HONG KONG

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GENERAL

Legislation

1. What main legislation is applicable to insolvencies and reorganizations?

The legislation principally applicable to the insolvency of companies in Hong Kong is the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O). Further detail is set out in subordinated legislation, the most important of which is contained in the Companies (Winding-up) Rules (CWUR) that largely govern the procedural matters in the winding up of a company, and the Companies (Disqualification of Directors) Proceedings Rules.

Certain provisions in the Bankruptcy Ordinance, which governs personal insolvency, may also be relevant to corporate insolvency to the extent that the C(WUMP)O applies those provisions specifically by reference. Other legislation that may be relevant in a corporate insolvency in Hong Kong include:

- the Companies Ordinance (CO), relating to general company law, including company formation and dissolution;
- the Conveyancing and Property Ordinance, relating to the voidable disposition of property and the powers of a receiver;
- the Protection of Wages on Insolvency Ordinance, relating to employees' claims for payments from the Hong Kong government's Protection of Wages on Insolvency Fund; and

- the Transfer of Businesses (Protection of Creditors) Ordinance, relating to the transfer of the business of a company in certain circumstances.

Other legislation may also contribute to the body of insolvency law in Hong Kong. Insurance companies and banks, for example, have specific legislation applicable to their insolvency, which may supplement, modify or disapply certain provisions in the C(WUMP)O governing general corporate insolvency. Case law also plays a significant role in the interpretation of insolvency legislation.

Several provisions in the C(WUMP)O and CWUR date back to the insolvency provisions in the English Companies Acts of 1929 and 1948, but Hong Kong did not follow many of the subsequent revisions to the English insolvency regime (eg, the administration or company voluntary arrangements procedure). The Hong Kong government enacted a new Companies Ordinance in 2014, which significantly reformed corporate governance and modernized company law in general. However, the statutory provisions relating to insolvency and winding up were not affected and remain in their pre-existing form (albeit now contained in the C(WUMP)O). The Hong Kong government previously announced that it would present the Companies (Corporate Rescue) Bill to the Legislative Council, which would introduce, among other things, a provisional supervision regime (analogous to the English administration procedure) and the concept of insolvent trading. At the time of writing, it is unclear when the Bill might be presented.

Excluded entities and excluded assets

2. What entities are excluded from customary insolvency or reorganisation proceedings and what legislation applies to them? What assets are excluded or exempt from claims of creditors?

As a general rule, a company formed and registered under the CO (including under the former Companies Ordinances of 1865 and 1911 and the

pre-amended CO (Cap 32)) may be wound up pursuant to section 169 of the C(WUMP)O and can be subject to all forms of insolvency processes (either by the court or voluntarily).

Unregistered companies, which include registered non-Hong Kong companies, can also be wound up by the court; however, no unregistered company may be wound up voluntarily under the C(WUMP)O (section 327(2)). The courts have the discretion to wind up overseas companies (which are not registered in Hong Kong) under sections 327(1) and 327(3) of the C(WUMP)O provided that three threshold requirements are satisfied:

- a sufficient connection with the jurisdiction;
- a reasonable possibility that the winding-up order would benefit those applying for it, whether tangible or intangible; and
- the court was able to exercise jurisdiction over one or more persons in the distribution of the company's assets – although this is subject to the discretion of the court (see, for example, *Shandong Chenming Paper Holdings Ltd v Arjowiggins HKK 2 Ltd* [2020] HKCA 670 and (2022) 25 HKCFAR 98).

There are special provisions in the Banking Ordinance and Insurance Ordinance relating to the winding up of authorized institutions and insurance institutions in Hong Kong. Meanwhile, the insolvency of partnerships (other than limited partnerships) is governed by the Partnership Ordinance.

Public enterprises

3. What procedures are followed in the insolvency of a government-owned enterprise? What remedies do creditors of insolvent public enterprises have?

There is no special regime applicable to the insolvency of a government-owned enterprise, and unregistered companies established by statute may be wound up

under Part X of the C(WUMP)O.

Protection for large financial institutions

4. Has your country enacted legislation to deal with the financial difficulties of institutions that are considered 'too big to fail'?

Hong Kong's Financial Institutions (Resolution) Ordinance (FIRO), which came into effect on 7 July 2017, is the primary legislation dealing with institutions that are considered too big to fail. The financial institutions that fall in the scope of FIRO are:

- all types of banks or authorized institutions (whether locally incorporated or Hong Kong branches of overseas banks);
- Securities and Futures Commission (SFC)-licensed corporations that are group companies with entities designated by the Financial Stability Board (FSB) as Global Systemically Important Banks or Global Systemically Important Insurers (G-SIIs);
- insurers that are group companies of G-SIIs;
- certain financial market infrastructures;
- certain exchanges; and
- other financial services entities designated by Hong Kong's Financial Secretary as in-scope financial institutions.

Many of the provisions of the FIRO also apply to holding companies and affiliated operating entities of in-scope financial institutions.

The Hong Kong Monetary Authority (HKMA), the SFC and the Insurance Authority are designated as the resolution authorities for in-scope banking sector entities, securities and futures sector entities and insurance sector entities, respectively.

The FIRO, among other things, grants to such resolution authorities powers that are consistent with the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (the Key Attributes), including powers with respect to resolvability assessments, resolution planning and stabilization options that may be applied where the FIRO's conditions to resolution are satisfied and the resolution authority has determined that resolution will be initiated. The conditions that must be satisfied before initiation of resolution are that:

- the institution has ceased (or is likely to cease) to be viable;
- there is no reasonable prospect that private sector action (outside of resolution) would result in the institution becoming viable within a reasonable period;
- the non-viability of the institution poses risks to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions; and
- resolution will avoid or mitigate those risks.

The possible stabilization options that a resolution authority may apply include, among other things:

- bail-in (eg, the write-down of equity or the write-down or conversion into equity of certain liabilities);
- transfer to a purchaser;
- transfer to a bridge institution;
- transfer of assets;
- rights and liabilities to an asset management vehicle;
- transfer to a temporary public ownership company; and

- suspension of a counterparty's termination rights under financial contracts.

The HKMA has provided more detailed guidance on some of these stabilization options. For example, on 26 August 2019, the HKMA introduced a new Resolution Facility to ensure that an authorized institution that has gone into resolution under the FIRO can access sufficient liquidity to meet its obligations until it is able to transition back to market-based funding. Furthermore, the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (the Stay Rules) came into operation in the form of subsidiary legislation on 27 August 2021. The Stay Rules require authorized institutions incorporated in Hong Kong and certain of their group companies to provide in certain non-Hong Kong law governed contracts that the parties agree to be bound by a temporary suspension of termination rights that may be imposed by HKMA as a resolution authority under the FIRO.

The FIRO also empowers resolution authorities to make rules prescribing requirements on loss-absorbing capacity (eg, requirements to issue bail-in instruments), and the following rules and guidance on loss-absorbing capacity requirements applicable to certain authorized institutions incorporated in Hong Kong have been issued, notably:

- the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules (the LAC Rules) came into effect on 14 December 2018;

- the HKMA's Code of Practice chapter: Resolution Planning – LAC Requirements (LAC-1) came into effect on 20 March 2019; and

- a set of standard LAC disclosure templates for resolution entities and material subsidiaries to make disclosures under the LAC Rules were effective for use from 31 October 2019.

If a resolution authority in Hong Kong is notified of a resolution action outside of Hong Kong (ie, a resolution action taken by a resolution authority in another jurisdiction), the FIRO provides that, in certain circumstances, the resolution authority in Hong Kong may take steps to give effect in Hong Kong to the overseas resolution action.

There are Hong Kong regulations, guidance and legislation, in addition to the FIRO, that could also assist with dealing with 'too big to fail' issues. For example, consistent with the Key Attributes requirements, each authorized institution is required by the HKMA's Supervisory Policy Manual module RE-1 (Recovery Planning) (the SPM RE-1) to develop a recovery plan that identifies options to restore financial strength and viability when the authorized institution comes under severe stress. As another example, if the HKMA is of the opinion that an authorized institution is insolvent or is likely to become unable to meet its obligations or is about to suspend payment, the HKMA in its capacity as regulator of Hong Kong's banking industry has wide-ranging powers over authorized institutions that include the power to appoint a manager to take charge of the authorized institution's business. The HKMA as banking regulator can exercise such powers under the Banking Ordinance even if it does not, as resolution authority, exercise its powers under the FIRO to initiate resolution of the authorized institution. The SPM RE-1 was updated on 19 June 2020 to provide guidance on the manner in which the HKMA's powers relating to recovery planning requirements in the Banking Ordinance are to be exercised.

Courts and appeals

5. What courts are involved? What are the rights of appeal from court orders? Does an appellant have an automatic right of appeal or must it obtain permission? Is there a requirement to post security to proceed with an appeal?

Hong Kong does not have any specialist courts as such that deal solely with

insolvency matters. Such matters are usually dealt with by the Companies Court. The High Court can wind up any company incorporated in Hong Kong (and, in some cases, foreign companies). Any criminal matters must be dealt with by the relevant criminal court.

Corporate insolvency cases are usually heard by a companies judge (a High Court judge with experience dealing with insolvency matters). Appeals against final orders of the High Court may be made to the Court of Appeal without leave and thereafter (with leave) to the Court of Final Appeal in Hong Kong.

There is no mandatory requirement to post security to proceed with an appeal.

TYPES OF LIQUIDATION AND REORGANISATION PROCESSES

Voluntary liquidations

6. What are the requirements for a debtor commencing a voluntary liquidation case and what are the effects?

There are two procedures for the voluntary liquidation of a company: a members' voluntary liquidation (MVL) (which is a solvent liquidation) and a creditors' voluntary liquidation (CVL) (typically an insolvent liquidation).

Members' voluntary liquidation

If the directors of the company issue a certificate of solvency, a company can be placed into MVL. The MVL is commenced once a 75 per cent majority of the shareholders has resolved to place the company into liquidation. The MVL commences from that date and the shareholders choose the liquidator. On the appointment of the liquidator, the powers of the company directors will cease.

If the liquidator subsequently determines that the company is in fact insolvent, the MVL should be converted into a CVL.

Creditors' voluntary liquidation

If the company is insolvent, or if a certificate of solvency has not been issued, a company can be placed into CVL. Again, a resolution must be passed by a 75 per cent majority of the members to place the company into liquidation. The CVL commences on the date on which the shareholders pass this resolution. The shareholders will also appoint a liquidator, but until the creditors' meeting referred to below has taken place, the powers of that liquidator will be limited.

The directors must then hold a creditors' meeting on the same day or on the next day, at which the creditors will be given information on the company (a statement of affairs). The creditors may also appoint a liquidator if a resolution is passed by a majority by value of the creditors present and voting. If the shareholders have previously appointed a liquidator, the creditors' choice of liquidator will prevail.

Section 228A of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O) is a 'special procedure' that allows the directors, in limited circumstances, to commence a voluntary winding up if they have formed the opinion that the company cannot, as a result of its liabilities, continue its business. This procedure may be used in limited circumstances only because the directors would have to declare that the winding up should be commenced under section 228A, because it would not be reasonably practicable to proceed under another section of the C(WUMP)O. A creditors' meeting will be held, and the winding-up process will, in general, follow that of a CVL.

Voluntary reorganizations

7. What are the requirements for a debtor commencing a voluntary reorganisation and what are the effects?

There is currently no statutory corporate reorganisation procedure (eg, a company voluntary arrangements or administrations procedure) in Hong Kong. However, where provisional liquidators are appointed pursuant to section 193

of the C(WUMP)O, the provisional liquidators may be granted powers to explore and facilitate a reorganisation of the company (see, eg, *Re China Solar Energy Holdings Ltd* [2018] HKCFI 555).

Schemes of arrangement under section 669 of the Companies Ordinance

The scheme of arrangement legislation under section 669 provides a mechanism to enable a company to enter into a compromise or arrangement with its creditors. This process is commenced by an application to the court, by either the company or any creditor (or, where relevant, the liquidator), for an order that a meeting of creditors is summoned. Any proposed compromise or arrangement will become binding on the creditors if it is approved by 75 per cent in value and the majority in number of each class of creditors present and voting, and it is then sanctioned by the court. A company may also enter into a scheme with its shareholders as part of a reorganisation, though a more detailed consideration of shareholder schemes is outside the scope of this chapter.

Creditors can challenge the scheme in court at either the hearing for permission to convene the scheme meetings or the hearing to sanction the scheme. The usual grounds for challenge are that the meetings were improperly constituted, the creditors were not given sufficient information or the scheme is unfair. During the scheme process, there is no statutory protection for the company from its creditors.

In terms of schemes of foreign companies, Hong Kong law is similar to English case law, which provides that a foreign company is entitled to enter into a scheme if it is capable of being wound up in England and Wales. Case law has clarified the position further, confirming that a company could be wound up in England and Wales if it could be said to have ‘sufficient connection’ with England and Wales.

The question as to what constitutes ‘sufficient connection’ is one that is dependent on the facts in each case. For example, the Hong Kong courts have

found that ‘sufficient connection’ existed for the following ‘non-exhaustive reasons’ (*Re Da Yu Financial Holdings Ltd* [2019] HKCFI 2531):

- the company is registered as an overseas company in Hong Kong;
- the company’s principal place of business is in Hong Kong;
- the company is listed in Hong Kong;
- the company’s debts are governed by Hong Kong law; and
- the vast majority of the scheme creditors are in Hong Kong.

Successful reorganizations

8. How are creditors classified for purposes of a reorganisation plan and how is the plan approved? Can a reorganisation plan release non-debtor parties from liability and, if so, in what circumstances?

When an insolvent company proposes a scheme, it should be compared against the ‘liquidation analysis’ (ie, the rights that the creditors would have against the company in an insolvent liquidation). The rights of creditors under a scheme can differ from the rights the creditors would have if the company went into insolvent liquidation; indeed, the purpose of many schemes is to produce an arrangement that differs from an insolvent liquidation. Depending on the differences, however, this may have an impact on the analysis of which creditors form a separate class for the purposes of the scheme meeting and whether the scheme is fair and should be sanctioned. If the differences apply equally to all creditors, no question of separate classes arises. If the differences produce a result that affects the rights of one group of creditors differently from another, subject to questions of materiality, they should form separate classes.

In a scheme, the process is commenced by an application to the court, by either the company or any creditor (or, where relevant, the liquidator or provisional liquidator), for an order that a meeting of creditors is summoned. There are

separate creditors' meetings for each class of creditors. It is the responsibility of the party proposing the scheme to determine the correct classes. If incorrect class meetings are held, then the court will not have the jurisdiction to sanction the scheme.

The classic test for determining the constitution of classes is that a class should comprise 'those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest' (*UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* [2001] HKCFA 19). Each class is determined in accordance with the creditors' rights under the scheme, as opposed to broader collateral interests. A broad view should be taken of the meaning of class, and whether a group of creditors forms a single class depends on the analysis of:

- the rights that are to be released or varied under the scheme; and
- the new rights (if any) that the scheme gives, by way of compromise or arrangement, to those whose rights are to be released or varied.

It can be seen from this that in many cases it is not possible to be certain that a particular type of claim constitutes a class of creditors. In certain cases, however, the distinction is relatively clear-cut; for example, secured creditors and unsecured creditors will almost certainly constitute separate classes.

For any proposed compromise or arrangement put forward under a scheme to become binding on the creditors, it must be approved by 75 per cent in value and the majority in number of each class of creditors present and voting, and then sanctioned by the court. The scheme will not be sanctioned unless it is fair – that is, a scheme that an intelligent and honest person, a member of the class concerned and acting in their best interests, might reasonably approve.

The English court has confirmed (see *La Seda de Barcelona SA* [2010] EWHC 1364 (Ch)) that, in the case of an English scheme of arrangement, guarantors that are themselves not bound by the scheme of arrangement can have their

guarantees released under the terms of the scheme. The court was particularly influenced by the fact that, in return for gaining the benefit of those releases, the guarantor company was itself releasing various group companies from outstanding intercompany debt obligations. This element of 'give and take' was seen as important in establishing a benefit to the scheme creditors and satisfying the court that its sanction of such releases would be appropriate. This approach was followed by the Hong Kong courts in *Re Winsway Enterprises Holdings Ltd* [2017] 1 HKLRD 1 and *Re China Singyes Solar Technologies Holdings Ltd* [2020] HKCFI 467.

Furthermore, the Hong Kong court has in the recent judgment of *Re Unity Group Holdings International Ltd* [2022] HKCFI 3419 held that a Hong Kong scheme of arrangement can be used to release debts of third-party obligors that were guaranteed by the scheme company without requiring a deed of contribution.

Involuntary liquidations

9. What are the requirements for creditors placing a debtor into involuntary liquidation and what are the effects? Once the proceeding is opened, are there material differences to proceedings opened voluntarily?

If a creditor seeks to place a company into involuntary liquidation (which is usually called compulsory liquidation or winding up by the court), that creditor must petition the court to have the company wound up. The most likely ground upon which a creditor would successfully petition the court for a winding-up order is that the company is unable to pay its debts.

If the court makes a winding-up order, the winding up is deemed to commence at the time of the presentation of the winding-up petition rather than on the date of the order. Any disposition of the company's property and any transfer of shares made after the commencement of the winding up is, unless the court orders otherwise, void (section 182 of the C(WUMP)O).

Once the winding-up order has been made or a provisional liquidator has been appointed by the court, no action may be started or proceeded against the company without the permission of the court. The directors' powers will also cease on that date. Also, the business of the company ceases except to the extent necessary for it to be wound up.

Involuntary reorganizations

10. What are the requirements for creditors commencing an involuntary reorganisation and what are the effects? Once the proceeding is opened, are there any material differences to proceedings opened voluntarily?

There is currently no statutory corporate reorganisation procedure in Hong Kong. However, where provisional liquidators are appointed pursuant to section 193 of the C(WUMP)O, the provisional liquidators may be granted powers to explore and facilitate a reorganisation of the company.

Expedited reorganizations

11. Do procedures exist for expedited reorganizations (eg, 'prepackaged' reorganizations)?

Many reorganizations result from informal negotiations with creditors outside any formal insolvency or restructuring procedures. As a consequence, the terms of the reorganisation and, therefore, any provisions as to the timetable for the reorganisation are subject to negotiation between all relevant parties.

There are no statutory provisions for the expedition of schemes of arrangement using 'prepackaged' reorganizations, and the implementation time for a scheme is a matter for the court's discretion and will depend on the scheme's complexity and any urgency. The court has been willing to hear applications on an expedited basis where there is an urgent requirement to do so.

Unsuccessful reorganizations

12. How is a proposed reorganisation defeated and what is the effect of a reorganisation plan not being approved? What if the debtor fails to perform a plan?

A proposed scheme of arrangement can be defeated if it does not obtain the statutory majority of creditors voting in favour of it. Assuming that the requisite majorities vote in favour at the scheme meeting, a scheme will be defeated if the court refuses to sanction the scheme because it does not have the jurisdiction to sanction it, for example, because the classes are incorrectly constituted or because it is unfair.

A dissenting creditor can defeat an informal reorganisation by refusing to take part or, where appropriate, by applying for the company to be wound up (although the court must exercise its discretion when making a winding-up order).

If a scheme of an insolvent company is defeated, unless new reorganisation proposals can be agreed with the requisite majorities of creditors, it is likely that the company will be placed in liquidation.

If there is a default by the debtor in performing an approved plan in a scheme, the consequences of default will usually be set out in the scheme document. The consequences of a breach by the debtor of any informal agreement will depend on the terms of the agreement but will usually result in the creditor having all its previous rights restored.

Corporate procedures

13. Are there corporate procedures for the dissolution of a corporation? How do such processes contrast with bankruptcy proceedings?

In addition to an MVL, a company may be dissolved under section 750 of the Companies Ordinance without the need for a formal liquidation procedure if all the shareholders agree, the company has never commenced business or

operations or ceased carrying on business or operations longer than three months ago, and the company has no outstanding liabilities.

Pursuant to section 760, such companies, as well as companies that have been dissolved following liquidation, may also be restored to the Companies Register following an application to the court by an interested party within 20 years of the date of dissolution.

The court will make an order for restoration if, at the time of the striking off, the company was carrying on business or in operation or if the court considers it just to do so.

Conclusion of case

14. How are liquidation and reorganisation cases formally concluded?

In the case of a voluntary winding up, once the company's affairs are fully wound up, the liquidator must present the final accounts showing how the liquidation has been conducted to a meeting of creditors. After the meeting, the liquidator will send a copy of the accounts to the Companies Registry. The company is then deemed dissolved after three months.

In the event of a compulsory liquidation, if the liquidator is not the Official Receiver, once the winding up of the company is complete (for practical purposes) the liquidator must summon a final general meeting of creditors. The liquidator will present their report of the winding up to the creditors. The liquidator must then notify the Companies Registry that the final meeting of creditors has been held. The company is deemed dissolved three months after the Companies Registry registers this notice. If the liquidator is the Official Receiver, the liquidation will end three months after the Official Receiver notifies the Companies Registry that the winding up is complete. Alternatively, if the company has insufficient assets to cover the costs of the liquidation and it appears to the Official Receiver that the affairs of the company do not require any further investigation, the Official Receiver may apply to the Companies

Registry for early dissolution of the company in liquidation.

Schemes of arrangement and informal reorganizations, if successful, will end in accordance with their terms.

INSOLVENCY TESTS AND FILING REQUIREMENTS

Conditions for insolvency

15. What is the test to determine if a debtor is insolvent?

'Insolvency' itself is not defined by the Companies (Winding Up and Miscellaneous Provisions) Ordinance. Instead, it contains the concept of a company being 'unable to pay its debts'. The main reasons that a company will be deemed unable to pay its debts are:

- if the company has not paid a claim for a sum due to a creditor exceeding HK$10,000 within three weeks of having been served with a written demand for payment (known as a statutory demand);
- if an execution or judgment against the company is unsatisfied;
- if it is proved to the satisfaction of the court that it is unable to pay its debts, also having regard to contingent and prospective liabilities, as they fall due (see the Insolvency Act in England), meaning the company is cash-flow insolvent; or
- if it is proved to the satisfaction of the court that the value of the company's assets is lower than its liabilities, taking into account contingent and prospective liabilities, meaning that the company is balance-sheet insolvent.

Mandatory filing

16. Must companies commence insolvency proceedings in particular circumstances?

There is no express duty on a company to commence insolvency proceedings at any particular time on the grounds of either cash-flow or balance-sheet insolvency.

DIRECTORS AND OFFICERS

Directors' liability – failure to commence proceedings and trading while insolvent

17. If proceedings are not commenced, what liability can result for directors and officers? What are the consequences for directors and officers if a company carries on business while insolvent?

In Hong Kong, there are currently no 'wrongful trading' or 'insolvent trading' provisions (similar to those in England or Australia) that would allow the liquidators to bring an action against directors for trading after a time when they knew, or ought to have concluded, that there was no reasonable prospect of the company avoiding insolvent liquidation. At present, Hong Kong law provides only for fraudulent trading, (ie, carrying on the business of a company with intent to defraud its creditors).

The Companies (Corporate Rescue) Bill is expected to include an 'insolvent trading' provision that allows the court to declare (on the application of a liquidator) that a director is responsible for insolvent trading and liable to make a contribution to the insolvent company's assets. The Bill has not been presented to the Legislative Council at the time of writing.

Directors' liability – other sources of liability

18. Apart from failure to file for proceedings, are corporate officers and directors personally liable for their corporation's obligations? Are they liable for corporate pre-insolvency or pre-reorganization actions? Can they be subject to sanctions for other reasons?

The company's officers and directors will not generally be personally liable for

obligations of their corporations unless they have entered into personal guarantees of those obligations. However, the company's officers can be held to be personally liable to contribute to the assets of the company for any one of the following reasons:

- misfeasance or breach of any fiduciary or other duty (section 276 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O)); or

- fraudulent trading: under section 275 of the C(WUMP)O, which provides that where it appears that any business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose, the court may declare (on application of a liquidator or any creditor or contributory of the company) that any persons who were knowingly parties to the carrying on of business in that manner are personally responsible. This section is not limited to directors and officers but applies to anyone who has been involved in carrying on the business of the company in a fraudulent manner. It is necessary to prove actual dishonesty.

Also, where a winding up is commenced on, or within one year after, the date on which payment out of capital was made in respect of the redemption or buy-back of any of its own shares, the directors who signed the solvency statement in relation to the payment out of capital could be jointly and severally liable with the past shareholders to contribute to the assets of the company (section 170A of the C(WUMP)O).

The remedies against some of the above claims that may be brought against the directors are designed to be compensatory for the liabilities incurred by the company.

The company's officers can also be criminally liable under sections 271 to 277 of the C(WUMP)O for fraud, misconduct, falsification of the company's books,

material omissions from statements and false representations. They are also liable to disqualification from being a director of any company for up to 15 years under Part IVA of the C(WUMP)O.

Directors' liability – defenses

19. What defenses are available to directors and officers in the context of an insolvency or reorganisation?

There are no specific defenses set out in either section 275 (fraudulent trading) or section 276 (misfeasance or breach of fiduciary duties) of the C(WUMP)O. Directors typically seek to establish that the elements of the relevant claim are not made out.

The Companies (Corporate Rescue) Bill is expected to provide several statutory defenses to liability for insolvent trading. These defenses may be available where the director had taken all reasonable steps to prevent the company from incurring the debt, or where, when the debt was incurred, the director believed in good faith that the debt was incurred for the purpose of retaining the company to a state of solvency, or that the debt was incurred for the benefit of the company and that the company was likely to return to a state of solvency. The Bill has not been presented to the Legislative Council at the time of writing.

Shift in directors' duties

20. Do the duties that directors owe to the corporation shift to the creditors when an insolvency or reorganisation proceeding is likely? When?

The directors' duty to act in the best interest of the shareholders shifts to a duty to act in the best interest of the creditors once the directors of a company know or ought to know that the company is or is likely to become insolvent (see *Cyberworks Audio Video Technology Ltd v Mei Ah (HK) Co Ltd* [2020] HKCFI

398).

Directors' powers after proceedings commence

21. What powers can directors and officers exercise after liquidation or reorganisation proceedings are commenced by, or against, their corporation?

The directors' powers in relation to the company cease on the appointment of the liquidator in a members' voluntary liquidation (MVL) or creditors' voluntary liquidation (CVL), except where their continuance is sanctioned:

- in the case of an MVL, by the company in general meeting or the liquidator (section 235 of the C(WUMP)O); or
- in the case of a CVL, by the committee of inspection or the creditors if there is no committee of inspection (section 244 of the C(WUMP)O).

MATTERS ARISING IN A LIQUIDATION OR REORGANISATION

Stays of proceedings and moratoria

22. What prohibitions against the continuation of legal proceedings or the enforcement of claims by creditors apply in liquidations and reorganizations? In what circumstances may creditors obtain relief from such prohibitions?

Liquidations

When a company is placed in compulsory liquidation (and the court order has been made), or when a provisional liquidator has been appointed, no action or proceeding may be started or proceeded with against the company or its property without the permission of the court (section 186 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O)). Permission will be refused if the proposed action raises issues that could be dealt with more conveniently and less expensively in the liquidation

proceedings; however, this will not restrict claims made by secured creditors in respect of secured assets.

When a creditors' voluntary liquidation is commenced there is no automatic moratorium on proceedings against the company. The liquidator or any creditor or member may, however, apply to the court for a stay on any proceedings. In a members' voluntary liquidation, no automatic moratorium applies.

Reorganizations

The vast majority of reorganizations are informal and there is, therefore, no strict procedure governing moratoria or stays of proceedings. Sometimes, it may be possible for the company to agree an informal moratorium with its creditors (commonly known as a standstill) before commencing a reorganisation. Otherwise, the company will be at risk of creditors commencing actions to wind it up, enforce security or seize its assets.

A reorganisation that is implemented by way of a scheme of arrangement lacks a moratorium on creditor actions. A dissenting minority (before it is bound to a scheme that has become effective), is able to petition for the winding up or take other legal action against the company and its property. The company or the supporting creditors may seek the appointment of a provisional liquidator to benefit from the statutory stay of proceedings while the terms of the reorganizations are being negotiated and implemented. The English court has permitted a temporary stay on claims brought by dissentient creditors where a scheme of arrangement is proposed (*Bluecrest Mercantile BV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm)).

The Companies (Corporate Rescue) Bill is expected to contain a 'provisional supervision' procedure. This is a corporate rescue procedure that would include a moratorium on civil proceedings and actions against the company and its property, during which the company and its creditors may negotiate and implement a reorganisation. The Bill has not been presented to the Legislative

Council at the time of writing.

Doing business

23. When can the debtor carry on business during a liquidation or reorganisation? Is any special treatment given to creditors who supply goods or services after the filing? What are the roles of the creditors and the court in supervising the debtor's business activities?

A company can carry on business during a reorganisation. If there is a consensual restructuring process underway, the creditors involved in that process (eg, the bank group or a bondholder committee) may require additional information about the company during the restructuring process and increased access to management. Other creditors (eg, suppliers) may also change their terms of business to give themselves greater protection should the reorganisation fail and the company go into insolvent liquidation. If no formal insolvency proceedings have commenced, creditors who continue to supply goods and services during the reorganisation process will not be subject to a particular statutory regime. Existing contractual arrangements continue to apply.

Post-filing credit

24. May a debtor in a liquidation or reorganisation obtain secured or unsecured loans or credit? What priority is or can be given to such loans or credit?

A liquidator can raise any money required on the security of the assets of the company. Such credit would have priority over ordinary unsecured creditors as an expense of the liquidation, but only in respect of the new funds.

However, any new loans will not take priority over pre-existing debt secured by legal or equitable mortgages or a fixed charge unless this is permitted under the terms of the pre-existing secured debt. Any new security granted to secure the

credit cannot take priority over pre-existing security unless this is permitted under the terms of the pre-existing security.

In an informal reorganisation or a reorganisation implemented by way of a scheme of arrangement, the obtaining of credit and the use of assets as security is a matter for agreement between the company and its creditors.

Sale of assets

25. In reorganizations and liquidations, what provisions apply to the sale of specific assets out of the ordinary course of business and to the sale of the entire business of the debtor? Does the purchaser acquire the assets 'free and clear' of claims or do some liabilities pass with the assets?

Reorganizations

In practice, many reorganizations result from informal negotiations with creditors outside of any formal insolvency or restructuring procedures. As a consequence, the terms of the reorganisation, and therefore any provisions as to the sale or use of assets, are subject to negotiation between all relevant parties.

Liquidations

Once a company has gone into liquidation, the directors will be unable to sell its assets. Instead, the liquidator can sell any of the company's property by public auction or private contract, provided the assets are beneficially owned by the company. This power can be exercised by the liquidator in both voluntary and compulsory liquidations without sanction of the court or committee of inspection.

Negotiating sale of assets

26. Does your system allow for 'stalking horse' bids in sale procedures and does your system permit credit bidding in sales?

There is no specific legislation that either prevents or encourages the use of

‘stalking horse’ bids in sale procedures. How a particular sale process is carried out will be at the discretion of the directors or liquidator or provisional liquidator (as applicable).

Credit bidding in sales is permitted, although there is also no specific legislation on this point; in considering whether to sanction such an arrangement, the court is likely to assess whether accepting the bid is consistent with the liquidator’s duty to act in the best interests of the whole body of creditors.

Rejection and disclaimer of contracts

27. Can a debtor undergoing a liquidation or reorganisation reject or disclaim an unfavourable contract? Are there contracts that may not be rejected? What procedure is followed to reject a contract and what is the effect of rejection on the other party? What happens if a debtor breaches the contract after the insolvency case is opened?

A liquidator may, with the leave of the court, disclaim any onerous property with the permission of the court (and subject to section 268 of the C(WUMP)O) at any time in the 12 months after the commencement of the winding up. Onerous property is defined as any property consisting of land burdened with onerous covenants, of shares or stock in companies or unprofitable contracts, and any other property of the company that is unsaleable, is not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act. A contract may be unprofitable if it gives rise to prospective liabilities and imposes continuing financial obligations on the company that may be detrimental to the creditors. A contract is not, however, unprofitable merely because it is financially disadvantageous – it is the nature and cause of the disadvantage that will be the decisive factor. The liquidator cannot disclaim a completed contract. This is because A liquidator may, with the leave of the court, disclaim any onerous property with the permission of the court (and subject to section 268 of the C(WUMP)O) at

any time in the 12 months after the commencement of the winding up. Onerous property is defined as any property consisting of land burdened with onerous covenants, of shares or stock in companies or unprofitable contracts, and any other property of the company that is unsaleable, is not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act. A contract may be unprofitable if it gives rise to prospective liabilities and imposes continuing financial obligations on the company that may be detrimental to the creditors. A contract is not, however, unprofitable merely because it is financially disadvantageous – it is the nature and cause of the disadvantage that will be the decisive factor. The liquidator cannot disclaim a completed contract. This is because disclaim. The effect of the loss of the right to disclaim is that the liquidator loses the right to terminate the contract unilaterally by notice, thus enabling the other party to elect to hold the contract open for future performance. If the liquidator chooses to allow the company to default on its obligations, the contract continues in force until the other party exercises a right to treat it as repudiated or obtains an order for rescission of the contract.

A disclaimer operates to determine, as at the date of the disclaimer, the rights, interests and liabilities of the company, but does not affect the rights or liabilities of any other person except insofar as is necessary for the purpose of releasing the company from any liability. Any person suffering loss or damage as a consequence of the operation of the disclaimer is deemed a creditor of the company and may submit proof for the loss or damage in a winding up.

Intellectual property assets

28. May an IP licensor or owner terminate the debtor's right to use the IP when a liquidation or reorganisation is opened? To what extent may IP rights granted under an agreement with the debtor continue to be used?

There is no automatic right of a licensor or owner of intellectual property (IP) to terminate the debtor's right to use IP assets. Such matters will be governed

by the terms of the licence (eg, in particular in the event of default and termination provisions). Also, an insolvency representative does not have the power to terminate a debtor's agreement with an IP licensor or owner and then continue to use the IP for the benefit of the estate.

Personal data

29. Where personal information or customer data collected by a company in liquidation or reorganisation is valuable, are there any restrictions in your country on the use of that information or its transfer to a purchaser?

Hong Kong provides statutory protection for the personal data of individuals under the Personal Data (Privacy) Ordinance (PDPO). While there has not been any case law in Hong Kong concerning the status of insolvent companies or the responsibilities of liquidators under the PDPO, we would expect a Hong Kong court to follow the reasoning of the English High Court in *Re Southern Pacific Personal Loans* [2014] Ch 426. In *Southern Pacific* (decided under the pre-GDPR data protection regime), the English court held that the liquidators were not data controllers in their own right and were not personally responsible for the company's compliance with the provisions of the English Data Protection Act 1988.

Under the PDPO, a Hong Kong company does not have an automatic right to dispose of personal data as part of a sale of its assets. Any transfer of personal data to a third party that is not consistent with the purposes for which the data was originally collected would require the consent of the individual data subjects concerned. On the other hand, a sale of the shares in the insolvent company preserves the status quo (namely that the company remains the data controller) and does not require a separate consent. In practical terms, liquidators proposing to sell the company's assets, including its data, should ensure that consent to the transfer to a purchaser was obtained at the time the personal data was originally collected.

Arbitration processes

30. How frequently is arbitration used in liquidation or reorganisation proceedings? Are there certain types of disputes that may not be arbitrated? Can disputes that arise after the liquidation or reorganisation case is opened be arbitrated with the consent of the parties?

Liquidation is a court-regulated procedure and generally does not utilize arbitration (except where the liquidator commences claims in arbitration against third parties). Where a winding-up order has been made, no action or proceedings may be continued or commenced against the company or its property, except with the permission of the court. Arbitration of disputes is likely to be treated as a legal process that would be subject to the same stay of proceedings.

On a related note, a winding-up petition will generally be dismissed in favour of arbitration if the following conditions are satisfied:

- the company disputes the debt relied on by the petitioner;
- the contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and
- the company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process and files an affirmation to demonstrate to the court that it has taken those steps.

It is not necessary for the party resisting the petition to show that there is a bona fide dispute on substantial grounds in relation to the debt (*Re Southwest Pacific Bauxite* (HK) Ltd [2018] 2 HKLRD 449).

CREDITOR REMEDIES

Creditors' enforcement

31. Are there processes by which some or all of the assets of a business may be seized outside of court proceedings? How are these processes carried out?

A secured creditor can potentially enforce its security outside of court proceedings by the appointment of a receiver over specified charged assets. The receiver will collect and realize the charged assets towards satisfying the debt. The primary duty of the receiver is owed to the secured creditor (but the receiver acts as the chargor's agent in relation to the charged assets). A mortgagee may take physical possession of the assets subject to the mortgagor's equity of redemption, and such possession does not require a court order. If the mortgagee wishes to foreclose (ie, to become the owner of the assets free of the mortgagor's equity of redemption), an order of the court is required.

Unsecured credit

32. What remedies are available to unsecured creditors? Are the processes difficult or time-consuming? Are pre-judgment attachments available?

Generally, the remedies available to unsecured creditors will depend on the terms of the contract or underlying obligation that gave rise to the debt. A landlord or other creditor who has completed the distraint against the company's assets before the commencement of insolvency (ie, the company's assets have been seized and sold) may keep the proceeds (there is, however, no equivalent to the English statutory provisions that would allow a landlord to distraint post-commencement of insolvency for up to six months of unpaid rent). A supplier of goods may protect itself by inserting a clause in the supply contract to the effect that title to the goods supplied will not pass to the buyer until payment has been received (known as a 'retention of title' or ROT clause). The contract can either provide for retention of title until the specific goods supplied by the contract have been paid for or, more usually, until all

monies outstanding from the debtor have been paid. The creditor is, therefore, contractually entitled to the return of its goods.

Unsecured creditors will also in general be entitled to commence proceedings against the debtor for recovery of its debt. If there is no substantive defence to the claim, the creditor can apply for summary judgment, which could take up to three months. If the debtor can show that it has a real prospect of successfully defending the claim, it could take much longer. In the meantime, if the creditor has evidence that the debtor is likely to dissipate the assets, it can apply to the court for an order that assets up to the amount claimed (eg, bank accounts) be frozen or prevented from being dealt with or dissipated. Once a judgment has been obtained, then proceedings to enforce the judgment can be commenced. Remedies include sending a court officer to seize the debtor's goods or diverting an income source (eg, bank balances or book debts) directly to a creditor (a third-party debt order, formerly known as a 'garnishee order').

There are no special rules for foreign creditors except that a foreign creditor may sometimes be required to provide security for the debtor's legal costs by making a payment into court (although the requirement to provide security for costs can also apply to non-foreign creditors in certain circumstances).

Unsecured creditors are also able to file winding-up petitions.

CREDITOR INVOLVEMENT AND PROVING CLAIMS

Creditor participation

33. During the liquidation or reorganisation, what notices are given to creditors? What meetings are held and how are they called? What information regarding the administration of the estate, its assets and the claims against it is available to creditors or creditors' committees? What are the liquidator's reporting obligations?

Generally, the Companies (Winding Up and Miscellaneous Provisions)

Ordinance (C(WUMP)O) provides for early notification of all creditors by advertisement and the holding of a meeting of creditors. The first creditors' meeting held in a creditors' voluntary liquidation (CVL) will take place on the same day or the day after the shareholders pass a resolution to place the company in liquidation. At this meeting, the main purposes will be to appoint a liquidator, fix the liquidator's remuneration and potentially appoint a committee of inspection. The liquidator must call a further meeting of the creditors generally if the liquidation lasts more than one year. Before the company is finally dissolved, the liquidator must call a final meeting of creditors.

In a compulsory liquidation, the Official Receiver is usually automatically appointed as the provisional liquidator until a meeting of the company's creditors and contributories is convened and the court has ordered the appointment of a liquidator. The liquidator must advertise their appointment.

In a liquidation (whether it is a CVL or compulsory liquidation), if one-tenth in value of the company's creditors (or contributories) request the liquidator to hold a meeting of creditors, then there is an obligation to do so.

Creditor representation

34. What committees can be formed (or representative counsel appointed) and what powers or responsibilities do they have? How are they selected and appointed? May they retain advisers and how are their expenses funded?

A committee of inspection may be appointed in a liquidation. The committee may ordinarily consist of no more than seven persons.

If a committee of inspection is appointed in either a CVL or a compulsory liquidation, its role is mainly supervisory. It also fixes the liquidator's remuneration and can sanction the exercise of certain of the liquidator's powers (which can also be sanctioned by the court). The liquidator must report to the

committee of inspection on a regular basis.

Enforcement of estate's rights

35. If the liquidator has no assets to pursue a claim, may the creditors pursue the estate's remedies? If so, to whom do the fruits of the remedies belong? Can they be assigned to a third party?

Creditors may determine that it is in their best interests to fund the estate or insolvency office holder so that a claim may be pursued by the insolvency office holder; however, creditors are not themselves able to pursue remedies on behalf of the estate (this being the function of the insolvency office holder) except:

- bringing proceedings against any officer of the company or anyone involved in the formation or promotion of the company in connection with any alleged misfeasance or breach of fiduciary duty under section 276 of (C(WUMP)O); or
- bringing proceedings for fraudulent trading under section 275 of the C(WUMP)O.

Assignment of remedies to a third party who has no interest in the action or any other motive to justify their interference in law is likely to be deemed as maintenance, which is illegal under Hong Kong law (Winnie Lo v HKSAR [2012] 15 HKCFAR 16). An exception exists in relation to a company in liquidation because under section 199(2) and Schedule 25 of the C(WUMP)O a liquidator may sell a cause of action vested in the company over which they have been appointed. However, this power does not extend to a cause of action that is vested in the liquidator themselves, such as, for instance, unfair preferences (*Re Cyberworks Audio Video Technology Limited* [2010] 2 HKLRD 1137).

Claims

36. How is a creditor's claim submitted and what are the time limits? How are claims disallowed and how does a creditor appeal? Can claims for contingent or unliquidated amounts be recognized? Are there provisions on the transfer of claims and must transfers be disclosed? How are the amounts of such claims determined?

Generally, unsecured creditors' claims are not submitted until the company is in liquidation. All creditors submit a claim by sending particulars of it to the liquidator by way of a 'proof of debt'. A creditor may make a claim in respect of a contingent or unliquidated amount provided that it arises before the date on which the company went into liquidation (this element has been the subject of much case law).

Time limits may be set for receipt and processing of claims before interim dividends are paid. If the creditor misses the deadline, it will be entitled to receive previous interim dividends once it has proved its claim. Once the liquidator has realized all the company's assets, they will give notice of intention to declare a final dividend. All claims must be established by the date set out in the notice declaring the final dividend.

The liquidator may reject a proof in whole or in part but must provide reasons to the creditors. A creditor may appeal to the court against a rejection within 21 days of receiving notice of it.

There are no specific provisions dealing with the purchase, sale or transfer of claims against the debtor.

Set-off and netting

37. To what extent may creditors exercise rights of set-off or netting in a liquidation or in a reorganisation? Can creditors be deprived of the right of set-off either temporarily or permanently?

Before the commencement of a formal insolvency procedure, the normal rules

on set-off and netting continue to apply. Contractual set-off can be amended by agreement as part of an informal reorganisation.

Theoretically, it would also be possible to amend rights of set-off as part of a formal restructuring (eg, via a scheme of arrangement), but this could only be done if it was 'fair' to the relevant creditors. This may be difficult to achieve as rights of set-off are likely to vary from creditor to creditor.

Insolvency set-off applies where there have been mutual dealings between a creditor and the company. The office holder is required to take an account of what is due from each party to the other in respect of dealings and set off the sums due from one party to the other. Insolvency set-off is mandatory and cannot be contracted out of.

Modifying creditors' rights

38. May the court change the rank (priority) of a creditor's claim? If so, what are the grounds for doing so and how frequently does this occur?

The court does not have general jurisdiction to change the priority of creditors' claims, which are determined by statute; however, where realizations are made from assets subject to a floating charge and there are insufficient assets to meet the statutory preferential debts, an insolvency office holder must apply the realizations to pay such preferential debts ahead of the floating charge holder.

Rule 179 of the Companies (Winding up) Rules sets out a list of winding-up expenses and the priority in which they should be paid out of the assets. Pursuant to section 220 of the C(WUMP)O, the court may, in the event of the assets being insufficient to satisfy the liabilities, make an order as to the payment, out of the assets, of the expenses incurred in the winding up in such order of priority as the court thinks just. However, the power of the court only extends to being able to vary the order of priority of the winding-up expenses set out in the aforementioned list. The court does not have jurisdiction to treat costs that are not contained in that list as expenses of the winding up.

The ‘anti-deprivation’ rule under common law also makes it clear that parties cannot contract out of the statutory rules for the realization and distribution of assets in insolvency that are contained in the C(WUMP)O.

Priority claims

39. Apart from employee-related claims, what are the major privileged and priority claims in liquidations and reorganizations? Which have priority over secured creditors?

An office holder will apply the proceeds of the realized assets and pay creditors in a specified order depending upon the source of the proceeds, that is, whether they come from fixed charge realizations, floating charge realizations or the realizations of uncharged assets.

Other than the costs of preserving and realizing the fixed charge assets (including the office holder’s costs relating to those assets), there are no priority claims that rank ahead of secured creditors with a fixed charge in relation to the proceeds of the sale of those assets.

In addition to the costs of preserving and realizing the floating charge assets, certain priority claims rank ahead of floating charge holders’ claims, and these are paid out of the proceeds of the sale of the assets secured by the floating charge. These priority claims are preferential debts. Primarily, these include wages and certain government debts.

The costs and expenses of the liquidator rank ahead of payments to unsecured creditors out of the realization of uncharged assets.

Creditors who can establish valid retention of title and other proprietary claims will have their property returned (or its monetary equivalent) in priority to those listed above. Where there have been mutual dealings between a creditor and the company, the liquidator is required to take an account of what is due from each party to the other in respect of dealings and set off the sums due

from one party to the other.

Employment-related liabilities

40. What employee claims arise where employees' contracts are terminated during a restructuring or liquidation? What are the procedures for termination? (Are employee claims as a whole increased where large numbers of employees' contracts are terminated or where the business ceases operations?)

Contracts of employment will automatically terminate upon a compulsory liquidation. Generally, employees will be unsecured creditors in the liquidation of the company, except to the extent that any of their claims constitute preferential debts under section 265 of the C(WUMP)O (eg, unpaid wages and certain employment-related claims up to a limit), which will be paid ahead of other unsecured creditors' claims. Contracts of employment will not automatically terminate upon a CVL as the business of the company does not terminate instantly.

When a liquidator sells part or all of a business in a CVL or members' voluntary liquidation (MVL), the liquidator must have regard to the total benefit of ownership (TBO), as the transferee may become liable for the debts of the transferor (including employment claims). Whether the transfer of assets will be considered as a transfer of business under the TBO depends on a number of factors, including, among other things:

- the use of the same or similar name;
- an assignment of goodwill;
- the use of the same premises, personnel and stock in trade; and
- the conduct of the same or similar type of business, servicing of the same customers (*BNP Paribas v GC Luckmate Trading Ltd* [2002] 2 HKLRD 156, [2003] 1 HKLRD 307).

However, the TBO does not apply to transfers effected by a liquidator appointed in a compulsory winding up (ie, other than CVL and MVL) or a receiver pursuant to a charge that has been registered for at least one year.

Pension claims

41. What remedies exist for pension-related claims against employers in insolvency or reorganisation proceedings and what priorities attach to such claims?

Unpaid contributions to occupational retirement schemes and the mandatory provident fund (under the Mandatory Provident Fund Schemes Ordinance) are categorized as preferential debts for the purpose of priority under section 265 of the C(WUMP)O.

Environmental problems and liabilities

42. Where there are environmental problems, who is responsible for controlling the environmental problem and for remediating the damage caused? Are any of these liabilities imposed on the insolvency administrator personally, secured or unsecured creditors, the debtor's officers and directors, or on third parties?

There is no stand-alone legislation in Hong Kong governing the treatment of such liabilities, thus it is likely that, in an insolvency context, any liability arising from environmental problems that pre-date the insolvency would be categorized as unsecured claims. It is unclear how any such liability arising as a result of anything done or omitted to be done by the insolvency office holder would be treated.

Liabilities that survive insolvency or reorganisation proceedings

43. Do any liabilities of a debtor survive an insolvency or a reorganisation?

Where a debtor uses a scheme of arrangement to reorganize, the terms of the scheme will determine the treatment of the debtor's liabilities (eg, the extent to which they are compromised).

Where a purchaser buys the assets from an insolvent debtor in a compulsory winding up, the liabilities remain with the debtor. However, transfers effected by a liquidator in CVL or MVL are covered by the TBO where the transfer of assets is considered to be a transfer of business, and in that case, the transferee will become liable for all debts and obligations arising out of the carrying on of the business by the transferor.

Distributions

44. How and when are distributions made to creditors in liquidations and reorganizations?

In liquidations, a distribution will be made when sufficient funds are available to justify it. In the case of a reorganisation, the terms of any distribution will usually be set out in the restructuring agreement or the scheme of arrangement, as appropriate.

SECURITY

Secured lending and credit (immovables)

45. What principal types of security are taken on immovable (real) property?

The principal type of security granted over immovable property is the legal mortgage. A legal mortgage is a transfer of the whole of the debtor's legal ownership in the property subject to the security. This is subject to the debtor's right to redeem the legal title upon repayment of the debt (known as the equity of redemption).

An alternative is the equitable mortgage, which differs from the legal mortgage

in that it creates a charge on the property but does not convey any legal estate or interest to the creditor. An equitable mortgage can be created by a written agreement to execute a legal mortgage, by a mortgage of an equitable interest or by a mortgage that fails to comply with the formalities for a legal mortgage.

Another alternative to the legal mortgage is the fixed charge. This involves no transfer of ownership but gives the creditor the right to have the designated property sold and the proceeds applied to discharge the debt. A fixed charge attaches to the property in question immediately on creation (or, if the property is acquired later, after creation but immediately upon the debtor acquiring the rights over the property to be charged). The debtor may then only dispose of the property once the debt has been repaid or with the consent of the creditor.

A company must register a mortgage or charge (whether fixed or floating) within one month of the date on which it was created (section 335 of the Companies Ordinance (CO)); failure to do so will not only expose the company and every person responsible for the company to criminal liability, but also render the security granted by the charge void against any liquidator and creditor of the company (section 337 of the CO).

Secured lending and credit (movables)

46. What principal types of security are taken on movable (personal) property?

The principal security devices relating to movable property are mortgages and fixed charges, floating charges, pledges and liens.

A floating charge does not attach to a specific asset but is created over a class of assets – present or future – and allows the debtor to buy and sell these assets while the charge remains floating. In practice, floating charges are generally created over the whole business and undertaking of a company and therefore cover all present and future assets of that company. It is only on the occurrence of certain events, such as default on the repayment of the debt, that the charge

attaches to the secured assets that are at that time owned by the debtor. This is called ‘crystallization. On crystallization, the charge acts like a fixed charge in that the debtor is no longer free to sell the assets without repayment of the debt or without the consent of the creditor.

A company must register a mortgage or charge (whether fixed or floating) within one month of the date on which it was created (section 335 of the CO); failure to do so will not only expose the company and every person responsible for the company to criminal liability, but also render the security granted by the charge void against any liquidator and creditor of the company (section 337 of the CO).

A pledge is a form of security that gives the creditor a possessory right to the pledged asset. It is usually created by delivering the asset to the creditor, although symbolic or constructive delivery may be sufficient.

A lien is a possessory right of a creditor to retain possession of a debtor’s asset until the debt has been repaid. It can be created by contract or by operation of law. The creditor has no right to deal with the asset and the lien is usually extinguished once the asset is returned to the debtor.

CLAWBACK AND RELATED-PARTY TRANSACTIONS

Transactions that may be annulled

47. What transactions can be annulled or set aside in liquidations and reorganizations and what are the grounds? Who can attack such transactions?

A transaction may be set aside by a liquidator under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O) if it is an unfair preference entered into within a specified look-back period. A company grants a preference where it does something, or allows something to be done, that puts a creditor, surety or guarantor in a better position than it would otherwise have

been if the company went into insolvent liquidation (section 266A of the C(WUMP)O). The court will, however, only make an order restoring the position to what it would have been if the company was influenced by a desire to put the other person in a better position. This desire to prefer is presumed where the recipient of the preference is connected with the company (otherwise than by reason only of being its employee) under section 266 of the C(WUMP)O. The look-back period is two years in the case of a person connected with the company (otherwise than by reason only of being its employee) and six months in other cases.

A transaction that is entered into by a company within five years before the commencement of its winding up may be set aside if no consideration was provided to the company or the consideration was significantly less than the value of the transaction.

In addition to unfair preferences, certain floating charges will also be invalid under section 267 of the C(WUMP)O, except to the extent of any valuable consideration (being money, goods or services supplied, or a discharge or reduction of any debt or interest) provided to the company in return for the company granting the floating charge. Where the floating charge is created in favour of a person who is connected with the company, it can be annulled if it was created within two years of commencement of winding up, whereas the corresponding period for floating charges created in favour of a non-connected person is 12 months.

The court will not make any order unless, at the time of making the preference, entering into a transaction at an undervalue, or granting the floating charge (other than in favour of a connected person), the company was unable to pay its debts, or became unable to pay its debts as a consequence of the transaction.

Separately, a liquidator may apply to the court to set aside an extortionate credit transaction, referring to a transaction including terms requiring grossly exorbitant payments to be made in respect of the provision of credit or

otherwise grossly contravened ordinary principles of fair dealing (section 264B of the C(WUMP)O).

A transaction may also be set aside by the court if it is a fraudulent conveyance under section 60 of the CPO, which is a disposition of property made with intent to defraud creditors.

Under Hong Kong law, there are no specific legislative provisions that allow for transactions to be annulled as a result of a reorganisation.

Separately, a liquidator may apply to the court to set aside an extortionate credit transaction, referring to a transaction including terms requiring grossly exorbitant payments to be made in respect of the provision of credit or otherwise grossly contravened ordinary principles of fair dealing (section 246B of the C(WUMP)O).

A transaction may also be set aside by the court if it is a fraudulent conveyance under section 60 of the Conveyancing and Property Ordinance, which is a disposition of property made with intent to defraud creditors.

Under Hong Kong law, there are no specific legislative provisions that allow for transactions to be annulled as a result of a reorganisation.

Equitable subordination

48. Are there any restrictions on claims by related parties or non-arm's length creditors (including shareholders) against corporations in insolvency or reorganisation proceedings?

There are no equitable subordination rules as such in Hong Kong insolvency law. The rules for distribution of an insolvent estate are set out in the C(WUMP)O and Companies (Winding up) Rules, and shareholders are last in the order of distribution in respect of their share capital, after unsecured creditors have been satisfied in full. Non-arm's length creditors will rank pari passu with the remainder of the unsecured creditors unless they have security,

in which case the usual rules of distribution apply.

The rules relating to unfair preference are more stringent if the transaction is with an 'associate' or is connected to the company. For example, an 'associate' is presumed to be influenced by the desire in giving a preference and the time limit is extended from six months before the commencement of the winding up to two years prior.

Lender liability

49. Are there any circumstances where lenders could be held liable for the insolvency of a debtor?

There is no clear Hong Kong law authority addressing this issue.

GROUPS OF COMPANIES

Groups of companies

50. In which circumstances can a parent or affiliated corporation be responsible for the liabilities of subsidiaries or affiliates?

Generally, Hong Kong law treats each member of a corporate group as an entirely distinct entity from other members of the group, other than in very specific circumstances.

Accordingly, a parent or affiliated corporation is not responsible for the liabilities of subsidiaries or affiliates in an insolvency process.

A parent company may conceivably be held liable for the acts of its subsidiary pursuant to the law of agency; however, there is no presumption that a subsidiary is the agent or alter ego of the parent company. In very limited circumstances, Hong Kong courts will permit the piercing of the corporate veil to allow action to be taken against those who control a company.

A parent company may also be liable for the acts of its subsidiaries under the

torts of conspiracy and negligence. In particular, depending on the facts, there can be a primary, direct duty of care on a parent company towards employees (and potentially others) affected by the activities of a subsidiary under the tort of negligence.

There is no mechanism under Hong Kong law by which assets may be dealt with at the level of the corporate group without regard to the insolvencies of individual entities.

Combining parent and subsidiary proceedings

51. In proceedings involving a corporate group, are the proceedings by the parent and its subsidiaries combined for administrative purposes? May the assets and liabilities of the companies be pooled for distribution purposes?

Hong Kong law treats each member of a corporate group as an entirely distinct entity from its members, other than in very specific circumstances. Accordingly, the assets and liabilities of companies are not combined into one pool for distribution in an insolvency process. As a practical matter, where there is a corporate group, there may be administrative advantages to having the same insolvency office holder appointed in respect of each of the companies in the group (subject to any conflicts), but each entity will still be treated separately.

INTERNATIONAL CASES

Recognition of foreign judgments

52. Are foreign judgments or orders recognized, and in what circumstances? Is your country a signatory to a treaty on international insolvency or on the recognition of foreign judgments?

Generally, Hong Kong courts will recognize judgments and orders made by courts in another jurisdiction where Hong Kong courts consider that such

judgment or order has been properly made under that foreign law and that the foreign court had the necessary jurisdiction.

At common law, a money judgment issued by a competent court from any jurisdiction may be enforced in Hong Kong if it is final and conclusive and enforcement would not be contrary to public policy. Also, the judgment cannot have been obtained by fraud or in contravention of natural justice, and the proceedings must not have been brought contrary to a dispute settlement agreement between the parties, or, if so, the person against whom judgment was granted must have either agreed to the bringing of the proceedings or submitted to the foreign court's jurisdiction.

A foreign money judgment that is final and conclusive may also be registered with the Hong Kong courts under the Foreign Judgments (Reciprocal Enforcement) Ordinance if the judgment originated from a superior court of a state specified in the Ordinance.

The court will normally try to act in a way consistent with the orders of courts of other competent jurisdictions, but this does not justify a departure from the normal rules of conflict of laws whether in the insolvency context or more generally. In *Re BJB Career Education Co Ltd* [2017] 1 HKLRD 113, the Hong Kong court formally adopted the approach of the UK Supreme Court in *Rubin v Eurofinance SA* [2012] UKSC 46, which considered in detail the common law power to recognize and grant assistance to foreign insolvency proceedings. There may be circumstances, however, where the Hong Kong court will restrict the application of a foreign insolvency order, as explained further in the response to question 11.6.1 below.

Hong Kong is not a signatory to any treaties on international insolvency. However, Hong Kong has entered into reciprocal enforcement treaties with a number of foreign jurisdictions. On 14 May 2021, the Supreme People's Court of China and the government of Hong Kong signed the 'Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special

Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region' (the 2021 Arrangement). Under the 2021 Arrangement, a liquidator or provisional liquidator in insolvency proceedings in Hong Kong (including compulsory winding up, creditors' voluntary winding up and scheme of arrangement) may apply to the mainland Chinese courts of one of the designated pilot areas (Shanghai, Xiamen and Shenzhen) for recognition and assistance. An administrator in mainland Chinese bankruptcy proceedings may also apply to the High Court of Hong Kong for recognition and assistance.

UNCITRAL Model Laws

53. Have any of the UNCITRAL Model Laws on Cross-Border Insolvency been adopted or is adoption under consideration in your country?

Hong Kong has not implemented the UNCITRAL Model Law on Cross-Border Insolvency.

Foreign creditors

54. How are foreign creditors dealt with in liquidations and reorganizations?

In general, foreign creditors and domestic creditors are treated the same under the Hong Kong insolvency regime. Foreign creditors will be able to provide evidence of their claims in a Hong Kong winding-up proceeding in the normal way. However, if there is a concurrent liquidation of the same company in the foreign jurisdiction, then a creditor proving its claim in Hong Kong will only be entitled to share in any distribution once any amount received in the foreign proceedings has been taken into account. Foreign currency debts are converted into Hong Kong dollars as at the date of the winding-up order. Section 34(3B) of the Bankruptcy Ordinance provides that, in the context of personal

insolvency, foreign currency debts are to be converted into Hong Kong dollars at the midpoint between the selling and buying telegraphic transfer rates of exchange quoted by the Hong Kong Association of Banks on the day the bankruptcy order is made. There is no equivalent provision in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (C(WUMP)O); however, section 264 of the C(WUMP)O provides that the same rules apply to the respective rights of secured and unsecured creditors and to debts provable in a winding up applying to the same in bankruptcy. The High Court has held that, in relation to foreign currency debts provable in a winding up, the relevant date for currency conversion is that of the making of the winding-up order rather that the presentation of the petition (see *Re Moulin Global Eyecare Trading Ltd* [2007] HKCFI 747).

Cross-border transfers of assets under administration

55. May assets be transferred from an administration in your country to an administration of the same company or another group company in another country?

Assets would only properly transfer to an insolvency in another country if it was demonstrated to the satisfaction of the relevant insolvency office holder that the Hong Kong company did not have right and title to the asset and that it should, in fact, be treated as an asset of another company (potentially within the same group). Given the insolvency office holder's duty to ensure the best return to creditors, they would not consent to the transfer of such assets without incontrovertible evidence that this was the case or that there was a sale of the assets for value.

COMI

56. What test is used in your jurisdiction to determine the COMI (centre of main interests) of a debtor company or group of companies? Is there a test for, or any experience with, determining the COMI of a

corporate group of companies in your jurisdiction?

The Hong Kong court recently laid down a list of non-exhaustive factors that the court will look at when determining the centre of main interests (COMI) of a company. The relevant factors include the location where the company:

- holds its directors' and board meetings;
- houses its principal officers;
- has relocated to;
- has operations;
- has bank accounts;
- has assets;
- maintains its books and records; and
- has conducted restructuring activities (see Re Global Brands Group Holding Limited (in liquidation) [2022] HKCFI 1789).

Cross-border cooperation

57. Does your country's system provide for recognition of foreign insolvency proceedings and for cooperation between domestic and foreign courts and domestic and foreign insolvency administrators in cross-border insolvencies and restructurings? Have courts in your country refused to recognize foreign proceedings or to cooperate with foreign courts and, if so, on what grounds?

Under the common law principle of judicial comity, a Hong Kong court will ordinarily recognize a liquidator appointed in the country of the company's incorporation where the foreign insolvency proceedings are collective insolvency proceedings and there are no public policy issues that would prevent recognition (see *Joint and Several Liquidators of CEFC Shanghai*

International Group Ltd [2020] HKCFI 167).

This includes recognizing:

- a foreign liquidator appointed voluntarily (see *Re The Joint Liquidators of Supreme Tycoon Limited (In Liquidation in the British Virgin Islands)* [2018] 1 HKLRD 1120, declining to follow the obiter view expressed by the Privy Council in *Singularis Holdings Limited v PricewaterhouseCoopers* [2014] UKPC 36 that common law recognition should not be extended to voluntary liquidations); and

- foreign liquidators appointed in civil law jurisdictions such as Japan or mainland China (see *Re Takamatsu* [2019] HKCFI 802, *Re The Joint and Several Liquidators of CEFC Shanghai International Group Ltd* [2020] HKCFI 167, *Re The Liquidator of Shenzhen Everich Supply Chain Co, Ltd* [2020] HKCFI 965, *Re HNA Group Co, Limited* [2021] HKCFI 2897 and *Nuoxi Capital v Peking University Founder Group Company Limited* [2021] HKCFI 3817).

Assistance may also be granted to liquidators of a solvent liquidation, although the assistance granted by the Hong Kong courts will be much more limited and on the basis of the agency theory (*Re Seahawk China Dynamic Fund (in provisional liquidation in the Cayman Islands)* [2022] HKCFI 1994).

A Hong Kong court has expressed the view that there are an increasing number of applications in Hong Kong for recognition and assistance of foreign soft-touch provisional liquidators involving companies incorporated in offshore 'letterbox' jurisdictions that are not their COMIs. In light of this practice involving Hong Kong and mainland China, the Hong Kong court decided that foreign insolvency proceedings should only be recognized and assistance granted if it constitutes a collective insolvency process and that process is conducted in the jurisdiction in which the company's COMI is located. If not, 'recognition and assistance should be declined' unless the application falls

within one of two exceptions:

- it is limited to recognition of a liquidator's authority, if appointed in the place of incorporation, to represent a company and orders that are an incident of that authority; and

- it is for recognition and 'limited and carefully prescribed' assistance that does not fall within the first category and that is required by a liquidator appointed in the place of incorporation as a matter of practicality.

The court also said that, going forward, it would generally decline to recognize offshore soft-touch provisional liquidators designed to frustrate winding-up proceedings in Hong Kong and to engineer a de facto moratorium that could not be obtained under Hong Kong law (*Re Lamtex Holdings Ltd* [2021] HKCFI 622 and *Re Global Brands Group Holding Limited (in liquidation)* [2022] HKCFI 1789).

Hong Kong proceedings may be required to establish the foreign insolvency officer's authority to deal with assets in Hong Kong. Recognition of a foreign insolvency officer's position will, in itself, confer standing on the officer to represent the foreign company in the Hong Kong courts. The officer may bring proceedings in the Hong Kong courts in the name of the foreign company and, generally, administer the assets of the foreign company present in Hong Kong. However, Hong Kong courts' power to assist a foreign office holder is limited by the extent to which the type of order sought is available under the Hong Kong insolvency regime and common law or equitable principles; hence, a court has, for example, refused to grant the application of administrators appointed in England and Wales for an order restraining the sale of property subject to a fixed charge on the basis that no such statutory moratorium or equivalent power exists in Hong Kong (see *Joint Administrators of African Minerals Ltd (in administration) v Madison Pacific Trust Ltd & Shandong Steel Hong Kong Zengli Ltd* [2015] HKCFI 645).

The Supreme People's Court of China and the government of Hong Kong have signed the 2021 Arrangement that facilitates the recognition by the mainland Chinese courts of liquidators and provisional liquidators in Hong Kong proceedings and the recognition by the Hong Kong courts of administrators in mainland Chinese bankruptcy proceedings.

Cross-border insolvency protocols and joint court hearings

58. In cross-border cases, have the courts in your country entered into cross-border insolvency protocols or other arrangements to coordinate proceedings with courts in other countries? Have courts in your country communicated or held joint hearings with courts in other countries in cross-border cases? If so, with which other countries?

Insolvency protocols have been used in cross-border insolvencies between insolvency representatives appointed by the Hong Kong court and the insolvency representatives in a number of other jurisdictions (eg, Bermuda and the Cayman Islands) to harmonize proceedings between the two relevant countries (*Re Kong Wah Holdings Limited* [2004] HKCFI 345).

In the Lehman Brothers case, it was clear that, because of the volume and size of the claims involved and the international dimension of the business, international cooperation would be of paramount importance. In 2009, Lehman Brothers' insolvency representatives in several jurisdictions, including Hong Kong, signed a protocol that focused on cooperation and exchange of information. The Hong Kong courts had in the past approved Hong Kong insolvency practitioners entering into and implementing such protocols in similar cross-border insolvency cases. In general, the court will proceed on the (rebuttable) presumption that the liquidator will normally be in the best position to take an informed and objective view as to what is in the best interests of the liquidation (see *Re Performance Investment Products Corp Ltd* [2014] HKCFI 481).

Article 25 of the Opinion published by the Supreme People's Court states that the courts in the pilot areas (Shanghai, Xiamen and Shenzhen) will communicate and cooperate with the courts in Hong Kong to the greatest extent possible. The Hong Kong court has stated that it is likely that cooperation with the mainland courts will initially be a relatively slow and incremental process given the materially different legal systems and different economic models between the two jurisdictions (see *Nuoxi Capital Ltd v Peking University Founder Group Co Ltd* [2021] HKCFI 3817).

Winding-up of foreign companies

59. What is the extent of your courts' powers to order the winding-up of foreign companies doing business in your jurisdiction?

Hong Kong courts have jurisdiction to wind up a foreign company in a number of circumstances, including where the company is insolvent or there are just and equitable grounds for doing so (section 327(1) of the C(WUMP)O). Whether the court with such jurisdiction will wind up a company is a matter of discretion. There are three threshold requirements relevant to the exercise of that discretion (see *Shandong Chenming Paper Holdings Ltd v Arjowiggins HKK 2 Ltd* [2020] HKCA 670 and (2022) 25 HKCFAR 98):

- there is a sufficient connection between the foreign company and Hong Kong;
- there is a reasonable possibility that the winding-up order would benefit those applying for it; and
- the court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets.

Furthermore, Hong Kong courts have decided that the mere fact that a company has been wound up in its place of incorporation is not a ground for the courts to decline to make a winding-up order against the company as well

(*Re Up Energy Development Group Limited* [2022] 2 HKLRD 993).

UPDATE AND TRENDS

Trends and reforms

60. Are there any emerging trends or hot topics in the law of insolvency and restructuring? Is there any new or pending legislation affecting domestic bankruptcy procedures, international bankruptcy cooperation or recognition of foreign judgments and orders?

The Court of Final Appeal has ruled that, in a case where there is an underlying dispute of the petition debt that was subject to an exclusive court jurisdiction clause, the court should decline to exercise the bankruptcy jurisdiction to determine the petition unless there are countervailing factors. Such countervailing factors may include the risk of insolvency affecting third parties or a dispute that borders on the frivolous or an abuse of process. The Court of Final Appeal also noted that public policy considerations behind the court's bankruptcy jurisdiction should still be considered, but it would carry less weight when the petition is brought by one creditor against another and there is no evidence of a creditor community at risk (*Re Guy Kwok-hung Lam* (2023) 26 HKCFAR 119). It is very likely that the same principle may also apply to winding-up petitions of companies.

Separately, at the time of writing, it remains to be seen whether the Companies (Corporate Rescue) Bill, which is expected to include a 'provisional supervision' procedure that offers a moratorium on civil proceedings and actions against the company and its property, during which the company and its creditors may negotiate and implement a reorganisation, will be presented to the Legislative Council.

**** The information in this chapter was accurate as at October 2023.***