Comments of Hong Kong Bar Association on Improvement of Corporate Insolvency Law Legislative Proposal Consultation Document

Chapter 2: Questions 1-8

Question 1: Do you support the proposal to adopt a prescribed form of statutory demand, which would contain key information as described in paragraph 2.7 as well as a statement of the consequences of ignoring the demand?

1. The HKBA supports the proposal for adopting a prescribed form of statutory demand with the specific information identified in §2.7 for the following reasons.

   1.1 The introduction of a prescribed form would bring the procedural regime for winding up of companies in line with that of bankruptcies.

   1.2 A statutory demand is the most common mechanism adopted by creditors seeking to wind-up a company on the ground of inability to pay debts. Adopting a prescribed form can ensure that the company receiving the statutory demand would know precisely the consequences for failing to take step to comply with the statutory demand, and the possible actions that can be taken, such as those listed at the end of Forms 162, 163 and 164 of the Bankruptcy (Forms) Rules (Cap. 6B). This would be particularly useful for companies whose management do not have the necessary knowledge or experience in dealing with such matter.

   1.3 The adoption of a prescribed form would also help to remove the potential challenges to the validity of a statutory demand on technical grounds, such as whether the demand used by the creditor is sufficient for the purposes of s.178 of the Companies Ordinance (Cap.

32) ("**CO**") and in particular, for the presumption of insolvency to apply.

Question 2: Do you think that the section 228A procedure, whereby the directors of a company may commence a voluntary winding-up of the company without first having the members of the company resolve to do so, should be maintained or repealed?

2. The HKBA is of the view that the section 228A procedure should be maintained subject, however, to the introduction of further improvement measures set out at §2.14 (b) and (c).

2.1 Section 228A is admittedly a controversial provision and although not many jurisdictions have a similar provision, other common law jurisdiction like Singapore does have such provision (s.291(1) of the Singapore Companies Act (Cap.50)). The controversy that surrounds this section is sometimes termed "Centrebinding" from the case Re Centrebind Ltd [1966] All ER 889 whereby the Court upheld the decision by members of an insolvent company to put the company into voluntary liquidation and appointed a friendly liquidator. In this way, the management of a company, through appointing a compliant liquidator, could sell the company's business and assets and not pursuing the directors for their misfeasance, thus leaving the creditors with nothing. This problem is inherent in all forms of voluntary winding-up and is not peculiar to s.228A procedure.

2.2 Under s.228A(1)(b) the directors cannot invoke the procedure unless "it is reasonably practicable" for winding-up to be commenced under another section of the CO. This is a more onerous requirement imposed on the directors and is only found in s.228A. The HKBA considers that with this requirement, the possibility of abuse can be minimized as failure to satisfy such requirement would lead to the Court staying the winding-up commenced under s.228A with adverse

costs consequence. See, for eg., Bank of China (Hong Kong) Ltd v Oasis HKTL 04A Ltd & Anor (unreported) HCA 763/2008, 26 May 2008.

2.3 This section is useful in circumstances where, for example, it is obvious that the company is insolvent and creditors have started to rush in to encumber or take away assets, such that any delay to the winding-up would upset the *pari passu* distribution of assets to its stakeholders. Without s.228A, the only available avenue would be for the directors to present a petition against the company on the ground that it is unable to pay its debts (under s.177(1)(d) of the CO) and apply to the court for appointment of provisional liquidators on an urgent basis. This can be a costly exercise as the company would need to pay the legal costs in preparing the application and be liable to pay all the fees prescribed in the Companies (Fees and Percentages) Order, (Cap. 32C).

Question 3: If the section 228A procedure is to be maintained, do you agree to the proposed improvement measures as set out in paragraph 2.14 to reduce the risk of abuse of the procedure?

3. The HKBA welcomes proposals (a), (b) and (c) which introduce changes to the s.228A procedure.

3.1 The HKBA agrees with the benefit which proposal (a) would bring, as it allows the members to have advance notice of the directors' intention to invoke the s.228A procedure before the commencement of the winding-up, so that if they feel aggrieved about the decision, they can take the necessary step to stop the process. In this way, the members of the company would not be faced with the unenviable position of a *fait accompli* by the directors.

3.2 In that sense, proposal (a) would also give teeth to the sentiment expressed by DHCJ To (as he then was) in SEG Investment Ltd v SEG International Securities (HK) Ltd (unreported) HCMP 4211/2003, 14.10.2005, at §19, where it was stated that wherever possible, the company in general meeting should decide the winding-up of a company and that directors are merely agents of the company, highlighting that the s.228A procedure should only be a measure of last resort.

3.3 As for proposal (b), the HKBA recognizes that to a certain extent, s.228A(8) already provides some protection to stakeholders by requiring a professional provisional liquidator to step in, which is likely to reduce possible abuse by the directors appointing their associates as provisional liquidator. That said, the HKBA agrees that the proposal would remove the present loophole and ensures that the directors cannot delay the appointment of the provisional liquidators (at present, s.228A(5)(b) only requires the directors to appoint a provisional liquidator "forthwith").

3.4 The HKBA supports proposal (c) which has the effect of limiting the powers presently vested on a provisional liquidator appointed under s.228A. The limited power given to the provisional liquidator is consistent with the statutory purpose of the s.228A procedure, which is to allow the directors to put the company under the control of provisional liquidator where there is an urgency to preserve the assets of the company.

Question 4: Do you agree to replacing the existing requirement of holding the first creditors' meeting on the same or the next following day of the members' meeting with the requirement of holding the first creditors' meeting on a day not later than the fourteenth day after the day on which the members' meeting is held in a creditors' voluntary winding-up case?

4. The HKBA agrees with the proposal provided that it is enacted in tandem with the proposal in §2.23, namely to limit the powers of a liquidator appointed by the company during the period before the holding of the first creditors' meeting.

4.1 Such proposal, coupled with the proposal at §2.20 regarding notice, would allow the creditors more time to understand the situation facing the company and to assess the options open to them. At the same time, the requirement for creditors' meeting to be held within 14 days will ensure that the creditors can participate in the decision process concerning the further conduct of the liquidation within a specified time.

4.2 The need for the enactment of the proposal on the restriction of a liquidator's powers before the first creditors' meeting is necessary to avoid the risk of "Centrebinding" in the period between the holding of members' meeting and creditors' meeting.

4.3 Such proposals would bring the position in Hong Kong in line with the position in the UK under section 98 of the UK Insolvency Act 1986.

Question 5: Do you support the proposal on prescribing a minimum notice period for calling the first creditors' meeting in a creditors' voluntary winding-up case? If so, do you consider a period of seven days appropriate?

5. The HKBA supports the proposal and agrees that 7 days would be appropriate, for the following reasons.

5.1 Imposing a prescribed minimum notice period would remove the arbitrariness that exists under the current regime whereby the notice

to the creditors hinges on the length of notice for the members' meeting.

5.2 The HKBA welcomes a proposal that promotes certainty and which has the advantage of giving the creditors more time to digest information put before them so as to allow them and, if necessary, take legal advice and properly assess their options before attending the first creditors' meeting.

5.3 A notice period of 7 days appears appropriate as that would give the creditors enough time to digest information whilst not being unduly long so as to unnecessarily delay the creditors' meeting.

Question 6: Do you agree to the proposal on limiting the powers of the liquidator appointed by the company during the period before the holding of the first creditors' meeting in a creditors' voluntary winding-up?

6. As stated above, the HKBA supports the proposal and agrees that it would ensure that the liquidator appointed by the members cannot dispose of non-perishable assets without Court sanction. This is vital as save for the non-perishable assets which need to be disposed of urgently, the other assets of the company should be placed in the hands of the liquidator chosen by the creditors, as they are the persons having real interest in the liquidation of the company.

Question 7: Do you agree to the proposed restrictions on the exercise of the directors' power before a liquidator is appointed in a creditors' voluntary winding-up case?

7. The HKBA agrees with such proposal. It is sensible to have a regime in place to ensure that the directors remaining in office before a liquidator is appointed in a creditors' voluntary winding-up would only have the powers to do what is necessary in the interim period.

Question 8: Do you agree with the proposed technical amendments relating to the commencement of winding-up as set out in Annex C?

8. The HKBA agrees with the 27 proposed amendments in Annex C. These amendments are uncontroversial and are necessary to remedy the minor anomalies or inconsistencies (e.g. proposal 27 of Annex C), clarify ambiguity (e.g. proposal 11 of Annex C) that have arisen in the rules themselves or by reason of piece-meal amendments through the years (e.g. proposal 13 of Annex C) or to repeal superfluous provisions (e.g. proposal 4 of Annex C).

Chapter 3: Question 9-17

Question 9(a): Do you agree to the expansion of the list of disqualified persons from being appointed as a provisional liquidator or a liquidator? If so, do you agree with disqualifying the types of persons as proposed in paragraphs 3.13, 3.15 and 3.16?

9. The HKBA agrees with all the proposed expansions.

10. Firstly, the Court has repeatedly expressed that it is inappropriate to appoint a person to be a liquidator/provisional liquidator if that person has had a personal or professional association with the company or its present or past officers (Re Davidson Beggs Insurance Pty Ltd (1984) 2 ACLC 735 per McLelland J at 735), or where that person has a "material profession relationship" with the company (Re Plus Holdings Ltd [2007] HKLRD 725 at 730, per Kwan J (as she then was)). The expansion therefore recognizes and codifies the judicial sentiment towards the suitability of provisional liquidators.

11. Secondly, it is not in the interest of the company to appoint anyone suffering from mental incapacity as liquidators or provisional liquidators to manage and administer the company's property and affairs.

12. Thirdly, a person unfit and disqualified to be a director of the company should not be entrusted with the appointment as provisional liquidators/ liquidators whose powers and duties are akin to directors, namely to manage and administer the company's property and affairs for the benefit of its stakeholders.

Question 9(b): Do you agree to provide clearly that the appointment of a disqualified person as a provisional liquidator or liquidator shall be void and that he shall be liable to a fine if he acts as a provisional liquidator or liquidator?

13. Where it is provided that the group of disqualified person shall not be appointed as provisional liquidators or liquidators of the company, the appointment of them as such must be a nullity and void (Portman Building Society v Gallway [1955] 1 All ER 227). The HKBA therefore agrees that express provisions should be made to reflect the position at common law. Furthermore, the HKBA suggests that there should be further provision to make it clear that where the appointment of the provisional liquidators / liquidators becomes void, the Committee of Inspection ("**COI**") (if there is one) or the creditors at general meeting shall within say 21 days appoint a replacement provisional liquidator / liquidator whose appointment shall take effect retrospectively from the date the appointment of the former provisional liquidator / liquidator becomes void. This is necessary to ensure that the company would not be left in a situation where there is no provisional liquidator / liquidator to manage its assets and affairs. If it is considered inappropriate for appointment to take effect retrospectively, provision would need to be made to provide for the Official Receiver ("**OR**") to be the "default" provisional liquidator / liquidator during the period when there is no incumbent provisional liquidator / liquidator.

14. The HKBA also agrees that a disqualified person who has acted as a provisional liquidator or liquidator shall be liable to a fine.

Question 9(c): Do you agree that the disqualification proposals should also apply to the appointment of a receiver or a receiver and manager of the property of a company with suitable modifications?

15. Receivers may be appointed either by the holder of the debenture or security contract which provides for appointment of receiver or by the court upon the application of a secured creditor such as a debenture holder.

15.1 In the case of out-of-court appointment, the security contract would generally provide that the receiver is the agent of the debtor or the company although in reality the receiver's primary duty is to preserve and realizes the assets of the company which would be applied to repay the debts owed to the secured creditor in priority to the debts owed to the unsecured creditors and, if there is any surplus, it would be paid to the members of the company. In respect of such receiver, it does not seem that it is fair or appropriate to disqualify a creditor (as proposed in §3.13(a)) for appointment as such receiver as it is the creditor who has the most substantial interest in the assets of the company.

15.2 In the case of court-appointed receiver, he is an officer of the court and acts under the supervision of the court. It is well-established that "some entirely indifferent person ought to be appointed" (Fripp v Chard Ry (1853) 11 Hare 241 at 260), and the appointee must not only be independent but be seen to be independent. The disqualification proposals are consistent with this principle and should be adopted in respect of court-appointed receivers. The HKBA therefore agrees with the proposed expansion with suitable modifications.

Question 10(a): Do you agree that a new statutory disclosure system should be introduced for the appointment of provisional liquidators and liquidators?

16. The HKBA agrees with the statutory disclosure system as proposed, as the person who seek to be appointed as provisional liquidator and liquidator is more often than not the only person who knows of the existence of his relationship with the company and its former management. To require such person to disclose his relationship with the company would enable the body empowered to make the appointment to have the requisite information to assess whether the there is any actual or potential conflict of interests in appointing him as provisional liquidator or liquidator.

Question 10(b): If yes, do you agree with the details of information required to be disclosed as set out in paragraph 3.21?

17. Consistency should be maintained between the relationships required to be disclosed as stated in §§3.21(a) and (b). Therefore, under §3.21(b), the prospective provisional liquidator should also disclose if he is the immediate family member of a member, a creditor or a debtor, an employee, a receiver or a manager, a legal advisor of the company or the holding company or a subsidiary of the company. The HKBA notes that references to these relationships are currently missing at §3.21(b).

Question 10(c): Do you agree that a statutory defence as proposed in paragraph 3.24 should be provided for a failure in disclosure?

18. The HKBA agrees that a statutory defence as suggested should be provided for a failure in disclosure.

Question 11(a): Do you agree that the existing prohibition on inducement being offered to members or creditors in relation to the appointment of liquidators should extend to cover inducement being offered to any person?

19. The HKBA agrees with the proposal and notes that similar proposal has already been adopted in Australia under s.595 of the Corporations Act 2001.

Question 11(b): Do you agree that the prohibition should also be extended to inducement offered in relation to the appointment of provisional liquidators, receivers and receivers and managers?

20. The HKBA agrees with the proposal. Again, similar proposal has already been adopted in Australia under s.595 of the Corporations Act 2001.

Question 12: Do you agree with the proposal to designate all provisional liquidators who take office upon and after the making of a winding-up order (i.e. section 194 PL) as "liquidators" such that they will be subject to the provisions in the CO which apply to liquidators?

21. Currently, s.2(1) of the CO defines "liquidator" as including "a provisional liquidator holding such office by virtue of section 194." In Re Lehman Brothers Securities Asia Ltd (No. 2) [2010] 1 HKLRD 58, Barma J held that this definition includes the OR who holds office as provisional liquidator under s.194(1A) of the CO but was **not** directed at a provisional liquidator continuing in office pursuant to s.194(1)(aa). This decision was followed by Harris J recently in Re MF Global Hong Kong Ltd (No 3) [2012] 5 HKLRD 486[1], who held that provisional liquidators in office under s.194(1)(aa) are not liquidators for the purpose of s.202(1) and, therefore, are not obliged to pay the money received by them to the companies liquidation account in accordance with s.202(1) of the CO.

22. The proposal seeks to go further - to categorize provisional liquidators in office under s.194(1)(aa) (after a winding up order has been made but before the meetings of the creditors and contributors) as liquidators. This is to ensure that such provisional liquidators would be subject to the same powers and duties as liquidators and whose remuneration would be

[1] The HKBA notes that this Decision is under appeal.

determined in the same way as liquidators (under s.196 of the CO). It is also suggested that "they will be able to carry out the winding-up of the company as soon as practicable for the benefit of the creditors involved."

23. The HKBA can see the benefit in consistency and clarity which the proposal may bring. However, there is an important distinction between the provisional liquidators appointed under s.194(1)(aa) and the liquidators whose appointment has been approved at the creditors' meeting and confirmed by the court, in that the s.194(1)(aa) provisional liquidators may not receive the approval of the creditors and contributories. If they are conferred with powers to carry out all the duties in the same way as liquidators, there is a risk that they would be able to carry on important matters (such as disposal of major assets) even before the creditors have considered and approved their appointment. For this reason, the HKBA suggests that, even in the case where a winding up order has been given, there should be a difference between the duties and powers of the s.194(1)(aa) provisional liquidators and the liquidators whose appointment has been approved by the creditors and contributories and confirmed by the court.

Question 13: Do you agree with the proposal to clearly stipulate that it is up to the court to determine the powers, duties, remuneration and termination of appointment of provisional liquidators who were appointed by the court before the making of a winding-up order (i.e. section 193 PL)?

24. Currently, the power of a section 193 PL is defined by the order appointing the provisional liquidator. Although s.193 is silent on the question of remuneration, as a matter of practice, the court would in the order specifying how they are to be remunerated albeit in general terms (such as based on the normal charge-out rates or the charge-out rates for Panel A liquidators maintained by the Office of the Official Receiver ("**ORO**")). Therefore, in practice, the Court has consistently determined the powers, duties and

remuneration of the court-appointed provisional liquidators. That said, the HKBA agrees that the proposal if enacted would make the position clear even to companies whose directors do not have the benefit of legal advice.

Question 14: Do you agree with the proposal of setting out the powers of liquidators now found in section 199(1) and (2) of the CO in a Schedule to improve the clarity of the provisions?

25. This is a matter of presentation rather than substance. The HKBA is of the view that the current form of s.199(1) and (2) are clear enough and has no strong views on this proposal.

Question 15: Do you agree that the requirement for the liquidator to apply to the court or the COI for exercising the power to appoint a solicitor in a court winding-up should be removed, provided that prior notification is given to the COI or, where there is no COI, the creditors when the liquidator exercise such power?

26. The HKBA agrees with the proposal as it would help to streamline the process for the engagement of solicitors by liquidators.

Question 16(a): Do you agree that, notwithstanding the release of a liquidator by the court, the liquidator should not be absolved from the provisions of section 276 of CO?

27. The HKBA agrees with the proposal that a liquidator shall not be absolved from the provisions of s.276 after his release. The proposal should be made in the same line as ss.174(6) and 212(4) of the Insolvency Act 1986. Consideration should also be given to whether the proposal should extend to provisional liquidator as well. Currently, the definition of "liquidator" was held to exclude a provisional liquidator continuing in office pursuant to s.194(1)(aa). Therefore, the reference to "liquidator" in s.276 of the CO does not include a provisional liquidator continuing in office under s.194(1)(aa). Thus, there is currently no provision to compel a delinquent s.194(1)(aa) provisional liquidator to restore the company's assets.

Question 16(b): Do you agree that, where the court has granted a release to a liquidator, the power to make an application under section 276 should only be exercisable with the leave of the court?

28. Subject to the comment in paragraph 27 above, we agree with the proposal.

Question 17: Do you agree with the proposed technical amendments relating to the appointment, powers, vacation of office and release of provisional liquidators and liquidators as set out in Annex?

29. Paragraph 5 – The HKBA agrees with the proposed amendment. By reason of the matters stated in paragraph 21 above, the current provisions in the CO applicable to liquidators do not apply to provisional liquidators appointed under s.228A. We agree that the specific provisions as set out should also apply to a provisional liquidators under s.228A.

30. Paragraph 6(a) - The procedures set out in rule 154 of the Companies (Winding Up) Rules (Cap.32H) ("**CWUR**") are not expressed to be limited to a court winding up. Rather, the Courts seem to have accepted that rule 154 is also applicable in a creditors' voluntary winding up (Re Goldcone Properties Limited, (unreported) HCCW 391/1999, 24 April 2002 per DHCJ Poon (as he then was)). Therefore, it is doubtful as to whether the proposed amendment is necessary, unless it is intended that, in case of voluntary winding up, procedures less stringent than the one set out in rule 154 should be followed.

31. Paragraph 6(b) –

31.1 The HKBA agrees that there is currently no express provision for the removal of liquidator by creditors under a creditors' voluntary winding up and that procedures to that effect should be provided. Reference should be made to rule 4.113 of the UK Insolvency Rules 1986 where detailed procedures regulating such creditors' meetings are set out.

31.2 The HKBA agrees with the proposed amendment that liquidators appointed by the Court in a creditors' voluntary winding-up can only be removed by the Court.

32. Paragraph 6(c) – The HKBA agrees with the proposed amendment. This suggestion is in fact an extension of the proposal as stated in Question 9(a) of Chapter 3.

33. Paragraph 6(d) – The HKBA agrees with the proposed amendment. In the event that it cannot be expected that the liquidator will make an application for a release by himself (e.g. due to his death and his mental incapacity), detailed procedures should be provided as to who should make the application on his behalf and how such an application should be made. Obviously, due to the liquidator's condition, there may be difficulty for a report on the liquidator's accounts to be prepared for the purpose of s.205 of the CO.

34. Paragraph 7 – The HKBA agrees with the proposed amendment as it ensures consistency between the provisions. In fact, under the s.109 of the UK Insolvency Act 1986, liquidators are required to publish a notice of his appointment within 14 days. Requiring liquidators to do so within 15 days in Hong Kong is not a too stringent requirement.

Chapter 4: Question 18-24

Question 18: Do you agree that a maximum and a minimum number of members should be set for the COI appointed in both a court winding-up and a creditors' voluntary winding-up? If so, are the proposed maximum number (seven) and minimum numbers (three) appropriate? Do you agree that the court should have the discretion to vary the maximum and minimum numbers on application by the liquidator?

35. The HKBA does not support the proposal to set a maximum and a minimum number of members for the COI, as there are good reasons why the creditors decide that there should be no COI or if there is one, its members should be less than 3. For example, the company in liquidation has less than 3 creditors or although there are more than 3 creditors, they are not willing to be appointed as COI. Moreover, it is not uncommon for a company to have a creditor whose debt far exceeds the debts owed to the other creditors and in such circumstances, it would not be fair for the 2 minority creditors to be able to outvote the majority creditor simply because they represent 2 out of 3 members of the COI. The HKBA believes that the present regime should be maintained, which has the benefit of leaving the decision as to whether to appoint COI and, if so, how many members to the creditors, who are in the best position to decide this question taking into account the circumstances of the company concerned.

36. The HKBA considers the proposal to allow the company to apply to the court to vary the maximum and minimum numbers of COI to be impractical, as it would create further "paper" applications made to the court which, at the moment, are already voluminous. It would also impose an unnecessary burden on the company to incur costs in making such application.

Question 19: Do you agree to allow the COI not to fill a vacancy if the liquidator and a majority of the remaining members of the COI so agree, provided that the total number of members does not fall below the proposed minimum number?

37. Save that the HKBA does not agree with the proposed minimum and maximum number of members of COI, the proposal to allow the COI to fill a causal vacancy is sensible as the creditors should have the power to determine such a matter.

Question 20: Do you agree to the proposals as set out in paragraphs 4.12 and 4.13 for streamlining and rationalising the proceedings of the COI?

38. The HKBA supports the proposal to remove the requirement that the COI must meet at least once a month.

39. The HKBA notes that the proposals set out in §§4.13(a), (c) and (d) are similar to those in rule 4.156(2) of the UK Insolvency Rules 1986 and supports such proposals. The proposal in §4.13(b) is also similar to the UK provision. But the current proposal should also include a provision stating that a meeting summoned according to the rules shall be presumed to have been duly summoned and held, notwithstanding that not all those to whom the notice is required to be given have received it. Such provision is similar to rule 12A.4 of the Insolvency Rules 1986, which was introduced by the Insolvency (Amendment) Rules 2010 to supplement rule 4.156.

40. The HKBA supports the proposal to empower the liquidator to determine where the meeting of the COI should be held provided that such decision may be varied by the majority of the members of the COI. This is necessary to ensure that the liquidator would not choose the venue for meeting which is not convenient to the majority of the members of the COI.

    40.1 There is no restriction in rule 4.156(3) of the UK Insolvency Rules 1986 that the meeting must take place within the UK.

    40.2 Rule 12A.26 of the UK Insolvency Rules 1986 provides that a meeting may take place by remote attendance of the members of the COI, in the form of video conference or other comparable means. This may explain why the UK Insolvency Rules 1986 have not placed any restriction on the venue of the meeting

Question 21: Do you support the proposal to enable the COI to function through written resolutions sent by post or using other electronic means (such as using emails

or through websites)?

41. The proposal to enable the COI to function through written resolutions sent by post or using other electronic means is supported. In fact, such means of deliberations have frequently been deployed by the COI without any problem.

42. The HKBA notes that the comparable provisions in the UK Insolvency Rules 1986 (i.e. rules 12A.3, 12A.10-12A.13) are supported by other rules and principles regarding the service of documents by post or by electronic means, which the current proposal does not seem to have taken into account.

43. Regarding service of written resolution by post:-

    43.1 Rule 12A.3 of the UK Insolvency Rules 1986 regulates postal delivery of documents, which states that the rules in CPR (Civil Procedure Rules of England and Wales) Part 6 apply unless otherwise provided by the UK Insolvency Act 1986.

    43.2 According to rules 6.14 and 6.26 of CPR Part 6, documents sent to an address within England and Wales are deemed to served on the second business day after the same were served. According to paragraph 3.1(1) of Practice Direction 6A under the Civil Procedure Rules of England and Wales, service by post is effected when the document is placed in a post box. It is submitted that the requirement under rule 4.167 of the UK Insolvency Rules 1986 that any member of the COI can request the liquidator to summon a meeting of the COI within 7 business days from the date of the liquidator sending out a resolution must be understood with such background in mind.

43.3 The current proposal does not introduce detailed rules determining how and when service of written resolution by post is considered to be effective.

43.4 It appears that the current proposal is inadequate to ensure that members of the COI are given sufficient time to consider whether they should request the liquidator to summon a meeting on receiving any written resolution sent by the liquidator by post. It is unclear when those members are deemed to have received the written resolutions by post.

43.5 In contrast, under s.8 of the Interpretation and General Clauses Ordinance (Cap.1), service by post is deemed to have been effected at the time which the document would be delivered in the ordinary course of post. Pursuant to Practice Direction 19.2 of the Hong Kong Courts, this is normally deemed to be the 4th working day after posting for registered post, and the 2nd working day after posting for ordinary post in relation to documents sent under court proceedings. In addition, Order 10 rule 1(3)(a) of the Rules of the High Court (Cap.4A), the service of a writ by registered post is deemed to be effected on the 7th day after posting.

43.6 Without any express provision as to when will written resolution sent by post be deemed to have been received by members of the COI, it is difficult to consider whether 7 days after the date of posting would leave sufficient time for the members after the time taken for the ordinary course of post.

43.7 Therefore, it is suggested that the current proposal should be amended by including express provision that, say, Practice Direction 19.2 shall apply in relation to the service of written resolution by post.

44. Regarding service of written resolution by electronic means:-

44.1 Rule 12A.10(1) of the UK Insolvency Rules 1986 provides that, before the liquidator is entitled to send any document by electronic means, the liquidator must first obtain the consent of the member, and ask that member to provide an electronic address for delivery.

44.2 Such requirement does not appear to have been expressly included under the current proposal. It is suggested that similar provisions should be included in any legislative proposal to clarify the circumstances under which the liquidator is entitled to circulate written resolution for approval by electronic means.

Question 22(a): Do you support the proposal to enable the COI to function through written resolutions sent by post or using other electronic means (such as using emails or through websites)?

45. The proposal is sensible and, if implemented, would expedite the process for approving payment of costs and charges of agents and certainly, reduce the costs of the liquidation. To ensure that the members of the COI have the necessary information to agree with the liquidators, it is suggested that the liquidators should be required to provide similar level of information presently required of them to justify the costs and charges in a taxation save for the preparation of detailed bills of costs the preparation of which are time consuming and costly.

46. The other advantage of the empowering the COI to agree with the liquidators on the costs or charges of agents is that the COI, due to its ongoing involvement in supervising the liquidation of the company, is in a better position than the court in deciding whether the proposed costs and charges are reasonable or necessary.

47. The proposal would bring the costs and charges of agents in line with the costs (remuneration) of the liquidator, where the COI and the liquidator may agree on the remuneration of the liquidator subject to the power of the OR to apply under s.196(2A) of the CO to the court for review of such agreement. Consideration should be given to extend the power of the OR to apply for review of the agreement reached between the liquidator and the COI on the agents' costs or charges, to ensure that there is an avenue for any aggrieved creditors to present their objection to the OR who, in turn, may decide whether there are proper grounds to apply for a review of the agreement reached.

48. In addition, consideration should be given to provide expressly that the court may in its discretion assess the costs or charges of agents or the remuneration of the liquidator summarily, so that they can be assessed by the court "on papers".

Question 22(b): Do you agree that if such agreement cannot be reached, the costs and charges of the agents shall be delivered up for taxation by the court?

49. The HKBA supports the proposal.

Question 23: Do you support the proposal to allow liquidators and provisional liquidators to communicate with creditors, contributories or other parties by electronic means, subject to the conditions as set out in paragraph 4.21?

50. The proposal is sensible and is supported by the HKBA. Consideration should be given to provide expressly for the date when the communication becomes effective, as discussed under Question 21 above. In practice, communications through electronic means have already been used widely the liquidators.

Question 24: Do you agree with the proposed technical amendments relating to the conduct of winding-up as set out in Annex C?

51. The technical amendments proposed in items 8 to 13 are supported.

Chapter 5: Question 25-28

Question 25(a): Do you agree that new provisions should be introduced to empower the court to make orders for restoring the position of a company to what it would have been if the company has not entered into a transaction at an undervalue?

52. The HKBA welcomes the proposal to introduce avoidance provisions for transactions at an undervalue in the company context, which is long overdue. Such powers of adjustment in the context of corporate insolvency should be enacted, following the same principles of the equivalent provision in the personal insolvency context.

53. While it is possible to make recoveries on behalf of the company, for example, in the form of a claim under s.60 of Conveyancing and Property Ordinance (Cap.219) (for transactions to defraud creditors), misfeasance proceedings against directors, a claim in knowing receipt or dishonest assistance against third parties, they do not provide a basis to avoid a transaction as a transaction at an undervalue such as that under s.49B of the Bankruptcy Ordinance (Cap.6) ("**BO**"). The HKBA considers that it is necessary to adopt similar provision for avoidance of transaction at undervalue similar to as s.49B of the BO for company in liquidation.

54. The HKBA believes the proposed legislation is a proportionate response to the need to protect unsecured creditors, having regard to the exceptions proposed to be introduced (based on s.238(5) of the Insolvency Act 1986).

Question 25(b): Do you agree to the proposal regarding "relevant time" as proposed in paragraph 5.10?

55. The HKBA supports the proposal regarding "relevant time" in §5.10, which is in line with the provisions on "relevant time" in the bankruptcy regime currently in place (under s.51 of the BO).

Question 25(c): Do you agree that transactions at an undervalue entered into by the company with a person who is connected with the company should be subject to a more stringent control as proposed in paragraph 5.11?

56. The HKBA understands that the proposal under §5.11 is to adopt the position under the BO. This means (a) where the transaction took place within 2 years of the commencement of the liquidation, such transaction would be caught (subject only to the exception provisions), but (b) where the transaction took place more than 2 years before but within 5 years of the commencement of the liquidation, the provision would only bite if it could be shown that the company was either insolvent at the time of the transaction or became insolvent in consequence of that transaction, though this requirement would be presumed to be satisfied where the counter-party to the transaction is an "associate" of the company. The HKBA supports this proposal.

Question 25(d): Do you agree that statutory protection should be provided for the party seeking to resist an application made by the liquidator of a company in respect of the undervalue transaction? If so, do you agree with the statutory protection as proposed in paragraph 5.12?

57. The HKBA also supports the proposal to introduce exceptions to this avoidance provision along the lines of s.238(5) of the Insolvency Act 1986. In this way companies in financial difficulties would retain sufficient scope of manoeuvre with the aim of trading out of their difficulties, while the unsecured creditors would still be protected.

Question 26(a): Do you agree that the current provisions in the CO incorporating the provisions in the BO on unfair preference should be replaced by new standalone provisions which apply to winding-up cases as proposed in paragraph 5.17 to rectify

the existing anomalies which limit the application and effectiveness of such provisions?

58. The HKBA agrees that the current ss.266, 266A and 266B of the CO should be replaced by new, "standalone" provisions applicable to companies. The current scheme of "cross-referencing" the BO is not desirable, and some of the problems arising from such "misfit" have been identified in §5.15. Further, such "misfit" means that the court at times has to undertake a (strained) interpretation of the provisions to ensure that the purpose of the avoidance provisions is not defeated by the lack of clarity in the words use: see eg. Re Phantom Records Ltd, (unreported) HCMP 2770/2003, 7 December 2006 at §§80-81.

58.1 This holding was however not without problem. See Tomasic & Tyler, Hong Kong Company Law – Legislation and Commentary, 2012, [11681] at p.3851B which summarised the counter-argument against the construction that a director of the company is by itself sufficient to invoke the statutory presumption, as well as the recommendation of the Law Reform Commission in its Report on the Winding-Up Provisions of the Companies Ordinance, July 1999, §21.10, that the exclusion of employees should not apply in the company context and the need for amendment the legislation governing unfair preference in the company context.

58.2 Even if the court is willing to undertake that exercise, it is still constrained by the express words used, and the efficacy of this means may be limited. It is far more preferable to have new provisions dedicated to companies alone.

Question 26(b): Do you agree with the definitions of "person who is connected with a company" and "associate" as proposed in paragraphs 5.19 and 5.20?

59. The HKBA notes that the proposed definitions of "person who is connected with the company" and "associate" are modelled on ss.249 and 435 of the Insolvency Act 1986 and are substantially the same (with some clarification directed at the company context) as s.51B of the BO. The HKBA supports the proposal.

Question 26(c): Do you agree that the existing protection for persons who have received benefits or acquired or derived interest in property in good faith and for value from unfair preference should be maintained, and that the same protection should also be applicable to the proposed new provisions on transactions at an undervalue?

60. The HKBA agrees that the current protection given to *bona fide* purchasers for value without notice in the unfair preference context should be preserved.

61. The HKBA sees no reason why similar protection should not be afforded to *bona fide* purchasers for value without notice in the case of a transaction at an undervalue. Such protection is available under s.51A of the BO and s.241 of the Insolvency Act 1986 to transaction at an undervalue and unfair preference.[2]

62. Separately, the HKBA notes that the proposed revision to the provisions concerning unfair preferences will also clarify who is entitled to make an application under the relevant provisions (by adopting the English approach of restricting that right to the liquidator only). This is helpful in clarifying the uncertainty arising from In re Goldcone Properties Ltd (unreported) HCCW 391/1999, 15 April 2004 at §11, cf. De Chang Fulfilment Ltd v Manley Toys Ltd (unreported) HCA 1161/2009, 13 May 2013 at §149.

Question 27: Do you agree to the proposed special provisions in relation to floating charges created by a company in favour of a person who is connected with the company as detailed in paragraph 5.26?

[2] The proposal may involve some overlapping with the current s.266A of the CO and the drafting should ensure that there would be no duplicative or inconsistent effect.

63. The HKB understands that the proposal in §5.26, which preserves the "new monies" exemption but removes the solvency of the company as a relevant consideration in cases concerning associates/ persons connected with the company, is intended to give effect to the primary purpose of preserving only those floating charges which are given for valuation consideration, and the view is taken that "insiders" of the company (compared to "outsiders") may have more scope to manoeuvre the affairs of the company such that the company could be rendered technically not insolvent at the time of the granting of the charge. Having regard to the above, the HKBA supports the proposed changes to remove solvency as a relevant consideration in the case of associates/ persons connected with the company.

Question 28: Do you support the expansion of the scope of the exemption of a floating charge from invalidation catered for genuine credit transactions to cover "property and services supplied to the company" and "money paid at the direction of the company" as detailed in paragraph 5.28?

64. The HKBA supports the proposed expansion (or rather, clarification) of the scope of the exemption as set out in §5.28.

Chapter 6: Question 29-32

Question 29: (a) Do you agree to expressly set out in the legislation the common law position that a person summoned for either a private or a public examination cannot invoke the privilege against self-incrimination during the examination? (b) If so, do you agree that we should introduce provisions to prohibit the subsequent use of answers given and statements made during the examination in subsequent criminal proceedings if certain conditions are satisfied, subject to certain exceptions such as offences relating to perjury and provision of false statement and offences under the future Companies (Winding Up and Miscellaneous Provisions) Ordinance?

65. The HKBA agrees with the proposal to expressly set out in the legislation the common law position that a person being summoned to attend before the

court for either a private or public examination cannot invoke the privilege against self-incrimination.

65.1 As discussed in the Consultation Document, there is ample authority to support the general proposition that the privilege against self-incrimination cannot be invoked. This is supported and/or commented on in *inter alia* Re Weihong Petroleum Co Ltd [2002] 1 HKLRD 541; Re Asher & Co. (Hong Kong) Ltd [2004] 2 HKLRD 37; Bishopsgate Investment Management Ltd v Maxwell [1993] Ch 1; Re Pantmaenog Timber Co Ltd (in liq) [2004] 1 AC 158; and Re RBG Resources Ltd [2002] All ER (D) 124.

65.2 Whilst the abrogation of the privilege is not expressly provided for in the equivalent UK legislation, there is no harm in seeking to make the Hong Kong legislation clearer in this regard.

66. The HKBA also agrees with the introduction of provisions to prohibit the subsequent use of answers given and statements made in subsequent criminal proceedings if certain conditions are satisfied.

66.1 This is necessary in order to achieve the appropriate balance between the need to ensure the effectiveness of public and/or private examinations (and to have proper regard for the public interest in such matters) on the one hand, and to safeguard the examinees' right to fair trial in subsequent matters or proceedings on the other hand.

66.2 That such prohibitions are important to the right to fair trial is clearly established in authorities such as Saunders v United Kingdom 23 EHRR 313; and R v K [2010] QB 343.

66.3 The introduction of such provisions would guard against a potential challenge to the constitutionality of ss.221 and 222 of the CO (as was alluded to by the Court of Final Appeal in Kennedy v Cheng Kelly (2009) 12 HKCFAR 601 at §333).

66.4 The Court of Appeal observed in Re Wing Fai Construction Co Ltd [2006] 4 HKLRD 58 that it may well be an error to presume that there is no equivalent to s.433 of the Insolvency Act 1986 in Hong Kong, in view of the existence of s.296(2A) of the CO.

66.5 However, the latter section only deals with this issue in a perfunctory manner and does not set out the depth of considerations or limits as reflected in s.433 of the Insolvency Act 1986. In fact, the legislative materials relating to the enactment of s.296(2A) of the CO suggests that no consideration or discussion was given by the legislature on the potentially wide-ranging ramification and prejudice to the examinee.

66.6 As such, the HKBA considers that it is necessary to enact a separate section which properly deals with the situations in which information obtained under compulsion (and without the benefit of the privilege against self-incrimination) may be utilized in subsequent proceedings.

Question 30: (a) Do you agree to the removal of the requirement that the OR or the liquidator must have alleged in his "further report" that fraud has been committed for initiating the public examination procedure, and to provide that a public examination may be ordered by the court upon the application by either the liquidator or the OR? (b) Do you agree with the proposed new categories of person that may be examined under the public examination procedure, namely (i) any person who has acted as liquidator of the company or receiver or receiver and manager of the property of the company; and (ii) any person who is or has been concerned, or has taken part, in the management of the company?

67. The HKBA agrees with the proposals to remove the requirement that the Official Receiver or the liquidator must alleged in his "further report" that

fraud has been committed for initiating the public examination procedure, and to provide that a public examination may be ordered by the court upon the application by either the liquidator or the OR.

67.1 The public examination procedure and the consequent public scrutiny that this entails put more pressure on examinees to cooperate and provide information. The public interest is also served through public examinations in that proceedings are more transparent.

67.2 At present, the requirement of the "further report" indicating an opinion that fraud has been committed poses a significant restriction on the usefulness of public examination proceedings.

67.3 The proposed amendments would enable the public examination procedure to be utilized more regularly in the appropriate cases.

68. We also agree with adding new categories of person that may be examined under the public examination procedure.

69. Similar reasoning applies to the proposal to add further categories of persons that may be subject to such public examination. This enables a more wide ranging ambit of control over parties who have been involved in the affairs of the company.

70. The above proposals are in line with provisions in the UK.

71. On the other hand, one needs to be alert to the possibility of "abuse" of this procedure by overzealous liquidators if the present restrictions are lifted and the effect of the section is widened. Given the public nature of the examinations, it could be argued that potentially innocent parties would be detrimentally and irreparably affected by negative publicity.

72. However, as the Court has oversight of the matter and the ultimate discretion lies with the judge hearing the application under s.222 of the CO and, the master presiding at the examination, any risk of injustice to the examinee ought to be sufficiently safeguarded.

Question 31: (a) Do you agree that if a company is wound up insolvent within one year of its shares being redeemed or bought back by payment out of capital, certain categories of persons should be required to contribute to the assets of the company for an amount not exceeding the payment made by the company in respect of the shares redeemed or bought back by the company so as to meet the deficiency in the company's assets? (b) If so, should the members from whom the shares were redeemed or bought back and the directors who made the solvency statement which supported the redemption or buy-back without having reasonable grounds for the opinion expressed in the statement be jointly and severally liable to contribute to such assets? (c) Should such persons be allowed to apply for winding-up of the company under the specific grounds as set out in paragraph 6.22?

73. The HKBA agrees that if a company in liquidation is insolvent within 1 year of its shares being redeemed or bought back by payment out of capital, certain categories of persons should be required to contribute to the assets for an amount not exceeding the payment made by the company so as to meet the deficiency in the company's assets.

74. This proposal safeguards the interests of creditors in the event of a company becoming insolvent shortly after the return of such capital, and is in line with the general principles that it is the creditors who have the real interest in the winding-up process of a company.

75. The HKBA agrees that such categories of persons should include the members from whom the shares were redeemed or bought back and the directors who made the solvency statement which supported the redemption or buy-back without having reasonable grounds for the opinion expressed in the statement, and that their liability should be jointly and severally liable.

75.1 In the absence of the requisite authorization under ss.49I to 49O of the CO, there is potential for recourse in ss.79B and 79M of the CO (as to which see also Tradepower (Holdings) Ltd v Tradepower (HK) Ltd (2009) 12 HKCFAR 417 at §§123-131).

75.2 However, there is no equivalent statutory means to require payment back from the relevant members and/or directors when there has already been authorization under ss.49I to 49O of the CO.

75.3 This proposal would ensure that the potential for abuse of the provisions on payment out of capital are kept in check.

75.4 This is largely in line with the provisions on unfair preferences (under ss.266-266B of the CO).

76. However, it is unclear whether such persons should be allowed to apply for winding-up of the company.

76.1 The rationale put forward in §6.22 is that the members and/or directors who would be jointly and severally liable under the proposed new provisions would be personally liable, and hence have an interest in the early winding-up of the company in order to prevent the company's business or assets, which have become depleted within the year following the redemption or buy-back, from becoming worse and making them liable for a greater sum.

76.2 It is unclear whether such rationale follows through. The proposed provisions would limit the amount of liability of the members and/or directors to *"an amount not exceeding so much of the relevant payment*

as was made by the company in respect of [the] shares [redeemed or bought back]".

76.3 On this basis, the members and/or directors would only be liable for that amount of capital that had been authorized to be paid out to them. There would not necessarily be any concern on their part regarding additional losses or depletion of assets which are not attributable to the redemption or buy back of the relevant shares.

76.4 As such, it is unclear to us why these parties should be entitled to petition for winding-up of the company on these grounds.

76.5 For the above reason, the HKBA does not agree with the proposal under Question 31(c).

Question 32: Do you agree with the proposed technical amendments relating to the investigation during winding-up, offences antecedent to or in the course of winding-up and powers of the court as set out in Annex C?

77. As regards the proposed technical amendments, we consider that Proposal 15 (Statement of Concurrence) is potentially open to abuse:-

77.1 Parties could seek to install "dummy" directors who are not actually the persons responsible for the affairs of the company, and yet who are put forward as the main party to which queries are referred. This would potentially hinder the true protagonists from being discovered or being required to give proper particulars in their own statements.

77.2 Requiring a statement of affairs from each individual requires each person to consider his or her answers specifically and individually and for them to take responsibility for such answers.

78. Save as aforesaid, the remainder of the technical amendments appear to be satisfactory.

Other Comments

79. The HKBA notes that the Consultation Document has not dealt with any provisions concerning the liquidation of unregistered companies or any cross-border insolvency issues. While the HKBA recognizes the complexity of the issues (at least when comparing with provisions relating to liquidation of Hong Kong companies), this is not a valid reason for not reviewing the relevant provisions.

80. The HKBA is concerned about the present regime – in which the provisions relating to winding-up of unregistered companies have not developed in line with the commercial reality. This is despite the fact that it is very common for businessmen in Hong Kong to use corporate vehicles incorporated in jurisdictions such as Bermuda, British Virgin Islands and Cayman Island to carry on their business. In particular, in England and Wales, there are provisions under the Insolvency Act 1986 which are designed to facilitate cross-border insolvency of foreign companies by, *inter alia*, empowering the Court to make order over the assets of the foreign companies located within the jurisdiction without requiring the English Courts to make a winding-up order against such foreign companies. There is no such provision in Hong Kong and the position remains as that developed in common law, namely, the winding-up order made by the foreign court will not be recognized or given effect in Hong Kong, and the only way for the foreign liquidators to deal with the assets located in Hong Kong is to apply for a winding-up order against the foreign companies. This would be time consuming and, certainly, not cost effective as once a winding-up order is made in Hong Kong, the liquidators will have to carry out all the statutory obligations imposed by the CO which are applicable to every winding-up. There is no power for the Court, let alone

the liquidator, to dispense with compliance with such statutory obligations. For a recent review of some of the problems relating to the winding up of unregistered companies, see Re Pioneer Iron & Steel Group Company Limited (unreported), HCCW 322/2010, 6 March 2013.

Dated: 3rd July 2013

Hong Kong Bar Association