transfer or pay over such property to which the company is prima facie entitled.

The evidential burden to satisfy this requirement is not high. However, there is no protection given to the office holder if it is found that the company is not entitled to the property. Accordingly, when contemplating such an application, the applicant must act reasonably and in good faith.

In Hong Kong, orders of this nature are not sought ex-parte except in exceptional circumstances.

Criminal liability

It is a criminal offence for any person (being a past or present officer of the company) to fail to deliver up such property to the liquidator.
Liens

A lien is a right to retain possession of the property of another as security for an outstanding debt and often arises where services have been performed but remain unpaid for. A lien may be legal or equitable, general or particular. It may arise by agreement or by operation of law (under statute or common law).

Whilst liens are a type of security, they do not have to be registered and can sometimes, even in the absence of registration, take priority over registered charges. The majority of liens are not "created" by the company and therefore do not need registration to retain their validity on insolvency.

The mere appointment of a receiver or liquidator will not necessarily preclude a lien holder from exercising his claim. However, in a compulsory liquidation, Section 182 of the C(WUMP)O may apply, which renders dispositions of the assets of the company after presentation of the petition, void.

Examination

The court may at any time after the appointment of a provisional liquidator or the making of a winding-up order, summon before it any officer of the company or person known or suspected to have in his possession any property of the company or if the court deems him capable of giving information concerning the promotion, formation, trade, dealings, affairs or property of the company. The court's discretion to grant such relief is unfettered.

Scope of order

It is now clear that the questioning at such examinations can go far beyond that which is required to reconstitute the knowledge of the company.

Voidable transactions

The underlying theme to all insolvency legislation in Hong Kong is that all creditors (save those which hold valid security) are treated equally and the assets of the company are distributed pari passu to the general body of creditors.

As a consequence, the legislature have introduced provisions which scrutinise the dealings of the company prior to the commencement of the formal insolvency.

Action taken by creditors prior to the insolvency in an effort to secure their position can be avoided by the appointed liquidator. Security given by a creditor to secure past indebtedness may be open to challenge by a liquidator on the basis that there was no fresh consideration for the grant of the security. This is discussed in the paragraphs below.

Unfair preferences

The C(WUMP)O empowers the liquidator to look back at the company's transactions for two years (or 6 months where the parties are not associates) prior to the commencement of the insolvency to ascertain whether an unfair preference has been given.

A company gives an unfair preference to a person if:

- that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities;
- the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company's insolvency, will be better than the position he would have been in if that thing had not been done; and
- the company is influenced by a desire to prefer, a subjective test.

If such a situation arises, the relevant transaction is void and the court may make such order as it thinks fit for restoring the position to what it would have been if the unfair preference was not given, including that the liquidator can recover any money paid and property transferred.

Desire is presumed if the preference was given to a person connected with the company (otherwise than by reason only of being its employee).
Undervalue transactions

A liquidator is empowered to look back as far as 5 years from the date of commencement of winding up (regardless of whether the transaction was entered into with a person connected with the company) to review and apply to the court to set aside suspicious transactions where the company received no consideration or consideration significantly less than the value of the consideration provided by the company.

To apply to set aside a transaction at an undervalue under section 265D of C(WUMP)O, the liquidator must prove that at the time the transaction took place, the company was insolvent or became insolvent as a result of it. Note that if the transaction took place with a connected person (otherwise than by reason only of being its employee), there will be a presumption that the company was insolvent at the relevant time.

Avoidance of floating charges

A floating charge given by the company over its assets may be declared void if created within 12 months of the commencement of the liquidation except to the extent that the company was solvent immediately after the creation of the charge or to the extent of new advances/monies given to the company in consideration of the charge. For persons connected with the company, the period has been extended to 2 years before commencement of the liquidation. Under such scenario, it is not necessary to establish that the company was insolvent at the time or became insolvent immediately after the creation of the charge.

Voidable dispositions

In a winding up by the court, any disposition of the property of the company, including things in action, and any transfer of shares, or alteration in the status of the members of the company, made after the commencement of the winding up, shall, unless the court otherwise orders, be void.

Fraudulent trading

Any knowing party assisting the trading of a business with an intent to defraud creditors is liable to both civil claims and criminal penalties. Such knowing parties can include any creditor depending on the precise circumstances of the case. It should be noted that criminal liability arises whether or not the business in question is in liquidation.

Extortionate Credit Transactions

The insolvency legislation generally does not allow bad bargains to be set aside for the benefit of creditors, but it does allow a transaction involving provision of credit to the company that was entered into within three years of the date of the resolution for winding-up or the date of the winding up order, and that requires grossly exorbitant payments to be made or otherwise grossly contravenes the principles of fair dealing, to be set aside.
Want to know more?

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